Bank of Ireland (UK) plc
Annual Report 2018

Bank of Ireland UK
The Partnership Bank

Bank of Ireland (UK) plc
Annual Report

for the year ended 31 December 2018

Company Number: 07022885

THIS PAGE HAS BEEN INTENTIONALLY LEFT BLANK

Contents

Bank of Ireland (UK) plc (the ‘Bank'), together with its subsidiary undertakings (which together comprise the ‘Group') is the principal United Kingdom retail and commercial banking business of the Governor and Company of the Bank of Ireland (the ‘Parent').

Percentages throughout the document are calculated on the absolute underlying figures and so may differ from the percentages calculated on the rounded numbers presented, where the percentages are not measured this is indicated by n/m.

Business Review

Our purpose is to enable our customers, colleagues and communities to thrive by being the leading Partnership Bank.

Desmond Crowley
Chief Executive Officer
and Executive Director

During 2018, the Group continued to transform the business, improving returns, launching new propositions and continuing to focus on improving our customer experience. I am therefore pleased to report that the Group reported a statutory profit before tax of £173 million, up 15% on the prior year, while new customer lending also increased by 13% to £5.1 billion. This performance was achieved against the backdrop of a very competitive market, which continues to weather both significant political and economic uncertainty, at a UK and global level.

For 2018 and looking forward our three strategic objectives are to 'Invest, Improve and Reposition' in order to transform Bank of Ireland (UK) plc in line with our unique Partnership Bank strategy. I am confident that given the focus on these priorities, combined with a strong risk culture, that we will continue to deliver sustainable returns for our stakeholders.

Des Crowley,
Bank of Ireland (UK) plc Chief Executive Officer

Key highlights

Strong financial performance	• £173 million statutory profit before tax • £190 million underlying profit before tax[1] • Net Interest Margin 2.11% • £70 million dividend paid to Parent in August 2018
Growth	• New lending of £5.1 billion up 13% on 2017 • Record new lending of over £1 billion in asset finance by Northridge Finance
Transformation	• Increased focus on technical innovation and product development • UK Customer Board established and responsible for delivery of the UK Customer Plan • Business model initiatives to drive increased efficiencies
Capital	• Maintained strong CET 1 ratio 15.0% • Total capital ratio 20.6%

[1] *Underlying profit before taxation excludes non-core items which the Group believes obscure the underlying performance trends in the business.*

Chairman's statement

Overview and strategy
2018 has been a year of investment and strategic transformation for the UK business, which was reiterated when our strategic priorities were presented at an Investor day in June 2018. The BOI Group confirmed its commitment to the UK market, which is regarded as a large, attractive and adjacent market, offering growth and diversification.

In the UK, our purpose is to enable our customers, colleagues and communities to thrive with a strategic focus on increasing overall returns through the distribution of consumer products via partnerships with trusted brands, a universal bank in Northern Ireland, and strong niche businesses in attractive customer segments.

Our three strategic priorities:

- Transform our business;
- Serve customers brilliantly; and
- Grow sustainable profits.

The Group[1] has undertaken a review of the UK business and has set objectives to:

- invest in businesses generating sustainable returns;
- improve the performance of existing businesses with potential to increase returns; and
- reposition those businesses which do not meet expected returns.

The UK financial services sector still faces a number of challenges. The market is highly competitive, the pace of technological change requires ongoing innovation and we have a full transformation agenda. Uncertainty remains around the level of economic growth, including the impact and outcome of the negotiation of the UK's withdrawal from the European Union. Against this backdrop, the Group continues to build on its unique partnership approach to retail banking in the UK.

I am pleased to report that 2018 has been a positive year with significant progress made against both our financial and strategic objectives.

2018 Financial Performance
Our statutory profit before tax of £173 million was £22 million higher than our 2017 reported profit of £151 million. This year-on-year performance reflects our focus on margin management, strict cost control, stable arrears performance and selected growth in new lending. Our net interest margin increased by 10 basis points, the cost to income ratio improved by 3% and our CET 1 capital ratio remains strong at 15%.

New lending across all portfolios increased in 2018 by 13% to £5.1 billion. We maintained commercial and risk management discipline, while we launched a number of new products including those supporting first time mortgage buyers. Our growth areas include unsecured personal lending and car finance.

Our Strategic Partnerships
Our partnership with the Post Office is an important part of our strategy and provides a successful and flexible business model. Through the Post Office brand we provide customers with easy access to a range of financial services to meet their needs, including savings, mortgages, loans, credit cards and ATMs.

The focus on personal lending via the Post Office has seen this business increase volumes by 130% in 2018 to c.£0.3 billion.

First Rate Exchange Services Limited, our foreign exchange joint venture with the Post Office, continues to be the largest provider of consumer foreign exchange in the UK with a 24% market share. Despite a challenging year for the UK travel market, I am pleased that this business has performed well contributing £33 million to the Group's performance.

Our partnership with the Automobile Association (AA) is now in its fourth year and maintains a good growth trajectory. We continue to work together to develop new product propositions for their members and other customers. Lending volumes increased by over 90% during 2018 to c.£0.5 billion being fully funded by AA customer deposits.

Invest, Improve, Reposition
It has been a year of record achievement for our car finance brand, Northridge Finance, which recorded gross new lending of c. £1.1 billion in a highly competitive market. This is an increase of over 30% in the year and we hope to maintain this momentum as the brand continues to grow and develop.

The mortgage distribution model offers a range of distribution partnerships in the mortgage intermediary market, primarily under both the Post Office and Bank of Ireland brands. In 2018, the mortgage market remained highly competitive, with higher levels of re-mortgage activity but lower levels of new lending, and in line with most of the industry new business margins have reduced year on year. However aligned with our strategy, we are exploring opportunities to develop innovative customer value propositions and to place less focus on the mainstream re-mortgage market. This strategy will continue into 2019.

Our Northern Ireland (NI) franchise has performed well by maintaining a consistent level of operating profit and improved impairments, resulting in an over 30% increase in underlying profit in 2018. We are proud to support the NI economy through our retail and commercial propositions and to ensure the long-term sustainability of this business. To meet customers' developing needs, we continue our programme of investment in our distribution channels.

Our focus remains to reduce our operating expenses and therefore the cost income ratio. By reducing our costs we will be able to invest in better customer propositions and service capabilities. A strategic review of our ATM business is now underway, acknowledging a declining cash market coupled with changes to ATM LINK fees. Also, as part of our strategic transformation we are progressing the sale of our UK consumer credit card portfolio.

Enhanced Value Delivery
We continue to look for opportunities to improve our end-to-end customer journeys and have worked closely with our partner, The Post Office, to improve customer application functionality, both online and through dedicated customer relationship assistants in Post Office branches. This has replaced the need for paper applications and has reduced processing times considerably.

Strong risk management, serving customers brilliantly and delivering against our people initiatives
Our strategic priorities are underpinned by a strong risk management framework and risk culture, a focus on serving customers brilliantly and delivering for our people.

Customers, Colleagues and Communities
Key to achieving our strategic objectives are our customers, for whom we must deliver an outstanding customer experience. The business is working to reduce the level of complaints, and we are seeking to increase the number of complaints resolved at the first point of contact. In the past year, the Bank of Ireland UK Customer Board has been

[1] *The Group refers to Bank of Ireland (UK) plc and its subsidiary undertakings.*

established to identify challenges, opportunities, and to ensure that we deliver on our customer plan.

Our Board and senior management have a vital role to play in embedding a healthy corporate culture and in 2018, we have taken even more steps on this journey. In March 2018 we signed up to the 'Women in Finance Charter', and have committed to a series of targets for management and leadership positions being held by women. We have a target that over 50% of management and leadership appointments will be female by December 2021. In 2018, we acted on the feedback from our colleagues in our groupwide 'OpenView' employee engagement surveys, and it is encouraging to see that the most recent follow-up surveys show an increase in overall employee engagement as well as improving trends of awareness, understanding, belief and demonstration of our culture and values. Of course, there is always more to do and ensuring our culture is correct is critical to the success of our business.
We have a proud history of supporting the communities we serve and I am delighted with the support for our flagship charity, The Alzheimer's Society, not to mention the range of other local charities and community projects our colleagues support.

Board Membership
We review the Board's composition and diversity regularly and are committed to ensuring we have the right balance of skills and experience on the Board. Two of our Non-Executive Directors, Susan Harris and Lewis Love, retired from the Board in 2018. I would like to thank them for their support, commitment and counsel as Board members. Our new appointments, who have a broad range of excellent skills and experience, include John Baines, Philip Moore, Ian Buchanan and Jackie Noakes. I would like to welcome them to the Board and I look forward to working with them in 2019.

Outlook
There is much more to do as we continue to operate in a rapidly changing and challenging environment and we are mindful of the risks and uncertainties relating to Brexit and the global economy. The UK business will continue to invest for growth, target improved customer outcomes and we are committed to meeting our strategic objectives.

Given our clear purpose and approach to continuing to transform the business, coupled with our focus on improving customer service and with the commitment of our colleagues, we look forward to the challenges and opportunities in 2019 and to delivering attractive, sustainable returns to our shareholder.

I would also like to take this opportunity to sincerely thank my Board colleagues, the Executive team, management and all the people working for the Group for their commitment, enthusiasm, professionalism and willingness to go the "extra mile" for our customers. I know this culture will continue into 2019 and beyond.

Robert Sharpe
Chairman
8 March 2019

Strategic report

Index	Page

Basis of presentation

The strategic report has been presented on a consolidated basis for the years ended 31 December 2018 and 31 December 2017.

Percentages presented throughout this document are calculated on the absolute underlying figures, so may differ from percentage variances calculated on the rounded numbers presented. Where percentages are not measured this is indicated by n/m.

The Bank of Ireland (UK) plc is a public limited company incorporated in England and Wales and domiciled in the UK.

References to the 'Group' throughout this document should be taken to refer to Bank of Ireland (UK) plc and its subsidiary undertakings and the 'Parent' refers to the Governor and Company of the Bank of Ireland.

Further details on the Group structure are shown in note 44.

The Group is regulated by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

Governance structure

The Board's role is to provide leadership of the Group within the boundaries of Risk Appetite and a framework of prudent and effective controls which enable risk to be identified, assessed, measured and controlled.

The Board sets the Group's strategic aims and risk appetite to support the strategy, ensuring that the necessary financial and human resources are in place for the Group to meet its objectives. During 2018 the Board met 11 times.

Robert Sharpe (N) (RE)
Chairman,
Non-Executive Director

Desmond Crowley
Chief Executive Officer,
Executive Director

Neil Fuller
Chief Risk Officer,
Executive Director

Thomas McAreavey
Chief Financial Officer,
Executive Director

Donal Collins
Non-Executive Director

Jackie Noakes
Non-Executive Director

John Maltby (A) (N) (RE) (RI)
Non-Executive Director

Mimi Kung (N) (RE) (RI)
Non-Executive Director

Philip Moore (A) (N) (RE) (RI)
Non-Executive Director

John Baines (A) (RI)
Non-Executive Director

Ian Buchanan
Non-Executive Director

(A) *Member of the Audit Committee.*
(N) *Member of the Nomination Committee.*
(RE) *Member of the Remuneration Committee.*
(RI) *Member of the Risk Committee.*

Governance structure *(continued)*

The Board is supported by a number of Committees:

Nomination Committee
Robert Sharpe *Chair*

Responsible for leading the process for Board, Board Committee and senior management appointments and renewals. The Committee regularly reviews succession plans for the Board, and the senior management team, and makes appropriate recommendations to the Board. The Committee meets at least twice a year.

Remuneration Committee
Robert Sharpe *Chair*

Holds delegated responsibility for setting remuneration strategy and policy for executive directors and senior management. The Committee meets at least twice a year.

Audit Committee
John Baines *Chair*

Monitors the integrity of the financial statements, oversees all relevant matters pertaining to the external auditors and reviews the Group's internal controls, including financial controls, and the effectiveness of the internal audit function. The Committee meets at least four times a year.

Board Risk Committee (BRC)
John Maltby *Chair*

Monitors risk governance and assists the Board in discharging it's responsibilities in ensuring that risks are properly identified, reported, assessed, and controlled and that strategy is cognisant of the Group's risk appetite. The Committee meets at least five times a year.

The Board Risk Committee is supported by the Executive Risk Committee (ERC), which is chaired by the Chief Risk Officer. The ERC membership comprises members of the Executive Committee and senior executives. Further details on the governance structure are included on page 26 of the Risk Management Report.

Group income statement

Summary consolidated income statement	2018 £m	2017 £m	Change %
Net interest income	508	471	8%
Net leasing income	9	1	n/m
Net other income	8	(1)	n/m
Total operating income	**525**	**471**	**11%**
Underlying operating expenses before non-core items	(334)	(328)	2%
Underlying operating profit before net impairment losses on financial instruments	**191**	**143**	**34%**
Net impairment losses on financial instruments	(34)	(26)	31%
Share of profit after tax of joint venture	33	34	3%
Underlying profit before taxation[1]	**190**	**151**	**26%**
Non-core items	(17)	-	n/m
Profit before taxation	**173**	**151**	**15%**
Taxation charge	(22)	(21)	5%
Profit for the period	**151**	**130**	**16%**
Performance measures			
Net interest margin	2.11%	2.01%	
Average interest earning assets (£m)[3]	24,111	23,386	
Cost income ratio[2]	67%	70%	

For further information on performance measures referred to in the strategic report see page 163.

Profit before taxation of £173 million for the year ended 31 December 2018 is 15% higher than 2017, recognising the impact of strong new business lending and reduced funding costs, but in a period which has experienced increasing margin pressures along with reduced consumer confidence as political uncertainty around Brexit prevailed.

Underlying profit before tax of £190 million in 2018 was £39 million or 26% higher than 2017.

Net interest income increased by £37 million compared to the previous year primarily reflecting the impact of volume growth in the consumer lending portfolios and improved deposits and other funding costs driven by focussed margin management, as well as lower funding costs on the subordinated debt which was restructured during 2017. This is partially offset by reduced interest income due to net mortgage redemptions, the deleveraging of the GB commercial banking business and margin pressure across the lending portfolios.

The Group's **net interest margin** in 2018 increased by 10 basis points despite challenging market conditions and continued margin pressures, which were particularly evident in the UK mortgage market. The increase is a result of more efficient balance sheet management and reflects our strong discipline in optimising the cost of funding.

Net leasing income of £9 million (2017: £1 million) is attributed to Marshall Leasing Limited (MLL) which was acquired in 2017

Net other income of £8 million, was £9 million higher than 2017. This was primarily due to gains on the disposal of non-performing assets of £6 million (2017: £nil); improved net trading income of £6 million (2017: £1 million net trading expense), and higher other operating income of £2 million, offset by increased net fees and commission expense of £5 million due to lower transaction fee income.

[1] *Underlying profit before taxation excludes non-core items which the Group believes obscure the underlying performance trends in the business.*
[2] *Cost income ratio is calculated on a statutory basis as total costs divided by total income.*
[2] *Average interest earning assets are calculated on a twelve month average as defined on page 175.*

Group income statement *(continued)*

Operating expenses before non-core items of £334 million were £6 million higher than the previous year. The majority of the Group's cost base relates to outsourced services, being the costs of distribution, product manufacture and support provided by the Parent under various contractual arrangements.

Staff costs decreased by £2 million while other operating expenses increased by £8 million as the Group continued to invest in the growth of the consumer lending businesses, while also incurring costs relating to repositioning of certain portfolios under our business strategy as set out on page 13.

Net impairment losses on financial instruments for the year ended 31 December 2018 were £34 million under IFRS 9, including a net loss of £37 million for loans and advances to customers at amortised cost compared to the £26 million charge under IAS 39 for 2017. The level of impairment losses primarily reflects volume growth and the strong performance of the Group's loan portfolios and ongoing resolution of non performing exposures.

Income from the joint venture relates to the Group's foreign exchange joint venture with the Post Office, First Rate Exchange Services Holdings Limited (FRESH). For further information refer to note 23.

Non-core items are costs of £17 million (2017: £nil) which are analysed in more detail below.

The **taxation charge** for the Group was £22 million compared to £21 million for 2017. Excluding the £33 million (2017: £34 million) income from the Group's joint venture, the effective tax rate for the year ended 31 December 2018 was 16% (year ended 31 December 2017: 18%). For further information on the taxation charge refer to note 14. The Group has disclosed its UK taxation policy in line with Schedule 19 of the UK Finance Act 2016 on its website, www.bankofirelanduk.com.

Non-core items

Underlying performance excludes non-core items which are those items that the Group believes obscure the underlying performance trends in the business. The Group has treated the following costs as non-core in the year ended 31 December 2018.

Non-core items	**2018 £m**	2017 £m
Cost of restructuring programme	(17)	-
Total non-core items	**(17)**	**-**

- Costs of £9 million in relation to the ATM business which experienced reduced transaction levels and net fee income. A strategic review of the business and its future performance is underway; and
- Costs of £7 million were recognised in relation to the planned disposal of the consumer credit card portfolio.

At 31 December 2018, £0.5 billion of credit card balances were classified as held for sale in the financial statements.

Group balance sheet

Summary consolidated balance sheet	2018 £m	2017 £m	Change %
Cash and balance with central banks	2,567	1,836	40%
Loans and advances to banks	2.348	2,764	(15%)
Loans and advances to customers	19,703	19,997	(1%)
Debt securities issued at amortised cost	915	-	n/m
Available for sale financial assets	-	1,008	n/m
Assets classified as held for sale	539	-	n/m
Total other assets	628	630	0%
Total assets	**26,700**	**26,235**	**2%**
Deposits from banks	3,152	3,561	(11%)
Customer accounts	19,769	18,961	4%
Subordinated liabilities	290	290	0%
Total other liabilities	1,485	1,424	4%
Total liabilities	**24,696**	**24,236**	**2%**
Equity attributable to owners of the parent	2,004	1,999	0%
Total equity and liabilities	**26,700**	**26,235**	**2%**
Statutory return on tangible equity	8.4%	6.7%	
Return on assets[1]	0.57%	0.50%	
Loan to deposit ratio[2]	102%	105%	
Liquidity coverage ratio (LCR)	158%	127%	
Net stable funding ratio (NSFR)	134%	130%	

Loans and advances to customers	2018 £m	2018 % of book	2017 £m	2017 % of book
Residential mortgages	15,880	80%	16,043	80%
Non-property SME and corporate	1,320	7%	1,371	7%
Commercial property and construction	502	2%	652	3%
Consumer	2,133	11%	2,086	10%
Loans and advances to customers (before impairment provisions)	**19,835**	**100%**	20,152	100%
Impairment provisions	(132)		(155)	
Loans and advances to customers (after impairment provisions)	**19,703**		19,997	

The Group's **cash and balances with central banks** which is cash placed with Bank of England increased by £0.7 billion at 31 December 2018.

Customer accounts	2018 £m	2017 £m
Bank of Ireland deposits and current accounts	4,826	4,740
Post Office deposits	14,237	13,924
AA deposits	706	297
Total customer accounts	**19,769**	**18,961**

The Group's **loans and advances to banks** of £2.3 billion decreased by £0.4 billion since 31 December 2017, primarily due to reduction in amounts due from the Parent.

Loans and advances to customers of £19.7 billion decreased by £0.3 billion partly attributable to the reclassification of the credit card portfolio of c.£0.5 billion to assets classified as held for sale at 31 December 2018. The comparative balance of £0.6 billion is included in loans and advances to customers at 31 December 2017.

The remaining loans and advances to customers increased by £0.2 billion, being gross new lending of £5.1 billion offset by repayments £4.9 billion.

New residential mortgages originated during 2018 were £3.3 billion, offset by repayments and redemptions on the existing portfolio of £3.4 billion resulting in a net decrease in the mortgage portfolio of £0.1 billion.

[1] *Return on assets is calculated on a statutory profit basis.*
[2] *Loan to deposit ratio includes the credit card assets classified as held for sale at 31 December 2018.*

Group balance sheet *(continued)*

Gross new lending in the commercial business was £0.2 billion in 2018 which, offset by repayments and the continued deleverage of the GB Business Banking portfolio, resulted in a net decrease of £0.2 billion in the closing balance.

The consumer banking businesses achieved strong performance in 2018 with gross new lending of £1.6 billion which was £0.5 billion higher than 2017. Northridge Finance had a record year with new lending in excess of £1 billion for the first time. New unsecured personal lending through our strategic partners, the Post Office and the AA, was c.£0.5 billion, an increase of 75% on 2017.

Excluding the credit card portfolio of £0.6 billion in 2017, the comparable increase in the consumer lending balances was c.£0.7 billion, an increase of 46% on the position at 31 December 2017.

The impairment provisions on loans and advances to customers under IFRS 9 of £132 million excludes the impairment provision on the credit card portfolio which is included in the assets held for sale at 31 December 2018. Excluding credit cards the impairment provisions have decreased by £7 million compared to 31 December 2017. Further details are included in note 20.

Debt securities issued at amortised cost of £0.9 billion comprises £0.4 billion of UK Government treasury bills, £0.3 billion of Multilateral Development Bank bonds and £0.2 billion of covered bonds at 31 December 2018. In total this is £0.1 billion lower than 2017.

From 1 January 2018, assets classified as available for sale have been reclassified as debt securities issued at amortised cost in accordance with IFRS 9.

Customer accounts increased by £0.8 billion to £19.8 billion at 31 December 2018. Retail deposits originated through the Post Office and AA brands have increased by £0.3 billion and £0.4 billion respectively, while Bank of Ireland current accounts and credit balances have increased by £0.1 billion. This increase in customer deposits contributed to the LCR increasing to 158% at December 2018 (31 December 2017: 127%).

Deposits from banks of £3.2 billion at 31 December 2018 decreased by £0.3 billion reflecting reduced borrowings under the Bank of England Indexed Long Term Repo scheme of £0.2 billion and a decrease in amounts due to the parent of £0.2 billion, offset by an increase in borrowings from the Bank of England Term Funding Scheme of £0.1 billion.

The Group's **equity** of £2.0 billion is largely consistent with 2017. Retained earnings increased year on year by £25 million, being £151 million of retained profit offset by £70 million dividend and £18 million AT1 coupons paid to the Parent along with the IFRS 9 transitional impact of £37 million and an actuarial loss on pension scheme of £1 million. Other reserves decreased by £20 million. Further details are shown in the statement of changes in equity on page 73.

Introduction of IFRS 9
IFRS 9 'Financial instruments' came into effect on 1 January 2018 and has changed the basis under which the Group calculates and measures impairment on financial instruments. The credit risk section of the Risk Management Report provides definitions of the significant categories now used by the Group under IFRS 9.

The impact of IFRS 9 on the Group's accounting policies and critical accounting estimates and judgements can be found in notes 1 and 2 to the financial statements. The detail of the changes to the Group's balance sheet as a result of reclassification and remeasurement on transition from IAS 39 to IFRS 9 can be found in note 16. Further details of the impact of IFRS 9 on loans and advances to customers can be found in note 20, while note 21 provides quantitative information about credit risk arising from financial instruments held by the Group.

Return on tangible equity	2018 £m	2017 £m
Profit for the period attributable to shareholders	151	130
Coupon on AT1 securities, net of tax	(18)	(18)
Amortisation of intangible assets, net of tax	5	4
Adjusted statutory profit after tax	**138**	**116**
Non-core items (net of tax)	14	-
Adjusted underlying profit after tax	**152**	**116**
Shareholders' equity, excluding AT1 capital	1,704	1,699
Intangible assets and goodwill	(54)	(61)
Shareholders' tangible equity	**1,650**	**1,638**
Average shareholders' tangible equity	**1,645**	**1,748**
Statutory return on tangible equity	**8.4%**	**6.6%**
Underlying return on tangible equity	**9.2%**	**6.6%**

Capital

31 December 2017 Regulatory and fully loaded %		31 December 2018 Regulatory[1] %	31 December 2018 Fully loaded[2] %
	Capital ratios[3]		
14.7%	Common equity tier 1	15.0%	14.5%
17.7%	Tier 1	17.8%	17.5%
20.5%	Total capital	20.6%	20.2%
6.6%	Leverage ratio	6.9%	6.7%

The Group is strongly capitalised with a total capital ratio on a regulatory basis of 20.6% (31 December 2017: 20.5%). The increase in the total capital ratio reflects an increase in capital resources of £69 million offset by growth in Risk Weighted Assets (RWA) of c.£0.3 billion.

Capital ratios have been presented including the benefit of the retained profit in the period in accordance with Article 26 (2) of the Capital Requirements Regulation (CRR).

Further details on the capital position of the Group are shown on pages 54 to 56 in the Capital Management section and can also be found in the Bank of Ireland (UK) plc Pillar III disclosure report for the year end 31 December 2018, available on the Group's website, www.bankofirelanduk.com.

Income statement - by business unit

2018

Consolidated income statement - underlying profit / (loss) before taxation	**GB consumer banking £m**	**Northern Ireland £m**	**GB business banking £m**	**Group centre £m**	**Total £m**
Operating income	339	145	13	28	525
Operating expenses	(182)	(82)	(3)	(67)	(334)
Operating profit / (loss) before net impairment gains / (losses) on financial instruments	**157**	**63**	**10**	**(39)**	**191**
Net impairment (losses) / gains on financial instruments	(40)	6	-	-	(34)
Share of profit of joint venture	33	-	-	-	33
Underlying profit / (loss) before taxation	**150**	**69**	**10**	**(39)**	**190**
Non-core items					(17)
Profit before taxation					**173**

2017

Consolidated income statement - underlying profit / (loss) before taxation	GB consumer banking £m	Northern Ireland £m	GB business banking £m	Group centre £m	Total £m
Operating income	292	147	19	13	471
Operating expenses	(175)	(84)	(8)	(61)	(328)
Operating profit / (loss) before net impairment gains / (losses) on financial instruments	117	63	11	(48)	143
Net impairment (losses) / gains on financial instruments	(17)	(10)	1	-	(26)
Share of profit of joint venture	34	-	-	-	34
Underlying profit / (loss) before taxation	134	53	12	(48)	151
Non-core items					-
Profit before taxation					151

[1] *Regulatory capital is reported including the IFRS 9 transitional adjustment.*
[2] *Fully loaded capital is reported excluding the IFRS 9 transitional adjustment.*
[3] *Capital ratios reflect the UK regulatory position of the BOI UK regulatory group which consists of the Bank and its subsidiary, NIIB Group Limited only.*

Capital *(continued)*

Income statement - by business unit *(continued)*

The business units are defined on page 13 in the business operations section.

Great Britain Consumer Banking
The underlying profit of Great Britain Consumer Banking increased by £16 million, 12% compared to 2017. This is primarily due to:

- new business growth in 2018 in the unsecured lending portfolios in line with the Group's agreed strategy;
- reduction in retail funding costs;
- income arising from the disposal of selected non-performing assets;
- the first full year of trading for Marshall Leasing Limited (MLL) within the Group; partially offset by
- reduced mortgage income given product mix and margin impacts;
- reduced fees and commission income;
- increased costs relating to the growth and repositioning strategies; and
- higher impairment charges primarily due to increased new lending balances.

Northern Ireland
The underlying profit of the Northern Ireland business increased by £16 million, 30% compared to 2017. This strong performance is due to consistent margin management and cost control, along with net impairment gains during 2018.

GB Business Banking
The underlying profit in the GB Business Banking portfolio decreased by £2 million which is in line with the continuing strategy to deleverage this business.

Group Centre
The Group Centre underlying loss has improved by £9 million, 19% compared to 2017, primarily due to lower interest costs associated with the Group's subordinated debt, which was restructured during 2017 and higher income on derivatives.

Further details on subordinated debt and related interest are included in notes 5 and 35.

Our business strategy and goals

Our purpose is to enable our customers, colleagues and communities to thrive by being the leading Partnership Bank.

The Group's strategic priorities are:

- Transform the bank;
- Serve customers brilliantly; and
- Grow sustainable profits.

In conjunction with our Parent, the Group is investing in a multi-year transformation programme to improve customer experiences, create efficiencies and support the Group's growth ambitions.

Our values

The Group has four key values which embody the commitments to customers, colleagues and communities. These are:

- **Customer focussed**
  We understand our customers well. We listen to them to ensure they feel valued. We use our insights to consider how best to serve their needs. We take appropriate actions to deliver solutions to meet customers' changing requirements.

- **One Group, one team**
  We know we work smarter when we come together behind our common purpose. We learn from each other and share ideas to expand our thinking. We build an open, trusting and supportive environment and foster diversity of thought, ideas and experiences to spark creativity.

- **Accountable**
  We are empowered to take ownership and trusted to do the right thing to support our customers, colleagues and communities. We lead by example and challenge ourselves and each other to do our best work at all times. We learn from our mistakes and celebrate our successes together.

- **Agile**
  We embrace change with an open mind and a can-do attitude. We respond quickly and proactively seek different perspectives. We challenge ourselves to look for new and simplified ways to efficiently deliver the best solutions for customers.

Our business strategy and goals *(continued)*

Our business operations

The Group manages the business operations under four units:

- **GB Consumer Banking** - offering consumer banking products through strategic partnerships with the Post Office, the AA and other intermediaries and the asset finance and leasing business of Northridge Finance and Marshall Leasing;
- **Northern Ireland** - a full service retail bank serving c.300,000 customers operating through a distribution network of 28 branches and 6 business centres and via direct channels (telephone, mobile and on-line). The Bank is also one of four banks authorised to issue bank notes in Northern Ireland;
- **GB Business Banking** – legacy commercial lending business which is undergoing a continued programme of deleveraging; and
- **Group Centre** – centralised management of risk and control functions and the Group's funding, liquidity and capital positions.

Strategic partnerships

The Group's financial services partnership with the Post Office currently covers the period to 2023. Together we offer a range of consumer products including savings, mortgages and personal loans online and through a distribution network of c.11,500 Post Office branches in the UK servicing c.2.1 million customers along with a supply contract for c. 2,400 free to use ATMs.

The Group's partnership with the AA commenced in July 2015 with a minimum period of ten years. The AA is regarded as one of the best known and trusted brands in the UK and the largest provider of roadside assistance, representing c.40% of the UK breakdown market with over three million members. Under the AA brand the Group offers savings and personal lending products to c.145,000 customers.

Our business strategy

During 2018 the Group's strategic focus was on:

- **Investing** in the growth of businesses which provide attractive returns;
- **Improving** those businesses with potential, which need to deliver better returns; and
- **Repositioning** those parts of the UK business where there is less certainty about achieving expectations.

Execution of these strategic objectives will enable the Group to:

- generate an improved and sustainable Return on Tangible Equity by 2021;
- continue to improve the cost of funds;
- reduce the cost income ratio; and
- increase loan book by more than 10% by 2021.

Customers are the core of our businesses, and we recognise that customer expectations and requirements are continually changing in this evolving digital age. Our customer focussed strategy is to deliver a brilliant experience to all of our customers. We will do this as we transform our business by providing products and services which meet their financial requirements through easy, simple and accessible processes which align to their digital expectations.

Investing

The Group delivered new mortgage lending of £3.3 billion, compared to £3.2 billion in 2017, while launching new products, including supporting first time buyers. In response to a competitive mortgage market and aligned with our strategy, the Group is progressing plans to move away from the mainstream re-mortgage market, developing enhanced customer value propositions and investing in digital capabilities to improve the customer experience while maintaining strong risk discipline.

It has been a successful year for the Group's unsecured lending business, with gross new lending of £0.5 billion through our Post Office and AA Strategic partners, an increase of 75% from 2017, primarily driven by continued investment in our customer experience. These improvements have been recognised through industry awards including our Post Office partner winning Moneyfacts Personal Finance provider of the year and our AA Partner receiving a Highly recommended award for Personal Loans provider of the year at the Moneynet awards.

During 2017, the Group acquired a leasing and fleet management business, MLL, which complements and supports the well established asset finance business, Northridge Finance. The first full year of trading with MLL provided the Group with additional optionality with products being distributed via Northridge channels with penetration in affinity schemes and via the broker network. Acknowledging its established brand and reputation MLL won the 2018 Fleet News Award for Leasing Company of the year in its category.

Northridge Finance has also experienced strong volume growth and completed the year with gross new lending of c.£1.1 billion, an increase of 31% on 2017 and a record for the business. The Group has seen the customer fleet in MLL grow by 19% in a reduced and highly competitive market. As well as strong sales performance, the customer experience has been enhanced through digital innovations such as systemised intermediary payments and web settlements.

A new Post Office Deposits Servicing Site launched in 2018 providing customers with an improved ability to self serve, thereby reducing call centre volumes. Investing in IT systems capability is a key factor in the Group's growth ambitions, with investments across saving, mortgages and the asset finance business during 2018.

Our business strategy and goals *(continued)*

Improving

The Group continued to make progress in managing deposit margins during 2018. This margin improvement has been delivered by offering new and attractive customer propositions, improved customer retention and through digital and process innovation.

The Group has also worked closely with the Post Office during 2018 to improve customer application functionality both online and through dedicated Customer Relationship Assistants in Post Office Branches, so that applications may be completed seamlessly (replacing the need for paper applications and reducing processing times considerably). Improvements in our mortgage end to end journey and new propositions have also been recognised, with the mortgage business winning eight industry awards during 2018, acknowledging the work with our partners to serve customers brilliantly.

After three years of trading the AA partnership has c.145,000 customers and has achieved a lending book of c. £0.5 billion at 31 December 2018, which is fully funded by £0.7 billion of AA originated customer deposits. The Group has also continued to move forward with our ambition to develop innovative propositions across existing and new products whilst continuing to develop AA member exclusive offerings.

First Rate Exchange Services, the Group's joint venture with the Post Office, continues to be the market leader for FX travel money with a market share of 24%. The market remains challenging, however the business has performed well and was awarded Best Foreign Exchange Provider at the British Travel Awards in November 2018, the 11th gold award in the last 12 years.

The Northern Ireland commercial lending portfolio decreased by £0.1 billion to £1.2 billion at December 2018. During 2018 Consumer and Business Direct teams in Northern Ireland were formed allowing customers to obtain borrowing facilities through a Northern Ireland based telephone channel.

The Group is focussed on enhanced cost awareness through heightened governance, increased staff communication, external recruitment and organisational design review. Agile initiatives piloted during 2018 such as 'Modern Ways of Working' have delivered incremental benefits to the business and will be rolled out across the Group in 2019.

Repositioning

During 2018 the Group reviewed all business operations for opportunities to optimise costs and returns.

Customer transactional behaviour both in branches and through ATM use continues to change as digital channels expand. During 2018 changes to the ATM LINK fee income came into effect which further influenced the performance of the ATM business. A strategic review of the business is now underway.

In July 2018,the Group disposed of a discrete portfolio of non-performing loans, recognising a gain of £6 million in the income statement.

At 31 December 2018, the Group's credit card portfolio of £0.5 billion was classified as held for sale on the balance sheet.

The strategy for the GB Business Banking division remains unchanged as it continues to deleverage over the medium term. At 31 December 2018 the lending balances had decreased to c.£0.2 billion (31 December 2017: £0.3 billion).

Capital

The Group's strategy is to optimise its capital position and capital returns and seek new lending and other business opportunities, in both the commercial and consumer business, which are aligned with its risk appetite. The Group maintained a strong capital position during 2018 with a regulatory CET1 ratio of 15.0% at 31 December 2018 (31 December 2017: 14.7%). For further details on capital refer to the Capital Management section page 54.

The planned disposal of the credit card business is estimated to reduce RWA by c. £0.4 billion in 2019.

Liquidity

At 31 December 2018 the Group continues to maintain a strong liquidity and funding position and is fully compliant with all liquidity and funding obligations. An efficient funding profile was maintained during the year. At 31 December 2018 the Group has a loan to deposit ratio of 102% (31 December 2017: 105%) and and an LCR of 158% (31 December 2017: 127%).

The Group actively monitors its liquidity position using various measures including LCR and NSFR and considers these in the creation, execution and review of its funding plans.

The Bank of England Term Funding Scheme (TFS) was designed to provide a cost effective source of funding to support additional lending to the UK economy and the Group utilised £1.3 billion from the scheme before it closed in February 2018. Further details on the TFS are included in note 29.

For further details on liquidity and funding risk refer to page 46.

UK economic and market environment

Key points:

- As a UK focussed financial services provider through Partnerships with the Post Office and AA and a full service retail bank in Northern Ireland, the Group's prospects remain closely linked to the strength of the UK economy overall and to the regional market.
- Despite heightened political uncertainties and increased volatility in financial markets, the UK economy continued to grow in 2018, supporting a further rise in overall employment levels and rates, helping sustain positive trends in credit quality.
- The Group continues to execute the business and customer strategy, including growth in lending books with an improved return on capital while remaining vigilant to risks that may materialise from near-term uncertainties, most notably relating to Brexit.
- The competitive landscape for UK retail banking is expected to remain intense with interest rates rising only slowly and gradually over time, while customer behaviours are changing with the rapid pace of technology adoption.

Review

While the UK economy has proved considerably more resilient than some feared immediately after the EU Referendum in 2016, the pace of growth in 2018 slowed to its weakest annual rate since 2012 (1.4%). Weather-related disruption contributed to a soft start to the year, followed by a more buoyant recovery in quarters two and three before activity levels succumbed to renewed political turbulence and Brexit-related uncertainties as the year drew towards a close.

The UK's scheduled exit from the EU in March 2019 continued to cast a large shadow over the market in 2018 with adverse impacts, particularly on business confidence and levels of investment but also on financial market performance during Q4.
UK house price growth lost some momentum as 2018 progressed with some regions actually reporting a modest price fall year on year while overall transaction volumes remained broadly flat.

Inflation remained above the official 2% target during 2018 although the direct impact from sterling's depreciation from 2016 has largely unwound. However, with limited wage growth for much of the year, disposable incomes remained stretched for many households.

More positively, the rate of unemployment fell below 4% and to its lowest level in over 40 years. While there has been some increase in recent years, household indebtedness still remains significantly below pre-crisis levels.

The BoE raised official interest rates for only the second time in a decade in August 2018, in a move largely expected, taking the Bank rate to 0.75%, and its highest level since 2009. However, with the larger number of lending fixed rate deals outstanding, the immediate impact on overall borrowing costs were limited. The combination of low interest rates and the Group's low risk approach has again been reflected in low levels of impairments in 2018 against lending balances.

Northern Ireland

The franchise business in Northern Ireland had a solid 2018 in an otherwise mixed year for the regional economy. The local housing and labour markets remained steady, boosting the demand for mortgages and helping annual gross lending in the market to recover. After a difficult decade, the rate of housebuilding is accelerating gradually again with the number of "starts" rising to its highest level since 2007. Total employment in the region reached a new record of 765,000 in Q4, although measures of inactivity and productivity continue to lag UK averages.

In the business sector, export-orientated firms enjoyed stronger growth than domestic-only. Tourism, hospitality and cross-border retailing continue to see some benefit from the lower sterling exchange rate while the region is acquiring a reputation in some of the niche technology segments such as cyber-security. At around 15% of the economy, manufacturing remains relatively more important to the region than the UK overall. Delays in the delivery of key infrastructure projects are having an impact on the construction sector.

The absence of a functioning devolved government in NI remains a concern and a barrier to much-needed long-term strategic decision-making which potentially could alter the long-term trajectory of the economy.

The potential operational impacts of the UK's scheduled exit from the EU will present risks for some customers' businesses in Northern Ireland.

Outlook

The outlook for the Group's core product markets is expected to mirror developments in the economy as a whole.

With barometers of household confidence suggesting a more challenging climate, the UK housing market overall seems set to remain relatively stable but subdued again in 2019.

Despite consecutive annual declines in new car registrations, linked to wider economic and industry developments, including weaker demand for new diesel vehicles, the used car market has remained more resilient as has the demand for car finance and competition among suppliers. The Group expects this to continue.

The drop in the UK savings ratio in recent years implies that households have been saving less overall, although the Group still anticipates that 2019 will be another year of low single digit % growth.

The commercial lending business in NI reported a healthy demand for credit from both existing and new customers for a large part of 2018 although the appetite to borrow for investment did appear to subside in the final quarter as wider business caution and Brexit-related uncertainties gripped sentiment. It was also noticeable that a number of businesses were accumulating higher cash balances as insulation for potential disruption ahead and to provide funds to exploit possible opportunities for when some of the uncertainties eventually fade.

Against the backdrop of increased political and economic uncertainty a continued focus on delivering for customers, developing attractive new propositions and ensuring cost efficient delivery will continue to be supportive of the Group's overall performance.

Corporate social responsibility

The Group's corporate responsibility is fully aligned to our purpose, with the focus on the three core pillars of our business, **Customers**, **Colleagues** and **Communities**.

Customers

As well as the investment in technology and new propositions to meet the needs of our customers, the Group has also invested in a number of initiatives to support our strategy to **serve customers brilliantly**.

During 2018 the Group has established the UK Customer Board, the principal executive committee responsible for the oversight and delivery of the UK Customer Plan. This Board is chaired by the UK Chief Executive Officer and includes senior executives, business heads and front line colleagues from around the business.

The UK Customer Board is responsible for the delivery of the UK Customer Plan, in particular:
- executing customer value propositions;
- customer journey management;
- consistent customer metrics;
- cultural alignment across teams; and
- complaint management and resolution.

The UK Customer Board monitors various internal and external KPIs, and while it is encouraging to see improvements in certain Net Promoter Scores and industry awards during 2018, the management team have agreed targets for further improvement in 2019 and beyond.

Customer Vulnerability
In addition, we continue to focus on improving our service for vulnerable customers. Recognising the diversity of brands, products and service providers who support the Group's overall business, to date, the UK business has progressed under a programme based approach. Working to empower colleagues with the skills, knowledge and confidence to support the needs of customers is fundamental to this approach; as is promoting the need to provide customers with suitable and easily accessible products and services.

Complaint Management
An additional focus of the UK Customer Board is on complaint management and resolution, namely:

- Complaint Volume Reporting - reviewing the Management Information on complaint volumes, key complaint categories and service level achievement to ensure trends and issues are identified and addressed and that complaints are being managed promptly and effectively.
- Complaint Handling Quality - reviewing reports from various functions on the results of complaint handling quality assessments.
- Outsourced Services - oversee the performance of outsourced services provided to the Group with performance managed in line with the UK Outsourcing Governance Framework.
- Complaint Root Cause Analysis (RCA) - Reviewing the RCA undertaken by the product and distribution business and ensure appropriate action is taken to learn from complaints and put in place appropriate actions to prevent recurrence.

Colleagues

The second part of our purpose is to '**enable our colleagues to thrive**'. The Group strives to ensure that our colleagues are engaged and have the skills and capabilities to serve our customers brilliantly and help our communities to thrive.

The current and future success of the Group in achieving its strategic priorities depends on having a continuous focus on:
- talent and capability development;
- engaging our workforce;
- managing business change; and
- supporting the regulatory agenda.

The Group is committed to investing in its people to ensure they can effectively support customers, deliver the Group's strategic priorities and develop their individual careers.

The Group seeks to operate at the highest ethical standards by encouraging an environment where our four values, as described on page 12 are embedded in the core of the organisation. The Group has clear expectations for behaviour and conduct with an annual mandatory training programme for all employees. The Group Code of Conduct sets the standards of ethical behaviour to create the right culture and the following standards and behaviours are expected from all employees:
- to act with integrity and honesty;
- to report wrongdoing;
- to avoid disclosing confidential information;
- to avoid conflicts of interest; and
- to comply with legislation and regulations.

The Group believes that by applying these standards, all colleagues can make sound decisions and, when faced with complex dilemmas achieve good outcomes for all our stakeholders. To help ensure that the Code of Conduct is embedded in every aspect of the business, the Group encourages and supports employees to speak out if they witness wrong doing, such as a breach, or suspected breach, of the Code of Conduct standards, or any concern they might have in respect of potential improprieties. Employees not only need to perform their duties with honesty and integrity, they also have to be seen to do so.

Be At Your Best (BAYB), is a wellbeing programme that helps colleagues support their physical health and mental wellbeing, while taking positive steps in their careers. It is about empowering our colleagues to take the time to invest in themselves, challenge their limitations and reach their highest potential. The programme is delivered through various workshops and expert training sessions with numerous events and challenges held during the year with all colleagues encouraged to take part.

Corporate social responsibility *(continued)*

Colleagues *(continued)*

Our career development programme supports colleagues to take ownership of their professional wellbeing, through awareness, support and recognition. Access to the Group's online Career Portal provides colleagues with a wide range of resources to help them take ownership of their career development by planning their career journey, accessing courses, articles and turtorials. In 2018, over 29,000 training hours were completed by UK employees via web based and classroom courses.

We are committed to creating an inclusive and diverse place to work where colleagues can be themselves and perform to their full potential. We want to attract, promote and retain diverse talent at all levels, to create a more innovative and high-performing business that can enable our customers, colleagues and communities to thrive. Our inclusion and diversity strategy, 'Many Voices: One Bank', focuses on valuing and celebrating diversity within our workforce, reflecting the communities in which we operate, an inclusive culture, which values diverse talents and recognises the unique needs of our colleagues, and an organisation that meets the needs of all customers, engaging the community.

The Bank of Ireland groupwide employee engagement survey "Openview" was last taken in late 2017. During 2018 various roadshows, Open Door sessions and follow up 'snapshot' surveys took place. As a result the Group has a number of initiatives and plans to address this feedback and all colleagues will have the opportunity to take part in Openview during 2019.

The Group is committed to creating better gender balance within the management and leadership population. The Group has a 58:42 female to male ratio overall and the management and leadership population is 35% female. The Group has set a target of 38% of management positions being held by women and that 50% of management appointments will be female by 31 December 2021. In March 2018 the Group signed up to the Women in Finance Charter which is a commitment by HM Treasury to work to build a more balanced and fair financial services industry in the UK. Our Gender Pay Gap report is published on our website at www.bankofirelanduk.com.

Communities

The third part of our purpose is to **enable our communities to thrive**. Our communities are those in which we live and work, and also include other stakeholders, both local and national, such as our partners, shareholders, regulators and Government. We support the wider community through our charity and community initiatives and by playing an active role in society.

Employees are actively involved in fundraising and volunteering in charitable events across the UK for our flagship charity, Alzheimer's Society. During 2018 the Group raised c.£300,000 and 875 employees undertook training to become a 'Dementia Friend'. In November 2018, the Bank in Northern Ireland was recognised at the Dementia Friendly Awards, being named as 'Large Organisation of the Year' and a finalist in the 'Uniting Against Dementia - Outstanding Contribution 2018' award.

In addition, colleagues have continued to raise funds for charities close to their heart through our Give Together programme. Give Together is the Group's charity and community initiative, through which staff lend their support to their nominated charities by fundraising, volunteering and making donations. The initiative provides paid leave for volunteering and provides matched fundraising awards.

The Group is proud to continue to support a wide range of Northern Ireland based community, business and sporting activities through sponsorship each year. Open Farm Weekend is one such event which the Group has sponsored since 2012. The annual event aims to raise awareness of food production and the local supply chain in Northern Ireland.

The Group's Innovation Matters programme offers a wide range of free initiatives and resources to schools across Northern Ireland to help prepare students for life in a technological world.

Our annual Northern Ireland Bank of Ireland Enterprise Week in 2018 focussed on ideas around export, innovation, enterprise and connections. This year we collaborated with the Centre of Competitiveness to run a number of seminars aimed at giving local companies advice and information on enhancing their competitiveness.

Our Parent continues to provide the Group with products and services to ensure the environment across the business is managed responsibly. Bank of Ireland Group plc seeks to be a responsible energy manager, promoting energy efficiency throughout its operations, reducing our use of energy resources and promotes the importance of good energy management for the economic, social and environmental well-being of its employees, customers and businesses. The Bank of Ireland Group Environmental and Group Energy policies are published on our Parent website www.bankofireland.com.

The Group strives to ensure that modern slavery or human trafficking does not support our supply chain or our businesses. This objective is explicit in our relevant policies and our approach to human rights. In accordance with relevant UK legislation, the Group has published its statement on Modern Slavery and Human Trafficking for 2018. The Statement sets out the steps and measures the Group has taken to seek to ensure that modern slavery and human trafficking does not occur within its supply chain or in its business operations. A copy of the statement is published on our Parent website www.bankofireland.com.

Non-financial information statement

The Group aims to comply with the non-financial reporting requirements contained in sections 414CA and 414CB of the Companies Act 2006. The purpose of this table is to assist stakeholders in understanding our policies and management of key non-financial matters.

The Group and all employees are subject to the provisions of the Bank of Ireland Group policies included below. Further details can be found in the Bank of Ireland Group annual report at www.bankofireland.com.

Reporting Requirement	Policies	Risk and Management *Bank of Ireland (UK) plc*	Risk and Management *Bank of Ireland Group Annual report*
Environmental matters	• Group Environment policy (ISO 14001)[1] • Group Energy policy (ISO 50001)[1]	• Communities (page 17)	• Environment and Energy (page 26)
Social and employee matters	• Inclusion and Diversity policy • Group Code of Conduct • Equal opportunities policy • Group Health and Safety policy • Employee Data Privacy • Group Vulnerable Customers Policy • Group Learning Policy	• Customers (page 16) • Colleagues (page 16) • Communities (page 17) • Conduct risk (page 53) • Business and strategy risk (page 52)	• Vulnerable customers (page 21) • Inclusion and diversity (page 23) • Learning (page 23) • Wellbeing (page 23) • Employee Representative Bodies (page 23) • Communities (page 24) • People risk (page 62)
Respect for human rights	• Modern slavery and human trafficking statement[1] • Group procurement policy • Group data protection and privacy policy	• Operational Risk (page 51)	• Information security (page 21) • Operational risk (page 103)
Bribery and corruption	• Group Code of Conduct • Speak Up policy • Group Anti-Money Laundering Policy (AML) • Group Anti-bribery and Corruption Policy	• Colleagues (page 16) • Conduct risk (page 53)	• Code of conduct (page 27) • Integrity and honesty (page 27) • AML (page 27) • Conduct risk (page 100)
Business model		• Business operations (page13)	• Divisional Review (page 42)
Policies followed, due diligence and outcome		• Risk management framework (page 26)	• Risk management framework (page 68)
Description of principal risks and impact of business activity		• Principal risks and uncertainties (page 19)	• Key risk types (page 31) • Principal risks and uncertainties (page 61)
Non-financial key performance indicators		• Key highlights (page 2)	• Key highlights (page 3)

[1] *These polices are available on the Bank of Ireland Group's website, www.bankofireland.com. All other policies are not published externally.*

Principal risks and uncertainties

Key risks identified by the annual risk identification process, together with key controls and mitigating factors are set out below.

The Group has taken steps to mitigate the negative effects of Brexit such as implementing measures to ensure that contracts will continue to be enforceable and that it maintains all necessary regulatory permissions. However, there remains ongoing uncertainty in respect of the UK's departure from the European Union and the associated potential economic impacts on the Group's performance.

This summary should not be regarded as a complete and comprehensive statement of all potential risks, uncertainties or mitigants, nor can it confirm that the mitigants would apply to fully eliminate or reduce the corresponding key risks.

Additionally, other factors not yet identified, or not currently material, may adversely affect the Group.

Principal risks	Potential risk impact	Key controls and mitigating factors
Credit risk The risk of loss resulting from a counterparty being unable to meet its contractual obligations to the Group in respect of loans or other financial transactions. Credit risk includes default risk, recovery risk, counterparty risk, country risk, credit concentration risk, settlement risk and residual value risk.	Should commercial or consumer customers be unable to meet their obligations in relation to borrowings from the Group, the Group may suffer increased losses and this would have an adverse impact on the Group's financial position.	• A Risk Appetite Framework is in place and aligned with the Group's overall strategy; • Leveraging of detailed macro-economic data, providing granular insight on geographic exposures and housing market movements on a quarterly basis to Credit Risk Portfolio Committee (CRPC); • External Mortgage Indemnity Guarantee for loans >90% LTV, providing protection against future loss occurrence; • Underlying lending policies are aligned to risk appetite; • Exposure to excessive credit losses is minimised through the operation of responsible lending practices and active portfolio management within clearly defined Board approved risk appetite limits; • The Group undertakes active credit management to maximise recoveries from impaired assets seeking the best outcome in accordance with the Group's Customer Charter; • Active management of credit risk concentrations is an integral part of the Group's approach with the risk appetite statement specifying a range of exposure limits for credit risk concentration over the planning period; • Regular monitoring of lending portfolios by senior management and the CRPC. For selected portfolios, this also includes a review (including stress scenarios) at the Executive Risk Committee (ERC), Board Risk Committee (BRC) and the Board; • At least annual reviews of all commercial portfolio cases to monitor case specific risk; • Processes to monitor and ensure compliance with policies and limits; • Dedicated work-out strategies focussed on the management and reduction of non-performing exposures; and • Residual value limits are set prudently to avoid over-exposure to second-hand vehicle values.
Liquidity and funding risk Liquidity risk is the risk that the Group will experience difficulty in financing its assets and / or meeting its contractual payment obligations as they fall due, or will only be able to do so at substantially above the prevailing market cost of funds. Funding risk is the risk that the Group does not have sufficiently stable and diverse sources of funding or has an inefficient funding structure.	The Group is primarily funded by way of retail deposits, therefore a loss of confidence in the Group's business specifically, or as a result of a systemic shock, could result in unexpectedly high levels of customer deposit withdrawals. This in turn would have a materially adverse effect on the Group's results, financial condition and liquidity position. A loss of confidence in the economy generally, the financial services industry, the Post Office brand, the AA brand or the Group or the Parent specifically, could lead to a reduction in the Group's ability to access customer deposit funding on appropriate terms.	• A Liquidity and Funding Risk Management Framework (RMF) which is reviewed annually, is in place. The Liquidity and Funding Risk Policy which governs management and monitoring, sits within this framework; • Daily monitoring and management of the liquidity position includes, but is not limited to, regulatory and internal liquidity stress testing, early warning signals, metrics and a defined escalation process; • Active management of the funding position to determine the amount of ongoing new retail deposit acquisition and retention required to fund the Group's asset base. As well as retail deposits, the Group also borrowed funds from the Bank of England and the Parent during the year; • Regular reporting to the Asset and Liability Committee (ALCO), the ERC, the BRC and the Board; • Maintenance of unencumbered liquidity resources in excess of internal stress scenarios and the regulatory requirements held in either cash or highly marketable liquid assets and contingent liquidity collateral; • Significant contingent liquidity collateral which is capable of being pledged against borrowings from central banks or other external market participants; • Active management of the funding position to determine the amount of ongoing new retail deposit acquisition and retention required to fund the Group's asset base; • Comprehensive Internal Liquidity Adequacy Assessment Process (ILAAP) undertaken annually which sets out how the Group assesses, quantifies and manages key liquidity and funding risks; and • Recovery Plan in place, which specifies a range of processes and potential actions that can be put in place enacted, in the event of any unexpected shortfall in liquidity and / or funding.

Principal risks and uncertainties *(continued)*

Principal risks	Potential risk impact	Key controls and mitigating factors
Market risk The risk of loss arising from movements in interest rates, FX rates or other market prices. Market risk arises from the structure of the balance sheet, the Group's business mix and discretionary risk taking. Market risk can also arise where variable rate assets and liabilities reprice at different frequencies, or where lending reprices with changes in central bank rates but is funded at short dated market rates.	The effective management of market risk is essential to the maintenance of stable earnings, the preservation of capital resources and the achievement of the Group's strategic objectives. Changes in the basis between different reference rates (such as assets repricing at base rate and liabilities repricing at London Interbank Offered Rate (LIBOR)) may have an adverse impact on the Group's net interest margin and profitability.	• A market risk management framework, which is reviewed annually, is in place and aligned with the Group's overall strategy to have no risk appetite for discretionary market risk and minimise its exposure to market risks in relation to Interest Rate Risk in the Banking Book (IRRBB) and FX. The market risk policy, which governs market risk management and monitoring, sits within this framework. The Group's market risk is mitigated through hedging with the Parent, using derivatives or cash hedging deals; • A product approval process incorporates review of product terms and conditions from a market risk perspective, to ensure compliance with existing risk appetite, policy and process; • Regular reporting to ALCO, the ERC, the BRC and the Board; • Daily market risk stress tests across all aspects of market risk (yield curve and repricing risk, basis risk, repayment risk, pipeline risk etc.) are produced and monitored against red, amber and green (RAG) limits set by Board and operational thresholds set by ALCO; and • Extreme stress scenarios are produced and monitored in line with regulatory shocks and are reported to ALCO.
Regulatory risk The risk of failure to meet new or existing regulatory and / or legislative requirements and deadlines or to embed requirements into processes. The Group's financial position and outlook are exposed to the risks associated with a change in tax laws, tax rates, regulations or practice and the risks associated with non-compliance with existing requirements. The Group is also exposed to the risk that tax authorities may take a different view to the Group on the treatment of certain items.	The increasing regulatory agenda necessitates an increase in resources and amendments to current processes which may impact the Group's cost base. Failure to comply with all aspects of the relevant regulatory regimes could result in the Group being subject to fines, customer compensation and / or the requirement to pay regulatory sanctions and harm its reputation. Failure to demonstrate that it is probable that future taxable profits will be available, or changes in government policy or tax legislation may reduce the recoverable amount of the deferred tax asset currently recognised in the financial statements.	• The Group has no appetite for failure to comply with its regulatory or legislative obligations; • Regular and open communication with the FCA, PRA and European Central Bank (ECB) on all aspects of the Group's activities; • Regular reporting to senior management, the Regulatory and Operational Risk Committee (R&ORC), the ERC, the BRC and the Board; • Regular monitoring, assessment and reporting of regulatory change (current and proposed) to ensure timely and appropriate response to regulatory change requirements at both a UK and EU level; • Risk-based regulatory and compliance monitoring performed by an independent compliance monitoring team; • Embedding of risk culture through the Risk Management Framework (RMF); • The Group has clearly defined tax compliance procedures to identify, assess, manage, monitor and report tax risks and to ensure controls mitigating those risks are in place and operate effectively; • The Group monitors the expected recovery period for deferred tax assets; • The Group monitors potential changes to tax legislation or government policy and considers any appropriate remedial action; and • The Group maintains a transparent relationship with the tax authorities and complies fully with its requirements.

Principal risks and uncertainties *(continued)*

Principal risks	Potential risk impact	Key controls and mitigating factors
Operational risk and financial crime Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. This definition includes legal and model risk but excludes strategic and reputational risk. Legal risk relates to the risk of being the subject of a claim or proceedings due to an infringement of laws, contracts or regulations. Model risk relates to the potential for adverse consequences from decisions based on incorrect or misused model outputs and reports. The key sub-classes of operational risk are defined as follows: Technology, Information Security and Cyber Security, Sourcing, Payments, Business Continuity, Financial Crime (incorporating the risk of facilitating money laundering, terrorist financing, sanction violation and fraud), People, Legal and Contractual, Model, Unauthorised Trading, Insurable, Disclosure, Regulatory Reporting and Data Quality and Reliability Risk.	Risks to availability, resilience, stability and security of Group's IT systems; security of Group's sensitive and customer information; continuity of the Group's operations and services; and risks arising from the Group's outsourcing arrangements could impact the Group's operational resilience and lead to disruption to the provision of services to customers, financial loss and / or reputational damage. Non-compliance with legislative and regulatory obligations may result in financial penalties, regulatory reprimand and reputational risk to the Group. People stretch and potential loss of key staff could have a detrimental impact on the Group's ability to achieve its strategic objectives. Litigation proceedings with adverse judgements could result in material impact on the Group's reputation.	• The Group’s operational risk management framework (ORMF) defines the Group’s approach to identifying, assessing, managing, monitoring and reporting on the operational risks that may impact the achievement of the Group’s objectives. The ORMF consists of processes and standards aimed at embedding adequate and effective risk management practices within business units throughout the Group; • The Group Risk Appetite incorporates Operational risk appetite statements and limits as approved by the Board; • The Group utilises a number of available strategies in controlling its exposure to operational risk, with the primary strategy being the maintenance of an effective control environment, coupled with appropriate management actions; • Specific policies and risk mitigation measures for material operational risks are in place; • The Group continues to enhance and invest in its risk management processes including the identification of and controls for potentially elevated / emerging risks such as, Information Technology, Information Security and Cyber Security, Business Disruption, Financial Crime and Fraud. This enhancement and investment is intended to, over time, improve the Group’s risk profile; • Security programmes are in place to protect the integrity and availability of the Group’s systems and mitigate the frequency and impacts of cyber-attacks. A staff education programme has been implemented on information protection and cyber security; • Continued focus on and regular review of User Access Management to ensure user access privileges are appropriately aligned to role requirements; • A comprehensive Model Risk Management Framework is in place to ensure existing or emerging model risks are identified and mitigated effectively and efficiently. Quarterly MI updates are submitted to the ERC and the BRC; • A programme has been delivered in 2018 to enhance the maturity levels of the anti-money laundering (AML) risk management framework, including automation of customer due diligence; • Arrangements entered into with the Parent and third party outsourced providers are managed through service level agreements, service descriptions and KPIs, with a Sourcing Risk Policy Standard and UK governance fora in place; • Business Continuity and Critical Incident frameworks ensure adequate planning is in place for any incidents impacting continuity of services. Processes were tested within the year; • The Group has processes in place to ensure its compliance with its legal obligations, together with clear controls in respect of the management and mitigation of such disputes, proceedings and investigations as may be instigated against the Group from time to time; • The Group has a Board approved people strategy to enable the Group to retain appropriate numbers and / or calibre of staff having regard to remuneration restrictions imposed by government, tax or regulatory authorities. These include Talent Board Reviews including succession planning, a Performance Management Framework, and a Career and Reward Framework; and • Regular monitoring and reporting to the R&ORC, the ERC, the BRC and the Board.

Principal risks and uncertainties *(continued)*

Principal risks	Potential risk impact	Key controls and mitigating factors
Business and Strategic risk The risk of volatility to the Group's projected outcomes, including the Income Statement and Balance Sheet impact and / or damage to its franchise including that of the Group's joint ventures. It includes volatilities caused by (1) changes in the macro and competitive environment, new market entrants, arrears levels etc and (2) failure/delays in executing the Group's strategy for new product/customer offerings, cost reduction delivery, or to anticipate or mitigate a related risk.	Adverse change in the Group's revenues and / or costs resulting in reduced profitability.	• A clearly defined strategic plan is developed within the boundaries of the Board approved risk appetite and risk identity, ensuring balanced growth in consumer lending and deposits with a stable funding profile that is appropriate for the asset mix; • The Group monitors the impact, risks and opportunities of changing, current and forecast macroeconomic conditions on the likely achievement of its strategy and objectives, including the challenges and uncertainty associated with the ongoing negotiations regarding the nature and impact of the UK's withdrawal from the EU; • The Group's competitive environment is reviewed and monitored on an ongoing basis to identify market developments, using external research and economic updates as required; • In the context of its Board approved strategy, the Group assesses and develops its complementary technology strategy which is reviewed and monitored on an ongoing basis; • Clearly defined and regularly monitored KPIs are reviewed at both Executive and Board committee level through regular reporting of business and strategic risks to ERC, BRC and Board; • A balanced scorecard is monitored, which considers key elements in the delivery and successful execution of the Group's strategic plan, including enhancing product returns, customer services levels, and the achievement of cost and efficiency targets, all within risk appetite parameters; and • The Group is strongly capitalised and self-funded predominantly through retail deposits with no sustained funding dependency on the parent or material dependency on the wholesale funding market. The Group also has significant liquidity collateral which is capable of being pledged against borrowings from central banks or other external market participants.
Brexit Ongoing uncertainty surrounding the UK's departure from the European Union (EU) continues to affect the markets in which the Group operates including pricing, partner appetite, consumer confidence and credit demand, collateral values and customers' ability to meet their contractual obligations and consequently the Group's financial performance, balance sheet, capital and dividend capacity.		• The Group has a longstanding Brexit programme to identify, monitor and mitigate risks associated with Brexit. The Board receives regular updates on the progress of risk mitigation in this area; • The Group's distribution in the UK is largely through partner brands which reduces investment in infrastructure and other fixed cost items; and • Services received from the Group's Parent company in Ireland are hedged to mitigate the risk of sterling/euro volatility in a hard Brexit scenario.

Principal risks and uncertainties *(continued)*

Principal risks	Potential risk impact	Key controls and mitigating factors
Reputation risk The risk to earnings or franchise value arising from adverse perception of the Group's image on the part of customers, suppliers, counterparties, shareholders, staff, partners, legislators or regulators. This risk typically manifests through a loss of business in the areas affected.	Adverse public or industry opinion, resulting from the actual or perceived manner in which the Group conducts its business activities or from actual or perceived practices in the banking industry (such as mis-selling financial products or money laundering), may adversely impact the Group's ability to have a positive relationship with key stakeholders and / or strategic partners and / or keep and attract customers. Ultimately this may result in an adverse impact on the Group's business, financial condition and prospects.	• The embedding and management of a positive customer conduct culture to ensure the interests of consumers remain at the heart of the Group's operation. Management decision making aims to deliver an accurate, open and positive external view of the Group to customers, regulators and the wider public and community; • Active management of all internal and external communications including social media and media monitoring which leads to escalation and, where required, management actions; • Regular reporting to the ERC, the BRC and the Board; and • Regular and open dialogue with key stakeholders, partners, regulators and industry bodies.

Principal risks and uncertainties *(continued)*

Principal risks	Potential risk impact	Key controls and mitigating factors
Conduct Risk Conduct risk is the risk of failure to deliver a product or service in a manner promised or reasonably expected by customers or to treat them fairly.	Conduct risk and / or poor outcomes for customers could lead to customer remediation, loss of business, adverse media coverage, financial penalties and / or other regulatory sanction.	• The Group seeks to be fair, accessible and transparent in the provision of products and services to its customers; • The Group's intention is to help its customers and communities to thrive and places customers at the heart of its business. It is central to the Group's Conduct Risk Culture which continues to be embedded across the business and provides a common and consistent framework for business decision making and product design across the Group; • The Group continues to enable, develop and enhance its conduct risk management tools and processes, including strengthening its treatment of vulnerable customers; • The Product & Services Approvals & Governance Committee (PSAGC) reviews, assesses and approves material new products and services prior to introduction or withdrawal or material change to an existing product or service. It also reviews the performance of existing products and services to ensure these remain appropriate; • A dedicated Customer Board oversees customer experience and customer outcomes including complaints; and • Regular reporting, complaints oversight and root cause analysis reviewed at the R&ORC, Customer Board, BRC and Board.
Capital adequacy risk The risk that the Group holds insufficient capital to absorb extreme and unexpected losses, which could eventually result in insolvency.	The Group's capital ratios would deteriorate relative to regulatory requirements as a result of materially worse than expected financial performance or unexpected increase in risk weighted assets.	• A capital management framework which is reviewed annually, is in place for the effective management of capital adequacy risk and its capital position. The capital management policy, which governs capital management and monitoring, sits within this framework; • Comprehensive Internal Capital Adequacy Assessment Process (ICAAP) undertaken annually, assessing the Group's capital adequacy and capital quality under plausible stress scenarios; • Capital adequacy risk appetite is central to the strategic planning process. The Group's appetite is to hold sufficient capital to achieve its strategic objectives, as well as to absorb extreme losses in a stress scenario; • Regular reporting to the ALCO, the ERC, the BRC and the Board; • Detailed capital plan continuously monitored and reviewed on a monthly basis, which informs the capital position for the Group; and • Recovery plan in place which specifies a range of processes and potential actions that can be enacted in the event of any unexpected shortfall in capital resources.

The Strategic report on pages 6 to 24 is approved by the Board of Directors and signed on its behalf by:

Thomas McAreavey

Thomas McAreavey
Director

8 March 2019

Company number: 07022885

Risk Management

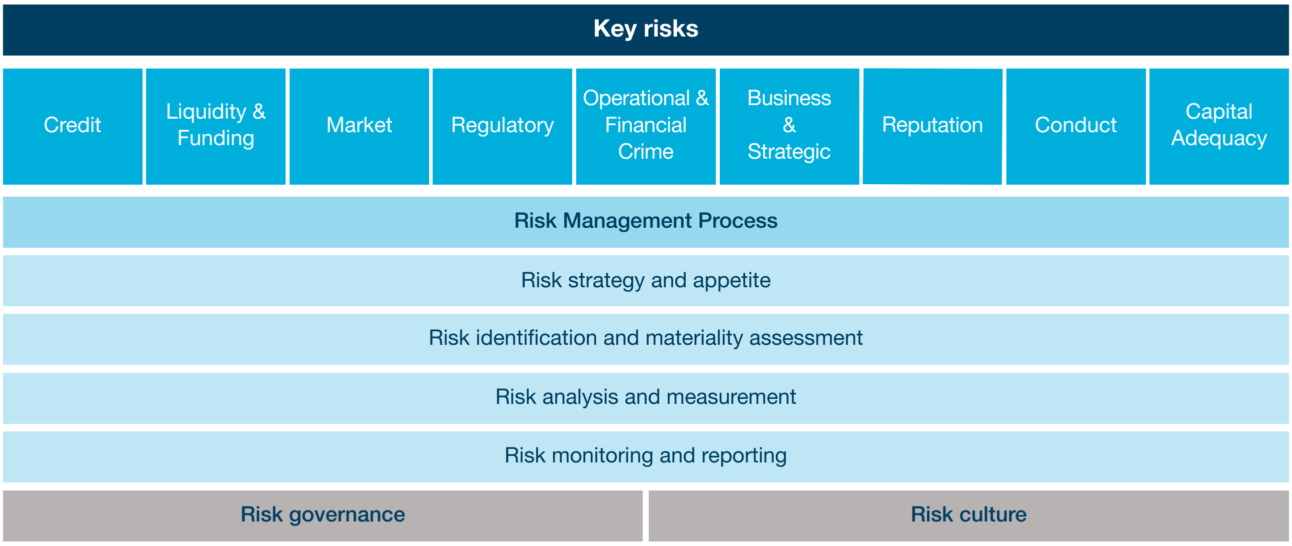
The information below in sections or paragraphs denoted as audited in sections 2 and 3 and all the tables (except those denoted unaudited) in the Risk Management Report form an integral part of the audited financial statements as described in the Basis of Preparation on page 77.

All other information in the Risk Management Report is additional disclosure and does not form part of the audited financial statements.

1 Risk management framework

The Group follows an integrated approach to risk management to ensure that all material classes of risk are taken into consideration and that the Group's overall business strategy and remuneration practices are aligned within its risk and capital management strategies. The Group's formal governance process to risk management is set out in the risk management framework, which has the objective of ensuring that risks are managed and reported in a consistent manner across the Group. The Framework outlines the approach for setting risk appetite, risk identification, assessment, measurement, monitoring and reporting. The review of the Framework takes into consideration any emerging factors, both internal (e.g. enhancements to capital allocation) and external (e.g. regulatory developments), as well as any lessons learnt. The Framework is reviewed, approved and cascaded annually to all relevant senior management in the Group, and is reviewed and approved by the Board of Directors (the 'Board'). The key components of the Framework are detailed below:

Key components of Group Risk Framework



1.1 Risk governance framework

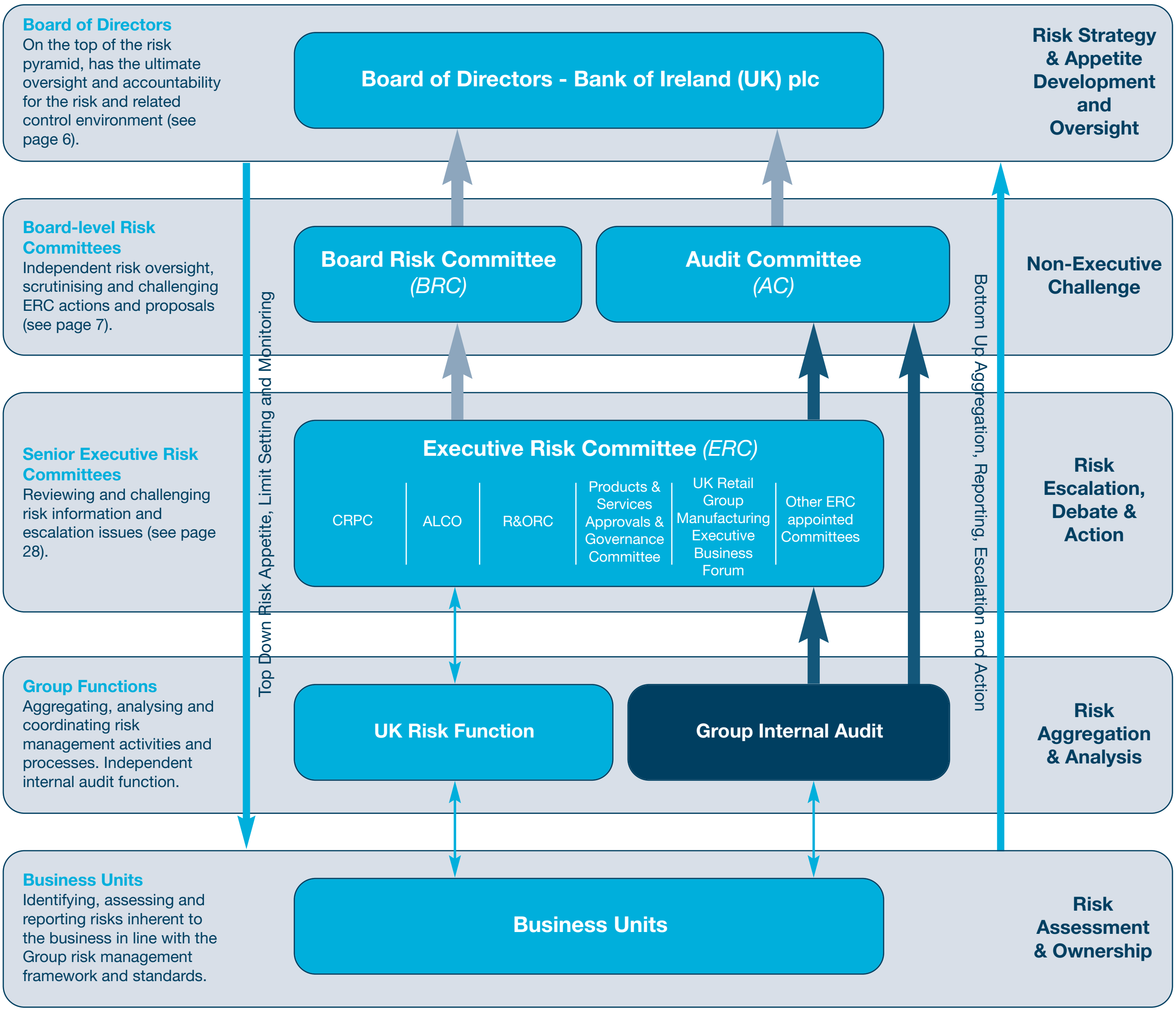
1.1.1 Risk governance

The identification, assessment and reporting of risk in the Group is controlled within the Risk Governance Framework which incorporates the Board, Risk Committees appointed by the Board (e.g. Board Risk Committee (BRC) and Audit Committee (AC)), the Executive Risk Committee (ERC) and its appointed committees (e.g. Regulatory & Operational Risk Committee (R&ORC), Credit Risk Portfolio Committee (CRPC), and Asset & Liability Committee (ALCO)).

The **Board** is responsible for ensuring that an appropriate system of internal control is maintained, and for reviewing its effectiveness. Each of the Risk Committees (including the **BRC** and **AC**) has detailed terms of reference, approved by the Board or their parent committee, setting out their respective roles and responsibilities.

1 Risk management framework *(continued)*

1.1.1 Risk governance *(continued)*



The **Executive Risk Committee (ERC)** is the most senior management Risk Committee and reports to the BRC. It is chaired by the UK CRO and its membership comprises members of the Executive Committee (ExCo) and control function executives. It met 17 times during 2018.

The ERC is responsible for managing all risk types across the Group, including monitoring and reviewing the Group's risk profile and compliance with risk appetite and other approved policy limits, approving risk policies and actions within discretion delegated to it by the BRC. The ERC reviews and makes recommendations on risk matters where the Board and the BRC has reserved authority. The BRC oversees the decisions of the ERC through a review of the ERC minutes and reports from the Committee Chairman. The ERC delegates specific responsibility for oversight of the major classes of risk to committees that are accountable to it.

The relevant committees are set out in the following table.

1 Risk management framework *(continued)*

1.1.1 Risk governance *(continued)*

Committee	Delegated responsibility
Asset & Liability Committee	ongoing review and monitoring of balance sheet, liquidity, funding, market risk and capital positions to ensure compliance with relevant Group RAS limits, regulatory requirements and industry best practice.
Credit Risk Portfolio Committee	overseeing the Group's development, deployment and management of the Credit Risk framework and corresponding risk appetite across all asset classes.
Regulatory & Operational Risk Committee	end-to-end management and oversight of Regulatory, Operational, Financial Crime and Conduct Risks within the Group.
Products & Services Approvals & Governance Committee	reviews, assesses and approves significant and material new products and services across the UK prior to introduction or prior to withdrawal or material changes to an existing product / service. It also considers the performance of existing products and services to ensure they remain fit for purpose.
Retail UK Group Manufacturing Business Executive Management Forum	joint executive meeting between the Group and the Parent's Group Manufacturing division to support effective management and oversight of services and risks associated with delivery of services from the Group's parent.

Three lines of defence approach
The Risk Governance Framework is supported by the Group's management body, with risk responsibilities extending throughout the organisation based on a three lines of defence approach.

First line of defence – Primary responsibility and accountability for risk management lies with line management across the business and front-line functions. They are responsible for the identification and management of risk against risk appetite at a business unit level including the implementation of appropriate controls and the reporting of all major risk events. Business units are accountable for the risks arising in their businesses / functions, and are the first line of defence for the Group in managing these. This applies irrespective of whether or not activities are outsourced to the Parent or to external third parties including strategic partners such as the Post Office and the AA.

In addition, the Group's treasury function is responsible for liquidity planning and management, transfer pricing, balance sheet management, cash and market risk management and as part of the Group's Recovery Plan, contingent capital and funding management actions. The UK Treasurer reports directly to the CFO.

The Group's operations team manages the delivery of technology and operational services provided by the Parent and third party service providers, and ensures compliance with FCA SYSC8 and MiFID requirements as well as the Group's Sourcing Strategy, Framework, Policy and Guidance. The Operations Director reports directly to the CEO.

Second line of defence – The Second Line Risk Function is responsible for maintaining independent risk oversight and ensuring a risk control framework is in place.

In order for the BRC, the ERC, and other risk committees to fulfil their delegated risk governance responsibilities, they are supported by the Risk Function which is responsible for establishing the RMF and designing risk policies and communicating these to all business units. The Risk Function also provides independent oversight, monitoring, measurement, analysis and reporting of key risks. This includes the monitoring and credit underwriting of individually significant credit exposures in the commercial loan book.

Third line of defence – The Internal Audit function (GIA) provides independent and reasonable assurance to key stakeholders on the effectiveness of the Group's risk management and internal control framework. GIA carries out risk based assignments covering Group businesses and functions (including outsourced service providers), with ratings assigned as appropriate. Findings are communicated to senior management and other key stakeholders, with remediation plans monitored for progress against agreed completion dates. The Group Credit Review (GCR) function, an independent function within Internal Audit, is responsible for reviewing the quality and management of credit risk assets across the Group.

1.2 Risk culture, strategy and principles

Risk culture
A strong risk culture is fundamental to the Group's management, with the Group's Risk Culture Statement being approved by the Board. The Group promotes a risk culture that is open and risk aware. Considerations about risk inform the Board, day-to-day management decision-making and product development. Clearly defined roles and responsibilities ensure risk is owned and controlled effectively across the organisation. A Speak Up policy protects employees who wish to raise concerns under whistleblowing arrangements.

Risk strategy
The Group's Risk Strategy is to protect its balance sheet, customers and reputation as well as those of its strategic partners, and help the business to build profitability. The Group seeks to accomplish this by:

- establishing Risk Appetite as the boundary condition for the Group's Strategic Plan and Annual Operating Plan / Budget;
- defining and implementing a Risk Management Framework to manage risk in an integrated approach;
- defining Risk Principles upon which risks may be accepted;
- allocating clear roles and responsibilities / accountability for the control of risk within the Group; and
- engendering a prudent risk management culture.

Risk principles
Risk Owners seeking to accept a risk at transaction, portfolio and Group level must operate in accordance with risk frameworks and policies including bringing this to the attention of the ERC where required.

In general, risks may be accepted if:

- they are aligned with the Risk Identity and within Risk Appetite
- the risks represent an attractive investment from a risk-return perspective. It is imperative that investment decisions achieve a return on capital which are in excess of the pre-defined hurdle rates and also managed within formally approved mandates. There are a number of return on capital metrics currently in use by the Group at a product level, namely the BoI Group Risk Adjusted Return on Capital (RAROC), Return on Equity (ROE) and Return on Regulatory Capital (RORC). At an entity level, the Group also use a Return on Tangible Equity (ROTE) measure which is based on the firm's statutory balance sheet.
- the Group has the resources and skills to analyse and manage the risks;
- stress and scenario tests around the risks exist, where appropriate, and results are satisfactory;
- appropriate risk assessment, governance and procedures have been observed as described in the appropriate documentation (e.g. frameworks, policies, processes, controls) pertaining to individual risk categories or at an aggregate Group-level; and
- acceptance of the risk does not cause undue risk concentration in order to remain within the approved Risk Appetite portfolio limits and not deviate from the Risk Identity.

1.3 Risk identity and risk appetite

Risk identity
The Group's purpose is to enable its customers, colleagues and communities to thrive by being the leading Partnership Bank.

To achieve its Risk Strategy, the Group operates a strong risk management framework and risk culture whilst pursuing an appropriate return to the risk taken.

Risk appetite
Risk appetite defines the amount and nature of risk that the Group is prepared to accept in pursuit of its strategic objectives. It is central to the strategic planning process, forms a boundary condition to strategy and guides the Group in its risk-taking and related business activities. The Risk Appetite Statement (RAS) is defined in accordance with the Group's RMF and is reviewed at least annually by the Risk Office and approved by the Board on the recommendation of the BRC.

Risk appetite is defined in qualitative and quantitative terms within a framework that facilitates discussion and monitoring both at the Board and management levels. At the highest level, risk appetite is based on the Group's risk identity, which qualitatively defines the relative positioning of the Group's activities within a spectrum of business models and market opportunities. Quantitative risk appetite measures, which are consistent with the Group's risk identity, are then used to inform the boundaries of the Group's strategy. These measures also inform individual risk limits and targets at management and business unit level.

The Group tracks actual and forecast results against these risk limits which are monitored and reported regularly to senior management as well as the ERC sub-committees; the ERC; the BRC and the Board.

The Group strives to ensure it operates within its risk appetite and therefore its risk appetite and risk profile must be aligned. Where the Group has a risk profile that is in excess of its risk appetite, it will take action to realign the risk profile through increased risk mitigation activities and risk reduction. The key risk mitigating activities are set out on pages 19 to 24 within the Strategic report.

1.4 Risk identification, measurement and reporting

Risk identification
Risks facing the Group are identified and assessed through the Group's risk identification process. Risks that are considered material are included in the Group's RMF, owners are identified, appropriate policies are put in place, and a formalised measurement and management process is defined and implemented. The Group periodically reviews the RMF and risk management policies and systems to reflect changes in markets, products and best market practice. The Group has identified risk types that it believes could have a material impact on earnings, capital adequacy, liquidity and on its ability to trade in the future and these are covered in the principal risks and uncertainties that are set out on pages 19 to 24 of the Strategic report.

Risk measurement
Risk management systems are in place to facilitate measurement, monitoring and analysis of risk and ensure compliance with regulatory requirements. In addition to the assessment of individual risks on a case-by-case basis, the Group also measures its exposure to risk at an aggregate level using, among other techniques, risk-adjusted return estimates and stress testing.

The Group conducts stress tests in order to assess the impacts of adverse scenarios on the Group's impairment charges on financial assets, earnings, capital adequacy, liquidity and financial prospects.

The results of stress tests are used to assess the Group's resilience to adverse scenarios and to aid the identification of potential areas of vulnerability. The tests are applied to the existing risk exposure of the Group and also consider changing business volumes, as envisaged in the Group's business plans and strategies. Macroeconomic scenarios of different levels of severity are combined with assumptions on volume changes and margin development.

Stress test results are presented to the BRC and the Board as an integral part of the ICAAP and the ILAAP, which assess the risks and capital and liquidity requirements of the Group.

The Group also performs reverse stress testing, primarily a qualitative process to derive severe stress scenarios which would breach the Group's ability to survive unassisted, thus helping to define risk tolerance boundaries for the business as well as appropriate controls and mitigants.

Risk reporting
Risks are measured, reported and monitored by the Group on a daily, weekly, monthly and / or quarterly basis depending on the materiality of the risk. The CEO and CRO reports submitted to each Board meeting provide an update on key risk issues as well as an update on performance against core risk appetite metrics. Additionally, material risks identified under the Group's RMF are assessed and their status is reported in the Monthly Risk Report (MRR) in the first instance. This report is submitted to both the ERC and the BRC.

The format of this report is approved by the BRC. The content of the MRR includes analysis of, and commentary on, all material risk types. It also addresses governance and control issues and the Group's capital position. In addition to the MRR, the BRC and the Board consider formal updates on other key risk areas as appropriate.

Data on the external economic environment and management's view of the implications of this environment on the Group's risk profile is also reviewed regularly at management and Board level. The BRC also receives risk information through the review of minutes from the ERC.

2 Management of key risks

2.1 Credit risk

Key points:

- The macroeconomic environment in the UK market continued to be favourable. Acknowledging the continued uncertainty regarding Brexit, this has no immediate impact on credit quality.
- Gross loans and advances to customers[1] increased by £0.2 billion to £20.4 billion at 31 December 2018 (2017: £20.2 billion), principally driven by growth in the unsecured Consumer portfolio.
- Overall asset quality trends have continued to improve. Total impaired loans reduced from £442 million (2%) to £348 million (2%).
- The residential mortgage portfolio has continued to perform well with default and possession rate performance aligned to the UK market.

2.1.1 Definition of credit risk

Definition *(audited)*
Credit risk is the risk of loss resulting from a counterparty being unable to meet its contractual obligations to the Group in respect of loans or other financial transactions. This risk comprises country risk, default risk, recovery risk, exposure risk, the credit risk in securitisation, cross border (or transfer) risk, concentration risk and settlement risk. At portfolio level, credit risk is assessed in relation to the degree of name, sector and geographic concentration to inform the setting of appropriate risk mitigation and transfer mechanisms and to assess risk capital requirements. The manner in which the Group's exposure to credit risk arises, its policies and processes for managing it, and the methods used to measure and monitor it, are set out below.

How credit risk arises
Credit risk arises from loans and advances to customers. It also arises from the financial transactions the Group enters into with financial institutions, sovereigns and state institutions. It comprises both drawn exposures and exposures the Group has committed to extend. While the Group could potentially suffer loss to an amount equivalent to its undrawn commitments, the Group does not expect to incur losses to that extent as most consumer related commitments can be cancelled by the Group and non-consumer related commitments are entered into subject to the customer continuing to achieve specific credit standards. The Group is also exposed to credit risk from its derivatives, debt securities at amortised cost and other financial assets.

Credit concentration risk
Credit concentration risk is the risk of loss due to exposure to a single entity, or group of entities, engaged in similar activities and having similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. Undue concentrations could lead to increased or unexpected volatility in the Group's earnings. Management of risk concentrations is an integral part of the Group's approach to risk management.

The Group imposes risk control limits and guide points to mitigate significant concentration risk. These limits are formed by the Group's risk appetite, and that of the Parent, and are set in the context of the Group's risk strategy. Monetary limits are reviewed by CRPC for recommendation through to the BRC or the Board. Single name concentrations are also subject to limits.

The Group's primary market is the UK and loans originated and managed in the UK represent a material concentration of credit risk.

Maximum exposure limits
The Group's risk appetite statement, credit policy and regulatory guidelines set out the maximum exposure limits to a customer, or a group of connected customers. The policy and regulatory guidelines cover both exposures to the Parent and other counterparties. Regulatory guidelines limit risk concentration in individual exposures.

Loans and advances to banks at 31 December 2018 of £2.3 billion include £0.9 billion due from the Parent, while deposits from banks at 31 December 2018 of £3.2 billion include £1.7 billion due to the Parent. At 31 December 2018, the Group therefore has a net exposure due to the Parent of £721 million (2017: £595 million net exposure due to the Parent).

At 31 December 2018, derivative assets and derivative liabilities include £31 million and £35 million respectively with the Parent and therefore a net exposure due to the Parent of £4 million (2017: £43 million net exposure due to the Parent).

Credit related commitments (audited)
The Group classifies and manages credit related commitments that are not reflected as loans and advances on the balance sheet, as follows:

Guarantees and irrevocable standby letters of credit: irrevocable commitments by the Group to make payments at a future date, in specified circumstances, on behalf of a customer. These instruments are assessed on the same basis as loans for credit approval and management.

Commitments: unused elements of authorised credit in the form of loans, guarantees or letters of credit, where the Group is potentially exposed to loss in an amount equal to the total unused commitments. The likely amount of loss is less than the total unused commitments, as most commitments are contingent upon customers maintaining specific credit and performance standards. These instruments are assessed on the same basis as loans for credit approval and management.

Letters of offer: where the Group has made an irrevocable offer to extend credit to a customer and the customer may, or may not, have confirmed acceptance of the offer on the terms outlined and in the specified timeframe. The exposure is assessed on the same basis as loans for credit approval and management. The ultimate exposure to credit risk is considerably less than the face value of offer letters, as not all offers are accepted.

[1] *Including assets classified as held for sale of £564 million at 31 December 2018 (with the corresponding gross carrying amount being £625 million at 31 December 2017).*

2.1.2 Credit risk management

Credit risk management – retail and commercial lending *(audited)*
The management of credit risk is focussed on a detailed analysis at origination, followed by early intervention and active management of accounts where creditworthiness has deteriorated. The Chief Credit Officer (CCO) has responsibility for credit management of the retail lending book, business banking book and the Northridge book. Supported by Directors / Heads of Retail Credit and Commercial Credit and the broader risk function, the CCO is responsible for overall credit risk reporting to the ERC, the BRC and the Board. The CCO reports to the CRO, who reports directly to the CEO. The broader risk function, under the management of the CRO, provides independent oversight and management of the Group's credit risk strategy and credit risk management information, as well as the Group's suite of credit risk policies.

Credit policy
The core values and principles governing the provision of credit are contained in the Credit Policy and Credit Framework, which are approved by the BRC. Individual sector / portfolio-level credit policies define in greater detail the credit approach appropriate to those sectors or portfolios. These policies take account of the Group's Risk Appetite Statement, applicable sectoral credit limits, the markets in which the Group operates and the products provided. Each staff member involved in developing customer relationships and / or assessing or managing credit, has a responsibility to ensure compliance with these policies. Procedures for the approval and monitoring of exceptions to policy are included in the policy documents.

Lending authorisation *(audited)*
The Group's credit risk management systems operate through a hierarchy of lending authorities, which are related to internal customer loan ratings and limits. In some consumer lending this includes the use of credit decisioning models, which are subject to strict governance processes. All exposures which exceed prescribed levels require approval or ratification by the BRC.

Other exposures are approved by personnel according to a system of tiered individual authorities, which reflect credit competence, proven judgement and experience. Material lending proposals are referred to credit underwriting units for independent assessment and approval, or formulation of a recommendation and subsequent adjudication by the appropriate approval authority.
All credit transactions are assessed at origination for credit quality and the borrower is assigned a credit grade based on a predefined credit rating scale. The risk, and consequently the credit grade, is reassessed periodically. The use of internal credit rating models, bespoke credit scoring tools and reference to extensive performance data from credit reference agencies, enables measurement of the relative degree of risk inherent in lending to specific counterparties, is central to the credit risk assessment and ongoing management processes in the Group. Details of these internal credit rating models are outlined in the section on credit risk methodologies on pages 39 to 45.

Counterparty credit risk
The continued weak international financial environment means that the Group continues to be exposed to increased counterparty risk. The Group has a number of measures in place to mitigate this increased risk. These include:
- reduced individual Group exposures across a wider spread of banking institutions;
- strict credit risk management procedures; and
- application of tight credit policy criteria, where required.

The Group's net exposure to the Parent (disclosed gross within loans and advances to banks, deposits from banks, derivative assets and derivative liabilities) is managed through a contractual master netting agreement with the Parent whereby, in the event of a default by either party, all amounts due or payable will be settled immediately on a net basis. In addition, derivatives executed with the Parent are subject to International Swaps and Derivatives Association (ISDA) and Credit Support Annex (CSA) standard documentation and therefore collateral requirements are calculated daily and posted as required. The net exposure to the Parent is measured and monitored on a daily basis and is maintained within the Group's large exposure limits.

The BRC is responsible for establishing an appropriate policy framework for the prudential management of treasury credit risk, including net exposure to the Parent.

Credit counterparties are subject to ongoing credit review and exposures are reported and monitored on a daily basis.

Loan loss provisioning
Through its ongoing credit review processes, the Group seeks early identification of deteriorating loans, with a view to taking corrective action to prevent the loan becoming impaired. Typically, loans that are at risk of impairment are managed by dedicated specialist units / debt collection teams focussed on working out loans.

The identification of loans for assessment as impaired is driven by the Group's credit risk rating systems and by trigger events identified in the Group's credit and impairment policies. It is the Group's policy to provide for impairment promptly and consistently across the loan book. For those loans that become impaired, the focus is on implementing appropriate work-out strategies, including consideration of vulnerable customers, which minimise the loss that the Group will incur from such impairment. This may involve entering into restructuring arrangements with borrowers, or taking action to enforce security.

Other factors taken into consideration in estimating provisions include the economic climate, changes in portfolio risk profile and the effect of any external factors, such as legal or regulatory requirements.

Under delegated authority from the Board, the Group's impairment policy is approved annually by the BRC.

The quantum of the Group's impairment charge, impaired loan balances, and provisions also reviewed by the ERC on a half-yearly basis, in advance of providing a recommendation to the Audit Committee.

An analysis of the Group's impairment loss allowances at 31 December 2018 is set out on page 37 and notes 20 and 21.

2.1.3 Credit risk mitigation

An assessment of the borrower's ability to service and repay the proposed level of debt is undertaken for credit requests and is the primary component of the Group's approach to mitigating risk.

In addition, the Group mitigates credit risk through both the adoption of preventative measures (e.g. controls and limits) and the development and implementation of strategies to assess and reduce the impact of particular risks, should these materialise. In the commercial portfolio, regular risk reassessments are conducted on larger cases in line with policy.

Collateral
Credit risk mitigation includes the requirement to obtain collateral, depending on the nature of the product and local market practice, as set out in the Group's policies and procedures. The nature and level of collateral required depends on a number of factors, including, but not limited to:
- the amount of the exposure;
- the type of facility provided;
- the term of the facility;
- the amount of the borrower's own cash input; and
- an evaluation of the level of risk or probability of default (PD).

The Group takes collateral as a secondary source of repayment which can be called upon if the borrower is unable or unwilling to service and repay debt as originally assessed.

A variety of types of collateral are accepted, as follows:
- residential and commercial real estate;
- physical assets (motor vehicles, plant and machinery, stock etc.);
- financial assets (lien over deposits, shares etc.); and
- other assets (debentures, debtors, guarantees, insurance etc.).

The Group's requirements around completion, valuation and management of collateral are set out in appropriate Group or business unit policies and procedures. Details of the valuation methodologies are set out in the credit risk methodologies section on page 42.

2.1.4 Credit risk reporting and monitoring (audited)

It is Group policy to ensure that adequate up-to-date credit management information is available to support the credit management of individual account relationships and the overall loan portfolio. Information is produced on a timely basis and at a frequency interval that reflects the purpose of the report. Credit risk information at a product / sector level is reported on a monthly basis to senior management. This monthly reporting includes detailed information on loan book volume, the quality of the loan book, concentrations and loan impairment provisions, including details of any large individual impaired exposures.

Performance against specified credit risk limits, as detailed in the risk appetite statement, is monitored and reported to senior management and to the BRC. The format of reports and commentaries are consistent across the Group to enable an assessment of trends in the loan book. Along with the regular suite of monthly and quarterly reporting, ad hoc reports are submitted to senior management and the BRC as required. GCR, an independent function within GIA, reviews the quality and management of credit risk assets across the Group and reports to the CRPC on a half yearly basis.

Regular portfolio review meetings covering the NI and GB commercial challenged portfolios are also conducted.
Group risk personnel as well as business and finance senior management review and confirm the appropriateness of impairment provisioning methodologies and the adequacy of impairment provisions on a half yearly basis. Their conclusions are reviewed by the BRC, the Parent's Credit Risk function and the Parent's Group Risk Policy Committee (GRPC).

2.1.5 Management of challenged assets

A range of initiatives, dependent on the nature of the risk, are in place to deal with the effects of the deterioration in the credit environment and decline in asset quality including:
- collections and recoveries processes;
- utilisation of specialist work-out teams to ensure early intervention in vulnerable cases;
- intensive review cycles for 'at risk' exposures and the management of excess positions;
- support from central teams in managing 'at risk' portfolios at a business unit level;
- modified and tighter lending criteria for specific sectors;
- a reduction in certain individual bank exposures; and
- revised Risk Appetite Framework and Statement.

The segregation of certain challenged portfolios and the realignment of resources to manage these assets allows the remaining portfolio managers to focus on the loan book classified as 'acceptable quality' or better and to work closely with those customers.

Forbearance strategies
Forbearance occurs when a borrower is granted a concession or agreed change to a loan ('forbearance measure') for reasons relating to the actual or apparent financial stress or distress of that borrower. If the concession or agreed change to a loan granted to a borrower is not related to the actual or apparent financial stress or distress of that borrower, forbearance has not occurred. An exposure continues to be classified as forborne until such time as it satisfies conditions to exit forbearance in line with EBA guidance.

2.1.5 Management of challenged assets

A range of forbearance strategies are used by the Group for customers in arrears or facing potential arrears on contracted loan repayments, in order to arrange, where viable, sustainable short term or longer term repayment solutions as appropriate.

A forbearance strategy may include, but is not necessarily limited to, one or more of the following measures:

- term extension: an arrangement where the original term of the loan is extended;
- adjustment to or non-enforcement of covenants: an arrangement whereby the Group agrees to either waive an actual or expected covenant breach for an agreed period, or adjust the covenant(s) to reflect the changed circumstances of the borrower;
- reduced payments (interest only): an arrangement where the borrower pays interest only on the principal balance, on a temporary or longer term basis, with the principal balance unchanged, rather than repaying some of the principal as required under the original facility agreement;
- facilities in breach of terms being placed on demand: an arrangement whereby the Group places a facility in breach of its contractual terms on a demand basis as permitted under the facility agreement rather than enforcing, and pending a more long term resolution;
- reduced payment (greater than interest only) incorporating some principal repayments: a temporary or medium term arrangement where the borrower pays the full interest due plus an element of principal due on the basis that principal payments will increase in the future; and
- capitalisation of arrears: an arrangement whereby arrears are added to the loan principal balance, effectively clearing the arrears, with either the repayments or the original term of the loan adjusted accordingly to accommodate the increased principal balance.

For business banking the monitoring of forbearance measures follows the normal review cycle for individual customer exposures based on amount and credit grade, as set out in the credit policy.

Mortgage accounts that are subject to forbearance are monitored and reviewed by way of monthly management information reporting. This includes tracking the aggregate level of default arrears that emerge on the forborne elements of the loan book. The impairment provisioning approach and methodologies are set out in the Group's Impairment Policy.

The forbearance strategies adopted by the Group seek to maximise recoveries and minimise losses arising from non repayment of debt, while providing suitable and sustainable restructure options that are supportive of customers in challenged circumstances. The Group has an operating infrastructure in place to assess and, where appropriate, implement such options on a case-by-case basis. Group credit policy outlines the core principles and parameters underpinning the Group's approach to forbearance with individual business unit policies defining in greater detail the forbearance strategies appropriate to each unit.

Forbearance requests are assessed on a case-by-case basis taking due consideration of the individual circumstances and risk profile of the customer to ensure, where possible, the most suitable and sustainable repayment arrangement is put in place (see also section 2.8 on page 53 which further comments on vulnerable customers). Forbearance will always be a trigger event for the Group to undertake an assessment of the customer's financial circumstances and ability to repay prior to any decision to grant a forbearance treatment. This assessment may result in a deterioration in the credit grade assigned to the loan, potentially impacting how frequently the loan must be formally reviewed. Where appropriate, and in accordance with the Group's credit risk management structure, forbearance requests are referred to credit units for independent assessment prior to approval by the relevant approval authority.

Forborne loans are reviewed in line with the Group's credit management processes, which include monitoring borrower compliance with the revised terms and conditions of the forbearance arrangement.

Borrower compliance with revised terms and conditions may not be achieved in all cases. Non-compliance could for example arise because the individual circumstances and risk profile of the borrower continue to deteriorate, or fail to show an expected improvement, to the extent that an agreed reduced level of repayment can no longer be met. In the event of non-compliance, a request for further forbearance may be considered. It is possible that the Group, by virtue of having granted forbearance to a borrower, could suffer a loss that might otherwise have been avoided had enforcement action instead been taken. This could for example arise where the value of security held in respect of a loan diminishes over the period of a forbearance arrangement which ultimately proves unsustainable.

2.1.6 Asset quality - loans and advances to customers

Asset quality methodology for the year ended 31 December 2018

The Group revised its asset quality reporting methodology to reflect the adoption of IFRS 9.

Under the new methodology, the Group has allocated financial instruments into one of the following categories at the reporting date:

- **Stage 1 – 12 month Expected Credit Losses (ECL) (not credit-impaired):** Financial instruments which have not experienced a significant increase in credit risk since initial recognition and are not credit-impaired. An impairment loss allowance equal to 12-month ECL is recognised, which is the portion of lifetime ECL resulting from default events that are possible within the next 12 months.

- **Stage 2 – Lifetime ECL (not credit-impaired):** Financial instruments which have experienced a 'significant increase in credit risk since initial recognition' and are not credit-impaired. An impairment loss allowance equal to lifetime ECL is recognised, being the ECL resulting from all possible default events over the expected life of the financial instrument. 'Credit risk' in this context refers to the change in the risk of a default occurring over the expected life of the financial instrument.

- **Stage 3 – Lifetime ECL (credit-impaired):** Credit-impaired financial instruments, other than purchased or originated credit-impaired financial assets. An impairment loss allowance equal to lifetime ECL is recognised. The manner in which the Group identifies financial assets as credit-impaired results in the Group's population of credit-impaired financial assets being consistent with its population of defaulted financial assets (in accordance with Article 178 of the CRR) in scope for the impairment requirements of IFRS 9. This encompasses loans where: (i) the borrower is considered unlikely to pay in full without recourse by the Group to actions such as realising security (including 'forborne collateral realisation' loans); and / or (ii) the borrower is greater than 90 days past due and the arrears amount is material. A broader population of loans is captured than under the discontinued classification of 'impaired' which comprised exposures carrying a specific provision under IAS 39.

- **Purchased or originated credit-impaired financial asset (POCI):** Financial assets that were credit-impaired at initial recognition. A POCI is not subject to any initial impairment loss allowance but an impairment loss allowance is subsequently recognised for the cumulative changes in lifetime ECL since initial recognition. A POCI remains classified as such until it is derecognised, even if assessed as no longer credit-impaired at a subsequent reporting date.

Further information on the approach to identifying a 'significant increase in credit risk since initial recognition' and in identifying credit-impaired assets is outlined in the credit risk methodologies section on pages 39 to 45.

The Group continued to apply the following classifications at the reporting date.

Forborne loans:
Loans where a forbearance measure has been granted and where the criteria to exit a forborne classification, in line with EBA guidance, are not yet met. Loans that have never been forborne or loans that are no longer required to be reported as 'forborne' are classified as 'non-forborne'.

'Forborne collateral realisation' loans (FCRs):
Loans (primarily residential mortgages) which meet both of the following criteria: (i) not greater than 90 days past due; and (ii) forbearance is in place and future reliance on the realisation of collateral is expected for the repayment in full of the loan when such reliance was not originally envisaged. Such loans are considered credit-impaired and include Split Mortgages and certain 'Interest Only' / 'Interest Only plus' arrangements.

Quantitative information about credit risk within financial instruments held by the Group can be found in the credit risk exposures note on page 112 in the financial statements.

The asset quality reporting methodology applicable under IAS 39 for the year ended 31 December 2017 is outlined on page 38.

2.1.6 Asset quality - loans and advances to customers *(continued)*

Composition and impairment
The table below summarises the composition, credit-impaired volumes and related impairment loss allowance of the Group's loans and advances to customers at 31 December 2018 and at 1 January 2018. Comparative figures for 31 December 2017 have not been restated and are presented on an IAS 39 classification and measurement basis.

31 December 2018 **Total loans and advances to customers at amortised cost - Composition and impairment**	**Advances (pre-impairment loss allowance) £m**	**Credit impaired loans £m**	**Credit impaired loans as % of advances %**	**Impairment loss allowance[1] £m**	**Impairment loss allowance as % of credit impaired loans %**
Residential mortgages	15,880	188	1%	18	10%
Non-property SME and corporate	1,320	41	3%	16	39%
Property and construction	502	79	16%	23	29%
Consumer	2,697	40	1%	29	73%
Total[2]	**20,399**	**348**	**2%**	**86**	**25%**

1 January 2018 Total loans and advances to customers at amortised cost - Composition and impairment	Advances (pre-impairment loss allowance) £m	Credit impaired loans £m	Credit impaired loans as % of advances %	Impairment loss allowance[1] £m	Impairment loss allowance as % of credit impaired loans %
Residential mortgages	16,043	183	1%	15	8%
Non-property SME and corporate	1,371	73	5%	32	44%
Property and construction	652	159	24%	61	38%
Consumer	2,086	27	1%	19	70%
Total	20,152	442	2%	127	29%

31 December 2017 Total loans and advances to customers Composition and impairment	Advances (pre-impairment) £m	Impaired loans £m	Impaired loans as % of advances %	Specific impairment provisions £m	Specific provisions as % of impaired loans %
Residential mortgages	16,043	67	-	7	10%
Non-property SME and corporate	1,371	50	4%	26	52%
Property and construction	652	134	21%	59	44%
Consumer	2,086	24	1%	16	67%
Total	20,152	275	1%	108	39%

At 31 December 2018, loans and advances to customers (pre-impairment loss allowance) of £20.4 billion were £0.2 billion higher than 1 January 2018, reflecting the combined impacts of net new lending, utilisation of impairment loss allowance and currency translation.

Credit impaired loans were £0.3 billion or 2% of customer loans at 31 December 2018 compared to £0.4 billion at 1 January 2018.

The stock of impairment loss allowance on credit-impaired loans decreased to £0.1 billion.

Impairment loss allowance as a % of credit-impaired loans is 25% (29% at 1 January 2018) with reductions seen across the majority of the Group's loan portfolios in 2018 and reflecting a combination of the reduction in credit-impaired loans, impairment loss allowance utilisation and a net impairment gain during the year.

Unaudited:
Of the £2.7 billion UK Consumer lending at 31 December 2018, £40 million is credit-impaired, with a credit-impaired, representing 1% of the portfolio (1% at January 2018) and a credit-impaired loans impairment loss allowance coverage ratio of 73%. High impairment loss allowance cover reflects the unsecured nature of this lending.

[1] *Impairment loss allowance on credit impaired loans.*
[2] *Including assets classified as held for sale of £564 million. See note 22 for further details.*

2.1.6 Asset quality - loans and advances to customers *(continued)*

Asset quality methodology for the year ended 31 December 2017

The Group revised its asset quality reporting methodology to reflect the adoption of IFRS 9 as outlined on page 36. The asset quality reporting methodology previously applicable under IAS 39 for the year ended 31 December 2017 is outlined below.

Asset quality - loans and advances to customers
The Group has revised its asset quality reporting methodology to align with EBA guidance on non-performing and forborne classifications.

Previously the Group did not apply a set time period after which the forborne classification on a performing loan was discontinued. Exit criteria are now applied in line with EBA guidance.

All exposures that are subject to forbearance and have a specific provision are reported as both forborne and impaired whereas previously in the non-mortgage portfolios where an exposure carried a specific provision it was reported as 'impaired' and not reported as 'forborne'.

The Group's definition of impaired loans has been modified to remove non-mortgage loans that are greater than 90 days in arrears but where a specific provision is not required, instead these loans are now classified as 'greater than 90 days in arrears and not impaired'.

Asset quality - financial assets
In line with the requirements of IFRS 7 the Group classifies financial assets as:
- neither past due nor impaired;
- past due but not impaired; and
- impaired.

The Group uses internal ratings, based on an assessment of the credit quality of the customer, as part of its credit risk management system. A thirteen point credit grade rating scale is used for more complex, individually managed exposures, including commercial and business lending. A thirteen point credit rating scale based on PD is used for residential mortgages. A seven-point credit grade rating scale is used for standard products (including personal and small business loans). Both credit scales have a defined relationship with the Group's PD scale.

Other financial assets are assigned an internal rating, supported by external ratings of the major rating agencies.

'Neither past due nor impaired' ratings are applied as follows:
- high quality ratings apply to highly rated financial obligors, strong corporate and business counterparties and consumer banking borrowers (including residential mortgages), with whom the Group has an excellent repayment experience. High quality ratings are derived from grades 1 to 4 on the thirteen-point grade scale, grades 1 and 2 on the seven-point grade scale. These ratings are broadly aligned to AAA, AA+, AA, AA-, A+, A, A-, BBB+ and BBB for the external major rating agencies;
- satisfactory quality ratings apply to good quality financial assets that are performing as expected, including loans and advances to SMEs, leveraged entities and more recently established businesses. Satisfactory quality ratings also include some element of the Group's retail portfolios. Satisfactory quality ratings are derived from grades 5 to 7 on the thirteen point grade scale, grade 3 on the seven-point grade scale, and external ratings equivalent to BBB-, BB+, BB and BB-;
- acceptable quality ratings apply to customers with increased risk profiles, that are subject to closer monitoring and scrutiny by lenders, with the objective of managing risk and moving accounts to an improved rating category. Acceptable quality ratings are derived from grades 8 and 9 on the thirteen-point grade scale, grade 4 on the seven-point scale and external ratings equivalent to B+; and
- the lower quality but not 'past due but not impaired' rating applies to those financial assets that are neither in arrears nor impaired, but where the Group requires a work down or work out of the relationship, unless an early reduction in risk is achievable. Lower quality ratings are derived from outstanding balances in rating grades 10 and 11 on the thirteen-point grade scale, grade 5 on the seven point grade scale, and external ratings equivalent to B or below.

'Impaired' loans are defined as exposures which carry a specific provision whether forborne or not. Specific provisions are as a result of either individual or collective assessment for impairment.

Past due but not impaired:
Past due but not impaired loans, whether forborne or not, are defined as follows:
- Loans where repayment of interest and / or principal are overdue by at least one day but which are not impaired.

Refer to page 44 for details on the loan loss provisioning methodology.

2.1.7 Credit risk methodologies (*audited*)

Credit risk methodologies for the year ended 31 December 2018

The Group's credit risk methodologies in respect of impairment were revised on adoption of IFRS 9 on 1 January 2018 and are as set out below. The Group's approach to internal credit rating models and rating systems is unchanged as set out below.

The Group's credit risk methodologies encompass internal credit rating models and scoring tools and impairment models.

Internal credit rating models
The use of internal credit rating models and scoring tools, which measure the degree of risk inherent in lending to specific counterparties, is central to the credit risk assessment and ongoing management processes within the Group. The primary model measures used are:
- Probability of Default (PD): the probability of a given counterparty defaulting on any of its borrowings from the Group within the next twelve months;
- Exposure at Default (EAD): the exposure the Group has to a defaulting borrower at the time of default; and
- Loss Given Default (LGD): the loss incurred (after the realisation of any collateral) on a specific transaction should the borrower default, expressed as a percentage of EAD.

These form an essential component of the Group's operational and strategic credit risk management and credit pricing practices.

For the Group's retail consumer and smaller business portfolios, the credit risk assessment is grounded on application and behavioural scoring tools. For larger commercial and corporate customers, the risk assessment is underpinned by statistical risk rating models which incorporate quantitative information from the customer (e.g. financial statements) together with a qualitative assessment of non-financial risk factors such as management quality and market / trading outlook. Lending to financial institutions is assigned an internal rating supported by external ratings of the major rating agencies.

For the purposes of internal credit rating models, estimates of PD on either or both of the following bases are produced:
- Through-the-Cycle (TtC) estimates are estimates of default over an entire economic cycle, averaged to a twelve month basis. These are in effect averaged expectations of PD for a borrower over the economic cycle; and
- Cyclical estimates are estimates of default applicable to the next immediate twelve months. These cyclical estimates partially capture the economic cycle in that they typically rise in an economic downturn and decline in an economic upturn but not necessarily to the same degree as default rates change in the economy.

Internal rating systems
The Group has adopted the standardised approach to capital calculation for both its retail and non-retail exposures. Under this approach supervisory risk weights are applied to the EAD values varying by portfolio. The Group benefits from the use of internal models approved for the internal ratings based approach. This facilitates enhanced understanding of the underlying credit risk than would otherwise be the case.

Uses of internal estimates
The specific uses of internal estimates differ from portfolio to portfolio, and for retail and non-retail approaches, but typically include:
- credit decisioning / automated credit decisioning and borrower credit approval;
- credit management;
- calculation of RAROC;
- internal reporting; and
- internal capital allocation between businesses of the Group.

Control mechanisms for credit rating and impairment models
The Model Risk Policy and Model Risk Standards, as approved by the ERC, set out specific requirements for the development, validation and use of credit rating and impairment models. Impairment models are described further on page 40.

Internal credit models and impairment models are subject to validation, at minimum, as part of any significant redevelopment, at the direction of model governance forums or as part of a rolling three year cycle.

When issues are raised on risk rating or impairment models, plans are developed to remediate or replace such models within an agreed timeframe.

In addition, GIA regularly reviews the risk control framework, including policies and standards, to ensure that these are being adhered to, meet industry good practices and are compliant with regulatory requirements.

Methodology for loan loss provisioning under IFRS 9 for the year ended 31 December 2018

Approach to measurement of impairment loss allowances
Impairment is measured in a way that reflects: (a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes; (b) the time value of money; and (c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions. Impairment is measured through the use of impairment models, individual discounted cash flow analysis and modelled loss rates; supplemented where necessary by Group management adjustments.

In general, a loss allowance is recognised for all financial instruments in scope for the impairment requirements of IFRS 9. However this may not be the case for very highly collateralised loans, such as residential mortgages at low loan to value ratios. There have been no significant changes in the quality of collateral or credit enhancements as a result of changes in the Group's collateral policies during the period. The Group's methodologies for valuation of property collateral are set out on page 42, noting further that Forward Looking Information (FLI) (see page 42) is applied to UK property collateral values in measuring impairment loss allowances under IFRS 9. The Group's critical accounting estimates

2.1.7 Credit risk methodologies (*audited*) *(continued)*

Methodology for loan loss provisioning under IFRS 9 for the year ended 31 December 2018 *(continued)*

and judgements, including those with respect to impairment of financial instruments, are set out in note 2 to the financial statements.

An analysis of the Group's impairment loss allowances and impairment gain or loss is set out in notes 21 and 12 of the financial statements.

Impairment models
The Group has in place a suite of IFRS 9 compliant impairment models which are executed on a monthly basis and which allocate financial instruments to stage 1, 2 or 3 and measure the appropriate 12 month or lifetime ECL. The characteristics of an exposure determine which impairment model is used, with influencing factors including product type (e.g. residential mortgage, unsecured personal loan, business loan) and market segment (e.g. owner occupier, buy-to-let, general corporate lending, general business lending).

ECLs are calculated as the sum of the marginal losses for each time period from the reporting date. The key components of the ECL calculation are Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD, which is expressed as a percentage of EAD) and are described below. Other components

include discount rate and maturity. The current contractual rate is generally used as the discount rate as it is considered a suitable approximation of the effective interest rate determined at initial recognition. For term lending including committed revolving credit facilities, contractual maturity is used in the ECL calculation. For other revolving facilities, behavioural life is generally used.

IFRS 9 PD
Where available, the ratings or underlying scores from internal credit rating models are used as a starting point for IFRS 9 PD calibration. While calibration techniques are similar to those used for regulatory purposes, the IFRS 9 PD differs from through-the-cycle or cyclical estimate PDs as it is an unbiased point-in-time PD based on current conditions and adjusted to reflect FLI.

A current point-in-time IFRS 9 PD is calculated as the expected default rate over the next 12 months. This PD is used in the calculation of 12-month ECL and as a starting point in the calculation of lifetime PD. Future point-in-time IFRS 9 PDs are also calculated, being the expected default rates for each year from the start of year 2 to maturity of the financial instrument. Transition matrices are used to determine how an exposure moves between different PD bands over time.

Together, the current point-in-time IFRS 9 PD and future point-in-time IFRS 9 PDs are used to generate an IFRS 9 lifetime PD expectation for each FLI scenario. The scenario weighted averages are used to generate an overall IFRS 9 lifetime PD expectation. At origination of a new financial instrument, these expectations are stored, together with prepayment estimates where relevant, and allow for comparison at future reporting dates as one of the key determinants as to whether a 'significant increase in credit risk' has occurred. As lifetime PD was not calculated historically, the Group used reasonable and supportable information available without undue cost or effort to approximate the residual IFRS 9 lifetime PD expectations at initial recognition for most financial instruments originated prior to the adoption of IFRS 9 on 1 January 2018.

IFRS 9 EAD
Current point-in-time EAD is the expected exposure at default were the borrower to default within the next 12 months. Future point-in-time EAD also incorporates expected contractual cash flows. IFRS 9 EAD differs from regulatory EAD in that it incorporates expected contractual cash flows and caps the exposure at the contractual limit.

IFRS 9 LGD
Current point-in-time LGD is the loss that would be incurred should default occur in the next 12 months. To facilitate the calculation of lifetime ECL, future point-in-time LGDs are calculated for each year from the start of year 2 to maturity of the exposure. The starting point for individual components of the calculation is historical data. Cure rate is incorporated as appropriate into the calculation and represents the expected propensity of borrowers to return to the non-defaulted book without a loss having been realised. FLI is also incorporated into LGD where UK property collateral is held. IFRS 9 LGD may differ from regulatory LGD as conservatism and downward assumptions are generally removed.

Individual discounted cash flow analysis
For credit-impaired financial instruments in Business Banking, Corporate Banking and certain other relationship-managed portfolios, the impairment loss allowance is primarily determined by an individual discounted cash flow analysis completed by lenders in business units and subject to review, challenge and, potentially, revision by independent credit professionals in underwriting units within Group Risk.

The expected future cash flows are based on the lender's assessment of future recoveries and include forecasted principal and interest payments (not necessarily contractual amounts due) and expected cash flows, if any, from the realisation of collateral / security held, less realisation costs.

Modelled loss rates
For some smaller and / or lower risk portfolios, impairment loss allowances are measured by applying modelled loss rates to exposure amounts. Modelled loss rates are generally determined on a component basis taking into account factors such as the nature and credit quality of the exposures and past default and recovery experience on the portfolio or on portfolios with similar risk characteristics. Generally a number of different loss rates will be set for a portfolio to allow differentiation of individual financial instruments within the portfolio based on their credit quality.

Identifying a significant increase in credit risk
The Group's standard criteria to identify financial instruments which have had a 'significant increase in credit risk since initial recognition' are applied to the vast majority of loans and advances to customers. 'Credit risk' in this context refers to the change in the risk of a default occurring over the expected life of the financial instrument. Unless credit-impaired or a POCI, a financial instrument is generally allocated to stage 2 if any of the following criteria are met at the reporting date:

- remaining lifetime PD is more than double and more than 50 basis points higher than the remaining lifetime PD at the reporting date as estimated based on facts and circumstances as at initial recognition (adjusted where relevant for changes in prepayment

2.1.7 Credit risk methodologies (*audited*) *(continued)*

Methodology for loan loss provisioning under IFRS 9 for the year ended 31 December 2018 *(continued)*

expectations);
- a contractual payment is greater than 30 days past due; and / or
- the exposure is a forborne loan or a non-performing exposure.

The above criteria are automatically applied as part of the monthly execution of the Group's impairment models. In addition, management considers whether there is reasonable and supportable information that would not otherwise be taken into account that would indicate that a significant increase in credit risk had occurred.

Where a financial asset has been modified but not derecognised, the quantitative assessment of 'significant increase in credit risk' continues to be based on the remaining lifetime PD at the reporting date as estimated based on facts and circumstances as at initial recognition (adjusted where relevant for changes in prepayment expectations).

The effectiveness of the staging criteria is assessed semi-annually, taking into account considerations such as the extent to which: (i) exposures have moved directly from stage 1 to stage 3; (ii) exposures have moved to stage 3, having spent only a short period in stage 2; (iii) exposures have moved frequently between stages 1 and 2; and (iv) there is potential over-reliance on backstop or qualitative criteria in identifying stage 2 exposures.

The Group applies the low credit risk expedient to most debt securities in scope for the impairment requirements of IFRS 9 and similarly to loans and advances to banks, central banks and investment firms. 'Low credit risk' encompasses PD grades 1 to 5 on the Group's internal PD rating system, which broadly aligns with ratings of AAA to BBB- for the external major rating agencies. Such financial instruments are allocated to stage 1.

For some smaller and / or low risk portfolios, the Group identifies a significant increase in 'credit risk since initial recognition' solely by reference to whether a contractual payment is greater than 30 days past due.

Identifying defaulted assets and credit-impaired assets
The Group's definition of default for impairment purposes (i.e. for the purposes of allocating financial instruments to 'stages' and for measuring impairment loss allowances under IFRS 9) is consistent with its application of the definition of default in Article 178 of the CRR noting that IFRS 9 requires the Group to use a definition which is consistent with that used for internal credit risk management purposes. The manner in which the Group identifies financial assets as credit-impaired results in the Group's population of credit-impaired financial assets being consistent with its population of defaulted financial assets in scope for the impairment requirements of IFRS 9. The Group considers certain events as resulting in mandatory default and credit-impaired classification without further assessment. These include:
- greater than 90 days past due and the past due amount is material;
- a forbearance arrangement is put in place where future reliance on realisation of collateral is expected for repayment in full when this was not originally envisaged;
- legal action is underway by the Group to enforce repayment or realise security;
- the Group or a receiver takes security into possession; and
- the Group has formally sought an insolvency arrangement in respect of the borrower.

Certain other events necessitate a lender assessment and, if the outcome of the lender assessment is that the contractual amount of principal and interest will not be fully repaid in what is assessed to be the most likely cash flow scenario, default and credit-impaired classification is mandatory. For larger value cases (typically greater than £850,000), the lender assessment involves production of an individual discounted cash flow analysis. The events differ by portfolio and include those set out below.

All portfolios:
- a forbearance measure has been requested by a borrower and formally assessed;
- the non-payment of interest (e.g. via interest roll-up, arrears capitalisation etc.) as a result of the terms of modification of loans, including refinancing and renegotiation of facilities where during the renegotiation process, the lender becomes aware that the borrower is under actual or apparent financial distress;
- evidence of fraudulent activity by the borrower or another party connected with the loan;
- the contractual maturity date has passed without repayment in full; or
- it becomes known that the borrower has formally sought an insolvency arrangement.

Residential mortgage portfolios:
- offer of voluntary surrender of security or sale of security at a possible shortfall; or
- it becomes known that the borrower has become unemployed with no comparable new employment secured.

Larger SME / corporate and property loans:
- internal credit risk rating, or external credit rating, has been downgraded below a certain level;
- financial statements or financial assessment indicates inability of the borrower to meet debt service obligations and / or a negative net assets position;
- the borrower has ceased trading;
- a fall in the assessed current value of security such that the loan to value ratio is greater than or equal to 120% (property and construction only);
- a fall in net rent such that it is inadequate to cover interest with little / no other income to support debt service capacity (investment property exposures only); or
- a fall in the assessed gross development value such that sale proceeds are no longer expected to fully repay debt (development exposures only).

Review of credit-impaired loans
It is Group policy to review credit-impaired loans above agreed thresholds semi-annually or on receipt of material new information, with the review including a reassessment of the recovery strategy and the continued appropriateness of a credit-impaired classification. The minimum requirements for a credit-impaired loan to return to non credit-impaired status are that the borrower must not be greater than 90 days past due on a material amount, the borrower must be considered likely to pay in full without recourse by the Group to actions such as realising security and there must be no forbearance arrangement in place where future reliance

2.1.7 Credit risk methodologies (*audited*) *(continued)*

Methodology for loan loss provisioning under IFRS 9 for the year ended 31 December 2018 *(continued)*

on realisation of collateral is expected for repayment in full when this was not originally envisaged. Typically, an updated assessment of the borrower's current financial condition and prospects for repayment is required with the borrower to have satisfactorily met repayments required under the original or modified agreement regularly for a reasonable period of time.

Methodologies for valuation of property collateral
The Group's approach to the determination of property collateral values is set out in a CRPC-approved Group Property Collateral Valuation Policy, supported by the Group Property Collateral Valuation Guidelines, and is summarised below. The Group's approach to applying Forward Looking Information to those values for the purposes of measuring impairment loss allowance for the year ended 31 December 2018 is set out in the BRC approved Group Impairment Policy and is described below.

Individual valuations are undertaken as part of the initial credit assessment process using either an automated valuation model or through physical inspection of the collateral. Retail UK mortgage loan book property values are determined by reference to the original or latest property valuations held indexed to the Nationwide UK house price index.

Commercial property valuations may include formal written valuations from external professionals or internally assessed valuations. Internally assessed valuations are informed by the most appropriate sources available for the assets in question. This may include property specific information / characteristics, local market knowledge, comparable transactions, professional advice (e.g. asset management reports) or a combination thereof, in line with more detailed guidance and metrics which are approved at least annually by the CRPC. These guidelines and metrics are informed by both internal and externally sourced market data / valuation information, including input from the Group's Real Estate Advisory Unit (REAU).

Internally assessed valuations are subject to review, challenge and, potentially, revision by experienced independent credit professionals in underwriting units within the Group Risk function and are approved as part of the normal credit process.

Typically, more frequent valuations are required for properties held as security for non-performing exposures with an annual valuation required for non-performing exposures in excess of £250,000. During 2018, the Group completed an exercise to ensure that recent external valuations were held for all non-performing exposures in excess of £250,000.

Forward Looking Information (FLI)
FLI refers to probability-weighted future macroeconomic scenarios approved semi-annually by the ERC and used in the assessment of 'significant increase in credit risk' and in the measurement of impairment loss allowances under IFRS 9.The Group generally uses three UK FLI scenarios, being a central scenario, an upside scenario and a downside scenario, all extending over a five year forecast period. In each case the central scenario is based on internal and external information and management judgement. The Group keeps under review the need for FLI for other economies.

The Group's FLI model uses the central scenario, recent actual observed values and historical data to generate many scenarios distributed around the central scenario. The central scenario is at the 50th percentile of the distribution of scenarios (meaning that there is a 50% likelihood of the expected ECL outcome being better and a 50% likelihood of it being worse) and the upside and downside scenarios are at chosen lower and higher percentiles respectively. The probability weightings attached to the scenarios are a function of the chosen percentiles, with lower probability weightings attached to scenarios which are at percentiles more distant from the central scenario.

Typically, one or two macroeconomic variables are incorporated into each impairment model, being those determined through macro regression techniques to be most relevant to forecasting default of the credit risk exposures flowing through that model.

The lifetime PD expectation for an exposure generated under each of the scenarios, weighted by the probability of each scenario occurring, is used to generate the lifetime PD expectations used for the assessment of 'significant increase in credit risk'. Forecasts of residential and commercial property price growth are incorporated as appropriate into the LGD component of the ECL calculation. The overall ECL for an exposure is determined as a probability-weighted average of the ECL calculated for each scenario, weighted by the probability of each scenario occurring.

Beyond the forecast period, default rates are assumed to revert over time to an observed long run average and the value of property collateral for LGD purposes is assumed to grow at an observed long-run rate.

The overall ECL for an exposure is determined as a probability-weighted average of the ECL calculated for each scenario, weighted by the probability of each scenario occurring.

Beyond the forecast period, default rates are assumed to revert over time to an observed long run average and the value of property collateral for LGD purposes is assumed to grow at an observed long-run rate.

The following table shows the mean average forecast values for some of the key macroeconomic variables under each scenario for the five year forecast period 2019-2023 together with the associated percentiles and probability weightings.

2.1.7 Credit risk methodologies (*audited*) *(continued)*

Methodology for loan loss provisioning under IFRS 9 for the year ended 31 December 2018 *(continued)*

	Downside	Central	Upside
Percentile	85th	50th	15th
Scenario probability weighting	29%	40%	31%
GDP growth	0.5%	1.5%	1.8%
Unemployment rate	5.5%	4.5%	4.5%
Residential property price growth	(0.4%)	0.4%	5.0%
Commercial property price growth	(5.5%)	0.2%	0.8%

FLI is generally not applied to exposures to which the low credit risk expedient has been applied given factors such as a lack of internal default history to inform macro regression and that applying FLI would be unlikely to have a material impact given low PDs and that exposures are subject to 12-month rather than lifetime ECL.

Group management adjustment
To ensure that the measurement of impairment reflects reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions, the need for a 'Group management adjustment' to the outputs of the Group's staging and impairment measurement methodologies is considered at each reporting date in arriving at the final impairment loss allowance. Such a need may arise, for example, due to a model limitation or late-breaking event.

Credit risk methodologies for the year ended 31 December 2017

The Group revised its credit risk reporting methodology in respect of impairment to reflect the adoption of IFRS 9 as outlined on page 39 to 43. The credit risk reporting methodology previously applicable under IAS 39 for the year ended 31 December 2017 is outlined below.

Loan loss provisioning methodology
Through its ongoing credit review processes, the Group seeks to identify deteriorating loans early, with a view to taking corrective action to prevent the loan becoming impaired. Loans that are at risk of impairment are managed by dedicated specialist units / debt collection teams, focussed on 'workout' strategies.

The identification of loans for impairment assessment as impaired is driven by the Group's credit risk rating systems. For those loans that become impaired, the focus is to minimise the loss that the Group will incur from the impairment. This may involve entering into restructuring arrangements, or action to enforce security, or legal pursuit of individuals who are personally liable for the loan.

All credit exposures, either individually or collectively, are regularly reviewed for objective evidence of impairment. Where such evidence of impairment exists, the exposure is measured for an impairment provision. The criteria used to determine if there is objective evidence of impairment include:

- delinquency in contractual payments of principal or interest;
- cash flow difficulties;
- breach of loan covenants or conditions;
- deterioration of the borrower's competitive position;
- deterioration in the value of collateral;
- external rating downgrade below an acceptable level;
- initiation of bankruptcy proceedings; and
- a request from a borrower for forbearance for reasons of financial stress or distress.

The following factors are also taken into consideration when assessing whether a loss event has occurred at the balance sheet date that may lead to recognition of impairment losses:

Residential mortgages and consumer lending
- debt service capacity; and
- repayment arrears.

Non-property SME and corporate
- debt service capacity;
- financial performance;
- adverse movements in net worth; and
- future prospects.

Commercial property and construction
- debt service capacity and the nature and degree of protection provided by cash flows; and
- the value of any underlying collateral.

Loans with a specific impairment provision attaching to them, together with loans (excluding residential mortgages) which are more than 90 days in arrears in the Bank and 60 days in arrears in Northridge or which meet the other EBA guidelines on non-performing and forborne classification are included in non-performing exposures.

Where objective evidence of impairment exists, as a result of one or more past events, the Group is required to estimate the recoverable amount of the exposure(s).

For financial reporting purposes, loans on the balance sheet, that become impaired, are written down to their estimated recoverable amount. The amount of this write down is taken as an impairment charge to the income statement.

International Accounting Standards (IAS) 39, Financial Instruments: Recognition and Measurement, requires that there is objective evidence of impairment, and that the loss has been incurred. IAS 39 does not permit the recognition of expected losses, no matter how likely these expected losses may appear. All exposures are assessed for impairment, either individually or collectively.

Methodology for individually assessing impairment
An individual impairment assessment is performed, for any exposure for which there is objective evidence of impairment, and where the exposure is above an agreed minimum threshold. The carrying amount of the exposure, net of the

2.1.7 Credit risk methodologies (*audited*) *(continued)*

Credit risk methodologies for the year ended 31 December 2017 *(continued)*

estimated recoverable amount (and thus the specific provision required), is calculated using a Discounted Cash Flow (DCF) analysis. This calculates the estimated recoverable amount as the present value of the estimated future cash flows, discounted at the exposure's original effective interest rate (or the current effective interest rate for variable rate exposures). The estimated future cash flows include forecast principal and interest payments (not necessarily contractual amounts due), including cash flows, if any, from the realisation of collateral / security held, less realisation costs.

Methodology for collectively assessing impairment
Where exposures fall below the threshold for individual assessment of impairment, such exposures, with similar credit risk characteristics, are pooled and are collectively assessed for impairment. A provision is then calculated by estimating the future cash flows of the exposures that are collectively evaluated for impairment. This estimation considers the expected contractual cash flows of the exposures in a portfolio, and the historical loss experience for exposures with credit risk characteristics similar to those in the portfolio being assessed. Assumptions and parameters used to create the portfolio provision, which are based on historical experience (i.e. amount and timing of cash flows / loss given default), are regularly compared against current experience in the loan book and current market conditions.

Where there is objective evidence of impairment on a collective basis, this is reported as a specific provision, in line with individually assessed loans.

Methodology for establishing IBNR provisions
Impairment provisions are also recognised for losses not specifically identified, but which, experience and observable data indicate, are present in the portfolio at the date of assessment. These are described as IBNR provisions. Statistical models are used to determine the appropriate level of IBNR provisions. These models estimate latent losses, taking into account three observed and / or estimated factors:

- loss emergence rates (based on historic grade migration experience or PD);
- the emergence period (historic experience adjusted to reflect the current conditions and the credit management model); and
- Loss Given Default (LGD) rates (loss and recovery rates using historical loan loss experience, adjusted where appropriate to reflect current observable data).

Methodology for loan loss provisioning and forbearance
Forbearance will always be a trigger event for the Group to undertake an assessment of the customer's financial circumstances and ability to repay. This assessment to determine if impairment has occurred, and if a specific provision is required, will always take place prior to any decision to grant a concession to the customer.

Individually assessing impairment and forbearance
The methodology for individually assessing impairment, whether an exposure is forborne or not, is as outlined above (i.e. on an individual case-by-case basis). The underlying credit risk rating of the exposure, and ultimately the individual impairment assessment, takes into account the specific credit risk characteristics of the exposure.

Collectively assessing impairment and forbearance
Forborne exposures are pooled together for collective impairment provisioning, including IBNR provision calculations, as detailed above. Assumptions and parameters used to create the portfolio provision(s) take into consideration the historical experience on assets subject to forbearance (e.g. amount and timing of cash flows, cure experience, emergence period etc.), adjusted where appropriate to reflect current conditions, and require the satisfactory completion of a twelve month probation period, while being less than 30 days past due, to be eligible to cure from 'probationary' status. Management adjustments are also applied, as appropriate, where historical observable data on forborne assets may be limited. Impairment provisioning methodologies and provisioning model factors applied to forborne loan pools are reviewed regularly, and revised if necessary, to ensure that they remain reasonable and appropriate and reflective of the credit characteristics of the portfolio being assessed and current conditions. This includes a comparison of actual experience to expected outcome.

Provisioning and forbearance
For residential mortgages, exposures which are subject to forbearance and have a specific provision are reported as both 'forborne' and 'impaired'. The total provision cover on residential mortgages that are subject to forbearance is higher than that of the similar residential mortgage portfolio of exposures which are not subject to forbearance.

Forbearance related disclosures are subject to evolving industry practice and regulatory guidance.

Impaired loans review
Irrespective of the valuation methodology applied, it is Group policy to review impaired loans above agreed thresholds on a six monthly basis, with the review including a reassessment of the recovery strategy, the continued appropriateness of the valuation methodology and the adequacy of the impairment provision.

Where information is obtained between reviews that impact expected cash flows (e.g. evidence of comparable transactions emerging, changes in local market conditions, etc.), an immediate review and assessment of the required impairment provision is undertaken.

An impaired loan is restored to unimpaired status when the contractual amount of principal and interest is deemed to be fully collectible. Typically, a loan is deemed to be fully collectible based on an updated assessment by the Group of the borrower's financial circumstances. The assessment includes a demonstration of the customer's ability to make payments on the original or revised terms and conditions as may be agreed with the Group as part of a sustainable forbearance arrangement.

Credit management process
For consumer and lower value commercial exposures, the review is largely based on account behaviour and is highly automated. Where there are loan arrears, excesses, dormancy etc., the account is downgraded to reflect the higher underlying risk.

2.1.7 Credit risk methodologies (*audited*) *(continued)*

Credit risk methodologies for the year ended 31 December 2017 *(continued)*

For larger commercial loans, the relationship manager reassesses the risk at least annually (more frequently if circumstances or grade require) and reaffirms or amends the grade (credit and PD grade) in light of new information or changes (e.g. up to date financial information, or changed market outlook). Grade migration and adjusted PD grades are analysed for inclusion in the loss model.

The emergence period used in the IBNR calculation is calculated using historical loan loss experience. The range of emergence periods is typically three to twelve months (consumer lending products twelve months; commercial property and commercial / SME lending three to four months).

The LGD used in the IBNR calculation is calculated using historical loan loss experience and is adjusted, where appropriate, to apply management's credit expertise to reflect current observable data.

Other factors taken into consideration in estimating provisions include domestic and international economic climates, changes in portfolio risk profile and the effect of any external factors, such as legal or competition requirements. Whilst provisioning is an ongoing process, all business units formally review and confirm the appropriateness of their provisioning methodologies and the adequacy of their impairment provisions on a half-yearly basis. Their conclusions are reviewed by the risk function and the BRC.

The Group's provisioning methodology is reviewed by the CRPC on a half yearly basis. The quantum of the Group's impairment charge, impaired loan balances, and provisions are also reviewed by the ERC on a half-yearly basis, in advance of providing a recommendation to the Audit Committee.

Methodologies for valuation of collateral
The Group uses a number of valuation approaches, depending on use of collateral and data availability. The Group has in place a formal valuation policy. Approaches include:

(1) ***Indexation and use of automated valuations - residential mortgages***
Mortgage loan book property values are determined by reference to the original or latest property valuations held indexed to the Nationwide UK house price index. Where cash flows arising from the realisation of collateral held are included in impairment assessments, management typically rely on valuations or business appraisals from independent external professionals. In line with others in the industry, the Group uses automated house price valuations to assess collateral positions in monitoring certain cohorts of the book.

(2) ***Formal written valuations from independent external professionals***
External valuations are sought in circumstances where there continues to be sufficient transactional evidence and market liquidity to support an expert objective view. External qualified firms, with appropriate knowledge of the particular market, are commissioned to provide formal written valuations, including an assessment of the timeline for disposal, in respect of the property.

(3) ***Assessed valuations, informed by consultations with external valuers***
Valuation policy permits the use of internally assessed valuations where appropriate. Verbal consultations with external valuers, familiar with local market conditions, provide general information on market developments, trends and outlook. These consultations are used to benchmark asset values, and the potential timeline for realisation, and form an element of the estimation of the recoverable amount to be used for impairment provisioning.

In some land and development cases, estimated valuations of undeveloped sites may be expressed on a 'per plot' or 'per acre' basis if there is suitable zoning / planning in place, whereas un-zoned rural land may be assumed to have only agricultural value. Assessed values are subject to oversight by the independent credit unit.

(4) ***Residual value methodologies***
Residual value methodologies are used to estimate the current value of a site or part completed development, based on a detailed appraisal that assesses the costs (building, funding and other costs) and receipts (forecast sales and / or lettings) associated with bringing a development to completion. The type, size and location of the property asset, and its development potential and marketability, are key factors in this assessment process. The Group may look to some of the other valuation methodologies outlined earlier, e.g. residual value methodologies may look to formal professional valuations, verbal consultations with external professionals, or local market knowledge made available by relevant Group management, in determining the appropriate inputs to this analysis.

The appropriate methodology applied depends, in part, on the options available to management to maximise recovery, which are driven by the particular circumstances of the loan and underlying collateral, e.g. the degree of liquidity and recent transactional evidence in the relevant market segment; the type, size and location of the property asset; and its development potential and marketability.

2.2 Liquidity and funding risk

Key points:

- At all times during the financial year the Group maintained appropriate levels of unencumbered liquid resources and an appropriate liquidity position, in line with regulatory and internally set requirements and limits.
- The Group held liquid assets of £3.6 billion at 31 December 2018 which was in excess of regulatory liquidity requirements and within the Group’s internal risk appetite. This represented a prudent liquidity position.
- The Group's loan to deposit ratio decreased from 105% at 31 December 2017 to 102% at 31 December 2018, which reflects an increase in customer accounts during 2018 given management actions.
- In order to diversify the funding base, the Group borrowed from its Parent and the Bank of England during the year.

Definition *(audited)*
Liquidity risk is the risk that the Group will experience difficulty in financing its assets and / or meeting its contractual payment obligations as they fall due, or will only be able to do so at substantially above the prevailing market cost of funds.

Liquidity risk arises from differences in timing between cash inflows and outflows. Cash inflows for the Group are driven by, among other things, the maturity structure of loans held by the Group, while cash outflows are primarily driven by outflows from customer deposits and lending origination.

Liquidity risk can increase due to the unexpected lengthening of maturities, non-repayment of assets or a sudden withdrawal of deposits.

Funding risk is the risk that the Group does not have sufficiently stable and diverse sources of funding or has an inefficient funding structure.

Liquidity and funding risk management *(audited)*
The liquidity and funding risk appetite statement is set by the Board and is reviewed on an annual basis and sets out the level of liquidity and funding risk that the Board has deemed acceptable and the key liquidity and funding metrics that the Group has determined best define its liquidity and funding risk appetite. The Group has established a liquidity and funding RMF, that is aligned to the Group’s risk appetite and risk targets, and which is aligned with its overall strategy to be a predominantly self-funded business, with funding diversification through the use of wholesale funding.

The Group’s liquidity and funding RMF is designed to ensure that the Group manages and monitors its liquidity in accordance with the defined liquidity and funding risk appetite statement. The operational oversight and adherence to risk appetite is delegated to the ALCO, an executive subcommittee of the ERC. The Group’s ILAAP sets out how the Group assesses, quantifies and manages the key liquidity and funding risks and details the Group’s approach to determining the level of internal liquidity resources required to be maintained by the Group, for both business-as-usual and stressed scenarios ranging in severity, nature and duration.

Liquidity and funding management in the Group consists of two main activities:

- *Tactical liquidity management* - which focuses on monitoring current and expected future daily cash flows, to ensure that the Group’s liquidity needs can be met. This takes into account the Group’s access to unsecured funding; the liquidity characteristics of its portfolio; liquid assets that are highly marketable assets; cash balances; and contingent assets that can be realised quickly to cover any unforeseen cash outflows; and
- *Structural liquidity management* - which focuses on assessing the optimal balance sheet structure on both a short term and long term basis taking account of the behavioural and contractual maturity profile of assets and liabilities.

A number of measures are used by the Group to monitor and manage liquidity and funding risk including ratios, deposit outflow triggers, liquidity triggers, stress scenarios and early warning signals. Liquidity risk is measured using stress testing and scenario analysis. The Group runs a number of internal liquidity stress scenarios based on market-wide stress events, Group specific stress events and a combination of market-wide and idiosyncratic stress events. These stress scenarios are also performed across a number of outflow time bands. The daily cashflows resulting from the stress scenarios are compared against the holding of liquid assets. Under the Group’s liquidity risk appetite, the Group must have unencumbered liquidity resources available which will be in excess of 100% of the stressed cashflows, from all stress scenarios performed.

Funding risk is measured by applying and monitoring specific metrics that determine the amount and type of ongoing new retail deposit acquisitions / retentions that are required to fund the Group's asset base across various maturity categories, the loan to deposit ratio alongside other funding metrics.

Bank of England Term Funding Scheme (TFS)
The Group’s funding structure also includes the utilisation of the Bank of England TFS. The TFS is designed to reinforce the transmission of bank rate cuts to the Group’s lending and deposit interest rates and provide a cost effective source of funding to support additional lending to the real economy. This allows the Group to borrow central bank reserves in exchange for eligible collateral over a four year term. The TFS eligible period closed in February 2018. Further details are included in note 29 to the financial statements.

The Group’s funding from the TFS was £1.3 billion at 31 December 2018.

Customer deposits
The Group's funding strategy is focussed, in particular, on maintaining a stable retail deposit base providing an appropriate basis to fund customer lending. £14.2 billion of deposits at 31 December 2018 relates to Post Office branded deposits which increased by £0.3 billion during the year. The AA deposit portfolio increased by £0.4 billion, as matched funding for the AA unsecured lending growth.

The Group's loan to deposit ratio, as defined on page 163, decreased from 105% at 31 December 2017 to 102% at 31 December 2018, as a result of planned management actions.

2.2 Liquidity and funding risk *(continued)*

Customer accounts *(unaudited)*	**2018 £m**	2017 £m
Bank of Ireland deposits and current accounts	4,826	4,740
Post Office deposits	14,237	13,924
AA deposits	706	297
Total	**19,769**	**18,961**

Liquid assets
The Group maintains an unencumbered liquid asset portfolio, comprising cash placements and securities that can be used to raise liquidity, either by sale or through secured funding transactions. As at 31 December 2018, the portfolio comprised cash balances with the Bank of England, UK Government Gilts, Supranational and Agency bonds, UK covered bonds and interbank placements.

The composition of the portfolio is set out above. Interbank placements comprised both placements with external banks and the Parent.

	Average in year		Year end	
Composition of the liquid asset portfolio *(unaudited)*	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Balances with central banks	2,236	1,574	2,538	1,806
Government bonds	421	501	415	428
Other listed securities	515	559	500	580
Interbank placements	223	202	200	220
Total	**3,395**	**2,836**	**3,653**	**3,034**

Liquidity and funding risk monitoring
The Group's daily, weekly and monthly liquidity reporting (including a comprehensive suite of liquidity early warning signals) are produced for use by the Group's Treasury function, to assess and manage the Group's current and future liquidity risk position. Daily liquidity reports, including daily liquidity stress test results, are reported and reviewed by the Treasury, Finance and Risk functions and by the Group's senior management. These reports include a series of limits and triggers which, if triggered, are reported regularly to the ALCO. MI is reported to the ALCO, the ERC, the BRC and the Board.

The Group's liquidity position is supported by its unencumbered liquid asset portfolio, the contingent liquidity collateral available and by the various management actions defined in its recovery plan.

Funding risk management is incorporated into the Group's funding plan which is monitored regularly and updated annually. During 2018, the Group has continued with the gradual replacement of gross flow cash hedging positions, as legacy placements and borrowings with the Parent expire. As a result the amounts due from and due to the Parent have changed from £1.4 billion and £2.0 billion, respectively at 31 December 2017, to £0.9 billion and £1.7 billion, respectively, at 31 December 2018.

At 31 December 2018, £3.5 billion of the liquid asset portfolio is eligible to be applied in liquid asset stress testing (2017: £2.8 billion). The eligible liquid assets do not include cash or general bank accounts that are utilised in the day to day operations of the Group.

In addition, the Group has a range of potential contingency funding actions that can be taken in the event of an unexpected shortfall in liquidity.

Balance sheet encumbrance *(unaudited)*
The Group treats an asset as encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn. It is Group policy to maximise the amount of assets available for securitisation / pledging through the standardisation of loan structures and documentation.

At 31 December 2018 and 2017 the Group had the following encumbered assets.

2.2 Liquidity and funding risk *(continued)*

Encumbered and unencumbered assets	2018 Encumbered[1] £m	2018 Unencumbered £m	2018 Total £m	2017 Encumbered[1] £m	2017 Unencumbered £m	2017 Total £m
Cash and balances with central banks	-	2,567	2,567	-	1,836	1,836
Mandatory deposits with central banks	1,285	25	1,310	1,206	17	1,223
Loans and advances to other banks[2]	75	33	108	125	22	147
Loans and advances to banks - related party transactions	2	928	930	40	1,354	1,394
Loans and advances to customers	2,989	16,714	19,703	3,077	16,920	19,997
Assets classified as held for sale	-	539	539	-	-	-
Debt securities at amortised cost	-	915	915	-	-	-
Available for sale financial assets	-	-	-	-	1,008	1,008
Other assets	-	628	628	-	630	630
Total assets	**4,351**	**22,349**	**26,700**	**4,448**	**21,787**	**26,235**
Encumbered cash and balances with central banks:						
Note cover[3]	1,227			1,172		
Cash ratio and other mandatory deposits	58			34		
	1,285			**1,206**		

Contingent liquidity
The Group holds significant contingent liquidity collateral, comprised of raw loans pre-positioned in Bank of England facilities. During the year, the securitisation vehicle Bowbell No 1 Plc was unwound to provide more efficient collateral for the Group. This contingent liquidity collateral can be pledged against borrowings from central banks and other external market participants.

Bank of Ireland UK ratings *(unaudited)*	2018 £m	2017 £m
Moody's	Baa2 positive outlook	Baa2 stable outlook
Fitch	BBB stable outlook	BBB stable outlook

External ratings
The Group is rated by both Moody's and Fitch. Given the Group's funding strategy and in particular its focus on growing and retaining retail deposits as its primary funding mechanism, the direct impact on liquidity risk of movements in the Group's credit rating is limited.

The key drivers of ratings upgrades in 2018 were improving asset quality; longer record of stable profitability; strengthened capitalisation; and further reductions in the Bank's legacy commercial book.

[1] *Included in the encumbered assets at 31 December 2018 is £2 million (31 December 2017: £40 million) of collateral placed with the Parent in respect of derivative liabilities.*
[2] *Encumbered assets includes assets that are segregated in order to meet the Financial Resilience requirements of the PRA's Supervisory Statement 9/16 "Operational Continuity in Resolution".*
[3] *Note cover relates to mandatory collateral with the Bank of England in respect of banknotes in circulation in Northern Ireland.*

2.2 Liquidity and funding risk *(continued)*

Maturity analysis of financial assets and liabilities
The following tables summarise the contractual maturity profile of the Group's financial assets and liabilities, at 31 December 2018 and 31 December 2017, based on the contractual discounted repayment obligations. The Group does not manage liquidity risk on the basis of contractual maturity, instead the Group manages liquidity risk by adjusting the contractual cash inflows and outflows of the balance sheet to reflect them on a behavioural basis. This includes the incorporation of the inherent stability evident in the retail deposit book.

Customer accounts include a number of term ISA accounts that contain access features which allow customers to access a portion of, or all of, their deposit, notwithstanding that this withdrawal could result in a financial penalty being paid by the customer. For such accounts, the balances have been classified as fully accessible in the following table.

2018 **Maturity analysis of financial assets and liabilities (discounted basis)** *(unaudited)*	**Demand** **£m**	**Up to 3 months** **£m**	**3-12 months** **£m**	**1-5 years** **£m**	**Over 5 years** **£m**	**Total** **£m**
Financial assets						
Cash and balances with central banks	2,567	-	-	-	-	2,567
Derivative financial instruments	-	10	7	12	3	32
Loans and advances to banks	48	1,332	38	-	-	1,418
Loans and advances to banks - related party transactions	367	-	273	281	9	930
Debt securities at amortised cost	-	55	245	615	-	915
Available for sale financial assets	-	-	-	-	-	-
Loans and advances to customers (before impairment loss allowance)[1]	445	1,306	1,597	6,559	10,492	20,399
Total assets	**3,427**	**2,703**	**2,160**	**7,467**	**10,504**	**26,261**
Financial liabilities						
Deposits from banks	25	-	200	1,276	-	1,501
Deposits from banks - related party transactions	371	1	1,026	235	18	1,651
Customer accounts	14,503	1,696	2,261	1,309	-	19,769
Derivative financial instruments	1	6	5	23	8	43
Subordinated liabilities	-	-	-	-	290	290
Total liabilities	**14,900**	**1,703**	**3,492**	**2,843**	**316**	**23,254**
Net total assets and liabilities	(11,473)	1,000	(1,332)	4,624	10,188	3,007
Cumulative net assets and liabilities	**(11,473)**	**(10,473)**	**(11,805)**	**(7,181)**	**3,007**	**3,007**

2017 Maturity analysis of financial assets and liabilities (discounted basis) *(unaudited)*	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Financial assets						
Cash and balances with central banks	1,836	-	-	-	-	1,836
Derivative financial instruments	2	5	5	14	1	27
Loans and advances to banks	147	1,223	-	-	-	1,370
Loans and advances to banks - related party transactions	434	-	275	668	17	1,394
Available for sale financial assets	-	121	111	763	13	1,008
Loans and advances to customers (before impairment provisions)	576	1,352	1,474	6,269	10,481	20,152
Total assets	2,995	2,701	1,865	7,714	10,512	25,787
Financial liabilities						
Deposits from banks	22	150	200	1,200	-	1,572
Deposits from banks - related party transactions	293	-	1,023	630	43	1,989
Customer accounts	14,085	1,951	2,396	529	-	18,961
Derivative financial instruments	-	5	5	43	12	65
Subordinated liabilities	-	-	-	-	290	290
Total liabilities	14,400	2,106	3,624	2,402	345	22,877
Net total assets and liabilities	(11,405)	595	(1,759)	5,312	10,167	2,910
Cumulative net assets and liabilities	(11,405)	(10,810)	(12,569)	(7,257)	2,910	2,910

[1] *Including assets classified as held for sale £564 million. See note 22 for further details.*

2.3 Market risk

Key points:

- The Group does not engage in speculative trading for the purposes of making profits as a result of anticipation of movements in financial markets. Therefore, no discretionary risk is taken by the Group.
- During 2018, the Group continued to manage interest rate and foreign exchange exposure at acceptable levels, by seeking natural hedge solutions within the balance sheet and by hedging remaining exposures with the Parent as the hedge counterparty.
- Basis risk continued to be hedged through the netting of asset and liability positions and the execution of fixed versus floating term swaps during 2018.
- The Group's structural risk continued to be re-hedged continuously within defined risk limits and to set a life-span.

Definition *(audited)*
Market risk is the risk of loss arising from movements in interest rates, FX rates or other market prices. Market risk arises from the structure of the balance sheet and the Group's business mix and discretionary risk taking.

The Group recognises that the effective management of market risk is essential to the maintenance of stable earnings, the preservation of capital resources and the achievement of the Group's strategic objectives.

Market risk management *(audited)*
The management of market risk in the Group is governed by the Group's Risk Appetite Statement and by the Group Policy on Market Risk. The Group has an established governance structure for market risk that involves the Board, the BRC, the ERC, and the ALCO, which has primary responsibility for the oversight of market risk in the Group within the confines of the risk appetite set by the Board.

The Group has no risk appetite for the holding of proprietary market risk positions or the running of material open banking book market risk exposures. The Group, therefore, does not consider itself to have proprietary positions and hedges open banking book exposure to deminimus levels. However, the Group does have customer derivative foreign exchange forward contracts, which are considered held for trading, as hedge accounting is not applied. These transactions are hedged with the Parent.

The Group manages its interest rate risk position by hedging with the Parent. The overall market risk hedging approach is prioritised as follows;

(i) naturally hedge within the balance sheet;
(ii) execute derivative hedging contracts with the Parent; or
(iii) execute gross cash hedges.

Derivatives executed for hedging purposes are executed with the Parent only and are subject to ISDA and CSA standard documentation. Collateral requirements are calculated daily and posted as required. The Group uses derivative contracts with the Parent for hedging purposes only and seeks to apply hedge accounting where possible.

The Group continues to maintain a deminimis limit for interest rate risk to reflect operational requirements only. This limit is monitored by the ALCO and approved by the Board. The Group's lending and deposits are almost wholly (>95%) denominated in sterling. Any foreign currency transactions are hedged to acceptable levels with the Parent. It is the Group's policy to manage structural interest rate risk, by investing its net non-interest bearing liabilities in a portfolio of fixed rate assets, with an average life of 3.5 years and a maximum life of 7 years. This has the effect of mitigating the impact of the interest rate cycle on the net interest margin.

Market risk measurement and sensitivity *(audited)*
The Group's interest rate risk position is measured and reported daily. The daily interest rate risk position is calculated by establishing the contractual and behavioural repricing of assets, liabilities and off-balance sheet items on the Group's balance sheet, before modelling these cash flows and discounting them at current yield curve rates.

In addition to this, the Group runs a series of stress tests, including parallel and non-parallel yield curve stress scenarios across all tenures, in order to further monitor and manage yield curve and repricing risk in the banking book. The Group also applies market risk stress scenarios to manage and monitor the impact of stress events in relation to interest rate option risk, basis risk and net interest income sensitivity.

A dual purpose of the Group's market risk stress testing is to meet regulatory requirements and to ensure that appropriate capital is held by the Group.

The impact on the Group's economic value from an immediate and sustained 50 basis points shift, up or down, in the sterling yield curve applied to the banking book at 2018 and 2017, is shown below.

The sensitivity is indicative of the magnitude and direction of exposures but is based on an immediate and sustained shift of the same magnitude across the yield curve (parallel shift).

(audited)	**2018 £m**	2017 £m
+ 50 basis points	(0.06)	(0.16)
- 50 basis points	0.06	0.16

2.4 Regulatory risk

Key points:

The FCA and PRA confirmed in their respective business plans that significant resource would be focussed on the UK's withdrawal from the European Union ('EU'), ensuring adequate resource is available to implement the change. However, throughout 2018, the FCA and PRA have committed to deliver on their statutory objectives:

- The FCA has focussed heavily on improving competition for customers in the markets it regulates, improving customers' access to banking services and the information they receive, and providing customers with greater choices of payment service providers. The Group has implemented numerous regulatory changes, including the Competition and Market Authorities Open Banking initiative, a revised Payment Services Directive ('PSD II) and the EU Payment Accounts Directive. Further enhancements to the Group's Open Banking services will be made throughout 2019. The FCA also intends to follow up on previous work on fair pricing strategies, vulnerable customers and access to financial services.
- In support of the PRA's primary objective on financial stability, the Group has delivered Operational Continuity in Resolution requirements, ensuring functions critical to the UK economy can continue to operate even in a resolution event. The PRA is extending its focus to operational resilience matters in recognition of the risks inherent in complex supply chains, a significant increase on technology in delivering on the demand for 24/7, 365 banking services.
- On 27 July 2018, the PRA issued a consultation paper on the definition of default with the aim of reducing the variability in industry practice of the interpretation of the CRR with their final policy statement published 6 March 2019. The Group will seek to align its definition of default for IFRS 9 purposes with the CRR, therefore, changes to the interpretation of the CRR may have consequential impacts on the modelling of the IFRS 9 expected credit losses. The changes arising from the PRA's consultation may impact the financial statements prior to the expected adoption date of 31 December 2020, as industry or regulator action converges industry practice.

Definition

Regulatory risk is the risk of failure to meet new or existing regulatory and / or legislative requirements and deadlines or to embed requirements into processes. The associated risk of regulatory change is the risk that a change in laws and regulations that govern the Group will materially impact the Group's business, profitability, capital, liquidity, products or markets; that the Group fails to take timely action; and/or that the Group fails to effectively manage the regulatory change process.

Risk management and measurement

The Group manages regulatory risk under its Risk Management Framework. The Framework identifies the Group's formal governance process around risk, including its framework for setting risk appetite and its approach to risk identification, assessment, measurement, management and reporting. This is implemented by accountable executives and monitored by the R&ORC, the ERC, the BRC and Board in line with the overall risk governance structure outlined in section 1.1. The effective management of regulatory risk is primarily the responsibility of business management and oversight is provided by the Compliance & Conduct Risk function. As detailed in its RAS, the Group has no appetite for failure to comply with its regulatory or legislative obligations. However, it acknowledges that instances may occur as a consequence of being in business. The Group has therefore established an approach to ensure the identification, assessment, monitoring, management and reporting of these instances.

Risk mitigation

Risk mitigants include the early identification, appropriate assessment and measurement and reporting of risks. The primary risk mitigants for regulatory risk are the existence of appropriate controls in place throughout the business and the effective planning for, and execution of, regulatory change.

Risk reporting

The current status of regulatory change programmes is reported to senior executives and Board members through the Monthly Risk Report. The Head of Compliance & Conduct reports to the R&ORC on the status of regulatory risk in the Group, including the status of the top regulatory risks, the progress of risk mitigation plans, issues and breaches, and significant regulatory interactions.

2.5 Operational risk

Key points:

- The Group seeks to operate an effective framework for the identification, assessment, mitigation and control of operational risk.
- Following delivery of a suite of risk improvement programmes through 2017 and 2018, the Group continues to enhance its operational risk management practices and to further embed the effective use of the operational risk management framework tools, in line with regulatory expectations.

Definition

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. This definition includes legal and model risk but excludes strategic and repetitional risk. Legal risk relates to the risk of being the subject of a claim or proceedings due to an infringement of laws, contracts or regulations. Model risk relates to the potential for adverse consequences from decisions based on incorrect or misused model outputs and reports.

The key sub-classes of operational risk are defined as follows:
Technology, Information Security and Cyber Security, Sourcing, Payments, Business Continuity, Financial Crime (incorporating the risk of facilitating money laundering, terrorist financing, sanction

2.5 Operational risk *(continued)*

violation and fraud), People, Legal and Contractual, Model, Unauthorised Trading, Insurable, Disclosure, Regulatory Reporting and Data Quality and Reliability Risk.

Risk management
The primary goal of operational risk management is to ensure the sustainability and integrity of the Group's operations and to protect its reputation by mitigating, controlling or transferring the impact of operational risk.

The objective of operational risk management is not to eliminate operational risk altogether but to manage it within appetite, taking into account the cost of mitigation and the level of reduction in the operational risk exposure that can be achieved in a cost effective manner.

The Group operates an Operational Risk Management Framework (ORMF) which defines its approach to managing operational risk and consists of, inter alia:

- Group operational risk appetite;
- Group operational risk policies and policy standards which specify the minimum control standards and staff obligations;
- Group's risk identification, assessment and treatment approaches, including minimum requirements for control testing and key indicators;
- Group's incident, event and issue management processes;
- Operational risk oversight, monitoring and independent assurance;
- Operational risk management information and reporting; and
- Operational risk training.

The Group undertakes an annual Internal Capital Adequacy Assessment Process (ICAAP) in order to determine the appropriate level of capital it must hold to protect itself against extreme but plausible operational risk exposures. The Group's regulatory minimum capital requirement (Pillar I) is determined by using the standardised approach (TSA). The Group uses scenario analysis and capital modelling to test the adequacy of Pillar 1 capital and set the overall (Pillar 1 and Pillar 2a) capital requirement for operational risk.

Risk reporting
The Group utilises an operational risk management system to record the outputs of risk and control self assessments, operational risk events (including financial losses, near misses and instances of non-compliance), issues, outcomes of controls testing, performance of key indicators, and other data.

2.6 Business and strategic risk

Key points:

- On an annual basis the Board reviews the Group’s strategic objectives to confirm that the strategic shape and focus of the Group remains appropriate. Longer term viability is monitored through its ICAAP and 5-year planning processes.
- In 2018 the Group delivered a statutory profit before tax of £173 million.
- While the UK economy continued to grow in 2018, uncertainty over the effects of the UK’s planned departure from the European Union continues to mean 2019 forecasts for the macroeconomic environment are challenging.
- The Competitive environment in the UK banking sector remains intense with increasing pressure on margins affecting banks’ ability to generate profitability. The Group’s current cost base adversely affects its competitiveness and acts as a drag on business performance.

Definition
Business and Strategic Risk is defined as the risk of volatility to the Group’s projected outcomes, including income statement and Balance Sheet impact and / or damage to the franchise, including that of the Group’s joint ventures. It includes volatilities caused by changes in the competitive environment, new market entrants, new products or failure to develop and execute a strategy or anticipate or mitigate a related risk.

The risk may arise from a change in the competitive environment, new market entrants, new products, or a failure to anticipate or mitigate a related risk, and a breakdown / termination of a relationship with, or a significant underperformance of, a distribution partner.

Risk management, measurement and reporting
Business units are responsible for delivery of their business plans and management of such factors as pricing, business volumes, operating expenses and other factors that can introduce earnings volatility.

The risk is overseen monthly through the CRO’s Monthly Risk Report with commentary on the economy, market development and competition, margin trends, direct and indirect costs, staff turnover and execution risk. Business and Strategic Risk is reported on an ongoing basis to the ERC, the BRC and the Board.

Risk mitigation
The Group mitigates business risk through business planning methods, such as the diversification of revenue streams, cost base management and oversight of business plans which are informed by expectations of the external environment and the Group’s strategic priorities.

At an operational level, the Group’s annual budget process sets expectation at a business unit level for volumes and margins. The regular tracking of actual and forecast volumes and margins against budgeted levels, is a key financial management process in the mitigation of business risk.

Strategic risk is mitigated through its ICAAP and 5-year plan aswell as updates to the Board on industry developments, regular updates on the key macroeconomic environment impacting the Group’s activities and a review of the competitive environment and strategies at both Group and business unit level.

The Group's Annual Strategy and Planning Process includes a review of the Group's business model.

Business Review
Risk Management
Governance
Financial Statements
Other Information

2.7 Reputation risk

Key points:

- The Group's reputation continues to be influenced and shaped by a range of factors including: macroeconomic and political environment, media, public and customer commentary and general sector developments. More specifically, the Group's decisions and actions in pursuit of its strategic and tactical business objectives and its interaction with the external environment will also influence its reputation.
- Throughout 2018, the Group continued to actively manage, measure and report on its reputation risk and to take this into account in its strategic decision making.

Definition
Reputation risk is defined as the risk to earnings or franchise value arising from adverse perception of the Group's image on the part of customers, partners, suppliers, counterparties, shareholders, investors, staff, legislators or regulators.

This risk typically materialises through a loss of business in the areas affected. Reputation is not a standalone risk but overlaps with other risk areas and may often arise as a consequence of external events or operational risk related issues.

Risk management, measurement and reporting
Reputation risk indicators are monitored on an ongoing basis.

These indicators are:
- media monitoring;
- market trends and events;
- stakeholder engagement and monitoring; and
- risk events which may have the potential to impact the Group.

The Group reviews reputation risk as part of the annual risk identification process. Regular updates are reported to the ERC, the BRC and the Board.

Risk mitigation
The Group's reputation is taken into account in decision-making and this is paramount in mitigating against reputation risk.

2.8 Conduct risk

Key points:

- The Group recognises the importance of good conduct and is committed to placing customers at the heart of its strategic and operational decision-making.
- In 2018 the Group continued to embed, develop and enhance its conduct risk management tools and processes, including strengthening its treatment of vulnerable customers.

Definition
Conduct risk is the risk of failure to deliver a product or service in a manner reasonably expected by the Group's customers or to treat them fairly. Poor conduct or customer detriment can result from a failure in the Group's control framework, policies, processes, systems and controls, and / or its people. Such failure may also result in a breach of legislation, regulatory rules or principles including that of fairness.

Customer Experience
The Group is taking steps to improve customer service, particularly following publication of the CMA's Banking Survey in August 2018. Changes underway to improve customer service include the introduction of more staff in branches and extended opening hours in Northern Ireland; additional investment in digital capability; and efforts to resolve complaints at the first point of contact. The industry continues to make adjustments to cater for the needs of vulnerable customers including ensuring they are treated fairly. The Group has in place an approach to vulnerable customers, which sets out desired outcomes and standards expected of business units and third party outsourced service providers in the treatment of those consumers that may be considered as vulnerable due to their personal circumstances and who are especially susceptible to detriment in the event that the Group does not act with the appropriate level of care.

A related matter identified through the regulator's work on vulnerability is the ability of customers to engage with financial services they need throughout their lifetime. The FCA considers that firms should be considering how best to provide access to financial services for customers who might otherwise be excluded from the financial services sector due to a diverse range of reasons, for example ageing population, firms' increased focus on digital transformation programmes and compliance reasons such as AML/CTF. The Group is continuing to consider what additional steps it can take to promote this area.

Risk management
The Group has no appetite for customer detriment and seeks to be fair, accessible and transparent in the provision of products and services to its customers at all times.

To ensure the Group's exposure to conduct risk is clearly defined, understood, measured, managed as appropriate and regularly reported upon, the Group has established risk appetite measures, underpinned by policies, procedures and reports to allow the identification and remediation of conduct risk.

2.8 Conduct risk *(continued)*

Conduct risk policy
The Group's exposure to conduct risk is governed by a policy approved by the BRC in accordance with the Board approved risk appetite and within the overall Group risk governance structure outlined on pages 26 to 28.

In addition to day-to-day control measures implemented by business units, monitoring of conduct risks and controls is conducted using a risk-based approach by an independent internal monitoring team within the Compliance and Conduct function.

Risk reporting
Each business unit in the Group produces a conduct risk scorecard aligned to the conduct risk appetite statement. These scorecards are reviewed by management and combined into an overall Conduct Risk Scorecard, which is used as the basis of onward reporting to the R&ORC, the ERC, the BRC and the Board.

3 Capital management

Key points:

- At all times during the financial year the Group maintained appropriate capital resources in line with regulatory requirements (audited).
- CET 1 ratio is 15.0% at 31 December 2018 under the regulatory basis and 14.5% under the fully loaded basis.
- The Group at 31 December 2018 was required to hold CET1 capital requirements of 9.52%.
- Sustained strong capital position enabled the payment of the equity dividend of £70 million to the Parent in August 2018.
- The leverage ratio is 6.9% at 31 December 2018 under the regulatory basis and 6.7% under the fully loaded basis.

Capital adequacy risk
Capital adequacy risk is the risk that the Group holds insufficient capital to absorb extreme and unexpected losses, which could eventually result in the Group not being able to continue operating.

Capital management objectives and policies
The Group manages its capital position to ensure that it has sufficient capital to cover the risks of its business, support its strategy and to comply at all times with regulatory capital requirements.

Capital adequacy and its effective management is critical to the Group's ability to operate its businesses, grow organically and pursue its strategy. The Group's business and financial condition could be adversely affected if it is not able to manage its capital effectively or if the amount or quality of capital held is insufficient. This could arise in the case of a materially worse than expected financial performance (including, for example, reductions in profits and retained earnings as a result of impairment losses or write downs, increases in RWA and delays in the disposal of certain assets as a result of market conditions).

Capital requirements and capital resources
The Group complied with all its regulatory capital requirements throughout 2018. The Group manages its capital resources to ensure that the overall amount and quality of resources exceeds the Group's capital requirements. Capital requirements are determined by the CRD IV, the CRR and firm specific requirements imposed by the PRA. The CRR minimum requirements are typically driven by credit risk, market risk and operational risk, and also require stress-absorbing buffers.

Additional firm-specific buffers reflect the PRA's view of the systemic importance of a bank and also internal capital adequacy which is determined by internal stress testing as part of the ICAAP.

An additional firm-specific countercyclical buffer is also required, reflecting the countercyclical buffer rates applicable to the exposures held by the Group.

The Group's regulatory requirements are summarised in the table below which shows the minimum CET 1 regulatory requirements of the Group. These requirements do not include the PRA buffer, which is not disclosed in line with regulatory preference.

Group CET 1 Captial Requirement (unaudited) 2018	Set by:	%
Pillar 1	CRR	4.5
Pillar 2A	PRA	2.14
Capital Conservation Buffer	CRD	1.88
UK Countercyclical Buffer	FPC	1.00
Total minimum CET 1 Regulatory Requirement		9.52

CRD IV Developments
CRD IV continues to evolve through amendments to current regulations and the adoption of new technical standards. On 23 November 2016, the European Commission (EC) published a set of legislative proposals, including amendments of the existing CRD and the Capital Requirements Regulation (CRR), as well as the related EU Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) Regulation. The proposed changes are expected to start entering into force in 2019 at the earliest.

In December 2017, the Basel Committee announced revisions to the Basel Framework. The revisions focus on the standardised and internal ratings based (IRB) approaches to measuring credit risk and include the introduction of an aggregate output floor to ensure banks' RWAs calculated via internal models are no lower than 72.5% of RWAs calculated under the standardised approach.

3 Capital management *(continued)*

The revised standards will take effect from 1 January 2022, with a phase-in period of five years for the aggregate output floor. The Group is currently assessing the impact of these revisions although any impact will depend on the implementation at EU level.

The Group actively monitors these developments and seeks to effectively comply with the new requirements when finalised.

IFRS 9 Capital Impact
The impact of adoption of IFRS 9, which came into effect on 1 January 2018, resulted in an increase in the stock of impairment provisions upon transition, which reduced the CET1 ratio by c.38 basis points, before application of the regulatory transitional arrangements.

The Group has elected to apply the transitional arrangements which, on a regulatory basis, partially mitigates the initial and future impacts in the period to 2022. This involves a capital add back of a portion of the increase in impairment loss allowance on transition to IFRS 9 and also subsequent increase in the stage 1 and 2 loss allowances at future reporting dates. The transition period is for five years, with a 95% add back allowed in 2018, decreasing to 85%, 70%, 50% and 25% in subsequent years.

Further details on the impact of IFRS 9 are shown in note 46.

The fully loaded capital ratios exclude the impact of these transitional arrangements.

Regulatory capital and key capital and leverage ratios
The Group is strongly capitalised with a total capital ratio on a regulatory basis of 20.6% at 31 December 2018 (2017: 20.5%).

Total regulatory capital resources increased by £69 million during 2018 to £2.2 billion due to:

- profit after tax for 2018 of £147 million;
- a reduction in regulatory adjustments of £68 million which includes the IFRS 9 transitional adjustment of £44 million; offset by;
- a dividend payment of £70 million paid to the Parent;
- additional tier 1 coupons of £24 million paid to the Parent less a tax credit of £6 million;
- £38 million reduction in retained earnings due to the impact of adopting IFRS 9 on 1 January 2018; and
- a decrease in other reserves of £20 million.

RWAs increased from £10.2 billion to £10.5 billion reflecting growth in the consumer portfolios, offset by a reduction in the commercial portfolios.

The reported capital position includes capital requirements on the credit card portfolio which is disclosed in the financial statements as held for sale at 31 December 2018.

The Group’s leverage ratio on a regulatory basis has increased from 6.6% to 6.9% at 31 December 2018 which is in excess of the Basel Committee minimum leverage requirement of 3% and the FPC minimum requirement of 3.25%. The European Commission has proposed the introduction of a binding leverage requirement of 3% as part of the CRD V package proposals. It is anticipated that the binding leverage requirement will be applicable from 2019 at the earliest pending the final agreement of the proposals at EU level.

Capital management reporting
The Group monitors and reports the capital position daily, monthly and quarterly. Reporting includes a suite of early warning triggers and measurement against risk appetite and is reviewed by the Prudential Risk team, the Capital Management Forum and the ALCO. The capital management information is reviewed by the ALCO, the ERC, the BRC and the Board.

Stress testing and capital planning
The Group uses stress testing as a key risk management tool to gain a better understanding of its risk profile and its resilience to internal and external shocks. In addition, stress testing provides a key input to the Group's capital assessments and related risk management and measurement assumptions.

The Group's stress testing is designed to:

- confirm the Group has sufficient capital resources;
- inform the setting of capital risk appetite measures; and
- ensure the alignment between the Group's RMF and senior management decision making.

The Group regularly assesses its existing and future capital adequacy under a range of scenarios of sufficient severity, using a combination of quantitative and qualitative analysis in the ICAAP, which is reviewed by the PRA and SSM on a periodic basis. The ICAAP, which acts as a link between the Group’s strategy, capital and risk under stress, is approved annually by the Board.

The Group also undertakes reverse stress testing on an annual basis which informs, enhances and integrates with the stress testing framework by considering extreme events that could cause the Group to fail. This testing also improves risk identification and risk management and the results are also approved by the Board, as part of the Group's ICAAP. The Group's capital planning process includes a review of the Group’s expected capital position which is reviewed and challenged on a monthly basis by senior management.

The Group's capital plan (which is approved at least annually by the Board) also includes sensitivities to ensure the continued resilience of the underlying assumptions under adverse conditions and changes to the regulatory landscape.

Minimum Requirements for Own Funds and Eligible Liabilities (MREL)
MREL is focussed on ensuring that banking groups have sufficient liabilities to absorb losses to allow them to return to business as usual following a recovery or resolution event and without recourse to taxpayer funds. The Bank of England issued a statement of Policy on MREL in June 2018 and as a result the Group expects to be subject to MREL on an interim basis from 1 January 2020, at 18% of RWA.

End-state MREL requirements will be effective from 1 January 2022. The Group considers the impact of MREL as part of the strategic and capital planning process, noting that the Parent as the sole shareholder and provider of capital is also expected to provide any future core MREL requirements.

3 Capital management *(continued)*

2017 Regulatory and fully loaded £m		2018 Regulatory[1] £m	2018 Fully loaded[2] £m
851	Ordinary share capital	851	851
566	Capital contribution and capital redemption reserve fund	566	566
215	Retained earnings and other reserves[3]	215	215
1,632	**Total equity**	**1,632**	**1,632**
(124)	**Regulatory adjustments**	**(55)**	**(99)**
(73)	*Deferred tax assets relying on future profitability*	*(72)*	*(72)*
(20)	*Intangible assets*	*(15)*	*(15)*
(23)	*Cashflow hedge reserve*	*(6)*	*(6)*
(7)	*Retirement benefit asset*	*(6)*	*(6)*
(1)	*Prudent valuation adjustment*	*(-)*	*(-)*
-	*IFRS 9 transitional adjustment*	*44*	*(-)*
1,508	**Common equity tier 1 capital**	**1,577**	**1,533**
	Additional tier 1		
300	Subordinated perpetual contingent conversion additional tier 1 securities	300	300
1,808	**Total tier 1 capital**	**1,877**	**1,833**
	Tier 2		
290	Dated loan capital	290	290
290	**Total tier 2 capital**	**290**	**290**
2,098	**Total capital**	**2,167**	**2,123**
10,231	**Total risk weighted assets (unaudited)**	**10,522**	**10,550**
27,260	**Total leverage ratio exposures (unaudited)**	**27,335**	**27,377**

1 *Regulatory capital is reported including the IFRS 9 transitional adjustment.*
2 *Fully loaded capital is reported excluding the IFRS 9 transitional adjustment.*
3 *The impact of adopting IFRS 9 at 1 January 2018 from a Regulatory Group perspective was a reduction in retained earnings of £38 million.*

Directors and other information

Chairman
Mr. Robert Sharpe (N) (RE)

Non-Executive Directors
Mr. Donal Collins
Mr. John Maltby (A) (RI) (N) (RE)
Ms. Mimi Kung (RI) (RE) (N)
Mr. Philip Moore (RI) (A) (RE) (N) (appointed 1 April 2018)
Mr. John Baines (RI) (A) (appointed 1 May 2018)
Mr. Ian Buchanan (appointed 4 September 2018)
Ms. Jacqueline Noakes (appointed 31 October 2018)

Executive Directors
Mr. Desmond Crowley
Mr. Neil Fuller
Mr. Thomas McAreavey

(A) Member of the Audit Committee
(N) Member of the Nomination Committee
(RI) Member of the Risk Committee
(RE) Member of the Remuneration Committee

Company Secretary
Hill Wilson Secretarial Limited

Registered Office
Bow Bells House,
1 Bread Street,
London,
EC4M 9BE.

Registered Number
07022885

Independent Auditors
KPMG LLP
Chartered Accountants and Statutory Auditors
15 Canada Square,
London,
E14 5GL.

The Board of Directors

Robert Sharpe
Chairman and Non-Executive Director

Term of Office:
Appointed in April 2016

Independent:
Yes

External Appointments
Chairman and Non-Executive Director of Al Rayan Bank. Chairman and Non-Executive Director of Honeycomb Investment Trust Ltd. Chairman and Non-Executive Director of Hampshire Trust Bank.

Experience
Appointed Chairman on the 27 April 2016, bringing over 35 years of Senior Executive and Board experience to the role, primarily in Retail Banking. Robert is currently Chairman atAl Rayan Bank plc, Honeycomb Investment Trust plc and Hampshire Trust Bank plc.

Robert worked extensively in the Middle East, where he held several Non-Executive Directorships at banks in the UAE, Oman and Turkey. Prior to this, Robert led the transformation and turnaround at West Bromwich Building Society as Chief Executive Officer, having formerly been Chief Executive at the Portman Building Society and Chief Executive of Bank of Ireland's business in the UK. His previous Non-Executive Director roles include Barclays Bank Pension Board, Chairman of Vaultex (UK) Ltd, George Wimpey plc, LSL Properties plc and the RIAS Group Ltd.

Desmond Crowley
Chief Executive Officer, Retail UK Division

Term of Office:
Appointed in September 2009

Independent:
No

External Appointments
None

Experience
Appointed Director of Bank of Ireland (UK) plc in September 2009 and appointed Chief Executive Officer of Bank of Ireland (UK) plc in March 2012. Des joined BoI Group in 1988 and in March 2000 became a member of the Bank of Ireland Group Executive Committee, on being appointed Chief Executive of Retail Banking Ireland. Appointed Chief Executive of UK Financial Services, Director of Bristol & West plc and Bank of Ireland UK Holdings plc in January 2006. Des was appointed Director of the Parent in October 2006, until his retirement from this position in June 2011 and was appointed as Chief Executive Officer – Retail (Ireland & UK) in May 2009 and Chief Executive- Retail UK Division in March 2012.

Des was previously Chairman of Post Office Financial Services. Des is currently Director of First Rate Exchange Services Limited, the foreign exchange joint venture with the UK Post Office and a Director of New Ireland Assurance Company plc.

Neil Fuller
Chief Risk Officer

Term of Office:
Appointed in October 2015

Independent:
No

External Appointments
None

Experience
Appointed Director of Bank of Ireland (UK) plc and Chief Risk Officer in October 2015. Neil joined Bank of Ireland from GE Capital UK, where he held the role of Chief Risk Officer since 2011. Neil has over 30 years of financial services experience, having previously worked for Royal Bank of Scotland & NatWest, where he held the role of Chief Risk Officer, UK Retail Division, and having previously held a number of senior management roles in UK Retail Banking across Credit Risk, Enterprise & Operational Risk and Operations. Neil is also a Director of First Rate Exchange Services Limited, the foreign exchange joint venture with the UK Post Office.

The Board of Directors *(continued)*

Thomas McAreavey
Chief Financial Officer

Term of Office:
Appointed in March 2017

Independent:
No

External Appointments
None

Experience
Appointed Director of Bank of Ireland (UK) plc and Chief Financial Officer in March 2017. Thomas has over 20 years' experience in the Bank of Ireland Group, having held various senior management positions within Finance, including leading a range of strategic projects for Bank of Ireland. Prior to that he held a management position within PricewaterhouseCoopers LLP. Thomas is a Fellow Chartered Accountant.
Thomas is also a Director of a number of BoI Group subsidiaries, including NIIB Group Limited.

Donal Collins
Head of Group Strategy & Development
- Bank of Ireland Group plc

Term of Office:
Appointed in July 2015

Independent:
No

External Appointments
None

Experience
Appointed Director of Bank of Ireland (UK) plc in July 2015. Donal joined Bank of Ireland Group in 1999 and became a member of the Group Executive Committee in 2014. Donal has held a number of senior management positions including Director, Corporate Banking, Head of Group Projects and Head of Group Strategy Development. Prior to joining Bank of Ireland, Donal worked for KBC Bank in a range of international senior management roles in aerospace, infrastructure and asset financing and KPMG Ireland as Director, Taxation. Donal is a Fellow of Chartered Accountants of Ireland and an Associate of the Irish Institute of Taxation.

Jackie Noakes
Group Chief Operating Officer
- Bank of Ireland Group plc

Term of Office:
Appointed in October 2018

Independent:
No

External Appointments
None

Experience
Appointed Director of Bank of Ireland (UK) plc in October 2018. Jackie joined Bank of Ireland as a Chief Operating Officer in August 2018. In her role as Chief Operating Officer Jackie oversees a range of services across technology, infrastructure and operations. Jackie has held a number of senior positions in the financial services sector, most recently at Legal & General (UK) as CEO of Mature Savings. Jackie also held the roles of Managing Director of Legal & General's Savings business, as well as Group IT & Shared Services Director and Chief Operating Officer for the firm's largest operating entity, Legal & General Assurance Society.

The Board of Directors *(continued)*

John Maltby
Non-Executive Director

Term of Office:
Appointed in November 2015

Independent:
Yes

External Appointments
Chairman and Non-Executive Director of Good Energy Group plc. Chairman and Non-Executive Director of Pepper UK plc Non-Executive Director at NCS Trust CIC Non-Executive Director of Simply Health Group Ltd

Experience
Appointed to the Board of Bank of Ireland (UK) plc in November 2015, and appointed Chair of the Risk Committee in August 2017. John is also a member of the Nomination, Audit and Remuneration Committees. John is currently Chairman of Good Energy Group plc, and a member of its Audit and Remuneration Committees. Previous Board appointments include CEO and member of Transitional Board of Williams & Glynn, Chairman of Board of Lloyds Commercial Finance, Member of the Board Cheltenham & Gloucester plc, Chairman of the Board of Start Mortgages Ireland, and Member of the Board of Lombard Bank. John has also previously been Group Chief Executive of Kensington Group PLC, a specialist mortgage business and Group Director, Commercial Banking for Lloyds Banking Group. John has also held senior executive roles throughout the financial services industry, including NatWest Group PLC, Barclays Bank PLC and Abbey National PLC.

Mimi Kung
Non-Executive Director

Term of Office:
Appointed in November 2017

Independent:
Yes

External Appointments
Non-Executive Director at Poste Italian. Non-Executive Director at Prysmian Group

Experience
Appointed as Director of Bank of Ireland (UK) plc in November 2017. Member of the Nomination, Remuneration and Risk Committees. Mimi attended the Boston University School of Management (1998) and Oxford University (2003). Mimi has held various senior positions at American Express since 1995 including that of Chief Financial Officer of American Express Europe and, most recently, that of Senior Vice-President, Head of the “Card Services Central Europe & International Currency Cards” function, and country manager for Italy.

Philip Moore
Non-Executive Director

Term of Office:
Appointed in April 2018

Independent:
Yes

External Appointments
Trustee and Chair of the Finance Committee of the Royal British Legion Non-Executive Director and Chair of the Audit and Risk Committee of Codan A/S and Codan Forsikring A/S

Experience
Appointed to the Board of Bank of Ireland (UK) plc in April 2018, and a member of the Nomination, Audit, Risk and Remuneration Committees. Philip has enjoyed an over 35-year international career in financial services comprising nearly 20 years as a CFO. Until 2017 he was Group Finance Director of LV=. Other previous executive roles have included Group Finance Director and subsequently Chief Executive at Friends Provident and a Partner at Pricewaterhouse Coopers LLP based in London and then Hong Kong. Philip’s past Non-Executive director roles have included F&C Asset Management, RAB Capital, Wealth Wizards and Towergate.

The Board of Directors *(continued)*

John Baines
Non-Executive Director

Term of Office:
Appointed in May 2018

Independent:
Yes

External Appointments
Non-Executive Director at State Bank of India (UK) Ltd. Non-Executive Director at Distribution Finance Capital Ltd.
Non-Executive Director at Interactive Investor Ltd

Experience
Appointed to the Board of Bank of Ireland (UK) plc in May 2018, and appointed Chair of the Audit Committee in May 2018. John is also a member of the Risk Committee. John qualified as a Chartered Accountant in 1987 and has subsequently spent his entire career working in financial services, initially in investment banking, before moving into wealth management and then retail and commercial banking. John has been the Finance Director of Aldermore Bank and also of the Co-operative Bank and has sat on the Boards of both businesses.

Ian Buchanan
Non-Executive Director

Term of Office:
Appointed in September 2018

Independent:
No

External Appointments
Non-Executive Director of Openworks Holdings Ltd.

Experience
Appointed Director of Bank of Ireland (UK) plc in September 2018. Ian is also a Director for the Board of Bank of Ireland Group plc and the Court of The Governor and Company of Bank of Ireland. Ian is also a Non-Executive Director at Openwork, one of the largest financial advisor networks in the UK. Ian was the Group Chief Information Officer for Barclays plc and Chief Operating Officer for Barclaycard until 2016. Before joining Barclays in 2011, Ian was Chief Operating Officer for Société Générale Corporate & Investment Banking (2009-2011), a member of the public board and Group Manufacturing Director of Alliance & Leicester plc (2005-2008), and a member of the executive committee and Chief Operations & Technology Officer of Nomura International (1994-2005). Ian's earlier career was spent at Credit Suisse, Guinness and BP.

Ian has extensive technology, digital, business transformation and customer operations experience gained through his work in a number of international retail, commercial and investment banks.

Report of the Directors

The Directors of Bank of Ireland (UK) plc present their consolidated audited report and financial statements for the year ended 31 December 2018. The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the EU, in accordance with the provisions of the Companies Act 2006. Directors are listed in the Governance section on pages 58 to 61. The Group's structure is set out in note 44 to financial statements and the future developments of the Group are incorporated in the strategic report.

Principal activities
The Bank is an 'authorised institution' under the Financial Services and Markets Act 2000 and is regulated by the FCA and the PRA. The principal activities of the Group are the provision of an extensive range of banking and other financial services in Great Britain and Northern Ireland.

Financial performance
The Group's profit for the year ended 31 December 2018 was £151 million (2017: £130 million). There was no profit or loss attributable to non-controlling interests for the year ended 31 December 2018 (2017: £nil). An analysis of performance is set out in the strategic report on pages 7 to 12.

Dividends
On 23 August 2018 a dividend payment of £70 million was paid to the Parent.

Board membership
The following Directors were appointed during the year and up to the date of signing:

- Philip Moore, Non-Executive, 1 April 2018;
- John Baines, Non-Executive, 1 May 2018;
- Ian Buchanan, Non-Executive, 4 September 2018; and
- Jackie Noakes, Non-Executive, 31 October 2018.

The following Directors resigned during the year and up to the date of signing:

- Lewis Love, Non-Executive, 23 February 2018; and
- Susan Harris, Non-Executive, 31 July 2018.

Corporate governance
It is the Group's policy not to include the disclosures in respect of the voluntary corporate governance codes of practice, as it is a wholly owned subsidiary of the Governor and Company of the Bank of Ireland, a company incorporated by charter in the Republic of Ireland. The ultimate parent is Bank of Ireland Group plc. The Consolidated Annual Report of Bank of Ireland Group plc details the Corporate Governance framework applicable to the Group and its subsidiaries. Bank of Ireland Group plc financial statements are available on www.bankofireland.com or at Bank of Ireland, Head Office, 40 Mespil Road, Dublin 4.

Corporate responsibility
The Group strives to make a positive contribution to the economy by supporting our customers and investing in the communities in which we operate. The Group participates in a number of Parent initiatives including Give Together, a community giving initiative under which employees are supported in raising money and volunteering days for good causes. The Parent is also conscious of its impact on the environment and has taken steps to reduce energy consumption at high usage locations that provide services to the Group.

Further details on the Group's commitment to corporate social responsibility can be found in the strategic report.

Risk management
The Group's principal risks and uncertainties are discussed in the strategic report on pages 19 to 24.

Additional risk disclosures for the Group can be found in the Risk Management section.

Employees
For the year ended 31 December 2018, the Group had an average of 318 direct employees (2017: 277 direct employees) and 406 employees (2017: 438 employees) who work under long-term secondment arrangements from the Parent.

The Group is committed to employment practices and policies which recognise the diversity of the Group's workforce and are based on equal opportunities for all employees. In recruitment and employment practices, the Group does not discriminate against individuals on the basis of any factor which is not relevant to performance including an individuals' sex, race, colour, disability, sexual orientation, marital status or religious beliefs.

The Group has a number of programmes to support colleagues who become disabled or acquire a long-term health condition.

To support continued employment and training, career development and promotion of all employees, the Group provides a suite of learning and development activities which are facilitated in conjunction with the Parent. Through the Group's ongoing employee performance monitoring and appraisal process, incorporating frequent line manager and employee discussions, individual employees are encouraged and supported to pursue their own personal development.

The Group also endeavours to ensure that employees are provided with information on matters of concern to them and encourages active involvement of employees to ensure that their views are taken into account in reaching decisions. To facilitate this, there is regular consultation with employees or their representatives, through regular meetings, bulletins and the use of the Group's intranet, which provides a flexible communication channel for employees.

Political donations
No political donations were made during the year ended 31 December 2018 or in the year ended 31 December 2017.

Voting Rights
Voting at any general meeting is by a show of hands or by poll. The Annual General Meeting of the Group is scheduled to take place on 26 March 2019, and a copy of the Notice of the Meeting will be available on the Group's website when it is issued. The Group is a wholly owned subsidiary of the Governor and Company of the Bank of Ireland. Details of the Parent's shareholding can be found in the Notes to the Accounts in note 37.

Auditors
PwC resigned as auditors during the year and KPMG LLP, Chartered Accountants, were appointed in their place and will continue in office in accordance with Section 489 of the Companies Act 2006.

Going concern
The Directors have considered the appropriateness of the going concern basis in preparing the financial statements, for the year ended 31 December 2018, on page 77 which forms part of the Report of the Directors.

Third party indemnity provision
A qualifying third party indemnity provision (as defined in Section 234 of the Companies Act 2006) was, and remains, in force for the benefit of all Directors of the Group and former Directors who held office during the year. The indemnity is granted under article 137 of the Bank's Articles of Association.

Post balance sheet events
These are described in note 47 to the financial statements.

Financial Statements

Statement of Directors' Responsibilities

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

Company law requires the directors to prepare Group and Bank financial statements for each financial year. Under that law they have elected to prepare the Group and Bank financial statements in accordance with International Financial Reporting Standards as adopted by the EU (IFRSs as adopted by the EU) and applicable law.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Bank and of their profit or loss for that period. In preparing each of the Group and Bank financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the Group and Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the Bank or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Bank and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

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

Audit confirmation

In accordance with Section 418 of the Companies Act 2006, the Directors Report shall include a statement in the case of each Director in office at the date the Director's report is approved, that:

(a) So far as the Director is aware, there is no relevant audit information of which the Group's auditors are unaware; and

(b) He / she 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 Group's auditors are aware of that information.

As approved by the Board and signed on its behalf by:

Thomas McAreavey
Director
8 March 2019

Company Number: 07022885

Independent auditor's report to the member of Bank of Ireland (UK) plc

1. Our opinion is unmodified

We have audited the financial statements of Bank of Ireland (UK) plc ("the Bank") for the year ended 31 December 2018 which comprise the consolidated and Bank balance sheets, consolidated and Bank income statements, consolidated and Bank statements of other comprehensive income, consolidated and Bank statements of changes in equity, consolidated cash flow statement and the related notes, including the accounting policies in note 1.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Bank's affairs as at 31 December 2018 and of the Group's and Bank's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
- the Bank financial statements have been properly prepared in accordance with UK accounting standards, including FRS 101 Reduced Disclosure Framework; and
- the financial statements 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 are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the directors on 1 May 2018. The period of total uninterrupted engagement is for the one financial year ended 31 December 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

Overview

Materiality	**£8.9 million**
Group financial statements as a whole	5% of profit before tax
Coverage	100% of group profit before tax

Key audit matters

- The impact of uncertainties due to the UK exiting the European Union on our audit
- Expected credit losses under IFRS 9 *Financial Instruments*
- Impact of prepayment estimates on the determination of the effective interest rate on mortgages
- The impact of IT access controls on the effectiveness of the control environment

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including 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. We summarise below the key audit matters in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

The impact of uncertainties due to the UK exiting the European Union on our audit
Refer to page 22 (principal risks).

This is relevant to both the Group and Bank financial statements.

The risk	Our response
Unprecedented levels of uncertainty All audits assess and challenge the reasonableness of estimates and judgements, in particular as described in expected credit losses under IFRS 9 and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements (see below). All of these depend on assessments of the future economic environment and the Group's future prospects and performance. Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.	We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included: • **Our Brexit knowledge:** We considered the directors' assessment of Brexit-related sources of risk for the Group's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks. • **Sensitivity analysis:** When addressing IFRS 9 expected credit loss and other areas that depend on forecasts, we compared the directors' analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty and, where forecast cash flows are required to be discounted at a rate other than the original effective interest rate, considered adjustments to discount rates for the level of remaining uncertainty. • **Assessing transparency**: As well as assessing individual disclosures as part of our procedures on IFRS 9 expected credit loss and going concern, we considered all of the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks. *Our results:* As reported under expected credit losses under IFRS 9 we found the resulting estimates and related disclosures of the changes in estimate that occurred during the period and the sensitivity disclosures and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

2. Key audit matters: our assessment of risks of material misstatement (continued)

Expected credit losses under IFRS 9
Expected credit loss provisions on held-to–collect assets
(£160 million; 1 January 2018: £195 million)

Refer to pages 83-85 (accounting policy) and pages 92-93 (critical accounting estimates and judgements) and page 100 and 106-122 (financial disclosures).
This is relevant to both the Group and Bank financial statements.

The risk

Subjective estimate
IFRS 9 was implemented by the Group on 1 January 2018. This new and complex standard requires the Group to recognise expected credit losses ("ECL") on financial instruments which involves significant judgement and estimates and resulted in an increase in credit loss provisions at 1 January 2018 of £40 million to £195 million and subsequent reduction to £160 million during the year. The key areas where we identified greater levels of management judgement and therefore increased levels of audit focus in the Group's implementation of IFRS 9 were:

Model estimations:
The calculation of ECLs uses complex and inherently judgemental modelling techniques. The Probability of Default ("PD") models used in the mortgage and personal loan portfolios are the key drivers of the Group's ECL results and are therefore most significant judgemental aspect of the Group's ECL modelling approach.

Significant Increase in Credit Risk ("SICR"):
For the mortgage and personal loan portfolios, the criteria selected to identify a significant increase in credit risk is a key area of judgement within the Group's ECL calculation as this criteria determines whether a 12 month or lifetime provision is recorded.

Forward looking macroeconomic scenarios:
IFRS 9 requires the Group to measure ECLs on a forward- looking basis reflecting future economic conditions. Significant management judgement is applied to determining the economic scenarios used and the probability weightings applied to them especially for the mortgage portfolio.

Qualitative adjustments:
Adjustments to the model-driven ECL results are raised by management to address known impairment model limitations or emerging trends. They represent £7 million of the ECL. Such adjustments are inherently uncertain and significant management judgement is involved in estimating these amounts for the mortgage portfolio.

The effect of these matters is that, as part of our risk assessment, we determined that the expected credit loss under IFRS 9 has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The credit risk sections of the financial statements disclose the sensitivities estimated by the Group.

Our response

The Bank of Ireland Group plc ("Parent") adopts a centralised approach to modelling ECL, thus our work was performed in conjunction with the auditors of the Parent ("Parent auditors").

Our procedures included:

Controls testing:
We performed end to end process walkthroughs to identify the key systems, applications and controls used in the ECL processes, utilising the work performed by the Parent auditors where the process is centralised. The Parent auditors also tested the general IT controls over key systems used in the process to provide data and calculate the ECL provisions as well as tested relevant IT access and change controls including controls over the model storage applications. Key aspects of our controls testing involved the following:

- For the relevant portfolios, testing the design and operating effectiveness of the key controls over the completeness and accuracy of the key data elements into the IFRS 9 impairment models;
- Testing over SICR criteria also involved testing controls relating to authorisation of the criteria, the validation metrics, and the application of the criteria in the models;
- Evaluating controls over the modelling process, including model monitoring, validation and approval;
- Evaluating controls over model outputs and authorisation and review of post model adjustments and management overlays; and
- Testing key controls relating to selection and implementation of material economic variables and the controls over the scenario selection and probabilities.

Financial risk modelling expertise:
For the relevant portfolios examined, the Parent auditors involved specialists to assist in evaluating the appropriateness of the SICR criteria including evaluating the accuracy of the IFRS 9 models.

Tests of detail:
Key aspects of testing performed by the Parent auditors and our team involved:

- Sample testing over key data elements impacting ECL calculations;
- Involving our economic specialists to assess the reasonableness of the economic forecasts and weights applied;
- Reperforming key aspects of the Group's SICR calculations and selecting samples of financial instruments to determine whether a SICR was appropriately identified;
- Reperforming key elements of model calculations and assessing backtesting results; and
- Evaluating post model adjustments and management overlays in order to assess the reasonableness of the adjustments by challenging key assumptions and inspecting the calculation.

In respect of both controls and tests of detail performed by Parent auditors, we were involved in the planning of their work, we had regular discussions throughout the audit and have reviewed the work that they have performed. Our review of the Parent auditors work included reviews performed by financial risk modelling and economic specialists.

Assessing transparency:
We assessed whether the disclosures appropriately disclose and address the uncertainty which exists when determining the expected credit losses. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we assessed whether the disclosure of the key judgements and assumptions made was sufficiently clear.

Our results:
We considered the ECL charge and provision recognised to be acceptable.

2. Key audit matters: our assessment of risks of material misstatement (continued)

Impact of prepayment estimates on the determination of the effective interest rate on mortgages
Refer to page 78 (accounting policy) and page 94 (critical accounting estimates and judgements)

This is relevant to both the Group and Bank financial statements.

The risk	Our response
Subjective estimate Interest earned and fees earned and incurred on loans and advances to customers are recognised using the effective interest rate ("EIR") method that spreads directly attributable expected income over the expected lives of the loans. This requires management to apply judgement in estimating the expected lives of the mortgage portfolios. This judgement is informed by past customer behaviour of when loans are repaid, with the EIR balance and amount recognised in the profit or loss being highly sensitive to minor changes in assumptions. In recent years, mortgage prepayment trends have varied significantly across the UK mortgage market and, as such, we identified greater levels of management judgement and have placed increased levels of audit focus on these assumptions. These assumptions impact both the acquired mortgage portfolio, as this was acquired at a discount, with any change in the expected life requiring the discount to be adjusted and spread over the remaining expected life, and to the portfolio which was originated since the incorporation of the Company. The expected life assumptions utilise repayment profiles which represent how customers are expected to repay. The effect of these matters is that, as part of our risk assessment, we determined that the impact of prepayment estimates on the determination of the effective interest rate on mortgages has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The critical accounting estimates and judgements note in the financial statements discloses the sensitivities estimated by the Group.	Our procedures included: ***Controls testing:*** We performed an end to end process walkthrough to identify the key applications and controls. We tested design, implementation and operating effectiveness of key controls relating to authorisation and review of management assumptions regarding EIR assets and liabilities. ***Tests of detail:*** • We critically assessed the expected customer lives and methodology used to make the estimate against our own knowledge of industry experience and trends, as well as independently modelling the redemption curve used by the Bank for non-acquired mortgages only. ***Sensitivity analysis:*** • We performed sensitivity analysis using parameters determined by us for judgemental assumptions, including expected customer lives, to critically assess which of these the EIR asset is most sensitive to. ***Historical comparison:*** • We evaluated the expected life assumptions against the Bank's historical experience of mortgage loans customers behaviour, and the back testing performed by management to support the assumptions for both the acquired and non-acquired portfolios. ***Assessing transparency:*** • We also considered the adequacy of the Bank's disclosures about the changes in estimate that occurred during the period and the sensitivity disclosures across the key loan books. ***Our results:*** We consider the EIR adjustments to interest income to be acceptable.

The impact of IT access controls on the effectiveness of the control environment
This is relevant to both the Group and Bank financial statements.

The risk	Our response
Data capture As with many banks, the Group is highly dependent on IT systems for the processing and recording of significant volumes of transactions. Our audit approach relies extensively on automated controls and therefore on the effectiveness of controls over IT systems. In common with many UK banks, the Group has been improving its IT user access controls in recent years. The Parent Group has an ongoing risk management programme in place to identify, rate, mitigate and report on risk including user access controls. We regard this area as a key audit matter owing to the high level of IT dependency within the Group as well as the associated complexity and the risk that automated controls are not designed and operating effectively. In particular we consider IT user access management controls to be critical in ensuring that only approved changes to applications and underlying data are authorised and made appropriately. Moreover, appropriate access controls contribute to mitigating the risk of potential fraud or error as a result of changes to applications and data. The Group has a complex IT environment and operates a large number of applications, many of which are legacy systems.	The Parent adopts a centralised approach to IT access controls, thus our work has performed in conjunction with the Parent auditors. Our procedures included: ***Controls testing:*** • We evaluated the design and operating effectiveness of the controls over the continued integrity of the IT systems that are relevant to financial reporting; • We examined the design of the governance framework associated with the Group's IT architecture. We tested relevant general IT controls for IT applications we considered relevant to the financial reporting process, including access management, performance development and change management; and • We also tested the design, implementation and operating effectiveness of key IT application controls, including the configuration, security and accuracy of end user computing controls. ***Test of detail:*** • Where IT controls could not be relied upon, we conducted additional tests of detail and where relevant, we determined whether compensating controls were effective mitigants for any design or operating deficiencies. In respect of both controls and tests of detail performed by Parent auditors, we were involved in the planning of their work, we have had regular discussions throughout the audit and have reviewed the work that they have performed. ***Our results:*** While we identified certain design and operating effectiveness deficiencies with user access, the combination of our controls and substantive testing provided us with sufficient evidence to rely on the operation of the Group's IT systems for the purposes of our audit.

3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £8.9m, determined with reference to a benchmark of Group profit before tax, of which it represents 5%.

Materiality for the Bank financial statements as a whole was set at £8.3m, determined with reference to a benchmark of profit before taxation, of which it represents 5%.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.45m, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the Group’s 10 reporting components, we subjected three to full scope audits for group purposes and one to specified risk-focused audit procedures. The latter were not individually financially significant enough to require a full scope audit for Group purposes, but did present specific individual risks that needed to be addressed.

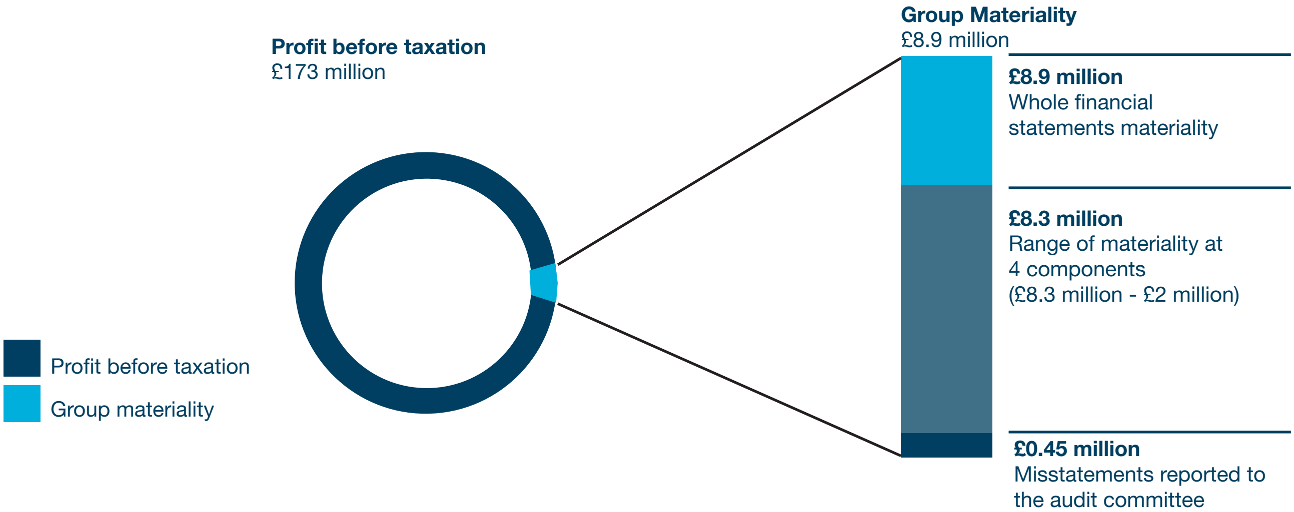
The components within the scope of our work accounted for the percentages illustrated opposite.

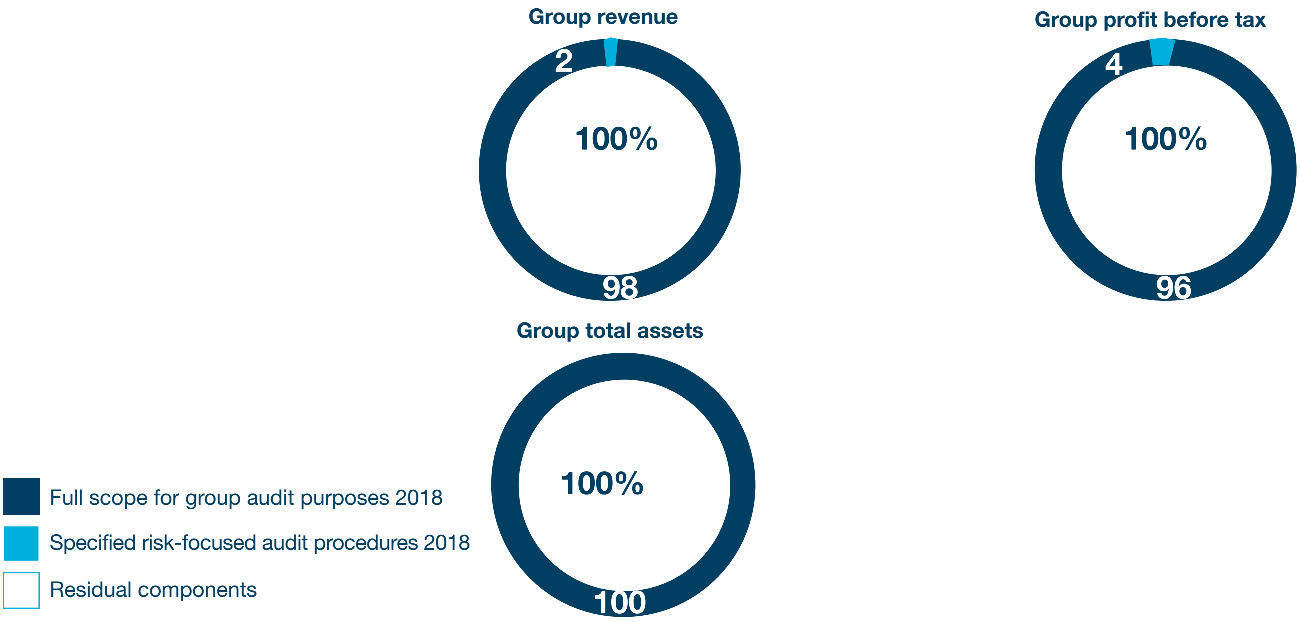
For the residual components, we performed analysis at an aggregated Group level to re-examine our assessment that there were no significant risks of material misstatement within these.

The components for which we performed work other than audits for Group reporting purposes were not individually significant but were included in the scope of our Group reporting work in order to provide further coverage over the group's results.

The Group audit team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved the component materialities, which ranged from £2m to £8.3m, having regard to the mix of size and risk profile of the Group across the components. The work on two of the four components was performed by component auditors and the rest, including the audit of the Bank, was performed by the Group team.

The Group audit team visited three component auditor locations. Telephone conference meetings were also held with these component auditors. At these visits and telephone conference meetings, an assessment was made of audit risk and strategy, the findings reported to the Group audit team were discussed in more detail, key working papers were inspected and any further work required by the Group audit team was then performed by the component auditor.





4. We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Bank or the Group or to cease their operations, and as they have concluded that the Bank’s and the Group’s financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements (“the going concern period”).

Our responsibility is to conclude on the appropriateness of the Directors’ conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Group or the Bank will continue in operation.

In our evaluation of the Directors’ conclusions, we considered the inherent risks to the Group’s and Bank’s business model and analysed how those risks might affect the Group’s and Bank’s financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Group’s and Bank’s available financial resources over this period were:
- availability of funding and liquidity in the event of a market wide stress scenario including the impact of Brexit, and
- impact on regulatory capital requirements in the event of an economic slowdown or recession.

As these were risks that could potentially cast significant doubt on the Group’s and the Bank's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Group’s financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise.

Based on this work, we are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

5. We have nothing to report on the strategic report and the Directors’ report

The Directors are responsible for the strategic report and the Directors’ report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the Directors’ report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:
- we have not identified material misstatements in those reports;
- in our opinion the information given in the strategic report and the Directors’ report for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

6. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion
- adequate accounting records have not been kept by the Bank, or returns adequate for our audit have not been received from branches not visited by us; or
- the Bank financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors’ remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities
As explained more fully in their statement set out on page 63, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and 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 they either intend to liquidate the Group or the Bank or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities
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 other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect
We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the Directors and other management (as required by auditing standards) and from inspection of the Group's regulatory correspondence and discussed with the Directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. This included communication from the Group to component audit teams of relevant laws and regulations identified at the Group level.

The potential effect of these laws and regulations on the financial statements varies considerably. Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation. We assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items. Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Group's license to operate. We identified the following areas as those most likely to have such an effect: specific areas of regulatory capital and liquidity, conduct, money laundering, sanctions list and financial crime, recognising the financial and regulated nature of the Group's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the Directors and other management and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Bank'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 Bank's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's member, as a body, for our audit work, for this report, or for the opinions we have formed.

J Bingham

Jonathan Bingham
(Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London, E14 5GL

8 March 2019

Financial Statements

Income statement *(for the year ended 31 December 2018)*

	Note	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Interest income calculated using the effective interest method	4	630	593	656	614
Interest income on finance leases and hire purchase receivables	4	65	58	-	-
Total interest income		**695**	**651**	**656**	**614**
Interest expense	5	(187)	(180)	(188)	(181)
Net interest income		**508**	**471**	**468**	**433**
Other leasing income	6	46	3	-	-
Other leasing expense	6	(37)	(2)	-	-
Net leasing income		**9**	**1**	**-**	**-**
Fee and commission income	7	104	114	103	113
Fee and commission expense	7	(110)	(115)	(109)	(115)
Net trading income / (expense)	8	5	(1)	5	(1)
Other operating income[1]	9	9	1	72	56
Total operating income		**525**	**471**	**539**	**486**
Operating expenses	10	(351)	(328)	(332)	(314)
Operating profit before impairment charges on financial assets		**174**	**143**	**207**	**172**
Net impairment losses on financial instruments	12	(34)	(26)	(32)	(24)
Operating profit		**140**	**117**	**175**	**148**
Share of profit after tax of joint venture	13	33	34	-	-
Profit before taxation		**173**	**151**	**175**	**148**
Taxation charge	14	(22)	(21)	(17)	(17)
Profit for the year		**151**	**130**	**158**	**131**

Statement of other comprehensive income *(for the year ended 31 December 2018)*

	Note	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Profit for the year		**151**	**130**	**158**	**131**
Items that may be reclassified to profit or loss in subsequent periods					
Net change in cash flow hedge reserve (net of tax)[2]		(17)	(9)	(17)	(9)
Total items that may be reclassified to profit or loss in subsequent periods		**(17)**	**(9)**	**(17)**	**(9)**
Items that will not be reclassified to profit or loss in subsequent periods					
Net actuarial (loss) / gain on defined benefit schemes[3]	34	(1)	6	-	-
Net change in revaluation reserve, net of tax		1	1	1	1
Total items that will not be reclassified to profit or loss in subsequent periods		**-**	**7**	**1**	**1**
Other comprehensive expense for the year, net of tax		**(17)**	**(2)**	**(16)**	**(8)**
Total comprehensive income for the year, net of tax		**134**	**128**	**142**	**123**

[1] *Other operating income for the Group for 2017 has been restated as net leasing income of £1 million, previously included in other operating income, is now presented separately in the income statement to align with the presentation for 2018.*

[2] *Net of tax credit £6 million (2017: credit £3 million).*

[3] *Net of tax £0.1 million (2017: £1 million).*

Balance sheet *(as at 31 December 2018)*

	Note	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Assets					
Cash and balances at central banks	15	2,567	1,836	2,567	1,836
Items in the course of collection from other banks		168	192	168	192
Derivative financial instruments	16	32	27	32	27
Loans and advances to banks	17	2,348	2,764	2,331	2,625
Debt securities at amortised cost	18	915	-	915	-
Available for sale financial assets	19	-	1,008	-	1,008
Loans and advances to customers	20	19,703	19,997	19,860	20,289
Assets classified as held for sale	22	539	-	539	-
Investment in subsidiaries		-	-	8	8
Interest in joint venture	23	62	61	2	2
Intangible assets and goodwill	24	54	61	14	19
Property, plant and equipment	26	117	104	24	23
Other assets	27	102	106	97	102
Deferred tax assets	28	85	71	80	65
Retirement benefit asset	34	8	8	-	-
Total assets		**26,700**	**26,235**	**26,637**	**26,196**
Equity and liabilities					
Deposits from banks	29	3,152	3,561	3,148	3,554
Customer accounts	30	19,769	18,961	19,824	19,045
Items in the course of transmission to other banks		106	108	106	108
Derivative financial instruments	16	43	65	43	65
Current tax liabilities		4	5	2	3
Other liabilities	31	1,318	1,233	1,298	1,217
Provisions	32	7	13	6	12
Loss allowance provision on loan commitments and financial guarantees	33	7	-	7	-
Subordinated liabilities	35	290	290	290	290
Total liabilities		**24,696**	**24,236**	**24,724**	**24,294**
Equity					
Share capital	37	851	851	851	851
Retained earnings		279	254	188	157
Other reserves		574	594	574	594
Other equity instruments	38	300	300	300	300
Total equity attributable to owners of the Bank		**2,004**	**1,999**	**1,913**	**1,902**
Total equity and liabilities		**26,700**	**26,235**	**26,637**	**26,196**

The financial statements on pages 71 to 161 were approved by the Board on 8 March 2019 and were signed on its behalf by:

Thomas McAreavey
Director
8 March 2019

Company Number: 07022885

Statement of changes in equity *(for the year ended 31 December 2018)*

		Group		Bank	
	Note	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Share capital					
Balance at 1 January		851	851	851	851
Balance at 31 December		**851**	**851**	**851**	**851**
Retained earnings					
Balance at 1 January		254	296	157	204
Impact of adopting IFRS 9 at 1 January 2018, net of tax	46	(37)	-	(39)	-
Restated balance at 1 January 2018		217	-	118	-
Profit for the year attributable to equity holders of the Bank		151	130	158	131
Dividend on ordinary shares		(70)	(160)	(70)	(160)
Distribution on other equity instruments - Additional tier 1 coupon, net of tax[1]		(18)	(18)	(18)	(18)
Remeasurement of the net defined benefit pension liability		(1)	6	-	-
Balance at 31 December		**279**	**254**	**188**	**157**
Other equity instruments					
Balance at 1 January		300	300	300	300
Balance at 31 December		**300**	**300**	**300**	**300**
Other reserves:					
Available for sale reserve					
Balance at 1 January		4	5	4	5
Impact of adopting IFRS 9 at 1 January 2018, net of tax	46	(4)	-	(4)	-
Restated balance at 1 January 2018		-	-	-	-
Changes in fair value, net of hedge accounting adjustments		-	(1)	-	(1)
Transfer to income statement (pre tax)		-	-	-	-
Deferred tax on reserve movements		-	-	-	-
Balance at 31 December		**-**	**4**	**-**	**4**
Revaluation reserve - property					
Balance at 1 January		1	-	1	-
Revaluation of property		1	1	1	1
Balance at 31 December		**2**	**1**	**2**	**1**
Cash flow hedge reserve					
Balance at 1 January		23	32	23	32
Changes in fair value		(11)	3	(11)	3
Transfer to income statement (pre tax)		(12)	(15)	(12)	(15)
Deferred tax on reserve movements		6	3	6	3
Balance at 31 December		**6**	**23**	**6**	**23**
Capital contribution					
Balance at 1 January		266	266	266	266
Balance at 31 December		**266**	**266**	**266**	**266**
Capital redemption reserve fund					
Balance at 1 January		300	300	300	300
Balance at 31 December		**300**	**300**	**300**	**300**
Total other reserves		**574**	**594**	**574**	**594**
Total equity		**2,004**	**1,999**	**1,913**	**1,902**
Included in the above:					
Total comprehensive income attributable to owners of the Bank		134	128	142	123
Total comprehensive income for the year		**134**	**128**	**142**	**123**

[1] *The Additional tier 1 coupon paid to the Parent of £18 million (2017: £18 million) is presented net of the related tax credit of £6 million (2017: £6 million), comprising £5 million (2017: £5 million) relating to current tax and £1 million (2017: £1 million) relating to deferred tax.*

Consolidated cash flow statement *(for the year ended 31 December 2018)*

	Note	2018 £m	2017 £m
Cash flows from operating activities			
Profit before taxation		173	151
Interest expense on subordinated liabilities and other capital instruments	5	13	24
Depreciation and amortisation	10,18, 26	31	11
Net impairment (gains) / losses on financial instruments	12	34	26
Share of results of joint venture	13	(33)	(34)
Net change in prepayments and interest receivable	27	10	6
Net change in accruals and interest payable	31	9	(24)
Charge for provisions	32	5	11
Other non-cash items		10	20
Cash flows from operating activities before changes in operating assets and liabilities		**252**	**191**
Net change in items in the course of collection to / from banks		22	(38)
Net change in derivative financial instruments		(36)	(4)
Net change in loans and advances to banks		350	571
Net change in loans and advances to customers including assets classified as held for sale		(327)	(217)
Net change in deposits from banks		(409)	800
Net change in customer accounts		807	(514)
Net change in provisions		(11)	(14)
Net change in retirement benefit obligation		(2)	(2)
Net change in other assets and other liabilities		70	46
Net cash flow from operating assets and liabilities		**464**	**628**
Net cash flow from operating activities before taxation		**716**	**819**
Taxation paid		(13)	(14)
Net cash flow from operating activities		**703**	**805**
Investing activities (section (a) - see next page)		78	89
Financing activities (section (b) - see next page)		(107)	(253)
Net change in cash and cash equivalents		**674**	**641**
Opening cash and cash equivalents		3,640	2,999
Closing cash and cash equivalents	15	**4,314**	**3,640**

Consolidated cash flow statement *(for the year ended 31 December 2018) (continued)*

	Note	**2018 £m**	2017 £m
(a) Investing activities			
Acquisition of a subsidiary, net of cash acquired	25	-	(41)
Additions to available for sale financial assets	19	-	(82)
Redemptions and disposals of available for sale financial assets	19	-	198
Additions to debt securities at amortised cost	18	(156)	-
Disposal / redemption of debt securities at amortised cost	18	232	-
Dividends received from joint venture	13	33	34
Additions to intangible assets	24	-	(1)
Additions to property, plant and equipment	26	(43)	(19)
Disposal of property, plant and equipment		12	-
Cash flows from investing activities		**78**	**89**
(b) Financing activities			
Dividend paid on ordinary shares	42	(70)	(160)
Additional tier 1 coupon paid	42	(24)	(24)
Interest paid on subordinated liabilities	5	(13)	(24)
Repurchase of subordinated liabilities	35	-	(135)
Issue of subordinated liabilities	35	-	90
Cash flows from financing activities		**(107)**	**(253)**

Notes to the Financial Statements

1 Accounting policies

Basis of preparation

These financial statements are the consolidated financial statements of Bank of Ireland (UK) plc ('the Bank') and its subsidiaries (collectively the 'Group'), and the separate financial statements of the Bank.

The financial statements comprise the Consolidated and Bank income statements, the Consolidated and Bank statements of other comprehensive income, the Consolidated and Bank balance sheets, the Consolidated and Bank statements of changes in equity, the Consolidated cash flow statement and the notes to the Consolidated and Bank financial statements. The financial statements include the information that is described as being an integral part of the audited financial statements contained in sections 2.1, 2.2, 2.3 and 3 of the Risk Management Report.

The separate financial statements of the Bank reflect the financial position of the Bank only and do not consolidate the results of any subsidiaries.

The consolidated financial statements of the Group are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS and with the European Union (Credit Institutions: Financial Statements) Regulations, 2015.

The financial statements of the Bank are prepared under FRS 101 'Reduced disclosure framework' and in accordance with the Companies Act 2006. In preparing these financial statements the Bank applies the recognition, measurement and disclosure requirements of IFRS as adopted by the EU. The Bank has applied the exemptions available under FRS 101 in respect of the following disclosures:

- the requirements of IAS 7 Statement of Cash Flows;
- disclosure requirements of IAS 24 in respect of transactions with wholly-owned subsidiaries;
- certain requirements of IAS 1 'Presentation of financial statements'; and
- the effects of new but not yet effective IFRSs (IAS 8).

The financial statements have been prepared on the going concern basis, in accordance with IFRS and IFRS IC interpretations, as adopted for use in the EU and as applied in accordance with the provisions of the Companies Act 2006.

The financial statements have been prepared under the historical cost convention, as modified to include the fair valuation of certain financial instruments. The preparation of the financial statements in conformity with IFRS or FRS 101 requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting year. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. A description of the critical estimates and judgements is set out on pages 92 to 94.

Going concern

The time period that the Directors have considered in evaluating the appropriateness of the going concern basis in preparing the financial statements for the year ended 31 December 2018 is a period of twelve months from the date of approval of these financial statements ('the period of assessment'). In making this assessment, the Directors considered the Group's business, profitability projections, liquidity, funding and capital plans, under both base and plausible stress scenarios, together with a range of other factors such as the outlook for the UK economy and the impact of Brexit. The Directors also considered the position of the Bank's parent, the Governor and Company of the Bank of Ireland as, in addition to being the Bank's sole shareholder, it is a provider of significant services to the Bank under outsourcing arrangements.
The matters of primary consideration by the Directors are set out below:

Capital
The Group has developed capital plans under both base and stress scenarios and the Directors believe that the Group has sufficient capital to meet its regulatory capital requirements throughout the period of assessment.

Funding and liquidity
The Directors have considered the Group's funding and liquidity position and are satisfied that the Group has sufficient funding and liquidity throughout the period of assessment, including sufficient collateral for further funding if required from the Bank of England.

The Bank's Parent
The Bank's Parent is its sole shareholder and provider of capital and is also a major provider of services under outsourcing arrangements.

The Directors note that the Court of the Bank's Parent has concluded that there are no material uncertainties that may cast significant doubt about the Bank of Ireland Group's ability to continue as a going concern and that it is appropriate to prepare accounts on a going concern basis. The audit report on the financial statements of the Bank's Parent is not qualified and does not contain an emphasis of matter paragraph in respect of going concern.

Conclusion
On the basis of the above, the Directors consider it appropriate to prepare the financial statements on a going concern basis having concluded that there are no material uncertainties related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern over the period of assessment.

Comparatives

Comparative information has been amended where necessary to ensure consistency with the current period.

Adoption of new accounting standards

The following new standards have been adopted and consistently applied by the Group during the year ended 31 December 2018:

- IFRS 9 'Financial Instruments';
- Amendment to IFRS 9 'Prepayment features with negative compensation'; and
- IFRS 15 'Revenue from Contracts with Customers'.

Further detail on the impact of the adoption of these standards is set below.

The Group has not early adopted any standard, interpretation or amendment that has been issued but is not yet effective.

The Group's accounting policies have been updated for the application of IFRS 9 and IFRS 15 from 1 January 2018. The

1 Accounting policies *(continued)*

updates together with the accounting policies for the comparative period up to 31 December 2017 are detailed below:

IFRS 9 'Financial instruments'
IFRS 9 'Financial instruments' replaces IAS 39 'Financial instruments: recognition and measurement'. It sets out requirements relating to recognition and derecognition, classification, measurement and hedge accounting. IFRS 9 retains but simplifies the mixed measurement model. Financial assets within its scope are required to be classified as being measured, subsequent to initial recognition, at amortised cost, fair value through other comprehensive income or fair value through profit or loss.

The classification is dependent on both the overall objective of the business model within which the asset is held and the contractual cash flow characteristics of the asset. Impairment under IFRS 9 is forward-looking and is based on expected rather than incurred losses. For financial liabilities, there is no change to classification and measurement except for recognition of changes in own credit risk in other comprehensive income for certain liabilities designated at fair value through profit or loss. The Group has made the accounting policy choice allowed under IFRS 9 to continue to apply the hedge accounting requirements of IAS 39.

The financial statements for the comparative period have not been restated to reflect the change. The effect of adoption of IFRS 9 is explained further in note 46.

Presentation
IFRS 9 amends IAS 1 'Presentation of financial statements' to require certain items to be presented as line items in the income statement, including impairment gains or losses, gains or losses arising from the derecognition of financial assets measured at amortised cost and interest revenue calculated using the effective interest method. Accordingly, interest income on financial assets calculated using the effective interest method is now presented separately from interest income on finance leases, recognised based on a pattern reflecting a constant periodic rate of return on the net investment in the lease.

IFRS 15 'Revenue from contracts with customers'
IFRS 15 specifies how and when an entity recognises revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard provides a single principles-based five-step model to be applied to all contracts with customers. The standard does not impact income recognition related to financial instruments within the scope of IFRS 9 and leases within the scope of IAS 17.

IFRS 15 did not have a material impact on the Group's financial statements.

Interest income and expense
Interest income and expense are recognised in the income statement using the effective interest method for financial instruments measured at amortised cost and financial assets which are debt instruments measured at fair value through other comprehensive income in accordance with IFRS 9. Interest income and expense from derivative financial instruments designated as hedging instrument are accounted for in net interest income, in line with the underlying hedged asset or liability. Interest in relation to derivatives not designated as a hedging instrument is included in trading income.

The effective interest method is the method that is used in the calculation of the amortised cost of a financial asset or liability and in the allocation and recognition of interest revenue or interest expense in profit or loss over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability.

When calculating the effective interest rate, the Group estimates the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but does not consider the expected credit losses (except in accordance with IFRS 9,in the case of purchased or originated credit-impaired financial assets where expected credit losses are included in the calculation of a 'credit-adjusted effective interest rate'). The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.
From 1 January 2018, in the case of a financial asset that is neither credit-impaired nor a purchased or originated credit-impaired financial asset, interest revenue is calculated by applying the effective interest rate to the gross carrying amount.

In the case of a financial asset that is not a purchased or originated credit-impaired financial asset but is credit-impaired at the reporting date, interest revenue is calculated by applying the effective interest rate to the amortised cost, which is the gross carrying amount adjusted for any impairment loss allowance.

In the case of a purchased or originated credit-impaired financial asset, interest revenue is recognised by applying the credit-adjusted effective interest rate to the amortised cost.

Where the Group revises its estimates of payments or receipts on a financial instrument (excluding modifications of a financial asset and changes in expected credit losses under the requirements of IFRS 9), it recalculates the gross carrying amount of the financial asset or amortised cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instrument's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets under IFRS 9). The adjustment is recognised as interest income or expense.

Modifications
From 1 January 2018, where the contractual cash flows of a financial asset are modified and the modification does not result in derecognition of the financial asset, the Group recalculates the gross carrying amount of the financial asset as the present value of the modified contractual cash flows that are discounted at the financial asset's original effective interest rate and recognises a modification gain or loss in the income statement. Where a modification is a forbearance measure which does not result in derecognition, the modification gain or loss is included in the income statement within net impairment gains or losses. Otherwise, the modification gain or loss is included within interest income.

Under both IFRS 9 and IAS 39, interest income and expense excludes interest on financial instruments at fair value through profit or loss which is instead included

1 Accounting policies *(continued)*

within the fair value movements recognised within net trading income.

Fee and commission income

The Group accounts for fee and commission income which is not an integral part of the effective interest rate of a financial instrument, when the contract with the customer is agreed and each party's rights under the contract, together with the payment terms, are identified. In addition it must be probable that the Group will collect the consideration to which it is entitled. Fee and commission income is measured based on the consideration specified in a contract with a customer and excludes amounts collected on behalf of third parties. The Group recognises revenue when it transfers control of a product or service to a customer. Fee income on the provision of current accounts to customers is recognised as the service is provided. Loan syndication and arrangement fees are recognised at a point in time when the performance obligation is completed. Other fees including interchange income, ATM fees and foreign exchange fees are recognised on completion of the transaction and once the Group has completed its performance obligations under the contract.

Previously, under IAS 18 up to 31 December 2017, fees and commissions which were not an integral part of the effective interest rate of a financial instrument were generally recognised as the related services were provided.

Financial assets

(1) Recognition, classification and measurement:

From 1 January 2018, the Group applies the following accounting policies to the classification, recognition and measurement policies to financial assets. A financial asset is recognised in the balance sheet when, and only when, the Group becomes a party to its contractual provisions. At initial recognition, a financial asset is measured at fair value (plus, in the case of a financial asset not at fair value through profit or loss, directly attributable transaction costs) and is assigned one of the following classifications for the purposes of subsequent measurement:

- financial assets at amortised cost;
- financial assets at fair value through other comprehensive income; or
- financial assets at fair value through profit or loss.

The Group determines the appropriate classification based on the contractual cash flow characteristics of the financial asset and the objective of the business model within which the financial asset is held.

In determining the business model for a group of financial assets, the Group considers factors such as how performance is evaluated and reported to key management personnel; the risks that affect performance and how they are managed; how managers are compensated; and the expected frequency, value and timing of sales of financial assets.

In considering the contractual cash flow characteristics of a financial asset, the Group determines whether the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. In this context, 'principal' is the fair value of the financial asset on initial recognition and 'interest' is consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin. In making the determination, the Group assesses whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making this assessment, the Group considers contingent events, leverage features, prepayment and term extensions, terms which limit the Group's recourse to specific assets and features that modify consideration of the time value of money.

(a) Financial assets at amortised cost.

Debt instruments

A debt instrument is measured, subsequent to initial recognition, at amortised cost where it meets both of the following conditions and has not been designated as measured at fair value through profit or loss:

- the financial asset has contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding; and
- the financial asset is held within a business model whose objective is achieved by holding financial assets to collect contractual cash flows.

Purchases and sales of debt securities at amortised cost are recognised on trade date: the date on which the Group commits to purchase or sell the asset. Loans measured at amortised cost are recognised when cash is advanced to the borrowers.

Interest revenue using the effective interest method is recognised in the income statement. An impairment loss allowance is recognised for expected credit losses with corresponding impairment gains or losses recognised in the income statement.

(b) Financial assets at fair value through other comprehensive income

Debt instruments

A debt instrument is measured, subsequent to initial recognition, at fair value through other comprehensive income where it meets both of the following conditions and has not been designated as measured at fair value through profit or loss:

- the financial asset has contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding; and
- the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

Gains and losses arising from changes in fair value are included in other comprehensive income. Interest revenue using the effective interest method and foreign exchange gains and losses on the amortised cost of the financial asset are recognised in

1 Accounting policies *(continued)*

the income statement. The impairment loss allowance for expected credit losses does not reduce the carrying amount but an amount equal to the allowance is recognised in other comprehensive income as an accumulated impairment amount, with corresponding impairment gains or losses recognised in the income statement. On derecognition, the cumulative gain or loss previously recognised in other comprehensive income is reclassified to the income statement.

Equity instruments
Where an irrevocable election has been made by the Group at initial recognition, an investment in an equity instrument that is neither 'held for trading' nor contingent consideration recognised by the Group in a business combination to which IFRS 3 'Business combinations' applies, is measured at fair value through other comprehensive income. Amounts presented in other comprehensive income are not subsequently transferred to profit or loss. Dividends on such investments are recognised in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment.

Regular way purchases and sales of financial assets measured at fair value through other comprehensive income are recognised on trade date.

(c) Financial assets at fair value through profit or loss
All other financial assets are measured, subsequent to initial recognition, at fair value through profit or loss. Financial assets at fair value through profit or loss comprise:

Financial assets mandatorily measured at fair value through profit or loss
Financial assets meeting either of the conditions below are mandatorily measured at fair value through profit or loss (other than in respect of an equity investment designated as at fair value through other comprehensive income):

- financial assets with contractual terms that do not give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding; and
- financial assets held within a business model whose objective is achieved neither by collecting contractual cash flows nor both collecting contractual cash flows and selling financial assets. This includes financial assets held within a portfolio that is managed and whose performance is evaluated on a fair value basis. It further includes portfolios of financial assets which are 'held for trading', which includes financial assets acquired principally for the purpose of selling in the near term and financial assets that on initial recognition are part of an identified portfolio where there is evidence of a recent pattern of short-term profit-taking.

Financial assets designated as measured at fair value through profit or loss
A financial asset may be designated at fair value through profit or loss only if doing so eliminates or significantly reduces measurement or recognition inconsistencies (an 'accounting mismatch') that would otherwise arise from measuring financial assets or liabilities or recognising gains and losses on them on different bases.

Regular way purchases and sales of financial assets at fair value through profit or loss are recognised on trade date. They are carried on the balance sheet at fair value, with all changes in fair value included in the income statement.

(2) Reclassification
When, and only when, the Group changes its business model for managing financial assets, it reclassifies all affected financial assets. Reclassification is applied prospectively from the reclassification date, which is the first day of the first reporting period following the change in business model that results in the reclassification. Any previously recognised gains, losses or interest are not restated.

(3) Derecognition
A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire or the Group has transferred substantially all the risks and rewards of ownership. Where a modification results in a substantial change to the contractual cash flows of a financial asset, it may be considered to represent expiry of the contractual cash flows, resulting in derecognition of the original financial asset and recognition of a new financial asset at fair value. The Group reduces the gross carrying amount of a financial asset and the associated impairment loss allowance when it has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof.

Impairment of financial instruments

Scope
The Group recognises impairment loss allowances for expected credit losses (ECL) on the following categories of financial instruments unless measured at fair value through profit or loss:

- financial assets that are debt instruments;
- loan commitments;
- lease receivables recognised under IAS 17 'Leases';
- financial guarantee contracts issued and not accounted for under IFRS 4 'Insurance contracts';
- receivables and contract assets recognised under IFRS 15 'Revenue from contracts with customers'.

Basis for measuring impairment
The Group allocates financial instruments into the following categories at each reporting date to determine the appropriate accounting treatment.

Stage 1: 12-month ECL (not credit-impaired)
These are financial instruments where there has not been a significant increase in credit risk since initial recognition. An impairment loss allowance equal to 12-month ECL is recognised. This is the portion of lifetime ECL resulting from default events that are possible within the next 12 months.

1 Accounting policies *(continued)*

Stage 2: Lifetime ECL (not credit-impaired)
These are financial instruments where there has been a significant increase in credit risk since initial recognition but which are not credit-impaired. An impairment loss allowance equal to lifetime ECL is recognised. Lifetime ECL are the ECL resulting from all possible default events over the expected life of the financial instrument.

Stage 3: Lifetime ECL (credit-impaired)
These are financial instruments which are credit-impaired at the reporting date but were not credit-impaired at initial recognition. An impairment loss allowance equal to lifetime ECL is recognised.

Purchased or originated credit-impaired financial assets
These are financial assets that were credit-impaired at initial recognition. They are not subject to any initial impairment loss allowance but an impairment loss allowance is subsequently recognised for the cumulative changes in lifetime ECL since initial recognition. A purchased or originated credit-impaired financial asset remains classified as such until it is derecognised, even if assessed as no longer credit-impaired at a subsequent reporting date.

With the exception of purchased or originated credit-impaired financial assets, a financial instrument may migrate between stages from one reporting date to the next.

Significant increase in credit risk
In determining if a financial instrument has experienced a significant increase in credit risk since initial recognition, the Group assesses whether the risk of default over the remaining expected life of the financial instrument is significantly higher than had been anticipated at initial recognition, taking into account changes in prepayment expectations where relevant. The Group uses reasonable and supportable information available without undue cost or effort at the reporting date, including forward-looking information. A combination of quantitative, qualitative and backstop indicators are generally applied in making the determination. For certain portfolios, the Group assumes that no significant increase in credit risk has occurred if credit risk is 'low' at the reporting date.

Credit-impaired
A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows have occurred. Evidence that a financial asset is credit-impaired includes observable data about the following events:
(a) significant financial difficulty of the issuer or the borrower;
(b) a breach of contract, such as a default or past due event;
(c) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;
(d) it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
(e) the disappearance of an active market for that financial asset because of financial difficulties; or
(f) the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

It may not be possible to identify a single discrete event - instead, the combined effect of several events may have caused financial assets to become credit-impaired.

Measurement of ECL and presentation of impairment loss allowances
ECL are measured in a way that reflects:
(a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
(b) the time value of money; and
(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

ECLs are measured as follows:
- Financial assets that are not credit-impaired at the reporting date: the present value of the difference between all contractual cash flows due to the Group in accordance with the contract and all the cash flows the Group expects to receive.
- Financial assets that are credit-impaired at the reporting date: the difference between the gross carrying amount and the present value of estimated future cash flows.
- Undrawn loan commitments: the present value difference between the contractual cash flows that are due to the Group if the commitment is drawn and the cash flows that the Group expects to receive.
- Financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Group expects to recover, discounted at an appropriate risk-free rate.

For financial assets, the discount rate used in measuring ECL is the effective interest rate (or 'credit-adjusted effective interest rate' for a purchased or originated credit-impaired financial asset) or an approximation thereof. For undrawn loan commitments, it is the effective interest rate, or an approximation thereof, that will be applied when recognising the financial asset resulting from the loan commitment.

Impairment loss allowances for ECLs are presented in the financial statements as follows:
- Financial assets at amortised cost: as a deduction from the gross carrying amount in the balance sheet.
- Loan commitments and financial guarantee contracts: generally, as a provision in the balance sheet.
- Debt instruments at fair value through other comprehensive income: an amount equal to the allowance is recognised in other comprehensive income as an accumulated impairment amount.

Utilisation of impairment loss allowances
The Group reduces the gross carrying amount of a financial asset and the associated impairment loss allowance when it has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. Indicators that there is no reasonable expectation of recovery include the collection process having been exhausted or it becoming clear during the collection process that recovery will fall short of the amount due to the Group. The Group considers, on a case-by-case basis, whether enforcement action in respect of an amount that has been written off from an accounting perspective is or remains appropriate. Any subsequent recoveries are included in the income statement as an impairment gain.

Forbearance
Forbearance occurs when a borrower is granted a concession or agreed change to a loan ('forbearance measure') for reasons

1 Accounting policies *(continued)*

relating to the actual or apparent financial stress or distress of that borrower. Forbearance has not occurred if the concession or agreed change to a loan granted to a borrower is not related to the actual or apparent financial stress or distress of that borrower.

Prior to any decision to grant forbearance, the Group performs an assessment of a customer's financial circumstances and ability to repay and assesses whether the loan is credit-impaired. Where the loan is credit-impaired, it is allocated to stage 3 (unless a purchased or credit-impaired financial asset). If a forborne loan has a variable interest rate, the discount rate for measuring ECL is the current effective interest rate determined under the contract before the modification of terms.

Financial assets to which forbearance has been applied continue to be reported as forborne until such time as they satisfy conditions to exit forbearance in line with EBA guidance on non-performing and forborne classifications. Forborne financial assets which are not credit-impaired are generally allocated to stage 2.

Where the cash flows from a forborne loan are considered to have expired, the original financial asset is derecognised and a new financial asset is recognised, initially measured at fair value. Any difference between the carrying value of the original financial asset and the fair value of the new financial asset on initial recognition are recognised in the income statement. The new financial asset may be initially allocated to stage 1 or, if credit-impaired, be categorised as a purchased or originated credit-impaired financial asset.

Where a forbearance measure represents a modification of the contractual cash flows of a financial asset and does not result in its derecognition, the Group recalculates the gross carrying amount of the financial asset as the present value of the modified contractual cash flows that are discounted at the financial asset's original effective interest rate (before any modification of terms) and a modification gain or loss is included in the income statement within net impairment gains or losses.

Comparative IAS 39 accounting policies

Until 31 December 2017, under the requirements of IAS 39, the Group classified its financial assets in the following categories: financial assets at fair value through profit or loss; loans and receivables; available for sale financial assets, and determined the classification of its financial assets at initial recognition. The Group's policies for classification, recognition and measurement of financial assets for the comparative period for the year ended 31 December 2017 under IAS 39 are as follows:

Regular way purchases and sales of financial assets are recognised on the trade date, which is the date the Group commits to purchase or sell the asset.

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss can either be held for trading, if acquired principally for the purpose of selling in the short term, or designated at fair value through profit or loss at inception.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans are recorded at fair value plus transaction costs on initial recognition. They are subsequently accounted for at amortised cost, using the effective interest method.

Where the Group acquires a portfolio of financial assets from an entity under common control with the Group, in a transaction which is not a business combination, the financial assets are measured on initial recognition at their fair value plus transaction costs.

To establish fair value, the Group uses a valuation technique, which reasonably reflects how the market could be expected to price the assets, and whose variables include market data. This valuation technique incorporates both expected credit losses and the differential between the contractual interest rates on the assets and current market interest rates for similar assets.

The difference between the initial carrying value of the assets and their principal balances is considered to be a 'fair value adjustment'. The portion of this fair value adjustment which relates to interest rate differentials is amortised to the income statement, as part of the effective interest rate of the assets, over their remaining lives.
The portion of the fair value adjustment which relates to expected credit losses is subsequently reduced by actual write offs of loans during each period. Additionally, an annual review is performed to ensure that the remaining amount of this portion of the fair value adjustment is adequate to cover future expected losses on the assets. This review identifies either the amount of any impairment provision required to be immediately recognised, if the remaining adjustment is less than the incurred losses on the assets, or any surplus amount of fair value adjustment which must be released to the income statement if it is no longer required to cover future expected losses.

(c) Available for sale

Available for sale financial assets are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates.

Purchases and sales of available for sale financial assets are recognised on trade date. They are initially recognised at fair value plus transaction costs. Fair value movements are recognised in other comprehensive income. Interest is calculated using the effective interest method and is recognised in the income statement. If an available for sale financial asset is derecognised or impaired, the cumulative gain or loss previously recognised in other comprehensive income is reclassified to the income statement.

(2) Derecognition

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

1 Accounting policies *(continued)*

Impairment of financial instruments under IAS 39

Assets carried at amortised cost

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset, or group of financial assets, is impaired. A financial asset, or a group of financial assets, is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

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

(i) delinquency in contractual payments of principal or interest;
(ii) cash flow difficulties;
(iii) breach of loan covenants or conditions;
(iv) deterioration of the borrower's competitive position;
(v) deterioration in the value of collateral;
(vi) external rating downgrade below an acceptable level;
(vii) initiation of bankruptcy proceedings; and
(viii) granting a concession to a loan borrower for economic or legal reasons relating to the borrower's financial difficulty that would not be considered.

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

If there is objective evidence that an impairment loss on loans and advances carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral type, past due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

When a loan is deemed uncollectible, it is derecognised and the provision for impairment is utilised. Subsequent recoveries decrease the amount of the charge for loan impairment in the income statement.

Forbearance

Forbearance occurs when a borrower is granted a temporary or permanent concession or an agreed change ('forbearance measure') to a loan for reasons relating to the actual or apparent financial stress or distress of that borrower. Forbearance has not occurred if the concession or agreed change to a loan granted to a borrower is not related to the actual or apparent financial stress or distress of that borrower.

Prior to any decision to grant forbearance the Group performs an assessment of a customer's financial circumstances and ability to repay. This assessment includes an individual assessment for impairment of the loan. If the Group determines that no objective evidence of impairment exists for an individually assessed forborne asset, whether significant or not, it includes the asset in a group of loans with similar credit risk characteristics and collectively assesses them for impairment.

Where the forborne loan is considered to be impaired the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the asset's original effective interest rate before the modification of terms. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a forborne asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract before the modification of terms. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

1 Accounting policies *(continued)*

Assets to which forbearance has been applied continue to be reported as forborne until such time as they satisfy conditions to exit forbearance in line with EBA guidance on non-performing and forborne classifications.

Where the cash flows from a forborne loan are considered to have expired, the original asset is derecognised and a new asset is recognised, initially measured at fair value. Any difference between the carrying value of the original asset and the fair value of the new asset on initial recognition are recognised in the income statement. Interest accrues on the new asset based on the current market rates in place at the time of the renegotiation.

Non-forbearance renegotiation
Where a concession or agreed change to a loan is not directly linked to apparent financial stress or distress, these amendments are not considered forbearance. Any changes in expected cash flows are accounted for under IAS 39 i.e. the carrying amount of the asset is adjusted to reflect any change to estimated cash flows discounted at the original effective interest rate, before the modification of terms. If a renegotiated asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. Any difference between the asset's carrying amount and the present value of estimated future cash flows is reflected in the income statement. However, where cash flows on the original asset are considered to have expired, the original asset is derecognised and a new asset is recognised at fair value. Any difference arising between the derecognised asset and the new asset is recognised in the income statement.

Available for sale financial assets
The Group assesses, at each balance sheet date, whether there is objective evidence that an available for sale financial asset is impaired. In addition to the factors set out above, a significant or prolonged decline in the fair value of an investment in an available for sale equity instrument below its cost is considered in determining whether an impairment loss has been incurred. If an impairment loss has been incurred, the cumulative loss that had been recognised in other comprehensive income is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

Financial liabilities
Under both IFRS 9 and IAS 39, the Group classifies its financial liabilities as being measured at amortised cost unless it has designated liabilities at fair value through profit or loss or is required to measure liabilities mandatorily at fair value through profit or loss such as derivative liabilities. Financial liabilities are initially recognised at fair value, (normally the issue proceeds i.e. the fair value of consideration received) less, in the case of financial liabilities subsequently carried at amortised cost, transaction costs. For financial liabilities carried at amortised cost, any difference between the proceeds, net of transaction costs, and the redemption value is recognised in the income statement using the effective interest method.

When a financial liability that is measured at amortised cost is modified without resulting in derecognition, a gain or loss should be recognised in profit or loss. The gain or loss is calculated as the difference between the original contractual cash flows and the modified contractual cash flows discounted at the original effective interest rate.

A financial liability may be designated as at fair value through profit or loss only when:
(i) it eliminates or significantly reduces a measurement or recognition inconsistency (an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
(ii) a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis in accordance with documented risk management or investment strategy; or
(iii) a contract contains one or more embedded derivatives that significantly changes the cash flows of the contract and the separation of the embedded derivative(s) is not prohibited.

The Group designates certain financial liabilities at fair value through profit or loss as set out in note 40 to the financial statements.

From 1 January 2018, the movement in own credit risk related to financial liabilities designated at fair value through profit or loss is recorded in other comprehensive income unless this would create or enlarge an accounting mismatch in profit or loss for the Group (in which case all gains or losses are recognised in profit or loss).

Financial liabilities are derecognised when they are extinguished, that is when the obligation is discharged, cancelled or expires.

Embedded derivatives
An embedded derivative is a component of a hybrid contract that also includes a non-derivative host, with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

If a hybrid contract contains a host that is not a financial asset within the scope of IFRS 9, an embedded derivative is separated from the host and accounted for as a derivative if, and only if, its economic characteristics and risks are not closely related to those of the host, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the hybrid contract is not measured at fair value through profit or loss.

Financial guarantees
A financial guarantee contract requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due.

From 1 January 2018, where the Group is the holder of such a guarantee and it is considered integral to the contractual terms of the guaranteed debt instrument(s), the guarantee is not accounted for separately but is considered in the determination of the impairment loss allowance for expected credit losses of the guaranteed instrument(s).

Under both IFRS 9 and IAS 39, the Group's liability under an issued financial guarantee contract is initially measured at fair value. The liability is subsequently measured at the higher of the initial

1 Accounting policies *(continued)*

measurement, less the cumulative amount of income recognised in accordance with the principles of IFRS 15, and the amount of the impairment loss allowance for expected credit losses determined in accordance with the requirements of IFRS 9. Up until 31 December 2017, subsequent to initial recognition, they were measured at the higher of the initial measurement, less cumulative amortisation, and the best estimate of the expenditure required to settle any financial obligation arising as a result of the guarantees at the reporting date.

Any change in the liability is taken to the income statement and recognised on the balance sheet within provisions.

Where the Group issues a financial liability which contains a financial guarantee, the liability is measured at amortised cost using the effective interest method.

Offsetting

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is currently a legally enforceable right of set off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. Under IFRS 9, no impairment loss allowance for expected credit losses is recognised on a financial asset, or portion thereof, which has been offset.

Valuation of financial instruments

The Group recognises assets and liabilities designated at fair value through profit or loss and derivatives at fair value in the balance sheet. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Group has access at that date.

The fair values of financial assets and liabilities traded in active markets are based on unadjusted bid and offer prices respectively. If an active market does not exist, the Group establishes fair value using valuation techniques. These include the use of recent arm's length transactions, DCF analysis, option pricing models and other valuation techniques commonly used by market participants. To the extent possible, these valuation techniques use observable market data. Where observable data does not exist, the Group used estimates based on the best information available.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, in an arm's length transaction, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique which uses only observable market inputs. When such evidence exists, the initial valuation of the instrument may result in the Group recognising a profit on initial recognition. In the absence of such evidence, the instrument is initially valued at the transaction price. Any day one profit is deferred and recognised in the income statement to the extent that it arises from a change in a factor that market participants would consider in setting a price. Straight line amortisation is used where it approximates to the amount. Subsequent changes in fair value are recognised immediately in the income statement without the reversal of deferred day one profits or losses. Where a transaction price in an arm's length transaction is not available, the fair value of the instrument at initial recognition is measured using a valuation technique. For liabilities designated at fair value through profit or loss, the fair values reflect changes in the Group's own credit spread.

Transfers between levels of the fair value hierarchy

The Group recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change occurred. The Group provides these disclosures in note 41.

Group financial statements

(1) Subsidiaries

Subsidiary undertakings are investees (including structured entities) controlled by the Group. The Group controls an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The Group reassesses whether it controls an investee when facts and circumstances indicate that there are changes to one or more elements of control. The existence and effect of potential voting rights are considered when assessing whether the Group controls an investee only if the rights are substantive.

A structured entity is an entity designed so that its activities are not governed by way of voting rights. The Group assesses whether it has control over such entities by considering factors such as the purpose and design of the entity; the nature of its relationship with the entity; and the size of its exposure to the variability of returns from the entity.

Assets, liabilities and results of all Group undertakings have been included in the Group financial statements on the basis of financial statements made up to the end of the financial period.

Business combinations

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. The Group uses the acquisition method of accounting to account for business combinations other than business combinations involving entities or business under common control. Under the acquisition method of accounting, the consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree, over the fair value of the Group's share of the identifiable net assets acquired, is recorded as goodwill.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also

1 Accounting policies *(continued)*

eliminated unless the transaction provides evidence of impairment of the asset transferred. Foreign exchange gains and losses which arise on the retranslation to functional currency of intercompany monetary assets and liabilities are not eliminated.

Accounting policies of subsidiaries have been changed, where necessary, to ensure consistency with the policies adopted by the Group.

(2) Associates and Joint Ventures
Associates are all entities over which the Group has significant influence but not control, over the entity's financial and operating decisions, generally accompanying a shareholding of between 20% and 50% of the voting rights.

A joint arrangement is an arrangement of which two or more parties have joint control.

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.

Investments in associates and joint ventures are accounted for by the equity method of accounting and are initially recognised at cost.

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators.

The Group accounts for the assets, liabilities, revenues and expenses relating to its interest in joint operations in accordance with the IFRSs applicable to the particular assets, liabilities, revenues and expenses.

Accounting policies of associates and joint ventures have been changed, where necessary, to ensure consistency with the policies adopted by the Group.

(3) Common control transactions
A business combination involving entities or businesses under common control is excluded from the scope of IFRS 3: 'Business Combinations'. The exemption is applicable where the combining entities or businesses are controlled by the same party, both before and after the combination. Where such transactions occur, the Group, in accordance with IAS 8, uses its judgement in developing and applying an accounting policy that is relevant and reliable. In making this judgement, management considers the requirements of IFRS dealing with similar and related issues and the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the framework. Management also considers the most recent pronouncements of other standard setting bodies that use a similar conceptual framework to develop accounting standards, to the extent that these do not conflict with the IFRS Framework or any other IFRS or interpretation. Accordingly, the Group applies the guidance set out in FRS 6: 'Acquisitions and Mergers' as issued by the Accounting Standards Board.

Where a transaction meets the definition of a group reconstruction or achieves a similar result, predecessor accounting is applied. The assets and liabilities of the business transferred are measured in the acquiring entity, upon initial recognition, at their existing book value in the consolidated financial statements of the Bank of Ireland Group, as measured under IFRS. The Group incorporates the results of the acquired businesses only from the date on which the business combination occurs.

Similarly, where the Group acquires an investment in an associate or joint venture from an entity under common control with the Group, the investment is recognised initially at its existing book value in the consolidated financial statements of the Bank of Ireland Group.

(4) Securitisations
Certain Group undertakings enter into securitisation transactions in order to finance specific loans and advances to customers.

All financial assets continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction, unless:

- the rights to the cash flows have expired or been transferred;
- substantially all the risks and rewards associated with the financial instruments have been transferred outside the Group, in which case the assets are derecognised in full; or
- a significant portion, but not all, of the risks and rewards have been transferred outside the Group. In this case the asset is derecognised entirely if the transferee has the ability to sell the financial asset. Otherwise the asset continues to be recognised only to the extent of the Group's continuing involvement.

Where the above conditions apply to a fully proportionate share of all or specifically identified cash flows, the relevant accounting treatment is applied to that proportion of the asset.

Foreign currency translation
The consolidated financial statements of the Group and the financial statements of the Bank are presented in Sterling. Foreign currency transactions are translated into functional currency at the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the transaction at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items such as equities, classified at fair value through other comprehensive income, are recognised in other comprehensive income.

Operating profit
Operating profit includes the Group's earnings from ongoing activities after impairment charges and before share of profit or loss on joint ventures (after tax) and profit on disposal of business activities.

Leases
Lessor
When assets are held under a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the

1 Accounting policies *(continued)*

receivable is recognised as unearned finance income. Lease income is included in net interest income and is recognised over the term of the lease reflecting a constant periodic rate of return on the net investment in the lease.

A lease that does not transfer substantially all the risks and rewards of ownership are treated as operating leases. The annual rentals are credited to the income statement on a straight-line basis over the term of the lease. Costs incurred, including depreciation, are recognised in line with the normal depreciation policy for similar assets.

Lessee
The total payments made under operating leases are charged to the income statement on a straight line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership, are classified as finance leases. Finance leases are capitalised at the lease's inception at the lower of the fair value of the leased property and the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are included in long term payables. The interest element of the finance costs is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Sale and repurchase agreements

Assets sold subject to repurchase agreements (repos) are retained on the balance sheet and reclassified as pledged assets when the transferee has the right by contract or custom to sell or re-pledge the collateral; the counterparty liability is included in deposits by banks or customer accounts, as appropriate.

Derivative financial instruments and hedge accounting

The Group has made the accounting policy choice allowed under IFRS 9 to continue to apply the hedge accounting requirements of IAS 39. Derivatives are initially recognised at fair value on the date on which the contract is entered into and are subsequently remeasured at their fair value at each reporting date. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Fair value gains or losses on derivatives are normally recognised in the income statement. However where they are designated as hedging instruments, the treatment of the fair value gains and losses depends on the nature of the hedging relationship.

The Group designates certain derivatives as either:

(i) hedges of the exposure to changes in the fair value of recognised assets or liabilities that is attributable to a particular risk (fair value hedge); or
(ii) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (cash flow hedge).

Hedge accounting is applied to these derivatives provided certain criteria are met. The Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. Hedge relationships are concluded to be effective if the hedging instruments that are used in hedging transactions offset the changes in fair value or cashflow of the hedged items within a range of 80% to 125%.

(a) Fair value hedge (micro)
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The hedged item in a micro fair value hedge is a single specified item e.g. a fixed commercial loan.

If the criteria for hedge accounting cease to be met, no further adjustments are made to the hedged item for fair value changes attributable to the hedged risk. The cumulative adjustment to the carrying amount of a hedged item is amortised to profit or loss over the period to maturity using the effective interest method.

(b) Fair value hedge (macro)
The hedged item in a macro fair value hedge is a pool of assets or liabilities with similar risk characteristics and profiles, such as a pool of fixed rate mortgages. Unlike micro fair value hedge accounting, macro fair value hedge accounting is not discontinued if an individual asset or liability within the pool of hedged items is sold, so long as the overall pool of hedged items retains its characteristics as documented at inception of the hedge. In addition, hedge effectiveness testing is performed on a portfolio basis rather than on an individual hedge relationship by hedge relationship basis.

The Group also avails of the relaxed hedge accounting provisions permitted by IAS 39 'Financial Instruments: recognition and measurement' as adopted by the EU. Under these provisions, the Group applies portfolio fair value hedge accounting of interest rate risk to its demand deposit book. The Group resets its macro fair value hedges on a monthly basis.

If the criteria for hedge accounting cease to be met, no further adjustments are made to the hedged item for fair value changes attributable to the hedged risk. The cumulative adjustment to the carrying amount of a hedged item is amortised to profit or loss over the period to maturity using the effective interest method.

(c) Cash flow hedge
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in other comprehensive income are reclassified to the income statement in the periods in which the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge

1 Accounting policies *(continued)*

accounting, any cumulative gain or loss existing in other comprehensive income at that time remains in other comprehensive income and is recognised in the income statement when the forecast transaction occurs. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately reclassified to the income statement. The Group resets its macro cash flow hedges on a monthly basis.

Property, plant and equipment

Freehold and long leasehold land and buildings are initially recognised at cost, and subsequently are revalued annually to open market value by independent external valuers. Revaluations are made with sufficient regularity to ensure that the carrying amount does not differ materially from the open market value at the reporting date.

All other property, plant and equipment, including freehold and leasehold adaptations, are stated at historical cost less accumulated depreciation.

Increases in the carrying amount arising on the revaluation of land and buildings are recognised in other comprehensive income. Decreases that offset previous increases on the same asset are recognised in other comprehensive income: all other decreases are charged to the income statement.

The Directors consider that residual values of freehold and long leasehold property based on prices prevailing at the time of acquisition or subsequent valuation are such that depreciation is not material.

Depreciation is calculated on the straight line method to write down the carrying value of other items of property, plant and equipment to their residual values over their estimated useful lives as follows:

- Adaptation works on freehold and leasehold property - fifteen years, or the remaining period of the lease; and
- Computer and other equipment - maximum of ten years.
- Motor vehicles held for leasing - over the lease term.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date. Property, plant and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if its carrying amount is greater than its estimated recoverable amount. The estimated recoverable amount is the higher of the asset's fair value less costs to sell or its value in use.

Gains and losses on the disposal of property, plant and equipment are determined by reference to their carrying amount and are taken into account in determining profit before tax. If the asset being disposed of had previously been revalued then any amount in other comprehensive income relating to that asset is reclassified directly to retained earnings on disposal, rather than the income statement.

Intangible assets

(a) Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives, which is normally five years.
Costs associated with developing or maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Group and which will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Direct costs include software development, employee costs and an appropriate portion of relevant overheads. Computer software development costs recognised as assets are amortised using the straight line method over their useful lives, which is normally between five and ten years.

(b) Other intangible assets

Other intangible assets are carried at cost less amortisation and impairment, if any, and are amortised on a straight line basis over their useful lives which range from five years to twenty years and assessed for impairment indicators annually or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If such indicators exist, the assets recoverable amount is estimated. An asset's carrying amount is written down immediately to its recoverable amount if its carrying amount is greater than its estimated recoverable amount. The estimated recoverable amount is the higher of the asset's fair value less costs to sell or its value in use.

(c) Goodwill

Goodwill represents the excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired. Goodwill on acquisition of subsidiaries is included in intangible assets.

Goodwill is tested annually for impairment or more frequently if there is any indication that it may be impaired, and carried at cost less accumulated impairment losses. Goodwill is allocated to cash generating units (CGU) for the purpose of impairment testing. An impairment loss arises if the carrying value of the CGU exceeds the recoverable amount. The recoverable amount of a CGU is the higher of its fair value less costs to sell and its value in use, where the value in use is the present value of the future cash flows expected to be derived from the CGU.

Assets and liabilities classified as held for sale

An asset or a disposal group is classified as held for sale if the following conditions are met:

- its carrying amount will be recovered principally through sale rather than continuing use;
- it is available for immediate sale; and
- the sale is highly probable within the next few months.

When an asset (or disposal group) is initially classified as held for sale, it is measured at the lower of its carrying amount or fair value less costs to sell at the date of classification, except for deferred tax assets, financial assets and assets arising from employee benefits, which are measured in accordance with the accounting policies applied to those assets prior to their classification as held for sale.

Impairment losses on initial classification of an asset (or disposal group) as held for

1 Accounting policies *(continued)*

sale, and on subsequent remeasurement of the asset (or disposal group), are recognised in the income statement. Increases in fair value less costs to sell of an asset (or disposal group) that have been classified as held for sale are recognised in the income statement to the extent that the increase is not in excess of any cumulative impairment loss previously recognised in respect of the asset (or disposal group).

Impairment losses are allocated to non-current assets within the measurement scope of IFRS 5 and the amount of impairment losses recognised in the financial statements is limited to the carrying value of those assets. Other assets and liabilities are measured in accordance with applicable IFRSs in both initial and subsequent measurement of the asset (or disposal group) held for sale. As a result, in accordance with IFRS 5 any impairment losses in excess of the carrying value of the non-current assets within the measurement scope of IFRS 5 are not recognised until disposal.

When an asset (or disposal group) is classified as held for sale, amounts presented in the balance sheet for the prior period are not reclassified. Where the criteria for the classification of an asset (or disposal group) as held for sale cease to be met, the asset (or disposal group) is reclassified out of held for sale and included in the appropriate balance sheet headings.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Provision is made for the anticipated costs of restructuring, including related redundancy costs, when an obligation exists. An obligation exists when the Group has a detailed formal plan for restructuring a business and has raised valid expectations in those employees affected by the restructuring by starting to implement the plan or announcing its main features.

A levy payable to a Government is provided for on the occurrence of the event identified by the legislation that triggers the obligation to pay the levy.

Contingent liabilities are not recognised but are disclosed unless the probability of their occurrence is remote.

Employee benefits

(a) Pension obligations

The Group operates one defined benefit scheme, the NIIB Group Limited (1975) Pension Scheme. In addition, certain of the Group's employees are members of other Bank of Ireland Group schemes, and these are accounted for as defined contribution schemes in the Group. The schemes are funded and the assets of the schemes are held in separate trustee administered funds. A defined benefit plan is a pension plan that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service or compensation.

The asset or liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the reporting date minus the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates on high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability.

Service cost and net interest on the net defined benefit liability / (asset) are recognised in profit or loss in operating expenses.

Remeasurements of the net defined benefit liability / (asset), including:

- actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions; and
- the return on plan assets, excluding amounts included in net interest on the net defined benefit liability / (asset); are recognised in other comprehensive income.

A settlement is a transaction that eliminates all further legal and constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions.

(b) Short term employee benefits

Short term employee benefits, such as salaries and other benefits, are accounted for on an accruals basis over the period in which the employees' service is rendered.

(c) Termination payments

Termination payments are recognised as an expense at the earlier of:

- when the Group can no longer withdraw the offer of those benefits; and
- when the Group recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits.

For this purpose, in relation to termination benefits for voluntary redundancies, the Group is considered to be no longer able to withdraw the offer on the earlier of the following dates:

- when the employee accepts the offer; and
- when a restriction (e.g. a legal, regulatory or contractual requirement) on the Group's ability to withdraw the offer takes effect.

Income taxes

(a) Current income tax

Income tax payable on profits is recognised as an expense in the year in which profits arise. Tax provisions are provided on a transaction by transaction basis using a best estimate approach. In arriving at such estimates, management assesses the relative merits and risks of tax treatments assumed, taking into account statutory, judicial and regulatory guidance and, where appropriate, external advice.

A current tax provision is recognised when the Group has a present obligation as a result of a past event and it is probable that there will be a future outflow of funds to a fiscal authority to settle the obligation.

1 Accounting policies *(continued)*

(b) Deferred income tax
Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and tax laws) that have been enacted, or substantively enacted, by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. The rates enacted, or substantively enacted, at the reporting date, are used to determine deferred income tax. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction, other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

The tax effects of income tax losses available for carry forward are recognised as deferred tax assets to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised and by reference to the expiry dates (if any) of the relevant unused tax losses or tax credits. Deferred tax assets and liabilities are not discounted. Deferred income tax is provided on temporary differences arising from investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future.

Deferred tax on items recognised in other comprehensive income is also recognised in other comprehensive income and is subsequently reclassified to the income statement, together with the deferred gain or loss. Income tax on items recognised directly in equity is recognised directly in equity.

Cash and cash equivalents
For the purposes of the cash flow statement, cash and cash equivalents comprise cash in hand and balances with central banks and other banks, which can be withdrawn on demand. It also comprises balances with an original maturity of less than three months.

Share capital and reserves
a) Equity transaction costs
Incremental external costs directly attributable to equity transactions, including the issue of new equity stock or options, are shown as a deduction from equity, net of tax.

(b) Dividends on ordinary shares
Dividends on ordinary shares are recognised in equity in the year in which they are approved by the Bank's shareholders or the Board of Directors, as appropriate.

(c) Available for sale reserve
Until 31 December 2017, under IAS 39, the requirements of the available for sale reserve represented the cumulative change in fair value of available for sale financial assets (net of tax and hedge accounting adjustments).

(d) Cash flow hedge reserve
The cash flow hedge reserve represents the cumulative changes in fair value (net of tax) excluding any ineffectiveness of cash flow hedging derivatives. These are transferred to the income statement when the hedged transactions impact the Group's profit or loss.

(e) Capital contribution
The capital contribution is measured as the initial amount of cash or other assets received.

(f) Capital redemption reserve fund
On 1 May 2015, preference stock of £300 million was repurchased. On the same date £300 million was transferred from capital contribution to the capital redemption reserve fund in order to identify these reserves as non-distributable.

(g) Other equity instruments
Other equity instruments represents Additional tier 1 securities issued by the Group to the Parent. See note 38 for details.

(h) Revaluation reserve
The revaluation reserve represents the cumulative gains and losses on the revaluation of property. The revaluation reserve is not distributable.

Collateral
The Group enters into master netting agreements with counterparties, to ensure that if an event of default occurs, all amounts outstanding with those counterparties will be settled on a net basis. The Group obtains collateral in respect of customer liabilities where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Group a claim on these assets for both existing and future liabilities. The collateral is, in general, not recorded on the Group's balance sheet.

The Group also receives collateral in the form of cash or securities in respect of other credit instruments, such as stock borrowing contracts and derivative contracts, in order to reduce credit risk. Collateral received in the form of cash is recorded on the balance sheet, with a corresponding liability recognised in deposits from banks or deposits from customers. Any interest payable arising is recorded as interest expense.

In certain circumstances, the Group pledges collateral in respect of liabilities or borrowings. Collateral pledged, in the form of securities or loans and advances, continues to be recorded on the balance sheet. Collateral placed in the form of cash is recorded in loans and advances to banks or customers. Any interest receivable arising is recorded as interest income.

1 Accounting policies *(continued)*

Impact of new accounting standards

The following standards, interpretations and amendments to standards will be relevant to the Group but were not effective at 31 December 2018 and have not been applied in preparing these financial statements. The Group's initial view of the impact of these accounting changes is outlined below.

Pronouncement
IFRS 16 'Leases'

Nature of change
IFRS 16 'Leases' addresses the definition of a lease, recognition and measurement of leases and establishes principles for reporting useful information to users of financial statements about the leasing activities of both lessees and lessors. A key change arising from IFRS 16 is that all operating leases will be accounted for on-balance sheet for lessees. The accounting for lessors will not materially change. The standard replaces IAS 17 'Leases' and related interpretations.

The revised standard was endorsed by the EU on 31 October 2017.

As permitted under IFRS 16, the Group has elected to apply the standard under the modified retrospective application rather than full retrospective application. Under the modified retrospective application, the Group as a lessee is not required to restate comparative information, instead recognising the cumulative effect of initially applying the standard as an adjustment to retained earnings.

As permitted, the Group is availing of the following exemptions:
- short-term leases (lease term of 12 months or less); and
- leases for which the underlying asset is of low value.

The Group will recognise the lease payments associated with those leases as an expense.

Effective date
Financial periods beginning on or after 1 January 2019 and earlier application was permitted if IFRS 15 'Revenue from contracts with customers' was applied at the same time.

Impact
The principal impact on the Group will be in relation to property leases that the Group, as the lessee, currently accounts for as operating leases under IAS 17. The Group will recognise a lease liability for leases previously classified as operating leases, measured at the present value of the remaining lease payments discounted using the Group's incremental borrowing rate (IBR). The Group will recognise a right of use (RoU) asset equal to the lease liability, adjusted by the amounts of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately prior to date of initial application. The estimated quantitative impact on initial adoption of IFRS 16 is an increase in both assets and liabilities of c.£30 million. The Group expects that there will be no material impact to retained earnings at 1 January 2019.

Pronouncement
IFRS 17 'Insurance contracts'

Nature of change
IFRS 17 replaces IFRS 4 'Insurance contracts', which was introduced as an interim standard in 2004. IFRS 17 addresses the comparison problems created by IFRS 4 by requiring all insurance contracts to be accounted for in a consistent manner. IFRS 17 establishes the principles for the recognition, measurement, presentation and disclosures of insurance contract liabilities, ensuring an entity provides relevant information that faithfully represents those contracts.

The standard is still subject to EU endorsement.

Effective date
Currently effective for financial periods beginning on or after 1 January 2021 however the IASB is considering delaying the mandatory implementation date by one year to 2022. Earlier application is permissible.

Impact
The Group does not expect that IFRS 17 will have a material impact on the financial statements.

Pronouncement
IFRIC 23 'Uncertainty over income tax treatments'

Nature of change
IFRIC 23 clarifies how the recognition and measurement requirements of IAS 12 'Income taxes', are applied where there isuncertainty over income tax treatments. IFRIC 23 explains how to recognise and measure deferred and current income tax assets and liabilities where there is uncertainty over a tax treatment.

An uncertain tax treatment is any tax treatment applied by an entity where there is uncertainty over whether that treatment will be accepted by the tax authority. IFRIC 23 applies to all aspects of income tax accounting where there is an uncertainty regarding the treatment of an item, including taxable profit or loss, the tax bases of assets and liabilities, tax losses and credits and tax rates.

The revised standard was endorsed by the EU on 23 October 2018.

Effective date
Financial periods beginning on or after 1 January 2019

Impact
The IFRIC is not expected to have a significant impact to the Group.

2 Critical accounting estimates and judgements

In preparing the financial statements, the Group makes estimates and judgements that affect the reported amounts of assets, liabilities, revenues, and expenses. 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. As management judgement involves an estimate of the likelihood of future events, actual results could differ from those estimates, and this could affect the future reported amounts of assets and liabilities. The estimates and judgements that have had the most significant effect on the amounts recognised in the Group's financial statements are set out below.

(a) Impairment charges on financial assets

The measurement of impairment loss allowance requires significant judgement and is dependent in large part on complex impairment models. In arriving at impairment loss allowances, accounting judgements and estimates which could have a material influence on the quantum of impairment loss allowance and net impairment charge include:

- the Group's criteria for assessing if there has been a significant increase in credit risk since initial recognition such that a loss allowance for lifetime rather than 12 month ECL is required;
- generation of forward-looking macroeconomic scenarios and their probability weightings which are used in both the assessment of 'significant increase in credit risk' and in the measurement of impairment loss allowances;
- selection of the most relevant macroeconomic variables for particular portfolios and determining associations between those variables and model components such as PD and LGD;
- the selection of appropriate methodologies and model factors for internal risk rating and impairment models;
- determining the period over which to measure ECL for uncommitted revolving credit facilities;
- valuing collateral and determining timeframe to realisation and likely net sale proceeds;
- the approximation made at transition to IFRS 9 of the residual lifetime PD curves for most exposures originated prior to adoption of IFRS 9; and
- determining what Group management adjustments may be necessary to impairment model outputs to address impairment model limitations or late breaking events.

The Group's approach to measurement of impairment loss allowances and associated methodologies is set out in the credit risk methodologies section on pages 39 to 43.

The quantum of impairment loss allowance is impacted by the application of three probability weighted future macro-economic scenarios. The following table indicates the approximate extent to which the impairment loss allowance at 31 December 2018, excluding management adjustments was increased by virtue of applying multiple scenarios rather than just a central scenario.

Impact of applying multiple scenarios rather than only a central scenario	Additional impairment loss allowance		Additional impairment loss allowance on stage 1 and 2 financial instruments	
	£m impact	% impact	£m impact	% impact
Residential Mortgages	(0.5)	(2.3%)	0.1	0.4%
Non-property SME and Corporate	0.8	3.0%	0.8	8.7%
Property & construction	0.1	0.6%	0.1	8.8%
Consumer	0.9	1.1%	0.9	1.7%
Total	**1.3**	**0.9%**	**1.9**	**2.6%**

The following table indicates the approximate extent to which the impairment loss allowance, excluding Group management adjustments, would be higher or lower than reported were a 100% weighting applied to the upside and downside future macro-economic scenarios respectively:

Impact of applying only an upside or downside scenario rather than applying multiple probability weighted scenarios	Impact of applying a 100% weighting to the FLI upside scenario		Impact of applying a 100% weighting to the FLI downside scenario	
	£m impact	% impact	£m impact	% impact
Residential Mortgages	(7)	(31%)	17	78%
Non-property SME and Corporate	(1)	(5%)	3	10%
Property & construction	(1)	(3%)	1	6%
Consumer	(3)	(4%)	5	5%
Total	**(12)**	**(8%)**	**26**	**17%**

At 31 December 2018, the impairment loss allowance for Residential Mortgages of £29 million includes a management adjustment of £7 million. This reflects consideration of factors specific to that portfolio including the evolving nature of impairment modelling under IFRS 9, measurement uncertainty and the non-linear relationship between macro-economic indicators and associated credit losses.

For the year ended 31 December 2017 the following critical accounting estimates and judgements applied under IAS 39.

> The Group reviews its loan portfolios for impairment on an ongoing basis. The Group first assesses whether objective evidence of impairment exists. This assessment is performed individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. Impairment provisions are also recognised for losses not specifically identified but which, experience and observable data indicate, are present in the portfolio at the date of assessment.
>
> Management uses estimates, based on historical loss experience for assets with credit risk characteristics, and objective evidence of impairment, similar to those in the portfolio, when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

2 Critical accounting estimates and judgements *(continued)*

The use of historical loss experience is supplemented with significant management judgement to assess whether current economic and credit conditions are such that the actual level of inherent losses is likely to differ from that suggested by historical experience. In normal circumstances, historical experience provides objective and relevant information from which to assess inherent loss in each portfolio. In other circumstances, historical loss experience provides less relevant information about the incurred loss in a given portfolio at the balance sheet date; for example, where there have been changes in economic conditions, such that the most recent trends in risk factors are not fully reflected in the historical information. In these circumstances, such risk factors are taken into account when calculating the appropriate levels of impairment allowances, by adjusting the impairment loss derived solely from historical loss experience. The detailed methodologies, areas of estimation, and judgement, applied in the calculation of the Group's impairment charge on financial assets, are set out in the Risk Management section on pages 39 to 43. See notes 20 and 21 for an analysis of impairment loss allowances.

The estimation of impairment losses is subject to uncertainty and is sensitive to factors such as the level of economic activity, unemployment rates, bankruptcy trends, property price trends, and interest rates. The assumptions underlying this judgement are subjective. The methodology and the assumptions used in calculating impairment losses are reviewed regularly, in light of differences between loss estimates and actual loss experience.

(b) Taxation

The taxation charge accounts for amounts due to UK authorities, and includes estimates based on a judgement of the application of law and practice, in certain cases, to determine the quantification of any liabilities arising. In arriving at such estimates, management assesses the relative merits and risks of tax treatments assumed, taking into account statutory, judicial, and regulatory guidance and, where appropriate, external advice.
At 31 December 2018, the Group had a net deferred tax asset of £85 million (2017: £71 million), of which £72 million (2017: £74 million) related to trading losses. See note 28.

The amount recognised represents the Group's best estimate of the taxation benefit of these trading losses. There is a possibility that the ultimate outcome could be different from the amounts that are currently recorded and any such differences would impact the deferred tax assets in the period in which such outcome is determined.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available, against which deductible temporary differences and unutilised tax losses can be utilised. The recognition of a deferred tax asset relies on management's judgements surrounding the probability and sufficiency of future taxable profits, and the future reversals of existing taxable temporary differences.

The most significant judgement relates to the Group's assessment of the recoverability of the portion of the deferred tax asset relating to trading losses. Under current UK tax legislation there is no time restriction on the utilisation of these losses. It is currently projected that the deferred tax asset in respect of tax losses will be recovered in full within a 15 year period.

UK legislation includes a restriction of 25% on the amount of a bank's annual taxable profit that can be offset by pre-April 2015 carried forward losses. This restriction significantly lengthens the period over which the Group could use its UK trading losses and has been considered in the context of the measurement and recognition of the deferred tax asset at 31 December 2018.

To the extent that the recognition of a deferred tax asset is dependent on sufficient future profitability, a degree of estimation and the use of assumptions are required. The Group's judgement takes into consideration the impact of both positive and negative evidence, including historical financial performance, projections of future taxable income, the impact of tax legislation, and future reversals of existing taxable temporary differences.

The Group's assessment of deferred tax recoverability is currently based on forecasts covering its 5 year initial planning period, and from year 5 onwards an assumed profit growth rate in line with macro-economic projections. The deferred tax recoverability is most sensitive to the forecast in the initial planning period. These forecasts assume a sustainable UK market return on equity in the high single digits over the long term for future profitability levels and a UK GDP growth of 2.0%. The Group's profitability projections are based on its agreed strategic priorities of "Invest, Improve and Reposition", where the focus will be to increase overall returns, improve cost efficiencies and grow sustainable profits.

Given the aforementioned forecasts it is expected that c.75% of the deferred tax asset will be utilised within 10 years (2017: c.85%). Management have carried out a series of sensitivity analyses on its profit forecasts which resulted in a range of recoverability periods between 15 and 25 years.

The achievement of these objectives will be carefully monitored as plans are implemented in 2019 and beyond.

(c) Unwind of fair value adjustments on acquired mortgages

Between 2012 and 2014 the Group acquired a number of tranches of mortgages from the Parent at fair value. These assets were initially recognised on the balance sheet at fair value plus transaction costs. The differential between the initial carrying value of the assets and the principal balances is considered to be a 'fair value adjustment'. The portion of this fair value adjustment which relates to interest rate differentials is amortised to the income statement, as part of the effective interest rate of the assets, over their remaining lives. The fair value adjustment also includes an element relating to the present value of expected losses, and the discount on this element also unwinds through the income statement over their remaining lives. At 31 December 2018, the impact of the fair value adjustment was to reduce the carrying amount of loans and advances to customers by £210 million. (2017: £251 million). In 2018, there was a benefit of £41

2 Critical accounting estimates and judgements *(continued)*

million (2017: £28 million) to the income statement from the unwind of, and revisions to, the fair value adjustment.

The most significant judgement relating to the fair value adjustment relates to the timing of the unwind. This requires significant management judgement in relation to customer repayment assumptions which determines the expected lives of the relevant loans, and therefore impacts on the amount of interest income recognised in each financial year. In arriving at the expected lives and hence the amount of the unwind, a sensitivity analysis is carried out which considers the impact of various scenarios, as follows:

- a reduction in the rate of repayments, resulting in the expected life of the buy to let mortgage portfolio increasing by 5 months, would give rise to a reduction in interest income of £18 million being recognised in 2018; and
- an increase in the rate of repayments, resulting in the expected life of the buy to let mortgage portfolio shortening by 5 months, would give rise to an increase in interest income of £18 million being recognised in 2018.

(d) Effective interest rate

IFRS 9 requires interest to be recognised using the effective interest rate, being the rate that exactly discounts estimated future cash flows over the expected life of the financial instrument to the net carrying amount of the financial instrument.

Adjustments to the carrying value of financial instruments may be required when actual cash flows vary from the initial estimation of future cash flows, with the corresponding adjustment being made to the income statement.

For secured mortgage lending management model future expected cash flows for each tranche of lending. In determining the future cash flows management use judgement to estimate the average life curve of each lending tranche. Management estimate expected future payments of interest and capital based on expected interest rates and redemption profiles of customers based on previous customer behaviour, incorporating estimates of the proportion of borrowers expected to incur early redemption charges. In particular, a key assumption in the effective interest rate models relates to the length of time which borrowers remain on a reversionary rate after the end of the fixed rate period.

Management considers the estimated life curve to be the most significant estimate, the accuracy of which could be impacted by customer repayment behaviour being different to expectations. The impact of a 10% decrease in expected life would be to reduce the value of loans on the balance sheet and interest income by c.£7 million in the year of change.

During the year, as a result of revisions to the EIR methodology and assumptions used, a charge of £20 million was recognised through interest income.

3 Transition from IAS 39 to IFRS 9

	Group Shareholders' equity £m	Bank Shareholders' equity £m
As reported under IAS 39 / 37 at 31 December 2017	1,999	1,902
Impact of remeasurement (after tax)	(41)	(43)
As reported under IFRS 9 at 1 January 2018	**1,958**	**1,859**

A description of the IAS 39 / 37 and IFRS 9 accounting policies is set out in pages 78 to 85 of this document. A reconciliation of the balance sheet classification as at 1 January 2018 under IAS 39 to the classification under IFRS 9 is included in note 46 (separately identifying by measurement category the changes in the carrying amount arising from reclassification and measurement on transition to IFRS 9). In addition, a reconciliation of the closing impairment provision under IAS 39 and provision under IAS 37 to the opening loss allowance at 1 January 2018 determined in accordance with IFRS 9 is included in note 46.

As set out in the basis of preparation and accounting policies, the financial information has been prepared in accordance with IFRS 9 as endorsed by the EU. The Group has availed of the exemption in paragraph 7.2.15 of IFRS 9 from restating prior periods in respect of the classification and measurement requirements of IFRS 9 and certain new presentation requirements in IAS 1. Accordingly, differences in the carrying amount of financial instruments arising from the adoption of IFRS 9 are recognised in equity as at 1 January 2018.

4 Interest income

Group	2018 £m	2017 £m
Financial assets measured at amortised cost		
Loans and advances to customers	599	569
Loans and advances to banks	14	24
Debt securities at amortised cost	15	-
Interest on hedging derivatives	(15)	(21)
Cash and balances with central banks	17	6
Interest income on financial assets measured at amortised cost	**630**	**578**
Financial assets at fair value through other comprehensive income		
Available for sale financial assets	-	15
Interest income calculated using the effective interest method	**630**	**593**
Interest income on finance leases and hire purchase receivables	65	58
Interest income	**695**	**651**

Included in interest income for the year ended 31 December 2018 is £14 million in respect of income earned by the Group on loans and advances to banks, relating to amounts placed with the Parent (2017: £24 million) offset by interest on hedging derivatives of £15 million which are also held with the Parent (2017: £21 million). Group share of joint operation interest income for the year ended 31 December 2018 is £27 million (2017: £11 million). Refer to note 23.

In 2018, £11 million of interest income was recognised on credit-impaired loans and advances to customers. In 2017, £4 million of interest income was recognised on impaired loans and advances to customers on which a specific impairment provision had been recognised.

In 2018, £12 million of interest income was received on credit-impaired loans and advances to customers. In 2017, £6 million of interest income was received on impaired loans and advances to customers on which a specific impairment provision had been recognised.

Interest income also includes £41 million relating to the unwind of, and revisions to, fair value adjustments associated with mortgages acquired from the Parent in prior years (2017: £28 million).

For the year ended 31 December 2018 interest recognised on total forborne loans and advances to customers was £5 million (2017: £10 million).
Finance lease and hire purchase receivables interest income arises from the Northridge business.

5 Interest expense

Group Interest expense	2018 £m	2017 £m
Customer accounts	148	137
Deposits from banks	26	19
Subordinated liabilities	13	24
Interest expense	**187**	**180**

Included in interest expense for the year ended 31 December 2018 is £26 million in respect of interest paid to the Parent on deposits and subordinated liabilities (2017: £36 million).

Group share of joint operation interest expense for the year ended 31 December 2018 is £7 million (2017: £3 million). Refer to note 23.

6 Other leasing income and expense

Group	2018 £m	2017 £m
Other leasing income	46	3
Other leasing expense	(37)	(2)
Net leasing income	**9**	**1**

Other leasing income and expense relate to the business activities of Marshall Leasing Limited (MLL), a wholly owned subsidiary which was acquired in 2017. MLL is a car and commercial leasing and fleet management company based in the UK. Other leasing expense includes depreciation of £21 million related to vehicles leased under operating leases (2017: £2 million). See note 26.

7 Fee and commission income and expense

Group 2018 **Fee and commission income**	**GB Consumer Banking[1] £m**	**NI and GB Business Banking[2] £m**	**Total £m**
Retail banking customer fees	60	33	93
ATM fees	*56*	*-*	*56*
Other fees	*4*	*33*	*37*
Other fees received	7	4	11
Total	**67**	**37**	**104**

Group 2017 Fee and commission income	GB Consumer Banking[1] £m	NI and GB Business Banking[2] £m	Total £m
Retail banking customer fees	67	34	101
ATM fees	*62*	*-*	*62*
Other fees	*5*	*34*	*39*
Other fees received	8	5	13
Total	**75**	**39**	**114**

Amounts include:	**2018 £m**	2017 £m
Group share of joint operation (note 23)	**1**	**2**

There has been no significant changes to any of the line items above as a result of the adoption of IFRS 15 for the year ended 31 December 2018. No impairment losses were recognised in relation to the Group's receivables arising from contracts with customers in 2018.

[1] *Great Britain (GB) Consumer Banking: offers consumer banking products through strategic partnerships with the Post Office, the AA and intermediaries.*

[2] *Northern Ireland (NI): the business includes the results of the Northern Ireland Bank of Ireland UK branch network and business centres, personal lending, together with the credit card and mortgage portfolio and the note issuing activity in Northern Ireland. Great Britain (GB) Business Banking: includes commercial lending and retail deposits. The commercial lending business is undergoing a continued programme of deleveraging.*

7 Fee and commission income and expense *(continued)*

Fee and commission expense	2018 £m	2017 £m
Fee and commission expense - external	102	107
Fees paid to the Parent	8	8
Fee and commission expense	**110**	**115**
Amounts include:		
Group share of joint operation (note 23)	2	2

8 Net trading income / (expense)

Group Net trading income / (expense)	2018 £m	2017 £m
Financial instruments held for trading	5	(1)
Net trading income / (expense)	**5**	**(1)**
Amounts include:		
Net trading income / (expense) from the Parent	33	9

Net trading income / (expense) from the Parent primarily comprises fair value movements on derivatives with the Parent which are in fair value hedge relationships.

9 Other operating income

Group	2018 £m	2017[1] £m
Other operating income	3	1
Net gains on derecognition of financial assets measured at amortised cost	6	-
Total other operating income	**9**	**1**

[1] *Other operating income for the Group for 2017 has been restated as net leasing income of £1 million, previously included in other operating income, is now presented separately in the income statement to align with the presentation for 2018.*

10 Operating expenses

Group Operating expenses	2018 £m	2017 £m
Administrative expenses		
Staff costs[1] (a)		
- Wages and salaries	39	39
- Social security costs	5	5
- Other pension costs[2]	8	10
Total staff costs	**52**	**54**
- Other administrative expenses	73	49
- Other administrative expenses – related parties (b)	219	220
Amortisation on intangible assets (note 24)	7	5
Total operating expenses	**351**	**328**
Amounts include:		
Group share of joint operation (note 23)	16	19

(a) Staff costs

Staff costs of £52 million (2017: £54 million) include all gross salaries, related social security costs, and pension contributions attributable to those employees directly employed by the Group. Gross salaries also include those costs associated with staff seconded to the Group from the Parent under a secondment agreement. The monthly average number of staff (direct and seconded full time equivalents) was 724 (2017: 715), of which 568 related to the Bank (2017: 594). Refer to note 42 for details of compensation paid to key management personnel (KMP).

(b) Other administrative expenses – related parties

Other administrative expenses are the costs incurred by the Group in relation to services provided by the Parent under a number of service level agreements. These comprise of services across a number of different activities and areas including, but not restricted to, product design, manufacture, distribution and management, customer service, and IT. Included in this management charge is the cost of a number of employees who carry out services for the Group on behalf of the Parent. These employees' employment contracts are with the Parent and their remuneration is included in the Parent's financial statements. Due to the nature of the services provided it is neither possible to ascertain separately the element of the management charge that reflects the employee staff charge, nor disclose separately employee numbers relevant to the Group's activities.

11 Auditors' remuneration

KPMG became the Group's principal auditor in 2018 prior to which PwC was the principal auditor. The figures shown in the table relate to fees paid to KPMG or PwC as principal auditor respectively.

The Group's Audit Committee has reviewed the level of fees and is satisfied that it has not affected the independence of the auditors. Audit related assurance services consist of fees in connection with accounting matters and regulatory compliance based work. It is the Group's policy to subject all major assignments to a competitive tender process.

Group	2018 £000's	2017 £000's
Fees payable for the audit of the Bank and Group financial statements	504	497
Audit of the Bank's subsidiaries pursuant to legislation	140	115
Audit related assurance services	15	9
Other assurance services	51	60
Auditors' remuneration	**710**	**681**

[1] Staff costs include amounts of £33 million (2017: £35 million) for wages and salaries, £4 million (2017: £5 million) for social security costs and £6 million (2017: £9 million) for other pension costs recorded in the Bank financial statements.

[2] Other pension costs include £1.2 million (31 December 2017: £0.4 million) in relation to the NIIB scheme which is accounted for as a defined benefit scheme (see note 34) with the balance relating to other schemes which are accounted for on a defined contribution basis..

12 Net impairment losses / (gains) on financial instruments

Group	2018 £m	2017 £m
Loans and advances to customers (note 20)	37	26
- Cash recoveries	*(9)*	*(12)*
- Movement in impairment (gains) / losses	*46*	*38*
Loans and advances to banks	(1)	-
Loan commitments (note 33)	(2)	-
Guarantees and irrevocable letters of credit (note 33)	-	-
Net impairment losses / (gains) on financial instruments	**34**	**26**

Loans and advances to customers at amortised cost

Net impairment losses / (gains)
The Group's net impairment losses / (gains) on loans and advances to customers at amortised cost is set out in this table. The comparative figures for the prior period have not been restated and are presented on an IAS 39 classification and measurement basis.

Group	2018 £m	2017 £m
Residential mortgages	7	2
Non-property SME and corporate	-	1
Property and construction	(6)	8
Consumer	36	15
Total	**37**	**26**

13 Share of profit after tax of joint venture

This represents the Group's 50% share of profit after tax of its joint venture in FRESH with Post Office Limited. It is accounted for using the equity method of accounting. See note 23 for further information.

Group	2018 £m	2017 £m
First Rate Exchange Services Holdings Limited	33	34
Share of profit after tax of joint venture	**33**	**34**

14 Taxation charge

The effective tax rate for the year is a charge of 13% (2017: charge of 14%). This rate is lower than the standard rate of 19% largely due to the impact of the treatment of the acquired mortgage portfolio and the impact of the results of the joint venture FRESH partly offset by the impact of the UK banking surcharge.

Group	2018 £m	2017 £m
Current tax		
Current year charge	19	19
Adjustment in respect of prior year	(2)	-
Total current taxation charge	**17**	**19**
Deferred tax		
Current year charge	5	3
Adjustment in respect of prior year	-	(1)
Total deferred taxation charge	**5**	**2**
Taxation charge	**22**	**21**

14 Taxation charge *(continued)*

This table shows a reconciliation of tax on the profit before taxation, at the standard UK corporation tax rate, to the Group's actual tax charge for the years ended 31 December 2018 and 31 December 2017.

Group	2018 £m	2017 £m
Profit before taxation	**173**	**151**
Multiplied by the standard rate of Corporation tax in UK of 19% (2017: 19.25%)	33	29
Effects of:		
Non-allowable expenses	-	1
Share of results of joint venture after tax in the income statement	(6)	(7)
Impact of UK banking surcharge	4	4
Non-taxable income on the unwind of fair value adjustments on acquired mortgages (see page 94)	(8)	(5)
Adjustment in respect of prior year	(2)	-
Other	1	(1)
Taxation charge	**22**	**21**

15 Cash and cash equivalents

	Group		Bank	
2018 Cash and cash equivalents	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Cash	29	30	29	30
Balances at central banks	2,538	1,806	2,538	1,806
Less impairment loss allowance on cash and balances at central banks	-	-	-	-
Total cash balances included in cash and cash equivalents	**2,567**	**1,836**	**2,567**	**1,836**
Loans and advances to banks	2,348	2,764	2,331	2,625
Less: amounts with a maturity of three months or more	(601)	(960)	(601)	(960)
Total loans and advances to banks included in cash and cash equivalents	**1,747**	**1,804**	**1,730**	**1,665**
Total cash and cash equivalents	**4,314**	**3,640**	**4,297**	**3,501**
Due from the Parent	367	434	359	424

From 1 January 2018 cash and balances at central banks have been classified and measured in accordance with IFRS 9. This involved measuring the impairment loss allowance on a 12 month and lifetime ECL approach. The impairment loss allowance for Group and Bank of £0.3 million is related to 12 month ECL not credit-impaired.

16 Derivative financial instruments

The Group's utilisation of objectives and policies in relation to managing the risks that arise in connection with derivatives, are included in the Risk Management section, on pages 25 to 56. The notional amounts of certain types of financial instruments do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Group's exposure to credit risk. The derivative instruments become assets or liabilities as a result of fluctuations in market rates or prices relative to their terms.

The Group holds certain derivatives with the Parent principally for interest rate risk management. The Group has applied hedge accounting to the majority of these derivatives, which are classified as held for hedging in the table below.

The Group also holds certain derivatives to which hedge accounting is not applied and these are considered to be held for trading in the table above. These primarily include foreign exchange forward contracts with customers, with a corresponding foreign exchange contract to hedge foreign exchange risk with the Parent.

As set out in the risk management policy on page 33, the Group uses netting arrangements and collateral agreements to reduce its exposure to credit losses. Of the derivative assets of £32 million at 31 December 2018 (2017: £27 million):

- £31 million (2017: £20 million) are available for offset against derivative liabilities under CSA and ISDA standard documentation. These transactions do not meet the criteria under IAS 32 to enable the assets to be presented net of the liabilities. At 31 December 2018 cash collateral of £2 million (2017: £40 million) was placed against these liabilities and is reported in Loans and advances to banks (note 17); and
- £1 million (2017: £7 million) are not covered under CSA and ISDA standard documentation.

Group and Bank	2018			2017		
	Contract notional amounts £m	Fair values Assets £m	Fair values Liabilities £m	Contract notional amounts £m	Fair values Assets £m	Fair values Liabilities £m
Derivatives held for trading						
Foreign exchange derivatives						
Currency forwards	198	1	5	156	3	1
Currency forwards – with the Parent	198	5	1	156	1	3
Currency swaps	219	-	3	207	4	1
Currency swaps - with the Parent	219	3	-	207	1	4
Total foreign exchange derivatives held for trading	**834**	**9**	**9**	**726**	**9**	**9**
Interest rate derivatives						
Interest rate swaps - with the Parent	4,079	9	2	2,064	3	2
Cross currency interest rate swaps - with the Parent	123	-	-	104	-	-
Total interest rate derivatives held for trading	**4,202**	**9**	**2**	**2,168**	**3**	**2**
Total derivatives held for trading	**5,036**	**18**	**11**	**2,894**	**12**	**11**
Derivatives held as fair value hedges						
Interest rate swaps - with the Parent	3,325	10	22	4,061	9	41
Derivatives held as cash flow hedges						
Interest rate swaps - with the Parent	3,557	4	10	3,590	6	13
Total derivative assets / liabilities held for hedging	**6,882**	**14**	**32**	**7,651**	**15**	**54**
Total derivative assets / liabilities	**11,918**	**32**	**43**	**10,545**	**27**	**65**

16 Derivative financial instruments *(continued)*

Hedge accounting
In applying hedge accounting, the Group designates certain derivatives as hedging instruments in either fair value or cash flow hedge relationships.

The timing of the nominal amounts (excluding those subject to a dynamic macro-hedging process) and the applicable average rates were as follows:

Group and Bank

Hedging Strategy	Risk Category	Hedging Instrument	Up to 1 year £m	1-2 years £m	2-5 years £m	>5 years £m
Fair Value Hedge	Interest Rate Risk	Interest rate swap	238	72	382	-
		Average fixed interest rate	1.80	1.11	1.84	0.60
Cash Flow Hedge	Interest Rate Risk	Interest rate swap	853	1,499	259	946
		Average fixed interest rate	0.69	0.99	1.11	1.19

Fair value hedges
Certain interest rate derivatives are designated as hedging instruments. These are primarily used to reduce the interest rate exposure on the Group's fixed rate financial assets and liabilities.

The amounts relating to items designated as hedging instruments and hedge ineffectiveness for the year are shown in the table below:

Group and Bank

2018

Risk Category	Hedging Instrument[1]	Nominal amount of the hedging instrument £m	Carrying amount of the hedging instrument Assets £m	Carrying amount of the hedging instrument Liabilities £m	Changes in value used for calculating hedge ineffectiveness[2,3] £m	Ineffectiveness recognised in profit or loss[2,3] £m
Interest rate risk	Interest rate swaps	3,325	10	(22)	(18)	-
Total		**3,325**	**10**	**(22)**	**(18)**	**-**

Group and Bank

2018

Risk Category	Line item on the balance sheet in which the hedged item is included	Carrying amount of the hedged item Assets £m	Carrying amount of the hedged item Liabilities £m	Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item Assets £m	Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item Liabilities £m	Changes in value used for calculating hedge ineffectiveness £m	Remaining adjustments for discontinued hedges £m
Interest rate risk	Debt securities at amortised cost	624	-	9	-	9	-
	Loans and advances to customers	2,500	-	(5)	-	9	-
	Customer accounts	-	235	-	(1)	-	-
Total		**3,124**	**235**	**4**	**(1)**	**18**	**-**

[1] *All hedging instruments are included within derivative financial instruments on the balance sheet.*
[2] *Ineffectiveness is included within net trading income / (expense) on the income statement.*
[3] *There are no material causes of ineffectiveness in the Group's fair value hedges.*

16 Derivative financial instruments *(continued)*

Cash flow hedges

The Group designates certain interest rate derivatives in cash flow hedge relationships in order to hedge the exposure to variability in future cash flows arising from floating rate assets.

The amounts relating to items designated as hedging instruments and hedge ineffectiveness for the year are as follows.

Group and Bank 2018 Risk Category	Hedging Instruments[1]	Nominal amount of the hedging instrument £m	Carrying amount of the hedging instrument Assets £m	Carrying amount of the hedging instrument Liabilities £m	Changes in value used for calculating hedge ineffectiveness £m	Changes in the value of the hedging instrument recognised in other comprehensive income £m	Ineffectiveness recognised in profit or loss[2,3] £m	Amount reclassified from the cash flow hedge reserve to profit or loss[3,4] £m
Interest rate risk	Interest rate swaps	3,557	4	10	(3)	4	1	(12)

The amounts relating to items designated as hedged items for the period are as follows.

Group and Bank 2018	Changes in the hedged risk used for calculating hedge ineffectiveness £m	Cash flow hedge reserve £m	Remaining adjustments for discontinued hedges £m
Interest rate risk	4	4	(12)
Foreign exchange risk	-	-	-
Total	**4**	**4**	**(12)**

This table below shows a reconciliation of the movements in the cash flow hedge reserve for 2018.

Group and Bank Cash flow hedge reserve	2018 £m
Changes in fair value	
- Interest rate risk	11
Transfer to income statement	
Interest income	
- Interest rate risk	2
Net trading income / (expense)[3]	
- Interest rate risk	10
Deferred tax on reserve movements	(6)
Net change in cash flow hedge reserve	**17**

In 2018, there were no forecast transactions to which the Group had applied hedge accounting which were no longer expected to occur. Movements in the cash flow hedge reserve are shown in the Consolidated statement of changes in equity (see page 73).

[1] *All hedging instruments are included within derivative financial instruments on the balance sheet.*
[2] *Ineffectiveness is included within trading income / (expense) on the income statement.*
[3] *There are no material causes of ineffectiveness in the Group's cash flow hedges.*
[4] *£nil relates to amounts transferred to profit or loss for which hedge accounting was previously applied but for which hedged future cash flows are not expected to occur.*

16 Derivative financial instruments *(continued)*

Group and Bank

The years in which the hedged cash flows are expected to occur are shown in the tables below:

2017	Up to 1 year £m	1-2 years £m	2-5 years £m	Over 5 years £m	Total £m
Forecast receivable cash flows	5	8	34	16	63
Forecast payable cash flows	(11)	(14)	(4)	-	(29)

The hedged cash flows are expected to impact on the income statement in the following years:

2017	Up to 1 year £m	1-2 years £m	2-5 years £m	Over 5 years £m	Total £m
Forecast receivable cash flows	6	9	34	14	63
Forecast payable cash flows	(12)	(13)	(4)	-	(29)

17 Loans and advances to banks

From 1 January 2018, loans and advances to banks have been classified and measured in accordance with IFRS 9. This involved reclassifying loans and advances to banks from loans and receivables to financial assets at amortised cost and measuring the associated impairment loss allowance on loans and advances to banks on a 12 month and lifetime ECL approach. The comparative figures have not been restated, with impairment provisions reflecting an IAS 39 incurred loss measurement basis.

	Group		Bank	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Placements with other banks	1,039	1,540	1,022	1,401
Mandatory deposits with central banks	1,310	1,223	1,310	1,223
Less impairment loss allowance on loans and advances to banks[1]	(1)	-	(1)	-
Loans and advances to banks at amortised cost	**2,348**	**2,763**	**2,331**	**2,624**
Loans and advances to banks at fair value through profit or loss	-	1	-	1
Total loans and advances to banks	**2,348**	**2,764**	**2,331**	**2,625**
Amounts include:				
Due from the Parent	930	1,394	923	1,383

Amounts due from the Parent, which are included within placements with other banks in the above table, arise from transactions with the Parent, which primarily relates to the management of the Group's interest rate risk position. Amounts due to the Parent are also disclosed in note 29. From a counterparty credit risk perspective, while these two amounts are disclosed on a gross basis, the Group has in place a contractual Master Netting Agreement with the Parent, whereby, in the event of default of either party, all amounts due or payable will be settled immediately on a net basis.

Represented in mandatory deposits with central banks is:
- an amount of £1,252 million relating to collateral with the Bank of England in respect of notes in circulation (2017: £1,189 million). £726 million of this relates to non-interest bearing collateral (2017: £683 million); and
- an amount of £58 million in relation to mandatory cash ratio deposits, which are non-interest bearing deposits placed with the Bank of England under the provisions of the Bank of England Act 1998 (2017: £34 million).

All loans and advances to banks for Group and Bank are stage 1.

[1] *The Group had no provision for impairment on loans and advances to banks at 31 December 2017.*

18 Debt securities at amortised cost

From 1 January 2018, financial assets which were classified as available for sale under IAS 39 have been classified and measured in accordance with IFRS 9. This involved reclassifying these securities as debt securities at amortised cost and measuring the associated impairment loss allowance on a 12 month and lifetime ECL approach. Comparative notes have not been restated, with impairment provisions reflecting an IAS 39 incurred loss measurement basis.

	Group 2018 £m	Bank 2018 £m
Government bonds	415	415
Other debt securities at amortised cost	500	500
Less impairment loss allowance	-	-
Debt securities at amortised cost	**915**	**915**

The following table shows the movement in debt securities at amortised cost for the year ended 31 December 2018. All debt securities at amortised cost were stage 1 (12 month ECL not credit-impaired) throughout the year ended 31 December 2018.

Group and Bank **2018** **Gross carrying amount (before impairment loss allowance)**	**Total £m**
Closing balance 31 December 2017	1,008
Impact of adopting IFRS 9 on 1 January 2018 (note 46)	(5)
Opening balance 1 January 2018[1]	**1,003**
Additions	156
Redemptions, repayments and disposals	(232)
Exchange adjustments	-
Measurement reclassification and other movements	(12)
Gross carrying amount at 31 December 2018	**915**

19 Available for sale financial assets

From 1 January 2018, available for sale financial assets have been classified and measured in accordance with IFRS 9. This involved reclassifying these securities as debt securities at amortised cost (see note 18).

Details of the IFRS 9 impact, reclassifications and re-measurement as at 31 December 2017 and 1 January 2018 are set out in note 46.

	Group 2017 £m	Bank 2017 £m
Government bonds	428	428
Debt securities listed	580	580
Available for sale financial assets	**1,008**	**1,008**

Movements on available for sale financial assets	Group 2017 £m	Bank 2017 £m
At 1 January	1,140	1,140
Revaluation adjustments	(12)	(12)
Additions	82	82
Redemptions / disposals	(198)	(198)
Amortisation	(4)	(4)
At 31 December	**1,008**	**1,008**

[1] *The opening gross carrying amount and impairment loss allowance on debt securities at amortised cost is now presented as those subject to 12 month and lifetime ECL measurement following the adoption of IFRS 9, with no comparative restatement of 31 December 2017 positions.*

20 Loans and advances to customers

From 1 January 2018, loans and advances to customers have been classified and measured in accordance with IFRS 9. This involved reclassifying loans and advances to customers from loans and receivables to financial assets at amortised cost and measuring the impairment loss allowance on a 12 month and lifetime ECL approach as appropriate. Comparative figures have not been restated, with impairment provisions reflecting an IAS 39 incurred loss measurement basis.

	Group		Bank	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Loans and advances to customers at amortised cost	18,079	18,741	19,982	20,433
Finance leases and hire purchase receivables (see below)	1,756	1,411	-	-
Less impairment loss allowance on loans and advances to customers	(132)	(155)	(122)	(144)
Total loans and advances to customers[1]	**19,703**	**19,997**	**19,860**	**20,289**
Amounts include:				
Group share of joint operation (note 23)	526	360	-	-
Due from subsidiaries	-	-	1,963	1,760
Due from entities controlled by the Parent	6	6	6	6
Finance leases and hire purchase receivables[2]				
Gross investment in finance leases:				
Not later than 1 year	574	491	-	-
Later than 1 year and not later than 5 years	1,321	1,027	-	-
Later than 5 years	6	5	-	-
	1,901	**1,523**	-	-
Unearned future finance income on finance leases	(145)	(112)	-	-
Net investment in finance leases	**1,756**	**1,411**	-	-
Not later than 1 year	531	455	-	-
Later than 1 year and not later than 5 years	1,220	951	-	-
Later than 5 years	5	5	-	-
	1,756	**1,411**	-	-

The Group's and the Bank's portfolios of loans and advances to customers were classified as follows at 31 December 2018:

Group **2018**	**Gross carrying amount at amortised cost £m**	**Impairment loss allowance £m**	**Total loans and advances to customers at amortised cost £m**
Loans and advances to customers at amortised cost	19,835	(132)	19,703
Loans and advances to customers classified as held for sale (note 22)	564	(27)	537
Total	**20,399**	**(159)**	**20,240**

Bank **2018**	**Gross carrying amount at amortised cost £m**	**Impairment loss allowance £m**	**Total loans and advances to customers at amortised cost £m**
Loans and advances to customers at amortised cost	19,982	(122)	19,860
Loans and advances to customers classified as held for sale (note 22)	564	(27)	537
Total	**20,546**	**(149)**	**20,397**

[1] *At 31 December 2017, loans and advances to customers included £2,886 million of residential mortgage balances that had been securitised but not derecognised. Refer to note 44.*

[2] *The Group's material finance leasing arrangements include the provision of instalment credit and leasing finance for both consumer and business customers. At 31 December 2018, the accumulated allowance for uncollectable minimum lease payments receivable was £nil (2017: £nil).*

20 Loans and advances to customers *(continued)*

The following tables show the gross carrying amount and impairment loss allowances subject to 12 month and lifetime ECL on loans and advances to customers at amortised cost (including assets classified as held for sale) at 1 January 2018 and at 31 December 2018. The opening gross carrying amount and impairment loss allowance on loans and advances to customers at amortised cost is presented as those subject to 12 month and lifetime ECL measurement following the adoption of IFRS 9, with no comparative restatement of 31 December 2017 positions. The Group had no financial assets that were initially purchased or originated credit-impaired during the year ended 31 December 2018.

Group

31 December 2018 **Gross carrying amount at amortised cost (before impairment loss allowance)**	**Residential mortgages £m**	**Non-property SME and corporate £m**	**Commercial property and construction £m**	**Consumer £m**	**Total £m**
Stage 1 - 12 month ECL (not credit impaired)	15,397	1,112	327	2,521	19,357
Stage 2 - Lifetime ECL (not credit impaired)	295	167	96	136	694
Stage 3 - Lifetime ECL (credit impaired)	188	41	79	40	348
Purchased / originated credit-impaired	-	-	-	-	-
Gross carrying amount at 31 December 2018	**15,880**	**1,320**	**502**	**2,697**	**20,399**

1 January 2018 Gross carrying amount at amortised cost (before impairment loss allowance)	Residential mortgages £m	Non-property SME and corporate £m	Commercial property and construction £m	Consumer £m	Total £m
Closing balance 31 December 2017	16,043	1,371	652	2,086	20,152
Impact of adopting IFRS 9 on 1 January 2018 (note 46)	-	-	-	-	-
Opening balance 1 January 2018	16,043	1,371	652	2,086	20,152
Stage 1 - 12 month ECL (not credit impaired)	15,462	1,148	352	1,913	18,875
Stage 2 - Lifetime ECL (not credit impaired)	398	150	141	146	835
Stage 3 - Lifetime ECL (credit impaired)	183	73	159	27	442
Purchased / originated credit-impaired	-	-	-	-	-
Gross carrying amount at 1 January 2018	16,043	1,371	652	2,086	20,152

Group

2018 **Gross carrying amount at amortised cost (before impairment loss allowance)**	**Stage 1 - 12 month ECL (not credit-impaired) £m**	**Stage 2 - Lifetime ECL (not credit-impaired) £m**	**Stage 3 - Lifetime ECL (credit-impaired) £m**	**Purchased / originated credit-impaired £m**	**Total gross carrying amount £m**
Closing balance 31 December 2017					20,152
Impact of adopting IFRS 9 on 1 January 2018 (note 46)					-
Opening balance 1 January 2018[1]	**18,875**	**835**	**442**	**-**	**20,152**
Total net transfers	(182)	23	159	-	-
- to 12-month ECL not credit-impaired	*900*	*(896)*	*(4)*	-	-
- to lifetime ECL not credit-impaired	*(1,010)*	*1,126*	*(116)*	-	-
- to lifetime ECL credit-impaired	*(72)*	*(207)*	*279*	-	-
Net changes in exposure	644	(166)	(171)	-	307
Impairment loss allowances utilised[2]	-	-	(83)	-	(83)
Exchange adjustments	-	-	-	-	-
Measurement reclassification and other movements	20	2	1	-	23
Gross carrying amount at 31 December 2018	**19,357**	**694**	**348**	**-**	**20,399**

[1] *The opening gross carrying amount and impairment loss allowance on loans and advances to customers at amortised cost is now presented as those subject to 12 month and lifetime ECL measurement following the adoption of IFRS 9, with no comparative restatement of 2017 positions.*

[2] *Impairment loss allowances utilised on loans and advances to customers at amortised cost during 2018 includes £15 million of contractual amounts outstanding that are still subject to enforcement activity.*

20 Loans and advances to customers *(continued)*

Group

31 December 2018 **Impairment loss allowance**	**Residential mortgages £m**	**Non-property SME and corporate £m**	**Commercial property and construction £m**	**Consumer £m**	**Total £m**
Stage 1 - 12 month ECL (not credit impaired)	5	3	-	34	42
Stage 2 - Lifetime ECL not credit impaired	6	5	1	19	31
Stage 3 - Lifetime ECL credit impaired	18	16	23	29	86
Purchased / originated credit-impaired	-	-	-	-	-
Impairment loss allowance at 31 December 2018	**29**	**24**	**24**	**82**	**159**

1 January 2018 Impairment loss allowance	Residential mortgages £m	Non-property SME and corporate £m	Commercial property and construction £m	Consumer £m	Total £m
Closing balance 31 December 2017	27	32	63	33	155
Impact of adopting IFRS 9 on 1 January 2018 (note 46)	(1)	8	2	29	38
Opening balance 1 January 2018	26	40	65	62	193
Stage 1 - 12 month ECL (not credit impaired)	5	3	1	25	34
Stage 2 - Lifetime ECL (not credit impaired)	6	5	3	18	32
Stage 3 - Lifetime ECL (credit impaired)	15	32	61	19	127
Purchased / originated credit-impaired	-	-	-	-	-
Impairment loss allowance at 1 January 2018	26	40	65	62	193

Group

2018 **Impairment loss allowance**	**Stage 1 - 12 month ECL (not credit-impaired) £m**	**Stage 2 - Lifetime ECL (not credit-impaired) £m**	**Stage 3 - Lifetime ECL (credit-impaired) £m**	**Purchased / originated credit-impaired £m**	**Total impairment loss allowance £m**
Closing balance 31 December 2017					155
Impact of adopting IFRS 9 on 1 January 2018 (note 46)					38
Opening balance 1 January 2018	**34**	**32**	**127**	**-**	**193**
Total net transfers	(18)	18	-	-	-
- to 12-month ECL not credit-impaired	*12*	*(10)*	*(2)*	-	-
- to lifetime ECL not credit-impaired	*(28)*	*37*	*(9)*	-	-
- to lifetime ECL credit-impaired	*(2)*	*(9)*	*11*	-	-
Net impairment (losses) / gains in income statement	26	(18)	38	-	46
- Re-measurement	*27*	*(8)*	*56*	-	*75*
- Net changes in exposure	*9*	*(7)*	*(16)*	-	*(14)*
- ECL model parameter and / or methodology changes	*(10)*	*(3)*	*(2)*	-	*(15)*
Impairment loss allowances utilised	-	-	(84)	-	(84)
Exchange adjustments	-	-	-	-	-
Measurement reclassification and other movements	-	(1)	5	-	4
Impairment loss allowance at 31 December 2018	**42**	**31**	**86**	**-**	**159**

20 Loans and advances to customers *(continued)*

Bank

31 December 2018 **Gross carrying amount at amortised cost (before impairment loss allowance)**	**Residential mortgages £m**	**Non-property SME and corporate £m**	**Commercial property and construction £m**	**Consumer £m**	**Total £m**
Stage 1 - 12 month ECL (not credit impaired)	15,397	2,719	327	1,119	19,562
Stage 2 - Lifetime ECL (not credit impaired)	295	160	96	99	650
Stage 3 - Lifetime ECL (credit impaired)	188	40	79	27	334
Purchased / originated credit-impaired	-	-	-	-	-
Gross carrying amount at 31 December 2018	**15,880**	**2,919**	**502**	**1,245**	**20,546**

1 January 2018 Gross carrying amount at amortised cost (before impairment loss allowance)	Residential mortgages £m	Non-property SME and corporate £m	Commercial property and construction £m	Consumer £m	Total £m
Closing balance 31 December 2017	16,043	2,786	652	952	20,433
Impact of adopting IFRS 9 on 1 January 2018 (note 46)	-	-	-	-	-
Opening balance 1 January 2018	16,043	2,786	652	952	20,433
Stage 1 - 12 month ECL (not credit impaired)	15,462	2,570	352	826	19,210
Stage 2 - Lifetime ECL (not credit impaired)	398	144	141	110	793
Stage 3 - Lifetime ECL (credit impaired)	183	72	159	16	430
Purchased / originated credit-impaired	-	-	-	-	-
Gross carrying amount at 1 January 2018	16,043	2,786	652	952	20,433

Bank

2018 **Gross carrying amount at amortised cost (before impairment loss allowance)**	**Stage 1 - 12 month ECL (not credit-impaired) £m**	**Stage 2 - Lifetime ECL (not credit-impaired) £m**	**Stage 3 - Lifetime ECL (credit-impaired) £m**	**Purchased / originated credit-impaired £m**	**Total gross carrying amount £m**
Closing balance 31 December 2017					20,433
Impact of adopting IFRS 9 on 1 January 2018 (note 46)					-
Opening balance 1 January 2018[1]	**19,210**	**793**	**430**	**-**	**20,433**
Total net transfers	(171)	17	154	-	-
- to 12-month ECL not credit-impaired	*888*	*(886)*	*(2)*	-	-
- to lifetime ECL not credit-impaired	*(993)*	*1,107*	*(114)*	-	-
- to lifetime ECL credit-impaired	*(66)*	*(204)*	*270*	-	-
Net changes in exposure	503	(162)	(170)	-	171
Impairment loss allowances utilised[2]	-	-	(81)	-	(81)
Exchange adjustments	-	-	-	-	-
Measurement reclassification and other movements	20	2	1	-	23
Gross carrying amount at 31 December 2018	**19,562**	**650**	**334**	**-**	**20,546**

[1] *The opening gross carrying amount and impairment loss allowance on loans and advances to customers at amortised cost is now presented as those subject to 12 month and lifetime ECL measurement following the adoption of IFRS 9, with no comparative restatement of 2017 positions.*

[2] *Impairment loss allowances utilised on loans and advances to customers at amortised cost during 2018 includes £12 million of contractual amounts outstanding that are still subject to enforcement activity.*

20 Loans and advances to customers *(continued)*

Bank

31 December 2018 **Impairment loss allowance**	**Residential mortgages £m**	**Non-property SME and corporate £m**	**Commercial property and construction £m**	**Consumer £m**	**Total £m**
Stage 1 - 12 month ECL (not credit impaired)	5	4	-	32	41
Stage 2 - Lifetime ECL not credit impaired	6	5	1	17	29
Stage 3 - Lifetime ECL credit impaired	18	15	23	23	79
Purchased / originated credit-impaired	-	-	-	-	-
Impairment loss allowance at 31 December 2018	**29**	**24**	**24**	**72**	**149**

1 January 2018 Impairment loss allowance	Residential mortgages £m	Non-property SME and corporate £m	Commercial property and construction £m	Consumer £m	Total £m
Closing balance 31 December 2017	27	31	63	23	144
Impact of adopting IFRS 9 on 1 January 2018 (note 46)	(1)	9	2	29	39
Opening balance 1 January 2018	26	40	65	52	183
Stage 1 - 12 month ECL (not credit impaired)	5	4	1	22	32
Stage 2 - Lifetime ECL (not credit impaired)	6	4	3	17	30
Stage 3 - Lifetime ECL (credit impaired)	15	32	61	13	121
Purchased / originated credit-impaired	-	-	-	-	-
Impairment loss allowance at 1 January 2018	26	40	65	52	183

Bank

2018 **Impairment loss allowance**	**Stage 1 - 12 month ECL (not credit-impaired) £m**	**Stage 2 - Lifetime ECL (not credit-impaired) £m**	**Stage 3 - Lifetime ECL (credit-impaired) £m**	**Purchased / originated credit-impaired £m**	**Total impairment loss allowance £m**
Closing balance 31 December 2017					144
Impact of adopting IFRS 9 on 1 January 2018 (note 46)					39
Opening balance 1 January 2018	**32**	**30**	**121**	**-**	**183**
Total net transfers	(19)	18	1	-	-
- to 12-month ECL not credit-impaired	*10*	*(10)*	*-*	-	-
- to lifetime ECL not credit-impaired	*(28)*	*37*	*(9)*	-	-
- to lifetime ECL credit-impaired	*(1)*	*(9)*	*10*	-	-
Net impairment (losses) / gains in income statement	28	(18)	33	-	43
- Re-measurement	*29*	*(10)*	*52*	-	*71*
- Net changes in exposure	*8*	*(5)*	*(17)*	-	*(14)*
- ECL model parameter and / or methodology changes	*(9)*	*(3)*	*(2)*	-	*(14)*
Impairment loss allowances utilised	-	-	(81)	-	(81)
Exchange adjustments	-	-	-	-	-
Measurement reclassification and other movements	-	(1)	5	-	4
Impairment loss allowance at 31 December 2018	**41**	**29**	**79**	**-**	**149**

20 Loans and advances to customers *(continued)*

The below table shows the movement in impairment provisions on total loans and advances to customers under IAS 39 for the year ended 31 December 2017.

Group 2017	Residential mortgages £m	Non-property SME and corporate £m	Commercial property and construction £m	Consumer £m	Total impairment provisions £m
Provision at 1 January 2017	28	58	152	28	266
Exchange adjustments	-	1	1	-	2
Provisions utilised	(2)	(31)	(106)	(16)	(155)
Recoveries	(1)	2	5	5	11
Other movements	-	1	3	1	5
Charge to the income statement	2	1	8	15	26
Provision at 31 December 2017	27	32	63	33	155

Bank 2017	Residential mortgages £m	Non-property SME and corporate £m	Commercial property and construction £m	Consumer £m	Total impairment provisions £m
Provision at 1 January 2017	28	57	152	19	256
Transfer between provisions	-	-	-	-	-
Exchange adjustments	-	1	1	-	2
Provisions utilised	(2)	(31)	(106)	(14)	(153)
Recoveries	(1)	2	5	4	10
Other movements	-	1	3	1	5
Charge to the income statement	2	1	8	13	24
Provision at 31 December 2017	27	31	63	23	144

Under IAS 39, impairment provisions included specific and IBNR provisions. IBNR provisions were recognised on all categories of loans for incurred losses not specifically identified but which, experience and observable data indicated, were present in the portfolio at the date of assessment.

Provisions utilised reflect impairment provisions which have been utilised against the related loan balance; the utilisation of a provision does not, of itself, alter a customer's obligations nor does it impact on the Group's rights to take relevant enforcement action.

The following table is the equivalent impairment loss allowance for the Group's loans and advances to customers as at 31 December 2017 as disclosed in the Group's Annual Report. The table has not been restated and is presented on an IAS 39 measurement and classification basis.

2017 Impairment provision by nature of impairment provision	Group £m	Bank £m
Specific provisions	108	101
Incurred but not reported (IBNR)	47	43
Total impairment provision	155	144

20 Loans and advances to customers *(continued)*

Modified financial assets
The following table provides analysis of financial assets for which the contractual cash flows have been modified while they had an impairment loss allowance measured at an amount equal to lifetime expected credit loss, and where the modification did not result in derecognition.

There were no modification gains or losses recognised during the year.

	2018 £m
Financial assets modified during the period	
- Amortised cost before modification	46
Financial assets modified since initial recognition	
- Gross carrying amount of financial assets for which ILA has changed from lifetime to 12 month ECL during the year as at 31 December 2018	28

21 Credit risk exposures

The following disclosures provide quantitative information about credit risk within financial instruments held by the Group. Details of the credit risk methodologies are set out on pages 39 to 45.

All disclosures for loans and advances to customers in this note also incorporate assets classified as held for sale (note 22).

In addition to credit risk, the primary risks affecting the Group through its use of financial instruments are: liquidity and funding risk and market risk. The Group's approach to the management of these risks, together with its approach to capital management, are set out in the Risk Management Report included on pages 25 to 56.

The table below illustrates the relationship between the Group's internal credit risk rating grades as used for credit risk management purposes and Probability of Default (PD) percentages, and further illustrates the indicative relationship with credit risk ratings used by external rating agencies.

Internal credit risk ratings		
PD Grade	**PD %**	**Indicative external ratings**
1-4	0% ≤ PD < 0.26%	AAA, AA+, AA, AA-, A+, A, A-, BBB+
5-7	0.26% ≤ PD < 1.45%	BBB, BBB-, BB+, BB
8-9	1.45% ≤ PD < 3.60%	BB-, B+
10-11	3.60% ≤ PD < 100%	B, Below B
12 (credit-impaired)	100%	n/a

Financial assets

Composition and risk profile
The table below summarises the composition and risk profile of the Group's financial assets subject to impairment. Comparative figures have not been restated and are presented on an IAS 39 classification and measurement basis.

Group	**31 December 2018**					31 December 2017
Financial asset exposure by stage (before impairment loss allowance)	**Stage 1 - (not credit-impaired) £m**	**Stage 2 - (not credit-impaired) £m**	**Stage 3 - (credit-impaired) £m**	**Purchased or originated credit-impaired £m**	**Total £m**	Total £m
Financial assets measured at amortised cost						
Loans and advances to customers	19,357	694	348	-	20,399	20,152
Loans and advances to banks	2,349	-	-	-	2,349	2,764
Debt securities	915	-	-	-	915	-
Other financial assets[1]	2,736	-	-	-	2,736	2,028
Total financial assets measured at amortised cost	**25,357**	**694**	**348**	**-**	**26,399**	**24,944**
Available for sale financial assets	-	-	-	-	-	1,008
Total	**25,357**	**694**	**348**	**-**	**26,399**	**25,952**

[1] *At 31 December 2018, other financial assets includes cash and balances at central banks and items in the course of collection from other banks.*

21 Credit risk exposures *(continued)*

Bank	31 December 2018					31 December 2017
Financial asset exposure by stage (before impairment loss allowance)	**Stage 1 - (not credit-impaired) £m**	**Stage 2 - (not credit-impaired) £m**	**Stage 3 - (credit-impaired) £m**	**Purchased or originated credit-impaired £m**	**Total £m**	Total £m
Financial assets measured at amortised cost						
Loans and advances to customers	19,562	650	334	-	20,546	20,433
Loans and advances to banks	2,332	-	-	-	2,332	2,625
Debt securities	915	-	-	-	915	-
Other financial assets[1]	2,736	-	-	-	2,736	2,028
Total financial assets measured at amortised cost	**25,545**	**650**	**334**	**-**	**26,529**	**25,086**
Available for sale financial assets	-	-	-	-	-	1,008
Total	**25,545**	**650**	**334**	**-**	**26,529**	**26,094**

Impairment loss allowance
The impairment loss allowance on financial assets is set out in the tables below. Comparative figures have not been restated and are presented on an IAS 39 classification and measurement basis.

Group	31 December 2018					31 December 2017
Impairment loss allowance on financial assets	**Stage 1 - (not credit-impaired) £m**	**Stage 2 - (not credit-impaired) £m**	**Stage 3 - (credit-impaired) £m**	**Purchased or originated credit-impaired £m**	**Total £m**	Total £m
Financial assets measured at amortised cost						
Loans and advances to customers	42	31	86	-	159	155
Loans and advances to banks	1	-	-	-	1	-
Debt securities	-	-	-	-	-	-
Other financial assets	-	-	-	-	-	-
Total financial assets measured at amortised cost	**43**	**31**	**86**	**-**	**160**	**155**
Total net impairment loss allowance on financial assets	**43**	**31**	**86**	**-**	**160**	**155**

Bank	31 December 2018					31 December 2017
Impairment loss allowance on financial assets	**Stage 1 - (not credit-impaired) £m**	**Stage 2 - (not credit-impaired) £m**	**Stage 3 - (credit-impaired) £m**	**Purchased or originated credit-impaired £m**	**Total £m**	Total £m
Financial assets measured at amortised cost						
Loans and advances to customers	41	29	79	-	149	144
Loans and advances to banks	1	-	-	-	1	-
Debt securities	-	-	-	-	-	-
Other financial assets	-	-	-	-	-	-
Total financial assets measured at amortised cost	**42**	**29**	**79**	**-**	**150**	**144**
Total net impairment loss allowance on financial assets	**42**	**29**	**79**	**-**	**150**	**144**

[1] *At 31 December 2018, other financial assets includes cash and balances at central banks and items in the course of collection from other banks.*

21 Credit risk exposures *(continued)*

Loans and advances to customers at amortised cost

Composition and risk profile

The table below summarises the composition and risk profile of the Group's loans and advances to customers at amortised cost. Comparative figures have not been restated and are presented on an IAS 39 classification and measurement basis. In the tables for the Bank, balances with its subsidiaries, primarily Northridge and Marshall Leasing, are included within the non-property SME and corporate portfolio.

Group	31 December 2018				31 December 2017	
Loans and advances to customers Composition and risk profile (before impairment loss allowance)	Not credit-impaired £m	Credit-impaired £m	Total £m	Total %	Total £m	Total %
Residential mortgages	15,692	188	15,880	78%	16,043	80%
Non-property SME and corporate	1,279	41	1,320	7%	1,371	7%
Commercial property and construction	423	79	502	2%	652	3%
Consumer	2,657	40	2,697	13%	2,086	10%
Total	**20,051**	**348**	**20,399**	**100%**	**20,152**	**100%**
Impairment loss allowance on loans and advances to customers	**73**	**86**	**159**	**100%**	**155**	**100%**

Bank	31 December 2018				31 December 2017	
Loans and advances to customers Composition and risk profile (before impairment loss allowance)	Not credit-impaired £m	Credit-impaired £m	Total £m	Total %	Total £m	Total %
Residential mortgages	15,692	188	15,880	77%	16,043	78%
Non-property SME and corporate	2,879	40	2,919	14%	2,786	14%
Commercial property and construction	423	79	502	3%	652	3%
Consumer	1,218	27	1,245	6%	952	5%
Total	**20,212**	**334**	**20,546**	**100%**	**20,433**	**100%**
Impairment loss allowance on loans and advances to customers	**70**	**79**	**149**	**100%**	**144**	**100%**

Asset quality - not credit-impaired

The table below summarises the composition and impairment loss allowance of the Group's loans and advances to customers that are not credit-impaired.

Group 31 December 2018	Stage 1				Stage 2			
Not credit-impaired loans and advances to customers Composition and impairment loss allowance	Loans £m	Loans as % of total advances %	Impairment loss allowance £m	Impairment loss allowance as % of loans %	Loans £m	Loans as % of total advances %	Impairment loss allowance £m	Impairment loss allowance as % of loans %
Residential mortgages	15,397	75%	5	0.03%	295	1%	6	2.03%
Non-property SME and corporate	1,112	5%	3	0.27%	167	1%	5	2.99%
Commercial property and construction	327	2%	-	-	96	-	1	1.04%
Consumer	2,521	12%	34	1.35%	136	1%	19	13.97%
Total	**19,357**	**94%**	**42**	**0.22%**	**694**	**3%**	**31**	**4.47%**

21 Credit risk exposures *(continued)*

Bank 31 December 2018	Stage 1				Stage 2			
Not credit-impaired loans and advances to customers Composition and impairment loss allowance	Loans £m	Loans as % of total advances %	Impairment loss allowance £m	Impairment loss allowance as % of loans %	Loans £m	Loans as % of total advances %	Impairment loss allowance £m	Impairment loss allowance as % of loans %
Residential mortgages	15,397	75%	5	0.03%	295	1%	6	2.03%
Non-property SME and corporate	2,719	13%	4	0.15%	160	1%	5	3.13%
Commercial property and construction	327	2%	-	-	96	-	1	1.04%
Consumer	1,119	5%	32	2.86%	99	1%	17	17.17%
Total	**19,562**	**95%**	**41**	**0.21%**	**650**	**3%**	**29**	**4.46%**

The table below provides analysis of the asset quality of loans and advances to customers at amortised cost that are not credit-impaired based on mapping the IFRS 9 twelve month probability of default (PD) of each loan to a PD grade based on the table provided on page 112.

Group 2018 Not credit-impaired loans and advances to customers Asset quality - PD grade	Residential mortgages £m	Residential mortgages %	Non-property SME and corporate £m	Non-property SME and corporate %	Commercial property and construction £m	Commercial property and construction %	Consumer £m	Consumer %	Total £m	Total %
Stage 1										
1-4	6,572	42%	269	21%	185	44%	61	2%	7,087	35%
5-7	8,146	52%	409	32%	120	28%	1,422	54%	10,097	50%
8-9	471	3%	427	33%	22	5%	317	12%	1,237	6%
10-11	208	1%	7	1%	-	-	721	27%	936	5%
Total Stage 1	**15,397**	**98%**	**1,112**	**87%**	**327**	**77%**	**2,521**	**95%**	**19,357**	**96%**
Stage 2										
1-4	12	-	56	4%	13	3%	-	-	81	1%
5-7	36	-	35	3%	42	10%	1	-	114	1%
8-9	15	-	25	2%	20	5%	7	-	67	-
10-11	232	2%	51	4%	21	5%	128	5%	432	2%
Total Stage 2	**295**	**2%**	**167**	**13%**	**96**	**23%**	**136**	**5%**	**694**	**4%**
Not credit-impaired										
1-4	6,584	42%	325	25%	198	47%	61	2%	7,168	36%
5-7	8,182	52%	444	35%	162	38%	1,423	54%	10,211	51%
8-9	486	3%	452	35%	42	10%	324	12%	1,304	6%
10-11	440	3%	58	5%	21	5%	849	32%	1,368	7%
Total not credit-impaired	**15,692**	**100%**	**1,279**	**100%**	**423**	**100%**	**2,657**	**100%**	**20,051**	**100%**

21 Credit risk exposures *(continued)*

Bank 2018 Not credit-impaired loans and advances to customers Asset quality - PD grade	Residential mortgages £m	%	Non-property SME and corporate £m	%	Commercial property and construction £m	%	Consumer £m	%	Total £m	%
Stage 1										
1-4	6,572	42%	2,233	77%	185	44%	55	5%	9,045	45%
5-7	8,146	52%	401	14%	120	28%	221	18%	8,888	44%
8-9	471	3%	78	3%	22	5%	122	10%	693	3%
10-11	208	1%	7	-	-	-	721	59%	936	5%
Total Stage 1	**15,397**	**98%**	**2,719**	**94%**	**327**	**77%**	**1,119**	**92%**	**19,562**	**97%**
Stage 2										
1-4	12	-	56	2%	13	3%	-	-	81	-
5-7	36	-	36	1%	42	10%	-	-	114	1%
8-9	15	-	24	1%	20	5%	8	1%	67	-
10-11	232	2%	44	2%	21	5%	91	7%	388	2%
Total Stage 2	**295**	**2%**	**160**	**6%**	**96**	**23%**	**99**	**8%**	**650**	**3%**
Not credit-impaired										
1-4	6,584	42%	2,289	79%	198	47%	55	5%	9,126	45%
5-7	8,182	52%	437	15%	162	38%	221	18%	9,002	45%
8-9	486	3%	102	4%	42	10%	130	11%	760	3%
10-11	440	3%	51	2%	21	5%	812	66%	1,324	7%
Total not credit-impaired	**15,692**	**100%**	**2,879**	**100%**	**423**	**100%**	**1,218**	**100%**	**20,212**	**100%**

The table below summarises the composition and impairment loss allowance of the Group's loans and advances to customers at amortised cost that are credit-impaired (i.e. stage 3).

All loans and advances to customers that are greater than 90 days past due are classified as being credit-impaired. All credit-impaired loans and advances to customers are risk rated PD grade 12.

Group 31 December 2018 Credit-impaired loans and advances to customers Composition and impairment loss allowance	Credit-impaired loans £m	Credit-impaired loans as % of total advances %	Impairment loss allowance £m	Impairment loss allowance as % of credit-impaired loans %
Residential mortgages	188	1%	18	10%
Non-property SME and corporate	41	-	16	39%
Commercial property and construction	79	1%	23	29%
Consumer	40	-	29	73%
Total credit-impaired	**348**	**2%**	**86**	**25%**

21 Credit risk exposures *(continued)*

Bank 31 December 2018 Credit-impaired loans and advances to customers Composition and impairment loss allowance	Credit-impaired loans £m	Credit-impaired loans as % of total advances %	Impairment loss allowance £m	Impairment loss allowance as % of credit-impaired loans %
Residential mortgages	188	1%	18	10%
Non-property SME and corporate	40	-	15	38%
Commercial property and construction	79	1%	23	29%
Consumer	27	-	23	85%
Total credit-impaired	**334**	**2%**	**79**	**24%**

Risk profile of forborne and non-forborne loans and advances to customers

Group 2018 Loans and advances to customers at amortised cost - Composition	Stage 1 (not credit-impaired) £m	Stage 2 (not credit-impaired) £m	Stage 3 (credit-impaired) £m	Purchased / originated credit-impaired £m	Total £m
Non-forborne loans and advances to customers					
Residential mortgages	15,396	237	149	-	15,782
Non-property SME and corporate	1,074	156	21	-	1,251
Commercial property and construction	334	38	8	-	380
- Investment	*307*	*35*	*8*	-	*350*
- Land and development	*27*	*3*	-	-	*30*
Consumer	-	-	-	-	-
Total non-forborne loans and advances to customers	**16,804**	**431**	**178**	**-**	**17,413**
Forborne loans and advances to customers					
Residential mortgages	1	58	39	-	98
Non-property SME and corporate	-	41	28	-	69
Commercial property and construction	-	53	69	-	122
- Investment	-	*49*	*57*	-	*106*
- Land and development	-	*4*	*12*	-	*16*
Consumer	-	-	-	-	-
Total forborne loans and advances to customers	**1**	**152**	**136**	**-**	**289**

21 Credit risk exposures *(continued)*

The Group mitigates its credit risk by taking collateral, which may take a variety of forms as set out in section 2.1.3 of the risk management report. The most material type of secured lending is residential mortgages, for which collateral information is given in the table below and on page 120 for the prior year.

Group	Standard		Buy to let		Self certified		Total		
31 December 2018 Loan to value (LTV) ratio of total mortgages	Not credit-impaired £m	Credit-impaired £m	Not credit-impaired £m	Credit-impaired £m	Not credit-impaired £m	Credit-impaired £m	Not credit-impaired £m	Credit-impaired £m	Total £m
Less than 50%	1,968	21	1,770	13	300	14	4,038	48	4,086
51% to 70%	3,081	24	2,721	21	285	20	6,087	65	6,152
71% to 80%	1,802	13	788	11	82	10	2,672	34	2,706
81% to 90%	1,998	8	181	7	47	6	2,226	21	2,247
91% to 100%	603	7	25	3	12	4	640	14	654
Subtotal	**9,452**	**73**	**5,485**	**55**	**726**	**54**	**15,663**	**182**	**15,845**
101% to 120%	14	2	2	1	2	2	18	5	23
121% to 150%	6	1	1	-	2	-	9	1	10
Adjusted Greater than 150%	2	-	-	-	-	-	2	-	2
Subtotal	**22**	**3**	**3**	**1**	**4**	**2**	**29**	**6**	**35**
Total	**9,474**	**76**	**5,488**	**56**	**730**	**56**	**15,692**	**188**	**15,880**
Weighted average LTV[1]:									
Stock of mortgages at period end	65%	64%	56%	64%	54%	65%	62%	64%	62%
New mortgages during period	76%	69%	60%	75%	53%	-	72%	70%	72%

Repossessed collateral on residential mortgages

At 31 December 2018 and 31 December 2017 the Group held collateral as security on residential mortgages as detailed in the table.

Repossessed properties are sold as soon as practicable, with the proceeds applied against outstanding indebtedness.

Group	2018		2017	
Repossessed collateral	Number of repossessions as at balance sheet date	Balance outstanding £m	Number of repossessions as at balance sheet date	Balance outstanding £m
Residential properties				
Owner occupier	8	1	13	2
Buy to let	24	2	17	2
Self certified	3	-	6	2
Total	**35**	**3**	**36**	**6**

Industry analysis of loans and advances to customers

The following table provides an industry breakdown of total loans (before impairment loss allowances).

Group Total loans - by industry analysis	2018 £m	2017 £m
Residential mortgages	15,880	16,043
Finance leases and hire purchase	1,756	1,411
Credit cards	564	625
Personal loans	681	327
Commercial property and construction	502	652
Business and other services	714	731
Manufacturing and distribution	289	356
Other	13	7
Total	**20,399**	**20,152**

21 Credit risk exposures *(continued)*

IAS 39 Comparatives

Group

2017

Risk profile of loans and advances to customers (before impairment provisions)	Residential mortgages £m	Non-property SME and corporate £m	Commercial property and construction £m	Consumer £m	Total loans and advances customers £m	Total loans and advances customers %
High quality	15,583	478	116	2,039	18,216	90%
Satisfactory quality	23	588	180	-	791	4%
Acceptable quality	38	169	95	-	302	2%
Lower quality but not past due nor impaired	-	48	88	-	136	1%
Neither past due nor impaired	15,644	1,283	479	2,039	19,445	97%
Past due but not impaired	332	38	39	23	432	2%
Impaired	67	50	134	24	275	1%
Total	16,043	1,371	652	2,086	20,152	100%

Group

2017

Financial assets - 'past due but not impaired': loans and advances to customers	Residential mortgages £m	Non-property SME and corporate £m	Commercial property and construction £m	Consumer £m	Total £m
Past due up to 30 days	107	6	1	13	127
Past due 31-60 days	145	7	21	8	181
Past due 61-90 days	29	2	2	2	35
Past due more than 90 days but not impaired	51	23	15	-	89
Total	332	38	39	23	432

Group
2017

Financial assets - 'impaired': loans and advances to customers	Advances £m	Impaired loans £m	Impaired loans as % of advances %	Specific provisions £m	Specific provisions as % of impaired loans %
Residential mortgages	16,043	67	-	7	10%
Non-property SME and corporate	1,371	50	4%	26	52%
Commercial property and construction	652	134	21%	59	44%
Consumer (excluding mortgages)	2,086	24	1%	16	67%
Total	20,152	275	1%	108	39%

21 Credit risk exposures *(continued)*

Loan to value profiles
The following table sets out an analysis of the LTV profile of the Group's residential mortgage portfolio as at 31 December 2017.

Group 2017 Loan to value (LTV) ratio of total mortgages	Standard % of book	Buy to let % of book	Self certified % of book	Total mortgage portfolio % of book
Less than 50%	23%	33%	38%	27%
51% to 70%	35%	48%	38%	40%
71% to 80%	18%	14%	13%	17%
81% to 90%	19%	4%	7%	13%
91% to 100%	5%	1%	4%	3%
Subtotal	100%	100%	100%	100%
101% to 120%	-	-	-	-
Greater than 120%	-	-	-	-
Total	100%	100%	100%	100%
Weighted average LTV[1]:				
Stock of mortgages at year end	64%	56%	56%	61%
New mortgages during year	74%	60%	-	72%

The following tables represent the credit risk exposures of the Bank for its loans and advances to customers and other financial instruments.

Bank 2017 Risk profile of loans and advances to customers (before impairment provisions)	Residential mortgages £m	Non- property SME and corporate £m	Commercial property and construction £m	Consumer £m	Total loans and advances to customers £m	Total loans and advances to customers %
High quality	15,583	136	116	925	16,760	82%
Satisfactory quality	23	2,347	180	-	2,550	12%
Acceptable quality	38	169	95	-	302	2%
Lower quality but not past due nor impaired	-	48	88	-	136	1%
Neither past due nor impaired	15,644	2,700	479	925	19,748	97%
Past due but not impaired	332	37	39	14	422	2%
Impaired	67	49	134	13	263	1%
Total	16,043	2,786	652	952	20,433	100%

[1] *Weighted Average LTVs are calculated at a property level and reflect the average of property values in proportion to the outstanding mortgage.*

21 Credit risk exposures *(continued)*

Bank 2017 Financial assets - 'past due but not impaired': loans and advances to customers	Residential mortgages £m	Non-property SME and corporate £m	Commercial property and construction £m	Consumer £m	Total £m
Past due up to 30 days	107	5	1	11	124
Past due 31-60 days	145	7	21	2	175
Past due 61-90 days	29	2	2	1	34
Past due more than 90 days but not impaired	51	23	15	-	89
Total	332	37	39	14	422

Bank 2017 Financial assets - 'impaired': loans and advances to customers	Advances £m	Impaired loans £m	Impaired loans as % of advances %	Specific provisions £m	Specific provisions as % of impaired loans %
Residential mortgages	16,043	67	-	7	10%
Non-property SME and corporate	2,786	49	2%	25	51%
Commercial property and construction	652	134	21%	59	44%
Consumer	952	13	1%	10	77%
Total	20,433	263	1%	101	38%

Debt securities at amortised cost - asset quality

For Group and Bank all debt securities are PD grade 1-4 and stage 1 at 31 December 2018. The impairment loss allowance at 31 December 2018 was £0.2 million.

Loans and advances to banks at amortised cost - asset quality

For Group and Bank all loans and advances to banks are PD grade 1-4 and stage 1 at 31 December 2018. The impairment loss allowance at 31 December 2018 was £1 million.

Other financial instruments - asset quality

Other financial instruments as set out in the table below include instruments that are not within the scope of IFRS 9 or are not subject to impairment under IFRS 9. These include derivative financial instruments. The table summarises the asset quality of these financial instruments by equivalent external risk ratings.

	Group		Bank	
Other financial instruments with ratings equivalent to:	**2018 £m**	2017[1] £m	**2018 £m**	2017[1] £m
Aaa to Aa3	-	2,358	-	2,233
A1 to A3	32	23	32	22
Baa1 to Baa3	-	1,418	-	1,405
Total	**32**	**3,799**	**32**	**3,660**

[1] *Comparative figures for the prior year have not been restated and include loans and advances to banks and available for sale financial assets.*

21 Credit risk exposures *(continued)*

Exposures by country

The following tables provide an analysis of the Group's exposure to sovereign debt and other country exposures (primarily financial institution exposure), by selected balance sheet line item, as at 31 December 2018 and 31 December 2017. In addition, for these line items, further information is included on the Group's exposures to selected countries and their associated credit ratings from Moody's.

Group 2018 **Asset quality: exposures by country**	**Credit rating[1]**	**Cash and balances[2] £m**	**Loans and advances to banks[3] £m**	**Debt securities at amortised cost[4] £m**	**Derivative financial instruments £m**	**Total £m**
Ireland	A2	-	931	-	31	962
United Kingdom	Aa2	2,567	1,406	639	1	4,613
Other	-	-	11	276	-	287
Total	**-**	**2,567**	**2,348**	**915**	**32**	**5,862**

2017 Asset quality: exposures by country	Credit rating[1]	Cash and balances[2] £m	Loans and advances to banks[3] £m	Available for sale financial assets[4] £m	Derivative financial instruments £m	Total £m
Ireland	A2	-	1,394	-	20	1,414
United Kingdom	Aa2	1,836	1,237	602	7	3,682
Other	-	-	133	406	-	539
Total	-	1,836	2,764	1,008	27	5,635

22 Assets classified as held for sale

Following a strategic review carried out in 2018, the Group is in the process of disposing of its UK credit card loan portfolio. As a result, these assets in the amount of £537 million net of impairment loss allowance have been reclassified from loans and advances to customers together with £2 million of related interest receivable reclassified from other assets to assets classified as held for sale.

Group and Bank	**2018 £m**	2017 £m
Gross carrying amount	564	-
Impairment loss allowance	(27)	-
Accrued interest	2	-
Total assets held for sale	**539**	**-**

[1] *Based on credit ratings from Moody's.*
[2] *Cash and balances in the United Kingdom primarily consist of amounts placed with the Bank of England.*
[3] *Loans and advances to banks in Ireland consist primarily of balances with the Parent and balances in the United Kingdom consist primarily of the Bank of England required collateral for notes in circulation.*
[4] *Debt securities at amortised cost consist of UK Government gilts, Supranational bonds and UK covered bonds. These were classified as available for sale financial assets under IAS 39.*

23 Interest in joint venture and joint operations

Joint arrangement	Holding	Classification	Country of operation	Nature of activities
First Rate Exchange Services Holdings Limited	50%	Joint venture	UK	Sale of foreign exchange products through the UK Post Office network
AA Financial Services	n/a	Joint operation	UK	Sale of AA branded credit cards, unsecured personal loans, savings and mortgages

Joint venture
The Group owns 50% of the shares in FRESH, a company incorporated in the United Kingdom which provides foreign exchange services.

The following table shows the movement in the Group's interest in FRESH during the years ended 31 December 2018 and 31 December 2017.

The investment in FRESH is unquoted and is measured using the equity method of accounting. There are no significant restrictions on the ability of this entity to transfer funds to the Group in the form of cash dividends, or to repay loans or advances made by the Group, nor is there any unrecognised share of losses either for the year ended 31 December 2018 or cumulatively in respect of this entity. The Group does not have any further commitments or contingent liabilities in respect of this entity other than its investment to date.

There are no significant risks associated with the joint venture that have been identified which require disclosure.

	2018 £m	2017 £m
At 1 January	61	61
Share of profit after taxation (note 13)	33	34
Dividends received	(33)	(34)
Other	1	-
At 31 December	**62**	**61**

The following amounts represent the Group's 50% share of the revenue, expenses, assets and liabilities of FRESH for the year ended 31 December 2018 and the year ended 31 December 2017.

	2018 £m	2017 £m
Revenue	69	70
Expenses	(28)	(28)
Profit before taxation	**41**	**42**
Taxation charge	(8)	(8)
Profit after taxation	**33**	**34**
Non-current assets	7	9
Current assets	237	214
Total assets	**244**	**223**
Current liabilities	(182)	(162)
Total liabilities	**(182)**	**(162)**
Net assets	**62**	**61**

Joint operation – AA Financial Services
In July 2015, the Group entered into a strategic partnership with AA Financial Services for the sale of AA branded credit cards, unsecured personal loans, savings and mortgages.
The above joint arrangement has been accounted for as a joint operation, on the basis that it is not a separate legal entity.

The Group combines its share of the joint operation in individual income and expenses, assets and liabilities and cash flows on a line-by-line basis.

24 Intangible assets and goodwill

Group	2018				2017			
	Goodwill £m	Computer software internally generated £m	Other externally purchased intangible assets £m	Total £m	Goodwill £m	Computer software internally generated £m	Other externally purchased intangible assets £m	Total £m
Cost								
At 1 January	30	35	87	152	-	35	76	111
Acquisitions (note 25)	-	-	-	-	30	-	10	40
Additions	-	-	-	-	-	-	1	1
At 31 December	**30**	**35**	**87**	**152**	**30**	**35**	**87**	**152**
Accumulated amortisation								
At 1 January	-	(34)	(57)	(91)	-	(34)	(52)	(86)
Charge to the income statement (note 10)	-	-	(7)	(7)	-	-	(5)	(5)
At 31 December	**-**	**(34)**	**(64)**	**(98)**	**-**	**(34)**	**(57)**	**(91)**
Net book value at 31 December	**30**	**1**	**23**	**54**	**30**	**1**	**30**	**61**

Bank	2018				2017			
	Goodwill £m	Computer software internally generated £m	Other externally purchased intangible assets £m	Total £m	Goodwill £m	Computer software internally generated £m	Other externally purchased intangible assets £m	Total £m
Cost								
At 1 January	-	34	76	110	-	34	76	110
Acquisitions	-	-	-	-	-	-	-	-
Additions	-	-	-	-	-	-	-	-
At 31 December	**-**	**34**	**76**	**110**	**-**	**34**	**76**	**110**
Accumulated amortisation								
At 1 January	-	(34)	(57)	(91)	-	(34)	(52)	(86)
Charge to the income statement (note 10)	-	-	(5)	(5)	-	-	(5)	(5)
At 31 December	**-**	**(34)**	**(62)**	**(96)**	**-**	**(34)**	**(57)**	**(91)**
Net book value at 31 December	**-**	**-**	**14**	**14**	**-**	**-**	**19**	**19**

Goodwill of £30 million and intangible assets of £10 million arose on the acquisition of Marshall Leasing Limited on 24 November 2017, as set out in note 25.

In the December 2017 financial statements, due to the proximity of the acquisition to the balance sheet date the intangible asset was provisionally valued at £5 million and the goodwill at £35 million. During 2018 the Group finalised the accounting for the acquisition which resulted in a reclassification from goodwill to intangible assets.

Goodwill is not amortised as it is deemed to have an indefinite useful life. The Group's investment in Marshall Leasing Limited has been reviewed for impairment for the purpose of December 2018 reporting and no impairment was identified as a result of this review.

Other Intangible assets have also been reviewed for any indication that impairment may have occurred. No impairment was identified in the year ended 31 December 2018 or 31 December 2017.

The impairment reviews estimate the recoverable amount of the relevant cash generating unit using projections based on the Group's most recent five year plans with a terminal growth rate of 2% thereafter. These cash flows are then discounted at a post tax discount rate of 10%.
The most critical assumptions underlying the impairment review are the cash flow projections in the Group's five year plan, as any reduction in these would reduce the recoverable amount. A significant reduction in these projections could lead to an impairment of the goodwill or intangible assets.

As part of the impairment review of goodwill management have also carried out a downside sensitivity analysis which assumes a 2% growth rate for the period of the five year plan as well as the period thereafter. This scenario continues to show positive headroom.

25 Acquisition of Marshall Leasing Limited

On 24 November 2017 the Group acquired 100% of the ordinary share capital of Marshall Leasing Limited (MLL), a car and commercial vehicle leasing and fleet management company based in Huntingdon, UK. This acquisition will help Northridge Finance to continue to develop and diversify its business.

Goodwill recognised relates to the expected growth, cost synergies and the value of MLL's workforce which cannot be separately recognised as an intangible asset. This goodwill has been allocated to the Group's GB Consumer Banking segment and is not expected to be deductible for tax purposes.

The acquisition was settled in cash of £41 million. Acquisition-related costs amounting to £1 million were recognised as an expense in the consolidated income statement, as part of operating expenses.

The acquisition of MLL had no material impact on the Group's total operating income and operating profit respectively, from the acquisition date to 31 December 2017. For the full year ended 31 December 2017, MLL had total revenue of £21 million (net of depreciation on rental vehicles of £19 million) and operating profit of £4 million.

For the purposes of the 2017 financial statements, due to the proximity of the acquisition to the balance sheet date, the difference between the book value of the acquired net assets and consideration payable was provisionally recognised as goodwill and intangible assets. During 2018 the Group finalised the accounting for the acquisition and the table above shows the final values recognised in respect of the acquisition.

Final values	**2017 £m**
Fair value of consideration transferred[1]	**41**
Recognised amounts of identifiable net assets:	
Property, plant and equipment	79
Intangible assets[2]	10
Other assets	5
Deferred tax assets	2
Deposits from banks	(71)
Other liabilities[3]	(13)
Current tax	(1)
Net identifiable assets and liabilities	**11**
Goodwill[4]	**30**

26 Property, plant and equipment

The historical cost of property, plant and equipment held at fair value at 31 December 2018 was £22 million (2017: £22 million). No depreciation is charged on freehold land and buildings and long leaseholds, as these are revalued annually.

Group	**2018**				2017			
	Computer and other equipment £m	**Freehold land and buildings and long leaseholds (held at fair value) £m**	**Vehicles leased under operating leases £m**	**Total £m**	Computer and other equipment £m	Freehold land and buildings and long leaseholds (held at fair value) £m	Vehicles leased under operating leases £m	Total £m
Cost or valuation								
At 1 January	1	23	82	106	1	7	-	8
Acquisition of subsidiary undertakings (note 25)	-	-	-	-	-	-	79	79
Revaluation adjustments	-	1	-	1	-	1	-	1
Additions	-	-	43	43	-	15	4	19
Disposals / write offs	-	-	(12)	(12)	-	-	(1)	(1)
At 31 December	**1**	**24**	**113**	**138**	**1**	**23**	**82**	**106**
Accumulated depreciation								
At 1 January	-	-	(2)	(2)	-	-	-	-
Disposals / write offs	-	-	2	2	-	-	-	-
Charge for the year	-	-	(21)	(21)	-	-	(2)	(2)
At 31 December	**-**	**-**	**(21)**	**(21)**	**-**	**-**	**(2)**	**(2)**
Net book value at 31 December	**1**	**24**	**92**	**117**	**1**	**23**	**80**	**104**

[1] Previously reported as £42 million.
[2] Previously reported as £5 million.
[3] Previously reported as £12 million.
[4] Previously reported as £35 million.

26 Property, plant and equipment *(continued)*

Bank Freehold land and buildings and long leaseholds (held at fair value)	2018 £m	2017 £m
Cost or valuation		
At 1 January	23	7
Revaluation adjustments	1	1
Additions	-	15
At 31 December	**24**	23
Accumulated depreciation		
At 1 January	-	-
Charge for the year	-	-
At 31 December	**-**	-
Net book value at 31 December	**24**	23

For vehicles leased under operating leases, the annual depreciation charge is calculated using residual values which represent the estimated net sales proceeds expected from the sale of the assets at the end of the operating lease period. Due to the inherent uncertainty associated with such valuation methodology and in particular the volatility of prices of second hand vehicles, the carrying value of the residual values may differ from their realisable value.

Management is careful to ensure that exposure to residual value risk is effectively managed to minimise the company's exposure to residual value risk. The residual values used mirror those utilised in the creation of the original client contract. Management benchmark internal residual values for the existing fleet of vehicles against industry standard valuation tools by third party providers. The residual values for the entire portfolio are reassessed using an independent valuation tool on a monthly basis throughout the life of the underlying contracts, with adjustments being made if required. The process of realising asset values is effectively managed to maximise net sale proceeds.

Depreciation on vehicles leased under operating leases is presented within net leasing income. See note 6.

The following residual values are included in the calculation of the net book value of fixed assets held for use in operating leases:

Group	2018 £m	2017 £m
Within 1 year	23	15
1 – 2 years	18	15
Greater than 2 years	14	18
Total	**55**	**48**

At 31 December 2018 and 31 December 2017 there was no future capital expenditure authorised by the directors but not contracted for, or contracted for but not provided for.

The Group has commitments on future rentals under non-cancellable operating leases as follows:

	Group		Bank	
Operating leases	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Not later than 1 year	4	4	4	4
Later than 1 year and not later than 5 years	16	14	16	14
Later than 5 years	19	20	19	20
	39	**38**	**39**	**38**

26 Property, plant and equipment *(continued)*

The Group has the following amounts of minimum lease receivables under non-cancellable operating leases as follows:

Operating lease receivables	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Not later than 1 year	23	21	-	-
Later than 1 year and not later than 5 years	24	25	3	3
Later than 5 years	-	1	-	1
	47	**47**	**3**	**4**

27 Other assets

Other assets	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Sundry and other receivables	55	54	51	51
Accounts receivable and prepayments	26	34	24	32
Interest receivable	16	18	17	19
Trade receivables	5	-	5	-
Other assets	**102**	**106**	**97**	**102**
Amounts include:				
Due from the Parent	-	1	-	1
Maturity profile of other assets				
Amounts receivable within 1 year	89	89	85	85
Amounts receivable after 1 year	13	17	12	17
Total	**102**	**106**	**97**	**102**

28 Deferred tax

	Group		Bank	
	2018 £m	2017 £m	**2018 £m**	2017 £m
The movement on the deferred tax account is as follows:				
At 1 January	71	69	65	63
Impact of adopting IFRS 9 at 1 January 2018	13	-	12	-
Income statement charge for the year (note 14)	(5)	(2)	(5)	(2)
Cash flow hedges - credit / (charge) to other comprehensive income	6	3	6	3
Additional tier 1 - credit to equity	1	1	1	1
Other movements	(1)	-	1	-
At 31 December	**85**	**71**	**80**	**65**
Deferred tax assets and liabilities are attributable to the following items:				
Deferred tax assets				
Unutilised tax losses	72	74	72	74
Fixed / leased assets	7	8	1	1
IFRS 9 transitional adjustment	11	-	10	-
Total deferred tax assets	**90**	**82**	**83**	**75**
Deferred tax liabilities				
Cash flow hedges	(2)	(8)	(2)	(8)
Available for sale securities	-	(1)	-	(1)
Deferred tax on property held at fair value	(1)	(1)	(1)	(1)
Other	(2)	(1)	-	-
Total deferred tax liabilities	**(5)**	**(11)**	**(3)**	**(10)**
Represented on the balance sheet as follows:				
Deferred tax assets	85	71	80	65
Total deferred tax	**85**	**71**	**80**	**65**

In accordance with IAS 12, in presenting the deferred tax balances above the Group offsets deferred tax assets and liabilities where:

- an entity has a legally enforceable right to set off current tax assets against current tax liabilities; and
- the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

The deferred tax asset primarily relates to losses which were transferred from the Parent as part of a banking trade transfer in 2010. Any adjustments to the Parent's tax computations in respect of legacy matters (details of which are outlined in the Parent's financial statements) could impact the amount of the losses available to the Company.

29 Deposits from banks

	Group		Bank	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Deposits from banks	**3,152**	**3,561**	**3,148**	**3,554**
Amounts include:				
Due to the Parent	1,651	1,989	1,646	1,982

Deposits from banks includes £1,278 million (2017: £1,200 million) of borrowings under the Bank of England Term Funding Scheme and £200 million (2017: £350 million) borrowed under the Bank of England Indexed Long - Term Repo scheme, both of which are collateralised with mortgage loans. Drawings under the Term Funding Scheme will be repaid within four years from the date of drawdown. The interest charged is based on the quantum of net lending by the Bank and by the Parent's UK branch to UK resident households, private non-financial corporations and certain non-bank credit providers from June 2016 to December 2017.

Amounts due to the Parent relates to borrowings in place to fund and manage interest rate risk on the Group's assets. Refer to note 17 for details of amounts due from the Parent, and note 42 in respect of changes in these balances during 2018.

30 Customer accounts

	Group		Bank	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Term deposits	6,985	6,492	7,028	6,574
Demand deposits	9,854	9,622	9,866	9,614
Non-interest bearing current accounts	2,661	2,492	2,661	2,502
Interest bearing current accounts	269	355	269	355
Customer accounts	**19,769**	**18,961**	**19,824**	**19,045**
Amounts include:				
Group share of joint operation (note 23)	706	297	-	-
Due to entities controlled by the Parent	8	8	8	8
Due to subsidiaries	-	-	55	84

31 Other liabilities

	Group		Bank	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Notes in circulation	1,143	1,084	1,143	1,084
Accrued interest payable	68	52	68	52
Sundry payables	99	82	79	66
Accruals and deferred income	8	15	8	15
Other liabilities	**1,318**	**1,233**	**1,298**	**1,217**
Amounts include:				
Due to the Parent	3	2	3	2
Group share of joint operation (note 23)	7	7	7	7
Maturity profile of other liabilities				
Amounts payable within 1 year	1,318	1,233	1,298	1,217
Amounts payable after 1 year	-	-	-	-

The Bank is authorised to issue banknotes in Northern Ireland under the Bank of Ireland (UK) plc Act 2012.

32 Provisions

As at 31 December 2018 the Group had a provision of £5 million has been made for certain commissions payable to the Post Office. In addition, as at 31 December 2018, the Group had a provision of £2 million to cover potential payments to customers in relation to various compliance matters. The provision is based upon management's current expectations of future payments to be made to customers.

31 December 2018	Group £m	Bank £m
Closing balance 31 December 2017	13	12
Net charge to the income statement	5	5
Utilised during the year	(11)	(11)
At 31 December	**7**	**6**
Expected utilisation period		
Used within 1 year	7	6
Used after 1 year	-	-

33 Loss allowance provision on loan commitments and financial guarantees

From 1 January 2018 loan commitments and guarantees and irrevocable letters of credit have been classified and measured in accordance with IFRS 9. This involves measuring the loss allowance provision for loan commitments and financial guarantees and irrevocable letters of credit on a 12 month or lifetime ECL approach.

During 2018, the Group held an impairment loss allowance of £7 million on loan commitments and financial guarantees, of which £7 million are classified as stage 1, £nil as stage 2 and £nil as stage 3.

Prior to the adoption of IFRS 9, provisions in respect of loan commitments and guarantees and irrevocable letters of credit were measured in accordance with IAS 37. Prior period comparative figures figures have not been restated.

Group	2018		2017	
2018	Amount £m	Loss allowance £m	Amount £m	Loss allowance £m
Loan commitments (note 36)	3,792	7	4,271	-
Guarantees and irrevocable letters of credit (note 36)	11	-	9	-
	3,803	**7**	**4,280**	**-**

Bank	2018		2017	
2018	Amount £m	Loss allowance £m	Amount £m	Loss allowance £m
Loan commitments (note 36)	3,760	7	4,252	-
Guarantees and irrevocable letters of credit (note 36)	11	-	9	-
	3,771	**7**	**4,261**	**-**

Group 2018	Loan commitments						Guarantees and irrevocable letters of credit					
Loan commitments and financial guarantees - Contract amount	Stage 1		Stage 2		Total		Stage 1		Stage 2		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%
PD Grade												
1-4	2,051	55%	20	25%	2,071	55%	7	70%	-	-	7	70%
5-7	1,470	40%	12	15%	1,482	39%	2	20%	-	-	2	20%
8-9	150	4%	10	13%	160	4%	1	10%	-	-	1	10%
10-11	35	1%	38	47%	73	2%	-	-	-	-	-	-
Total	**3,706**	**100%**	**80**	**100%**	**3,786**	**100%**	**10**	**100%**	**-**	**-**	**10**	**100%**

Bank 2018	Loan commitments						Guarantees and irrevocable letters of credit					
Loan commitments and financial guarantees - Contract amount	Stage 1		Stage 2		Total		Stage 1		Stage 2		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%
PD Grade												
1-4	2,019	55%	20	25%	2,039	54%	7	70%	-	-	7	70%
5-7	1,470	40%	12	15%	1,482	40%	2	20%	-	-	2	20%
8-9	150	4%	10	13%	160	4%	1	10%	-	-	1	10%
10-11	35	1%	38	47%	73	2%	-	-	-	-	-	-
Total	**3,674**	**100%**	**80**	**100%**	**3,754**	**100%**	**10**	**100%**	**-**	**-**	**10**	**100%**

The tables above for Group and Bank show the loan commitments and guarantees and irrevocable letters of credit by PD grade for stage 1 and stage 2. The remaining balances for Group and Bank of £6 million on loan commitments and £1 million on guarantees and irrevocable letters of credit are stage 3.

34 Retirement benefit obligations

The Group's employees' membership of a particular pension scheme is dependent on their specific employment contract. Where an employee is seconded directly to the Group, the Group only incurs the cost of the future service contribution to those particular schemes. The Group does not have any liability for payment in respect of increases to pension contributions arising from any historic or future shortfall in the pension assets relative to the pension liabilities of the BoI Group operated schemes. Consequently, the schemes have been accounted for as defined contribution schemes in these financial statements and where applicable will be included in the disclosures for defined benefit schemes in the financial statements of BoI Group.

NIIB Group Limited (1975) Pension Scheme (the 'NIIB scheme')
The NIIB defined benefit scheme is based on final pensionable salary and operates for eligible employees of NIIB Group Limited and its subsidiaries. Contributions by the company and the employees are invested in a trustee-administered fund. As the scheme's underlying assets and liabilities are identifiable as those of the Group the scheme has been accounted for as a defined benefit scheme (as set out in the accounting policy for pension obligations) and the disclosures set out in the remainder of this note relate to this scheme.

In determining the level of contributions required to be made to the scheme and the relevant charge to the income statement the Group has been advised by independent actuaries, Willis Towers Watson.

The scheme has been closed to new members since late 2006.

Regulatory framework
The NIIB scheme operates under the UK pension regulatory framework. Benefits are paid to members from a trustee-administered fund. The trustees are responsible for ensuring that the plan is sufficiently funded to meet current and future benefit payments. If the plan experience is worse than expected, the Group's obligations are increased.

Plan details at last valuation date	By number	By % of scheme liability
Scheme members		
Active	70	30
Deferred	122	28
Pensioners / dependants	68	42

Under UK pensions legislation, the trustees must agree a funding plan with the Group such that any funding shortfall is expected to be met by additional contributions and investment outperformance. In order to assess the level of contributions required, triennial valuations are carried out with the scheme's obligations measured using prudent assumptions (relative to those used to measure accounting liabilities) and discounted based on the return expected from assets held in accordance with the actual scheme investment policy.

The trustees' other duties include managing the investment of the plan assets, administration of the plan benefits, ensuring contributions are received, compliance with relevant legislation and exercising of discretionary powers. The Group works closely with the trustees, who manage the plan.

Actuarial valuation of the NIIB scheme
A formal valuation of the NIIB scheme was carried out as at 1 May 2016. The funding method used measures liabilities taking account of the projected future levels of pensionable earnings at the time of commencement of benefits i.e. at normal retirement date. Discussions in relation to the valuation were completed in 2017 and a schedule of contributions and recovery plan, setting out how the shortfall in the scheme will be met, was agreed between the trustees and the Group and submitted to, and signed off by, the Pensions Regulator.

Under the schedule of contributions the Group agreed to make contributions of £1.31 million by 1 August 2017 plus £1.095 million by 1 April 2018, to meet the shortfall in the scheme of £3.0 million as at the date of the triennial valuation, in addition to the cost of future benefit accrual. The next formal valuation of the NIIB scheme is due to be carried out as at 1 May 2019.

Plan details
The above table sets out details of the membership of the NIIB scheme as at 1 May 2016.

Financial and demographic assumptions
The assumptions used in calculating the costs and obligations of the NIIB scheme, as detailed below, were set after consultation with Willis Towers Watson.

The discount rate used to determine the present value of the obligations is set by reference to market yields on corporate bonds. The methodology was updated at the end of 2017, primarily to remove a number of bonds that did not obviously meet the criteria of 'corporate bonds' from the universe considered.

The methodology used to determine the assumption for retail price inflation uses an inflation curve derived by Willis Towers Watson using market data which reflects the characteristics of the Bank's liabilities with an appropriate adjustment to reflect distortions due to supply and demand. The assumption for consumer price inflation is set by reference to retail price inflation, with an adjustment applied, as no consumer price inflation linked bonds exist.

The salary assumption takes into account inflation, seniority, promotion and current employment market relevant to the Group.

34 Retirement benefit obligations *(continued)*

Financial assumptions
The financial assumptions used in measuring the Group's defined benefit asset / liability under IAS 19 are set out in the table below.

Financial assumptions	2018 % p.a.	2017 % p.a.
Consumer price inflation	2.20	2.20
Retail price inflation	3.20	3.20
Discount rate	2.95	2.75
Rate of general increase in salaries	3.70	3.70
Rate of increase in pensions in payment	3.00	3.00
Rate of increase in deferred pensions	2.20	2.20

Mortality assumptions
The mortality assumptions adopted are outlined in the table below.

Post retirement mortality assumptions	2018 Years	2017 Years
Longevity at age 70 for current pensioners		
Men	18.6	18.5
Women	20.0	19.9
Longevity at age 60 for active members currently aged 60 years		
Men	27.8	27.7
Women	29.4	29.4
Longevity at age 60 for active members currently aged 40 years		
Men	29.4	29.3
Women	31.0	30.9

Amounts recognised in financial statements
The table below outlines where the Group's defined benefit plans are recognised in the financial statements.

	2018 £m	2017 £m
Total charge in operating expenses	**(1)**	**(1)**
Total gain in remeasurements[1]	**(1)**	**7**
Total asset in the balance sheet	**8**	**8**

A pension asset is recognised on the basis that the Group has an unconditional right to a refund.

[1] *Shown before deferred tax.*

34 Retirement benefit obligations *(continued)*

The movement in the net defined benefit asset / obligation is as follows:

	2018			2017		
	Present value of obligation £m	**Fair value of plan assets £m**	**Surplus / (deficit) of plan £m**	Present value of obligation £m	Fair value of plan assets £m	Surplus / (deficit) of plan £m
At 1 January	**(38)**	**46**	**8**	**(40)**	**40**	**-**
Current service cost	(1)	-	(1)	(1)	-	(1)
Interest (expense) / income	(1)	1	-	(1)	1	-
Total amount in recognised income statement	**(2)**	**1**	**(1)**	**(2)**	**1**	**(1)**
Return on plan assets not included in income statement	-	(3)	(3)	-	3	3
Change in demographic assumptions	-	-	-	1	-	1
Change in financial assumptions	2	-	2	3	-	3
Experience losses	-	-	-	-	-	-
Total remeasurements in other comprehensive income	**2**	**(3)**	**(1)**	**4**	**3**	**7**
Benefit payments	1	(1)	-	1	(1)	-
Employer contributions	-	2	2	-	2	2
Other	-	-	-	(1)	1	-
Other movements	**1**	**1**	**2**	**-**	**2**	**2**
At 31 December	**(37)**	**45**	**8**	**(38)**	**46**	**8**

Asset breakdown	**2018 £m**	2017 £m
Equities (quoted)[2]	27	28
Index linked government bonds (quoted)[2]	18	18
Total fair value of assets	**45**	**46**

Sensitivity of defined benefit obligation to key assumptions
The table sets out how the defined benefit obligation would have been affected by changes in the significant actuarial assumptions that were reasonably possible at 31 December 2018.

Some of the changes in assumptions may have an impact on the value of the scheme's investment holdings. For example, the plan holds a proportion of its assets in index-linked bonds. A fall in the rate of inflation would be expected to lead to a reduction in the value of these assets, thus partly offsetting the reduction in the defined benefit obligation. The extent to which these sensitivities are managed is discussed further below. The methods and types of assumptions used in preparing the sensitivity analysis are unchanged compared to the prior year.

Impact on defined benefit obligation	**Change in assumptions**	**Increase in assumptions £m**	**Decrease in assumptions £m**
Discount rate	0.25%	(2.0)	2.2
Inflation[1]	0.1%	0.5	(0.4)
Salary growth	0.1%	0.2	(0.2)
Life expectancy	1 year	1.1	(1.1)

[1] *Including other inflation-linked assumptions (consumer price inflation, pension increases, salary growth).*
[2] *These are held indirectly against managed funds.*

34 Retirement benefit obligations *(continued)*

Future cash flows
The plan's liabilities represent a long-term obligation and most of the payments due under the plan will occur several decades into the future. The duration, or average term to payment for the benefits due, weighted by liability, is c.23 years.

Expected employer contributions for the year ended 31 December 2019 are £0.6 million. Expected employee contributions for the year ended 31 December 2019 are £57,000.

Years	Benefit payments from plan assets £m
2019 - 2028	(11)
2029 - 2038	(19)
2039 - 2048	(26)
2049 - 2058	(27)
2059 - 2068	(20)
2069 - 2078	(11)
2079 - 2088	(4)
2089 - 2098	-
Total	**(118)**

Risks and risk management
The NIIB scheme has a number of areas of risk. The key areas of risk, and the ways in which the Group has sought to manage them, are set out in the table below.

The risks are considered from both a funding perspective, which drives the cash commitments of the Group, and from an accounting perspective, i.e. the extent to which such risks affect the amounts recorded in the Group's financial statements.

Risk	Description
Asset volatility	The funding liabilities are calculated using a discount rate set with reference to government bond yields, with allowance for additional return to be generated from the investment portfolio. The defined benefit obligation in the Group's financial statements is calculated using a discount rate set with reference to high quality corporate bond yields. The plan holds a significant proportion of its assets in equities and other return-seeking assets. The returns on such assets tend to be volatile and are not correlated to government bonds. This means that the funding level is likely to be volatile in the short-term, potentially resulting in short-term cash requirements and an increase in the net defined benefit liability recorded on the balance sheet.
Changes in bond yields	Interest rate and inflation risks, along with equity risk, are the scheme's largest risks. From an accounting liability perspective, the scheme is also exposed to movements in corporate bond spreads. The scheme uses an investment in index-linked bonds to manage its interest rate and inflation risk. This portfolio is used to broadly hedge against movements in long-term interest rates and inflation expectations. The portfolio does not completely eliminate risk and addresses only a portion of the scheme's interest rate and inflation risks. Furthermore, it does not hedge against changes in the credit spread available on corporate bonds used to derive the accounting liabilities. The investment in index-linked bonds offers a degree of matching, i.e. the movement in assets arising from changes in bond yields partially matches the movement in the funding or accounting liabilities. In this way, the exposure to movements in bond yields is reduced.
Inflation risk	A significant proportion of the scheme's benefit obligations are linked to inflation and higher inflation will lead to higher liabilities, although in most cases caps on the level of inflationary increases are in place to protect the plan against inflation.
Life expectancy	The majority of the plan's obligations are to provide a pension for the life of the member, which means that increases in life expectancy will result in an increase in the plan's liabilities.

35 Subordinated liabilities

	Group		Bank	
	2018 £m	2017 £m	**2018 £m**	2017 £m
£200 million subordinated floating rate notes 2025[1]	200	200	200	200
£90 million subordinated floating rate notes 2027[2]	90	90	90	90
Subordinated liabilities	**290**	**290**	**290**	**290**

	Group		Bank	
Movement on subordinated liabilities	**2018 £m**	2017 £m	**2018 £m**	2017 £m
At 1 January	290	335	290	335
Issued during the year	-	90	-	90
Repurchased	-	(135)	-	(135)
At 31 December	**290**	**290**	**290**	**290**

These liabilities constitute unsecured obligations of the Group to its Parent, subordinated in right of payments to the claim of depositors, and other unsubordinated creditors of the Group. The subordinated liabilities meet the definition of a financial liability as the Group does not have an unconditional right to avoid the repayment of the principal or interest. Therefore, the liabilities are recognised on the balance sheet at amortised cost, using the effective interest method.

All of the current notes are redeemable in whole but not in part, subject to the prior approval of the PRA, on the fifth anniversary of their drawdown date. In the event of a wind up of the Group, the loans will become immediately due and payable without demand, together with all interest accrued thereon.

36 Contingent liabilities and commitments

	Group		Bank	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Contingent liabilities				
Guarantees and irrevocable letters of credit	11	9	11	9
Other contingent liabilities	4	5	4	5
Total contingent liabilities	**15**	**14**	**15**	**14**
Loan commitments				
Undrawn formal standby facilities, credit lines and other commitments to lend				
- revocable or irrevocable with original maturity of 1 year or less	3,741	4,224	3,709	4,205
- irrevocable with original maturity of over 1 year	51	47	51	47
Total commitments	**3,792**	**4,271**	**3,760**	**4,252**

The table sets out the contractual amounts of contingent liabilities and commitments. The maximum exposure to credit loss under contingent liabilities and commitments is the contractual amount of the instrument in the event of non-performance by the other party where all counter claims, collateral, or security prove worthless. Loss allowance provisions of £7 million recognised on loan commitments and guarantees and irrevocable letters of credit are shown in note 33. Provisions on all other contingent liabilities and commitments are shown in note 32 (where applicable).

[1] Initial call date 26 November 2020. If not repaid at this point, they are due in full on their final maturity date of 26 November 2025. They bear interest at a floating rate of 4.225% per annum above the sterling LIBOR three month rate.

[2] Initial call date 19 December 2022. If not repaid at this point, they are due in full on their maturity date of 19 December 2027. They bear interest at a floating rate of 2.72% per annum above the sterling LIBOR three month rate.

36 Contingent liabilities and commitments *(continued)*

Guarantees and letters of credit are given as security to support the performance of a customer to third parties. As the Group will be required to meet these obligations only in the event of the customer's default, the cash requirements of these instruments are expected to be considerably below their nominal amounts.

Other contingent liabilities primarily include performance bonds and are generally short term commitments to third parties which are not directly dependent on the customer's credit worthiness. Other contingent liabilities also include documentary credits which commit the Group to make payments to third parties, on production of documents, which are usually reimbursed immediately by customers.

In February 2019, Bank of Ireland Group plc (BOI Group) received a letter before claim from investors in Eclipse film finance schemes asserting various claims in connection with the design, promotion and operation of such schemes. BOI Group's involvement in these schemes was limited to the provision of commercial finance. BOI Group was not the designer, promoter or operator in respect of any of the schemes. The claims asserted against BOI Group are at a very early stage. Based on the facts currently known, it is not practicable to predict the outcome of these claims as alleged, including the timing or possible aggregate impact.

Commitments to lend are agreements to lend to a customer in the future, subject to certain conditions.

37 Share capital

	Group		Bank	
Ordinary £1 shares	**2018 £m**	2017 £m	**2018 £m**	2017 £m
At 1 January and 31 December	851	851	851	851

At 31 December 2017 and at 31 December 2018, all shares issued by the Group were held by the Parent and were fully paid.

38 Other equity instruments

	Group		Bank	
	2018 £m	2017 £m	**2018 £m**	2017 £m
At 1 January and 31 December	300	300	300	300

Other equity instruments consist of Additional tier 1 securities held by the Parent:

- £200 million issued on 1 May 2015; and
- £100 million issued on 26 November 2015

The principal terms of the Additional tier 1 securities are as follows:

- the securities constitute direct, unsecured and subordinated obligations of the Group, rank behind Tier 2 instruments and in priority to ordinary shareholders;
- the securities bear a fixed rate of interest (7.9% for the May 2015 issuance; 8.4% for the November 2015 issuance) until the first call date (1 May 2020 and 26 November 2020 respectively). After the initial call date, in the event that they are not redeemed, the Additional tier 1 securities will bear interest at rates fixed periodically in advance for five-year periods based on market rates at that time;
- the Group may elect at its sole and full discretion to cancel (in whole or in part) the interest otherwise scheduled to be paid on any interest payment date;
- the securities have no fixed redemption date, and the security holders will have no right to require the Group to redeem or purchase the securities at any time;
- the Group may, in its sole and full discretion, but subject to the satisfaction of certain conditions, elect to redeem all (but not some only) of the securities on the initial call date or on any interest payment date thereafter. In addition, the Additional tier 1 securities are repayable, at the option of the Group, due to certain regulatory or tax reasons. Any repayments require the prior consent of the regulatory authorities; and
- the securities will convert into ordinary shares if the Group's CET 1 ratio (on a CRD IV full implementation basis) falls below 7%.

39 Liquidity risk

The tables below summarise the maturity profile of the Group's financial liabilities, at 31 December 2018 and at 31 December 2017, based on contractual undiscounted repayment obligations. See also Risk Management section 2.2 for details of the maturity of assets and liabilities on a discounted basis.

The Group does not manage liquidity risk on the basis of contractual maturity. Instead, the Group manages liquidity risk based on expected cash flows. The balances shown below will not agree directly to the consolidated balance sheet because the table incorporates all cash flows, on an undiscounted basis, related to both principal and interest payments.

Customer accounts include a number of term accounts that contain easy access features. These allow the customer to access a portion or all of their deposit notwithstanding that this repayment could result in a financial penalty being paid by the customer. For such accounts the portion subject to the potential early access has been classified accordingly in the table below as 'demand'.

Group **2018** **Maturity profile of financial liabilities**	**Demand** **£m**	**0-3 months** **£m**	**3-12 months** **£m**	**1-5 years** **£m**	**Over 5 years** **£m**	**Total** **£m**
Deposits from banks	396	8	1,244	1,537	20	3,205
Customer accounts	14,541	1,711	2,295	1,362	-	19,909
Subordinated liabilities	-	4	10	57	326	397
Contingent liabilities	15	-	-	-	-	15
Commitments	2,947	32	762	51	-	3,792
Total	**17,899**	**1,755**	**4,311**	**3,007**	**346**	**27,318**

2017 Maturity profile of financial liabilities	Demand £m	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits from banks	315	155	1,242	1,865	45	3,622
Customer accounts	14,039	2,043	2,424	545	-	19,051
Subordinated liabilities	-	3	9	53	339	404
Contingent liabilities	14	-	-	-	-	14
Commitments	3,218	20	987	46	-	4,271
Total	17,586	2,221	4,662	2,509	384	27,362

Bank **2018** **Maturity profile of financial liabilities**	**Demand** **£m**	**0-3 months** **£m**	**3-12 months** **£m**	**1-5 years** **£m**	**Over 5 years** **£m**	**Total** **£m**
Deposits from banks	392	8	1,244	1,537	20	3,201
Customer accounts	14,552	1,722	2,319	1,370	-	19,963
Subordinated liabilities	-	4	10	57	326	397
Contingent liabilities	15	-	-	-	-	15
Commitments	2,947	-	762	51	-	3,760
Total	**17,906**	**1,734**	**4,335**	**3,015**	**346**	**27,336**

2017 Maturity profile of financial liabilities	Demand £m	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits from banks	308	155	1,242	1,865	45	3,615
Customer accounts	14,041	2,053	2,459	582	-	19,135
Subordinated liabilities	-	3	9	53	339	404
Contingent liabilities	14	-	-	-	-	14
Commitments	3,218	-	987	47	-	4,252
Total	17,581	2,211	4,697	2,547	384	27,420

39 Liquidity risk (continued)

The table below summarises the maturity profile of the Group's derivative liabilities. The Group manages liquidity risk based on expected cash flows, therefore the undiscounted cash flows payable on derivatives liabilities are classified according to their contractual maturity.

Group and Bank 2018 Maturity profile of derivative liabilities	**Demand £m**	**0-3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Gross settled derivative liabilities - outflows	(2)	(70)	(56)	(12)	-	(140)
Gross settled derivative liabilities - inflows	2	64	53	12	-	131
Gross settled derivative liabilities - net flows	-	(6)	(3)	-	-	(9)
Net settled derivative liabilities	-	(6)	(8)	(18)	-	(32)
Total derivatives cash flows	**-**	**(12)**	**(11)**	**(18)**	**-**	**(41)**

2017 Maturity profile of derivative liabilities	Demand £m	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Gross settled derivative liabilities - outflows	(11)	(210)	(197)	(16)	-	(434)
Gross settled derivative liabilities - inflows	11	205	193	16	-	425
Gross settled derivative liabilities - net flows	-	(5)	(4)	-	-	(9)
Net settled derivative liabilities	-	(7)	(11)	(31)	(4)	(53)
Total derivatives cash flows	-	(12)	(15)	(31)	(4)	(62)

40 Measurement basis of financial assets and financial liabilities

The tables below analyse the carrying amounts of the financial assets and financial liabilities, by accounting treatment and by balance sheet heading.

Group	**At fair value through profit or loss**				
2018	**Mandatorily £m**	**Designated £m**	**Held at amortised cost £m**	**Derivatives designated as hedging instruments £m**	**Total £m**
Financial assets					
Cash and balances with central banks	-	-	2,567	-	2,567
Items in the course of collection from other banks	-	-	168	-	168
Derivative financial instruments	18	-	-	14	32
Loans and advances to banks	-	-	2,348	-	2,348
Debt securities at amortised cost	-	-	915	-	915
Loans and advances to customers	-	-	19,703	-	19,703
Assets classified as held for sale	-	-	539	-	539
Total financial assets	**18**	**-**	**26,240**	**14**	**26,272**
Financial liabilities					
Deposits from banks	-	-	3,152	-	3,152
Customer accounts	-	-	19,769	-	19,769
Items in the course of transmission to other banks	-	-	106	-	106
Derivative financial instruments	11	-	-	32	43
Loss allowance provision on loan commitments and financial guarantees	-	-	7	-	7
Subordinated liabilities	-	-	290	-	290
Total financial liabilities	**11**	**-**	**23,324**	**32**	**23,367**

40 Measurement basis of financial assets and financial liabilities *(continued)*

Group

2017	At fair value through profit or loss Derivatives designated as fair value hedging instruments £m	At fair value through profit or loss Held for trading £m	At fair value through profit or loss Designated upon initial recognition £m	At fair value through OtherComprehensive income (OCI) Available for sale £m	At fair value through OtherComprehensive income (OCI) Cash flow hedge derivatives £m	Held at amortised cost £m	Total £m
Financial assets							
Cash and balances with central banks	-	-	-	-	-	1,836	1,836
Items in the course of collection from other banks	-	-	-	-	-	192	192
Derivative financial instruments	9	12	-	-	6	-	27
Loans and advances to banks	-	-	1	-	-	2,763	2,764
Available for sale financial assets	-	-	-	1,008	-	-	1,008
Loans and advances to customers	-	-	-	-	-	19,997	19,997
Total financial assets	9	12	1	1,008	6	24,788	25,824
Financial liabilities							
Deposits from banks	-	-	-	-	-	3,561	3,561
Customer accounts	-	-	1	-	-	18,960	18,961
Items in the course of transmission to other banks	-	-	-	-	-	108	108
Derivative financial instruments	41	11	-	-	13	-	65
Subordinated liabilities	-	-	-	-	-	290	290
Total financial liabilities	41	11	1	-	13	22,919	22,985

Bank

2018	**At fair value through profit or loss** **Mandatorily £m**	**At fair value through profit or loss** **Designated £m**	**Held at amortised cost £m**	**Derivatives designated as hedging instruments £m**	**Total £m**
Financial assets					
Cash and balances with central banks	-	-	2,567	-	2,567
Items in the course of collection from other banks	-	-	168	-	168
Derivative financial instruments	18	-	-	14	32
Loans and advances to banks	-	-	2,331	-	2,331
Debt securities at amortised cost	-	-	915	-	915
Loans and advances to customers	-	-	19,860	-	19,860
Assets classified as held for sale	-	-	539	-	539
Total financial assets	**18**	**-**	**26,380**	**14**	**26,412**
Financial liabilities					
Deposits from banks	-	-	3,148	-	3,148
Customer accounts	-	-	19,824	-	19,824
Items in the course of transmission to other banks	-	-	106	-	106
Derivative financial instruments	11	-	-	32	43
Loss allowance provision on loan commitments and financial guarantees	-	-	7	-	7
Subordinated liabilities	-	-	290	-	290
Total financial liabilities	**11**	**-**	**23,375**	**32**	**23,418**

40 Measurement basis of financial assets and financial liabilities *(continued)*

Bank	At fair value through profit or loss			At fair value through OtherComprehensive income (OCI)			
2017	Derivatives designated as fair value hedging instruments £m	Held for trading £m	Designated upon initial recognition £m	Available for sale £m	Cash flow hedge derivatives £m	Held at amortised cost £m	Total £m
Financial assets							
Cash and balances with central banks	-	-	-	-	-	1,836	1,836
Items in the course of collection from other banks	-	-	-	-	-	192	192
Derivative financial instruments	9	12	-	-	6	-	27
Loans and advances to banks	-	-	1	-	-	2,624	2,625
Available for sale financial assets	-	-	-	1,008	-	-	1,008
Loans and advances to customers	-	-	-	-	-	20,289	20,289
Total financial assets	9	12	1	1,008	6	24,941	25,977
Financial liabilities							
Deposits from banks	-	-	-	-	-	3,554	3,554
Customer accounts	-	-	1	-	-	19,044	19,045
Items in the course of transmission to other banks	-	-	-	-	-	108	108
Derivative financial instruments	41	11	-	-	13	-	65
Subordinated liabilities	-	-	-	-	-	290	290
Total financial liabilities	41	11	1	-	13	22,996	23,062

The fair value and contractual amount due on maturity, of financial liabilities designated at fair value upon initial recognition, are shown in the table below.

Group and Bank	**2018**		2017	
	Fair values £m	**Contractual amount due on maturity £m**	Fair values £m	Contractual amount due on maturity £m
Customer accounts	**-**	**-**	1	1

41 Fair value of assets and liabilities

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

Where possible, the Group calculates fair value using observable market prices. Where market prices are not available, fair values are determined using valuation techniques which may include DCF models or comparisons to instruments with characteristics either identical or similar to those of the instruments held by the Group or recent arm's length market transactions.

These fair values are classified within a three-level fair value hierarchy, based on the inputs used to value the instrument. Where the inputs might be categorised within different levels of the fair value hierarchy, the fair value measurement in its entirety is categorised in the same level of the hierarchy as the lowest level input that is significant to the entire measurement. The levels are defined as:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for the asset or liability. Transfers between different levels are assessed at the end of all reporting periods.

(a) Financial assets and liabilities recognised and subsequently measured at fair value
All financial instruments are initially recognised at fair value. The Group subsequently measures derivatives and certain other financial assets and liabilities designated or mandatorily at fair value through profit or loss at fair value in the balance sheet. These instruments are shown as at fair value through profit or loss in note 40 on the measurement basis of financial assets and liabilities. A description of the methods and assumptions used to calculate fair values of these assets and liabilities is set out below.

Derivative financial instruments
The Group's derivative financial instruments are valued using valuation techniques commonly used by market participants. These consist of DCF and options pricing models, which typically incorporate observable market data, principally interest rates, basis spreads, foreign exchange rates, equity prices and counterparty credit (level 2 inputs).

Loans and advances to banks
Loans and advances to banks designated at fair value at 31 December 2017 through profit or loss consisted of loans, which contained an embedded derivative (typically an equity option). These instruments were valued using valuation techniques, using observable market data (level 2 inputs).

Customer accounts
Customer accounts designated at fair value through profit or loss at 31 December 2017 consisted of deposits, which contained an embedded derivative (typically an equity option). These instruments were valued using valuation techniques, using observable market data. The Group incorporated the effect of changes in its own credit spread when valuing these instruments. The Group estimated this spread by reference to recent transactions in the same instrument or in similar instruments issued by the Parent (level 2 inputs).

Available for sale financial assets
At 31 December 2017, the Group also measured available for sale financial assets at fair value. These assets were subsequently reclassified to financial assets at amortised cost from 1 January 2018. For available for sale financial assets for which an active market existed, fair value at 31 December 2017 was determined directly from observable market prices (level 1 inputs).

(b) Financial assets and liabilities held at amortised cost
For financial assets and liabilities which are not subsequently measured at fair value on the balance sheet, the Group discloses their fair value in a way that permits them to be compared to their carrying amounts. The methods and assumptions used to calculate the fair values of these assets and liabilities are set out below.

Loans and advances to banks
The estimated fair value of floating rate placements and overnight placings is their carrying amount. The estimated fair value of fixed interest bearing placements is based on discounted cash flows, using prevailing money market interest rates for assets with similar credit risk and remaining maturity (level 2 inputs).

Loans and advances to customers
Loans and advances to customers are carried net of provisions for impairment. The fair value of both fixed and variable rate loans and advances to customers is estimated using valuation techniques, which include:
- recent arm's length transactions in similar assets (level 2 inputs); and
- the discounting of estimated future cash flows at current market rates, incorporating the impact of current credit spreads and margins. The fair value reflects both loan impairments at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans (level 3 inputs).

Debt securities at amortised cost
From 1 January 2018 financial assets which were classified as available for sale under IAS 39 have been reclassified as debt securities at amortised cost. For these assets where an active market exists, fair value has been determined directly from observable market prices (level 1 inputs) or yields through a recognised pricing source or an independent broker, price-provider or investment bank (level 2 inputs).

Deposits from banks and customer accounts
The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on discounted

41 Fair value of assets and liabilities *(continued)*

cash flows, using interest rates for new deposits with similar remaining maturity (level 2 inputs).

Subordinated liabilities
As quoted market prices are not available, the fair value is estimated by benchmarking the yield against similar bonds issued by the Parent, which have similar maturity dates (level 2 inputs).

(c) Fair value of non-financial assets
Property
A revaluation of Group property was carried out as at 31 December 2018. All freehold and long leasehold commercial properties were valued by Lisney (or its partner, Sanderson Weatherall) as external valuers. Lisney valuations were made on the basis of observable inputs such as comparable lettings and sales (level 2 inputs). Unobservable inputs such as profile, lot size, layout and presentation of accommodation are also used (level 3 inputs). Using reasonably possible alternative assumptions would not have a material impact on the value of these assets. All properties are valued based on highest and best use.

Group	**2018**				2017			
	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Fair value of financial assets held at amortised cost								
Loans and advances to banks	-	2,353	-	2,353	-	2,779	-	2,779
Debt securities at amortised cost	918	-	-	918	-	-	-	-
Loans and advances to customers	-	-	20,128[1]	20,128	-	-	20,031	20,031
Total	918	2,353	20,128	23,399	**-**	**2,779**	**20,031**	**22,810**
Fair value of financial liabilities held at amortised cost								
Deposits from banks	-	3,161	-	3,161	-	3,576	-	3,576
Customer accounts	-	19,780	-	19,780	-	18,970	-	18,970
Subordinated liabilities	-	282	-	282	-	301	-	301
Total	-	23,223	-	23,223	-	**22,847**	**-**	**22,847**

Bank	**2018**				2017			
	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Fair value of financial assets held at amortised cost								
Loans and advances to banks	-	2,336	-	2,336	-	2,640	-	2,640
Debt securities at amortised cost	918	-	-	918	-	-	-	-
Loans and advances to customers	-	-	20,288[1]	20,288	-	-	20,325	20,325
Total	918	2,336	20,288	23,542	**-**	**2,640**	**20,325**	**22,965**
Fair value of financial liabilities held at amortised cost								
Deposits from banks	-	3,156	-	3,156	-	3,569	-	3,569
Customer accounts	-	19,835	-	19,835	-	19,055	-	19,055
Subordinated liabilities	-	282	-	282	-	301	-	301
Total	-	23,273	-	23,273	-	**22,925**	**-**	**22,925**

[1] *Inclusive of loans and advances to customers which are classified as assets held for sale at 31 December 2018.*

41 Fair value of assets and liabilities *(continued)*

Group and Bank	2018				2017			
	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets held at fair value								
Derivative financial instruments	-	32	-	32	-	27	-	27
Loans and advances to banks	-	-	-	-	-	1	-	1
Available for sale financial assets	-	-	-	-	1,008	-	-	1,008
Non-financial assets held at fair value								
Property held at fair value	-	-	24	24	-	-	23	23
Total assets held at fair value	**-**	**32**	**24**	**56**	**1,008**	**28**	**23**	**1,059**
As a % of fair value assets	**-**	**57%**	**43%**	**100%**	**95%**	**3%**	**2%**	**100%**
Financial liabilities held at fair value								
Customer accounts	-	-	-	-	-	1	-	1
Derivative financial instruments	-	43	-	43	-	65	-	65
Total financial liabilities held at fair value	**-**	**43**	**-**	**43**	**-**	**66**	**-**	**66**
As a % of fair value liabilities	**-**	**100%**	**-**	**100%**	**-**	**100%**	**-**	**100%**

There were no transfers between levels 1, 2 or 3 during the year ended 31 December 2018 or 31 December 2017.

Movements in level 3 assets

	Group		Bank	
Property held at fair value	**2018 £m**	2017 £m	**2018 £m**	2017 £m
At 1 January	23	7	23	7
Additions	-	15	-	15
Revaluation of property	1	1	1	1
At 31 December	**24**	**23**	**24**	**23**

Quantitative information about fair value measurements using significant unobservable inputs (level 3)

Group and Bank			Fair Value		Range	
Level 3 assets	**Valuation technique**	**Unobservable input**	**2018 £m**	2017 £m	**2018 %**	2017 %
Property held at fair value	Market comparable property transactions	Property valuation assumptions	24	23	Third party pricing	Third party pricing

41 Fair value of assets and liabilities *(continued)*

The carrying amount and the fair value of the Group's financial assets and liabilities which are carried at amortised cost are set out in the table below. Items where the carrying amount is a reasonable approximation of fair value are not included, as permitted by IFRS 7.

	Group				Bank			
	2018		2017		**2018**		2017	
	Carrying amount £m	**Fair values £m**	Carrying amount £m	Fair values £m	**Carrying amount £m**	**Fair values £m**	Carrying amount £m	Fair values £m
Financial Assets								
Loans and advances to banks[1]	2,348	2,353	2,764	2,780	2,331	2,336	2,625	2,641
Debt securities at amortised cost	915	918	-	-	915	918	-	-
Loans and advances to customers[2]	20,240	20,128	19,997	20,031	20,397	20,288	20,289	20,325
Financial Liabilities								
Deposits from banks	3,152	3,161	3,561	3,576	3,148	3,156	3,554	3,569
Customer accounts[1]	19,769	19,780	18,961	18,971	19,824	19,835	19,045	19,056
Subordinated liabilities	290	282	290	301	290	282	290	301

42 Related party transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions or one other party controls both. The definition includes subsidiaries, joint ventures and the Parent, as well as key management personnel.

(a) Parent

The immediate parent and owner of the entire share capital of the Group is The Governor and Company of the Bank of Ireland, a corporation established in Ireland in 1783 under Royal Charter.

Bank of Ireland Group Plc is listed as the holding company and ultimate parent of the Bank of Ireland Group and Bank of Ireland (UK) plc. The results of the Group are consolidated in the Bank of Ireland Group financial statements, which are available at Bank of Ireland, Head Office, 40 Mespil Road, Dublin 4, Ireland being the registered office of the immediate and ultimate Parent (website: www.bankofireland.com).

The Governor and Company of the Bank of Ireland acts as guarantor for the Bank in its transactions with the Bank of England (including its subsidiary, the Bank of England Asset Purchase Facility Fund Limited). If in any circumstances the Bank fails to make payment of guaranteed amounts to the Bank of England or does not perform any of its other obligations under the relevant agreement, the Governor and Company of the Bank of Ireland may be required to pay the amounts or perform its obligations upon written demand from the Bank of England.

The Group receives a range of services from its Parent and related parties, including loans and deposits, forward exchange, interest rate cover including derivatives and various administrative services. In the course of operating its business, the Group utilises a number of key services from its Parent, which are subject to a number of Service Level Agreements and costs, and these are disclosed in note 10 of the financial statements.

Other transactions with the Parent in 2018 and 2017

(i) On 23 August 2018 a dividend payment of £70 million was paid to the Parent. (2017: £160 million)

(ii) On 19 December 2017 the Group repaid £135 million of subordinated debt to the Parent. On the same date the Group issued £90 million of Tier 2 subordinated floating rate notes to the Parent (refer to note 38).
On 3 May 2018 a coupon payment of £16 million was paid to the Parent in relation to the £200 million Additional tier 1 instrument (2017: £16 million) (refer to note 38). On 29 November 2018 a coupon payment of £8 million was paid to the Parent in relation to the £100 million Additional tier 1 instrument (2017: £8 million) (refer to note 38).

(iii) In April 2017 the Group acquired a 50% interest in a freehold property from the Parent for £15 million.

1 *The 2017 amounts include £1 million which was designated at fair value through profit and loss.*
2 *Including assets classified as held for sale £537 million (2017: £nil). See note 20.*

42 Related party transactions *(continued)*

(b) Pension funds

The Group provides a range of normal banking and financial services, which are not material to the Group, to various pension funds operated by the Bank of Ireland Group for the benefit of employees, which are conducted on similar terms to third party transactions.

Group Summary - Parent[1]	2018 £m	2017 £m
Income statement		
Interest income (note 4)	(1)	3
Interest expense (note 5)	(26)	(36)
Fees and commissions expense (note 7)	(8)	(8)
Net trading expense (note 8)	33	9
Operating expenses paid for services provided (note 10)	(219)	(220)
Total	**(221)**	**(252)**
Assets		
Loans and advances to banks (note 17)	930	1,394
Loans and advances to customers (note 20)	6	6
Other assets (note 27)	-	1
Derivatives (note 16)	31	20
Total assets	**967**	**1,421**
Liabilities		
Deposits from banks (note 29)	1,651	1,989
Customer accounts (note 30)	8	8
Other liabilities (note 31)	3	2
Derivatives (note 16)	35	63
Subordinated liabilities (note 35)	290	290
Total liabilities	**1,987**	**2,352**
Net exposure	**(1,020)**	**(931)**

[1] *This relates to amounts in respect of the Parent and entities controlled by the Parent.*

42 Related party transactions *(continued)*

Bank	2018 Parent[1] £m	2018 Joint venture £m	2018 Total £m	2017 Parent[1] £m	2017 Joint venture £m	2017 Total £m
Income statement						
Interest income	(1)	-	(1)	3	-	3
Interest expense	(26)	-	(26)	(36)	-	(36)
Fees and commission expense	(8)	-	(8)	(8)	-	(8)
Net trading expense	33	-	33	9	-	9
Other operating income	-	33	33	-	34	34
Operating expenses paid for services provided	(215)	-	(215)	(216)	-	(216)
Total income / (expense)	**(217)**	**33**	**(184)**	**(248)**	**34**	**(214)**
Assets						
Loans and advances to banks	923	-	923	1,383	-	1,383
Loans and advances to customers	6	-	6	6	-	6
Other assets	-	-	-	1	-	1
Derivatives	31	-	31	20	-	20
Total assets	**960**	**-**	**960**	**1,410**	**-**	**1,410**
Liabilities						
Deposits from banks	1,646	-	1,646	1,982	-	1,982
Customer accounts	8	-	8	8	-	8
Other liabilities	3	-	3	2	-	2
Derivatives	35	-	35	63	-	63
Subordinated liabilities	290	-	290	290	-	290
Total liabilities	**1,982**	**-**	**1,982**	**2,345**	**-**	**2,345**
Net exposure	**(1,022)**	**-**	**(1,022)**	**(935)**	**-**	**(935)**

(c) Transactions with key management personnel

i. *Loans to Directors*

The following information is presented in accordance with Section 413 of the Companies Act 2006. For the purposes of the Companies Act disclosures, 'Directors' means the Board of Directors and any past Directors who were Directors during the relevant year.

All loans to Directors are made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for similar transactions with other persons, unconnected with the Group and of similar financial standing. They do not involve more than the normal risk of collectability.

Group (i) **Companies Act disclosures Loans to Directors 2018**	**Balance as at 1 January 2018[2] £'000**	**Balance as at 31 December 2018[3] £'000**	**Aggregate maximum amount outstanding during the year ended 31 December 2018[4] £'000**
Loans to Directors	3	4	17

Companies Act disclosures Loans to Directors 2017	Balance as at 1 January 2017[5] £'000	Balance as at 31 December 2017[3] £'000	Aggregate maximum amount outstanding during the year ended 31 December 2017[4] £'000
Loans to Directors	2	3	8

[1] *This relates to amounts in respect of the Parent and entities controlled by the Parent.*
[2] *The opening balance includes balances and transactions with Directors who have retired during 2018 and are not related parties during the current year. Therefore, these Directors are not included in the maximum amounts outstanding.*
[3] *Balance includes principal and interest.*
[4] *These figures include credit card exposures at the maximum statement balance. In all cases, Directors have not exceeded their approved limits. The maximum approved credit limit on any credit card held by any Director is £14,000.*
[5] *Foreign currency amounts are converted to GBP, using exchange rates at 1 January 2018 and the average exchange rate for the year, as appropriate.*

42 Related party transactions *(continued)*

ii. Key management personnel - loans and deposits

For the purposes of IAS 24 Related Party Disclosures, 'key management personnel' comprise the Directors of the Board, the COO, the Managing Director Northern Ireland, the Managing Director of AA Business, the Director of Consumer Banking UK, the Interim HR Director, Head of Capability Development and any past KMP, who were a KMP during the relevant year.

KMP, including Directors, hold products with the Group in the ordinary course of business. All loans to Non-executive Directors are made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons, and do not involve more than the normal risk of collectability or present other unfavourable features. Loans to KMP, other than Non-executive Directors, are made on terms similar to those available to staff generally, and / or in the ordinary course of business on normal commercial terms.

The aggregate amounts outstanding, in respect of all loans, quasi-loans and credit transactions, between the Group, its KMP (as defined above) and KMP of the Parent, including members of their close families and entities influenced by them are shown in the table.

Group **(ii)** **2018** **Key management personnel**	**Balance as at 1 January 2018[5] £'000**	**Balance as at 31 December 2018[1] £'000**	**Aggregate maximum amounts outstanding during the year ended 31 December 2018[2,3] £'000**	**Total number of KMP as at 1 January 2018**	**Total number of KMP as at 31 December 2018**
Loans	65	59	80	7	7
Deposits	109	513	823	11	13

2017 Key management personnel	Balance as at 1 January 2017[4,5] £'000	Balance as at 31 December 2017[1] £'000	Aggregate maximum amounts outstanding during the year ended 31 December 2017[2,3] £'000	Total number of KMP as at 1 January 2017	Total number of KMP as at 31 December 2017
Loans	3	65	84	3	7
Deposits	195	109	871	13	11

1 *Balance includes principal and interest.*
2 *These figures include credit card exposures at the maximum statement balance. In all cases, KMP have not exceeded their approved limits. The maximum approved credit limit on any credit card held by KMP is £14,000.*
3 *The maximum amount outstanding was calculated using the maximum balance on each account. The highest maximum outstanding liability, during the year ended 31 December 2018 for any member of KMP and their close family did not exceed £79,886 (31 December 2017: £72,896). The closing balance includes interest accrued and interest paid; the maximum balance includes interest paid.*
4 *Foreign currency amounts are converted to GBP, using exchange rates at 1 January 2018 and the average exchange rate for the year, as appropriate.*
5 *The opening balance includes balances and transactions with KMP who retired during the previous year and are not therefore related parties during the year. Therefore, these KMP's are not included in the maximum amounts outstanding.*

42 Related party transactions *(continued)*

CRD IV Pillar 3 disclosures for the Group also include information on remuneration. This can be found on the website of the Bank of Ireland (UK) plc at www.bankofirelanduk.com.

- Total compensation paid to KMP was £3.3 million for the year ended 31 December 2018 and of this amount £1.7 million was paid to Directors. This compared to £4.5 million and £1.6 million respectively for the comparative year ended 31 December 2017.
- During the year ended 31 December 2018 or the year ended 31 December 2017, there was no remuneration paid to the Executive Directors of the Parent in respect of their services as Non-executive Directors of the Group, or for managing the Group or its subsidiaries;
- The highest total amount paid to any Director for the year ended 31 December 2018 was £470,650 comprising salary and other benefits (2017: £411,764). The total accrued pension and accrued lump sum of this Director at the year ended 31 December 2018 was £nil;
- One Executive Director accrued retirement benefits under a defined benefit and defined contribution Bank of Ireland Group Pension Scheme for year ended 31 December 2018.
- Pension costs were paid by the Parent and the costs incurred recharged on an agreed basis through the service level agreements.
- There were no additional benefits, paid by the Group or any other party, in respect of compensation to the Directors for their services for managing the Group or its subsidiaries, either for the year ended 31 December 2018 or the year ended 31 December 2017.

Group **(d) Compensation of key management personnel**	**2018** **£000's**	2017 £000's
Remuneration		
Salaries and other short term benefits	3,016	4,007
Pension benefits	303	458
Total	**3,319**	**4,465**

43 Offsetting financial assets and liabilities

The following items have been offset in the balance sheet, in accordance with paragraph 42 of IAS 32.

In addition, as set out in section 2.1.2 of the Risk management report, the Group's net exposure to the Parent is managed through a contractual master netting agreement with the Parent. These amounts do not meet the criteria for offset under paragraph 42 of IAS 32 and are presented gross within loans and advances to banks, derivatives and deposits by banks respectively. Further detail on these amounts is set out in notes 16, 17 and 29 of the financial statements.

Group	**2018**			2017		
Assets	**Gross amounts of recognised financial assets £m**	**Gross amounts of recognised financial liabilities[1] set off in the balance sheet £m**	**Net amounts of financial assets presented in the balance sheet £m**	Gross amounts of recognised financial assets £m	Gross amounts of recognised financial liabilities[1] set off in the balance sheet £m	Net amounts of financial assets presented in the balance sheet £m
Loans and advances to customers	266	(266)	-	449	(449)	-

[1] *Loans and advances to customers represent loan agreements entered into by the Group that are fully collateralised by the Parent. Ultimate recourse is to the Parent. These loans are netted on the balance sheet against deposits received from the Parent.*

44 Interests in other entities

Group Names	Principal activity	Country of incorporation	Statutory year end	Percentage of ordinary share capital held %	Percentage of voting rights held %	Registered address
NIIB Group Limited	Personal finance and leasing	Northern Ireland	31 December	100	100	1 Donegall Square South, Belfast, BT1 5LR.
Leader Financial Services Limited[1]	Personal finance and leasing	Northern Ireland	31 December	100	100	Dissolved 12 December 2018
Bank of Ireland Personal Finance Limited	Personal finance	Northern Ireland	31 December	100	100	1 Temple Back East, Temple Quay, Bristol, BS1 6DX.
Bank of Ireland Trustee Company Limited[2]	Client Investment Services	Northern Ireland	31 December	100	100	1 Temple Back East, Temple Quay, Bristol, BS1 6DX.
Midasgrange Limited	Dormant	England and Wales	30 September	100	100	Bow Bells House, 1 Bread Street, London, EC4M 9BE.
First Rate Exchange Services Holdings Limited[3]	Foreign Exchange	England and Wales	31 March	50	50	Great West House, Great West Road, Brentford, London, TW8 9DF.
First Rate Exchange Services Limited	Foreign Exchange	England and Wales	31 December	50	50	Great West House, Great West Road, Brentford, London, TW8 9DF.
Marshall Leasing Limited[4]	Vehicle Leasing	England and Wales	31 December	100	100	Bow Bells House, 1 Bread Street, London, EC4M 9BE.
Gates Contract Hire Limited[4]	Dormant	England and Wales	31 December	100	100	Bow Bells House, 1 Bread Street, London, EC4M 9BE
Bowbell No.1 plc[5]	Securitisation	England and Wales	31 December	n/a	n/a	6th floor, 65 Gresham Street, London, EC2V 7NQ.
Bowbell No.2 plc	Dormant	England and Wales	31 December	n/a	n/a	Level 37, 25 Canada Square, London, E14 5LQ.

Copies of the financial statements of these undertakings can be obtained from the relevant addresses listed above.

Management has assessed its involvement in all entities in accordance with the definitions and guidance in:

- IFRS 10: Consolidated Financial Statements;
- IFRS 11: Joint Arrangements;
- IAS 28: Investments in Associates and Joint Ventures; and
- IFRS 12: Disclosure of interests in other entities.

The Group controls an entity when it has power over the entity, is exposed to or has rights to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Generally, control or significant influence is identified by the level of ownership of ordinary shares and the level of management involvement in the relevant activities of the entity. However, in the case of 'structured entities', management's judgement is required in determining how the investee should be accounted for.

There are no significant restrictions on the Group's ability to access or use the assets and settle the liabilities of the Group.

1 *Leader Financial Services Limited (formerly Northridge Finance Limited) was liquidated on 12 December 2018.*
2 *In February 2014 Bank of Ireland Trustee Company Limited ceased to be actively trading.*
3 *This entity is a joint venture with the UK Post Office in which the Group holds 50% of the equity of the company. FRESH holds 100% of the equity in FRES.*
4 *On 24 November 2017 the Group acquired 100% of Marshall Leasing Limited and its dormant subsidiary, Gates Contract Hire Limited. See note 25 for further details..*
5 *The securitisation was unwound during 2018.*

44 Interests in other entities *(continued)*

Structured entities
A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

In assessing whether it has control over such an entity, the Group assesses whether it has power over the relevant activities by considering factors such as who manages the assets of these entities, if the Group has lending to them or has a residual interest in them.

In the case of structured entities, the Group considers it has control over the investee where it is a securitisation vehicle whose purpose is to finance specific loans and advances to customers. In such cases the Group considers that it has power over the entity, is exposed to or has rights to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

The Group has had a structured securitisation entity, Bowbell No. 1 plc ('Bowbell 1') for a number of years, whose purpose was to acquire mortgage loans and other financial assets and issue mortgage backed securities. Bowbell 1 is incorporated in Great Britain, with 100% of its ordinary share capital and voting rights being held by its ultimate holding company, Bowbell No 1 Holdings Limited (not a subsidiary of the Group). The creditors of Bowbell 1 have no recourse to the Group.

As at 31 December 2017, all notes issued by Bowbell 1 were held by the Bank. The assets of Bowbell 1 were consolidated in the Group's financial statements and were collateral for its obligations. The assets and liabilities of Bowbell 1 at 31 December 2017 are shown in the table below.

Group		**2018**		2017	
Activity	**Company**	**Loans and advances to customers £m**	**Notes in issue £m**	Loans and advances to customers £m	Notes in issue £m
Acquiring mortgage loans and issuing mortgage backed securities	Bowbell No 1 plc	-	-	2,886	1,155

During the year ended 31 December 2018 all mortgage loans held by Bowbell 1 were transferred back to the Bank, and the mortgage backed securities previously issued by Bowbell 1 to the Bank were fully repaid. During 2018 and 2017 there were no contractual arrangements that required the Group to provide financial support to Bowbell 1 and the Group did not provide any financial or other support during these years, nor does it expect to do so.

45 Transferred financial assets

At 31 December 2018, neither the Group nor the Bank had transferred any financial assets which were not derecognised from the balance sheet.

At 31 December 2017, the Group had not transferred any financial assets which were not derecognised from the balance sheet. However, the Bank had transferred certain assets that were not derecognised from its balance sheet, being the assets which were transferred into Bowbell No. 1 Plc, a securitisation vehicle (see note 44 and the table below for more detail), which was unwound during 2018.The Bank was exposed substantially to all risks and rewards including credit and market risk associated with the transferred assets.

Neither the Group nor the Bank is recognising any asset to the extent of its continuing involvement.

Bank Securitisation 2017	Carrying amount of assets £m	Carrying amount of associated liabilities £m	Fair value of transferred assets £m	Fair value of associated liabilities (Fair value of notes in issue) £m
Residential mortgage book (Bowbell No. 1 plc)[1]	3,000	3,000	2,886	2,886

[1] *For the purposes of this disclosure, associated liabilities include liabilities issued by Bowbell No. 1, held by the Bank.*

46 IAS 39 to IFRS 9 transitional disclosures

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement under IFRS 9 for the Group's financial assets and financial liabilities.

Group
Financial assets

IAS 39 balance sheet line item	Note	Classification under IAS 39	Carrying amount under IAS 39 31 December 2017 £m	Classification under IFRS 9	Carrying amount under IFRS 9 1 January 2018 £m	IFRS 9 balance sheet line item
Cash and balances at central banks	15	Loans and receivables	1,836	Amortised cost	1,836	Cash and balances at central banks
Items in the course of collection from other banks		Loans and receivables	192	Amortised cost	192	Items in the course of collection from other banks
Derivative financial instruments (assets)	16	FVTPL	27	FVTPL (mandatory)	27	Derivative financial instruments (assets)
Loans and advances to banks	17	Loans and receivables FVTPL	2,763 1	Amortised cost FVTPL (mandatory)	2,761 1	Loans and advances to banks at amortised cost Loans and advances to banks at FVTPL
Available for sale financial assets	18,19	Available for sale	1,008	Amortised cost	1,003	Debt securities at amortised cost
Loans and advances to customers	20	Loans and receivables	19,997	Amortised cost	19,959	Loans and advances to customers at amortised cost
Other assets (interest receivable)	27	Loans and receivables	18	Amortised cost	18	Other assets
Total			**25,842**		**25,797**	

46 IAS 39 to IFRS 9 transitional disclosures *(continued)*

Group
Financial liabilities

IAS 39 balance sheet line item	Note	Classification under IAS 39	Carrying amount under IAS 39 31 December 2017 £m	Classification under IFRS 9	Carrying amount under IFRS 9 1 January 2018 £m	IFRS 9 balance sheet line item
Deposits from banks	29	Amortised cost	3,561	Amortised cost	3,561	Deposits from banks
Customer accounts	30	Amortised cost FVTPL (designated)	18,960 1	Amortised cost FVTPL (designated)	18,960 1	Customer accounts at amortised cost Customer accounts at FVTPL
Items in the course of transmission to other banks		Amortised cost	108	Amortised cost	108	Items in the course of transmission to other banks
Derivative financial instruments (liabilities)	16	FVTPL	65	FVTPL (mandatory)	65	Derivative financial instruments (liabilities)
Subordinated liabilities	35	Amortised cost	290	Amortised cost	290	Subordinated liabilities
Other liabilities - accrued interest payable	31	Amortised cost	52	Amortised cost	52	Other liabilities - accrued interest payable
Loss allowance provision on loan commitments and financial guarantees	33	Amortised cost	-	Amortised cost	9	Loss allowance provision on loan commitments and financial guarantees
Total			**23,037**		**23,046**	

46 IAS 39 to IFRS 9 transitional disclosures *(continued)*

The basis of classification of financial assets under IFRS 9 depends on the entity's business model and the contractual cash flow characteristics of the financial asset. In order to be accounted for at amortised cost, it is necessary for individual instruments to have contractual cash flows that are solely payments of principal and interest (SPPI). The Group's available for sale debt instruments have been classified at amortised cost under IFRS 9 as they are within a hold to collect business model.

The following tables provide a reconciliation of the Group's balance sheet by measurement category from IAS 39 to IFRS 9 at 1 January 2018.

Group Assets	Carrying amount under IAS 39 31 December 2017 £m	Reclassification £m	Remeasurement £m	Carrying amount under IFRS 9 1 January 2018 £m
Financial assets at amortised cost				
Cash and balances at central banks	**1,836**	**-**	**-**	**1,836**
Items in the course of collection from other banks	**192**	**-**	**-**	**192**
Loans and advances to banks				
Opening balance	2,763	-	-	2,763
Increase in impairment loss allowance	-	-	(2)	(2)
Total loans and advances to banks	**2,763**	**-**	**(2)**	**2,761**
Debt securities at amortised cost				
Opening balance	-	-	-	-
From available for sale financial assets	-	1,008	-	1,008
Release of available for sale reserve	-	-	(5)	(5)
Total debt securities at amortised cost	**-**	**1,008**	**(5)**	**1,003**
Loans and advances to customers				
Opening balance	19,997	-	-	19,997
Increase in impairment loss allowance	-	-	(38)	(38)
Total loans and advances to customers	**19,997**	**-**	**(38)**	**19,959**
Other assets (interest receivable)	**18**	**-**	**-**	**18**
Total	**24,806**	**1,008**	**(45)**	**25,769**
Financial assets measured at fair value through profit or loss				
Derivative financial instruments	**27**	**-**	**-**	**27**
Loans and advances to banks	**1**	**-**	**-**	**1**
Available for sale financial assets				
Opening balance	1,008	-	-	1,008
To debt securities at amortised cost	-	(1,008)	-	(1,008)
Total available for sale financial assets	**1,008**	**(1,008)**	**-**	**-**
Net deferred tax asset				
Net opening balance	71	-	-	71
Tax on impairment loss allowance - remeasurement	-	-	12	12
Release of tax on available for sale reserve	-	-	1	1
Total net deferred tax	**71**	**-**	**13**	**84**
Total inclusive of net deferred tax	**25,913**	**-**	**(32)**	**25,881**

46 IAS 39 to IFRS 9 transitional disclosures *(continued)*

Group Liabilities	Carrying amount under IAS 39 31 December 2017 £m	Reclassification £m	Remeasurement £m	Carrying amount under IFRS 9 1 January 2018 £m
Financial liabilities at amortised cost				
Deposits from banks	3,561	-	-	3,561
Customer accounts	18,960	-	-	18,960
Items in the course of transmission to other banks	108	-	-	108
Subordinated liabilities	290	-	-	290
Other liabilities (accrued interest payable)	52	-	-	52
Total financial liabilities at amortised cost	**22,971**	**-**	**-**	**22,971**
Loss allowance provision on loan commitments and financial guarantees				
Opening balance	-	-	-	-
Increase in loss allowance provision	-	-	9	9
Total loss allowance provision on loan commitments and financial guarantees	**-**	**-**	**9**	**9**
Financial liabilities at fair value through profit or loss				
Derivative financial instruments	65	-	-	65
Customer accounts	1	-	-	1
Total net deferred tax	**23,037**	**-**	**9**	**23,046**

Group Equity	Carrying amount under IAS 39 31 December 2017 £m	Reclassification £m	Remeasurement £m	Carrying amount under IFRS 9 1 January 2018 £m
Available for sale reserve				
Opening balance	4	-	-	4
Reduction in available for sale reserve related to assets at amortised cost	-	-	(5)	(5)
Release of tax on available for sale reserve	-	-	1	1
Total available for sale reserve	**4**	**-**	**(4)**	**-**
Retained earnings				
Opening balance	254	-	-	254
Impairment loss allowance - remeasurement	-	-	(49)	(49)
Deferred tax on remeasurement	-	-	12	12
Total impact on retained earnings	**254**	**-**	**(37)**	**217**
Total impact on equity	**258**	**-**	**(41)**	**217**

46 IAS 39 to IFRS 9 transitional disclosures (continued)

The following table provides the reconciliation of the Group's closing impairment provision in accordance with IAS 39 and provisions in accordance with IAS 37 to the opening loss allowance determined in accordance with IFRS 9.

Group Impairment loss allowance	Carrying amount under IAS 39 31 December 2017 £m	Reclassification £m	Remeasurement £m	Carrying amount under IFRS 9 1 January 2018 £m
Financial assets at amortised cost				
Opening balance	155	-	-	155
Increase in impairment loss allowance	-	-	40	40
Total assets at amortised cost	**155**	**-**	**40**	**195**

Group Loss allowance provision	Carrying amount under IAS 39 31 December 2017 £m	Reclassification £m	Remeasurement £m	Carrying amount under IFRS 9 1 January 2018 £m
Provision on loan commitments and financial guarantees				
Opening balance	-	-	-	-
Increase in loss allowance provision in loan commitments, guarantees and irrevocable letters of credit	-	-	9	9
Total loss allowance provision on loan commitments and financial guarantees	**-**	**-**	**9**	**9**

46 IAS 39 to IFRS 9 transitional disclosures *(continued)*

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement under IFRS 9 for the Bank's financial assets and financial liabilities.

Bank
Financial assets

IAS 39 balance sheet line item	Note	Classification under IAS 39	Carrying amount under IAS 39 31 December 2017 £m	Classification under IFRS 9	Carrying amount under IFRS 9 1 January 2018 £m	IFRS 9 balance sheet line item
Cash and balances at central banks	15	Loans and receivables	1,836	Amortised cost	1,836	Cash and balances at central banks
Items in the course of collection from other banks		Loans and receivables	192	Amortised cost	192	Items in the course of collection from other banks
Derivative financial instruments (assets)	16	FVTPL	27	FVTPL (mandatory)	27	Derivative financial instruments (assets)
Loans and advances to banks	17	Loans and receivables FVTPL	2,624 1	Amortised cost FVTPL (mandatory)	2,620 1	Loans and advances to banks at amortised cost Loans and advances to banks at FVTPL
Available for sale financial assets	18,19	Available for sale	1,008	Amortised cost	1,003	Debt securities at amortised cost
Loans and advances to customers	20	Loans and receivables	20,289	Amortised cost	20,252	Loans and advances to customers at amortised cost
Other assets (interest receivable)	27	Loans and receivables	19	Amortised cost	19	Other assets
Total			**25,996**		**25,950**	

46 IAS 39 to IFRS 9 transitional disclosures *(continued)*

Bank
Financial liabilities

IAS 39 balance sheet line item	Note	Classification under IAS 39	Carrying amount under IAS 39 31 December 2017 £m	Classification under IFRS 9	Carrying amount under IFRS 9 1 January 2018 £m	IFRS 9 balance sheet line item
Deposits from banks	29	Amortised cost	3,554	Amortised cost	3,554	Deposits from banks
Customer accounts	30	Amortised cost FVTPL (designated)	19,044 1	Amortised cost FVTPL (designated)	19,044 1	Customer accounts at amortised cost Customer accounts at FVTPL
Items in the course of transmission to other banks		Amortised cost	108	Amortised cost	108	Items in the course of transmission to other banks
Derivative financial instruments (liabilities)	16	FVTPL	65	FVTPL (mandatory)	65	Derivative financial instruments (liabilities)
Subordinated liabilities	35	Amortised cost	290	Amortised cost	290	Subordinated liabilities
Other liabilities - accruals interest payable	31	Amortised cost	52	Amortised cost	52	Other liabilities - accruals interest payable
Loss allowance provision on loan commitments and financial guarantees	33	Amortised cost	-	Amortised cost	9	Loss allowance provision on loan commitments and financial guarantees
Total			**23,114**		**23,123**	

46 IAS 39 to IFRS 9 transitional disclosures *(continued)*

The basis of classification of financial assets under IFRS 9 depends on the entity's business model and the contractual cash flow characteristics of the financial asset. In order to be accounted for at amortised cost, it is necessary for individual instruments to have contractual cash flows that are solely payments of principal and interest (SPPI). The Group's available for sale debt instruments have been classified at amortised cost under IFRS 9 as they are within a hold to collect business model.

The following tables provide a reconciliation of the Bank's balance sheet by measurement category from IAS 39 to IFRS 9 at 1 January 2018.

Bank Assets	Carrying amount under IAS 39 31 December 2017 £m	Reclassification £m	Remeasurement £m	Carrying amount under IFRS 9 1 January 2018 £m
Financial assets at amortised cost				
Cash and balances at central banks	**1,836**	**-**	**-**	**1,836**
Items in the course of collection from other banks	**192**	**-**	**-**	**192**
Loans and advances to banks				
Opening balance	2,624	-	-	2,624
Increase in impairment loss allowance	-	-	(2)	(2)
Total loans and advances to banks	**2,624**	**-**	**(2)**	**2,622**
Debt securities at amortised cost				
Opening balance	-	-	-	-
From available for sale financial assets	-	1,008	-	1,008
Release of available for sale reserve	-	-	(5)	(5)
Total debt securities at amortised cost	**-**	**1,008**	**(5)**	**1,003**
Loans and advances to customers				
Opening balance	20,289	-	-	20,289
Increase in impairment loss allowance	-	-	(39)	(39)
Total loans and advances to customers	**20,289**	**-**	**(39)**	**20,250**
Other assets (interest receivable)	**19**	**-**	**-**	**19**
Total	**24,960**	**1,008**	**(46)**	**25,922**
Financial assets measured at fair value through profit or loss				
Derivative financial instruments	**27**	**-**	**-**	**27**
Loans and advances to banks	**1**	**-**	**-**	**1**
Available for sale financial assets				
Opening balance	1,008	-	-	1,008
To debt securities at amortised cost	-	(1,008)	-	(1,008)
Total loans and advances to customers	**1,008**	**(1,008)**	**-**	**-**
Net deferred tax asset / liability				
Opening balance	65	-	-	65
Tax on impairment loss allowance - remeasurement	-	-	11	11
Other changes	-	-	1	1
Total net deferred tax	**65**	**-**	**12**	**77**
Total inclusive of net deferred tax	**26,061**	**-**	**(34)**	**26,027**

46 IAS 39 to IFRS 9 transitional disclosures *(continued)*

Bank Liabilities	Carrying amount under IAS 39 31 December 2017 £m	Reclassification £m	Remeasurement £m	Carrying amount under IFRS 9 1 January 2018 £m
Financial liabilities at amortised cost				
Deposits from banks	3,554	-	-	3,554
Customer accounts	19,044	-	-	19,044
Items in the course of transmission to other banks	108	-	-	108
Subordinated liabilities	290	-	-	290
Other liabilities (accrued interest payable)	52	-	-	52
Total financial liabilities at amortised cost	**23,048**	**-**	**-**	**23,048**
Loss allowance provision on loan commitments and financial guarantees				
Opening balance	-	-	-	-
Increase in loss allowance provision	-	-	9	9
Total loss allowance provision on loan commitments and financial guarantees	**-**	**-**	**9**	**9**
Financial liabilities at fair value through profit or loss				
Derivative financial instruments	65	-	-	65
Customer accounts	1	-	-	1
Total	**23,114**	**-**	**9**	**23,123**

Bank Equity	Carrying amount under IAS 39 31 December 2017 £m	Reclassification £m	Remeasurement £m	Carrying amount under IFRS 9 1 January 2018 £m
Available for sale reserve				
Opening balance	4	-	-	4
Reduction in available for sale reserve related to assets at amortised cost	-	-	(5)	(5)
Tax on available for sale financial assets	-	-	1	1
Total available for sale reserve	**4**	**-**	**(4)**	**-**
Retained earnings				
Opening balance	157	-	-	157
Impairment loss allowance - remeasurement	-	-	(50)	(50)
Deferred tax on remeasurement	-	-	11	11
Total impact on retained earnings	**157**	**-**	**(39)**	**118**
Total impact on equity	**161**	**-**	**(43)**	**118**

46 IAS 39 to IFRS 9 transitional disclosures *(continued)*

The following table provides the reconciliation of the Bank's closing impairment provision in accordance with IAS 39 and provisions in accordance with IAS 37 to the opening loss allowance determined in accordance with IFRS 9.

Bank Impairment loss allowance	Carrying amount under IAS 39 31 December 2017 £m	Reclassification £m	Remeasurement £m	Carrying amount under IFRS 9 1 January 2018 £m
Financial assets at amortised cost				
Opening balance	144	-	-	144
Increase in impairment loss allowance	-	-	41	41
Total assets at amortised cost	**144**	**-**	**41**	**185**

Bank Loss allowance provision	Carrying amount under IAS 39 31 December 2017 £m	Reclassification £m	Remeasurement £m	Carrying amount under IFRS 9 1 January 2018 £m
Provision on loan commitments and financial guarantees				
Opening balance	**-**	**-**	**-**	**-**
Increase in loss allowance provision in loan commitments, guarantees and irrevocable letters of credit	-	-	9	9
Total loss allowance provision on loan commitments and financial guarantees	**-**	**-**	**9**	**9**

The following table shows the effects of the reclassification of available for sale financial assets under IAS 39 to amortised cost under IFRS 9.

Group and Bank	2018 £m
From available for sale financial assets under IAS 39	764
Fair value gain / (loss) that would have been recognised in 2018 in other comprehensive income if the financial assets had not been reclassified	1

47 Post balance sheet events

There are no post balance sheet events that require disclosure in the financial statements.

48 Approval of financial statements

The Board of Directors approved the financial statements on 8 March 2019.

Other Information

Principal business units and addresses[1]

Bank of Ireland (UK) plc
Bow Bells House, 1 Bread Street, London EC4M 9BE
Tel: +44 207 236 2000
Website: www.bankofirelanduk.com

Bank of Ireland Great Britain Consumer Banking
Mortgages, Credit Cards, Personal Loans
PO Box 27, One Temple Quay, Bristol BS1 9HY
Tel: + 44 117 979 2222 and + 44 117 909 0900

Bank of Ireland Northern Ireland Business Banking
1 Donegall Square South, Belfast, BT1 5LR
Tel: +44 28 9043 3000

First Rate Exchange Services Limited
Great West House, Great West Road, Brentford, London, TW8 9DF
Tel: + 44 208 577 9393, Fax: + 44 208 814 6685
Website: www.firstrate.co.uk

NIIB Group Limited (trading as Northridge Finance)
1 Donegall Square South, Belfast BT1 5LR
Tel: + 44 844 892 1848
website: www.northridgefinance.com

Marshall Leasing Limited
Bridge House, Orchard Lane, Huntingdon, Cambridgeshire, PE29 3QT
Tel: + 44 148 041 4541

Pillar 3 disclosures

The Group's Pillar 3 document for the year ended 31 December 2018 can be accessed on the Group's website: www.bankofirelanduk.com. The Group's obligations under Article 89 of the CRD IV have been met by consolidation of Group data in the Parent’s country by country reporting which is published on the Bank of Ireland Group website www.bankofireland.com.

[1] *Registered addresses for subsidiary companies are included in note 44.*

Performance measures

Further information related to certain measures referred to in the strategic report.

The Group considers that the alternative performance measures included in the strategic report provide meaningful information to enable a consistent basis for comparing the financial performance between reporting periods.

In arriving at an underlying basis, the effect of certain items that do not promote an understanding of future or historical performance are excluded. Management considers that this presents a more meaningful basis for year on year comparison. These non-core items are set out on page 8.

Alternative performance measures

Average interest earning assets – is defined as the twelve month average of total loans and advances to customers (less ECL stage 3 balances), cash placements, securities balances and net balances owed by the Parent (the Governor and Company of the Bank of Ireland).

Cost income ratio – is calculated on a statutory basis being operating expenses divided by operating income.

Gross new lending volumes – represents loans and advances to customers drawn in the year.

Net interest margin – is defined as net interest income for the year divided by average interest earning assets.

Return on assets – is calculated as statutory profit after tax divided by total assets, in line with the requirement in the European Union (Capital Requirements) Regulations (CRR) 2014.

Statutory return on tangible equity – is calculated as being profit attributable to shareholders (net of tax) divided by average shareholders' equity less intangible assets and goodwill.

Underlying return on tangible equity – is calculated as being profit attributable to shareholders less non-core items (net of tax) divided by average shareholders' equity less intangible assets and goodwill.

Regulatory performance measures

Leverage ratio – is calculated as the tier 1 capital divided by total balance sheet assets and off balance sheet exposures.

Liquidity coverage ratio (LCR) – is calculated as the high quality liquid assets, divided by net cash outflows over the next 30 days, expressed as a percentage.

Loan to deposit ratio – is calculated as net loans and advances to customers including those classified as held for sale expressed as a percentage of customer deposits.

Net stable funding ratio (NSFR) – is defined as the total amount of available stable funding divided by the total amount of required stable funding, expressed as a percentage.

Risk weighted assets (RWAs) – on and off balance sheet assets are risk weighted based on the amount of capital required to support the assets. The Group adopts a standardised approach for calculating RWAs.

Abbreviations

ALCO	Asset and Liability Committee
AML	Anti Money Laundering
ATM	Automatic Teller Machine
BoI	Bank of Ireland
BRC	Board Risk Committee
Brexit	The outcome of the UK referendum to leave the EU
CCO	Chief Credit Officer
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CGU	Cash Generating Unit
CMA	Competition and Markets Authority
COO	Chief Operating Officer
CRD	Capital Requirement Directive (EU)
CRO	Chief Risk Officer
CRPC	Credit Risk Portfolio Committee
CRR	Capital Requirements Regulation
CSA	Credit Support Annex
DCF	Discounted Cash Flow
EBA	European Banking Authority
ECL	Expected Credit Loss
EIR	Effective Interest Rate
ERC	Executive Risk Committee
EU	European Union
FCA	Financial Conduct Authority
FLI	Forward Looking Information
FPC	Financial Policy Committee
FRES	First Rate Exchange Services Limited
FRESH	First Rate Exchange Services Holdings Limited
GBP	ISO 4217 currency code for Pound Sterling
GCR	Group Credit Review
GIA	Group Internal Audit
GRPC	Group Risk Policy Committee
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IBNR	Incurred but not Reported
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IFRS IC	IFRS Interpretations Committee
ILAAP	Individual Liquidity Adequacy Assessment Process
IRRBB	Interest Rate Risk in the Banking Book
ISDA	International Swaps and Derivatives Association
IT	Information Technology
KMP	Key Management Personnel
KPI	Key Performance Indicator
LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
LIBOR	London Interbank Offered Rate
LLP	Limited Liability Partnership
LTD	Limited
LTV	Loan to Value
MLL	Marshall Leasing Limited
MRR	Monthly Risk Report
NSFR	Net Stable Funding Ratio
OCI	Other Comprehensive Income
ORMF	Operational Risk Management Framework
PD	Probability of Default
POCI	Purchased or originated credit-impaired financial assets
PRA	Prudential Regulation Authority
PSAGC	Product & Services Approvals & Governance Committee
PwC	PricewaterhouseCoopers LLP
RAG	Red, Amber, Green
RAROC	Risk Adjusted Return on Capital
RAS	Risk Appetite Statement
RMF	Risk Management Framework
ROE	Return on Equity
RORC	Return on Regulatory Capital
ROTE	Return on Tangible Equity
R&ORC	Regulatory and Operational Risk Committee
RWA	Risk Weighted Assets
SME	Small / Medium Enterprises
SSM	Single Supervisory Mechanism
TFS	Term Funding Scheme
£m	Million
’000	Thousands

THIS PAGE HAS BEEN INTENTIONALLY LEFT BLANK