Sainsbury's Bank plc

Annual Report and Financial Statements for the period ended 28 February 2015

COMPANY NUMBER: 3279730

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Strategic report

The Directors present their strategic report of Sainsbury's Bank plc ('the Bank') for the 14 months ended 28 February 2015.

Principal activities

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

Change of accounting reference date

Following the change in ownership, the Bank has changed its accounting reference date from 31 December to 28 February in line with the J Sainsbury plc group of companies. The current financial statements report on the 14 month period from 1 January 2014 to 28 February 2015 and the comparative figures presented within these financial statements are for the 12 months from 1 January 2013 to 31 December 2013.

Strategic review

Following the change in ownership, the Bank has progressed its transition programme to move to a standalone operating model from the previous joint venture model with Lloyds Banking Group (LBG), known as the New Bank Programme (NBP). Throughout the transitional phase the Directors have set three strategic principles against which to measure progress:

- Maintenance of 'business as usual';
- Deliver the NBP in line with plan; and
- Development of the business to support the longer term strategy.

Delivery of NBP represents a significant financial investment for the Bank and transitional costs of £104m (2013: £nil) have resulted in a loss before tax for the period of £33m (2013 restated[1]: profit before tax of £56m). In order to track 'business as usual' performance, management has monitored underlying profit before tax[2] which excludes the transitional expenditure of a non-recurring nature.

Maintenance of 'business as usual'

The Bank has a strong customer base within its core products of unsecured personal loans, credit cards, savings accounts, insurances, travel money and ATMs. It is critical to the success of the Bank to protect its relationship with its customers and maintain 'business as usual' performance alongside the development and delivery of its new operational capability.

Despite the reported loss for the period (driven by NBP transitional costs), underlying performance of the Bank has remained strong in a challenging market, led by a growth in unsecured personal lending products and supported by careful cost management and good credit quality of the Bank's customers. This has contributed to a growth in underlying profit before tax of 26.8% (8.7% on a comparable annualised basis[3]).

During the period the Bank enhanced its credit card proposition resulting in a 36% growth in balances. A Europe-wide change in interchange fee structures will be fully introduced by April 2016, with a phased introduction from card scheme providers during 2015. Whilst this will lead to a reduction in fee income going forward, the impact on the Bank's profitability and capital position is dependent on a number of factors which management continue to monitor closely.

The loans business had another very successful year, continuing to provide competitive, best buy table loan rates. The Bank made an entry into the larger loans market, becoming only one of two providers to offer unsecured loans of up to £35,000 as customers look for loans to improve and extend their homes rather than moving house.

Continued investment in the Bank's ATM estate has seen this grow to over 1,575 free to use ATMs during the period, accounting for 2.3% of all UK ATMs – £1 in every £12 dispensed via LINK ATMs is from a Sainsbury's Bank ATM. 40% of ATMs are now fitted with voice technology for the visually impaired.

Insurance sales volumes and commission declined year on year, due partly to increased competition in the car and home markets and partly to a strategic decision to reduce marketing and acquisition expenditure in these areas. Pet insurance, however, reported continued growth in new business sales.

The quality of the Bank's product offering is demonstrated through recent awards including Your Money: Best Direct Credit Card Provider; Best Direct Pet Insurance provider; Best Online Personal Loan Provider (July 2014) and Personal Loan Provider of the Year, 2015 Consumers Moneyfacts Highly Commended Award, as well as being named Best Loan Provider by Moneysupermarket.com Supers for the fourth consecutive year.

Delivery of the New Bank Programme

Whilst the Bank has made good progress in certain areas of the transition programme in terms of building its new banking platform and planning customer migration, a complex project of this size always brings challenge and the Bank has faced into a number of issues that are likely to impact the total costs. Whilst our transition plans remain on time and in line with budget to date, we see total costs (capital and revenue) for the project going forward rising to between £80 million to £120 million, taking our overall spend to between £340 million to £380 million. The smooth migration of savings customers in winter 2015 remains the Bank's primary near term objective.

During the period, the Bank acquired a new Customer Services Contact Centre for colleagues transferring in from Lloyds Banking Group. The centre will become operational as the Bank's new savings platform begins to go live.

Development of the business

The Bank's longer term strategy is to develop its product set, distribution plans and customer proposition in order to provide return on the NBP investment. The Bank's growth strategy is aligned to the J Sainsbury plc strategy to develop complementary channels and services.

In March 2015 the Bank created a new in-house travel money team, welcoming 574 Travelex colleagues over to Sainsbury's Bank, and opened its 168th Bureau – a key milestone in the transition to becoming a standalone bank. Travelex will continue to offer over 50 currencies with Sainsbury's Bank setting its own pricing and delivering a range of services including Western Union money transfers.

The Bank continues to look at ways to enhance its product offering to benefit its customers.

Whilst retail deposits remain the Bank's primary source of funding, the Bank has diversified into new sources during the period to further support its growth, including a securitisation issue and non-bank unsecured wholesale deposits (see note 22 to the financial statements). The Bank's participation in the Bank of England Funding for Lending Scheme (FLS) has provided an additional source of liquidity, allowing the Bank to grow its customer asset base and reduce levels of customer deposits held relative to lending (see notes 10 and 20). The Bank will continue to develop a diversified range of funding as it moves forward.

1. Restated following the implementation of IFRIC 21 – see note 1d and note 39
2. Profit before tax excluding non-recurring items that are material and infrequent in nature
3. Calculated by pro-rating the income statement for the 14 months ended 28 February 2015 by 12/14 when comparing to the 12 months ending 31 December 2013

Financial performance and position

The Bank's performance for the 14 months ended 28 February 2015 and financial position at the end of that period are presented in the income statement and balance sheet. A summarised income statement and balance sheet are presented below:

Summary income statement	14 months to 28 Feb 2015 £m	Restated[1] 12 months to 31 Dec 2013 £m	Change %
Net interest income	**180**	128	40.6
Net Fees and commissions receivable	**120**	110	9.1
Total income	**300**	238	26.1
Operating expenses	**(306)**	(154)	
Add: items excluded from underlying results*	**104**	–	
Underlying operating expenses	**(202)**	(154)	(31.2)
Impairment losses on financial assets	**(26)**	(28)	7.1
Losses realised on financial instruments	**(1)**	–	–
Underlying profit before taxation	**71**	56	26.8
Items excluded from underlying results*	**(104)**	–	–
(Loss)/profit before tax	**(33)**	56	(158.9)
Taxation	**8**	(13)	161.5
(Loss)/profit for the financial period	**(25)**	43	(158.1)

* Expenditure of a non-recurring nature excluded from the underlying performance relates exclusively to transitional costs connected to the NBP. Any increased operational costs arising as a result of the new operating model that will form part of the Bank's cost base going forward have been included in underlying operating costs.

Summary balance sheet	28 Feb 2015 £m	Restated 31 Dec 2013 £m	Change %
Loans and advances to customers	**3,032**	2,592	16.9
Cash and cash equivalents (note 11b)	**882**	2,008	(56.1)
Other	**323**	201	60.7
Total assets	**4,237**	4,801	(11.7)
Customer deposits	**3,488**	3,524	(1.0)
Deposits by banks	**–**	752	(100.0)
Wholesale funds	**171**	–	–
Other	**120**	172	(30.2)
Total liabilities	**3,779**	4,448	(15.0)
Net assets	**458**	353	29.7

In monitoring the financial performance and position of the Bank the Directors track a variety of key measures including the following ratios:

	28 Feb 2015	31 Dec 2013
Net interest margin	**3.6%**	2.7%
Cost: income ratio (underlying)	**67.3%**	64.7%
Bad debt asset ratio	**0.7%**	1.1%
Loans to deposits ratio	**86.9%**	73.6%
Core Tier 1 capital ratio	**12.7%**	12.3%
Risk asset ratio	**12.7%**	15.1%
Leverage ratio	**7.4%**	6.0%
Net stable funding ratio	**115%**	135%

Net interest income

Net interest income grew by 40.6% on a statutory basis which equates to 20.5% increase on a comparable annualised basis. This has been achieved in an increasingly competitive marketplace where the Bank has remained among the lowest priced providers including our lowest ever headline personal loans rate of 3.6% to Nectar card holders. Falling yield has been offset by a growth in our lending to customers where lending has increased to £3,032m.

The Net Interest Margin has improved from 2.7% to 3.6% period on period which has been achieved through a reduction in funding costs. Liquidity requirements have been carefully managed following the repayment of £752m relating to the previous borrowing facility with Lloyds Banking Group as part of the contractual arrangements following the change in ownership in January 2014, which has reduced the Bank's funding requirements. The Bank has also benefited from access to the FLS which has resulted in lower funding costs and supported a growth in customer lending. In line with lending, market deposit rates have also fallen in the period. Further detail on net interest income is provided in note 2 to the financial statements.

Fees and commissions receivable

Although commission income grew by 9.1% on a statutory basis, on a comparable 14 month like for like basis commission income fell by 6.5% reflecting a fall in home and car insurance sales where the market has been increasingly price competitive. The Bank has consciously reduced its acquisition activity through proposition and pricing in these areas. Other non-lending product segments continued to show growth during the period including pet insurance and travel money.

Operating expenses

Overall the underlying cost income ratio increased from 64.7% to 67.3% reflective of the Bank's continued investment towards standalone operating capability, including additional staff and systems operating expenditure. This ratio is expected to remain at an elevated level throughout the transitional period and beyond. Continued control of costs, particularly in relation to NBP, is a priority for the Bank in sustaining its future profitability.

Impairment losses

The bad debt asset ratio continues to fall, ending the year at 0.7% and actual impairment costs fell by 20.4% on a comparable annualised basis. This remains comfortably within the Bank's appetite for credit risk (see note 31 to the financial statements). The Bank's high quality customer portfolio combined with low market interest rates and improving economic conditions contributed to the performance. The Bank continues to carefully monitor the impairment provision assumptions alongside external economic conditions including the interest rate environment where a future increase in interest rates could increase pressure on customers' budgets.

Assets

Customer lending grew 16.9% in the period overall across credit cards and personal loans, driven by the Bank's competitive customer propositions.

Cash and cash equivalents reduced to £882m from £2,008m at December 2013 as a result of changes to the funding structure following the repayment of fixed term borrowings with Lloyds Banking Group against which the Bank previously held liquid funds. The Bank has also reduced its liquidity held on balance sheet following entry into the FLS scheme, in line with risk appetite.

Remaining assets have grown by £122m which principally reflects capitalisation of the new banking platform intangibles as part of the NBP, as referred to in note 16.

1. Restated following the implementation of IFRIC 21 – see note 1d and note 39

Financial performance and position continued

Liabilities
As a result of optimised liquidity requirements, availability of the FLS and the diversification of funding sources, retail customer deposits fell marginally by £36m (1%) in the period. The loans to deposits ratio increased from 73.6% to 86.9% reflecting the diversification of liquidity and funding. This remains within the Bank's risk appetite for this ratio.

Net assets
Overall net assets have increased by £105m in the period as a result of additional share capital issued to J Sainsbury plc in support of their investment in the NBP, offset by the loss for the period of £25m. Liquidity and capital ratios have remained strong throughout the period, exceeding both internal and external regulatory requirements (see notes 31 and 32 for further analysis). The Bank is well positioned to support its future strategic development and is now looking at external as well as internal capital options to support its growth plans.

Risk management approach

The Bank aims to appropriately manage all risks that arise from its activities. Through its normal operations the principal risks to the Bank are retail credit risk, wholesale credit risk, liquidity & funding risk, market risk, operational risk and compliance & conduct risk. Alongside these, the Bank is currently exposed to additional operational risks associated with its transition to a new stand-alone operating model following the transfer to full ownership by J Sainsbury plc in 2014.

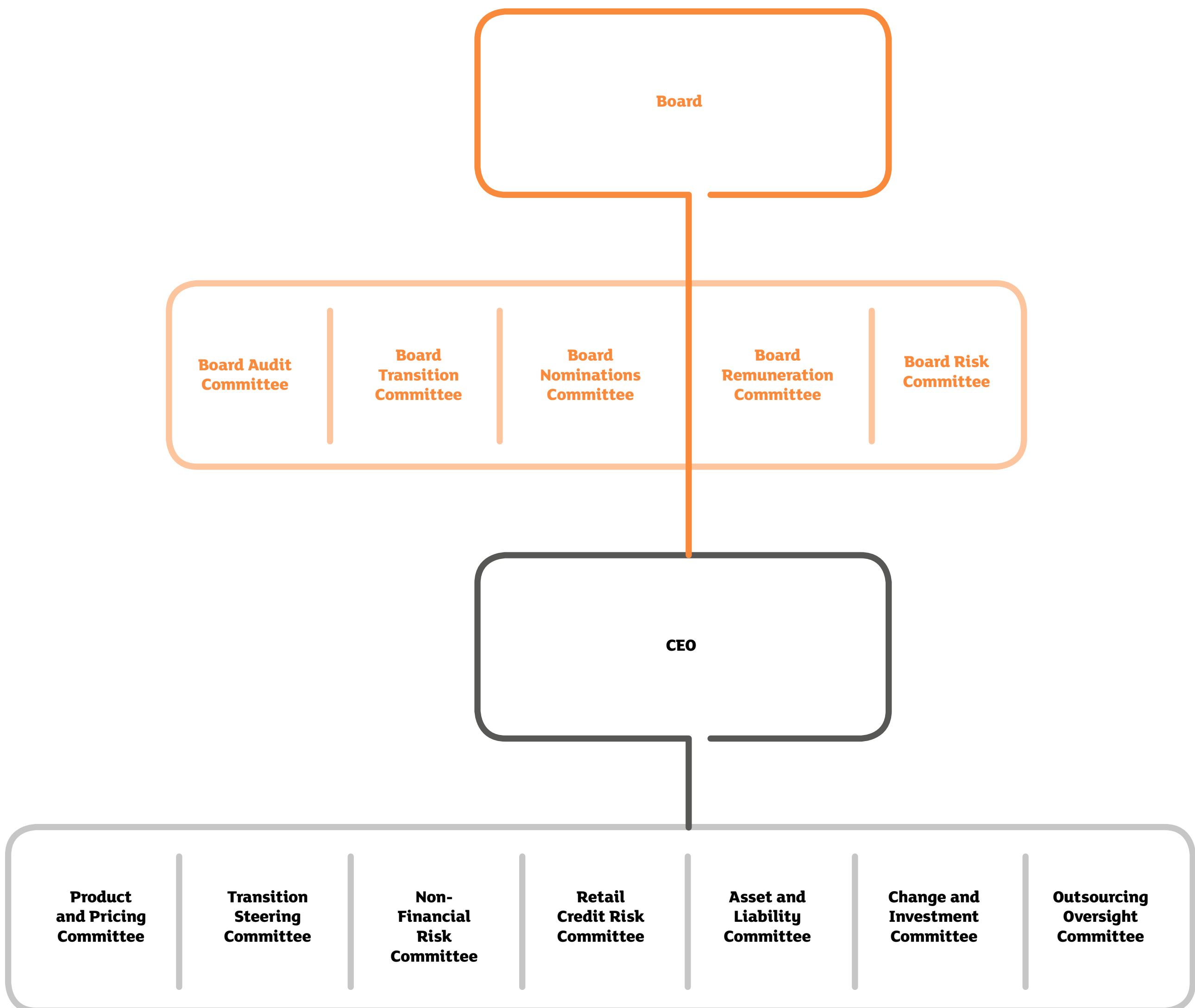
The Bank has established a risk framework and formal structure to monitor and manage risks across its operations. The Board has agreed statements of risk appetite and these are adhered to via detailed risk management policies and through various governance committees.

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

— Board level governance

— Collective management level governance

— Executive level governance



Risk management approach continued

Board level governance

The Board level governance holds overall accountability for the outcomes achieved, decisions made and steering the Bank, subject to specific reserved matters which require the consent of J Sainsbury plc. The Board then subsequently delegates the appropriate responsibility, authority and accountability to the CEO to deliver the Bank's Strategy through the appropriate governance committees and Executive Management Team.

The Board

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

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

Audit Committee

The Audit Committee's key responsibility is to advise the Board on the Bank's financial statements both interim and final, including systems and controls and related policy issues together with relationships with external auditors. The Committee is also responsible for reviewing and approving the internal audit plan and budget, and for ensuring that the function is adequately resourced. During 2014, the Committee monitored the effectiveness of internal audit and approved the resourcing model to support delivery of the audit plan.

Transition Committee

The Transition Committee oversees delivery of the NBP and the transition to new banking platforms, systems and processes following the transfer of full ownership to J Sainsbury plc in 2014.

Nominations Committee

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

Remuneration Committee

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

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

Board Risk Committee

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

Collective management level governance

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

Product and Pricing Committee

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

Transition Steering Committee

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

Non-Financial Risk Committee

The Non-Financial Risk Committee (NFRC) is in place to ensure the effective management of operational risk and compliance & conduct risk, including areas such as fraud, information security and business continuity. It makes those decisions necessary to ensure that the Bank operates within its defined risk appetite.

Retail Credit Risk Committee

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

Asset and Liability Committee

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

Change and Investment Committee

The Change and Investment Committee (CIC) is responsible for the management and oversight of operational risk associated with the Bank's 'business as usual' change portfolio ensuring appropriate prioritisation of projects and tracking of progress versus plan.

Outsourcing Oversight Committee

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

Executive level governance

This is the Executive Committee and their mandates in relation to working groups.

Risk management approach continued

Risk appetite

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

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

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

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

Risk model

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

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

Principal risks and uncertainties

The principal risks to the Bank are retail credit risk, wholesale credit risk, liquidity & funding risk, market risk, operational risk and compliance & conduct risk. The principal risks and uncertainties table sets out these risks in more detail and also provides examples of relevant controls and mitigating factors. It should be noted that the risk assessment and mapping employed by the Bank goes beyond this assessment and captures less material risks that may still impact the business and require monitoring for future changes in materiality.

As noted above, the Bank is managing through a transitional period following the transfer to full ownership by J Sainsbury plc in 2014. During this period, the Bank is exposed to additional operational risks associated with the transition which could have an impact on people, processes, regulatory compliance and technical infrastructure. Oversight of these transitional risks is being maintained through the Bank's existing risk oversight framework.

Principal risks and uncertainties continued

Principal risk	Nature of risk	Key controls and mitigating factors
Retail credit risk	The Bank is exposed to UK economic conditions. Adverse changes in unemployment, indebtedness, consumer confidence, and consumer spending would all have the potential to impact the credit quality of the Bank's underlying assets as well as new lending activity.	—Regular reporting framework in place to identify adverse performance versus forecast and risk appetite. Tracking includes reference to external benchmarking. —Dedicated credit risk team who report directly to the Chief Risk Officer (CRO). —Low risk appetite resulting in better than industry average credit quality being maintained. —Impact of severe economic scenarios regularly considered as part of stress testing and capital adequacy assessment process.
Wholesale credit risk	The Bank is exposed to losses where institutional counterparties fail or do not meet their contractual cash flow obligations.	—The Bank's exposure to wholesale credit risk is reported to ALCO, BRC, Audit Committee and the Board, including reference to credit default swaps prices, news and industry consensus. —Daily reporting to the Treasurer and Treasury Risk (2nd line) on economic environment and any pertinent industry information. —Regular stress testing and daily monitoring of pricing. —Any changes to risk appetite or credit lines approved by ALCO, BRC and Board.
Liquidity & funding risk	The risk of the Bank being unable to meet its obligations as they are expected to fall due.	—The Bank undergoes an annual liquidity assessment process (ILAA) which is provided to the Prudential Regulatory Authority (PRA). Through this process the Bank's Individual Liquidity Guidance (ILG) is calculated to determine the liquidity buffer requirements. —The Bank aims to maintain sufficient funding to cover operations for a 90 day period whilst ensuring it meets regulatory requirements for minimum holdings of eligible assets. —Early warning indicators are reviewed daily by senior management and an escalation process is in place. —The Bank has a liquidity crisis management plan which is subject to regular review and testing. —The Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are regularly monitored and forecast alongside other cash flow and liquidity ratios. Actual and forward looking forecasts for these ratios are reported to the Treasurer and Treasury Risk daily and to ALCO, BRC and the Board. —Diversified sources of funding (e.g. securitisation and FLS). —The Bank aims to achieve a minimum buffer above the regulatory capital guidance thresholds.
Market risk	The risk that the value of the Bank's assets, liabilities or costs may fluctuate as a result of adverse change to market rates.	—The Bank has a detailed market risk policy, which sets out its risk appetite statement with reference to defined interest rate shocks. —Regular reporting to ALCO on earnings and market value sensitivity. —Monthly reporting of prepayment behaviour versus forecast and general product re-pricing assumptions. —All new banking products or amendments to the terms of existing products are reviewed from an interest rate risk perspective to ensure compliance with existing risk appetite.
Operational risk	Represents the risk of loss stemming from failed processes, systems, human error or fraud.	—Operational risk team in place to provide a second line of defence reporting to the CRO as part of the Enterprise Risk team. —Ongoing assessment undertaken where the adequacy of the control framework is considered and action plans agreed. —Ongoing maintenance of risk registers with appropriate oversight by NFRC, BRC and the Board. Risk registers include quantification of risks following an agreed methodology. —Process in place for capturing operational risk losses and ensuring action is taken to mitigate the possibility of reoccurrence. —Formal engagement with strategic partners to understand the impact of change. Project lifecycle methodology in place and all projects are managed accordingly to the level of assessed risk and appetite. —Outsourced services provided by LBG are managed under a Transitional Services Agreement (TSA).
Compliance & conduct risk	The risk of the Bank failing to meet the requirements of legislation and regulatory requirements as defined by the PRA, Financial Conduct Authority (FCA) and any other requirements from relevant regulatory bodies.	—Compliance and Conduct teams in place to provide a second line of defence reporting to the CRO. —Structure of Compliance and Conduct related policies, standards, framework and toolkits to ensure adequate business management of current and future regulatory and conduct related risks. —2nd line oversight plan to test the adequacy of the control environment for key compliance and conduct related processes. —Regular reporting of regulatory risks to NFRC, BRC, and Board —Regular and open communication with the FCA and PRA on all aspects of Bank activity but with particular focus on regulatory risk and conduct related themes relating to fair customer outcomes.

Pillar 3 report

Further information on the risks and controls can be found in the Bank's Pillar 3 Disclosure Report for the period ending 28 February 2015. This report is published in the investor relations section of the J Sainsbury's corporate website: www.j-sainsbury.co.uk/investor-centre.

Capital and liquidity

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

The Bank manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. Note 32 provides information on the capital resources of the Bank at the year end. The Bank's regulatory capital position at 28 February 2015 and 31 December 2013 was as follows:

	28 February 2015 (unaudited)	31 December 2013 (unaudited)
Risk weighted assets (£m)	**2,782**	2,475
Core Equity Tier 1 capital ratio	**12.7%**	12.3%
Risk asset ratio	**12.7%**	15.1%

The funding and liquidity position of the Bank remained robust throughout the year. This is described in more detail in note 31. Customer deposits continued to be well in excess of customer lending and the Bank has diversified into new sources of funding in the period. The Bank maintains a significant level of highly liquid assets, with the combined holding of Treasury Bills, including those held under the FLS which are not recognised on the balance sheet, and Bank of England Reserve account balance increasing to £773m representing 22% of deposits (2013: £510m, 14.5% of deposits).

Issued share capital

On 31 January 2014, the Bank became a wholly owned subsidiary of J Sainsbury plc through the acquisition of the remaining 50% shareholding in the Bank previously held by Lloyds Banking Group. During the period, the Bank has issued 128.75m Ordinary shares of £1 each to J Sainsbury plc taking the total share capital of the Bank to £298.75m as at 28 February 2015. £50m of this was issued upon repayment of subordinated undated loan capital. The remaining share capital issued during the period was primarily in support of the investment in more flexible banking platforms being developed as the Bank migrates from existing Lloyds Banking Group systems. The Bank forecasts and monitors capital requirements on an ongoing basis.

By order of the Board

David Arden
Chief Financial Officer and Company Secretary
5 May 2015

Directors' report

The Directors have pleasure in submitting their annual report and the financial statements of Sainsbury's Bank plc ('the Bank') for the 14 month period ended 28 February 2015.

Directors

The Directors at 28 February 2015 were:

Mr Roger Davis	(Chairman)	
Mr Peter Griffiths	(Chief Executive Officer)	
Mr David Arden		
Ms Gwyn Burr		
Ms Marcia Campbell		
Mr Alan Cook		
Mr Richard Keys		
Mr Mark Mullington		
Mr John Rogers		
Mr Andrew Simmonds		Appointed 3 February 2014
Ms Sarah Warby		Appointed 14 March 2014

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

Mr Ian Fox		Resigned 31 January 2014
Mr Alan Brindley		Resigned 31 January 2014
Mr Steven Burke	Appointed 31 January 2014	Resigned 3 October 2014

Directors who were appointed to the Board after 28 February 2015, but prior to the signing of the financial statements were:

Mr Stuart Deane	Appointed 11 March 2015

The Board comprises four Executive Directors and eight Non-Executive Directors. The position and remuneration of members serving as at 28 February 2015 is described in the following table:

Name	Position	Remunerated by Sainsbury's Bank plc	Remunerated by J Sainsbury plc
Roger Davis	Chairman (Independent Non-Executive)	●	
Peter Griffiths	Chief-Executive Officer	●	
David Arden	Executive	●	
Gwyn Burr	Non-Executive	●	
Marcia Campbell	Independent Non-Executive	●	
Alan Cook	Independent Non-Executive	●	
Richard Keys	Independent Non-Executive	●	
Mark Mullington	Executive	●	
John Rogers	Non-Executive		●
Andrew Simmonds	Independent Non-Executive	●	
Sarah Warby	Non-Executive		●

Prior to 1 February 2014, Mr Ian Fox and Mr Alan Brindley were remunerated by Lloyds Banking Group plc.

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

Board selection criteria

The Bank takes succession at Board and senior management level very seriously and recruitment into the Board combines an assessment of both technical capability and competency skills to ensure the optimum blend of individual and aggregate capability having regard to the Bank's long term strategic plan. Board recruitment is subject to the approval of the Nominations Committee, the Board and the relevant regulatory bodies (PRA/FCA).

Board diversity

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

Directors' indemnities

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

Charitable and other donations

During the period the Bank made charitable donations in the UK of £54,837 (2013: £29,199). No political donations were made during the period (2013: nil).

Colleagues

We aim to make our Bank a great place to work for all colleagues. We want our people to develop their skills and knowledge to be the best they can be, learning from each other, their managers and through structured learning activity that develops behavioural and technical capability. We want our colleagues to stay with us because they feel valued and stimulated. Because of this, they will recommend us as a place to work to colleagues who haven't yet joined us. How it feels to work at our Bank makes us different because our values guide everything we do and we have a warm culture where inventive collaborative thinking is encouraged. Cornerstones of our approach include investing time in two-way communication between leaders and other colleagues – informing and listening – and up-skilling leaders to be effective communicators and leaders of people. Underpinning our approach is a comprehensive suite of communications channels and clear policies that are regularly reinforced. These policies help keep our workplace fair and ensure we more than meet our legal requirements such as equal opportunities for all colleagues, irrespective of sex, race, colour, disability or marital status.

Independent auditors

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

Disclosure of information to auditors

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

Going concern

The Directors believe that the Bank is in a stable financial position and is well placed to generate profits in the future. In assessing whether the going concern basis continues to be appropriate, the Bank has considered the Financial Reporting Council's (FRC) guidance on assessing going concern and liquidity risk.

The risk management framework is considered adequate in managing liquidity and other key risks in the current environment. The Bank continues to maintain its strong capital and liquidity position and has also been subject to review and challenge by the PRA as part of its remit as lead regulator of the Bank. Further information on the key financial risks of the business can be found in note 31.

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

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

Dividends

The loss after tax for the period attributable to the shareholders is £25m (2013 restated: profit of £43m). The Directors do not recommend payment of a dividend (2013: £nil).

By order of the Board and signed on its behalf by

David Arden
Chief Financial Officer and Company Secretary
5 May 2015

Statement of Directors’ responsibilities

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company’s transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

By order of the Board and signed on its behalf by

David Arden
Chief Financial Officer and Company Secretary
5 May 2015

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

Report on the financial statements

Our opinion

In our opinion, Sainsbury's Bank plc's financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 28 February 2015 and of its loss and cash flows for the 14 month period (the "period") then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

What have we audited

Sainsbury's Bank plc's financial statements comprise:

- the balance sheet as at 28 February 2015;
- the income statement and statement of comprehensive income for the period then ended;
- the cash flow statement for the period then ended;
- the statement of changes in equity for the period then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

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

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

Opinion on other matter prescribed by the Companies Act 2006

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

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

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

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors

As explained more fully in the Statement of Directors' responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

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

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

Lindsay Gardiner
Senior Statutory Auditor
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
5 May 2015

Income statement

For the period to 28 February 2015

	Note	14 months to 28 Feb 2015 £m	Restated* 12 months to 31 Dec 2013 £m
Interest receivable	2	**238**	206
Interest payable	2	**(58)**	(78)
Net interest income		**180**	128
Fees and commissions receivable	3	**120**	110
Total income		**300**	238
Administrative expenses	4	**(299)**	(149)
Depreciation and amortisation			
Property, plant and equipment	17	**(5)**	(3)
Intangible assets	16	**(2)**	(2)
		(306)	(154)
Impairment losses on financial assets	10	**(26)**	(28)
Losses realised on financial instruments	7	**(1)**	–
(Loss)/profit before taxation	8	**(33)**	56
Taxation	9	**8**	(13)
(Loss)/profit for the financial period attributable to the owners of the Bank		**(25)**	43

* Restated following the implementation of IFRIC 21 – see note 1d and note 39

The accompanying notes on pages 17 to 50 form part of these financial statements.

Statement of comprehensive income

For the period to 28 February 2015

	Note	14 months to 28 Feb 2015 £m	Restated* 12 months to 31 Dec 2013 £m
(Loss)/profit for the financial period		**(25)**	43
Other comprehensive income:			
Items that may be reclassified subsequently to profit or loss:			
Movement on revaluation of available for sale financial assets	28	**1**	2
Total other comprehensive income for the year, net of tax		**1**	2
Total comprehensive (expense)/income		**(24)**	45

* Restated following the implementation of IFRIC 21 – see note 1d and note 39

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 17 to 50 form part of these financial statements.

Balance sheet

As at 28 February 2015

	Note	28 Feb 2015 £m	Restated* 31 Dec 2013 £m
Assets			
Loans and advances to customers	10	**3,032**	2,592
Cash and balances with central banks	11b	**696**	444
Loans and advances to banks	12	**138**	1,059
Derivative financial instruments	13	**1**	2
Financial investments – available for sale			
Treasury bills	14	**53**	510
Investment securities	15	**–**	32
Intangible assets	16	**104**	4
Property, plant and equipment	17	**27**	18
Prepayments and accrued income		**42**	37
Other assets	19	**144**	103
Total assets		**4,237**	4,801
Liabilities			
Customer accounts	20	**3,488**	3,524
Deposits by banks	21	**–**	752
Other deposits	22	**23**	–
Other borrowed funds	23	**148**	110
Derivative financial instruments	13	**6**	7
Other liabilities	24	**100**	44
Provisions for liabilities and charges	25	**14**	11
Total liabilities		**3,779**	4,448
Equity			
Called up share capital	26	**299**	170
Retained earnings	27	**159**	184
Other reserves	28	**–**	(1)
Total equity		**458**	353
Total equity and liabilities		**4,237**	4,801

* Restated following the implementation of IFRIC 21 – see note 1d and note 39

The financial statements on pages 12 to 50 were approved by the Board of Directors on 5 May 2015 and signed on its behalf by:

Peter Griffiths
Director and Chief Executive

David Arden
Director and Chief Financial Officer

The accompanying notes on pages 17 to 50 form part of these financial statements.

Sainsbury's Bank plc – Company number 3279730

Statement of changes in equity

For the period to 28 February 2015

	Notes	Called up share capital £m	Retained earnings £m	Other reserves £m	Total £m
At 1 January 2014 restated*		**170**	**184**	**(1)**	**353**
Loss for the financial period		**–**	**(25)**	**–**	**(25)**
Other comprehensive income:					
Available for sale financial assets fair value movements (net of tax)	28	**–**	**–**	**1**	**1**
Total comprehensive (expense)/income			**(25)**	**1**	**(24)**
Transactions with owners:					
Shares issued in the period		**129**	**–**	**–**	**129**
At 28 February 2015		**299**	**159**	**–**	**458**
At 1 January 2013		170	139	(3)	306
IFRIC 21 revised restatement		–	2	–	2
At 1 January 2013 restated		170	141	(3)	308
Profit for the financial year restated		–	43	–	43
Other comprehensive income/(expense):					
Available for sale financial assets fair value movements (net of tax)	28	–	–	2	2
Total comprehensive income		–	43	2	45
At 31 December 2013		170	184	(1)	353

* Restated following the implementation of IFRIC 21 – see note 1d and note 39

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 17 to 50 form part of these financial statements.

Cash flow statement

For the period ended 28 February 2015

	Note	14 months to 28 Feb 2015 £m	Restated* 12 months to 31 Dec 2013 £m
(Loss)/profit before taxation		**(33)**	56
Non-cash items included in profit before taxation		**36**	34
Change in operating assets and liabilities		**(1,025)**	(137)
Income taxes paid		**(6)**	(16)
Cash flows used in operating activities	11a	**(1,028)**	(63)
Purchase of equipment		**(14)**	(4)
Purchase of intangibles		**(102)**	(1)
Cash flows used in investing activities		**(116)**	(5)
Proceeds from issue of share capital		**129**	–
Repayment of dated and undated loan capital		**(110)**	–
Interest paid on other borrowed funds		**(1)**	(1)
Cash flows generated from/(used in) financing activities		**18**	(1)
Net decrease in cash and cash equivalents		**(1,126)**	(69)
Opening cash and cash equivalents		**2,008**	2,077
Closing cash and cash equivalents	11b	**882**	2,008

* Restated following the implementation of IFRIC 21 – see note 1d and note 39

The accompanying notes on pages 17 to 50 form part of these financial statements.

Notes to the financial statements

1. Accounting policies

a. Statement of compliance

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

b. Basis of preparation

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

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

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

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

Subsidiaries

Subsidiaries are entities, including special purpose entities (SPEs), over which the Bank has the power to govern the financial and operating policies. The results of subsidiaries are included in the income statement of the ultimate parent J Sainsbury plc.

Investments in subsidiaries are carried at cost less any impairment loss in the financial statements of the Bank.

Securitisation transactions

The Bank has securitised certain personal loans by the transfer of the loans to SPEs controlled by the Bank. The securitisation supports the issuance of debt by the SPEs to investors who gain the security of the cash flows from the securitised loans. The Bank continues to recognise the loans on its own balance sheet after the transfer because it retains the risks and rewards of ownership through the contractual arrangements with the SPEs. The proceeds received from the transfer are accounted for as a deemed loan repayable to the SPEs.

Designation of financial instruments

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

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

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

Loans and advances including impairment

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

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

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

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

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

Investment securities including impairment

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

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

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

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

1. Accounting policies continued

Sale and repurchase agreements
Securities sold subject to standard sale and repurchase agreements ('repos') are not derecognised where the Bank retains substantially all the risks and rewards of ownership by virtue of the predetermined repurchase price. The counterparty liability is included in Deposits by Banks.

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

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

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

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

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

Freehold buildings and leasehold properties – 50 years, or the lease term if shorter
Fixtures and equipment – three to ten years or, in the case of tenant's improvements, the lease term if shorter

Capital work in progress is not depreciated.

Gains and losses on disposal are determined by comparing proceeds with the asset's carrying amount and are recognised within operating profit. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

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

Capitalised development expenditure and purchased software is stated at cost less accumulated amortisation and impairment losses. Such assets are assessed for impairment where there is an indication of impairment or, in the case of assets which are not yet available for use, at least annually. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement. The amortisation charge for the asset is then adjusted to reflect the asset's revised carrying amount.

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

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

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

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

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

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

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

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

Other borrowed funds
Other borrowed funds comprises deemed loans to SPEs arising where assets transferred to the SPEs have not met the derecognition criteria, and subordinated loan capital. These are initially recognised at fair value and subsequently held at amortised cost and the interest payable is recognised in the income statement through interest payable.

1. Accounting policies continued

Financial liabilities

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

Other liabilities

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

Foreign currencies

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

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

Derivative instruments

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

— hedges of the fair value of the particular risks inherent in recognised assets or liabilities (fair value hedges)

— hedges of highly probable future cash flows attributable to recognised assets or liabilities (cash flow hedges).

These are accounted for as follows:

Cash flow hedging

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

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

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

Portfolio fair value hedging

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

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

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

Marketing expenditure

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

Share-based payments

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

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

For cash-settled share-based payments the fair value of the employee services rendered is determined at each balance sheet date and the charge recognised through the income statement over the vesting period of the share-based payment scheme, with the corresponding increase in accruals.

The value of the charge is adjusted in the income statement over the remainder of the vesting period to reflect expected and actual levels of options vesting, with the corresponding adjustments made in equity and accruals.

Provisions

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

Share capital

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

c. Critical accounting estimates and judgements

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

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

Impairment of investment securities

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

1. Accounting policies continued

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

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

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

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

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

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

Cash and cash equivalents
Fair value approximates to carrying value because they have minimal credit losses and are either short term in nature or re-price frequently.

Loans and advances to customers
The fair value of loans and advances is estimated by discounting anticipated cash flows, including interest, at a current market rate of interest.

Loans and advances to banks and deposits by banks
The fair value of floating rate placements and overnight deposits is equal to carrying value. The fair value of fixed interest bearing deposits is based on cash flows discounted using current money market interest rates for debts with similar maturity and credit risk characteristics.

Customer accounts and other borrowings
The fair value of customer deposits with no stated maturity date is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings with no quoted market price is calculated using a cash flow model discounted using interest rates for debts with similar maturity.

Investment securities
Fair value is based on market prices or broker/dealer valuations. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics. In 2014/15 and 2013 all securities were valued from market prices or broker/dealer valuations.

Derivatives
Fair value is based on valuation techniques including discounted cash flow models using solely observable market data. The most significant inputs into these models are interest rate yield curves which are developed from publicly quoted rates.

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

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

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

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

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

Further details of the provision are included in note 25.

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

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

Further details of the FSCS and the provision are included in note 25.

During the period the Bank implemented IFRIC 21 'Levies' which resulted in a change to the timing of recognition of the Levy resulting in the restatement of comparative figures. Further details of the prior year adjustment are included in note 1d below.

1. Accounting policies continued

d. Accounting developments

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

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

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

IFRIC 21 'Levies' provided additional guidance around the recognition of a liability to pay a levy. Previously, under IAS 37 'Provision, contingent liabilities and contingent assets', the Bank recognised the provision at the 31 December preceding the start of the levy period as the charge is based on the value of deposits at that date. IFRIC 21 clarified that the obligating event that triggers recognition of the levy is the commencement of the levy period, changing the Bank's existing recognition policy. The interpretation has been applied retrospectively in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', resulting in an adjustment of prior year financial information.

The impact of the change has resulted in the following change to the opening balance sheet as at 1 January 2013:

	1 Jan 2013 (as reported) £m	1 Jan 2013 (restated) £m
Total Assets	4,989	4,989
Total Liabilities	4,683	4,681
Shareholders' funds	306	308

The restatement also resulted in an increase of £1m to previously reported profit before tax for the year ended 31 December 2013 as a result of a reduction to administrative expenses. A fully restated income statement and balance sheets are included at note 39.

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

Standards and interpretations effective for the Company for the year beginning 1 March 2015

- Annual improvements to IFRSs 2010-2012 cycle*
- Annual improvements to IFRSs 2011-2013 Cycle*
- IAS 19 'Defined Benefit Plans: Employee Contributions'*

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

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

Standards and interpretations effective for the Company in future periods:

- IFRS 9 'Financial Instruments'.
- IFRS 14 'Regulatory Deferral Accounts'.
- IFRS 15 'Revenue from Contracts with Customers'.
- Amendments to IFRS 11 'Accounting for Acquisitions of Interests in Joint Operations'
- Amendments to IAS 16 and IAS 38 'Clarification of Acceptable Methods of Depreciation and Amortisation'
- Amendments to IAS 16 and IAS 41 'Agriculture: Bearer Plants'

IFRS 9 (as revised in 2014) was issued in July 2014 and will supersede IAS 39 in its entirety from its effective date for accounting periods commencing on or after 1 January 2018. Key features are as follows:

New classification and measurement criteria in determining whether debt instruments should be measured at amortised cost, fair value through profit and loss or fair value through other comprehensive income.

Impairment methodology should reflect expected credit losses as opposed to incurred credit losses under IAS 39.

The general hedge accounting mechanisms of IAS 39 have been retained, however greater flexibility has been introduced over the instruments eligible for hedge accounting and effectiveness testing criteria has been more closely aligned with the underlying economic hedge with the removal of retrospective testing.

The Bank is currently implementing a project to assess the impact of IFRS 9 and implement systems to ensure ongoing compliance with its requirements. The most significant impact on the Bank is likely to be in relation to impairment methodology as a result of the move to the expected credit loss model.

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes a number of existing standards and interpretations from its effective date for accounting periods beginning on or after 1 January 2017. IFRS 15 introduces principals to recognise revenue by allocation of the transaction price to performance obligations.

IFRS 15 will apply to the Banks fee and commission income, superseding IAS 18. Income from financial instruments will continue to be recognised under IAS 39 / IFRS 9. The Bank has considered that application of the new principals is unlikely to have a material change to current income recognition.

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

2. Net interest income

	14 months to 28 Feb 2015 £m	12 months to 31 Dec 2013 £m
Interest income on loans and receivables	**235**	205
Interest income from available for sale financial instruments	**3**	1
Interest receivable	**238**	206
Interest expense on loans and receivables	**(53)**	(78)
Interest expense on derivative liabilities	**(5)**	–
Interest payable	**(58)**	(78)
Net interest income	**180**	128

Amounts relating to cash flow hedges transferred to profit or loss during the period are reflected as a component of interest income or expense. Net ineffectiveness recognised on cash flow hedges during the period was £nil (2013: £nil). Net ineffectiveness recognised on fair value hedges was £0.1m (2013: £nil).

3. Fees and commissions receivable

	14 months to 28 Feb 2015 £m	12 months to 31 Dec 2013 £m
Banking income	**89**	74
Insurance income	**27**	33
Other income	**4**	3
	120	110

4. Administrative expenses

	14 months to 28 Feb 2015 £m	Restated* 12 months to 31 Dec 2013 £m
Staff costs:		
Wages and salaries	**29**	–
Social security costs	**2**	–
Pension costs	**2**	–
Other costs including secondee recharges and temporary contractors	**3**	22
	36	22
Marketing costs	**34**	34
Other operating costs	**229**	93
	299	149

* Restated following the implementation of IFRIC 21 – see note 1d and note 39

See note 5 for further details on employee arrangements.

5. Employees

During the month to 31 January 2014 and the entire financial year ending 31 December 2013 the Bank was a joint venture between J Sainsbury plc and Lloyds Banking Group plc and did not directly employ individuals. The individuals who worked for the Bank during that period had contracts of employment with either a member of the J Sainsbury plc group of companies or a member of the Lloyds Banking Group plc group of companies. The remuneration cost of these individuals was met by the Bank.

Following the acquisition of 100% of the share capital of the Bank by J Sainsbury plc on 31 January 2014, relevant employee contracts were transferred to the Bank under Transfer of Undertakings (Protection of Employment) (TUPE) regulations.

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

	14 months to 28 Feb 2015 Number	12 months to 31 Dec 2013 Number
Full time		
Head office and administration (from 31 January 2014)	**402**	–
Seconded colleagues (Prior to 31 January 2014)	**29**	304
	431	304
Part time		
Head office and administration (from 31 January 2014)	**31**	–
Seconded colleagues (Prior to 31 January 2014)	**2**	23
	33	23
	464	327

Colleague costs are disclosed in other administrative expenses in note 4.

From 1 February 2014 (and throughout the period for colleagues who were previously employed by the J Sainsbury plc group of companies) colleagues were eligible to join the defined contribution arrangements. These plans are also used where colleagues have been automatically enrolled into a pension. Contributions paid by the Bank are based on grade and the amount that the colleague chooses to pay or whether they have been automatically enrolled.

The Bank also previously incurred certain costs for colleagues who were members of the Sainsbury's Pension Scheme, a defined benefit scheme which was closed to future accrual on 28th September 2013. All members were moved to the defined contribution pension arrangements at that time and now have deferred pensions.

As the Bank was not a participating employer in the Sainsbury's Pension Scheme, it does not have a share in the Scheme's assets and liabilities and, as such, the pension recharges were treated as a defined contribution charge.

The pension cost recharge for the year represents contributions payable by the Bank to both types of pension scheme and amounted to £1.5m (2013: £0.9m) for the defined contribution schemes and £nil (2013: £0.5m) for the defined benefit schemes.

Prior to 31 January 2014 the Bank incurred certain costs for colleagues who worked for various entities within the Lloyds Banking Group plc group of companies in accordance with and subject to certain agreed principles. These entities are participating employers in both a defined contribution pension scheme and a defined benefit pension scheme based upon final pensionable pay, operated by Lloyds Banking Group plc. Prior to the transfer of employment, a total of 75 (2013: 74) employees participated in the defined benefit scheme, the HBOS Final Salary Pension Scheme (HBOS FSPS), which was formed on 3 July 2006 following the merger of various other schemes within the HBOS plc group of companies. As the Bank was not a participating employer in the HBOS FSPS, it did not have a share in the scheme assets and liabilities and as such the pension recharges were treated as a defined contribution charge.

6. Directors' emoluments

	14 months to 28 Feb 2015 £m	12 months to 31 Dec 2013 £m
Emoluments	**2.3**	1.6
Share based payments	**0.3**	–
Loss of office	**0.1**	–
	2.7	1.6
Highest paid director:		
Emoluments	**0.7**	0.6
Share based payments	**0.1**	–
	0.8	0.6

In addition to the above, emoluments representing employer's pension contributions of £0.15m (2013: £0.09m) were made in the year. The employer's pension contributions in respect of the highest paid Director were £0.05m (2013: £0.03m).

The emoluments set out above include those Executive Directors who held office during the period.

From 1 February 2014 onwards, all Executive Directors were employed and remunerated by the Bank.

6. Directors' emoluments continued

Prior to 1 February 2014 all directors were employed by and paid by either J Sainsbury plc or Lloyds Banking Group plc. The Bank was recharged emolument costs in accordance with, and subject to the terms of, arrangements agreed with the relevant employer. During this period, no recharge was made by either organisation to the Bank in respect of shares in J Sainsbury plc or Lloyds Banking Group plc granted to colleagues. During the period 4 directors (2013: 4) received awards under these schemes reflective of qualifying services. No Directors (2013: 2) exercised share options in the year.

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

7. Losses realised on financial instruments

During the period the Bank sold its remaining financial instruments in order to reduce the overall wholesale credit risk of the Bank. This realised a loss of £1m previously accumulated in reserves. There were no such disposals during the year ended 31 December 2013.

8. (Loss)/profit before taxation

	14 months to 28 Feb 2015 £m	12 months to 31 Dec 2013 £m
(Loss)/profit before taxation is stated including the following items of income and (expense):		
Interest on impaired loan balances	**2**	2
Operating lease rentals	**(2)**	(1)
Loss on disposal of property, plant and equipment	**(1)**	–
Auditors' remuneration:		
Statutory audit of the Bank	**(0.2)**	(0.3)
Non-audit services	**(0.1)**	(0.1)

Non-audit services primarily relate to advice on colleague related matters. In addition to the above, also included in other operating costs is £0.3m (2013: £nil) payable to LBG in respect of a review by their auditors, PricewaterhouseCoopers LLP, of controls undertaken on the Bank's behalf by LBG under contractual arrangements.

9. Taxation

	14 months to 28 Feb 2015 £m	12 months to 31 Dec 2013 £m
UK corporation tax on (loss)/profit for the year	**(7)**	12
Adjustments in respect of prior years	**–**	–
Current tax	**(7)**	12
Deferred tax (credit)/charge		
Origination and reversal of temporary differences	**(1)**	1
Impact of change in UK corporation tax rate	**–**	–
Deferred tax	**(1)**	1
Total tax (credit)/charge	**(8)**	13

The taxation credit of £8m (2013: charge of £13m) represents 22.93% of pre-tax losses (2013: 23.64% of pre-tax profits). The tax rate applicable to the Bank during the period reduced from 23% to 21% on 1 April 2014. On 20 March 2013, the Chancellor announced that the main rate of UK Corporation tax would reduce to 20.0% from 1 April 2015. This was substantively enacted on 2 July 2013 and has been applied as at 28 February 2015 and 31 December 2013. Differences to the UK corporation tax rate for the year of 21.42% are explained below:

	14 months to 28 Feb 2015 £m	12 months to 31 Dec 2013 £m
(Loss)/Profit before taxation	**(33)**	55
Tax on ordinary activities at 21.42% (2013: 23.25%)	**(7)**	13
Effects:		
Other tax adjustments	**(1)**	–
Total income tax (credit)/expense recognised in the income statement	**(8)**	13

10. Loans and advances to customers

	28 Feb 2015 £m	31 Dec 2013 £m
Gross advances	**3,114**	2,676
Impairment	**(87)**	(82)
Adjustment in relation to fair value hedging	**5**	(2)
Loans and advances to customers	**3,032**	2,592
Repayable on demand	**834**	613
Other loans and advances repayable:		
In 3 months or less	**234**	204
Between 3 months and 1 year	**596**	536
Between 1 and 5 years	**1,404**	1,272
After 5 years	**46**	51
Gross advances	**3,114**	2,676

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

	28 Feb 2015 £m	31 Dec 2013 £m
Individuals:		
Home Mortgages	**50**	60
Unsecured Personal Lending	**3,064**	2,616
Gross loans and advances to customers	**3,114**	2,676

The Bank has assigned the beneficial interest in a portion of its personal loans book to a Special Purpose Entity (SPE) for use as collateral in securitisation transactions. The Bank has also prepositioned a portion of its personal loans book with the Bank of England to facilitate participation in the Funding for Lending Scheme (FLS).

As at 28 February 2015 £191m (2013: £nil) of the personal loans portfolio was assigned to SPE's for use as collateral in securitisation transactions.

£487m (2013: £nil) of the personal loans book was pledged to the FLS facilitating £240m (2013: £nil) of drawings.

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

14 months ending 28 February 2015	Unsecured lending £m	Secured lending £m	Total £m
At 1 January 2014	**82**	**–**	**82**
New impairment provisions less releases	**28**	**–**	**28**
Recoveries of amounts previously written off	**(2)**	**–**	**(2)**
Amounts written off	**(19)**	**–**	**(19)**
Discount unwind on impaired loans and advances to customers	**(2)**	**–**	**(2)**
At 28 February 2015	**87**	**–**	**87**
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	**106**	**1**	**107**

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

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

11. Notes to the cash flow statement

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

	14 months to 28 Feb 2015 £m	Restated* Year to 31 Dec 2013 £m
(Loss)/profit before taxation	**(33)**	56
Non-cash items included in profit before taxation		
Impairment losses on loans and advances	**26**	28
Depreciation on property, plant and equipment	**5**	3
Amortisation of intangible assets	**2**	2
Loss on disposal of fixed assets	**1**	–
Loss on disposal of investment securities	**1**	–
Interest on borrowed funds	**1**	1
	36	34
Change in operating assets and liabilities		
Net (increase) in loans and advances to customers	**(466)**	(73)
Net decrease in loans to banks repayable in greater than 3 months	**–**	245
Net decrease/(increase) in derivative assets	**1**	(2)
Net decrease in investment securities	**32**	–
Net (decrease)/increase in derivative liabilities	**(1)**	1
Net (increase) in other assets	**(34)**	(64)
Net (increase) in prepayments and accrued income	**(5)**	(15)
Net (decrease)/increase in customer accounts	**(36)**	256
Net (decrease) in borrowed funds	**(581)**	(482)
Net increase/(decrease) in other liabilities	**65**	(3)
	(1,025)	(137)
Cash used in operations	**(1,022)**	(47)
Income taxes paid	**(6)**	(16)
Cash flows (used in)/generated from operating activities	**(1,028)**	(63)
Operational cash flows from interest		
Interest paid	**(63)**	(66)
Interest received	**239**	206

* Restated following the implementation of IFRIC 21 – see note 1d and note 39

b. Cash and cash equivalents

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

	28 Feb 2015 £m	31 Dec 2013 £m
Cash and balances with central banks	**696**	444
Cash ratio deposit held at central banks	**(5)**	(5)
	691	439
Loans and advances to other banks:		
Repayable on demand	**16**	38
Repayable in less than three months	**122**	1,021
Treasury bills	**53**	510
	882	2,008

12. Loans and advances to banks

	28 Feb 2015 £m	31 Dec 2013 £m
Sterling loans and advances to banks	**138**	1,059
Repayable on demand (included in cash equivalents)	**16**	38
Other loans and advances repayable:		
In 3 months or less (included in cash equivalents)	**122**	1,021
Gross advances	**138**	1,059

Loans and advances to banks includes £7m (2013: £957m) due to Lloyds Banking Group.

13. Derivative financial instruments

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

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

Portfolio fair value hedges

	Notional amount £m	Assets £m	Liabilities £m
Interest rate swap			
At 28 February 2015	**1,657**	**1**	**(6)**
At 31 December 2013	637	2	–

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

Cash flow hedges

	Notional amount £m	Assets £m	Liabilities £m
Currency swaps			
At 28 February 2015	**–**	**–**	**–**
At 31 December 2013	27	–	(7)

The Bank was exposed to foreign exchange risks from cash flows arising on its available for sale investment securities. These forecast transactions in foreign currencies were hedged with currency swaps. The cash flows on the currency swaps substantially matched the cash flow profile of the hedged investment securities. During the period all remaining foreign currency investment securities were disposed of and the related currency swap was terminated. Prior to this there were no transactions for which cash flow hedge accounting had to be ceased (2013: nil) as a result of the highly probable cash flows no longer being expected to occur. All cash flow hedges are non-current.

14. Treasury bills

	28 Feb 2015 £m	31 Dec 2013 £m
Treasury bills	**53**	510
Of which:		
Maturing in three months or less	**40**	243
Maturing between three months and one year	**13**	267
	53	510

Treasury bills include £nil (2013: £nil) pledged as collateral under sale and repurchase agreements.

15. Investment securities

	28 Feb 2015 £m	31 Dec 2013 £m
Investment securities		
Unlisted – issued by banks and building societies	–	32
Of which:		
Between 1 and 5 years	–	32
Investment securities	–	32

All remaining investment securities were disposed of during the period. Prior to disposal, the fair value movement during the period on investment securities classified as available for sale was a gain of £0.6m (2013: a gain of £3m).

16. Intangible assets

	28 Feb 2015 £m	31 Dec 2013 £m
Cost		
At 1 January	**21**	20
Additions	**102**	1
Disposals	**–**	–
As at 28 February/31 December	**123**	21
Accumulated amortisation		
At 1 January	**(17)**	(15)
Charge for the year	**(2)**	(2)
Disposals	**–**	–
As at 28 February/31 December	**(19)**	(17)
Net book value as at 28 February 2015/31 December 2013	**104**	4

Intangible assets comprise of acquired computer software. Additions in the period relate primarily to the development of new banking platforms as part of the New Bank Programme, as described further in the strategic report.

17. Property, plant and equipment

14 months ending 28 February 2015	Land and buildings £m	Fixtures and equipment £m	Total £m
Cost			
At 1 January 2014	**–**	**57**	**57**
Additions	**1**	**14**	**15**
Disposals	**–**	**(2)**	**(2)**
As at 28 February 2015	**1**	**69**	**70**
Accumulated depreciation			
At 1 January 2014	**–**	**(39)**	**(39)**
Charge for the year	**–**	**(5)**	**(5)**
Disposals	**–**	**1**	**1**
As at 28 February 2015	**–**	**(43)**	**(43)**
Net book value as at 28 February 2015	**1**	**26**	**27**
Capital work in progress included above	**1**	**–**	**1**

12 months ending 31 December 2013	Land and buildings £m	Fixtures and equipment £m	Total £m
Cost			
At 1 January 2013	–	54	54
Additions	–	4	4
Disposals	–	(1)	(1)
As at 31 December 2013	–	57	57
Accumulated depreciation			
At 1 January 2013	–	(37)	(37)
Charge for the year	–	(3)	(3)
Disposals	–	1	1
As at 31 December 2013	–	(39)	(39)
Net book value as at 31 December 2013	–	18	18
Capital work in progress included above	–	–	–

18. Subsidiary undertakings

The following company is a subsidiary undertaking of the Bank, being the SPE established in connection with the Bank's personal loans securitisation transactions. Although the Bank has no direct or indirect ownership interest in the equity of the SPE, the SPE was established for the purpose of providing a source of funding to the Bank by way of contractual agreement and the Bank has the rights to all benefits from its activities. The SPE is therefore effectively controlled by the Bank.

	Nature of business	Country of registration or incorporation
Lochside Asset Purchaser No.1 plc	Issue of securitised notes	England

19. Other assets

	28 Feb 2015 £m	31 Dec 2013 £m
Customer funds in the course of settlement	**10**	3
Bank funds in course of settlement	**121**	100
Current tax asset	**7**	–
Deferred tax asset	**1**	–
Cash collateral paid	**5**	–
	144	103

Other assets have no fixed maturities but are expected to be realised within 12 months, with the exception of the deferred tax asset of which £1m is recoverable after more than 12 months (2013: £nil).

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

	28 Feb 2015 £m	31 Dec 2013 £m
At 1 January	**–**	1
Movement in deferred tax asset charged to income statement	**1**	(1)
At 28 February/31 December	**1**	–
Tax effect of timing differences due to:		
Other temporary differences	**1**	–

20. Customer accounts

Customer accounts comprise Sterling interest bearing deposits.

	28 Feb 2015 £m	31 Dec 2013 £m
Repayable:		
On demand	**3,020**	2,897
Within 3 months	**75**	47
Between 3 months and 1 year	**209**	269
Between 1 and 5 years	**184**	311
	3,488	3,524

21. Deposits by banks

	28 Feb 2015 £m	31 Dec 2013 £m
Repayable:		
On demand	**–**	2
Within 3 months	**–**	98
Between 3 months and 1 year	**–**	227
Between 1 and 5 years	**–**	425
More than five years	**–**	–
	–	752

As at 28 February 2015 deposits by banks includes £nil (2013: £nil) secured on investment securities sold under sale and repurchase agreements.

22. Other deposits

Other deposits comprise non-bank wholesale deposits. Other deposits are denominated in Sterling.

	28 Feb 2015 £m	31 Dec 2013 £m
Repayable:		
Within 3 months	**3**	–
Between 3 months and 1 year	**17**	–
Between 1 and 5 years	**3**	–
	23	–

23. Other borrowed funds

	28 Feb 2015 £m	31 Dec 2013 £m
Dated loan capital		
£60 million floating rate subordinated loan 2014		
Repayable in less than 1 year	–	60
	–	60
Undated loan capital		
£50 million floating rate subordinated loan – undated	–	50
Deemed loan on securitisation		
Repayable in less than 1 year	**70**	–
Repayable between 1 and 5 years	**78**	–
	148	–
Other borrowed funds	**148**	110

Deemed Loan on securitisation

As at 28 February 2015, the beneficial interest in certain personal loans advanced to customers have been assigned to Lochside Asset Purchaser No.1 plc for the purposes of raising funds through the issue of collateralised loan notes. As the Bank retains substantially all risks and rewards of ownership of the relevant loans through contractual arrangements with Lochside Asset Purchaser No.1 plc, the loans continue to be recognised on the balance sheet of the Bank with a corresponding deemed loan recognised to Lochside Asset Purchaser No.1 plc.

Of the total £400m facility, £150m of Senior 'A Notes' have been issued by Lochside Asset Purchaser No.1 plc backed by the cashflows from the relevant personal loans.

As part of the structure the Bank has acquired £50m of subordinated 'B Notes'. As described in Note 31, the B Notes are offset against the deemed loan to Lochside Asset Purchaser No.1 plc and are not presented as a separate asset because their recoverability is linked to the collectability of the purchased receivables which also remain as an asset on the Bank's balance sheet.

Dated loan capital

At 31 December 2013 the dated subordinated loan was split in proportion to shareholder funding. On 31 January 2014 the £30m loan from Lloyds Banking Group was transferred to J Sainsbury plc in exchange for consideration equal to the book value of the loan. The £60m loan was repaid on its maturity date of 2 December 2014 following approval from the PRA. Interest on the £60 million Floating Rate subordinated loan dated 2014, was payable three months in arrears at LIBOR plus a margin of 0.60% per annum for the duration of the loan.

Undated loan capital

At 31 December 2013 the undated subordinated loans were split in proportion to shareholder funding. On 31 January 2014 the £25m loan from Lloyds Banking Group was transferred to J Sainsbury plc in exchange for consideration equal to the book value of the loan and on 28 February 2014 the £50m loan was repaid by issue of 50m of £1 ordinary shares to J Sainsbury plc following approval from the PRA. Interest on the £50 million Floating Rate undated loan capital was payable 3 months in arrears at LIBOR plus a margin of 1.0% per annum for the duration of the loan.

24. Other liabilities

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

	28 Feb 2015 £m	31 Dec 2013 £m
Customer funds in course of settlement	**26**	4
Bank funds in course of settlement	–	2
Current tax liabilities	–	6
Accruals and deferred income	**73**	31
Other liabilities	**1**	1
	100	44

25. Provisions for liabilities and charges

	Customer redress £m	FSCS £m	Onerous costs £m	Other provisions £m	Total £m
At 1 January 2014 restated	**6**	**2**	**–**	**3**	**11**
Charge to administrative expenses	**–**	**2**	**7**	**1**	**10**
Unused amounts reversed	**(1)**	**–**	**–**	**–**	**(1)**
Utilised in year	**–**	**(3)**	**–**	**(3)**	**(6)**
At 28 February 2015	**5**	**1**	**7**	**1**	**14**

	Customer redress £m	FSCS £m	Onerous costs £m	Other provisions £m	Total £m
At 1 January 2013 restated	–	2	–	1	3
Charge to administrative expenses restated	6	2	–	4	12
Utilised in year	–	(2)	–	(2)	(4)
At 31 December 2013 restated	6	2	–	3	11

Customer redress provisions

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

Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) is funded by levies on authorised financial services firms, based on their level of deposits taken at 31 December each year. The Bank, as a regulated deposit taker, is subject to levies imposed by the FSCS whose costs are made up of management expenses and compensation payments. As described within note 1d, accounting policies, the timing of recognition of the provision changed as a result of the application of IFRIC 21, Levies resulting in the restatement of comparative figures.

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

The closing provision at 28 February 2015 represents the estimated share of levies that will be raised by the FSCS including the interest on the loan in respect of the levy years, 2013/2014, 2014/2015 and the principal repayment levy for 2014/2015 and is based on an estimate of the interest that the FSCS will pay on the loan and an estimate of the Bank's market participation in the relevant periods. Hence, the provision is based on the interest estimated on the current borrowings from HM Treasury.

Onerous costs

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

Other provisions

Other provisions relate to the cost of bonus Nectar points and, previously, to ATM cash retracts.

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

The ATM cash retracts provision was paid in full to the relevant financial institutions during the period and no further provision is required. When a customer makes a withdrawal at an ATM, the cash is presented for only a short period. If the customer fails to remove their cash, the ATM will retract the money to prevent a passer-by from taking it. The generic term for this is a cash retract. The Bank previously recognised a provision to refund relevant financial institutions in respect of cash retracts that were never claimed by those institutions between 2006 and 2011. In March 2011 the LINK scheme rules changed to require pro-active returning of cash retracts. The Bank is fully compliant with those rules.

26. Called up share capital

	'A' ordinary shares of £1 £m	'B' ordinary shares of £1 £m	Ordinary shares of £1 £m	Total £m
Allotted, called up and fully paid:				
At 1 January 2014	**85**	**85**	**–**	**170**
Reclassification	**(85)**	**(85)**	**170**	**–**
Issued ordinary shares	**–**	**–**	**129**	**129**
At 28 February 2015	**–**	**–**	**299**	**299**
At 1 January 2013	85	85	–	170
Issued ordinary shares	–	–	–	–
At 31 December 2013	85	85	–	170

Prior to 1 February 2014 share capital was divided into class 'A' and class 'B' Ordinary shares which ranked pari passu in all respects. From 1 February 2014, the Bank altered its Articles of Association to change the status of its share capital to one class of ordinary shares. At the same time, the authorised share capital limit of the Bank was removed in line with the provisions of the Companies Act 2006.

During the period the Bank issued 50m ordinary shares of £1 each to J Sainsbury plc in exchange for repayment of the subordinated undated loan capital.

During the period the Bank issued 78.75m ordinary shares of £1 each at par to J Sainsbury plc.

For further details on the issue of share capital from J Sainsbury plc, see the strategic report.

27. Retained earnings

	28 Feb 2015 £m	Restated* 31 Dec 2013 £m
At 1 January	**184**	141
Profit for the financial year	**(25)**	43
At 31 December	**159**	184

* Restated following the implementation of IFRIC 21 – see note 1d and note 39

28. Other reserves

Other reserves comprise the fair value movements for available for sale securities and the effective portion of changes in the fair value of cash flow hedges. As at 28 February 2015 the cash flow hedge reserve is nil following the disposal of the underlying investment securities. The available for sale reserve will unwind in line with the maturity profile of the underlying investment securities.

	Available for sale reserve £m	Cash flow reserve £m	Total £m
At 1 January 2014	**(1)**	**–**	**(1)**
Realised losses transferred to the income statement on disposal	**1**	**–**	**1**
Net unrealised losses		**–**	
At 28 February 2015	**–**	**–**	**–**
At 1 January 2013	(3)	–	(3)
Net unrealised losses	2	–	2
At 31 December 2013	(1)	–	(1)

These balances include tax of £nil in the available for sale reserve (2013: £0.4m) and £nil in the cash flow hedge reserve (2013: £nil).

29. Analysis of financial assets and liabilities by measurement basis

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

At 28 February 2015	Loans and receivables £m	Available for sale securities £m	Derivatives designated as fair value hedging instruments £m	Total £m
Assets:				
Loans and advances to customers	**3,032**	**–**	**–**	**3,032**
Cash and balances with central banks	**696**	**–**	**–**	**696**
Loans and advances to banks	**138**	**–**	**–**	**138**
Derivative financial instruments	**–**	**–**	**1**	**1**
Financial investments – available for sale				
Treasury bills	**–**	**53**	**–**	**53**
Prepayments and accrued income	**38**	**–**	**–**	**38**
Other assets	**136**	**–**	**–**	**136**
Total financial assets	**4,040**	**53**	**1**	**4,094**
Non-financial assets:				
Prepayments and accrued income				**4**
Property, plant and equipment				**27**
Intangible and tax assets				**111**
				4,236

	Financial liabilities at amortised cost £m	Derivatives designated as cash flow hedging instruments £m	Derivatives designated as fair value hedging instruments £m	Total £m
Liabilities:				
Customer accounts	**3,488**	**–**	**–**	**3,488**
Other deposits	**23**	**–**	**–**	**23**
Other borrowed funds	**148**	**–**	**–**	**148**
Derivatives	**–**	**–**	**6**	**6**
Other liabilities	**97**	**–**	**–**	**97**
Total financial liabilities	**3,756**	**–**	**6**	**3,762**
Non-financial liabilities:				
Other liabilities				**3**
Provisions				**14**
Current tax				**–**
				3,779

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

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

	Financial liabilities at amortised cost £m	Derivatives designated as cash flow hedging instruments £m	Derivatives designated as fair value hedging instruments £m	Total £m
Liabilities:				
Customer accounts	3,524	–	–	3,524
Deposits by banks	752	–	–	752
Other borrowed funds	110	–	–	110
Derivatives	–	7	–	7
Other liabilities	34	–	–	34
Total financial liabilities	4,420	7	–	4,427
Non-financial liabilities:				
Other liabilities				4
Provisions restated				11
Current tax				6
				4,448

30. Loan and operating lease commitments

Loan commitments

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

	28 Feb 2015 £m	31 Dec 2013 £m
Commitments to extend credit	**79**	43

Operating lease commitments

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

	28 Feb 2015 £m	31 Dec 2013 £m
Due within one year	**–**	1
Due within 1 to 5 years	**4**	2
Due in more than 5 years	**7**	8
	11	11

31. Risk management

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

Credit risk

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

Wholesale and derivative credit risk

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

Retail credit risk

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

At 28 February 2015, the maximum credit exposure of the Bank in the event of other parties failing to perform their obligations is equal to the sum of loans and advances to banks, loans and advances to customers and credit lines and other commitments to lend. These are set out in notes 12, 10 and 30, respectively. No account is taken of any collateral held and the maximum exposure to loss is considered to be the instrument's balance sheet carrying amount.

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

	28 Feb 2015 £m	31 Dec 2013 £m
Credit risk exposures relating to on-balance sheet items		
Loans and advances to customers		
Unsecured	**2,982**	2,532
Secured	**50**	60
Cash and balances with central banks	**696**	444
Loans and advances to banks	**138**	1,059
Derivative financial instruments	**1**	2
Treasury bills	**53**	510
Investment securities	**–**	32
Prepayments and accrued income	**38**	18
Other assets	**136**	103
Credit risk exposures relating to off-balance sheet items		
Loans commitment and other related liabilities	**79**	43
Treasury bills drawn under FLS	**240**	–
Total credit risk exposures	**4,413**	4,803

Risk concentrations

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

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

Geographical sectors

Maximum exposure	28 Feb 2015 £m	31 Dec 2013 £m
United Kingdom	**4,337**	4,464
Switzerland	**28**	–
Countries in Europe adopting the Euro	**48**	339
	4,413	4,803

Concentration by location for loans and advances is measured based on the location of the Bank's operations, which has a high correlation with the location of the borrower. Concentration by location for investment securities is measured based on the location of the issuer of the security. The analysis reflects the credit risk associated with the balance and is not reflective of a currency exposure. The Bank had no foreign currency exposure as at 28 February 2015.

31. Risk management continued

Industry sectors

Maximum exposure	28 Feb 2015 £m	31 Dec 2013 £m
Corporate	**–**	307
Sovereign – UK	**777**	515
Bank	**474**	1,326
Retail	**3,162**	2,655
	4,413	4,803

The maximum credit exposure to any client or counterparty as of 28 February 2015 was £719m to the Bank of England (2013: £963m to Lloyds Banking Group) before taking into account collateral or other credit enhancements of £nil (2013: £211m). The exposure to Bank of England consists of £479m of cash held with the central bank, and £240m of Treasury Bills obtained under the Funding for Lending Scheme (FLS). FLS Treasury Bills are accounted for off-balance sheet but are available as a source of liquidity to the Bank.

Credit quality per class of financial asset

Loans and advances to customers

Loans and advances are summarised as follows:

	28 Feb 2015 £m	31 Dec 2013 £m
Impaired	**107**	101
Past due but not impaired	**16**	17
Neither past due nor impaired	**2,991**	2,558
Gross	**3,114**	2,676
Less: allowance for impairment	**(87)**	(82)
hedging fair value adjustment	**5**	(2)
	(3,032)	2,592

Credit quality analysis

At 28 February 2015	Unsecured lending £m	Secured lending £m	Total £m
Impaired			
Less than 3 months, but impaired	**2**	**–**	**2**
Past due 3 to 6 months	**6**	**–**	**6**
Past due 6 to 12 months	**–**	**–**	**–**
Past due over 12 months	**–**	**1**	**1**
Recoveries	**98**	**–**	**98**
Possession	**–**	**–**	**–**
Total gross impaired loans	**106**	**1**	**107**
Past due but not impaired			
Past due up to 3 months but not impaired	**14**	**2**	**16**
Total gross past due but not impaired	**14**	**2**	**16**
Neither past due nor impaired*			
Not impaired	**2,944**	**47**	**2,991**
Total gross neither past due nor impaired	**2,944**	**47**	**2,991**
Total gross amount due	**3,064**	**50**	**3,114**

* Includes £2.0m of loans and advances that would have been past due or impaired had their terms not been renegotiated.

31. Risk management continued

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

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

Mortgages held over residential properties represent the only collateral held by the Bank for retail exposures. The market value of collateral held for impaired loans and loans past due but not impaired was £8m (2013: £9m). The fair value of collateral held against possession cases was £nil (2013: £nil).

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

Loans and advances to banks

The total gross amount of individually impaired loans and advances to banks as at 28 February 2015 was £nil (2013: £nil). The fair value of collateral held for loans and advances to banks was £nil (2013: £209m). Collateral takes the form of security over UK government gilt securities. The table below presents an analysis of lending to banks by rating agency designation, based on Moody's ratings.

	28 Feb 2015 £m	31 Dec 2013 £m
Aaa to A3	**138**	1,059

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

The total gross amount of individually impaired debt securities, cash and balances with central banks, treasury bills and other eligible bills as at 28 February 2015 was £nil (2013: £nil). No collateral is held regarding these assets. The tables below present an analysis of the credit quality of money market funds included within cash and cash equivalents. The credit quality of treasury bills and investment securities by market value is also included. Analysis is by rating agency designation, based on Moody's ratings:

At 28 February 2015	**Cash and balances with central banks £m**	**Treasury Bills £m**	**Investment securities £m**	**Total £m**
Aaa to A3	**–**	**53**	**–**	**53**
ATM cash and balances with central banks	**696**	**–**	**–**	**696**
	696	**53**	**–**	**749**

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

31. Risk management continued

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

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

				Related amounts not offset in the balance sheet		
At 28 February 2015	Gross assets/ (liabilities) recognised £m	Amounts offset £m	Net amounts recognised in the balance sheet £m	Financial instruments £m	Collateral pledged £m	Net amounts £m
Derivative financial instruments – assets	1	–	1	–	(1)	–
Derivative financial instruments – liabilities	(6)	–	(6)	–	6	–
	(5)	–	(5)	–	5	–
At 31 December 2013						
Derivative financial instruments	2	–	2	–	(2)	–
Loans to banks	926	–	926	(750)	(209)	(33)
	928	–	928	(750)	(211)	(33)

The Bank has derivatives which are supported by credit agreements whereby if the fair value exceeds a pre-agreed level, cash collateral is required. At 28 February 2015, the Bank had provided collateral of £5m (31 December 2013: the Bank held £2m of collateral) against the derivatives.

The Bank previously invested with Lloyds Banking Group plc through a reverse repo facility, which was 100% collateralised with gilts. At 31 December 2013, the Bank held £209m of gilts. There were no such transactions at 28 February 2015.

The Bank was also previously permitted to settle net its fixed-term borrowing facility against loans made to Lloyds Banking Group plc. At 31 December 2013, the Bank had £750m fixed-term borrowing and £719m of loans made to Lloyds Banking Group plc. There was no such facility at 28 February 2015.

Operational risk

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

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

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

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

Liquidity and funding risk

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

As required by the regulation the Bank has completed an Individual Liquidity Adequacy Assessment (ILAA). This allows the Bank to demonstrate that it understands the liquidity risks it is running and has appropriate controls in place to mitigate them. The Bank has established a Liquidity Risk appetite as well as a suite of limits stemming from the ILAA process that has led to a minimum level of liquidity held. Limits are informed by a number of stress scenarios that assess the survival period of the Bank. In meeting internal limits as well as PRA requirements, the Bank maintains a stock of high quality liquid assets that can be readily sold to meet the Bank's obligations to depositors and other creditors. The portfolio of assets is managed on a daily basis and within the framework as outlined in the ILAA and by the PRA.

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

Risk indicators for wholesale funding concentration by maturity date, sector, geography, etc and asset encumbrance ratios are reported regularly to ALCO.

31. Risk management continued

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

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

Residual contractual maturity analysis

At 28 February 2015	Less than 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Assets						
Non-derivative assets						
Loans and advances to customers	**852**	**175**	**702**	**1,572**	**19**	**3,320**
Cash and balances at central banks	**696**	**–**	**–**	**–**	**–**	**696**
Loans and advances to banks	**48**	**75**	**–**	**–**	**–**	**123**
Treasury bills	**–**	**40**	**13**	**–**	**–**	**53**
Prepayments and accrued income	**38**	**–**	**–**	**–**	**–**	**38**
Other assets	**136**	**–**	**–**	**–**	**–**	**136**
	1,770	**290**	**715**	**1,572**	**19**	**4,366**
Derivative assets						
Fair value hedges						
Outflow	**–**	**–**	**(2)**	**(3)**	**–**	**(5)**
Inflow	**–**	**–**	**2**	**2**	**–**	**4**
Net derivative cash flows	**–**	**–**	**–**	**(1)**	**–**	**(1)**
	1,770	**290**	**715**	**1,571**	**19**	**4,365**
Liabilities						
Non-derivative liabilities						
Customer accounts	**3,402**	**55**	**214**	**187**	**–**	**3,858**
Other deposits	**–**	**4**	**16**	**3**	**–**	**23**
Other borrowed funds	**7**	**14**	**52**	**83**	**–**	**156**
Other liabilities	**101**	**–**	**–**	**–**	**–**	**101**
	3,510	**73**	**282**	**273**	**–**	**4,138**
Derivative liabilities						
Fair value hedges						
Outflow	**1**	**2**	**7**	**9**	**–**	**19**
Inflow	**(1)**	**(1)**	**(4)**	**(4)**	**–**	**(10)**
Net derivative cash flows	**–**	**1**	**3**	**5**	**–**	**9**
Unrecognised loan commitments	**79**	**–**	**–**	**–**	**–**	**79**
	3,589	**74**	**285**	**278**	**–**	**4,226**
Net liquidity	**(1,819)**	**216**	**430**	**1,293**	**19**	**139**

31. Risk management continued

Residual contractual maturity analysis continued

At 31 December 2013	Less than 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Assets						
Non-derivative assets						
Loans and advances to customers	812	153	620	1,390	59	3,034
Cash and balances at central banks	444	–	–	–	–	444
Loans and advances to banks	971	50	–	–	–	1,021
Treasury bills	97	146	267	–	–	510
Investment securities	–	–	–	34	–	34
Prepayments and accrued income	18	–	–	–	–	18
Other assets	103	–	–	–	–	103
	2,445	349	887	1,424	59	5,164
Derivative assets						
Fair value hedges						
Outflow	–	(1)	(3)	(6)	–	(10)
Inflow	–	1	3	7	–	11
Net derivative cash flows	–	–	–	1	–	1
	2,445	349	887	1,425	59	5,165
Liabilities						
Non-derivative liabilities						
Customer accounts	3,435	35	278	318	–	4,066
Deposits by banks	32	69	234	433	–	768
Other borrowed funds	–	–	61	6	64	131
Other liabilities	38	–	–	–	–	38
	3,505	104	573	757	64	5,003
Derivative liabilities						
Cash flow hedges						
Outflow	–	–	–	34	–	34
Inflow	–	–	–	(28)	–	(28)
Net derivative cash flows	–	–	–	6	–	6
Unrecognised loan commitments	43	–	–	–	–	43
	3,548	104	573	763	64	5,052
Net liquidity	(1,103)	245	314	662	(5)	113

Asset Encumbrance

An asset is defined as encumbered if it has been pledged as collateral against an existing or off-balance sheet liability and therefore is no longer available for disposal or as collateral to support liquidity or funding requirements of the Bank. The encumbrance levels of assets as at 28 February 2015 are shown in the following table:

At 28 February 2015	**Encumbered £m**	**Unencumbered £m**	**Total £m**
Loans and advances to customers	**678**	**2,354**	**3,032**
Other debtors	**5**	**128**	**133**
Cash and balances with central banks	**5**	**691**	**696**
	688	**3,173**	**3,861**

At 31 December 2013	Encumbered £m	Unencumbered £m	Total £m
Loans and advances to customers	–	2,592	2,592
Other debtors	–	103	103
Cash and balances with central banks	5	439	444
	5	3,134	3,139

Encumbered loans and advances to customers represent unsecured personal loans pledged as collateral for secured funding. Collateral paid in respect of derivative margins is included in other debtors. The Bank of England Cash Ratio Deposit is held within Cash and balances with central banks.

31. Risk management continued

The following tables show average asset encumbrance for the most recent 12 month rolling period ended 28 February 2015:

Encumbered Assets	Carrying amount of encumbered assets £m	Carrying amount of unencumbered assets £m
Loans on demand	**3**	**541**
Debt securities	**38**	**224**
Loans and advances other than loans on demand	**339**	**2,625**
Other assets	**5**	**271**
Assets of the reporting institution	**385**	**3,661**

Sources of encumbrance	Matching liabilities, contingent liabilities or securities lent £m	Assets collateral received and own debt securities issued other than covered £m
Derivatives	**3**	**3**
Deposits	**185**	**365**
Debt securities issued	**12**	**16**
Carrying amount of selected financial liabilities	**200**	**384**

The main sources of encumbrance in the Bank relate to margin requirements for derivative transactions and collateral relating to secured funding transactions. Cash collateral is advanced and received as variation margin on derivatives transactions. Eligible personal loans with applicable haircuts are used as collateral for securitisation and central bank funding. The personal loans used to secure the funding (in note 23) are held within Loans and advances to customers. Included within the carrying value of unencumbered assets, there are assets which would not normally be considered available for encumbrance in the normal course of the Bank's business including intangible assets, property, plant and equipment, prepayments and accruals and deferred tax assets.

Market risk

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

Interest rate risk

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

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

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

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

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

The primary measures used by the Bank to capture interest rate risk include analysis of the impact of small and extreme changes in interest rates on the market value of the Bank's assets and liabilities and on the Bank's earnings. As at 28 February 2015, the market value sensitivity (change in equity) and earnings at risk (change in net interest income) for changes in interest rates of +/-200 basis points and +/-100 basis points movements in rates are as follows:

	28 February 2015		31 December 2013	
	Change on net interest income £m	Change in equity £m	Change on net interest income £m	Change in equity £m
+/- 200 basis points	**(17) / 18**	**(12) / 12**	(4) / 2	(16) / 16
+/- 100 basis points	**(8) / 8**	**(8) / 8**	(2) / –	(8) / 8

31. Risk management continued

Foreign exchange risk

Foreign exchange risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank was previously primarily exposed to foreign exchange risks from currency cash flows arising from its investment security denominated in Euros, which was disposed of during the period. Prior to disposal, these currency cash flows were fully hedged into sterling with currency swaps. At 28 February 2015, the Euro notional value of the foreign investment securities was €nil (2013: €40m). This was exactly matched by the Euro notional value of the derivative obligations.

32. Capital resources

The following table analyses the regulatory capital resources of the Bank under both transitional and end point measures of CRD IV for which there is no difference. CRD IV regulations are being phased in over a 5 year period from 2013–2018:

	28 Feb 2015 £m	31 Dec 2013 £m
Core Equity Tier 1 (CET 1) capital:		
Ordinary share capital	**299**	170
Allowable reserves	**184**	139
Losses recognised	**(25)**	–
Regulatory adjustments	**(104)**	(4)
Total Core Equity Tier 1 (CET 1) capital	**354**	305
Tier 1 Capital	**354**	305
Tier 2 capital:		
Qualifying subordinated debt	**–**	62
Collectively assessed impairment provisions	**–**	6
Total Tier 2 capital	**–**	68
Total capital	**354**	373

Regulatory capital is calculated under the Capital Requirements Regulations and Capital Requirements Directive (collectively known as CRD IV) as enacted in the UK. Core Equity Tier 1 (CET 1) capital includes ordinary share capital, other reserves, losses and regulatory deductions. Tier 2 capital held at December 2013 represented the amortised value of dated loan stock which was repaid to J Sainsbury plc on maturity in December 2014. There is a regulatory requirement that Tier 2 capital must not exceed 25% of total capital. The Bank meets this requirement.

The movement of CET 1 capital during the financial year is analysed as follows:

	28 Feb 2015 £m	31 Dec 2013 £m
At 1 January	**305**	264
Share capital issued	**129**	–
Verified profit attributable to shareholders[1]	**45**	40
Losses recognised	**(25)**	–
(Increase)/decrease in intangible assets	**(100)**	1
As at 28 February/31 December	**354**	305

1. Relates to Bank audited profits to December 2013 which were not recognised in regulatory reserves in the prior year financial statements. These were not yet verified by the Bank's auditors at the accounting date. It is now standard industry practice to include annual profits in reserves for the period to which they relate, providing these have been verified prior to the date the financial statements are signed. Losses are recognised as a deduction form CET 1 capital as they arise.

Reconciliation of statutory reserves to regulatory reserves

	28 Feb 2015 £m	31 Dec 2013 £m
Total shareholders' funds at 28 February/31 December (restated)	**458**	353
Profit not verified at balance sheet date	**–**	(41)
IFRIC 21 revised restatement	**–**	(3)
Intangible assets	**(104)**	(4)
CET 1 capital as at 28 February 2015	**354**	305

32. Capital resources continued

Leverage ratio (Unaudited)

The leverage ratio is defined as the ratio of Tier 1 capital to adjusted assets. The denominator represents the total non-risk weighted assets adjusted for certain off-balance sheet exposures assets and regulatory deductions and provides a non-risk-weighted 'backstop' capital measure. The leverage ratio is planned to become a Pillar 1 measure from 1 January 2018. The leverage ratio is calculated below as at 28 February 2015 - this represents both transitional and end point CRD IV measures. The Bank's leverage ratio of 7.4% exceeds the minimum Basel leverage ratio of 3%. The Financial Policy committee of the Bank of England are currently consulting on additional leverage requirements for UK Banks.

	28 Feb 2015 £m	31 Dec 2013 £m
Components of the leverage ratio		
Total assets as per published financial statements	**4,237**	4,801
Removal of accounting value of derivatives and SFTs	**(1)**	(2)
Exposure value for derivatives and SFTs	**5**	3
Off-balance sheet exposures: unconditionally cancellable (10%)	**313**	255
Off-balance sheet: other (100%)	**318**	49
Deduction of Intangible assets	**(104)**	(4)
	4,768	5,102
Tier 1 capital	**354**	305
Leverage ratio	**7.4%**	6.0%

Capital management

The Bank manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. During the period to 28 February 2015, the Bank has repaid dated and subordinated liabilities of £110m and has received planned injections of £129m of ordinary share capital to support the forecast costs and deductible intangible assets generated through the development of flexible banking platforms. Capital adequacy is monitored on an ongoing basis by senior management, the Asset and Liability Committee, the Executive Risk Committee and the Board Risk Committee. Our submissions to the PRA in the year have shown that the Bank has complied with all externally imposed capital requirements.

The Bank will disclose Pillar 3 information as required by the Capital Requirements Regulations and PRA prudential sourcebook on the J Sainsbury plc external website during June 2015.

33. Fair value of financial instruments

The fair values of financial instruments are based on market prices where available, or are estimated using other valuation techniques. Where they are short term in nature or re-price frequently, fair value approximates to carrying value. The fair value information presented does not represent the fair value of the Bank as a going concern at 28 February 2015 or 31 December 2013. The classification adopted by the Bank is shown in the following table:

	28 Feb 2015		31 Dec 2013	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Assets:				
Loans and advances to customers	**3,032**	**3,024**	2,592	2,561
Cash and balances at central banks	**696**	**696**	444	444
Loans and advances to banks	**138**	**138**	1,059	1,059
Derivative financial instruments	**1**	**1**	2	2
Treasury bills	**53**	**53**	510	510
Investment securities	**–**	**–**	32	32
Liabilities:				
Customer accounts	**3,488**	**3,490**	3,524	3,533
Deposits by banks	**–**	**–**	752	759
Other deposits	**23**	**23**	–	–
Other borrowed funds	**148**	**148**	110	88
Derivative financial instruments	**6**	**6**	7	7

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

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

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

33. Fair value of financial instruments continued

Fair value hierarchy

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

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

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

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

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

At 28 February 2015	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Loans and advances to customers	**–**	**3,024**	**–**	**3,024**
Cash and balances at central banks	**–**	**696**	**–**	**696**
Loans and advances to banks	**–**	**138**	**–**	**138**
Derivatives financial instruments	**–**	**1**	**–**	**1**
Treasury bills	**53**	**–**	**–**	**53**
Total assets	**53**	**3,859**	**–**	**3,912**
Customer accounts	**–**	**(3,490)**	**–**	**(3,490)**
Other deposits	**–**	**(23)**	**–**	**(23)**
Other borrowed funds	**–**	**(148)**	**–**	**(148)**
Derivative financial instruments	**–**	**(6)**	**–**	**(6)**
Total liabilities	**–**	**(3,667)**	**–**	**(3,667)**

At 31 December 2013	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Loans and advances to customers	–	2,561	–	2,561
Cash and balances at central banks	–	444	–	444
Loans and advances to banks	–	1,059	–	1,059
Derivatives financial instruments	–	2	–	2
Treasury bills	510	–	–	510
Investment securities	–	32	–	32
Total assets	510	4,098	–	4,608
Customer accounts	–	(3,533)	–	(3,533)
Deposits by banks	–	(759)	–	(759)
Other borrowed funds	–	(88)	–	(88)
Derivative financial instruments	–	(7)	–	(7)
Total liabilities	–	(4,387)	–	(4,387)

34. Parent company

The immediate and ultimate parent company and controlling party of the Bank is J Sainsbury plc, which is registered in England and Wales. J Sainsbury plc forms the only group into which the financial statements of the Bank are consolidated. Copies of the parent company's financial statements may be obtained from www.j-sainsbury.co.uk. Prior to 1 February 2014, J Sainsbury plc and Bank of Scotland plc each held 50% of the issued share capital of the Bank, with a contractual arrangement in place to share joint control.

35. Share-based payments

The Bank recognised £0.4 million (2013: £nil) of employee costs (note 4) related to share-based payment transactions made during the financial year. Of these, £nil (2013: £nil) were cash-settled.

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

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

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

b. Long-Term Incentive Plan 2006

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

The awards granted between 2006 and 2011 will vest if the threshold levels of two co-dependent performance conditions – Return on Capital Employed ('ROCE') and growth in cash flow per share at the J Sainsbury plc group level, are achieved over the three-year performance period. The award granted in 2012 and 2013 is assessed against Group ROCE, cumulative underlying cash flow from operations and relative sales measured against the IGD Index, with an Earnings Per Share gateway. The award granted in 2014 is assessed against ROCE, cumulative underlying cash flow from operations and relative sales measured against the IGD Index. The core award can grow by up to four times, dependent on the level of performance. Straight-line vesting will apply if performance falls between two points. Awards are structured as nil cost options.

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

c. Deferred Share Award

The Deferred Share Award targets a diverse range of business critical financial and strategic scorecard measures. These are intended to reward the top 45 managers in the Group, including Executive Directors, for driving the short-term objectives that will directly lead to building the sustainable, long-term growth of the Group. Awards are structured as nil cost options.

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

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

d. Bonus Share Award

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

60 per cent of the bonus is paid in cash and 40 per cent converted into shares, which are automatically released after three financial years. The share element of the bonus arrangement is called the Bonus Share Award. Bonus Shares are subject to forfeiture if the participant resigns or is dismissed for cause prior to their release date. Dividends accrue on these shares and are released at the end of the three year retention period.

Full share based payment disclosure for the J Sainsbury plc group including reconciliation of the number of awards outstanding and related valuations has been published in the J Sainsbury plc consolidated financial statements.

36. Related party transactions

a. Transactions with Related Entities

The Bank is a wholly owned subsidiary of J Sainsbury plc. Prior to 1 February 2014, the Bank was a joint venture between the shareholders, J Sainsbury plc and Bank of Scotland plc (part of the Lloyds Banking Group plc group of companies). The Bank has a subsidiary undertaking, Lochside Asset Purchaser No.1 plc.

J Sainsbury plc

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

	28 Feb 2015 £m	31 Dec 2013 £m
Transactions during the period		
Services and loans provided by J Sainsbury plc:		
Management services	**98**	30
Interest expense paid in respect of interest bearing loans	**1**	1
Subordinated dated loan capital repaid in the period	**60**	–
Subordinated undated loan capital repaid in the period	**50**	–
Share capital issued to J Sainsbury plc	**129**	–
Balances at end of period		
Payables:		
Management services	**13**	6
Interest payable	**–**	–
Subordinated dated loan capital	**–**	30
Subordinated undated loan capital	**–**	25

On 31 January 2014, £30m of subordinated dated loan capital and £25m of subordinated undated loan capital previously held by Lloyds Banking Group were assigned to J Sainsbury plc in exchange for consideration equal to the book value of the loan.

Lloyds Banking Group plc

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

The below table shows transactions up to 31 January 2014, after which time the parties were no longer related:

	28 Feb 2015 £m	31 Dec 2013 £m
Transactions during the period		
Services and loans provided by Lloyds Banking Group plc group of companies:		
Management and banking services	**4**	35
Interest expense paid in respect of subordinated loan capital	**–**	1
Deposits by banks:		
Fixed term	**–**	–
Deposits repaid during the period	**(752)**	(482)
Net interest paid in respect of interest rate swaps, loans and advances	**2**	19
Break costs on early repayment of borrowing facility	**8**	–
Loans given to and commission received from Lloyds Banking Group plc group of companies:		
Total loans and advances made during the period	**87**	5,534
Loans and advances repaid during the period	**(957)**	(5,844)
Net interest received in respect of interest rate swaps, loans and advances	**1**	4
Commission income earned	**–**	8
Balances at end of period		
Receivables:		
Loans and advances	**–**	957
Derivative assets	**–**	2
Prepayments and accrued income	**–**	2
Interest receivable	**–**	1
Commission receivable	**–**	1
Payables:		
Management and banking services	**–**	10
Interest payable	**–**	1
Deposits by banks	**–**	752
Derivative liabilities	**–**	7
Subordinated dated loan capital	**–**	30
Subordinated undated loan capital	**–**	25

The Loans and advances figures at 31 December 2013 above included balances collateralised under a reverse repo arrangement which is supported by 100% UK gilt collateral.

36. Related party transactions continued

Lochside Asset Purchaser No.1 plc

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

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

	28 Feb 2015 £m	31 Dec 2013 £m
Transactions during the period		
Interest receivable on intercompany loan	**–**	–
Interest paid on deemed loan	**–**	–
Servicer fee received	**–**	–
Balances at 28 February		
Other Assets:		
Intercompany loan	**3**	
Payables:		
Interest payable	**–**	–
Deemed Loan	**150**	–
		–
Book value of personal loans for which beneficial interest has transferred to SPE	**191**	–

For additional disclosure on the nature of the deemed loan and offsetting arrangements, see notes 23 and 31.

b. Transactions with key management personnel

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

Remuneration and other compensation

	28 Feb 2015 £m	31 Dec 2013 £m
Short term employee benefits	**2.9**	2.3
Post-employment benefits	**0.2**	0.1
Termination benefits	**0.1**	–
Share-based payments	**0.4**	0.4
	3.6	2.8

Short term employee benefits represent salary, bonus and benefits in kind. Post-employment benefits relate to employer's contributions to defined benefit and money purchase pension schemes operated by J Sainsbury plc and, prior to 31 January 2014, Lloyds Banking Group plc.

Share based payments relates to share schemes operated by J Sainsbury plc and, prior to 31 January 2014, the Lloyds Banking Group plc. No recharge is made by either organisation to the Bank in respect of shares granted to colleagues. Both schemes are equity-settled in respect of the joint venture parents. Details of the J Sainsbury plc schemes are disclosed in note 35.

36. Related party transactions continued

Product transactions

Details of transactions, under terms and conditions available to all colleagues, between the Bank and key management personnel are provided below. For this purpose, key management personnel include Sainsbury's Bank key management personnel and members of their close families.

	Number of key management personnel	Directors £'000	Other £'000
Mortgages, credit cards and term loans			
At 1 January 2013	5	11	2
Resignations during 2013	(4)	(10)	(2)
Appointments/New accounts during 2013	3	–	–
Amounts advanced during the period	–	46	–
Amounts repaid during the period	–	(46)	–
At 31 December 2013	**4**	**1**	**–**
Resignations during 2014/15	**–**	**–**	**–**
Appointments/New accounts during 2014/15	**4**	**1**	**1**
Amounts advanced during the period	**–**	**70**	**1**
Amounts repaid during the period	**–**	**(68)**	**(2)**
At 28 February 2015	**8**	**4**	**–**

	Number of key management personnel	Directors £'000	Other £'000
Savings and deposit accounts			
At 1 January 2013	6	429	1
Resignations during 2013	(3)	(104)	(1)
Appointments/New accounts during 2013	–	–	–
Amounts deposited during the period	–	122	–
Interest paid	–	7	–
Amounts withdrawn during the period	–	(59)	–
At 31 December 2013	**3**	**395**	**–**
Resignations during 2014/15	**–**	**–**	**–**
Appointments/New accounts during 2014/15	**2**	**–**	**1**
Amounts deposited during the period	**–**	**76**	**–**
Interest paid	**–**	**6**	**–**
Amounts withdrawn during the period	**–**	**(128)**	**–**
At 28 February 2015	**5**	**349**	**1**

Based on the Companies Act definition of Loans to Directors, total lending outstanding at 28 February 2015 was £nil (2013: £nil).

37. Capital commitments

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

	28 Feb 2015 £m	31 Dec 2013 £m
Property, plant and equipment	**1**	1
Software development	**13**	2
	14	3

38. Contingent liabilities

The Bank has considered the existence of any legal claims and regulatory action against the Bank and whether any of these could materialise in a future outflow of resources from the Bank. The Bank has not identified any such issues that would result in the probable outflow of resources that would result in a significant adverse impact on the financial position of the Bank.

39. Restatement of prior period information

As described more fully in note 1d, the Bank has implemented IFRIC 21 in the year resulting in restatement of the comparative figures within the financial statements. The following tables summarise the adjustments:

Income statement

	12 months to 31 Dec 2013 £m	Change to accounting policy £m	**Restated 12 months to 31 Dec 2013 £m**
Interest receivable	206	–	**206**
Interest payable	(78)	–	**(78)**
Net interest income	128	–	**128**
Fees and commissions receivable	110	–	**110**
Total income	238	–	**238**
Administrative expenses	(155)	1	**(154)**
Impairment losses on financial assets	(28)	–	**(28)**
Profit before taxation	55	1	**56**
Taxation	(13)	–	**(13)**
Profit for the financial period attributable to the owners of the Bank	42	1	**43**

Balance sheet as at 31 December 2013

	31 Dec 2013 £m	Change to accounting policy £m	**Restated 31 Dec 2013 £m**
Assets			
Loans and advances to customers	2,592	–	**2,592**
Cash and balances with central banks	444	–	**444**
Loans and advances to banks	1,059	–	**1,059**
Derivative financial instruments	2	–	**2**
Financial investments – available for sale			
Treasury bills	510	–	**510**
Investment securities	32	–	**32**
Intangible assets	4	–	**4**
Property, plant and equipment	18	–	**18**
Prepayments and accrued income	37	–	**37**
Other assets	103	–	**103**
Total assets	4,801	–	**4,801**
Liabilities			
Customer accounts	3,524	–	**3,524**
Deposits by banks	752	–	**752**
Other borrowed funds	110	–	**110**
Derivative financial instruments	7	–	**7**
Other liabilities	44	–	**44**
Provisions for liabilities and charges	14	(3)	**11**
Total liabilities	4,451	(3)	**4,448**
Equity			
Called up share capital	170	–	**170**
Retained earnings	181	3	**184**
Other reserves	(1)	–	**(1)**
Total equity	350	3	**353**
Total equity and liabilities	4,801	–	**4,801**

39. Restatement of prior period information continued

Balance sheet as at 1 January 2013

	1 Jan 2013 £m	Change to accounting policy £m	Restated 1 Jan 2013 £m
Assets			
Loans and advances to customers	2,547	–	2,547
Cash and balances with central banks	474	–	474
Loans and advances to banks	1,377	–	1,377
Financial investments – available for sale			
Treasury bills	474	–	474
Investment securities	29	–	29
Intangible assets	5	–	5
Property, plant and equipment	17	–	17
Prepayments and accrued income	22	–	22
Other assets	44	–	44
Total assets	4,989	–	4,989
Liabilities			
Customer accounts	3,268	–	3,268
Deposits by banks	1,234	–	1,234
Other borrowed funds	110	–	110
Derivative financial instruments	6	–	6
Other liabilities	60	–	60
Provisions for liabilities and charges	5	(2)	3
Total liabilities	4,683	(2)	4,681
Equity			
Called up share capital	170	–	170
Retained earnings	139	2	141
Other reserves	(3)	–	(3)
Total equity	306	2	308
Total equity and liabilities	4,989	–	4,989