Annual Report & Consolidated Financial Statements.

Clydesdale Bank PLC.

30 September 2011.

Company Number: SC001111.

Clydesdale Bank

CLYDESDALE BANK PLC

ANNUAL REPORT AND CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 SEPTEMBER 2011

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Directors

Chairman:

Sir Malcolm Williamson #

Executive:

David Thorburn (Chief Executive Officer) # | Cameron Clyne | John Hooper #

Non-executive:

Jonathan Dawson * #
Sir David Fell KCB *
Richard Gregory OBE * #
Roy Nicolson * #
Elizabeth Padmore

* Member of the European Boards' Audit Committee
# Member of the European Boards' Risk Committee

UK Executive Committee

David Thorburn, Chief Executive Officer
John Hooper, Executive Director
Scott Butterworth, Chief Financial Officer (appointed 1 March 2011)
Debbie Crosbie, Operations and Technology Director
Eric Gunn, Chief Risk Officer
Steven Martin, Head of Strategic Development
Lynn McManus, Head of the CEO Office (appointed 1 July 2011)
Kevin Page, Transformation Director
Steve Reid, Retail Director
Michael Webber, Head of Legal Services and Company Secretary
Arthur Willett, Human Resources Director
Mike Williams, Executive General Manager iFS

Joint Company Secretary

Michael Webber
Lorna McMillan (appointed 28 July 2011)

Registered Office

30 St Vincent Place
Glasgow, G1 2HL

Bankers

National Australia Bank Limited

Auditor

Ernst & Young LLP
1 More London Place
London, SE1 2AF

CLYDESDALE BANK PLC
Chairman's Statement

Sir Malcolm Williamson, Chairman

Clydesdale Bank PLC (the "Bank"), together with its subsidiary undertakings, has delivered a creditable set of underlying results given the ongoing challenges facing the UK economy and banking sector. Despite the significant impact of provisions for payment protection insurance redress the Bank remained profitable generating £21 million profit before tax on a statutory basis, and £155 million on a pro forma basis, demonstrating that the underlying business continues to be sound. The Bank has continued to support its customers and to strengthen its balance sheet.

The results demonstrated the continued effectiveness of our business model. Offering a broad range of products to our business and retail customers, we continue to evolve our propostion to respond to customer demand. The Bank reached its two year gross new lending target of £10 billion three months early.

Capital has been increased during the year. As regards funding and liquidity, the balance sheet continues to reflect prudent choices and we have no direct exposure to peripheral Eurozone economies. Our emphasis on funding through our customers deposits has continued and we have maintained a high quality liquid assets portfolio.

Operating expenses continue to be tightly controlled, rising at a rate well below UK inflation. We have simultaneously maintained our investment spend in order to develop our business, respond to regulatory initiatives and enhance our customer offering. Our business model fits well with the proposed market changes driven by the Independent Commission on Banking and we offer an important and attractive alternative to the larger UK banks.

Our asset quality has continued to stabilise, which is reflective of the tentative economic recovery and continued close engagement with our customers.

In summary, we believe that the Bank is very well placed to continue to strenghten its distinctive position in the market through a combination of a clear focus on our customers, a soundly structured balance sheet and a robust approach to cost control. Whilst the UK economy continues to have a number of obvious challenges the Board believes it can look ahead with a degree of optimism about the Bank's prospects.

Malcolm Williamson

Sir Malcolm Williamson
Chairman
15 November 2011

David Thorburn, Chief Executive Officer

Overview

Clydesdale Bank PLC (the "Bank”), together with its subsidiary undertakings (which together comprise the "Group”), is the United Kingdom retail and commercial banking business of National Australia Bank Limited. The Group operates under both the Clydesdale and Yorkshire Bank brands. It offers a range of banking services for both personal and business customers through retail branches, integrated Financial Solutions (iFS) centres, direct banking and brokers.

Strategic Highlights & Business Developments

The Group's profit before tax for the year ended 30 September 2011 was £21 million compared to £49 million in the prior year. On a pro forma basis, operating profit after tax but before significant items was £117 million, £54 million (85.7%) more than the prior year.

Business performance has continued to improve, although the operating environment remains challenging, and the franchise has supported its customers with new lending. The business exceeded the pledge that it made to advance £10 billion of gross new lending over two years, with £12.2 billion actually advanced over the period.

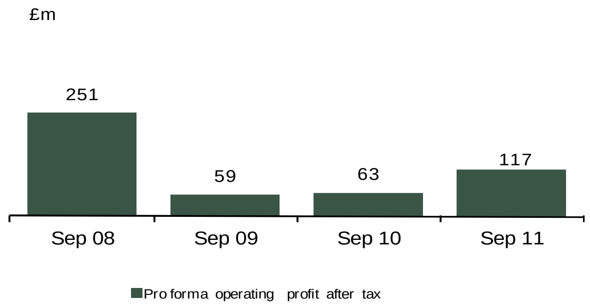
Levels of customer engagement remain strong and asset quality continues to stabilise. However this remains a key area of focus given the current economic challenges.

We have adapted our distribution channels in response to changing customer needs and the overall operating environment. A new small business service was launched during the year and we extended our support for mid-corporate businesses. Investment has also been made in direct banking and our broker channel performed well. While subdued demand for credit in the UK generally has resulted in only very modest balance sheet growth the business did achieve above system growth in mortgages.

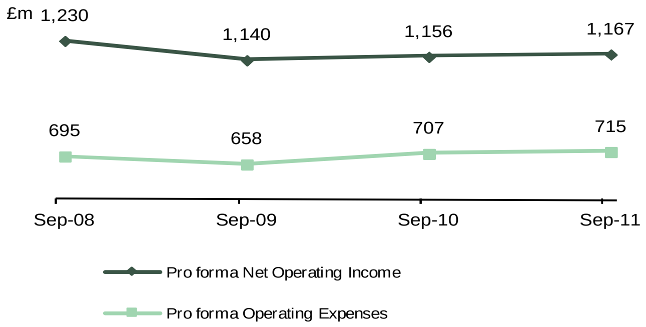
A strong liquidity position was maintained and both the Customer Funding (84.9%) and Stable Funding (96.7%) Indices remain high.

Strategic Highlights & Business Developments (continued)

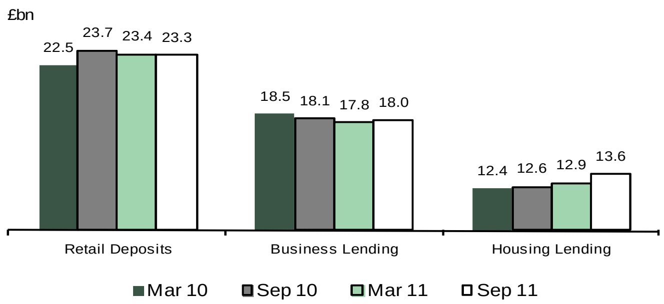
Pro Forma* Operating Profit After Tax



Pro Forma* Income and Expense Trends



Loans and Deposits Half Year Average



* The pro forma financial analysis table is shown on page 7. The table includes the efficiency, quality and service initiatives costs, Financial Services Compensation Scheme levy, Bank levy and Payment Protection Insurance redress as significant items whereas these are shown in their respective income and expense lines in the audited consolidated income statement on page 19.

Operating Environment

Economic growth in the UK economy was slower than most forecasters anticipated and the immediate outlook remains uncertain. GDP growth for the final quarter was estimated at 0.5% despite the first quarter of the period recording a contraction in GDP of 0.1%.

The unemployment rate rose over the year to 8.1% in the quarter to August 2011, its highest level since 1994. The housing market remains subdued. Prices for both commercial and residential properties remain below peak and in some regions are still falling. The Consumer Price Index inflation rate was 5.2% in September 2011, more than double the Bank of England target of 2.0%, driven by an increase in VAT in January and higher energy and commodity prices. Despite the above target inflation rate, the Bank of England Base Rate has remained at 0.5% throughout the year. Markets are not expecting the rate to change in the short term.

The regulatory and legislative landscape for financial services continues to evolve, with changes emerging that affect taxation, capital, funding and liquidity, including:

- In his budget in March 2011 the Chancellor announced that the corporation tax rate will now decrease by 2% rather than the previously announced 1%. This means that in the 2011-12 tax year the corporation tax rate will fall to 26% and decrease to 23% by 2014-15. This has impacted the Group's deferred tax assets and liabilities, resulting in a modest benefit to profit. However, in the financial year the UK operations were subject to the Bank Levy for the first time. The levy applied for the period between January 2011 and September 2011 and led to a charge of £3 million.

Operating Environment (continued)

- The new Basel III capital and liquidity requirements were endorsed by the G20 at a summit in November 2010. The revised proposals have two main aims; to promote a more resilient banking sector by strengthening global capital and liquidity regulations, and to improve the sector's ability to absorb shocks arising from financial and economic stress. The proposals will be phased in over a number of years starting in 2013 and ending in 2019.

- During the year the FSA published rules on platform regulation as part of its Retail Distribution Review (RDR). The rules extend the consumer protection elements of the RDR into investment services and have two key aims; to ensure that customers receive a better service; and for the market to be more transparent and operate more efficiently. These rules will come into effect from 31 December 2012.

- The Independent Commission on Banking (ICB) published a series of recommendations in September 2011 designed to improve stability and competition in the UK banking industry. The UK Government will now consider whether and when to take these recommendations forward.

Following publication in April 2011 of the High Court's judgement regarding the Financial Services Authority's Policy Statement on Payment Protection Insurance complaints handling (PS 10/12), and the subsequent decision by the British Bankers' Association not to appeal the High Court decision, the Bank has made further provision for current and potential future redress claims. The Financial Statements as at 30 September 2011 include a provision of £102 million to meet future costs associated with these claims. The Bank continues to keep the matter under review.

Customer, Employees and Community

The Group is committed to high standards of customer service and supporting both customers and employees.

We recognise the importance of supporting the communities in which we operate and continue to work with a range of community and charitable causes.

Since its launch over 3 years ago, the Group's partnership with Help the Hospices has raised over £1.9 million. In addition, the Yorkshire and Clydesdale Bank Foundation continues to provide financial support to a large number of charities across the UK and in the last year has distributed over £0.8 million to more than 650 worthy causes.

The Group has also invested £0.4 million in its flagship community programme, “Count Me In” which focuses on numeracy and is delivered through local libraries across 19 local authorities in England and Wales. In addition, the “Count and Grow” programme, in partnership with the Potato Council, which focuses on improving the mathematics skills of primary school children is now in its 7th year. It aims to have 1,000 primary schools participating this year.

The Group sponsored the Clydesdale Bank Scottish Premier Football League and the England and Wales Cricket Board’s domestic '40-over' competition during the year.

Customer engagement scores continue to outperform market levels with customer attrition levels showing a 3% improvement this year.

During the year the Group won two 'Your Mortgage' Awards; Yorkshire Bank was named 'Best Regional Mortgage Lender' and Clydesdale Bank was named 'Best Mortgage Lender in Scotland'. In addition, the Group's Enterprise Data Foundation programme also won Compliance Project of the Year at the 2011 Financial Sector Technology Awards.

Investment Spend

The Group continued to maintain its investment in the business at a similar level to that of prior years. This was focused on regulatory and compliance, efficiency and simplification and revenue generation categories.

The delivery of an enhanced customer proposition continued to be a significant focus during the year. Key achievements during the second half of the year included successful completion of the pilot phase of the Business Online product in June, with customer roll out now underway.

A programme to deliver improved online and telephone sales channels was mobilised in the first half of the year. The first element of this programme is the delivery of personal loans capability through the direct channel and is due to be delivered in 2011.

Pro Forma[1] Financial Analysis

	Year to			Half year to		
	Sep 11 £m	**Sep 10 £m**	**Sep 11 v Sep 10 %**	**Sep 11 £m**	**Mar 11 £m**	**Sep 11 v Mar 11 %**
Net interest income	**983**	960	2.4%	**494**	489	1.0%
Non interest income	**184**	196	(6.1%)	**103**	81	27.2%
Total operating income	**1,167**	1,156	1.0%	**597**	570	4.7%
Total operating expenses	**(715)**	(707)	1.1%	**(354)**	(361)	(1.9%)
Operating profit before impairment losses	**452**	449	0.7%	**243**	209	16.3%
Impairment losses on credit exposures [2]	**(297)**	(362)	(18.0%)	**(147)**	(150)	(2.0%)
Group operating profit	**155**	87	78.2%	**96**	59	62.7%
Tax expense	**(38)**	(24)	58.3%	**(24)**	(14)	71.4%
Pro forma operating profit after tax	**117**	63	85.7%	**72**	45	60.0%
Significant items:						
Efficiency, quality and service initiatives	**(11)**	(19)		**(11)**	-	
Financial Services Compensation Scheme levy	**(4)**	(2)		**-**	(4)	
Bank levy	**(3)**	-		**(3)**	-	
Payment Protection Insurance redress	**(116)**	(17)		**-**	(116)	
Tax on significant items	**35**	11		**3**	32	
Profit/(loss) attributable to equity holders *	**18**	36	(50.0%)	**61**	(43)	large

** Profit attributable to equity holders is stated after tax. The profit before tax for the year ended 30 September 2011 was £21m (2010: £49m).*

Average Volumes (£bn)						
Gross loans and acceptances [3]	**32.9**	32.8	0.3%	**33.2**	32.6	1.7%
Interest earning assets	**41.5**	40.8	1.6%	**41.8**	41.2	1.5%
Total assets	**44.4**	43.9	1.1%	**44.6**	44.2	0.9%
Retail deposits [4]	**23.4**	23.1	1.1%	**23.3**	23.4	(0.6%)

Pro Forma Performance Measures						
Operating profit after tax on average assets	**0.26%**	0.14%	12 bps	**0.32%**	0.20%	12 bps
Net interest margin	**2.37%**	2.35%	2 bps	**2.36%**	2.38%	(2) bps
Cost to income ratio	**61.3%**	61.2%	10 bps	**59.3%**	63.3%	(400) bps
Operating profit after tax per average FTE (£'000s)	**21**	11		**25**	16	
FTEs (spot) [5]	**5,699**	5,611		**5,699**	5,665	

(1) The table includes the efficiency, quality and service initiatives costs, Financial Services Compensation Scheme levy, Bank levy and Payment Protection Insurance redress as significant items whereas these are shown in their respective income and expense lines in the audited consolidated income statement on page 19.

(2) Impairment provisions and impairment losses on credit exposures relate solely to Loans and Advances to Customers (see notes 16 and 17 to the Financial Statements) and exclude the credit risk adjustments on loans at fair value through profit or loss which is incorporated in the movement in fair value assets in non interest income.

(3) Gross loans and acceptances include gross loans and advances to customers, loans designated at fair value through profit or loss and due from customers on acceptances.

(4) Retail deposits include current accounts, savings accounts, term deposits and business retail deposits.

(5) The full time equivalent (FTE) staff numbers above disclose the staff remunerated directly by the Group but exclude employees working within other National Australia Group Europe Limited subsidiaries who provide support services to the Group. The number of staff employed in the UK Banking Region at 30 September 2011 was 8,351. UK Banking represents the Business Banking, Retail Banking and Central and Other Functions of Clydesdale Bank PLC together with the UK Wealth Management business of NAB Group. See note 3 for further details of UK Banking.

September 2011 v September 2010

Profit after tax of £18 million is £18 million (50%) lower than the prior year. Excluding the charge for PPI redress and other significant items, the **pro forma operating profit after tax** of £117 million increased by £54 million over the prior year. Higher operating income and lower charges to provide for bad and doubtful debts were partly offset by higher expenses.

Net interest income increased by £23 million (2.4%), primarily driven by re-pricing activity on the existing portfolio and higher margins on new lending. This was partially offset by higher funding costs, and the impact of the low interest rate environment on the structure of the balance sheet with swap rates continuing to deteriorate.

Average gross loans and acceptances increased by £0.1 billion (0.3%) due to growth in mortgages. Mortgage growth of 5.6% was substantially higher than system growth of 0.3%* and was largely offset by the subdued demand for business credit, a reduction in unsecured personal lending and an active downward management of the commercial property book.

Average retail deposits increased by £0.3 billion (1.1%), reflecting careful management of retail funding costs. Growth has been primarily in current accounts, with customers looking to retain instant access to funds in what continues to be a challenging economic and low interest rate environment.

The **net interest margin** increased by two basis points primarily due to higher lending margins. This was partially offset by higher funding and liquidity costs and margin dilution from the increase in low yielding liquid assets as the balance sheet was strengthened.

Non interest income decreased by £12 million (6.1%). This was largely driven by adverse fair value movements including credit risk adjustment and estimation changes on tailored business loans and hedge ineffectiveness losses. These adverse movements offset the benefits of higher fee and commission income with growth in the Signature Current Account product a key highlight in the year.

Operating expenses increased by £8 million (1.1%) over the prior year. The Group has demonstrated strong cost control by keeping expenses below inflation levels while continuing to invest in the business in order to satisfy regulatory requirements and improve the customer proposition.

Impairment losses on credit exposures have decreased by £65 million (18.0%) over the prior year, primarily due to lower unsecured retail lending losses from an improvement in portfolio delinquency, and a lower business lending impairment charge as the asset quality profile of the non-defaulted portfolio improves. Asset quality remains under close scrutiny by management.

September 2011 v March 2011

Pro forma operating profit after tax for the period was £72 million, £27 million higher than in the March 2011 half. This reflects an increase in income, lower expenses and lower impairment losses on credit exposures.

Net interest income increased by £5 million (1.0%) driven by higher lending income. This was partially offset by higher funding costs.

Average gross loans and acceptances increased by £0.6 billion (1.7%) to £33.2 billion due to above system mortgage growth. Demand for credit remains subdued with business lending volumes relatively flat compared to the prior period and lower unsecured personal lending balances.

Average retail deposits decreased by £0.1 billion (0.6%), however the business has maintained a strong Customer Funding Index (CFI) in the competitive environment.

The **net interest margin** reduced by 2bps to 2.36%. Benefits from repricing of the lending book were offset by a reduction in Treasury income and higher funding costs.

* (Source: Bank of England – August 2011).

September 2011 v March 2011 (continued)

Non interest income increased by £22 million (27.2%). This was driven by higher lending and account fees (£7 million) and commission income (£3 million). Other income was £7 million higher in the half. Gains from hedge ineffectiveness in the half were offset by adverse movements in fair valued tailored business lending.

Operating expenses decreased by £7 million (1.9%) driven by lower personnel costs resulting from a reduction in average FTEs and contractor costs.

Impairment losses on credit exposures decreased by £3 million (2.0%) when compared to the March 2011 half. The rate of improvement slowed in the second half reflecting the slow pace of economic recovery.

Asset Quality

	As at		
	Sep 11	Mar 11	Sep 10
Specific provision for doubtful debts (£m)	**131**	98	74
Collective provision for doubtful debts (£m)	**243**	277	288
Specific provision on loans at fair value (£m)	**15**	37	26
Collective provision on loans at fair value (£m)	**142**	97	105
90+ DPD assets (£m)	**199**	262	265
Gross impaired assets (£m) (1)	**890**	898	796
90+ DPD plus gross impaired assets to gross loans and acceptances (1)	**3.23%**	3.55%	3.24%
Specific Provision/gross impaired assets (1)	**16.5%**	15.1%	12.6%
Net write-offs to gross loans and acceptances (annualised)	**0.84%**	0.85%	1.03%
Total provision as a percentage of net write-offs (2)	**187%**	185%	147%
Total provision to gross loans and acceptances (2)	**1.58%**	1.56%	1.50%
Bad and doubtful debt charge to credit risk weighted assets	**1.14%**	1.16%	1.39%

	As at		
Impairment provisions on credit exposures (£m) (3)	**Sep 11**	Mar 11	Sep 10
Business lending (£m)	**300**	294	282
Retail lending (£m)	**74**	81	80
	374	375	362

	Year to		Half year to	
Impairment losses on credit exposures (£m) (3)	**Sep 11**	Sep 10	**Sep 11**	Mar 11
Business lending (£m)	**243**	294	**135**	108
Retail lending (£m)	**54**	68	**12**	42
	297	362	**147**	150
Of which:				
Specific (£m)	**341**	346	**180**	161
Collective (£m)	**(44)**	16	**(33)**	(11)
	297	362	**147**	150

(1) Gross impaired assets for September 2011, March 2011 and September 2010 include £22m, £48m and £42m gross impaired fair value assets respectively.

(2) Total provision to gross loans and acceptances includes the credit risk adjustments on loans at fair value through profit or loss.

(3) Impairment provisions and impairment losses on credit exposures relate solely to Loans and Advances to Customers (see notes 16 and 17 to the Financial Statements) and exclude the credit risk adjustments on loans at fair value through profit or loss which are incorporated in the movement in fair value assets in non interest income.

The overall credit quality of the portfolio has improved in a number of areas over the year. As a result of well established and strong underwriting criteria, effective recovery processes and the low interest rate environment, retail credit quality has improved leading to a lower delinquency profile. Non-retail credit quality has also improved.

The total 90+ DPD balances have reduced through the year to £199 million at September 2011, compared with £265 million at September 2010. The majority of this reduction was in the business portfolio although, there were also reductions in the home loan and unsecured portfolios.

The level of impaired assets has increased to £890 million in the year to September 2011, with the portfolio remaining relatively stable in the second half. Property business remains the largest component of the impaired asset portfolio as a result of the ongoing economic uncertainty and challenging property market conditions.

Asset Quality (continued)

The ratio of total provisions to gross loans and acceptances increased to 1.58% in September 2011, as growth in balance sheet provisions were balanced with growth in the portfolio. The write-off rate declined during the year but remained stable in the second half.

The Bank has no direct Sovereign exposure to any Eurozone countries including those currently facing economic difficulties as listed below.

2011	**Greece £m**	**Ireland £m**	**Italy £m**	**Portugal £m**	**Spain £m**	**Total £m**
Residential mortgage backed securities	-	-	-	-	-	**-**
Covered bonds	-	-	-	-	-	**-**
Senior debt	-	-	-	-	-	**-**
Subordinated debt	-	-	-	-	-	**-**
Other assets	-	-	-	-	-	**-**
	-	-	-	-	-	**-**

2010	**Greece £m**	**Ireland £m**	**Italy £m**	**Portugal £m**	**Spain £m**	**Total £m**
Residential mortgage backed securities	-	-	-	-	-	**-**
Covered bonds	-	-	-	-	-	**-**
Senior debt	-	-	-	-	-	**-**
Subordinated debt	-	-	-	-	-	**-**
Other assets	-	-	-	-	-	**-**
	-	-	-	-	-	**-**

Capital & Funding Position

Tier 1 capital	**2011 £m**	2010 £m
Permanent share capital	**942**	842
Profit and loss account and other reserves [(1)]	**1,236**	1,215
Share premium account	**243**	243
Pension fund net deficit add back [(2)]	**104**	180
Perpetual non-cumulative preference shares subject to limit	**300**	100
Deductions from tier 1 capital	**(2)**	(1)
Total tier 1 capital after deductions	**2,823**	2,579
Tier 2 capital		
Upper tier 2 capital		
Revaluation reserves	**2**	2
General/collective provisions	**243**	288
Total upper tier 2 capital	**245**	290
Lower tier 2 capital		
Long term subordinated debt	**1,276**	1,176
Total lower tier 2 capital	**1,276**	1,176
Deductions from tier 2 capital	**(2)**	(1)
Total tier 2 capital after deductions	**1,519**	1,465
Total capital after deductions [(3)]	**4,342**	4,044
Risk weighted assets [(4)]	**28,406**	28,662
Capital ratios		
Core tier 1 ratio	**8.9%**	8.6%
Tier 1 ratio	**9.9%**	9.0%
Total capital ratio	**15.3%**	14.1%

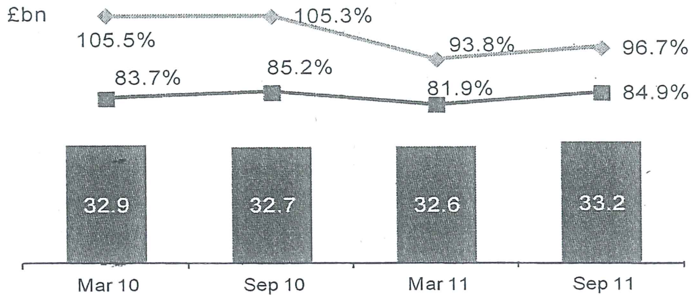
(1) Profit and loss account includes profits for the year.

(2) For regulatory capital purposes, the pension fund deficit is added back to regulatory capital and substituted with an estimate of additional pension fund contributions to be made over the next five years, adjusted for deferred tax.

(3) There is no tier 3 capital.

(4) Risk weighted assets are calculated under the standardised approach.

Stable Funding and Customer Funding Indices



(1) CFI - Customer deposits divided by core assets.

(2) SFI - Term funding index (TFI) plus CFI. The TFI is term wholesale funding (with a remaining maturity to first call date greater than 12 months) divided by Core Assets.

There have been periods of market dislocation in the past year. The Group has a well balanced funding base between wholesale and retail funding and the maturity of the deposit book. Clydesdale has taken steps to strengthen its capability to raise wholesale funding in the past year. Actions included the establishment of a Regulated Covered Bond programme, the re-structure of the current securitisation platform to include only owner occupied mortgages and the establishment of a Buy-to-Let securitisation platform. NAB provides funding to Clydesdale in the ordinary course of business.

The Group has maintained a strong Customer Funding Index (CFI) which has demonstrated the Bank's ability to retain and manage deposits relative to lending in this competitive market.

The Stable Funding Index (SFI) has fallen in the last year, reflecting the remaining maturity of historic term funding issuances. The liquid asset portfolio remains strong and includes UK Government gilts, Bank of England Reserve Account, Treasury bills and note cover required to cover Clydesdale's notes in circulation.

The Bank issued £200 million of preference shares to National Australia Group Europe Limited ("NAGE") in December 2010 and £100 million of ordinary shares in July 2011, improving the Tier 1 capital ratio (FSA basis under the standardised approach) from 9.0% as at September 2010 to 9.9% as at September 2011.

Liquid Assets

	As at	
	Sep 11	Sep 10
	£bn	£bn
UK Government Treasury Bills & Gilts	**5.5**	4.5
Cash & cash at central bank	**4.5**	2.6
Note cover *	**1.6**	1.5
Government guaranteed assets	**0.3**	1.3
Interbank lending	**0.1**	0.1
Liquid assets	**12.0**	10.0

* Note cover is excluded from FSA regulatory liquidity.

Clydesdale has increased its holding of highly liquid assets during the year. Clydesdale holds £100 million fixed rate notes issued by EIB (European Investment Bank). The Bank has no direct exposure to Italy, Portugal, Ireland, Greece or Spain.

D Thorburn.

David Thorburn
Chief Executive Officer
15 November 2011

The Directors of Clydesdale Bank PLC (the "Bank") with its subsidiary undertakings (which together comprise the "Group") submit their report and consolidated Financial Statements for the year ended 30 September 2011.

Activities

The Bank is an "authorised person" under the Financial Services and Markets Act 2000 and is regulated by the Financial Services Authority (FSA).

The Bank and its subsidiaries offer access to a comprehensive range of banking and other related financial services through 72 Financial Solutions Centres and 337 retail branches in the UK. Developments in the Group's existing business and future prospects are discussed below.

Profits and appropriations

The Group profit before tax for the year ended 30 September 2011 amounted to £21m (2010: £49m). The profit attributable to the shareholders for the year ended 30 September 2011 amounted to £18m (2010: £36m). Preference share dividends of £21m (2010: £12m) were paid during the year.

The Group's strategic highlights and business developments are set out in the Business Review on pages 4 to 11.

Financial instruments

The Group's risk management objectives and policies are discussed in note 43.

Directors and Directors' interests

The current Directors are shown on page 2. Directors who are not full-time employees of the Bank or a related body corporate are appointed in accordance with the Articles of Association and may be eligible for reappointment thereafter. No Directors retired by rotation during the year.

Resignations

Lynne Peacock resigned as a Director of the Company on 30 June 2011.
Peter Wood resigned as a Non-executive Director of the Company on 21 October 2011.

Directors' interests

No Director had any interest in the shares of the Bank or its subsidiaries at any time during the year. As the Bank is a wholly-owned subsidiary of National Australia Bank Limited (NAB), which is incorporated in the State of Victoria in Australia, any interest which the Directors may have in NAB does not need to be notified to the Bank, and therefore is not disclosed in this report.

Directors' liabilities

During the year the NAB Group paid a premium for a contract insuring the Directors and Officers of National Australia Bank Limited, its subsidiaries and controlled entities against personal liabilities which may arise in the course of the performance of their duties, as well as protecting the Group itself to the extent that it is obligated to indemnify Directors and Officers for such liability.

Company Secretary

<u>Appointments</u>

Lorna McMillan was appointed as Joint Company Secretary on 28 July 2011.

Employee involvement

The Group carries out an information programme to keep staff informed of business objectives and results. This is achieved through regular meetings, circulars, bulletins and specially commissioned videos as well as training courses for staff.

Under the UK National Share Incentive Plan, employees are entitled to purchase up to £1,500 worth of NAB shares each year. Participants contribute each month and the trustee uses the contributions to purchase shares on market which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares whilst they are members of the plan and there is no risk of forfeiture. In addition, up to £3,000 of free shares per employee may be gifted per annum through the plan.

During the year, under the UK National Share Incentive Plan, the NAB gifted ordinary shares of A$1,100 in total to each eligible employee based on Group performance in respect of the 2010 financial year. On 2 November 2011, NAB notified employees that ordinary shares of A$1,000 would be awarded based on the Group performance in respect of the 2011 financial year.

Employment of disabled persons

It is the policy of the Group to promote equality of employment opportunities by giving full and fair consideration to applications from disabled people. If existing employees become disabled, every effort is made to retain them within the workforce wherever reasonable and practicable. The Group also endeavours to provide equal opportunities in the training, promotion and general career development of disabled employees.

The Group is authorised as a "two tick" symbol user by Jobcentre Plus. The disability symbol is a recognition given by Jobcentre Plus to employers who have agreed to take action to meet five commitments regarding the employment, retention, training and career development of disabled employees, and to continually review progress and improve on what we do. Employers who wish to become a symbol user have to evidence they can achieve those commitments in their application.

Charitable and political donations

The total amount given for charitable purposes by the Group during the year ended 30 September 2011 was £816,000 (2010: £922,500). The Group channels its charitable donations through the Yorkshire and Clydesdale Foundation, which was established during 2008. The Foundation has made donations to many charities, including £265,000 during the year to Help the Hospices, the Bank's charity partner (2010: £269,000). During the past four years and together with staff led initiatives, over £1.9m has been raised and donated to Help the Hospices and 112 local hospices.

No political donations were made during the year (2010: £Nil).

Corporate governance

It is the Group’s policy not to include all of the disclosures in respect of voluntary corporate governance Codes of Practice as it is a wholly owned subsidiary of NAB. The NAB Group's Annual Financial Report details the Corporate Governance framework applicable to the Bank and its subsidiaries. These disclosures are made after consideration of authoritative pronouncements on Audit Committees and associated disclosures in Australia, the USA, and the United Kingdom. Remuneration policy is not the responsibility of the Board. The policy that applies to employees and Directors of the Bank is decided at the NAB Group level.

Management of risk

The Group has a well established Committee for the consideration of risks. The membership is shown on the list of Directors on page 2 and the Committee meets at quarterly intervals. The NAB Group publishes an annual and half-yearly "Risk and Capital Report" which provides extensive and rigorous coverage of all aspects of risk considered relevant including the position in the UK.

Going concern

The Group's Directors have made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future.

The Group's use of the going concern basis for preparation of the accounts is discussed in note 2 on page 25.

Events after the balance sheet date

There have been no subsequent events which have occurred since 30 September 2011 that would require disclosure in the Financial Statements of Clydesdale Bank PLC.

Auditors

In accordance with section 485 of the Companies Act 2006, a resolution to reappoint Ernst & Young LLP, and to authorise the Directors to fix their remuneration, will be proposed at the next Annual General Meeting.

Directors' statement as to disclosure of information to auditors

The Directors who were members of the Board at the time of approving the Report of the Directors are listed on page 2. Having made enquiries of fellow Directors and of the Group's auditors, each of these Directors confirms that:

- to the best of each Director's knowledge and belief, there is no information relevant to the preparation of their report of which the Group's auditors are unaware; and

- each Director has taken all the steps a Director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Group's auditors are aware of that information.

By order of the Board

Michael Webber

Michael Webber
Secretary
15 November 2011

The Directors are responsible for preparing the 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 elected to prepare the Financial Statements in accordance with International Financial Reporting Standards (IFRSs) and applicable law. Under company law the Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Bank and of the profit or loss of the Group and Bank for that period. In preparing these Financial Statements the Directors are required to:

- select suitable accounting policies in accordance with International Accounting Standard 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;

- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;

- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and

- state that the Group and Bank have complied with IFRSs, subject to any material departures disclosed and explained in the Financial Statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Bank 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 Group and Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CLYDESDALE BANK PLC

We have audited the Financial Statements of Clydesdale Bank PLC for the year ended 30 September 2011 which comprise the Consolidated Income Statement, the Group and Bank Statements of Comprehensive Income, the Group and Bank Balance Sheets, the Group and Bank Statements of Changes in Equity, the Group and Bank Statements of Cash Flow and the related notes 1 to 48. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 15, 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). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the Financial Statements

An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group and Bank's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the Financial Statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited Financial Statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on Financial Statements

In our opinion:

- the Financial Statements give a true and fair view of the state of the Group and Bank's affairs as at 30 September 2011 and of the Group's profit for the year then ended;
- the Group and Bank's Financial Statements have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- the Group and Bank's Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

- adequate accounting records have not been kept by the Group and Bank, or returns adequate for our audit have not been received from branches not visited by us; or
- the Group and Bank's Financial Statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Ernst & Young LLP

Peter Wallace (Senior statutory auditor)
for and on behalf of Ernst & Young LLP,
Statutory Auditor, London
15 November 2011

Notes
1. The maintenance and integrity of the Clydesdale Bank plc web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

CLYDESDALE BANK PLC
Consolidated Income Statement
for the year ended 30 September 2011

	Note	2011 £m	2010 £m
Interest receivable and similar income		**1,425**	1,392
Interest expense and similar charges		**(442)**	(432)
Net interest income	4	**983**	960
Gains less losses on financial instruments at fair value		**(89)**	(49)
Other operating income		**157**	228
Non interest income	5	**68**	179
Total operating income		**1,051**	1,139
Personnel expenses		**(265)**	(251)
Depreciation expense		**(15)**	(21)
Efficiency, quality and service initiatives		**(11)**	(19)
Other operating expenses		**(442)**	(437)
Total operating expenses before impairment losses	6	**(733)**	(728)
Operating profit before impairment losses		**318**	411
Impairment losses on credit exposures	17	**(297)**	(362)
Profit before tax		**21**	49
Analysed as:			
Profit before tax, Payment Protection Insurance redress, FSCS levy and Bank levy		**144**	68
Payment Protection Insurance redress	27	**(116)**	(17)
Financial Services Compensation Scheme levy		**(4)**	(2)
Bank levy	47	**(3)**	-
Profit before tax		**21**	49
Tax expense	7	**(3)**	(13)
Profit for the financial year attributable to the equity holders of the parent		**18**	36

All material items dealt with in arriving at the profit on ordinary activities for 2011 and 2010 relate to continuing activities.

CLYDESDALE BANK PLC
Statements of Comprehensive Income
for the year ended 30 September 2011

		Group		Bank	
		2011	2010	**2011**	2010
	Note	**£m**	£m	**£m**	£m
Profit for the year		**18**	36	**38**	6
Other comprehensive income/(losses)					
Change in available for sale investments reserve	8	**15**	(11)	**14**	(11)
Taxation	7	**(5)**	3	**(5)**	3
Change in cash flow hedge reserve	8	**(19)**	36	**7**	47
Taxation	7	**9**	(9)	**1**	(12)
Actuarial gains/(losses) on defined benefit pension plans	8	**49**	(65)	**49**	(65)
Taxation	7	**(27)**	10	**(27)**	10
Taxation on employee share compensation	7	**(2)**	(1)	**(2)**	(1)
Other comprehensive income/(losses) net of tax		**20**	(37)	**37**	(29)
Total comprehensive income/(losses) for the year net of tax		**38**	(1)	**75**	(23)
Attributable to:					
Equity holders of the parent		**38**	(1)	**75**	(23)

CLYDESDALE BANK PLC
Balance Sheets
at 30 September 2011

		Group		Bank	
		2011	2010	2011	2010
	Note	£m	£m	£m	£m
Assets					
Cash and balances with central banks	10	**6,022**	4,070	**6,022**	4,070
Due from related entities	11	**4,950**	2,839	**9,803**	7,777
Due from other banks	12	**12**	11	**12**	10
Investments					
- Available for sale	13	**1,110**	2,262	**1,109**	2,262
- Held to maturity	13	**-**	-	**701**	413
Other financial assets at fair value	14	**5,327**	5,396	**5,531**	5,396
Derivative financial instruments	15	**537**	719	**324**	385
Loans and advances to customers	16	**28,238**	26,981	**23,585**	22,176
Due from customers on acceptances		**7**	8	**7**	8
Current tax assets		**14**	10	**40**	65
Property, plant and equipment	19	**151**	157	**151**	157
Investment properties	20	**81**	77	**78**	-
Property inventory	21	**27**	31	**11**	-
Investments in controlled entities, joint ventures and associates	22	**3**	2	**637**	639
Deferred tax assets	23	**112**	144	**106**	139
Other assets	24	**661**	953	**646**	677
Total assets		**47,252**	43,660	**48,763**	44,174
Liabilities and equity					
Due to other banks	25	**1,507**	1,373	**1,507**	1,373
Other financial liabilities at fair value	14	**1,005**	896	**1,248**	896
Derivative financial instruments	15	**81**	117	**81**	117
Due to customers	26	**28,170**	28,434	**28,279**	28,434
Liabilities on acceptances		**7**	8	**7**	8
Provisions	27	**108**	27	**108**	27
Due to related entities	11	**7,758**	3,386	**10,480**	6,011
Bonds, notes and subordinated debt	28	**3,553**	4,409	**2,108**	2,727
Retirement benefit obligations	29	**185**	317	**185**	317
Deferred tax liabilities	23	**32**	43	**29**	32
Other liabilities	30	**1,967**	2,103	**2,038**	1,908
Total liabilities		**44,373**	41,113	**46,070**	41,850
Equity (parent entity interest)					
Share capital	31	**1,242**	942	**1,242**	942
Share premium account	32	**243**	243	**243**	243
Merger reserve	32	**338**	338	**338**	338
Share option reserve	32	**14**	1	**14**	1
Asset revaluation reserve	32	**2**	2	**2**	2
Available for sale investments reserve	32	**16**	6	**15**	6
Cash flow hedge reserve	32	**120**	130	**114**	106
Retained earnings	32	**904**	885	**725**	686
Total equity		**2,879**	2,547	**2,693**	2,324
Total liabilities and equity		**47,252**	43,660	**48,763**	44,174

These Financial Statements were approved by the Board of Directors on 15 November 2011 and were signed on its behalf by:

Sir Malcolm Williamson
Chairman

David Thorburn
Chief Executive Officer

CLYDESDALE BANK PLC
Statement of Changes in Equity
at 30 September 2011

Group	Note	Share capital £m	Share premium account £m	Merger reserve £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total equity £m
At 1 October 2009		632	243	338	2	2	14	103	916	**2,250**
Profit for the year		-	-	-	-	-	-	-	36	**36**
Other comprehensive income/(losses)		-	-	-	(1)	-	(8)	27	(55)	**(37)**
Total comprehensive income/(losses) for the period		-	-	-	(1)	-	(8)	27	(19)	**(1)**
Dividends paid - preference shares		-	-	-	-	-	-	-	(12)	**(12)**
Shares issued - ordinary		310	-	-	-	-	-	-	-	**310**
Share options granted		-	-	-	17	-	-	-	-	**17**
Share options settled		-	-	-	(17)	-	-	-	-	**(17)**
At 30 September 2010		**942**	**243**	**338**	**1**	**2**	**6**	**130**	**885**	**2,547**
Profit for the year		-	-	-	-	-	-	-	18	**18**
Other comprehensive income/(losses)		-	-	-	(2)	-	10	(10)	22	**20**
Total comprehensive income/(losses) for the period		-	-	-	(2)	-	10	(10)	40	**38**
Dividends paid - preference shares		-	-	-	-	-	-	-	(21)	**(21)**
Shares issued - ordinary		100	-	-	-	-	-	-	-	**100**
Shares issued - preference		200	-	-	-	-	-	-	-	**200**
Share options granted		-	-	-	15	-	-	-	-	**15**
At 30 September 2011	31, 32	**1,242**	**243**	**338**	**14**	**2**	**16**	**120**	**904**	**2,879**

CLYDESDALE BANK PLC
Statement of Changes in Equity
at 30 September 2011

Bank	Note	Share capital £m	Share premium account £m	Merger reserve £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total equity £m
At 1 October 2009		632	243	338	2	2	14	71	747	**2,049**
Profit for the year		-	-	-	-	-	-	-	6	**6**
Other comprehensive income/(losses)		-	-	-	(1)	-	(8)	35	(55)	**(29)**
Total comprehensive income/(losses) for the period		-	-	-	(1)	-	(8)	35	(49)	**(23)**
Dividends paid - preference shares		-	-	-	-	-	-	-	(12)	**(12)**
Shares issued - ordinary		310	-	-	-	-	-	-	-	**310**
Share options granted		-	-	-	17	-	-	-	-	**17**
Share options settled		-	-	-	(17)	-	-	-	-	**(17)**
At 30 September 2010		**942**	**243**	**338**	**1**	**2**	**6**	**106**	**686**	**2,324**
Profit for the year		-	-	-	-	-	-	-	38	**38**
Other comprehensive income/(losses)		-	-	-	(2)	-	9	8	22	**37**
Total comprehensive income/(losses) for the period		-	-	-	(2)	-	9	8	60	**75**
Dividends paid - preference shares		-	-	-	-	-	-	-	(21)	**(21)**
Shares issued - ordinary		100	-	-	-	-	-	-	-	**100**
Shares issued - preference		200	-	-	-	-	-	-	-	**200**
Share options granted		-	-	-	15	-	-	-	-	**15**
At 30 September 2011	31, 32	**1,242**	**243**	**338**	**14**	**2**	**15**	**114**	**725**	**2,693**

CLYDESDALE BANK PLC
Statements of Cash Flows
for the year ended 30 September 2011

		Group		Bank	
		2011	2010	**2011**	2010
	Note	**£m**	£m	**£m**	£m
Operating Activities					
Profit/(loss) on ordinary activities before tax		**21**	49	**-**	(33)
Adjustments for:					
Non cash or non operating items included in profit before tax	38	**(630)**	(690)	**(560)**	(599)
Changes in operating assets	38	**(1,304)**	1,119	**(2,334)**	951
Changes in operating liabilities	38	**32**	1,380	**875**	1,413
Interest received		**1,649**	1,070	**1,640**	949
Interest paid		**(553)**	(134)	**(825)**	(206)
Tax (paid)/received		**(13)**	(10)	**58**	47
Net cash (used in)/provided by operating activities		**(798)**	2,784	**(1,146)**	2,522
Cash flows from investing activities					
Dividends received		**-**	-	**137**	86
Interest received		**25**	26	**25**	26
Purchase of available for sale investments		**-**	(735)	**-**	(735)
Purchase of shares in controlled entities		**-**	-	**-**	(22)
Purchase of held to maturity investments		**-**	-	**(159)**	(160)
Cash inflow from matured held to maturity investments		**-**	639	**-**	639
Proceeds from sale of investments		**1,174**	4	**1,173**	4
Purchase of property, plant and equipment (including investment property and property inventory)		**(41)**	(73)	**(105)**	(16)
Proceeds from sale of property, plant and equipment (including investment property and property inventory)		**33**	17	**9**	8
Investment in joint venture		**(1)**	-	**-**	-
Net cash provided by/(used in) investing activities		**1,190**	(122)	**1,080**	(170)
Cash flows from financing activities					
Interest received		**22**	15	**51**	55
Interest paid		**(141)**	(115)	**(132)**	(133)
Proceeds from ordinary shares issued	31	**100**	310	**100**	310
Proceeds from redeemable preference shares issued	31	**200**	-	**200**	-
Redemption of bonds and notes		**(856)**	(877)	**(619)**	(225)
Share options settled		**-**	(17)	**-**	(17)
Net increase in amount due from related entities		**(2,111)**	(868)	**(2,026)**	(855)
Net increase/(decrease) in amount due to related entities		**4,368**	180	**4,465**	(200)
Dividends paid	9	**(21)**	(12)	**(21)**	(12)
Net cash provided by /(used in) financing activities		**1,561**	(1,384)	**2,018**	(1,077)
Net increase in cash and cash equivalents		**1,953**	1,278	**1,952**	1,275
Cash and cash equivalents at beginning of the year		**3,891**	2,613	**3,882**	2,607
Cash and cash equivalents at end of the year	38	**5,844**	3,891	**5,834**	3,882

1. Authorisation of Financial Statements and statement of compliance with IFRS

In these Financial Statements Clydesdale Bank PLC is referred to as the "Bank". The "Group" consists of the Bank and its controlled entities. The principal controlled entities are listed in note 22. The consolidated Financial Statements comprise the Financial Statements of the Group.

The consolidated Financial Statements of the Bank for the year ended 30 September 2011 were authorised for issue by the Board of Directors on 15 November 2011 and the balance sheets were signed on the Board's behalf by Sir Malcolm Williamson and Mr David Thorburn.

Clydesdale Bank PLC is incorporated in the UK and registered in Scotland.

Copies of the Annual Report and Consolidated Financial Statements may be obtained from the Corporate Affairs Department, Clydesdale Bank PLC, 20 Waterloo Street, Glasgow, G2 6DB.

The ultimate parent undertaking, and ultimate controlling party is National Australia Bank Limited ("NAB"), a company incorporated in the State of Victoria, Australia. This company also heads the largest group in which the results of the Group are consolidated. The smallest group in which the results of the Group are consolidated is that headed by National Australia Group Europe Limited ("NAGE") which is incorporated and registered in England and Wales.

Statement of compliance

The Group and Bank's Financial Statements have been prepared on the going concern basis, in accordance with IFRS as adopted for use in the European Union and as applied in accordance with the provisions of the Companies Act 2006. There are no differences in the accounting policies adopted by the Group and Bank. The principal accounting policies adopted by the Group are set out in note 2.

2. Accounting policies

Basis of preparation

The preparation of Financial Statements in conformity with IFRS requires the use of certain critical accounting estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. Assumptions made at each balance sheet date are based on best estimates at that date. Although the Group has internal control systems in place to ensure that estimates can be reliably measured, actual amounts may differ from those estimates.

The Financial Statements have been prepared on the going concern basis under the historical cost convention, as modified by the application of fair value measurements.

As permitted by section 408 of the Companies Act 2006, no Income Statement is presented for the Bank.

Significant accounting judgements and estimates

In the process of applying the Group's accounting policies, management has exercised judgements and estimates in determining the amounts recognised in the Financial Statements. The most significant use of judgements and used estimates are as follows:

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review. In addition, note 43 to the Financial Statements includes the Group's risk management objectives and note 44 to the Financial Statements includes the Group's objectives, policies and processes for managing its capital.

The Group has access to financial resources and a stable customer deposit base. NAB provides funding to the Group in the ordinary course of business. As a consequence, the Directors believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the Directors have a reasonable expectation that the Bank and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

2. Accounting policies (continued)

Significant accounting judgements and estimates (continued)

Equity compensation
The Bank's ultimate parent, NAB, granted shares and share options to the Bank's employees as a part of employee remuneration which is recharged to the Bank. IFRS 2 requires recognition of an expense for those shares and share options at the fair value on the grant date. For shares granted to employees, the fair value is measured directly at the market price of NAB Group's shares, adjusted to take into account the terms and conditions upon which the shares were granted. For share options granted to employees, the fair value of the equity instruments granted is estimated using a valuation technique consistent with generally accepted valuation methodologies.

Fair value of financial instruments
Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities. The most significant judgement is in relation to the Groups fair value loan portfolio. The valuation of these financial instruments is described in more detail in note 14.

With effect from 1 October 2010, the estimation basis for the valuation of loans and advances designated at fair value through profit or loss was revised. The effect of this revision at 30 September 2011 is a £65 million reduction to the carrying value. It is impractical to estimate the impact on future periods, principally due to uncertainties over levels of lending, the margins achieved and variability of long-term risk-free interest rates.

Impairment losses on loans and advances
The Bank reviews its individually significant loans and advances at each balance sheet date to assess whether an impairment loss should be recorded in the income statement. In particular, judgement by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the Bank makes judgements about the borrower's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the impairment allowance.

To the extent that recovery rates differ from those presently used within each of the Bank's collective provisioning models by 5%, the impairment provision on loans and advances would change by approximately £16m.

Loans and advances that have been assessed individually and found not to be impaired and all not individually significant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident.

The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risk and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups). The impairment loss on loans and advances is disclosed in more detail in note 17.

Payment Protection Insurance redress provision
The Group held a provision of £102 million at 30 September 2011. Significant judgement by management is required in determining the assumptions used to estimate the quantum of the provision, including the level of complaint volumes, uphold rates and redress costs. The most significant of the individual assumptions are the level of complaints and average payout per complaint. If the number of complaints was 1% higher or lower than that originally estimated, the provision would have increased / decreased by approximately £1 million. If the average redress cost was 5% higher or lower than that originally estimated, the provision would have increased / decreased by approximately £4 million. There are inter-dependencies between a number of the key assumptions which add to the complexity of the judgements the Group has to make which mean that no single factor is likely to move independent of others, however the sensitivities disclosed above assume all other assumptions remain unchanged.

Retirement benefit obligations
The cost of the defined benefit pension plan is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. Refer to note 29 for the assumptions used.

2. Accounting policies (continued)

Principles of consolidation

Controlled entities
The consolidated Financial Statements comprise the Financial Statements of the Bank and its controlled entities. Controlled entities are all entities (including special purpose entities ("SPEs")) over which the Bank has the power to govern the financial and operating policies so as to obtain economic benefits from their activities. The Bank sponsors the formation of SPEs, primarily for the purpose of facilitation of asset securitisation transactions to accomplish certain narrow and well defined objectives. SPEs require consolidation in circumstances such as those where the Bank in substance has control over them through access to the majority of the residual income or is exposed to the majority of the residual risk associated with the SPE.

Controlled entities are consolidated from the date on which control is transferred to the Bank. They are deconsolidated from the date that control ceases. The purchase method of accounting is used to account for the acquisition of controlled entities.

The effects of transactions between entities within the economic entity are eliminated in full upon consolidation.

Foreign currency translation
Functional and presentation currency
Items included in the Financial Statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (functional currency). The consolidated financial report is presented in pounds sterling (GBP), which is the Group's functional and presentation currency, rounded to the nearest million pounds (£m) unless otherwise stated.

Transactions and balances
Initially, at the date of a foreign currency transaction, the Group records an asset, liability, expense or revenue arising from a transaction using the end of day spot exchange rate between the functional and foreign currency on the transaction date.

Subsequently, at each reporting date, the Group translates foreign currency monetary items at the closing rate. Foreign exchange differences arising on translation or settlement of monetary items are recognised in the income statement during the period in which the gains or losses arise. Foreign currency non-monetary items measured at historical cost are translated at the date of the transaction. Foreign currency non-monetary items measured at fair value will be translated at the date when the fair value is determined. Foreign exchange differences are recognised directly in equity for non-monetary items where any component of associated gains or losses is recognised directly in equity. Foreign exchange differences arising from non-monetary items, whereby any portion of associated gains or losses are recognised in the income statement, are also recognised in the income statement.

Segment reporting

An operating segment is defined as a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other operating segments. The results of the Group's operating segments are disclosed in note 3.

Fair value measurement

Fair value is defined as the amount for which an asset could be exchanged or a liability transferred, between willing parties in an arm's length transaction.

Where the classification of a financial asset or liability requires it to be stated at fair value, the fair value is determined by reference to the quoted bid or offer price in the most advantageous active market to which the Group entity has immediate access, wherever possible.

Fair value for a net open position in a financial liability that is quoted in an active market is the current offer price, and for a financial asset the bid price, multiplied by the number of units of the instrument held or issued.

Where no such active market exists for the particular asset or liability, the Group uses a valuation technique to arrive at the fair value, including the use of transaction prices obtained in recent arm's length transactions where possible, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. In doing so, fair value is estimated using a valuation technique that makes maximum use of market inputs and places minimal reliance upon entity-specific inputs.

2. Accounting policies (continued)

Fair value measurement (continued)

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Group recognises profits on day one.

Where a valuation technique involves little or no observable data, this should not give rise to a valuation that differs from the transaction price as in this situation the transaction price will be regarded as the best evidence of fair value.

The carrying value of financial assets at fair value through profit or loss reflects the credit risk attributable to the counterparty. Changes in the credit profile of the counterparty are reflected in the fair value of the asset and recognised in the income statement.

Assets

On initial recognition all financial assets are recorded at fair value and classified as either fair value through profit or loss, available for sale, held to maturity or loans and receivables. Upon initial recognition, where a financial asset is not measured at fair value through profit or loss , transaction costs are added to the fair value where they are directly attributable to the acquisition of the financial asset.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash and liquid assets, amounts due from other banks (to the extent less than 90 days) and short-term government securities (which have the same characteristics as cash).

Due from other banks

Due from other banks includes certain loans, reverse repurchase agreements, nostro balances and settlement account balances due from other financial institutions.

Items classified as fair value through profit or loss

Purchases and sales of financial assets classified within fair value through profit or loss are recognised on trade date, being the date that the Group is committed to purchase or sell a financial asset.

Financial assets held for trading
A financial asset is classified as held for trading if it is acquired principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative not in a qualifying hedge relationship.

Financial instruments designated at fair value through profit or loss
Upon initial recognition, financial assets may be designated as held at fair value through profit or loss. Financial assets classified as fair value through profit or loss are initially recognised at fair value, with transaction costs being recognised in the income statement immediately. Subsequently, they are measured at fair value with gains and losses recognised in the income statement as they arise.

Restrictions are placed on the use of the designated fair value option and the classification can only be used in the following circumstances:

- if a host contract contains one or more embedded derivatives, the Group may designate the entire contract as being held at fair value;
- designating the instruments will eliminate or significantly reduce measurement or recognition inconsistencies (i.e. eliminate an accounting mismatch) that would otherwise arise from measuring assets or liabilities on a different basis; or
- assets and liabilities are both managed and their performance is evaluated on a fair value basis in accordance with documented risk management and investment strategies.

2. Accounting policies (continued)

Derivative financial instruments and hedge accounting

All derivatives are recognised in the balance sheet at fair value on trade date and are classified as trading except where they are designated as part of an effective hedge relationship. The carrying value of a derivative is measured at fair value throughout the life of the contract. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

The method of recognising the resulting fair value gain or loss on a derivative depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged. The Group designates certain derivatives as either hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge); or hedges of highly probable future cash flows attributable to a recognised asset or liability, or a highly probable forecast transaction (cash flow hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Group makes use of derivative instruments to manage exposures to interest rate and foreign currency, including exposures arising from forecast transactions and firm commitments. In order to manage particular risks, the Group applies hedge accounting for transactions which meet the specified criteria.

The Group documents, at the inception of a transaction, the relationship between hedging instruments and the hedged items, and the Group's risk management objective and strategy for undertaking these hedge transactions. The Group documents how effectiveness will be measured throughout the life of the hedge relationship and its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. A hedge is expected to be highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%.

Fair value hedge
The carrying value of the hedged item on initial designation is adjusted for the fair value attributable to the hedged risk. Subsequent to initial designation, changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The movement in fair value of the hedged item attributable to the hedged risk is made as an adjustment to the carrying value of the hedged asset or liability. Where the hedged item is derecognised from the balance sheet, the adjustment to the carrying amount of the asset or liability is immediately transferred to the income statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement on an effective yield basis over the remaining period of the original hedge relationship.

Cash flow hedge
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity, while the gain or loss relating to the ineffective portion is recognised immediately in the income statement. The carrying value of the hedged item is not adjusted.

Amounts accumulated in equity are transferred to the income statement in the period in which the hedged item will affect profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Derivatives that do not qualify for hedge accounting
Certain derivative instruments do not qualify for hedge accounting. This could occur for two reasons:

- the derivative is held for purposes of short-term profit taking; or
- the derivative is held to economically hedge an exposure but does not meet the accounting criteria for hedge accounting.

In both these cases, the derivative is classified as a trading derivative and changes in the value of the derivative are immediately taken to the income statement.

2. Accounting policies (continued)

Derivative financial instruments and hedge accounting (continued)

Certain derivatives embedded in financial instruments are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract and the host contract is not carried at fair value. These embedded derivatives are separately measured at fair value with changes in fair value recognised in the income statement.

Available for sale investments

Available for sale investments are non-derivative financial assets that are designated as available for sale and are not categorised into any of the categories of (i) fair value through profit or loss (ii) loans and receivables or (iii) held to maturity.

Consistent with financial assets classified as fair value through profit or loss the Group applies trade date accounting to purchases and sales of available for sale investments.

Available for sale investments are initially recognised at fair value including direct and incremental transaction costs. They are subsequently held at fair value. Gains and losses arising from changes in fair value are included as a separate component of equity until sale or impairment when the cumulative gain or loss is transferred to the income statement.

Interest income is determined using the effective interest method. Impairment losses and translation differences on monetary items are recognised in the income statement within the period in which they arise. Available for sale investments are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership. Available for sale investments consist primarily of debt securities with an immaterial investment in equity securities.

Held to maturity financial assets

Held to maturity investments are non derivative financial assets with fixed or determinable payments that the Group has the intention and ability to hold to maturity. Held to maturity assets are initially recognised at fair value and subsequently recorded at amortised cost using the effective interest method.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not classified as 'available for sale' or designated at fair value through profit or loss. They arise when the Group provides money or services directly to a customer with no intention of trading the loan. Loans and receivables include overdrafts, credit card lending, market rate advances, bill financing, mortgages, lease finance and term lending.

Loans and advances are initially recognised at fair value including direct and incremental transaction costs. They are subsequently recorded at amortised cost, using the effective interest method, adjusted for impairment losses and unearned income. They are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership.

As noted above, in certain limited circumstances the Group applies the fair value measurement option to financial assets. This option is applied to loans and advances where there is an embedded derivative within the loan contract and the Group has entered into a derivative to offset the risk introduced by the embedded derivative. The loan is designated as being carried at fair value through profit or loss to offset the movements in the fair value of the derivative within the income statement. When this option is applied the asset is included within other financial assets at fair value and not loans and advances. When a loan is held at fair value, a statistical-based calculation is used to estimate expected losses attributable to adverse movements in credit risk on the assets held. This adjustment to the credit quality of the asset is then applied to the carrying amount of the loan to arrive at fair value.

2. Accounting policies (continued)

Repurchase and reverse repurchase agreements

Securities sold subject to repurchase agreements ("repos") are retained in their respective balance sheet categories. The counterparty liability is included in amounts due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate based upon the counterparty to the transaction.

Securities purchased under agreements to resell ("reverse repos") are accounted for as collateralised loans. The difference between the sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Such amounts are normally classified as deposits with other banks or cash and cash equivalents. Securities lent to counterparties are also retained in the Financial Statements. Securities borrowed are not recognised in the Financial Statements unless they are sold to third parties in which case the purchase and sale are recorded with the gain or loss included in trading income. The obligation to return securities borrowed is recorded at fair value as a trading liability.

Impairment of financial assets other than fair value loans

The Group assesses at each balance sheet date whether there is evidence that a financial asset or a portfolio of financial assets that is not carried at fair value through profit or loss is impaired. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the balance sheet date ('a loss event'), and that loss event or events has had an impact on the estimated future cash flows of the financial asset or the portfolio that can be reliably estimated.

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

For loans and receivables and held to maturity investments, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The amount of the loss is recognised using an allowance account and the amount of the loss is included in the income statement.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure and any costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar risk characteristics, taking into account asset type, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the counterparty's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist. In addition, the Group uses its experienced judgement to estimate the amount of an impairment loss. This incorporates amounts calculated to overcome model deficiencies and systemic risks where appropriate and supported by historic loss experience data. The use of such judgements and reasonable estimates is considered by management to be an essential part of the process and does not impact reliability.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Following impairment, interest income is recognised using the original effective rate of interest which was used to discount the future cash flows for the purpose of measuring the impairment loss.

2. Accounting policies (continued)

Impairment of financial assets (continued)

When a loan is uncollectible, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the provision for loan impairment in the balance sheet.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Renegotiated loans
The Bank's objective in restructuring a loan will primarily be to maximise the potential recovery of its outstanding debt. A loan restructuring is the modification or elimination of a loan prior to or at its maturity date by means other than those prescribed under the contractual terms of the loan agreement. This may involve extending the payment arrangements and the agreement of new loan conditions. When the terms of the loan have been renegotiated, the loan is no longer considered past due. The bank continually reviews renegotiated loans to ensure that all criteria are met and future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

Equity and debt instruments
In the case of equity instruments classified as available for sale, the Group seeks evidence of a significant or prolonged decline in the fair value of the security below its cost to determine whether impairment exists. Where such evidence exists, the cumulative net loss that has been previously recognised directly in equity is removed from equity and recognised in the income statement. Reversals of impairment of equity shares classified as available for sale are not recognised in the income statement. Increases in the fair value of equity shares classified as available for sale after impairment are recognised directly in equity.

In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as all other financial assets. Reversals of impairment of debt securities classified as available for sale are recognised in the income statement.

Investments in controlled entities and associates

The Bank's investments in controlled entities and associates are valued at cost or valuation less any provision for impairment. Such investments are reviewed annually for impairment, or more frequently when there are indications that impairment may have occurred. Losses relating to impairment in the value of shares in controlled entities and associates are recognised in the income statement.

Property, plant and equipment

All freehold and long-term leasehold land and buildings are revalued annually on an open market basis by the Directors to reflect current market values, based on advice received from independent valuers. In addition, full independent valuations are carried out on a three year cycle on an open market basis, including directly attributable acquisition costs but without deducting expected selling costs. For properties that are vacant, valuations are carried out on an open market basis. Revaluation increments are credited to the asset revaluation reserve, unless these reverse deficits on revaluations charged to the income statement in prior years. To the extent that they reverse previous revaluation gains, revaluation losses are charged against the asset revaluation reserve. This policy is applied to assets individually. Revaluation increases and decreases are not offset, even within a class of assets, unless they relate to the same asset.

All other items of property, plant and equipment are carried at cost, less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to acquisition.

Property, plant and equipment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of (i) the asset's fair value less costs to sell and (ii) the asset's value in use.

Where a group of assets working together supports the generation of cash inflows largely independent of cash inflows from other assets or groups of assets, recoverable amount is assessed in relation to that group of assets (cash-generating unit).

2. Accounting policies (continued)

Property, plant and equipment (continued)

With the exception of freehold land, all items of property, plant and equipment are depreciated or amortised using the straight-line method, at rates appropriate to their estimated useful life to the Group. For major classes of property, plant and equipment, the annual rates of depreciation or amortisation are:

- buildings - 2%;
- leases (leasehold improvements) - the lower of the lease term and 10 years; and
- motor vehicles, fixtures and equipment - 10% to 33.33%.

Assets residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Gains or losses on the disposal of property, plant and equipment, which are determined as the difference between the net sale proceeds and the carrying amount at the time of sale are included in the income statement.

Any realised amounts in the asset revaluation reserve are transferred directly to retained earnings.

Investment properties

Investment property is property (land or building - or part of a building - or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

(a) use in the production or supply of goods or services or for administrative purposes; or
(b) sale in the ordinary course of business.

Investment property assets are carried at fair value, with fair value increments and decrements taken to the income statement in the period in which they arise. Investment property assets are revalued annually by Directors to reflect fair values. Directors' valuations are based on advice received from independent valuers. Such valuations are performed on an open market basis being the amounts for which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable willing seller in an arm's length transaction at the valuation date. Newly acquired investment property assets are held at cost (i.e. equivalent to fair value due to their recent acquisition) until the time of the next annual review, a period not exceeding twelve months.

Property inventory

Property acquired or being constructed for sale in the ordinary course of business, rather than to be held for rental or capital appreciation, is held as inventory and is measured at the lower of cost and net realisable value.

Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether:

- fulfilment of the arrangement is dependent on the use of a specific asset or assets; and
- the arrangement conveys a right to use the asset.

As lessee
The leases entered into by the Group as lessee are primarily operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

Sale and leaseback leases entered into by the Group as lessee are primarily operating leases. Where an operating lease is established at fair value, any excess of sales proceeds over the carrying amount is recognised immediately in the income statement.

2. Accounting policies (continued)

Leases (continued)

As lessor
Leases entered into by the Group as lessor, where the Group transfers substantially all the risks and rewards of ownership to the lessee, are classified as finance leases. The net investment in the lease, which is comprised of the present value of the lease payments including any guaranteed residual value and initial direct costs, is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is unearned income. Income is recognised over the term of the lease using the net investment method (before tax) reflecting a constant periodic rate of return.

Assets under operating leases are included within property, plant and equipment at cost and depreciated over the useful life of the lease after taking into account anticipated residual values. Operating lease rental income is recognised within 'Other operating income' in the income statement on a straight line basis over the life of the lease. Depreciation is recognised within 'Depreciation expense' in the income statement consistent with the nature of the asset (refer to note 19, Property plant and equipment).

Liabilities

Financial liabilities

Financial liabilities comprise items such as due to other banks, due to customers, liabilities on acceptances, trading liabilities and deposits and other borrowings.

Financial liabilities may be held at fair value through profit or loss or at amortised cost. Items held at fair value through profit or loss comprise both items held for trading and items specifically designated as fair value through profit or loss at initial recognition.

Financial liabilities held at fair value through profit or loss are initially recognised at fair value with transaction costs being recognised immediately in the income statement. Subsequently they are measured at fair value and any gains and losses are recognised in the income statement as they arise.

Liabilities may be designated as fair value through profit or loss if they meet the following criteria:

- designating instruments will eliminate or significantly reduce measurement or recognition inconsistencies (eliminate an accounting mismatch) that would otherwise arise from measuring assets or liabilities on a different basis; or

- if a host contract contains one or more embedded derivatives the Group may designate the entire contract as being held at fair value; or

- assets and liabilities are both arranged and their performance evaluated on a fair value basis in accordance with documented risk management and investment strategies.

A financial liability is classified as held-for-trading if it is incurred principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship).

All other financial liabilities are measured at amortised cost using the effective interest method. A financial liability is derecognised from the balance sheet when the Group has discharged its obligation, the contract is cancelled or expires.

Provisions

Provisions are recognised when a legal or constructive obligation exists as a result of past events and it is probable that an outflow of economic benefit will be necessary to settle the obligation, and can be reliably estimated. Provisions are not discounted to the present value of their expected net future cash flows except where the time value of money is considered material.

Contingent liabilities

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognised in the balance sheet but are disclosed unless they are remote.

2. Accounting policies (continued)

Restructuring costs

Provisions for restructuring costs include provisions for expenses incurred but not yet paid and future expenses that will arise as a direct consequence of decisions already made. A provision for restructuring costs is only made where the Group has made a commitment and entered into an obligation such that it has no realistic alternative but to carry out the restructure and make future payments to settle the obligation. Provision for restructuring costs is only recognised when a detailed plan has been approved and the restructuring has either commenced or has been publicly announced. This includes the cost of staff termination benefits and surplus leased space. Costs related to ongoing activities are not provided for.

Surplus leased space

Surplus leased space is an onerous contract and a provision is recognised when the expected benefits to be derived from the contract are less than the costs that are unavoidable under the contract. This arises where premises are currently leased under non-cancellable operating leases and either the premises are not occupied, or are being sub-leased for lower rentals than the Group pays, or there are no substantive benefits beyond a known future date. The provision is determined on the basis of the present value of net future cash flows.

Dividends on ordinary and preference shares

Dividends on ordinary and preference shares classified as equity instruments are recognised as a liability and deducted from equity when they are approved by the Bank's Directors. Interim dividends are deducted from equity when they are declared and no longer at the discretion of the Bank.

Dividends for the year that are approved after the balance sheet date are disclosed as an event after the balance sheet date.

Financial guarantees

The Group provides guarantees in the normal course of business on behalf of its customers. Guarantees written are conditional commitments issued by the Group to guarantee the performance of a customer to a third party. Guarantees are primarily issued to support direct financial obligations such as commercial bills or other debt instruments issued by a counterparty. It is the rating of the Group as a guarantee provider that enhances the marketability of the paper issued by the counterparty in these circumstances.

The financial guarantee contract is initially recorded at fair value which is equal to the premium received, unless there is evidence to the contrary. Subsequently, the Group records and measures the financial guarantee contract at the higher of:

- where it is likely the Group will incur a loss as a result of issuing the contract, a liability is recognised for the estimated amount of the loss payable; and
- the amount initially recognised less, when appropriate, amortisation of the fee which is recognised over the life of the guarantee.

Pension and post retirement costs

Employees of the Group are entitled to benefits on retirement, disability or death from the Group's pension plans. The Group operates both defined benefit and defined contribution pension schemes.

Defined contribution pension scheme
The defined contribution scheme receives fixed contributions from Group companies and the Group's obligation for contributions to these plans are recognised as an expense in the income statement as incurred. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payment is available.

Defined benefit pension scheme
The defined benefit scheme provides defined benefits based on years of service and career averaged revalued earnings. A liability or asset in respect of the defined benefit scheme is recognised in the balance sheet. The present value of the defined benefit obligations for the scheme is discounted by the AA credit rated corporate bond rates for the bonds that have maturity dates approximating to the terms of the Group's obligations.

2. Accounting policies (continued)

Defined benefit pension scheme (continued)
Pension expense attributable to the Group's defined benefit scheme comprises current service cost, interest cost, expected return on plan assets, curtailment gains and past service cost. The Group's policy where actuarial gains and losses arise as a result of actual experience is to fully recognise such amounts directly into retained earnings through the Statement of Comprehensive Income.

The Group also provides post retirement health care for certain retired employees. The calculation of the post retirement health care liability is calculated in the same manner as the defined benefit pension obligation.

Securitisation

Through its loan securitisation programme, the Group packages and sells loans (principally housing mortgage loans) as securities to investors through a securitisation vehicle. All such financial instruments continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction as the Group retains substantially all the risks and rewards.

Preference shares

Preference shares are classified as an equity instrument if and only if both of the following conditions are met:
(a) The instrument includes no contractual obligation:
- (i) to deliver cash or another financial asset to another entity; or
- (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

(b) If the instrument will or may be settled in the issuer's own equity instruments and it is:
- (i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
- (ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose the issuer's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.

Where preference shares do not satisfy the above conditions, then they are classified as a financial liability. The Bank's preference shares currently issued do not meet the criteria of a financial liability and are classified as equity.

Income tax

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 is related to items recognised in equity, in which case the tax is also recognised in equity.

Income tax expense or revenue is the tax payable (or receivable) on the current period's taxable income based on the applicable tax rate adjusted by changes in deferred tax assets and liabilities.

Current tax
Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax
Deferred tax assets and liabilities are recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated Financial Statements. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are only recognised for temporary differences, unused tax losses and unused tax credits if it is probable that future taxable amounts will arise to utilise those temporary differences and losses.

Deferred tax liabilities are not recognised for temporary differences arising from investments in subsidiaries and associates where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. Deferred tax assets are not recognised for temporary differences arising from investments in subsidiaries and associates where it is probable that the difference will not reverse in the foreseeable future, and it is not probable that taxable profit will be available against which the temporary difference can be utilised.

2. Accounting policies (continued)

Income tax (continued)

The effects of income taxes arising from asset revaluation adjustments are recognised directly in the asset revaluation reserve where relevant.

Deferred tax assets and liabilities related to fair value re-measurement of cash flow hedges, which are charged or credited directly to equity, are also credited or charged directly to equity. The tax associated with these transactions will be recognised in the income statement at the same time as the underlying transaction.

Subordinated liability and related entity balances

Subordinated liabilities and related entity balances are recorded at amortised cost. Subordinated liabilities are included within amounts due to related entities on the balance sheet.

Subordinated liabilities comprise undated and dated loan capital which is provided to the Bank by NAGE and NAB.

Debt issues

Debt issues are short and long term debt issued by the Group including commercial paper, notes, term loans, medium term notes and residential mortgage backed securities. Debt issues are typically recorded at amortised cost using the effective interest method. Premiums, discounts and associated issue expenses are recognised using the effective interest method through the income statement from the date of issue to accrete the carrying value of securities to redemption values by maturity date. Interest is charged to the income statement using the effective interest method.

Where debt issues are classified as held at fair value through profit or loss they are initially recognised at fair value with transaction costs being recognised immediately in the income statement. Subsequently, they are measured at fair value and any gains and losses are recognised in the income statement as they arise.

Equity

Share option reserve
The share option reserve records the value of equity benefits provided to employees and Directors as part of their remuneration including deferred tax.

Cash flow hedge reserve
The cash flow hedge reserve records the fair value revaluation of derivatives designated as cash flow hedging instruments.

Offsetting financial instruments

A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet if, and only if, the Bank has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Revenue and expense recognition

Net interest income

Interest income is reflected in the income statement using the effective interest method.

The effective interest method is a method of calculating amortisation using the effective interest rate of a financial asset or financial liability. The effective interest rate is the rate that exactly discounts the estimated stream of future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or liability.

When calculating the effective interest rate, the cash flows are estimated considering all contractual terms of the financial instrument (e.g. prepayment, call and similar options) excluding future credit losses.

2. Accounting policies (continued)

Net interest income (continued)

The calculation of the effective interest rate includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. Where it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments) are used.

Loan origination fees are recognised as revenue over the life of the loan as an adjustment of yield. Commitment fees are deferred, and recognised over the life of the loan as an adjustment of yield, or if unexercised, recognised as revenue upon expiration of the commitment. Where commitment fees are retrospectively determined and nominal in relation to market interest rates on related loans, commitment fees are recognised as revenue when charged. Where the likelihood of exercise of the commitment is remote, commitment fees are recognised as revenue over the commitment period. Loan related administration and service fees are recognised as revenue over the period of service.

Direct loan origination costs are netted against loan origination fees and the net amount recognised as revenue over the life of the loan as an adjustment of yield. All other loan related costs are expensed as incurred.

Fees and commissions

Unless included in the effective interest calculation, fees and commissions are recognised on an accruals basis when the service has been provided. Fees and commissions not integral to the effective interest rate arising from services provided to customers and third parties are recognised once the service has been provided.

Gains less losses on financial instruments at fair value through profit or loss

Gains less losses on financial instruments at fair value through profit or loss comprises fair value gains and losses from three distinct activities:

- trading financial instruments;
- hedging assets, liabilities and derivatives designated in hedge relationships; and
- financial assets and liabilities designated at fair value through profit or loss.

Trading financial instruments recognises fair value movements on all trading financial instruments. For trading derivatives a full fair value is determined inclusive of interest income and expense arising on those derivatives.

Gains less losses on financial instruments at fair value through profit or loss (continued)

Hedging assets, liabilities and derivatives designated in hedge relationships result in the recognition of fair value movements on both the hedged item and hedging derivative in a fair value hedge relationship, and hedge ineffectiveness for both fair value and cash flow hedge relationships.

Financial instruments designated at fair value through profit or loss recognises fair value movements (excluding interest) on those items designated as fair value through profit or loss at inception.

Interest income and interest expense on hedging assets, liabilities and derivatives and financial assets and liabilities designated as fair value through profit or loss at initial recognition are recognised in net interest income.

Equity based compensation

The Group engages in share-based payment transactions in respect of services received from certain of its employees. The fair value of the services received is measured by reference to the fair value of the shares or share options of NAB granted, on the date of the grant. The cost of the employee service received is measured by reference to the fair value of the shares or share options of NAB granted, on the date of the grant. The cost of the employee service received in respect of the shares or share options granted is recognised in the income statement over the period that the services are received by the Group, which is the vesting period, with a consequent increase in equity. The increase in share option reserve is reduced on repayment to the ultimate parent company.

2. Accounting policies (continued)

Equity based compensation (continued)

The fair value of the options granted is determined using option pricing models, which take into account the exercise price of the option, the current share price, the risk free interest rate, the expected volatility of the NAB share price over the life of the option and other relevant factors. In the absence of market prices, the fair value of the instruments at the date of the grant is estimated using an appropriate valuation technique.

Except for those which include terms related to market conditions, vesting conditions included in the terms of the grant are not taken into account in estimating fair value.

Non market vesting conditions are taken into account by adjusting the number of share or share options included in the measurement of the cost of employee services so that ultimately, the amount recognised in the income statement reflects the number of vested shares or share options. Where vesting conditions are related to market conditions, the charges for the services received are recognised regardless of whether or not the market related vesting condition is met, provided that the non market vesting conditions are met.

Accounting developments

The Group has adopted the following standards, interpretations and amendments which have been endorsed by the European Union. None of the following standards, interpretations and amendments had a material impact on the Group's Financial Statements.

(i) Applied in the current financial year

- *Improvements to IFRSs 2009*
  Improvements to IFRSs 2009, issued 16 April 2009, makes numerous non-urgent but necessary changes to accounting standards arising from the IASB's annual improvement project. Certain amendments are effective for financial periods beginning on or after 1 January 2010.

- *Improvements to IFRSs 2010*
  Improvements to IFRSs 2010, issued 6 May 2010, makes numerous non-urgent but necessary changes to accounting standards arising from the IASB's annual improvement project. Certain amendments are effective for financial periods beginning on or after 1 July 2010.

- *Amendments to IFRS 2 - Group Cash-settled Share-based Payment*
  Amendment to IFRS 2 - Group Cash-settled Share-based Payment Transactions, issued 18 June 2009, is effective for financial periods beginning on or after 1 January 2010. The main feature of the amendment clarifies the accounting for group cash-settled share-based payment transactions.

- *Amendment to IAS 32 Financial Instruments: Presentation - Classification of Rights Issues*
  Amendment to IAS 32 Classification of Rights Issue, issued 8 October 2009, is effective for financial periods beginning on or after 1 February 2010. The main feature of the Amendment requires that when certain conditions are met, rights issues (i.e. rights, options or warrants) that are denominated in a currency other than the functional currency of the issuer, are classified as equity regardless of the currency in which the exercise price is denominated.

- *IFRIC 19 - Extinguishing Financial Liabilities with Equity Instruments*
  IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments, issued 26 November 2009, is effective for financial periods beginning on or after 1 July 2010. The main feature of this Interpretation is to provide guidance on the accounting treatment by an entity, a debtor, for when the terms of a financial liability are renegotiated and result in the entity (debtor) issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability.

(ii) Early adopted and applied in the current financial year

The Group has not early adopted any standard, interpretation or amendment.

2. Accounting policies (continued)

Accounting developments (continued)

(iii) To be applied in a future reporting period

The following standards, interpretations and amendments were available for adoption in the European Union, but not mandatory, for the 30 September 2011 reporting period. Those amendments which are applicable to the Group and which are not likely to have an impact on the Group's Financial Statements and have not yet been applied by the Group in preparing this financial report are as follows:

- Revision to IAS 24 Related Party Disclosures, issued 4 November 2009 and effective for financial periods beginning on or after 1 January 2011.

- Amendment to IFRIC 14 Prepayment of a Minimum Funding Requirement, issued 26 November 2009 and effective for financial periods beginning on or after 1 January 2011.

The following standards, interpretations and amendments were not available for adoption in the European Union for the 30 September 2011 reporting period. Those amendments which are applicable to the Group and, which are likely to have an impact on the Group's Financial Statements, and have not yet been applied or early adopted by the Group in preparing this financial report are:

- Improvements to IFRSs 2010, issued 6 May 2010 and effective for various financial periods with the earliest beginning on or after 1 January 2010.

- Amendment to IFRS 7 Financial Instruments: Disclosures, issued 7 October 2010 and effective for financial periods beginning on or after 1 July 2011.

- IFRS 9 Financial Instruments, issued 12 November 2009, is effective for financial periods beginning on or after 1 January 2015. The Group has not yet assessed the potential impact of the standard, although changes which include the removal of the Available for Sale asset category will affect the Group's accounting for financial assets.

- IFRS 10 Consolidated Financial Statements, issued May 2011 and effective for financial periods beginning on or after 1 January 2013.

- IFRS 11 Joint Arrangements, issued May 2011 and effective for financial periods beginning on or after 1 January 2013

- IFRS 12 Disclosure of Interests in Other Entities, issued May 2011 and effective for financial periods beginning on or after 1 January 2013.

- Amendments to IAS12 Deferred Tax: Recovery of Underlying Assets, issued 20 December 2010, is effective for financial periods beginning on or after 1 January 2012.

- IFRS 13 Fair Value Measurement, issued May 2011 and effective for financial periods beginning on or after 1 January 2013

- Amendments to IAS19 Employee Benefits, issued June 2011, is effective for financial periods beginning on or after 1 January 2013.

3. Segment information

The Group's operating and reportable segments are operating units engaged in providing different products or services and whose operating results are regularly reviewed by the entity's chief operating decision maker. Financial information for each identified segment is regularly reported to the UK Executive Committee for the purposes of evaluating performance and resource allocation. The businesses are managed separately as each requires a strategy focused on the specific services provided for the economic, competitive and regulatory environment in which it operates.

The Group's business is organised into two principal operating segments: Business Banking (including Financial Solutions centres) and Retail Banking (consisting of the retail branch networks and small business customers). The Group's Central Functions are Finance, Risk, Banking Delivery Services, Strategy, Legal, CEO Office Support, Funding and Treasury, Human Resources, and other functions which are not considered to be separate reportable operating segments. For management and NAB divisional reporting purposes, Retail also includes the insurance business of National Wealth Management Europe Holdings Limited, which is a controlled entity of NAB and not part of the Group.

Business Banking

Business Banking comprises the Integrated Financial Solutions (iFS) operating segment which provides a range of banking products and services including loans and finance, day to day banking, international services, treasury solutions and corporate and structured finance.

Retail Banking

Retail Banking comprises the Integrated High Street and Wealth Management operating segments which provide a range of banking products and services including current accounts, mortgages, overdrafts, personal loans, savings accounts and insurances.

Business Banking, Retail Banking and Central Functions together represent total UK Banking, the aggregate results of which are also regularly provided to the UK Executive Committee. Wholesale Banking by virtue of its size, is not considered a separately reportable segment for the purposes of this note and is therefore included in Central Functions.

The accounting policies of the operating segments are consistent with those described in note 2 to these Financial Statements.

The Group evaluates each operating segment's performance on the basis of cash earnings. Cash earnings represents the net profit attributable to members of the Company, adjusted for certain non-cash items, primarily fair value adjustments and significant items.

Revenues, expenses and tax directly associated with each operating segment are included in determining their result. Transactions between operating segments are based on agreed recharges between segments.

Segment revenue represents revenue directly attributable to a segment and a portion of the Banking Group's revenue that can be allocated to a segment on a reasonable basis. Segment revenue includes Net Interest Income and Other Operating Income, and includes transfer pricing adjustments to reflect inter-segment funding arrangements. Segment profit represents operating profit before unrealised fair value gains or losses on financial instruments and income or expenses which are one-off in nature or are not part of the Banking Group's core business operations. Lending assets and deposit liabilities represent additional key metrics that are regularly provided to the UK Executive Committee.

Reporting changes during the current period

The Retail Banking segment now includes certain income and costs for mortgages, credit cards and ATMs which were previously reported within the Central and Other Functions segment. The prior period comparatives have been restated accordingly. Certain information in the comparative periods may however not be directly comparable with those in the current financial period as a result of changes in internal measurement and allocation.

3. Segment information (continued)

Major Customers

Revenues from no one single customer amount to greater than 10% of the Group's revenues.

Geographical areas

The Group has no material operations outside the UK and therefore no secondary geographical area information is presented.

The following tables provide revenue and profit information regarding the Group's principal operating segments.

Operating Segments 2011	**Business £m**	**Retail £m**	**Central and Other Functions £m**	**UK Banking £m**
Net interest income	440	420	112	972
Other operating income	206	166	(85)	287
Operating income	646	586	27	1,259
Operating expenses	(156)	(151)	(419)	(726)
Impairment losses on credit exposures	(255)	(41)	-	(296)
Group operating profit/(loss)	235	394	(392)	237
Tax expense	(61)	(102)	109	(54)
UK Banking cash earnings after tax	**174**	**292**	**(283)**	**183**
Non-cash earnings items after tax	-	-	(154)	(154)
Profit/(loss) after tax	**174**	**292**	**(437)**	**29**
Average assets	**23,948**	**8,372**	**12,626**	**44,946**

Operating Segments 2010	Business £m	Retail £m	Central and Other Functions £m	UK Banking £m
Net interest income	404	439	119	962
Other operating income	152	142	(33)	261
Operating income	556	581	86	1,223
Operating expenses	(141)	(135)	(436)	(712)
Impairment losses on credit exposures	(269)	(82)	4	(347)
Group operating profit/(loss)	146	364	(346)	164
Tax expense	(41)	(102)	97	(46)
UK Banking cash earnings after tax	105	262	(249)	118
Non-cash earnings items after tax	-	-	(66)	(66)
Profit/(loss) after tax	105	262	(315)	52
Average assets	23,958	8,090	12,406	44,454

The prior year treatment of non-cash earnings after tax has been adjusted to conform with the current year presentation.

3. Segment information (continued)

Reconciliations between segment and statutory results are as follows:

The following tables reconcile the information in the operating segment tables on the previous page to the Income Statement.

2011	**UK Banking £m**	**Non-Cash Earnings Items £m**	**Other Segments and Adjustments £m**	**CB PLC Total £m**
Net interest income	972	-	11	983
Other operating income	287	(209)	(10)	68
Operating income	1,259	(209)	1	1,051
Operating expenses	(726)	-	(7)	(733)
Impairment losses on credit exposures	(296)	-	(1)	(297)
Group operating profit/(loss)	237	(209)	(7)	21
Tax expense	(54)	55	(4)	(3)
Cash Earnings after tax	**183**	**(154)**	**(11)**	**18**
Non-cash earnings items after tax:				
Fair value and hedge ineffectiveness	(79)	79	-	-
Payment Protection Insurance redress	(75)	75	-	-
Profit/(loss) after tax	**29**	**-**	**(11)**	**18**
Average assets	**44,946**	**-**	**(521)**	**44,425**

2010	UK Banking £m	Non-Cash Earnings Items £m	Other Segments and Adjustments £m	CB PLC Total £m
Net interest income	962	-	(2)	960
Other operating income	261	(74)	(8)	179
Operating income	1,223	(74)	(10)	1,139
Operating expenses	(712)	(19)	3	(728)
Impairment losses on credit exposures	(347)	-	(15)	(362)
Group operating profit/(loss)	164	(93)	(22)	49
Tax expense	(46)	27	6	(13)
Cash Earnings after tax	118	(66)	(16)	36
Non-cash earnings items after tax:				
Fair value and hedge ineffectiveness	(66)	66	-	-
Profit/(loss) after tax	52	-	(16)	36
Average assets	44,454	-	(553)	43,901

NAB Group publishes segmental financial results of which UK Banking forms one segment. The segmentation is based on geographical lines, the exception being the Wholesale Banking business which is treated as a global business segment in its own right. Certain lines of the Wholesale Banking business are written on the Group balance sheet and therefore this business is not included in the UK Banking results. The UK Wealth Management business, which operates through separate legal entities, is also included in the UK Banking results but is not part of the Group. Additionally, the UK Banking division of NAB Group result excludes fair value and hedge ineffectiveness income and significant items in determining cash earnings.

For NAB segmental reporting purposes, PPI redress costs incurred in the first half of the year (prior to the announcement of the additional provision of £100m on 19 May 2011) have been included in other operating income in the UK Banking result. However, as a result of the size of the provision required the additional PPI provision of £100m (before tax) was excluded from cash earnings.

4. Net interest income

	2011 £m	2010 £m As restated
Loans and advances to other banks	**19**	20
Investments		
- available for sale assets	**25**	25
- held to maturity assets	**-**	1
Loans and advances to customers	**1,238**	1,220
Due from related entities (note 11)	**22**	15
Other interest income	**2**	2
	1,306	1,283
Financial assets at fair value through profit or loss	**119**	109
Total interest income	**1,425**	1,392
Interest expense		
Due to other banks	**13**	15
Financial liabilities at fair value through profit or loss	**2**	1
Due to customers	**286**	300
Bonds and notes	**63**	64
Due to related entities (note 11)	**78**	51
Other interest expense	**-**	1
Total interest expense	**442**	432
Net interest income	**983**	960

Prior period interest has been reallocated between loans and advances to customers and financial assets at fair value through profit or loss to better reflect the cash flows from the two components of the portfolio.

5. Non interest income

	2011 £m	2010 £m
Gains less losses on financial instruments at fair value		
Movement in fair value of assets (see note commentary)	**(109)**	46
Interest rate derivatives (see note commentary)	**9**	(121)
Foreign exchange derivatives	**21**	20
Ineffectiveness arising from fair value hedges (note 15)	**(6)**	9
Ineffectiveness arising from cash flow hedges (note 15)	**(4)**	(3)
	(89)	(49)
Other operating income		
Fees and commission	**139**	210
Net fair value movement on investment properties	**1**	3
Loss on disposal of investment properties	**-**	(1)
Other income	**17**	16
	157	228
Total non interest income	**68**	179

Certain financial assets are designated at inception as fair value through profit or loss. These assets are predominantly fixed interest rate loans which are individually hedged and are fair valued with the movements in fair value taken through the income statement as part of non interest income. The fair value of the loan is derived from the future loan cash flows using appropriate discount rates and includes adjustments for credit risk and credit losses. This valuation technique is reflective of current market conditions and therefore is regularly reviewed to ensure it appropriately captures the continued economic uncertainty and volatility currently being experienced in the markets. Without this calibration, the carrying value of these assets as at 30 September 2011 would have been £65m higher.

5. Non interest income (continued)

As interest rates fall, the carrying value of the loan increases. Similarly, as interest rates increase, the carrying value of the loan decreases. To the extent that the fair value of the loan reflects movements in interest rates there will be an offsetting movement in the underlying derivative. Movements in the fair value of loans that relate to changes in the creditworthiness of the loan counterparty and the margin earned on the loan are not offset with a movement in the hedging derivative valuation. The difference in the fair value movement between the loan and derivative is the net present value of the credit margin.

Fees and commission income includes £9m (2010: £11m) in relation to financial instruments at fair value through profit or loss and is reported net of charges of £116m (2010: £17m) for Payment Protection Insurance redress costs.

6. Operating expenses

	2011 £m	2010 £m
Personnel expenses		
Salaries, wages and non cash benefits	**192**	177
Related personnel expenses	**17**	16
Defined contribution pension expense	**10**	9
Defined benefit pension expense	**24**	25
Equity-based compensation	**15**	17
Other personnel expenses	**7**	7
	265	251
Depreciation expense		
Depreciation of property, plant & equipment (note 19)	**15**	21
Efficiency, quality and service initiatives		
Other personnel expenses	**10**	6
Other occupancy expenses	**-**	1
Other expenses	**1**	12
	11	19
Other operating expenses		
Operating lease rental	**42**	40
Other occupancy expenses	**41**	44
Related entity recharges (note 11)	**264**	254
Other operating expenses	**95**	99
	442	437
Total operating expenses	**733**	728

Other operating expenses includes £4m (2010: £2m) in respect of the Financial Services Compensation Scheme levy and £3m (2010: £Nil) in respect of the Bank levy.

Auditors' remuneration
The Group paid the following amounts to its auditors in respect of the audit of the Financial Statements and for other services provided to the Group.

	2011 £'000	2010 £'000
Audit of the Financial Statements	**895**	920
Other fees to auditors:		
Audit of the Group pension scheme	**89**	102
Local statutory audits for subsidiaries	**150**	150
Other assurance including regulatory compliance based work	**30**	262
	1,164	1,434

Auditors' remuneration is included within other operating expenses.

7. Tax expense

a) Analysis of Group charge in the year

Tax charged in the income statement

The charge for taxation comprises:

	2011	2010
Current tax	**£m**	£m
United Kingdom Corporation Tax at 27% (2010: 28%)		
- current year	**3**	(5)
- prior year	**(4)**	3
Other overseas taxation	**10**	10
Total current tax	**9**	8
Deferred tax		
Origination and reversal of temporary differences		
- current year	**(8)**	10
- prior year	**2**	(5)
Total deferred income tax	**(6)**	5
Income tax expense reported in income statement	**3**	13

Tax relating to items charged or credited to equity

	2011	2010
Current tax	**£m**	£m
Available for sale investments	**5**	(3)
Release of transitional deferred tax	**(6)**	(6)
Deferred tax asset		
Actuarial losses on defined benefit pension schemes	**27**	(10)
Employee share compensation	**2**	1
Release of transitional deferred tax	**6**	6
Deferred tax liability		
Net (loss)/gain on revaluation of cash flow hedges	**(9)**	9
Tax charge/(credit) in the statement of comprehensive income	**25**	(3)

7. Tax expense (continued)

b) Factors affecting Group tax charge for the year

The tax assessed for the period reflects the standard rate of Corporation Tax in the UK (27%) (2010: 28%). The factors are explained below:

	2011 £m	2010 £m
Profit on ordinary activities before tax	**21**	49
Profit on ordinary activities multiplied by standard rate of Corporation Tax in the UK of 27% (2010: 28%)	**6**	14
Effects of:		
Expenses not deductible for tax purposes	**2**	3
Bank levy	**1**	-
Rate differences	**(5)**	(3)
Adjustments to tax charge in respect of previous periods	**(2)**	(2)
Other	**1**	1
Total income tax expense for year	**3**	13

On 23 March 2011, the Chancellor announced a further reduction in the standard rate of corporation tax from the already announced 27% to 26% from 1 April 2011. The UK Government also confirmed its intention to reduce the rate further by 1% per annum falling to 23% with effect from 1 April 2014. The 25% rate was substantively enacted in July 2011. As such the closing deferred tax balances at 30 September 2011 have been stated at a rate of 25%.

The maximum effect on deferred tax of the reduction in the UK corporation tax rate to 23% is expected to be £6m (equivalent to 2% of the closing gross balances on which deferred tax is calculated). This adjustment will impact both the income statement and reserves.

8. Components of other comprehensive income

Reserves movements	Group		Bank	
	2011 £m	2010 £m	2011 £m	2010 £m
Cash flow hedge reserve:				
(Losses)/gains during the year	**(23)**	33	**(41)**	27
Transfer of losses to the income statement	**4**	3	**48**	20
	(19)	36	**7**	47
Available for sale investment reserve:				
Gains/(losses) during the year	**20**	(10)	**20**	(10)
Transfer of gains to the income statement	**(5)**	(1)	**(6)**	(1)
	15	(11)	**14**	(11)
Defined benefit pensions:				
Actuarial gains/(losses) during the year (note 29)	**49**	(65)	**49**	(65)

9. Dividends paid

	2011 £m	2010 £m
Preference dividends paid - 12% per annum payable semi-annually (6p per share)	**12**	12
Preference dividends paid - 6 month LIBOR plus margin of 779bps payable semi-annually (4.5p per share)	**9**	-
	21	12

On 15 December 2010, 200,000,000 preference shares of £1 each were issued at par.

10. Cash and balances with central banks

	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Cash assets	**951**	846	**951**	846
Balances with central banks	**5,071**	3,224	**5,071**	3,224
	6,022	4,070	**6,022**	4,070

Balances with central banks include mandatory deposits of £29m (2010: £30m) which are not available for use in the Group's day to day business. Mandatory deposits include cash ratio deposits which are non-interest bearing deposits placed with the Bank of England under the provisions of the Bank of England Act 1998. Balances with central banks include deposits made in respect of the Bank's own notes in issue.

11. Related party transactions

The Bank is a wholly owned controlled entity of National Australia Group Europe Limited. The ultimate parent entity of the Bank is National Australia Bank Limited. During October 2010, National Europe Holdings Limited transferred ownership of Clydesdale Bank PLC to National Australia Group Europe Limited. National Europe Holdings Limited had a liquidator appointed to wind up the company under a members voluntary liquidation.

During the year there have been transactions between the Bank, its ultimate parent, controlled entities of the ultimate parent, controlled entities of the Bank, and other related parties.

The Bank provides a range of services to related parties, including the provision of banking facilities and standby financing arrangements. Other dealings include granting loans and accepting deposits, and the provision of finance, foreign exchange and interest cover. Those transactions are normally subject to commercial terms and conditions.

The Bank and Group receives a range of services from the parent and related parties, including loans and deposits, foreign exchange and interest rate cover and various administrative services. Fees may be charged for these services.

Amounts due from related entities	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Loans				
Ultimate parent	**4,921**	2,810	**4,921**	2,810
Controlled entities of the ultimate parent	**-**	-	**4,853**	4,938
	4,921	2,810	**9,774**	7,748
Other receivables				
Ultimate parent	**13**	8	**13**	8
Controlled entities of the ultimate parent	**16**	21	**16**	21
	29	29	**29**	29
Total amounts due from related entities	**4,950**	2,839	**9,803**	7,777
Interest income on the above amounts was as follows:				
Ultimate parent (note 4)	**22**	15	**22**	15
Controlled entities of the ultimate parent	-	-	**50**	55
	22	15	**72**	70

Reverse repurchase agreements
Included in both the Group and Bank numbers in "Amounts due from related entities - Ultimate parent" is £4,284m (2010: £2,234m) for securities purchased under agreements to resell (Group and Bank). As part of these reverse repurchase agreements, the Group and Bank has received securities that it is allowed to sell or re-pledge. The fair value of the securities accepted under these terms as at 30 September 2011 amounts to £4,343m (2010: £2,223m) for the Group and Bank, of which £204m (2010: £106m) for the Group and Bank has been sold or re-pledged to third parties in connection with financing activities or to comply with commitments under short sale transactions. The Group is obliged to return equivalent securities on maturity of the transaction. These transactions are conducted under terms that are usual and customary to standard lending and securities borrowing activities.

11. Related party transactions (continued)

Amounts due to related entities	**Group**		**Bank**	
	2011	2010	**2011**	2010
Group	**£m**	£m	**£m**	£m
Deposits				
Ultimate parent	**6,606**	2,618	**6,606**	2,618
Controlled entities of the Bank	**-**	-	**2,722**	2,625
	6,606	2,618	**9,328**	5,243
Subordinated liabilities				
Ultimate parent	**550**	300	**550**	300
Controlled entities of the ultimate parent	**526**	426	**526**	426
	1,076	726	**1,076**	726
Other payables				
Ultimate parent	**21**	10	**21**	10
Controlled entities of the ultimate parent	**55**	32	**55**	32
	76	42	**76**	42
Total amounts due to related parties	**7,758**	3,386	**10,480**	6,011
Interest expense on the above amounts was as follows:				
Ultimate parent	**68**	45	**68**	45
Controlled entities of the ultimate parent	**10**	6	**10**	6
Controlled entities of the Bank	**-**	-	**82**	82
	78	51	**160**	133

Subordinated liabilities

Subordinated liabilities comprises undated and dated loan capital which is provided to the Bank by NAGE and NAB. Interest on the loans is payable at rates related to the London Interbank Offered Rate ("LIBOR"). The undated loans are subject to five years and one day's notice of redemption by the lenders and are repayable at par. Early repayment is at the option of the borrower, subject to the prior consent of the Financial Services Authority. The loans are subordinated to the claims of other creditors and are unsecured. The loans are employed in the general business of the Bank.

Details of subordinated liabilities in excess of 10% of the total balance of the subordinated loans are disclosed below:

The rates of interest stated below apply at 30 September 2011.	**2011**	2010
	£m	£m
6.55219% (2010: 6.45750%) 10-year, non-call five years with a final maturity of 17 February 2019	**300**	300
5.25281% 10-year, non-call with a final maturity of 25 January 2021	**250**	-
1.48313% (2010: 1.33188%) undated subordinated notes	**-**	100
	550	400
Other undated subordinated notes	**526**	326
Total subordinated debt	**1,076**	726

11. Related party transactions (continued)

Securitisation

The Bank has securitised part of its residential mortgage portfolio and the cash raised via the issue of residential mortgaged backed securities (RMBS) through special purpose entities forms part of the Bank's medium term funding. The value of the RMBS in issue to external counterparties was £1,589m (2010: £1,827m). A further portfolio of Buy to Let Mortgages has been securitised via the Lannraig Master Trust Issuer programme and a total of £500m of the securities issued have been purchased by National Australia Bank.

Other transactions with related entities

	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Non interest income received				
Controlled entities of the ultimate parent	**9**	10	**9**	10
Administrative expenses *(note 6)*				
Ultimate parent	**8**	5	**8**	5
Controlled entities of the ultimate parent	**256**	249	**254**	247
	264	254	**262**	252

Compensation of key management personnel (including Directors)	Group	
	2011	2010
	£m	£m
Salaries and other short-term benefits	**13**	10
Share based payments	**4**	6
	17	16

Directors emoluments are analysed in note 40.

Transactions with key management personnel (KMP)

For the purposes of IAS24 "Related Party Disclosures" key management personnel comprise Directors of the Bank, members of the UK Executive Committee and FSA approved persons with a control function of 1 to 29.

KMPs, their close family members and any entities controlled or significantly influenced by the KMPs have undertaken the following transactions with the Group in the normal course of business. The transactions were made on the same terms and conditions as applicable to other Group employees, or on normal commercial terms.

	2011	2010
	£m	£m
Loans and advances	**6**	5
Deposits	**4**	8

No provisions have been recognised in respect of loans provided to key management personnel. There were no debts written off or forgiven during the year ended 30 September 2011 (2010: £Nil).

Included in the above are ten (2010: thirteen) loans totalling £1.9m (2010: £1.4m) made to Directors.

11. Related party transactions (continued)

Other related party transactions

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.4m in the year ended 30 September 2011 (2010: £0.3m) were charged to the Group sponsored Scheme. The Group has deposits of £2.8m (2010: £4.9m) at the year end placed by the Scheme at market rates.

The following payments were made to the Yorkshire and Clydesdale Bank Pension Scheme sponsored by the Bank:

	2011	2010
	£m	£m
Clydesdale Bank Section	**65**	57
Yorkshire Bank Section	**42**	36
	107	93

12. Due from other banks

	Group		**Bank**	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Transaction balances with other banks	**12**	11	**12**	10

13. Investments

	Group		**Bank**	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Available for sale - listed	**1,103**	2,256	**1,103**	2,256
Available for sale - unlisted	**7**	6	**6**	6
	1,110	2,262	**1,109**	2,262

Included in the available for sale (AFS) listed securities are £0.06bn (2010: £1.2bn) investments in other banks' debt securities, which are subject to a UK Government backed guarantee plus £0.9bn in UK Government Gilts and £0.1bn in other banks' debt securities.

	Group		**Bank**	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Held to maturity - listed	**-**	-	**701**	413

The Group held to maturity investments matured in the year to 30 September 2010.

14. Other financial assets and liabilities at fair value

Group	2011 £m	2010 £m
Other financial assets at fair value through profit or loss		
Loans and advances	**4,846**	5,027
Other derivatives		
Other derivatives financial assets (note 15)	**324**	297
Derivative financial assets - related entities (note 15)	**157**	72
	481	369
	5,327	5,396
Other financial liabilities at fair value through profit or loss		
Due to customers - term deposits	**155**	66
Other derivatives		
Other derivative financial liabilities (note 15)	**44**	58
Derivative financial liabilities - related entities (note 15)	**806**	772
	850	830
	1,005	896

Bank	2011 £m	2010 £m
Other financial assets at fair value through profit or loss		
Loans and advances	**4,846**	5,027
Other derivatives		
Other derivatives financial assets (note 15)	**528**	297
Derivative financial assets - related entities (note 15)	**157**	72
	685	369
	5,531	5,396
Other financial liabilities at fair value through profit or loss		
Due to customers - term deposits	**155**	66
Other derivatives		
Other derivative financial liabilities (note 15)	**287**	58
Derivative financial liabilities - related entities (note 15)	**806**	772
	1,093	830
	1,248	896

14. Other financial assets and liabilities at fair value (continued)

Loans and advances

Included in other financial assets at fair value is a portfolio of loans which have embedded derivative characteristics. These loans are hedged with interest rate derivative contracts with matching cash flows. The hedges do not achieve the criteria for hedge accounting and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £4,846m (2010: £5,027m). The cumulative reserves movement in fair value of the loans attributable to changes in credit risk losses amounts to £157m (2010: £131m) and the change for the current period is £26m (2010: £21m).

The expected changes in fair value of the designated loans attributable to credit risk have been calculated using an established statistical based calculation used to estimate expected losses attributable to adverse movements in credit risk. With effect from 1 October 2010, the estimation basis for the valuation of the loans and advances held at fair value was revised (see note 5).

Due to customers - term deposits

Included in other derivative financial liabilities at fair value are fixed rate defeasance deposits which have been hedged with interest rate derivative contracts with matching cash flows.

The change in fair value attributable to changes in the Bank credit risk is £Nil (2010: £Nil). The Bank is contractually obligated to pay £17m (2010: £7m) less than the carrying amount at maturity to the deposit holder.

15. Derivative financial instruments

Derivatives

A derivative financial instrument is a contract or agreement whose value is related to the value of an underlying instrument, reference rate or index. Derivatives are usually separated into three generic classes: forward and futures contracts, options, and swaps, although individual products may combine the features of more than one class. The principal features of each of these classes, for derivatives that the Group enters into, are summarised below.

Use of derivatives

The Group uses derivatives to hedge its balance sheet. The Group's principal objective in holding or issuing derivatives is asset and liability management.

The operations of the Group are subject to the risk of interest rate fluctuations, to the extent that there is a difference between the amount of the interest-earning assets and the amount of interest-bearing liabilities that mature or reprice in specified periods. One of the objectives of asset and liability management is to protect levels of net interest income, while maintaining acceptable levels of liquidity to meet the Group obligations as they fall due.

To achieve these objectives, the Group uses a combination of derivative financial instruments, including foreign exchange, forward rate agreements, swaps, options, caps, floors, and other contingent contracts. Provided IAS 39 cash flow hedging criteria are met, the fair value changes on the related hedging instruments that are deemed effective are deferred in the cash flow reserve and transferred to the income statement at the time the hedged item affects income. Hedge effectiveness is monitored, and any hedge ineffectiveness is recognised in the income statement immediately.

Subsequent to initial designation, changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The movement in fair value of the hedged item attributable to the hedged risk is made as an adjustment to the carrying value of the hedged asset or liability.

The Group does not have a trading book. However, certain derivatives do not meet the IAS39 hedging criteria and are accounted for as trading derivatives.

Forward and futures contracts

Forward and futures contracts are contracts for delayed delivery of a specific underlying asset in which the seller agrees to settle at a specified future date at a specified price or yield. A forward rate agreement is a confirmed agreement between two parties to exchange an interest rate differential on a notional principal amount at a given future date.

Options

Options are contracts that allow the holder of the option the right, but not the obligation, to purchase or sell a financial instrument at a specified price and within a specified period. Interest rate caps and floors are option contracts and are included as such in the disclosures below. They require the seller to pay the purchaser at specified future dates the amount, if any, by which a specified market interest rate exceeds the fixed cap rate or falls below the fixed floor rate, applied to the notional principal amount.

Swaps

Interest rate swap transactions generally involve the exchange of fixed and floating interest payment obligations without the exchange of the underlying notional principal amount. A vanilla cross currency swap takes the form of an agreement to exchange one currency for another and to re-exchange the currencies at the maturity of the swap, using the same exchange rate, with the exchange of interest payments throughout the swap period. A balance guarantee cross currency swap protects the Group if securitisation amortisation payment frequencies change.

15. Derivative financial instruments (continued)

Risk management

The Group's management of certain key risk factors that may impact the future results is discussed in note 43. The factors discussed should not be considered to be the complete list of all potential risks.

Derivative contracts are disclosed as follows:

	Fair Value		Fair Value	
Group	**Assets**	**Liabilities**	Assets	Liabilities
	2011	**2011**	2010	2010
	£m	**£m**	£m	£m
Derivative financial assets and liabilities	**537**	**81**	719	117
Other derivative financial assets and liabilities at fair value through profit or loss (note 14)	**324**	**44**	297	58
Derivative financial assets and liabilities at fair value - related entities (note 14)	**157**	**806**	72	772
	1,018	**931**	1,088	947

	Fair Value		Fair Value	
Bank	**Assets**	**Liabilities**	Assets	Liabilities
	2011	**2011**	2010	2010
	£m	**£m**	£m	£m
Derivative financial assets and liabilities	**324**	**81**	385	117
Other derivative financial assets and liabilities at fair value through profit or loss (note 14)	**528**	**287**	297	58
Derivative financial assets and liabilities at fair value - related entities (note 14)	**157**	**806**	72	772
	1,009	**1,174**	754	947

Certain derivative financial assets and liabilities have been booked in consolidated special purpose vehicles.

Derivative financial assets and liabilities held at fair value through profit or loss (FVTPL) include the hedges for the Group Securitisation programme, Medium Term Note ("MTNs") programmes and cash flow hedges.

The carrying value of the currency liabilities issued through securitisation and MTN programmes fluctuates as a result of foreign exchange movements. There is a corresponding movement in the value of the hedging derivative.

The carrying value of the cash flow hedge derivatives increases as LIBOR yield curves used to discount the future cash flow reduce.

15. Derivative financial instruments (continued)

Group	**Contract Amount 2011**	**Fair Value Assets 2011**	**Fair Value Liabilities 2011**	Contract Amount 2010	Fair Value Assets 2010	Fair Value Liabilities 2010
Total derivatives held	**£m**	**£m**	**£m**	£m	£m	£m
Foreign exchange rate related contracts						
Spot, forwards and futures	**5,328**	**92**	**56**	4,039	56	84
Currency swaps	**1,730**	**430**	**1**	1,952	455	4
Options	**572**	**9**	**9**	279	6	6
Total	**7,630**	**531**	**66**	6,270	517	94
Interest rate related contracts						
Swaps	**42,652**	**461**	**800**	37,227	544	783
Swaptions	**539**	**12**	**13**	529	10	10
Options	**2,072**	**13**	**51**	2,491	16	59
Total	**45,263**	**486**	**864**	40,247	570	852
Commodity derivatives	**40**	**1**	**1**	22	1	1
Total derivative contracts	**52,933**	**1,018**	**931**	46,539	1,088	947

Bank	**Contract Amount 2011**	**Fair Value Assets 2011**	**Fair Value Liabilities 2011**	Contract Amount 2010	Fair Value Assets 2010	Fair Value Liabilities 2010
Total derivatives held	**£m**	**£m**	**£m**	£m	£m	£m
Foreign exchange rate related contracts						
Spot, forwards and futures	**5,328**	**92**	**56**	4,039	56	84
Currency swaps	**951**	**430**	**244**	618	157	4
Options	**572**	**9**	**9**	279	6	6
Total	**6,851**	**531**	**309**	4,936	219	94
Interest rate related contracts						
Swaps	**42,151**	**452**	**800**	36,727	509	783
Swaptions	**539**	**12**	**13**	529	10	10
Options	**2,072**	**13**	**51**	2,491	15	59
Total	**44,762**	**477**	**864**	39,747	534	852
Commodity derivatives	**40**	**1**	**1**	22	1	1
Total derivative contracts	**51,653**	**1,009**	**1,174**	44,705	754	947

15. Derivative financial instruments (continued)

Cash flow hedges

Included in the derivative contracts are the following cash flow hedge derivatives:

	Contract Amount 2011 £m	**Fair Value Assets 2011 £m**	**Fair Value Liabilities 2011 £m**	Contract Amount 2010 £m	Fair Value Assets 2010 £m	Fair Value Liabilities 2010 £m
Interest rate-related contracts	**7,320**	**176**	**19**	12,362	261	78

The Group macro hedges its interest rate exposure using cash flow hedges. These are vanilla fixed rate interest rate swaps for which the Group has the following commitments in the time bands noted:

Nominal values per time period	**2011 £m**	2010 £m
0 to 6 months	**2,795**	3,995
6 to 12 months	**1,440**	2,032
1 to 2 years	**800**	4,235
2 to 5 years	**2,285**	2,100
	7,320	12,362

The Group has hedged the following forecast cash flows, which primarily vary with interest rates. These cash flows are expected to impact the income statement in the following periods, excluding any hedge adjustments that may be applied:

	Forecast receivable cash flows 2011 £m	**Forecast payable cash flows 2011 £m**	Forecast receivable cash flows 2010 £m	Forecast payable cash flows 2010 £m
- within one year	**6**	**143**	16	216
- between one and two years	**-**	**78**	7	123
- between two and three years	**-**	**54**	-	62
- between three and four years	**-**	**32**	-	40
- between four and five years	**-**	**8**	-	19
	6	**315**	23	460

	2011 £m	2010 £m
Loss from cash flow hedges recognised in the income statement due to hedge ineffectiveness (note 5)	**(4)**	(3)

15. Derivative financial instruments (continued)

Fair value hedges

In addition the Group has the following fair value hedges that are designated as sterling interest rate related swaps:

	2011	2010
	£m	£m
Nominal values per time period		
0 to 6 months	**1,650**	250
1 to 2 years	**-**	1,650
> 5 years	**758**	758
	2,408	2,658

Finally the Group has the following fair value hedges that are designated as cross currency related swaps:

		2011	2010
		£m	£m
Nominal values per time period			
6 to 12 months	Exchange rate £/Euro = 1.1496	**855**	-
6 to 12 months	Exchange rate £/USD = 1.5571	**312**	-
1 to 2 years	Exchange rate £/Euro = 1.1496	**-**	964
1 to 2 years	Exchange rate £/USD = 1.5571	**-**	484
		1,167	1,448

	2011	2010
	£m	£m
Gains or (losses) arising from fair value hedges (note 5)		
Hedging instrument	**(137)**	(290)
Hedged item attributable to the hedged risk	**131**	299
	(6)	9

16. Loans and advances to customers

	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Overdrafts	**4,075**	4,163	**4,162**	4,163
Credit cards	**483**	526	**483**	526
Lease finance	**901**	1,001	**636**	534
Mortgages	**13,981**	12,781	**9,462**	8,416
Other term lending - business	**8,503**	8,083	**8,503**	8,084
Other term lending - retail	**858**	1,069	**858**	1,069
Other lending	**30**	20	**30**	20
Gross loans and advances to customers	**28,831**	27,643	**24,134**	22,812
Unearned income	**(150)**	(251)	**(129)**	(251)
Deferred and unamortised fee income	**(69)**	(49)	**(60)**	(41)
Impairment provisions on credit exposures (note 17)	**(374)**	(362)	**(360)**	(344)
	28,238	26,981	**23,585**	22,176

The Group and Bank have transferred £2,916m and £1,783m respectively (2010: £2,066m and £1,241m) of mortgages through securitisation arrangements that do not qualify for derecognition from the balance sheet (note 18). The mortgages do not qualify for derecognition because the Group and Bank remain exposed to the risks and rewards of ownership on an ongoing basis. The Group and Bank continue to be exposed primarily to the liquidity risk, interest rate risk and credit risk of the mortgages. The Group is also exposed to the residual rewards of the mortgages as a result of its ability to benefit from the future performance of the mortgages through the receipt of deferred consideration. The carrying amount of the associated liability before transactional costs is £1,439m (2010: £1,693m).

On 30 September 2011 the Group and Bank securitised a portfolio of Buy to Let Mortgages totalling £990m and £822m respectively and £829m of mortgage backed securities were issued via the Lannraig Master Trust Issuer programme. A total of £329m of these securities have been purchased by the Bank and £500m by NAB which is included in amounts due to the ultimate parent (note 11).

Included within Group and Bank loans and advances to customers are £809m and £489m respectively (2010: £2,230m and £1,530m) of mortgages assigned to a bankruptcy remote special purpose entity, Clydesdale Covered Bonds LLP. These loans provide security for issues of covered bonds made by Clydesdale Bank PLC. These transactions do not qualify for derecognition from the balance sheet. During the current financial year the Bank redeemed £1,850m of the £2,450m self issued covered bonds issued under its covered bond programme, which are held by Clydesdale Bank PLC at 30 September 2011. As the covered bonds issued are held by Clydesdale Bank PLC no accounting entries are required in these Financial Statements.

During the current financial year the Bank established a new covered bonds programme under which the Group and Bank have assigned £1,451m and £787m residential mortgage loans to a bankruptcy remote special purpose entity Clydesdale Bank Covered Bonds LLP No 2. These transactions do not qualify for derecognition from the balance sheet.

Lease finance
The Bank leases a variety of assets to third parties under operating and finance lease arrangements, including vehicles and general plant and machinery.

The costs of assets acquired by the Group during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £24m (2010: £17m) and £480m (2010: £393m) respectively. The total closing balances of finance leases and hire purchase contracts were £38m (2010: £37m) and £802m (2010: £882m) respectively.

16. Loans and advances to customers (continued)

Loans and advances to customers include finance lease receivables, which may be analysed as follows:

	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Gross investment in finance lease receivables:				
Due within one year	**351**	422	**242**	228
Due within one to five years	**505**	558	**371**	286
Due after more than five years	**45**	21	**23**	20
Total gross investment in lease finance receivables	**901**	1,001	**636**	534
Deduct: Unearned future finance income on lease receivables	**(61)**	(82)	**(39)**	(82)
Net investment in lease finance	**840**	919	**597**	452

There are specific provisions of £4.8m (2010: £8.9m) in relation to finance lease receivables, with a collective provision of £1.2m (2010: £1.2m) as at 30 September 2011.

Maximum exposure to credit risk
The amounts disclosed are the maximum exposure to credit risk of "Loans and advances", before taking account of any collateral held or other credit enhancements unless such credit enhancements meet offsetting requirements. For financial assets recognised on the balance sheet, the exposure to credit risk equals their carrying amount.

For financial guarantees granted, the maximum exposure to credit risk is the maximum amount that the Group would have to pay if the guarantees are called upon. For loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities, the maximum exposure to credit risk is the full amount of the committed facilities (note 42).

Description of collateral held as security and other credit enhancements
The Group evaluates each customer's creditworthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Group upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include:

- specific charges over defined assets of the counterparty;
- a floating charge over all assets and undertakings of an entity, including uncalled capital and called but unpaid capital; specific or
- interlocking guarantees; and
- loan agreements which include affirmative and negative covenants and in some instances guarantees of counterparty obligations.

Distribution of loans and advances by credit quality

	Business lending		Retail lending	
	2011	2010	**2011**	2010
Group	**£m**	£m	**£m**	£m
Gross loans and advances:				
Neither past due nor impaired	**12,349**	12,032	**14,884**	13,936
Past due but not impaired	**363**	526	**367**	395
Impaired	**797**	709	**71**	45
	13,509	13,267	**15,322**	14,376

	Business lending		Retail lending	
	2011	2010	**2011**	2010
Bank	**£m**	£m	**£m**	£m
Gross loans and advances:				
Neither past due nor impaired	**12,189**	11,623	**10,552**	9,740
Past due but not impaired	**349**	497	**217**	247
Impaired	**793**	681	**34**	24
	13,331	12,801	**10,803**	10,011

16. Loans and advances to customers (continued)

Restructured / renegotiated loans

There have been six Business loans totalling £63m (2010: six Business loans totalling £20m) that have had their terms renegotiated and continue to be disclosed within the impaired assets category. There are no other loans (2010: none) that would otherwise have been past due or impaired whose terms have been renegotiated.

Collateral and other credit enhancements obtained

Generally, the Group does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on its balance sheet.

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for its own business use.

Credit quality of loans and advances

The Group has an internally developed credit rating system that uses data drawn from a number of sources to assess the potential risk in lending to the Group's customers. The Group has a single common master scale across all (business and retail lending) counterparties for probability of default. This probability of default master scale can be broadly mapped to external rating agencies and has performing (pre-default) and non-performing (post default) grades. Impaired assets consist of retail mortgages with security insufficient to cover principal and arrears of interest revenue; business lending where there is sufficient doubt about the ultimate collectability of principal and interest; and off-balance sheet credit exposures where current circumstances indicate that losses may be incurred.

Distribution of loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the Group's standard credit rating system. The credit rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Group's rating policy.

The table below presents the analysis of business lending credit quality of loans and advances that are neither past due nor impaired:

	2011	2010
	£m	£m
Group		
Senior investment grade	**1,486**	1,902
Investment grade	**2,517**	1,862
Sub-investment grade	**8,346**	8,268
	12,349	12,032

	2011	2010
	£m	£m
Bank		
Senior investment grade	**1,456**	1,837
Investment grade	**2,555**	1,798
Sub investment grade	**8,178**	7,988
	12,189	11,623

16. Loans and advances to customers (continued)

For the non-retail analysis, Investment Grades are determined by the Customer Rating System (eCRS) as defined under the Credit Risk Management Policy.

- Senior Investment Grade is eCRS Ratings 1 to 5.
- Investment Grade is eCRS Ratings 6 to 11.
- Sub-investment Grade is eCRS Ratings 12 to 23.

These ratings were applied based on the Group determined eCRS distribution curve utilising UK sourced data. The results of this are then applied to the loans and advances to determine the allocation between investment grades.

Loans and advances which were past due but not impaired

	Business lending		**Retail lending**	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Group				
1 to 29 days past due	**256**	370	**132**	120
30 to 59 days past due	**12**	15	**84**	91
60 to 89 days past due	**2**	4	**45**	56
Past due over 90 days	**93**	137	**106**	128
	363	526	**367**	395

	Business lending		**Retail lending**	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Bank				
1 to 29 days past due	**245**	327	**75**	74
30 to 59 days past due	**10**	29	**49**	55
60 to 89 days past due	**1**	12	**25**	36
Past due over 90 days	**93**	129	**68**	82
	349	497	**217**	247

Loans and advances that are past due but are not impaired are classified as such where the net current market value of supporting security is sufficient to cover all principal, interest and other amounts (including legal, enforcement, realisation costs etc.) due on the facility.

16. Loans and advances to customers (continued)

The distribution of loans and advances by credit quality can be further analysed for 2011 as follows:

Distribution of loans and advances by credit quality

Group 2011	Retail overdrafts 2011 £m	Credit cards 2011 £m	Lease finance 2011 £m	Mortgages 2011 £m	Business lending * 2011 £m	Other retail lending 2011 £m	Total 2011 £m
Gross loans and advances:							
Neither past due nor impaired	104	455	855	13,620	11,337	862	**27,233**
Past due but not impaired	13	28	28	300	335	26	**730**
Impaired	-	-	18	61	789	-	**868**
	117	**483**	**901**	**13,981**	**12,461**	**888**	**28,831**

Bank 2011	Retail overdrafts 2011 £m	Credit cards 2011 £m	Lease finance 2011 £m	Mortgages 2011 £m	Business lending 2011 £m	Other retail lending 2011 £m	Total 2011 £m
Gross loans and advances:							
Neither past due nor impaired	163	455	617	9,279	11,365	862	**22,741**
Past due but not impaired	13	28	14	150	335	26	**566**
Impaired	-	-	5	33	789	-	**827**
	176	**483**	**636**	**9,462**	**12,489**	**888**	**24,134**

Loans and advances which were past due but not impaired

Group 2011	Retail overdrafts 2011 £m	Credit cards 2011 £m	Lease finance 2011 £m	Mortgages 2011 £m	Business lending 2011 £m	Other retail lending 2011 £m	Total 2011 £m
1 to 29 days past due	8	14	25	102	231	8	**388**
30 to 59 days past due	2	3	2	74	10	5	**96**
60 to 89 days past due	1	3	1	37	1	4	**47**
Past due over 90 days	2	8	-	87	93	9	**199**
	13	**28**	**28**	**300**	**335**	**26**	**730**

Bank 2011	Retail overdrafts 2011 £m	Credit cards 2011 £m	Lease finance 2011 £m	Mortgages 2011 £m	Business lending 2011 £m	Other retail lending 2011 £m	Total 2011 £m
1 to 29 days past due	8	14	14	46	230	8	**320**
30 to 59 days past due	2	3	-	38	11	5	**59**
60 to 89 days past due	1	3	-	17	1	4	**26**
Past due over 90 days	2	8	-	49	93	9	**161**
	13	**28**	**14**	**150**	**335**	**26**	**566**

** Business lending includes business overdrafts.*

16. Loans and advances to customers (continued)

The indexed loan to value (LTV) analysis of the Group's mortgages is described below:

	2011	2010
	%	%
< 50%	**22**	23
50% - 75%	**36**	34
76% - 80%	**9**	9
81% - 85%	**7**	7
86% - 90%	**6**	7
91% - 95%	**6**	6
96% - 100%	**4**	4
> 100%	**5**	4
Unknown	**5**	6
	100	**100**

17. Impairment provisions on credit exposures

Group 2011	**Business lending £m**	**Retail lending £m**	**Total £m**
Opening balance	282	80	362
Charge for the year	243	54	297
Amounts written off	(242)	(91)	(333)
Recoveries of amounts written off in previous years	17	31	48
Closing balance	**300**	**74**	**374**
Specific	112	19	131
Collective	188	55	243
	300	**74**	**374**

Group 2010	Business lending £m	Retail lending £m	Total £m
Opening balance	244	92	336
Charge for the year	294	68	362
Amounts written off	(262)	(121)	(383)
Recoveries of amounts written off in previous years	6	41	47
Closing balance	282	80	362
Specific	64	10	74
Collective	218	70	288
	282	80	362

Bank 2011	**Business lending £m**	**Retail lending £m**	**Total £m**
Opening balance	267	77	344
Charge for the year	239	47	286
Amounts written off	(226)	(91)	(317)
Recoveries of amounts written off in previous years	16	31	47
Closing balance	**296**	**64**	**360**
Specific	108	13	121
Collective	188	51	239
	296	**64**	**360**

17. Impairment provisions on credit exposures (continued)

Bank 2010	Business lending £m	Retail lending £m	Total £m
Opening balance	232	88	320
Charge for the year	289	66	355
Amounts written off	(260)	(118)	(378)
Recoveries of amounts written off in previous years	6	41	47
Closing balance	267	77	344
Specific	53	7	60
Collective	214	70	284
	267	77	344

	Group		Bank	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Amounts included in				
Loans and advances to customers (note 16)	**374**	362	**360**	344
Non accrual loans				
Loans and advances to customers	**868**	754	**827**	705
Provisions	**(131)**	(74)	**(121)**	(60)
Total	**737**	680	**706**	645

18. Securitisation

Securitised advances are subject to non-recourse finance arrangements. These loans have been transferred at principal value to special purpose entities (SPEs), from Clydesdale Bank PLC, and have been funded through the issue of amortising mortgage backed securities to investors. The transfers do not meet the derecognition tests in IAS39. The Group financial statements include the results, assets and liabilities of the securitisation SPEs, on a line by line basis.

The balances of assets and liabilities in relation to securitisation notes in issue at 30 September 2011 within the Group's balance sheet are as follows:

	2011 £m	2010 £m
Assets		
Cross currency swaps on bonds and notes	**204**	251
Loans and advances to customers (note 16)	**2,916**	2,066
Accrued interest receivable	**14**	13
	3,134	2,330
Liabilities		
Bonds and notes (note 28)	**1,439**	1,693
Due to related entities	**500**	-
Accrued interest payable	**11**	10
	1,950	1,703

18. Securitisation (continued)

The Bank's balance sheet includes the following assets and liabilities in relation to securitisation notes in issue at 30 September 2011:

	2011	2010
	£m	£m
Assets		
Derivative financial assets	**243**	-
Loans and advances to customers (note 16)	**1,783**	1,241
Accrued interest receivable	**8**	3
Other assets	**1,133**	676
	3,167	1,920
Liabilities		
Derivative financial liabilities	**243**	-
Due to related entities	**1,704**	1,814
	1,947	1,814

At 30 September 2011 the SPEs had cash deposits with Clydesdale Bank PLC amounting to £67m (2010: £70m). This balance is restricted in use to the repayment of the debt securities issued by the SPEs and other legal obligations.

Lanark Master Issuer redeemed £232.2m of subordinated notes on their call date of 22 February 2010 and subsequently issued a series of unrated subordinated ‘Z’ notes for £159.8m. Clydesdale Bank PLC subscribed for these notes. The class Z notes give the required subordination to the remaining outstanding senior notes. Clydesdale Bank PLC paid £72.4m into the structure to meet the note payment obligations on the junior notes in return for an increased share of the trust property. The ratings of the remaining senior notes have been affirmed by Standard and Poor's, Moody's and Fitch.

On 28 June 2011, following a change in the S&P's counterparty criteria, the cross currency swap between Lanark Master Issuer and the external counterparty was novated. On the same date Clydesdale Bank entered into separate cross currency swaps with the external counterparty and Lanark Master Issuer.

On 30 September 2011 a portfolio of Buy to Let Mortgages totalling £990m were securitised and £829m of mortgage backed securities were issued via the Lannraig Master Trust Issuer programme. A total of £329m of these securities have been purchased by the Bank and £500m by National Australia Bank.

19. Property, plant and equipment

Movements on property, plant and equipment

Group and Bank	Freehold land and buildings £m	Leases of 50 years and over unexpired £m	Leases of under 50 years unexpired £m	Motor vehicles, fixtures and equipment £m	Total £m
Cost or valuation					
At 1 October 2010	36	3	141	139	**319**
Additions	-	-	11	5	**16**
Disposals	(1)	-	(14)	(35)	**(50)**
Transfers	(1)	1	-	-	**-**
At 30 September 2011	**34**	**4**	**138**	**109**	**285**
Accumulated depreciation					
At 1 October 2010	1	1	72	88	**162**
Charge for the period	-	1	7	7	**15**
Disposals	-	(1)	(11)	(31)	**(43)**
Transfers	-	(1)	1	-	**-**
At 30 September 2011	**1**	**-**	**69**	**64**	**134**
Net book value					
At 30 September 2011	**33**	**4**	**69**	**45**	**151**
At 30 September 2010	35	2	69	51	157

Valuations

Cost and valuation of freehold and leasehold land and buildings comprises:

	2011 £m	2010 £m
At current year valuation	**38**	39
At cost	**138**	141
	176	180

The Bank's properties are carried at their fair value as determined by independent valuers and the Bank's own Director valuations. Fair values were determined in accordance with guidance published by the Royal Institution of Chartered Surveyors. Valuations are performed annually in July.

On the historical cost basis, freehold and leasehold land and buildings would have been included as follows:

	2011 £m	2010 £m
Cost	**225**	229
Accumulated depreciation	**(96)**	(96)
Net book value	**129**	133

Land and buildings occupied for own activities

	2011 £m	2010 £m
Net book value	**124**	126

Included are freehold and leasehold properties and fixtures and fittings.

20. Investment properties

Group	2011 £m	2010 £m
At 1 October	**77**	33
Additions	**12**	48
Disposals	**(8)**	(7)
Increment/(deficit) on revaluation	**-**	3
	81	77

Bank	2011 £m	2010 £m
At 1 October	**-**	-
Additions	**78**	-
	78	-

During the year 93% (2010: 90%) of the investment properties generated rental income of £2.61m (2010: £0.97m) and incurred operating expenses of £2.01m (2010: £0.8m). The operating expenses of the investment properties that did not generate rental income were £0.15m (2010: £0.09m).

Investment properties are stated at fair value, which has been determined based on valuations performed by independent valuers and the Bank's own Director valuations. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards.

On 29 September 2011 £78m of properties were transferred from St Vincent Investments Limited to Clydesdale Bank.

21. Property inventory

Group	2011 £m	2010 £m
Cost		
At 1 October	**31**	25
Additions	**12**	9
Disposals	**(16)**	(3)
Properties completed and under construction	**27**	31

Bank	2011 £m	2010 £m
Cost		
At 1 October	**-**	-
Additions	**11**	-
	11	-

Included within property inventory is property under construction of £16.4m (2010: £25.1m). The remaining properties are complete and available for sale.

On 29 September 2011 £11m of properties were transferred from St Vincent Investments Limited to Clydesdale Bank.

22. Investments in controlled entities, joint ventures and associates

	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
At 30 September	**3**	2	**637**	639

Principal controlled entities at 30 September 2011	**Nature of business**	**Country of incorporation and principal operations**
Clydesdale Bank Asset Finance Limited	Leasing and hire purchase	Scotland
Yorkshire Bank Home Loans Limited	Mortgage finance	England
Yorkshire Bank Investments Limited	Investment holding	England

All the principal subsidiary undertakings are wholly owned by the Bank. Details of all subsidiary undertakings will be annexed to the next Annual Return of the Bank.

The following companies are SPEs established in connection with the Bank's and Group's securitisation programme (see note 18). Although the Bank has no direct or indirect ownership interest in these companies, they are regarded as controlled entities as described in note 2.

	Nature of business	**Country of incorporation**
Lanark Trustees Limited	Mortgages trustee	Jersey
Lanark Funding Limited	Funding company	England
Lanark Master Issuer PLC	Issuer of securitised notes	England
Lannraig Trustees Limited	Mortgages trustee	Jersey
Lannraig Funding Limited	Funding company	England
Lannraig Master Issuer PLC	Issuer of securitised notes	England

All of the above controlled entities have a 30 September financial year end.

Associates are undertakings over which the Bank exerts significant influence but not control. Investments in associates are accounted for using the equity method. The attributable share of profit and reserves of the associated undertaking is based on the management accounts as at 30 September 2011. The associated undertaking is Scottish Agricultural Securities Corporation PLC, its country of registration and operations being Scotland. The associated undertaking's principal activity is in the provision of finance and the Group's interest of 33.33% in the issued equity capital of £2m is held by the Bank. The associated undertaking has a 31 March year end.

23. Deferred tax

	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Deferred tax asset				
Opening balance	**144**	147	**139**	146
Tax expense recognised in income statement	**3**	(10)	**3**	(10)
Deferred taxation recognised in equity	**(35)**	3	**(36)**	3
Transfers from deferred tax liability	**-**	4	**-**	-
Closing balance	**112**	144	**106**	139

The deferred tax asset is attributable to the following items:

Defined benefit pension liability	**48**	90	**48**	90
Impairment reserve on credit exposures	**24**	30	**24**	30
Employee share based payments	**4**	9	**4**	4
Other	**36**	15	**30**	15
	112	144	**106**	139

	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Deferred tax liability				
Opening balance	**43**	50	**32**	28
Tax credit recognised in income statement	**(3)**	(5)	**(2)**	(5)
Deferred taxation recognised in equity	**(9)**	9	**(1)**	10
Transfers to deferred tax asset	**-**	4	**-**	-
Other	**1**	(15)	**-**	(1)
Closing balance	**32**	43	**29**	32

The deferred tax liability is attributable to the following items:

Accelerated capital allowances	**(10)**	(7)	**(11)**	(8)
Net gain on revaluation of properties	**2**	2	**2**	1
Cash flow hedge reserve	**40**	48	**38**	39
	32	43	**29**	32

On 23 March 2011, the Chancellor announced a further reduction in the standard rate of corporation tax from the already announced 27% to 26% from 1 April 2011. The UK Government also confirmed its intention to reduce the rate further by 1% per annum falling to 23% with effect from 1 April 2014. The 25% rate was substantively enacted in July 2011. As such the closing deferred tax balances at 30 September 2011 have been stated at a rate of 25%.

The maximum effect on deferred tax of the reduction in the UK corporation tax rate to 23% is expected to be £6m (equivalent to 2% of the closing gross balances on which deferred tax is calculated). This adjustment will impact both the income statement and reserves.

24. Other assets

	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Prepayments and accrued income	**403**	671	**495**	446
Other	**258**	282	**151**	231
	661	953	**646**	677

25. Due to other banks

Group and Bank	**2011 £m**	2010 £m
Transaction balances with other banks	**8**	6
Securities sold under agreements to repurchase	**510**	631
Deposits from other banks	**989**	736
	1,507	1,373

26. Due to customers

	Group		**Bank**	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Non interest bearing demand deposits	**1,370**	1,205	**1,434**	1,205
Interest bearing demand deposits	**16,816**	16,667	**16,861**	16,667
Term deposits	**6,586**	7,078	**6,586**	7,078
Other wholesale deposits	**3,398**	3,484	**3,398**	3,484
	28,170	28,434	**28,279**	28,434

27. Provisions

Group and Bank	**2011 £m**	2010 £m
Payment Protection Insurance		
Opening balance	**15**	4
Charge to income statement	**116**	17
Provisions utilised	**(29)**	(6)
Closing balance	**102**	15
Other provisions		
Opening balance	**12**	10
Charge to income statement	**3**	7
Provisions utilised	**(9)**	(5)
Closing balance	**6**	12
Total provisions	**108**	27

Refund of current account fees and associated costs are now included within other provisions. Prior period amounts have also been reallocated.

27. Provisions (continued)

Payment Protection Insurance

As at 30 September 2011, Clydesdale Bank PLC (CB PLC) was carrying a provision of £102m (2010: £15m) to cover potential customer claims for refunds of premiums associated to the alleged mis-selling of Payment Protection Insurance policies. The provision is based upon known pipeline cases and expectation of future claims. It is management’s best estimate of expected costs.

The quantum of the provision required is dependent upon a number of factors. These include the nature and volume of claims and the circumstances of each complaint (note 2).

There are a number of factors which will determine the eventual level of future claims that the Bank is unable to predict with any degree of certainty. The provision reflects an assessment of future PPI claims based upon estimates, statistical analysis and assumptions in relation to a wide range of uncertain factors, including how many PPI claims will be made against Clydesdale Bank PLC, for what value, and the prospects of mis-selling being established in relation to those claims. The final amount required to settle the potential liability is therefore uncertain. The Bank continues to keep the matter under review.

Other
This category includes provisions for costs arising in respect of a number of legal actions and claims arising in the ordinary course of the Group's business.

28. Bonds, notes and subordinated debt

	Group 2011 £m	Group 2010 £m	Bank 2011 £m	Bank 2010 £m
Medium term notes	**1,898**	2,250	**1,898**	2,250
Subordinated medium term notes	**200**	450	**200**	450
Residential mortgage backed securities (note 18)	**1,439**	1,693	**-**	-
Total bonds, notes and subordinated debt	**3,537**	4,393	**2,098**	2,700
Fair value hedge adjustments	**16**	16	**10**	27
	3,553	4,409	**2,108**	2,727

£250m of externally placed subordinated debt was called on 17 February 2011. This followed the issue of £250m subordinated debt to National Australia Bank on 25 January 2011 (note 11).

	Group 2011 £m	Group 2010 £m	Bank 2011 £m	Bank 2010 £m
Total bonds and notes were recorded as:				
Amortised cost	**1,088**	1,438	**499**	850
Amortised cost adjusted for fair value hedge accounting	**2,465**	2,971	**1,609**	1,877
	3,553	4,409	**2,108**	2,727

Details of the terms and conditions of the medium term notes issued by Clydesdale Bank PLC as at 30 September 2011 were as follows:

Issue date	Issue currency	Carrying value £m	Coupon rate %	Maturity date
Medium term notes				
30 May 2007	EUR	**648**	1.61500%	30 May 2012
09 December 2008	GBP	**750**	3.37500%	9 December 2011
11 December 2008	GBP	**500**	1.44688%	11 November 2011
		1,898		
Subordinated medium term notes				
30 March 2007	GBP	**200**	5.75000%	30 March 2017

Details of the terms and conditions of the residential mortgage backed securities externally issued by Lanark Master Issuer PLC as at 30 September 2011 were as follows:

Issue date	Issue currency	Carrying value £m	Coupon rate %	Maturity date
Class A residential mortgage backed securities				
06 August 2007	GBP	**590**	1.02188%	22 May 2013
06 August 2007	USD	**413**	0.43778%	22 August 2012
06 August 2007	EUR	**436**	1.67500%	22 August 2012
		1,439		

29. Retirement benefit obligations

The Group is sponsoring employer in one funded defined benefit scheme, the Yorkshire and Clydesdale Bank Pension Scheme ('the Scheme'). This is a fully sectionalised arrangement where the discrete assets and liabilities of the two sections (Clydesdale and Yorkshire) are independently calculated in accordance with the previously existing scheme structures. The assets of the Scheme are held in trustee administered funds.

The Group closed the defined benefit scheme to new members in 2004. Since that time the principal scheme available to new members is the defined contribution scheme, 'Total Pension'. In relation to this scheme, the pension charge for the year for the Group is disclosed in note 6.

In April 2006, the Group implemented a number of reforms in relation to the Scheme. Defined benefits accruing after April 2006 are determined on a "career average revalued earnings" basis. Benefits for active members which have built up to April 2006 revalue in the future in line with price inflation. Pensions in payment which built up after April 2006 increase in line with price inflation subject to a maximum annual increase of 2.5%. In addition, in the Clydesdale Bank section, any pension entitlement built up before April 1997 is subject to a similar cap.

On 29th September 2011, the Group announced it would be entering into a 60 day consultation period with members of the defined benefit pensions scheme over a package of changes which would see the introduction of member contributions and a change to the inflation index for the revaluation of future benefit accrual. The ultimate parent company, NAB, is a participating employer in the scheme and concurrently announced the intention to commence consultation with its staff around withdrawal from future active participation in the scheme. The ceasing of active participation may trigger a payment from National Australia Bank Limited to the trustees of the defined benefits pension scheme under Section 75 of the Pensions Act. The valuation of the schemes in the Financial Statements has not incorporated any potential impact that may arise from these announcements.

The last full valuation of the Scheme was carried out at 30 September 2007 and has been updated to 30 September 2010 by qualified independent actuaries. The effective date of the last triennial valuation was 30 September 2010, with results of the actuarial review due by December 2011.

The Group also provides post-retirement health care under a defined benefit scheme for pensioners and their dependant relatives for which provision has been made. This is a closed scheme and the provision will be utilised over the life of the remaining scheme members. A one percentage point change in the assumed rate of increase in healthcare costs would change the defined benefit pension obligation by £0.35m (2010: £0.4m) and would have no material impact upon service costs and interest costs.

The principal financial assumptions used in the Schemes' valuations at 30 September 2011 were as follows:

	2011	2010
	% p.a.	% p.a.
Inflation	**3.05**	3.20
Rate of increase for pensions in payment:		
pre 5 April 1997 benefits (Clydesdale Bank Pension Scheme)	**2.25**	2.25
pre 5 April 1997 benefits (Yorkshire Bank Pension Fund)	**2.95**	3.10
post April 1997 (both Schemes)	**2.95**	3.10
post April 2006 (both Schemes)	**2.25**	2.25
Rate of increase for pensions in deferment (based upon the Consumer Price Index for 2010[1])	**2.05**	2.50
Discount rate	**5.40**	5.10
Post-retirement mortality:		
Current pensioners at 60 - male	**26.4 years**	25.5 years
Current pensioners at 60 - female	**28.2 years**	27.3 years
Future pensioners at 60 - male	**28.0 years**	26.5 years
Future pensioners at 60 - female	**29.7 years**	28.2 years

[1]The assumption for the rate of increase for pensions in deferment has been linked to the Consumer Price Index from 30 September 2010, following a government announcement on 8 July 2010 relating to increases in pensions which are not specifically linked to the Retail Prices Index.

29. Retirement benefit obligations (continued)

Total contributions made to the Scheme during the year were £107m (2010: £93m).

The fair value of the Scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the Scheme's liabilities, which are derived from cash flow projections over long periods and thus inherently uncertain, were:

Summary

	2011	2010	2009	2008	2007
	£m	£m	£m	£m	£m
Clydesdale Bank Section					
Total market value of scheme assets	**1,183**	1,144	1,037	1,036	1,123
Present value of scheme liabilities	**(1,294)**	(1,350)	(1,242)	(926)	(1,060)
Net pension (liability)/asset	**(111)**	(206)	(205)	110	63
Yorkshire Bank Section					
Total market value of scheme assets	**893**	867	791	806	885
Present value of scheme liabilities	**(962)**	(973)	(896)	(667)	(789)
Net pension (liability)/asset	**(69)**	(106)	(105)	139	96

Clydesdale Bank Section	**2011**		2010	
	£m	**% of fair value of scheme assets**	£m	% of fair value of scheme assets
Assets				
Equities	**577**	**48.82**	596	52.10
Property	**69**	**5.79**	68	5.94
Government bonds	**271**	**22.91**	204	17.83
Corporate bonds	**258**	**21.81**	248	21.68
Cash	**8**	**0.67**	28	2.45
Total market value of scheme assets	**1,183**	**100.00**	1,144	100.00
Present value of scheme liabilities	**(1,294)**		(1,350)	
Net pension liability	**(111)**		(206)	

The Clydesdale section of the Scheme includes certain property investments leased by the Group. These investments are within the 5% self-investment limit.

29. Retirement benefit obligations (continued)

Yorkshire Bank Section	**2011**		2010	
	£m	**% of fair value of scheme assets**	£m	% of fair value of scheme assets
Assets				
Equities	**446**	**49.94**	462	53.29
Property	**33**	**3.67**	32	3.69
Government bonds	**209**	**23.43**	159	18.34
Corporate bonds	**199**	**22.31**	193	22.26
Cash	**6**	**0.65**	21	2.42
Total market value of scheme assets	**893**	**100.00**	867	100.00
Present value of scheme liabilities	**(962)**		(973)	
Net pension liability	**(69)**		(106)	

The Scheme has not invested in any of the Group's own financial instruments nor in other assets used by the Group apart from the property investments leased by the Group disclosed previously.

Expected rate of return on plan assets
The expected return on assets assumption has been determined by considering the assets expected to be held over the following year and the expected returns for each asset class.

	2011	2010	2009	2008	2007
	% p.a.	% p.a.	% p.a.	% p.a.	% p.a.
Equities	**7.90**	8.00	8.15	8.70	8.35
Property	**6.85**	6.55	6.80	8.00	7.15
Government bonds	**3.55**	3.55	3.95	4.70	5.00
Corporate bonds	**4.95**	4.95	5.35	7.00	5.95
Cash	**3.55**	3.55	3.95	5.00	5.75

Reconciliation of fair value of scheme assets

	Clydesdale Bank Section		**Yorkshire Bank Section**		**Total**	
	2011	2010	**2011**	2010	**2011**	2010
	£m	£m	**£m**	£m	**£m**	£m
Fair value of scheme assets at 1 October	**1,144**	1,037	**867**	791	**2,011**	1,828
Actual return on scheme assets	**18**	97	**14**	72	**32**	169
Employer contributions	**65**	57	**42**	36	**107**	93
Benefits paid	**(44)**	(47)	**(30)**	(32)	**(74)**	(79)
Fair value of scheme assets at 30 September	**1,183**	1,144	**893**	867	**2,076**	2,011

29. Retirement benefit obligations (continued)

Reconciliation of defined benefit obligation

	Clydesdale Bank Section		Yorkshire Bank Section		Total	
	2011	2010	**2011**	2010	**2011**	2010
	£m	£m	**£m**	£m	**£m**	£m
Defined benefit obligation at 1 October	**1,350**	1,242	**973**	896	**2,323**	2,138
Interest cost	**68**	67	**49**	48	**117**	115
Current service cost	**22**	20	**14**	13	**36**	33
Benefits paid	**(45)**	(47)	**(30)**	(32)	**(75)**	(79)
Actuarial (Loss)/gain	**(102)**	67	**(44)**	46	**(146)**	113
Past service cost	**1**	1	**-**	2	**1**	3
Defined benefit obligation at 30 September	**1,294**	1,350	**962**	973	**2,256**	2,323

Reconciliation of balance sheet liability

	Clydesdale Bank Section		Yorkshire Bank Section		Total	
	2011	2010	**2011**	2010	**2011**	2010
	£m	£m	**£m**	£m	**£m**	£m
Balance sheet liability at 1 October	**(206)**	(205)	**(106)**	(105)	**(312)**	(310)
Employer contributions	**65**	57	**42**	36	**107**	93
Total pension expense	**(16)**	(18)	**(8)**	(10)	**(24)**	(28)
Actuarial gain/(loss) per statement of comprehensive income	**46**	(40)	**3**	(27)	**49**	(67)
Balance sheet liability at 30 September	**(111)**	(206)	**(69)**	(106)	**(180)**	(312)

	2011	2010
Post Retirement Medical Benefits Scheme		
Balance sheet liability at 1 October	**(5)**	(10)
Benefits paid	-	2
Settlement gain	-	1
Statement of comprehensive income	-	2
Balance sheet liability at 30 September	**(5)**	(5)
Balance sheet liability at 30 September	**(185)**	(317)

29. Retirement benefit obligations (continued)

Pension expense for the year

	Clydesdale Bank Section		Yorkshire Bank Section		Total	
	2011	2010	**2011**	2010	**2011**	2010
	£m	£m	**£m**	£m	**£m**	£m
Current service cost	**22**	20	**14**	13	**36**	33
Past service costs	**1**	1	**-**	2	**1**	3
Interest cost	**68**	67	**49**	48	**117**	115
Expected return on assets	**(74)**	(70)	**(56)**	(53)	**(130)**	(123)
Total pension expense/(credit)	**17**	18	**7**	10	**24**	28

Statement of comprehensive income (SOCI)

	Clydesdale Bank Section		Yorkshire Bank Section		Medical Benefits		Total	
	2011	2010	**2011**	2010	**2011**	2010	**2011**	2010
	£m	£m	**£m**	£m	**£m**	£m	**£m**	£m
(Loss)/gain on scheme asset	**(56)**	27	**(41)**	19	-	-	**(97)**	46
Experience gains/(losses) on scheme liabilities	**9**	27	**(25)**	18	-	-	**(16)**	45
Gain/(loss) from change in actuarial assumptions								
- Defined benefit plans	**93**	(94)	**69**	(64)	-	-	**162**	(158)
- Post Retirement Medical Benefits	**-**	-	**-**	-	**-**	2	**-**	2
Total amount recognised in SOCI	**46**	(40)	**3**	(27)	**-**	2	**49**	(65)
Cumulative amount recognised in SOCI	**(236)**	(282)	**(117)**	(120)	**2**	2	**(351)**	(400)

History of experience gains and losses
Clydesdale Bank Section

	2011	2010	2009	2008	2007
Difference between the expected and actual return on scheme assets					
Amount (£m)	**(56)**	27	(63)	(178)	27
Percentage of scheme assets	**-4.70%**	2.36%	-6.08%	-17.18%	2.40%
Experience gains and (losses) on scheme liabilities					
Amount (£m)	**9**	27	(4)	(16)	1
Percentage of the present value of the scheme liabilities	**0.70%**	2.00%	-0.32%	-1.73%	0.10%
Total amount recognised in SOCI					
Amount (£m)	**46**	(40)	(344)	(6)	119
Percentage of the present value of the scheme liabilities	**3.58%**	-2.96%	-27.68%	-0.65%	11.23%

29. Retirement benefit obligations (continued)

History of experience gains and losses
Yorkshire Bank Section

	2011	2010	2009	2008	2007
Difference between the expected and actual return on scheme assets					
Amount (£m)	**(41)**	19	(49)	(141)	22
Percentage of scheme assets	**-4.62%**	2.19%	-6.19%	-17.49%	2.49%
Experience gains on scheme liabilities					
Amount (£m)	**(25)**	18	2	20	-
Percentage of the present value of the scheme liabilities	**-2.64%**	1.85%	0.22%	3.00%	0.00%
Total amount recognised in SOCI					
Amount (£m)	**3**	(27)	(247)	11	103
Percentage of the present value of the scheme liabilities	**0.30%**	-2.77%	-27.57%	1.65%	13.05%

30. Other liabilities

	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Accruals and deferred income	**40**	28	**39**	26
Notes in circulation	**1,335**	1,269	**1,335**	1,269
Accrued interest payable	**450**	702	**538**	476
Other liabilities	**142**	104	**126**	137
	1,967	2,103	**2,038**	1,908

31. Called up share capital

Group and Bank

	2011	2010
Allotted, called up and fully paid	**£m**	£m
Ordinary shares of £1 each - equity		
At 1 October	**842**	532
Issued during the period	**100**	310
At 30 September	**942**	842
Preference Shares		
Preference shares of £1 each - equity		
At 1 October	**100**	100
Issued during the period	**200**	-
At 30 September	**300**	100
Share capital	**1,242**	942

On 15 December 2010, 200,000,000 preference shares of £1 each were issued at par, resulting in an increase of £200m in the preference share capital.

On 19 July 2011, 100,000,000 ordinary shares of £1 each were issued at par, resulting in an increase of £100m in the allotted, called up and fully paid share capital.

The preference shares issued on 17 December 2008 entitle the holder to a discretionary fixed non-cumulative dividend of 12% per annum on the capital paid up thereon, and in the case of any other preference shares at such rate as the Directors may determine annually in arrears commencing on 17 June 2009, until the first redemption date. The dividends payable on the preference shares are at the Bank's discretion based on a number of factors. The preference shares are redeemable, in whole only, at the option of Clydesdale Bank PLC on the first business day following the 5th anniversary of the date of issue. No such redemption may be made without the consent of the FSA.

The preference shares issued on 15 December 2010 entitle the holder to a discretionary non-cumulative dividend of LIBOR plus 779bps every six months on the capital paid up thereon. The preference shares are redeemable, in whole only, at the option of Clydesdale Bank PLC on the first business day following the fifth anniversary of the date of issue. No such redemption may be made without the consent of the FSA.

32. Reserves

	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Share premium account	**243**	243	**243**	243
Merger reserve	**338**	338	**338**	338
Share option reserve	**14**	1	**14**	1
Asset revaluation reserve	**2**	2	**2**	2
Available for sale investments reserve	**16**	6	**15**	6
Cash flow hedge reserve	**120**	130	**114**	106
Retained earnings	**904**	885	**725**	686
	1,637	1,605	**1,451**	1,382

Merger reserve

The merger reserve arose as a result of the transfer of the entire business and undertakings of Yorkshire Bank PLC to Clydesdale Bank PLC on 1 December 2004. As no consideration was paid in relation to the transfer the only impact arising was the crystallisation of the Yorkshire Bank PLC Share Capital and Share Premium into a Merger Reserve in the combined entity.

Share option reserve

The Bank's share option reserve represents the outstanding fair value amount in respect of share based payment expense recharged by its ultimate parent that has been charged through the income statement and adjusted for deferred tax.

Asset revaluation reserve

The asset revaluation reserve includes the gross revaluation increments and decrements arising from the revaluation of land and buildings.

Available for sale investments reserve

The available for sale investments reserve records the gains and losses arising from changes in the fair value of available for sale investments.

Cash flow hedge reserve

The cash flow hedge reserve records fair value revaluations of derivatives designated as cash flow hedging instruments to the extent that they are effective.

33. Memorandum items

	Contract amount 2011 £m	Contract amount 2010 £m
Contingent liabilities		
Group and Bank		
Guarantees and assets pledged as collateral security		
- Guarantees and irrevocable letters of credit	**285**	258
- At call	**-**	2
- Due in less than three months	**40**	43
- Due 3 months through to 1 year	**46**	41
- Due 1 year through to 3 years	**65**	29
- Due 3 years through to 5 years	**10**	6
- Due after 5 years	**109**	125
- No specified maturity	**15**	12
	285	258
Commitments		
Group		
Sale and option to repurchase transactions	**812**	812
- Due 3 months through to 1 year	**500**	-
- Due 1 year through to 3 years	**-**	500
- Due 3 years through to 5 years	**312**	312
	812	812
Group and Bank		
Other commitments		
- Undrawn formal standby facilities, credit lines and other commitments to lend at call	**10,568**	10,788

The tables above give the contract amounts of off balance sheet transactions for the Group. The contract amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk.

Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

34. Capital commitments

The Group and Bank had future capital expenditure which had been contracted for but not provided for in the Financial Statements of £0.2m (2010: £3m) at 30 September 2011.

35. Lease commitments

Group and Bank **Operating lease commitments**	**Land and buildings 2011 £m**	Land and buildings 2010 £m
Payments committed to be made during the next year under non-cancellable operating leases which expire:		
- within 1 year	**3**	2
- between 1 and 5 years	**9**	6
- over 5 years	**8**	9
	20	17
Where the Group is the lessee the future minimum lease payments under non-cancellable operating leases are:		
- within 1 year	**1**	1
- within 1 and 5 years	**34**	37
- over 5 years	**436**	373
	471	411

36. Other contingent liabilities

The Bank is named in and is defending a number of legal actions arising in the ordinary course of business. No material adverse impact on the financial position of the Group or the Bank is expected to arise from the ultimate resolution of these legal actions.

Financial Services Compensation Scheme

The UK Financial Services Compensation Scheme (FSCS) provides compensation to depositors in the event that a financial institution is unable to repay amounts due. Following the failure of a number of financial institutions, the FSCS has raised borrowings from the UK Government to cover compensation in relation to protected deposits. These borrowings are anticipated to be repaid from the realisation of the assets of the institutions. In the interim the FSCS has estimated levies due to 31 March 2012 from the banking industry to support interest payments on the borrowings, and an accrued expense of £4.5 million is presently held for the Group's calculated liability for this period. If the assets of the failed institutions are insufficient to repay the Government loan additional levies will become payable in future periods.

37. Employees

The average number of full time equivalent employees of the Group during the year was made up as follows:

	2011 Number	2010 Number
Managers	**1,714**	1,529
Clerical staff	**3,875**	4,008
	5,589	5,537

All staff are contracted employees of National Australia Group Europe Limited ("NAGE") (the immediate parent company of the Bank). The numbers above disclose the staff remunerated directly by the Group but exclude employees working within other NAGE subsidiaries who provide support services to the Group. The average number of staff employed in the UK Banking operating division of National Australia Bank Limited (the ultimate parent) in the year to 30 September was 8,587 (2010: 8,608). The comparative employee numbers at 30 September 2010 have been restated to include supply staff and technology contractors.

38. Notes to the statements of cash flows

	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Non cash items included in profit before tax				
Interest receivable	**(1,425)**	(1,392)	**(1,290)**	(1,255)
Interest payable	**442**	432	**479**	462
Depreciation (note 6)	**15**	21	**15**	21
Profit on sale of land & buildings	**(2)**	(2)	**(2)**	(3)
Profit on investments classified as held to maturity	**-**	-	**-**	12
Gain on revaluation of investment properties	**-**	(3)	**-**	-
Transfer from available for sale reserve	**(5)**	(1)	**(6)**	(1)
Transfer from cash flow hedge reserve	**4**	(3)	**48**	(20)
Derivative financial instruments fair value movements	**30**	(121)	**30**	(101)
Impairment losses on credit exposures (note 17)	**297**	362	**286**	355
Dividends received from subsidiaries	**-**	-	**(137)**	(86)
Adjustment to carrying value of investments	**(1)**	-	**2**	-
Share options granted	**15**	17	**15**	17
	(630)	(690)	**(560)**	(599)
Changes in operating assets				
Net (increase)/decrease in:				
Balances with supervisory central banks	**1**	(3)	**1**	(3)
Due from other banks	**(1)**	329	**(2)**	329
Derivative financial assets	**153**	344	**31**	140
Financial assets at fair value through profit or loss	**46**	626	**(176)**	654
Held to maturity investments	**-**	-	**(130)**	41
Loans and advances to customers	**(1,554)**	(196)	**(1,695)**	(137)
Due from customers on acceptances	**1**	(6)	**1**	(6)
Other assets	**50**	25	**(364)**	(67)
	(1,304)	1,119	**(2,334)**	951
Changes in operating liabilities				
Net increase/(decrease) in:				
Due to other banks	**148**	(731)	**148**	(731)
Derivative financial liabilities	**(36)**	4	**(36)**	4
Financial liabilities at fair value through profit or loss	**109**	299	**352**	299
Due to customers	**(264)**	1,778	**(155)**	1,778
Liabilities on acceptances	**(1)**	6	**(1)**	6
Provisions	**81**	13	**81**	13
Defined benefit pension obligations	**(83)**	(68)	**(83)**	(68)
Other liabilities	**78**	79	**569**	112
	32	1,380	**875**	1,413

For the purposes of the statement of cash flows, cash and cash equivalents comprises the following balances with less than three months maturity from the date of acquisition.

	Group		Bank	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Cash assets (excluding mandatory balances with central banks - note 10)	**5,993**	4,040	**5,993**	4,040
Other assets	**152**	125	**142**	116
Due to other banks	**(174)**	(189)	**(174)**	(189)
Due to related entities	**(12)**	(8)	**(12)**	(8)
Other liabilities	**(115)**	(77)	**(115)**	(77)
	5,844	3,891	**5,834**	3,882

39. Share based payments

Share incentive plans, share offers, performance options and performance rights in NAB, the Group's ultimate parent company, are used to provide short-term and long-term incentives to employees. These incentives are an integral part of the Group's remuneration strategy in rewarding employees' current and future contribution to the Group's performance.

The plans described below involve the provision of shares in NAB to employees of the Group and to directors of the Company, and performance options and performance rights to senior employees of the Group. The Group reimburses NAB for the cost of these shares and the value of the performance options and performance rights.

Short Term Incentive (STI)
Employees are required to take any awards in excess of A$500 above their STI target in the form of NAB shares (with a minimum one year restriction period). During the first year after allocation the shares are forfeited if the employee resigns (or upon termination for serious misconduct), or if the employee fails to pass both quality gates (behaviour and compliance) in respect of their performance review at the end of the following financial year.

Recognition Shares
These shares enable retention and recognition awards to be provided in the form of shares, rather than in cash. Such awards are made on a very limited basis with NAB Group executive general manager approval, to individuals in significant key roles where retention is critical over a medium-term timeframe (two to three years). Awards under the program may also be provided to individuals accepting significant project leadership or additional responsibilities for a limited period of time with no related increase in their fixed remuneration. The provision of shares under this plan is desired over the use of cash payments as it provides a stronger retention and shareholder value link to the reward. The shares are subject to forfeiture if the participant resigns or retires before specified key dates and/or milestones are not met, if the participant’s performance falls below specified levels, for conduct in breach of the Company’s Code of Conduct or other applicable standards set from time to time, and on termination for serious misconduct. The minimum restriction period is until the final key date or milestone has been achieved.

Commencement Shares
These shares enable 'buy-out' of evidenced equity from previous employment for significant new hires. Shares are provided under this program or Commencement performance options and performance rights if more appropriate. The shares are subject to forfeiture if the participant resigns before specified key dates, for conduct in breach of the Company's Code of Conduct or other applicable standards set from time to time, or in the event of termination for serious misconduct.

UK National Share Incentive Plan
Under the UK National Share Incentive Plan, employees are entitled to purchase up to £1,500 worth of NAB shares each year through the National Partnership Share Plan. Participants contribute each month and the trustee uses the contributions to purchase shares on market which are then held in trust for the participants. Participants are entitled to receive dividends and exercise voting rights in respect of these shares and there is no risk of forfeiture. In addition, up to £3,000 of free shares per employee may be gifted per annum through the plan.

General employee shares
Up to a target value of $1,000 of NAB shares are offered to each eligible employee when the Group's performance is on target, measured against a scorecard of objectives for the financial year. These shares are held in trust restricted from dealing for three years and in the UK these shares are forfeited if an employee is summarily dismissed prior to the end of three years.

Long term incentives (LTI)
LTI's help to drive management decisions focussed on the long term prosperity of NAB Group through the use of challenging performance hurdles. The Executive LTI program is awarded to senior executives across the NAB Group. A LTI target is set with reference to external and internal relativities for each executive who must also meet minimum performance and compliance thresholds. Performance hurdles (both internal and external) are measured at the end of a three year restriction period and during the restriction period an executive will forfeit their shares (or their performance rights will lapse) for voluntary cessation of employment, if compliance requirements are not met or if performance hurdles are not met.

39. Share based payments (continued)

Performance options and performance rights
These are used to provide long-term incentives in recognition of executive potential and talent in the Group.

A variety of performance measures are used for different grants of long-term incentives (taking the form of shares, performance options, or performance rights) including Total Shareholder Return (TSR) compared against peer companies, and regional or NAB Group ROE and cash earnings. The measures used depend on the level and impact of the participant's role, the business or region in which they work, and the relevant program. Vesting generally occurs to the extent that the relevant performance hurdle is satisfied (as determined by the NAB Board Remuneration Committee). The performance options and performance rights generally have an expiry date between three and eight years from the effective date if unexercised.

Each performance option or performance right is exchanged for one fully paid ordinary share in NAB upon exercise, subject to standard adjustments for capital actions. The exercise price for performance options is generally the market price for the NAB's fully paid ordinary shares as at the date the performance option was granted or such other relevant date determined by the NAB Board Remuneration Committee. No exercise price is payable by the holder on exercise of performance rights.

Performance options are predominantly offered only to key senior executives of the Group and generally lapse after a specified number of days after cessation of employment as determined by the NAB Board.

The following significant assumptions were adopted to determine the fair value of options and performance rights at each issue date:

Grant date	16-Jan-09	28-Feb-08	14-Feb-08	28-Aug-07
Risk-free interest rate (per annum)	3.47%	6.54%	6.54%	6.10%
Life of options	4 years	3.5 years	4 years	5 years
Volatility of share price	36.00%	19.00%	19.00%	15.00%
Dividend rate (per annum)	5.30%	4.50%	4.50%	4.40%
Exercise price of options	A$19.89	N/A	A$31.7	A$43.43
Fair value of performance options	A$3.54	N/A	A$3.73	A$2.69
Fair value of performance rights	N/A	A$26.18	N/A	N/A

Grant date	03-Aug-07	07-Feb-07	31-Oct-06	31-Jul-06
Risk-free interest rate (per annum)	6.19%	5.90%	5.80%	5.90%
Life of options	5 years	5.5 years	4.75 years	5.5 years
Volatility of share price	15.00%	15.00%	15.00%	15.50%
Dividend rate (per annum)	4.40%	4.70%	4.90%	5.00%
Exercise price of options	A$40.91	A$40.91	A$38.29	A$35.50
Fair value of performance options	A$2.68	A$4.20	A$3.73	A$3.98
Fair value of performance rights	A$13.57	A$18.67	A$19.59	A$20.11

Grant date	03-May-06	03-May-06	06-Feb-06	06-Feb-06
Risk-free interest rate (per annum)	5.70%	5.70%	5.20%	5.20%
Life of options	5.5 years	5.5 years	5.5 years	5 years
Volatility of share price	15.00%	15.00%	15.00%	15.00%
Dividend rate (per annum)	5.00%	5.00%	5.30%	5.30%
Exercise price of options	A$37.55	A$34.53	A$34.53	A$34.53
Fair value of performance options	A$3.75	A$4.65	A$3.39	A$3.23
Fair value of performance rights	A$19.51	A$19.51	A$18.23	N/A

Grant date	19-Dec-05	08-Jul-05	22-Feb-05	07-Feb-05
Risk-free interest rate (per annum)	5.20%	5.10%	5.40%	5.30%
Life of options	5 years	5 years	5 years	5 years
Volatility of share price	15.00%	16.00%	16.00%	16.00%
Dividend rate (per annum)	5.30%	5.80%	5.80%	5.80%
Exercise price of options	A$31.78	A$29.93	A$30.41	A$29.93
Fair value of performance options	A$2.74	A$2.80	A$1.54	A$2.80
Fair value of performance rights	A$17.11	A$18.31	A$7.37	A$17.15

39. Share based payments (continued)

The movement in share options and performance rights granted and exercised during the year was as follows:

Share options	**2011** **Number**	**2011** **Weighted Average Exercise Price A$**	2010 Number	2010 Weighted Average Exercise Price A$
Outstanding at 1 October	**5,135,858**	**35.41**	6,448,003	34.52
Forfeited during the year	**(1,703,060)**	**32.89**	(1,312,145)	31.04
Outstanding at 30 September	**3,432,798**	**36.65**	5,135,858	35.41
Exercisable at 30 September	**2,388,925**		2,611,492	

No share options were exercised during the year (2010: Nil). For share options outstanding at 30 September 2011, the weighted average remaining contractual life is 0.87 years (2010: 1.32 years*). The range of exercise prices for options outstanding at the end of the year was A$19.89 - A$43.43 (2010: A$19.89 - A$43.43).

Performance rights	**2011** **Number**	**2011** **Weighted Average Exercise Price A$**	2010 Number	2010 Weighted Average Exercise Price A$ As restated
Outstanding at 1 October	**1,271,959**	**-**	1,520,885	-
Forfeited during the year	**(508,629)**	**-**	(248,926)	-
Exercised	**(17,346)**		-	
Outstanding at 30 September	**745,984**	**-**	1,271,959	-
Exercisable at 30 September	**561,257**		721,608	

17,346 performance rights were exercised during the year (2010: Nil). For share rights outstanding at 30 September 2011, the weighted average remaining contractual life is 0.70 years (2010: 1.31 years*). No exercise price is payable by the holder on exercise of performance rights.

** The weighted average remaining contractual life has been restated due to a calculation amendment.*

40. Directors' emoluments

2011

	Salary and fees (1) £'000	Benefits and allowances (2) £'000	Performance Related Pay – Short Term Incentive Schemes (3) – Annual (cash) £'000	Deferred (shares) £'000	Total short term (PRP) £'000	Long Term Incentive Schemes – Shares £'000	Total emoluments £'000
Executive Directors							
Cameron Clyne	-	-	-	-	-	-	-
John Hooper	627	144	103	412	515	194	1,480
Lynne Peacock (4)	854	197	459	-	459	-	1,510
David Thorburn	389	113	64	256	320	341	1,163
Total Executive	1,870	454	626	668	1,294	535	4,153
Non-executive Directors							
Jonathan Dawson	75	-	-	-	-	-	75
Sir David Fell	78	-	-	-	-	-	78
Richard Gregory OBE	93	-	-	-	-	-	93
Roy Nicolson	75	-	-	-	-	-	75
Elizabeth Padmore	60	-	-	-	-	-	60
Sir Malcolm Williamson	140	-	-	-	-	-	140
Peter Wood	68	-	-	-	-	-	68
Total Non-executive	589	-	-	-	-	-	589
Total Directors	2,459	454	626	668	1,294	535	4,742

2010

	Salary and fees (1) £'000	Benefits and allowances (2) £'000	Performance Related Pay – Short Term Incentive Schemes (3) – Annual (cash) £'000	Deferred (shares) £'000	Total short term (PRP) £'000	Long Term Incentive Schemes – Shares £'000	Total emoluments £'000
Executive Directors							
Cameron Clyne	-	-	-	-	-	-	-
John Hooper	534	185	326	326	652	177	1,548
Lynne Peacock	440	188	200	200	400	484	1,512
David Thorburn	352	89	236	249	485	106	1,032
Total Executive	1,326	462	762	775	1,537	767	4,092
Non-executive Directors							
Jonathan Dawson	75	-	-	-	-	-	75
Sir David Fell	78	-	-	-	-	-	78
Richard Gregory OBE	93	-	-	-	-	-	93
Roy Nicolson	75	-	-	-	-	-	75
Elizabeth Padmore	60	-	-	-	-	-	60
Sir Malcolm Williamson	161	-	-	-	-	-	161
Peter Wood	68	-	-	-	-	-	68
Total Non-executive	610	-	-	-	-	-	610
Total Directors	1,936	462	762	775	1,537	767	4,702

40. Directors' emoluments (continued)

In addition to amounts shown in the above table, social security costs were payable in respect of emoluments for directors amounting to £777,000 (2010: £522,000) and in respect of emoluments for the Highest Paid Director of £383,000 (2010: £120,000).

Notes

(1) Salary costs include salaries paid to Executive Directors and fees paid to Non-executive Directors. Cameron Clyne did not receive any remuneration in respect of services to the Group. He is remunerated by the Group's ultimate parent, NAB. Details can be found in the Remuneration Report disclosed in the NAB Annual Financial Report. Sir Malcolm Williamson's directorship fees exclude NAB Board and Risk Committee fees of AUD $250,000 (2010: AUD $250,000).

(2) Benefits and allowances include cash payments in lieu of pension contributions and other taxable allowances and benefits. Retirement benefits accrued to one director (2010: One) under a defined benefit pension plan. Pension contributions amounting to £38,000 (2010: £34,000) were paid during the year of which contributions for the highest paid Director amounts to £Nil (2010: £Nil).

(3) Performance related pay relates to the respective financial year. The cash element will be paid in the forthcoming year and the deferred amount represents shares deferred for one and two years. The Remuneration Report disclosed in the NAB Annual Financial Report details the actual remuneration received in the year, for certain of the Directors, including cash paid and the value of equity that vested and lapsed without providing any value. The highest paid Director received 127,394 shares (2010: 18,040) that vested during the period, with a fair value of £1,408,870 (2010: £303,115).

(4) Lynne Peacock resigned as a Director of the Company on 30 June 2011. On cessation of employment, she received a termination benefit of £475,000 (included within salary and fees in the Directors' emoluments table) under her contract entered into in May 2003, as varied in August 2004 and January 2005. Payment of a pro-rated STI award based on her performance and Group results for 2011 will be paid in December 2011 in the usual course. Shares, performance options and performance rights were retained in accordance with the relevant terms and conditions of each grant and remain subject to the relevant performance hurdles and restriction periods. Further, the NAB Board allowed the release and retention of some shares. These arrangements are in line with the Group's policy and practice in such circumstances.

(5) The long term incentive scheme amounts represents share options, share rights and deferred shares for services rendered during the year which require the achievement of performance hurdles and/or milestones before they vest. Typically, the performance period is three years. The value attributed is the fair value of the shares at the date of granting. Two Directors (2010: Three) were entitled to receive benefits under a long term incentive scheme. No Director exercised share options during the year (2010: Nil).

(6) The table below shows, for the highest paid Director in the given year, the number of shares in respect of share options, share rights, short term incentive, long term incentive and other employee share plans (including free shares, commencement shares, recognition shares).

2011	**Share Options**	**Share Rights**	**Short Term Incentive Shares**	**Long Term Incentive Shares**	**Other Employee Share Plans**
Outstanding at 1 October 2010	**838,209**	**119,055**	**57,451**	**101,773**	**125,377**
Granted during the year	**-**	**-**	**12,322**	**42,177**	**46**
Forfeited during the year	**(181,769)**	**(45,442)**	**-**	**(28,705)**	**-**
Exercised	**-**	**(6,982)**	**(25,000)**	**-**	**(25,000)**
Expired during the year	**(50,000)**	**(12,500)**	**-**	**-**	**-**
Restrictions ceased	**-**	**-**	**(32,451)**	**(27,298)**	**(100,377)**
Outstanding at 30 September 2011	**606,440**	**54,131**	**12,322**	**87,947**	**46**

2010	Share Options	Share Rights	Short Term Incentive Shares	Long Term Incentive Shares	Other Employee Share Plans
Outstanding at 1 October 2009	669,022	80,586	26,330	49,293	26,352
Granted during the year	-	-	-	13,088	52
Forfeited during the year	(127,448)	(24,362)	-	-	-
Outstanding at 30 September 2010	541,574	56,224	26,330	62,381	26,404

The 2010 short term incentive shares granted during the year have been reclassified to long term incentive shares.

41. Fair values of financial instruments

Financial instruments include both financial assets and financial liabilities and also derivatives. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. For the purposes of this note, carrying value refers to amounts reflected in the Consolidated Balance Sheet.

		2011		2010	
Group		**Carrying Value**	**Fair value**	Carrying Value	Fair value
	Footnote	**£m**	**£m**	£m	£m
Financial assets					
Cash and balances with central banks	(a)	**6,022**	**6,022**	4,070	4,070
Due from related entities	(f)	**4,950**	**4,951**	2,839	2,839
Loans and advances to other banks	(b)	**12**	**12**	11	11
Investments - available for sale	(i)	**1,110**	**1,110**	2,262	2,323
Other financial assets at fair value	(d)	**5,327**	**5,327**	5,396	5,396
Derivative financial assets	(c)	**537**	**537**	719	719
Loans and advances to customers	(e)	**28,238**	**28,343**	26,981	27,140
Due from customers on acceptances	(a)	**7**	**7**	8	8
Other assets	(g)	**380**	**380**	650	650
Financial liabilities					
Due to other banks	(e)	**1,507**	**1,500**	1,373	1,402
Other financial liabilities at fair value	(d)	**1,005**	**1,005**	896	896
Derivative financial liabilities	(c)	**81**	**81**	117	117
Due to customers	(e)	**28,170**	**28,140**	28,434	28,496
Liabilities on acceptances	(a)	**7**	**7**	8	8
Due to related entities	(f)	**7,758**	**7,758**	3,386	3,386
Bonds, notes and subordinated debt	(e)	**3,553**	**3,544**	4,409	4,449
Other liabilities	(h)	**1,785**	**1,785**	1,971	1,971

The fair value estimates are based on the following methodologies and assumptions:

(a) The carrying amounts of these financial assets and financial liabilities approximate fair value.

(b) The carrying value of loans and advances to other Banks is net of allowance for impairment losses and unearned income. The fair value of loans and advances equate to the carrying value at 30 September.

(c) The fair value of derivatives, including foreign exchange contracts, interest rate swaps, interest rate and currency option contracts, and currency swaps, are obtained from quoted closing market prices as at the balance sheet date, discounted cash flow models or option pricing models as appropriate.

(d) The fair value of assets and liabilities designated as being carried at fair value through profit or loss are based on quoted market prices and data or valuation techniques based upon observable market data as appropriate to the nature and type of the underlying instrument.

(e) The fair value of these financial assets and financial liabilities are obtained from discounted cash flow models.

(f) The carrying value of amounts due from and due to related entities is considered to approximate fair value. Amounts due from are repayable on demand or within twelve months. Amounts due to are repayable up to five years and over but are materially repriced every 3-6 months relative to market rates. As a result, the carry value approximates the fair value.

(g) Other financial assets include accrued interest receivable and other short term receivables whose carrying values approximate fair value.

(h) Other financial liabilities include accrued interest payable and notes in circulation.

(i) The fair value of investments are based on quoted closing market prices. Where investments are unlisted and quoted market prices are not available, the Group obtains fair value by means of other valuation techniques that are commonly used by market participants.

41. Fair values of financial instruments (continued)

Group 2011	Note	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total Fair Value £m**
Financial assets at fair value through profit or loss					
Loans and advances	14	-	4,846	-	**4,846**
Financial assets at fair value through equity					
Investments - Available for sale	13	1,103	-	7	**1,110**
Hedging derivatives					
Derivative financial assets	15	-	537	-	**537**
Other derivatives financial assets	15	-	324	-	**324**
Derivative financial assets - related entities	15	-	157	-	**157**
		-	1,018	-	**1,018**
		1,103	**5,864**	**7**	**6,974**
Financial liabilities at fair value through profit or loss					
Due to customers - term deposits	14	-	155	-	**155**
Hedging derivatives					
Derivative financial liabilities	15	-	81	-	**81**
Other derivative financial liabilities	15	-	44	-	**44**
Derivative financial liabilities - related entities	15	-	806	-	**806**
		-	931	-	**931**
		-	**1,086**	**-**	**1,086**

Group 2010	Note	Level 1 £m	Level 2 £m	Level 3 £m	Total Fair Value £m
Financial assets at fair value through profit or loss					
Loans and advances	14	-	5,027	-	5,027
Financial assets at fair value through equity					
Investments - Available for sale	13	853	1,403	6	2,262
Hedging derivatives					
Derivative financial assets	15	-	719	-	719
Other derivatives financial assets	15	-	297	-	297
Derivative financial assets - related entities	15	-	72	-	72
		-	1,088	-	1,088
		853	7,518	6	8,377
Financial liabilities at fair value through profit or loss					
Due to customers - term deposits	14	-	66	-	66
Hedging derivatives					
Derivative financial liabilities	15	-	117	-	117
Other derivative financial liabilities	15	-	58	-	58
Derivative financial liabilities - related entities	15	-	772	-	772
		-	947	-	947
		-	1,013	-	1,013

41. Fair values of financial instruments (continued)

Bank 2011	Note	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total Fair Value £m**
Financial assets at fair value through profit or loss					
Loans and advances	14	-	4,846	-	**4,846**
Financial assets at fair value through equity					
Investments - Available for sale	13	1,103	-	6	**1,109**
Hedging derivatives					
Derivative financial assets	15	-	324	-	**324**
Other derivatives financial assets	15	-	528	-	**528**
Derivative financial assets - related entities	15	-	157	-	**157**
		-	1,009	-	**1,009**
		1,103	**5,855**	**6**	**6,964**
Financial liabilities at fair value through profit or loss					
Due to customers - term deposits	14	-	155	-	**155**
Hedging derivatives					
Derivative financial liabilities	15	-	81	-	**81**
Other derivative financial liabilities	15	-	287	-	**287**
Derivative financial liabilities - related entities	15	-	806	-	**806**
		-	1,174	-	**1,174**
		-	**1,329**	**-**	**1,329**

Bank 2010 As restated	Note	Level 1 £m	Level 2 £m	Level 3 £m	Total Fair Value £m
Financial assets at fair value through profit or loss					
Loans and advances	14	-	5,027	-	5,027
Financial assets at fair value through equity					
Investments - Available for sale	13	853	1,403	6	2,262
Hedging derivatives					
Derivative financial assets	15	-	385	-	385
Other derivatives financial assets	15	-	297	-	297
Derivative financial assets - related entities	15	-	72	-	72
		-	754	-	754
		853	7,184	6	8,043
Financial liabilities at fair value through profit or loss					
Due to customers - term deposits	14	-	66	-	66
Hedging derivatives					
Derivative financial liabilities	15	-	117	-	117
Other derivative financial liabilities	15	-	58	-	58
Derivative financial liabilities - related entities	15	-	772	-	772
		-	947	-	947
		-	1,013	-	1,013

41. Fair values of financial instruments (continued)

Level 1 inputs are those with quoted prices for similar instruments, level 2 inputs have directly observable market inputs other than level 1 inputs and level 3 inputs are not based on observable market data.

Transfers between level 1 and level 2

There have been no transfers between level 1 and level 2 of the fair value hierarchy for financial assets and liabilities which are recorded at fair value.

Movement in level 3 financial instruments measured at fair value

Group	**At 1 October 2010**	**Fair value gain/(loss) recorded in the income statement**	**Gains/ (losses) recorded in equity**	**Net purchases, sales and settlements**	**Reclassified to loans and receivables**	**Transfers from level 1 and level 2**	**At 30 September 2011**
Financial assets at fair value through profit and loss							
Investments	**6**	**-**	**1**	**-**	**-**	**-**	**7**

Bank	**At 1 October 2010**	**Fair value gain/(loss) recorded in the income statement**	**Gains/ (losses) recorded in equity**	**Net purchases, sales and settlements**	**Reclassified to loans and receivables**	**Transfers from level 1 and level 2**	**At 30 September 2011**
Financial assets at fair value through profit and loss							
Investments	**6**	**-**	**-**	**-**	**-**	**-**	**6**

Group	At 1 October 2009	Fair value gain/(loss) recorded in the income statement	Gains/ (losses) recorded in equity	Net purchases, sales and settlements	Reclassified to loans and receivables	Transfers from level 1 and level 2	At 30 September 2010
Financial assets at fair value through profit and loss							
Investments	10	-	(3)	(1)	-	-	6

Bank	At 1 October 2009	Fair value gain/(loss) recorded in the income statement	Gains/ (losses) recorded in equity	Net purchases, sales and settlements	Reclassified to loans and receivables	Transfers from level 1 and level 2	At 30 September 2010
Financial assets at fair value through profit and loss							
Investments	10	-	(3)	(1)	-	-	6

Comparative disclosures have been restated to show Group and Bank separately in line with current year presentation.

42. Financial risk management

Strategy in using financial instruments

By their nature, the Group's activities are principally related to the use of financial instruments including derivatives. The Group accepts deposits from customers at both fixed and floating rates for various periods, and seeks to earn above-average interest margins by investing these funds in high-quality assets. The Group seeks to increase these margins by consolidating short-term funds and lending for longer periods at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

The Group also seeks to raise its interest margins by obtaining above-average margins, net of allowances, through lending to commercial and retail borrowers with a range of credit standing. Such exposures involve not just on-balance sheet loans and advances, but the Group also enters into guarantees and other commitments such as letters of credit and performance, and other bonds.

Fair value hedges
The Group hedges part of its existing interest rate and foreign currency risk resulting from any potential decrease in the fair value of fixed rate assets or increase in fair value of fixed rate liabilities attributable to both interest rate and foreign currency risk denominated both in local and foreign currencies using interest rate, cross currency interest rate and cross currency swaps. The net fair value of these swaps is disclosed in note 15. There were no transactions for which fair value hedge accounting had to be ceased in 2011.

Cash flow hedges
The Group hedges a portion of the variability in future cash flows attributable to interest rate risk of variable interest rate assets and liabilities, using interest rate swaps, forward rate agreements and futures contracts.

There were no transactions for which cash flow hedge accounting had to be ceased in 2011 as a result of the highly probable cash flows no longer expected to occur. The fair value of derivatives entered into is disclosed in note 15. The movement in fair value of derivatives deferred within the cash flow hedge reserve to hedge forecast future cash flows is disclosed in note 32.

Credit risk

Credit is defined as any transaction that creates an actual or potential obligation for a borrower to pay the Group. Credit risk is the potential that a borrower will fail to meet its obligations to the Group in accordance with agreed terms.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees where appropriate.

Derivatives
The Group maintains control limits on net open derivative positions (i.e. the difference between purchase and sale contracts), by both amount and term. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair value is positive), which in relation to derivatives is only a small fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements.

Credit-related commitments
Credit-related commitments are facilities where the Group is under a legal obligation to extend credit unless some event occurs, which gives the Group the right, in terms of the commitment letter of offer or other documentation to withdraw or suspend the facilities. The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry similar credit risk as loans.

42. Financial risk management (continued)

Credit-related commitments (continued)
Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss of an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Maximum exposure to credit risk

The Group's credit exposure has been determined in accordance with capital adequacy guidelines. The Group has comprehensive credit risk management policies that restrict the level of exposure to any one borrower or group of borrowers, industries and countries. Unless otherwise noted, the amount that best represents the maximum credit exposure at reporting date is the carrying value of the financial asset.

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 use of master netting and collateral agreements.

	Group		**Bank**	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
		As restated		As restated
Cash and balances with central banks	**6,022**	4,070	**6,022**	4,070
Due from related entities	**4,950**	2,839	**9,803**	7,777
Loans and advances to other banks	**12**	11	**12**	10
Investments - available for sale	**1,110**	2,262	**1,109**	2,262
Investments - held to maturity	**-**	-	**701**	413
Other financial assets at fair value	**5,327**	5,396	**5,531**	5,396
Derivative financial assets	**537**	719	**324**	385
Loans and advances to customers	**28,238**	26,981	**23,585**	22,176
Due from customers on acceptances	**7**	8	**7**	8
	46,203	42,286	**47,094**	42,497
Contingent liabilities (note 33)	**285**	258	**285**	258
Commitments (note 33)	**11,380**	11,600	**10,568**	10,788
Total credit risk exposure	**57,868**	54,144	**57,947**	53,543

The commitments balance includes sale and option to repurchase transactions and other commitments. Prior period balances have been adjusted to include amounts due from related entities and held to maturity investments.

Forbearance
Forbearance is temporary relief granted by a lender to enable customers in financial difficulty to mitigate or repay arrears on sustainable terms and ultimately aim to minimise the risk of the customer losing their home. The Group operates a policy of providing forbearance to its customers when it is appropriate to their individual circumstances and some of the facilities it operates are noted below.

Temporary 'rehabilitation' tools for customers in arrears or predelinquency:
- Change in payment date.
- Change in payment method.
- Arrangement or short term promise to pay.
- Payment of fees/charges on behalf of the customer to protect security of the property.

Temporary 'reduced repayment' tools for customers in arrears or predelinquency:
- Reduced payment concession.
- Short-term deferral of payment pending sale of property.
- Temporary transfer to interest only terms.
- Payment holidays / redraw of previous overpayments.

42. Financial risk management (continued)

Maximum exposure to credit risk (continued)

Forbearance (continued)
Permanent Forbearance tools resulting in contractual changes:
- Extension of mortgage term.
- Permanent transfer to interest only terms.
- Capitalisation of arrears.

Hardship/Repossession tools:
- Government mortgage rescue schemes.
- Assisted sale / voluntary possession.

At 30 September 2011 there were 783 (2010: 811) forbearance arrangements in relation to the retail mortgage portfolio of which 615 (2010: 514) were permanent in nature. Accordingly loans subject to forbearance are of low significance in the context of the Groups lending operations.

The credit quality of financial assets other than cash, balances with central banks and loans and advances to customers, that are neither past due nor impaired, are as follows:

		Investments		
	Due from other banks	**Available for sale**	**Held to maturity**	**Acceptances**
Group	**£m**	**£m**	**£m**	**£m**
2011				
Senior investment grade	11	1,103	-	2
Investment grade	1	7	-	5
	12	**1,110**	**-**	**7**
Group				
2010				
Senior investment grade	10	2,256	-	-
Investment grade	1	6	-	8
	11	2,262	-	8
Bank				
2011				
Senior investment grade	12	1,103	-	2
Investment grade	-	6	542	5
Sub investment grade	-	-	159	-
	12	**1,109**	**701**	**7**
Bank				
2010				
Senior investment grade	10	2,256	-	-
Investment grade	-	6	253	8
Sub investment grade	-	-	160	-
	10	2,262	413	8

See note 16 for information about the credit quality of loans and advances to customers that are neither past due nor impaired.

Market risk

The Group's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and to manage the liquidity and interest rate risks arising from these activities.

The focus of the Group's activity is to provide high quality banking services to its customers. These services include provision of foreign exchange and derivative products to enable customer to manage risks within their businesses. As a result of these activities the Group may be exposed to forms of market risk that would arise from movements in price on these products. These risks are managed to a de minimus risk position in accordance with the Bank's Trading Policy Statement.

42. Financial risk management (continued)

Prepayment Risk

Early repayment charges on fixed rate business loans are calculated on an economic cost basis, fully recompensing the Bank for any loss on the unwinding of the underlying hedge. Early repayment charges on fixed rate mortgages are calculated on a sliding scale basis, whereby an agreed percentage of the balance is charged dependant upon the residual time to maturity of the loan.

Although interest rates have remained low during the year the level of prepayments has been lower than otherwise may have been expected due to reduced availability of credit across the market.

Interest rate risk in the banking book (IRRBB)

IRRBB is measured, monitored, and managed on a regional basis from both an internal management and regulatory perspective. The risk management framework incorporates both market valuation and earnings based approaches in accordance with the Group IRRBB policy. Risk measurement techniques include: Value at Risk (VaR), Earnings at Risk (EaR), interest rate risk stress testing, repricing analysis, cash flow analysis, and scenario analysis.

The key features of the internal interest rate risk management model:

- Historical simulation approach utilising instantaneous interest rate shocks.
- Static balance sheet (i.e. any new business is assumed to be matched, hedged or subject to immediate repricing).
- VaR and EaR are measured on a consistent basis.
- 99% confidence level.
- Three month holding period.
- EaR utilises a twelve month forecast period.
- 8 years of business day historical data (updated daily by Group Non-Traded Market Risk).
- Rate changes are proportional rather than absolute.
- Investment term for capital is modelled with an established benchmark term of between 1 and 5 years.
- Investment term for core "non-interest bearing" (non-interest rate bearing assets and liabilities) is modelled on a behavioural basis with a term that is consistent with sound statistical analysis.

Model parameters and assumptions are reviewed and updated on at least an annual basis by Non-Traded Market Risk, in consultation with Treasury. Material changes require the approval of the Asset and Liability Committee.

	As at 30 September		**Average value during reporting period**	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Value at risk				
Interest Rate Risk	**41**	23	**31**	12
Earnings at risk				
Interest Rate Risk	**14**	7	**9**	6

	Minimum value during reporting period		**Maximum value during reporting period**	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Value at risk				
Interest Rate Risk	**26**	2	**41**	25
Earnings at risk				
Interest Rate Risk	**2**	3	**14**	10

42. Financial risk management (continued)

Interest rate risk in the banking book (IRRBB) (continued)

Risk concentration

Concentration of risk is managed by client / counterparty, by product, by geographical region and by industry sector. In addition single name exposure limits exist to limit exposure to single entity / counterparty.

Industry concentration of assets

The following table shows the levels of industry concentration of assets at 30 September:

Group 2011	Loans designated at fair value through profit or loss £m	Loans at amortised cost £m	Contingent liabilities and credit related commitments £m
Government and public authorities	14	20	-
Agriculture, forestry, fishing and mining	718	1,146	745
Financial, investment and insurance	59	1,051	999
Real estate - construction	1,608	2,828	827
Manufacturing	123	924	242
Instalment loans to individuals and other personal lending (including credit cards)	100	2,453	4,022
Mortgages	-	13,981	1,581
Asset and lease financing	-	901	-
Other commercial and industrial	2,224	5,527	3,249
	4,846	**28,831**	**11,665**

	Due from other banks £m	Investments Available for sale £m	Held to maturity £m	Acceptances £m
Government and public authorities	-	-	-	-
Agriculture, forestry, fishing and mining	-	-	-	-
Financial, investment and insurance	12	1,110	-	-
Real estate - construction	-	-	-	-
Manufacturing	-	-	-	7
Instalment loans to individuals and other personal lending (including credit cards)	-	-	-	-
Mortgages	-	-	-	-
Asset and lease financing	-	-	-	-
Other commercial and industrial	-	-	-	-
	12	**1,110**	**-**	**7**

42. Financial risk management (continued)

Industry concentration of assets (continued)

Group 2010	Loans designated at fair value through profit or loss £m	Loans at amortised cost £m	Contingent liabilities and credit related commitments £m
Government and public authorities	13	24	1
Agriculture, forestry, fishing and mining	612	1,158	677
Financial, investment and insurance	73	202	1,245
Real estate - construction	81	630	415
Manufacturing	142	817	202
Instalment loans to individuals and other personal lending (including credit cards)	170	2,575	3,933
Mortgages	-	12,781	1,552
Asset and lease financing	-	1,001	-
Other commercial and industrial	3,936	8,455	3,833
	5,027	27,643	11,858

	Due from other banks £m	Investments Available for sale £m	Investments Held to maturity £m	Acceptances £m
Government and public authorities	-	-	-	-
Agriculture, forestry, fishing and mining	-	-	-	-
Financial, investment and insurance	11	2,262	-	-
Real estate - construction	-	-	-	-
Manufacturing	-	-	-	8
Instalment loans to individuals and other personal lending (including credit cards)	-	-	-	-
Mortgages	-	-	-	-
Asset and lease financing	-	-	-	-
Other commercial and industrial	-	-	-	-
	11	2,262	-	8

42. Financial risk management (continued)

Industry concentration of assets (continued)

Bank 2011	**Loans designated at fair value through profit or loss £m**	**Loans at amortised cost £m**	**Contingent liabilities and credit related commitments £m**
Government and public authorities	14	20	-
Agriculture, forestry, fishing and mining	718	1,146	745
Financial, investment and insurance	59	1,051	187
Real estate - construction	1,608	2,828	827
Manufacturing	123	924	242
Instalment loans to individuals and other personal lending (including credit cards)	100	2,453	- 4,022
Mortgages	-	9,462	1,581
Asset and lease financing	-	636	-
Other commercial and industrial	2,224	5,614	3,249
	4,846	**24,134**	**10,853**

	Due from other banks £m	**Investments Available for sale £m**	**Investments Held to maturity £m**	**Acceptances £m**
Government and public authorities	-	-	-	-
Agriculture, forestry, fishing and mining	-	-	-	-
Financial, investment and insurance	12	1,109	701	-
Real estate - construction	-	-	-	-
Manufacturing	-	-	-	7
Instalment loans to individuals and other personal lending (including credit cards)	-	-	-	-
Mortgages	-	-	-	-
Asset and lease financing	-	-	-	-
Other commercial and industrial	-	-	-	-
	12	**1,109**	**701**	**7**

42. Financial risk management (continued)

Industry concentration of assets (continued)

Bank 2010	Loans designated at fair value through profit or loss £m	Loans at amortised cost £m	Contingent liabilities and credit related commitments £m
Government and public authorities	13	24	1
Agriculture, forestry, fishing and mining	612	1,158	677
Financial, investment and insurance	73	202	433
Real estate - construction	81	630	415
Manufacturing	142	817	202
Instalment loans to individuals and other personal lending (including credit cards)	170	2,575	3,933
Mortgages	-	8,416	1,552
Asset and lease financing	-	534	-
Other commercial and industrial	3,936	8,456	3,833
	5,027	22,812	11,046

	Due from other banks £m	Investments Available for sale £m	Investments Held to maturity £m	Acceptances £m
Government and public authorities	-	-	-	-
Agriculture, forestry, fishing and mining	-	-	-	-
Financial, investment and insurance	10	2,262	413	-
Real estate - construction	-	-	-	-
Manufacturing	-	-	-	8
Instalment loans to individuals and other personal lending (including credit cards)	-	-	-	-
Mortgages	-	-	-	-
Asset and lease financing	-	-	-	-
Other commercial and industrial	-	-	-	-
	10	2,262	413	8

The Bank has implemented the Standard Industrial Classification of Economic Activities (SIC) 2007 codes as defined by the Office for National Statistics. This was a requirement for all UK financial institutions with effect from January 2011 and has resulted in material movements between some of the industry categories shown above between the 2011 and 2010 comparative disclosures. The most notable change is that property developers previously classified within 'Other commercial and industrial' are now classified within 'Real estate - construction'.

42. Financial risk management (continued)

Maturity analysis of assets and liabilities

The following tables represent a breakdown of the Group's balance sheet for the last two years as at 30 September according to the assets and liabilities contractual maturity. Many of the longer-term monetary assets are variable rate products, with actual maturities shorter than the contractual terms. Accordingly, this information is not relied upon by the Group in its management of interest rate risk . See "Cash flows payable under financial liabilities by contractual maturities" for the Group's contractual undiscounted repayment obligations.

In 2011 the Group and Bank have disclosed certain term facilities with a revolving element at the maturity of the facility as this best reflects their contractual and behavioural maturity.

Group 2011	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	5,071	-	-	-	-	951	**6,022**
Due from related entities	799	2,724	1,427	-	-	-	**4,950**
Due from other banks	-	12	-	-	-	-	**12**
Investments							
- Available for sale	-	-	66	100	937	7	**1,110**
Other financial assets at fair value	-	167	437	2,147	2,576	-	**5,327**
Derivative financial assets	-	5	393	135	4	-	**537**
Loans and advances to customers	4,979	652	2,435	5,015	14,674	483	**28,238**
Due from customers on acceptances	-	7	-	-	-	-	**7**
All other assets	152	-	-	-	-	897	**1,049**
Total assets	**11,001**	**3,567**	**4,758**	**7,397**	**18,191**	**2,338**	**47,252**
Liabilities							
Due to other banks	238	655	614	-	-	-	**1,507**
Other financial liabilities at fair value	-	30	59	279	637	-	**1,005**
Derivative financial liabilities	-	-	16	2	63	-	**81**
Due to customers	16,672	5,838	4,044	1,616	-	-	**28,170**
Liabilities on acceptances	-	7	-	-	-	-	**7**
Due to related entities	34	1,153	2,415	2,151	2,005	-	**7,758**
Bonds, notes and subordinated debt	-	1,255	1,504	590	204	-	**3,553**
All other liabilities	115	-	-	-	-	2,177	**2,292**
Total liabilities	**17,059**	**8,938**	**8,652**	**4,638**	**2,909**	**2,177**	**44,373**

42. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Group 2010	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	3,224	-	-	-	-	846	4,070
Due from related entities	778	336	1,725	-	-	-	2,839
Due from other banks	-	11	-	-	-	-	11
Investments							
- Available for sale	-	-	-	2,256	6	-	2,262
Other financial assets at fair value	54	204	429	2,233	2,476	-	5,396
Derivative financial assets	-	4	50	648	17	-	719
Loans and advances to customers	5,172	2,147	1,181	4,099	13,856	526	26,981
Due from customers on acceptances	-	8	-	-	-	-	8
All other assets	124	-	-	-	-	1,250	1,374
Total assets	9,352	2,710	3,385	9,236	16,355	2,622	43,660
Liabilities							
Due to other banks	43	617	202	511	-	-	1,373
Other financial liabilities at fair value	2	57	62	281	494	-	896
Derivative financial liabilities	-	1	25	54	37	-	117
Due to customers	18,132	4,995	3,614	1,693	-	-	28,434
Liabilities on acceptances	-	8	-	-	-	-	8
Due to related entities	137	693	800	601	1,155	-	3,386
Bonds, notes and subordinated debt	-	-	350	3,609	450	-	4,409
All other liabilities	77	-	-	-	-	2,413	2,490
Total liabilities	18,391	6,371	5,053	6,749	2,136	2,413	41,113

42. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Bank 2011	**Call £m**	**3 months or less £m**	**3 to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**No specified maturity £m**	**Total £m**
Assets							
Cash and balances with central banks	5,071	-	-	-	-	951	**6,022**
Due from related entities	5,429	2,947	1,427	-	-	-	**9,803**
Due from other banks	-	12	-	-	-	-	**12**
Investments							
- Available for sale	-	-	66	100	937	6	**1,109**
- Held to maturity	-	-	-	701	-	-	**701**
Other financial assets at fair value	-	167	641	2,147	2,576	-	**5,531**
Derivative financial assets	-	5	189	126	4	-	**324**
Loans and advances to customers	5,120	650	2,308	4,662	10,362	483	**23,585**
Due from customers on acceptances	-	7	-	-	-	-	**7**
All other assets	142	-	-	-	-	1,527	**1,669**
Total assets	**15,762**	**3,788**	**4,631**	**7,736**	**13,879**	**2,967**	**48,763**
Liabilities							
Due to other banks	238	655	614	-	-	-	**1,507**
Other financial liabilities at fair value	-	30	302	279	637	-	**1,248**
Derivative financial liabilities	-	-	16	2	63	-	**81**
Due to customers	16,781	5,838	4,044	1,616	-	-	**28,279**
Liabilities on acceptances	-	7	-	-	-	-	**7**
Due to related entities	34	1,959	2,415	4,067	2,005	-	**10,480**
Bonds, notes and subordinated debt	-	1,255	59	590	204	-	**2,108**
All other liabilities	115	-	-	-	-	2,245	**2,360**
Total liabilities	**17,168**	**9,744**	**7,450**	**6,554**	**2,909**	**2,245**	**46,070**

42. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Bank 2010	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Assets							
Cash and balances with central banks	3,224	-	-	-	-	846	4,070
Due from related entities	5,522	530	1,725	-	-	-	7,777
Due from other banks	-	10	-	-	-	-	10
Investments							
- Available for sale	-	-	-	2,256	6	-	2,262
- Held to maturity	-	-	-	413	-	-	413
Other financial assets at fair value	54	204	429	2,233	2,476	-	5,396
Derivative financial assets	-	5	50	313	17	-	385
Loans and advances to customers	5,202	2,142	970	3,658	9,678	526	22,176
Due from customers on acceptances	-	8	-	-	-	-	8
All other assets	117	-	-	-	-	1,560	1,677
Total assets	14,119	2,899	3,174	8,873	12,177	2,932	44,174
Liabilities							
Due to other banks	43	617	202	511	-	-	1,373
Other financial liabilities at fair value	2	57	62	281	494	-	896
Derivative financial liabilities	-	1	25	54	37	-	117
Due to customers	18,132	4,995	3,614	1,693	-	-	28,434
Liabilities on acceptances	-	8	-	-	-	-	8
Due to related entities	137	1,493	800	2,426	1,155	-	6,011
Bonds, notes and subordinated debt	-	-	350	1,927	450	-	2,727
All other liabilities	77	-	-	-	-	2,207	2,284
Total liabilities	18,391	7,171	5,053	6,892	2,136	2,207	41,850

42. Financial risk management (continued)

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities when they fall due.

The Group manages liquidity and funding risk through a combination of positive cash flow management, the maintenance of portfolios containing high quality liquid assets, maintenance of a prudent funding strategy and diversification of its funding base. The Group undertakes a conservative approach by imposing internal limits, including stress and scenario testing that are in addition to regulatory requirements.

Cash flows payable under financial liabilities by contractual maturities

Group 2011	**Call £m**	**3 months or less £m**	**3 to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**No specified maturity £m**	**Total £m**
Due to other banks	238	662	617	-	-	-	**1,517**
Other financial liabilities at fair value	-	2	5	59	130	-	**196**
Derivative financial liabilities	-	-	-	-	-	44	**44**
Deposits and other borrowings	16,688	5,862	4,069	1,667	-	-	**28,286**
Liability on acceptances	-	7	-	-	-	-	**7**
Bonds, notes and subordinated debt	-	1,270	1,526	640	210	-	**3,646**
All other liabilities	-	-	-	-	-	1,335	**1,335**
Hedging derivatives							
- contractual amounts payable	-	11	18	1	-	-	**30**
- contractual amounts receivable	-	(2)	(4)	-	-	-	**(6)**
	16,926	**7,812**	**6,231**	**2,367**	**340**	**1,379**	**35,055**

Group 2010	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	679	222	509	-	-	1,410
Other financial liabilities at fair value	-	8	2	45	27	-	82
Derivative financial liabilities	-	-	-	-	-	58	58
Deposits and other borrowings	15,446	6,780	3,166	1,952	-	1,205	28,549
Liability on acceptances	-	8	-	-	-	-	8
Bonds, notes and subordinated debt	-	33	408	3,717	472	-	4,630
All other liabilities	-	-	-	-	-	1,269	1,269
Hedging derivatives							
- contractual amounts payable	-	23	59	30	-	-	112
- contractual amounts receivable	-	(5)	(11)	(7)	-	-	(23)
	15,446	7,526	3,846	6,246	499	2,532	36,095

42. Financial risk management (continued)

Cash flows payable under financial liabilities by contractual maturities (continued)

Bank 2011	**Call £m**	**3 months or less £m**	**3 to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**No specified maturity £m**	**Total £m**
Due to other banks	238	662	617	-	-	-	**1,517**
Other financial liabilities at fair value	-	2	5	59	130	-	**196**
Derivative financial liabilities	-	-	-	-	-	44	**44**
Deposits and other borrowings	16,688	5,862	4,069	1,667	-	-	**28,286**
Liability on acceptances	-	7	-	-	-	-	**7**
Bonds, notes and subordinated debt	-	1,269	660	46	210	-	**2,185**
All other liabilities	-	-	-	-	-	1,335	**1,335**
Hedging derivatives							
- contractual amounts payable	-	11	18	1	-	-	**30**
- contractual amounts receivable	-	(2)	(4)	-	-	-	**(6)**
	16,926	**7,811**	**5,365**	**1,773**	**340**	**1,379**	**33,594**

Bank 2010	Call £m	3 months or less £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	No specified maturity £m	Total £m
Due to other banks	-	679	222	509	-	-	1,410
Other financial liabilities at fair value	-	8	2	45	26	-	81
Derivative financial liabilities	-	-	-	-	-	58	58
Deposits and other borrowings	15,446	6,780	3,166	1,952	-	1,205	28,549
Liability on acceptances	-	8	-	-	-	-	8
Bonds, notes and subordinated debt	-	43	398	2,005	472	-	2,918
All other liabilities	-	-	-	-	-	1,269	1,269
Hedging derivatives	-	-	-	-	-	-	
- contractual amounts payable	-	23	59	30	-	-	112
- contractual amounts receivable	-	(5)	(11)	(7)	-	-	(23)
	15,446	7,536	3,836	4,534	498	2,532	34,382

Refer to note 33 for off-balance sheet items disclosed by cash flow maturity.

The balances in the cash flow tables above will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments. The balances for other financial liabilities at fair value and derivative financial liabilities are less than shown on the consolidated balance sheet as they exclude cash flows on related party balances.

43. Management of risk

Effective management of risk is a key capability for a successful financial services provider, and is fundamental to the Group's strategy, as well as that of its ultimate parent entity NAB Group. A key component of the NAB Group's risk management strategy is the establishment by the Board of a formal 'risk appetite statement' for the NAB Group and all major subsidiaries.

This places an overall limit on the total amount of risk that the NAB Group is prepared to take. This position is set with respect to the returns that the NAB Group is seeking to provide to shareholders, the credit rating that the NAB Group is seeking to maintain, and the NAB Group's capital position and desired capital ratios.

This position informs the Group's risk, capital and business management limits and policies. It is periodically reviewed by the Boards as a part of the strategic planning process, or as the commercial circumstances of the Group change.

The Group's approach to risk management is based on an overriding principle that risk management capability must be embedded within the business' front-line teams to be effective. This overriding principle embodies the following concepts:

- all business decisions proactively consider risk;
- business managers use the risk management framework which assists in the appropriate balancing of both risk and reward components;
- all employees are responsible for risk management in their day-to-day activities; and
- risk management is a core competency area for all employees.

The Group manages risk within the 'three lines of defence' framework. Control is exercised through clearly defined delegation of authority, with clear and rapid communication and escalation channels throughout the organisation. The first line of defence comprises the business units managing the risks associated with their activities. The second line encompasses dedicated risk functions who are accountable for independent monitoring and oversight. The third line of defence relates to Internal Audit independently reviewing, monitoring, and testing business unit compliance with risk policies and procedures, and regularly assessing the overall effectiveness of the risk management framework.

The NAB Group Risk Management Committee, chaired by the Group Chief Executive Officer, serves as the principal risk strategy and policy decision making body within the NAB Group, and provides the Principal Board with assurance in the performance of the overall risk management framework. This committee is supported by three sub-committees - NAB Group Credit Risk Committee, NAB Group Asset and Liability Committee, and NAB Group Capital Committee - each with a specialised focus.

Within the UK there is a UK Risk Committee (UKRC) comprised of senior regional executives, which serves to provide a leadership focus on key risk issues from a regional perspective. The Committee is supported by UK Governance Committees including Asset and Liability Committee (UK ALCO), Credit Oversight Committees (COC) and the Operational Risk and Compliance Committee (OR &CC). In addition, the Boards provide review and oversight of the risk profile and risk appetite of the UK.

The UK risk management team independently monitors and systematically assesses the risk profile within the region against established risk appetite parameters. They also assist the front line businesses in the design and implementation of appropriate risk management policies/strategies, and work with the businesses to promote awareness of the need to manage risk. Together with the NAB Group Risk Management function, efforts continue to evolve the organisational culture and staff behaviour.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people or systems, or from external events. This includes risk relating to the management of ongoing activities, as well as to organisational changes such as project and change initiatives.

43. Management of risk (continued)

Operational risk (continued)

Various reports are produced at management, Board sub-committee and Board level to assist with their oversight and monitoring obligations. This incorporates regional reporting of risk profiles, key operational risk events, as well as consideration of external events and their relevance to the NAB Group. This process generates visibility and understanding of the NAB Group's overall operational risk profile.

The Operational Risk Framework ("ORF") is based on a set of core principles and defines the NAB Group's standards for operational risk management and compliance. Its design recognises the importance of embedding operational risk into "business-as-usual" activities. It has particular focus on defining and implementing the right behaviour and incorporating risk considerations into the NAB Group's systems and processes.

The ORF is an essential element of the business strategy, which underpins all operational risk management activities. It includes:
- an established governance structure that is used to ensure consistent application, control and reporting of the operational risk management process. This element also includes the establishment and communication of the NAB Group's operational risk appetite;
- a structured process to facilitate the identification, quantification and management of risks.

Credit risk

Credit risk is the potential that a borrower or a counterparty will fail to meet its obligations in accordance with agreed terms. The NAB Group's credit risk management infrastructure is framed to provide sound management principles and practices for the maintenance of appropriate asset quality across the NAB Group. These principles and practices are followed by the Group. Group Credit Oversight and Credit Frameworks, divisions of NAB Group Risk Management, are responsible for the development and maintenance of credit policies and key credit risk systems.

The management of credit risk within the Group is achieved through both the traditional focuses on approval and monitoring of individual transactions and asset quality, analysis of the performance of the various credit risk portfolios and the independent oversight of credit portfolios across the Group. Portfolio monitoring techniques cover such areas as industry or geographic concentrations and delinquency trends. Roles and responsibilities between Group Chief Credit Officer (and associated teams) and the Regional Risk Management teams are clearly defined.

Significant credit risk strategies and policies are approved, and reviewed annually, by the NAB Board, and the NAB Risk Committee. Through such policies the NAB Board establishes the NAB Group's tolerance for risk. These policies are delegated to, and disseminated under the guidance and control of, executive management within the UK.

The NAB Group's credit policies, which are subject to ongoing review, are documented and disseminated in a form that provides a consistent view of all major credit policies supporting the credit operations of the NAB Group.

For complex credit products and services, the Group Chief Credit Officer (and associated teams) provide a policy framework that identifies and quantifies risks and establishes the means of mitigating such risks.

Single large exposure policies are in place within the CB Group. Overall composition and quality of credit portfolio exposures are monitored and periodically reported to the Board, and, where required, to the relevant regional supervisory authorities.

A key factor in the introduction of new products and services is the identification of credit risk inherent in such products and services. For high risks, this is managed through a process requiring acceptance by all impacted areas of the business and approval by Risk Management Committees prior to implementation.

Non-traded market risk

Non-traded market risk includes liquidity and funding risk, structural interest rate risk and foreign exchange risk. The primary objective for the management and oversight of non-traded market risk is to maintain the risk profile within approved risk appetite and limits, while implementing strategies that protect current and future earnings from the impact of market volatility.

43. Management of risk (continued)

Non-traded market risk (continued)

Policies, inclusive of risk appetite and limits, are approved by the NAB Board, with Group authority delegated to the NAB Group Asset and Liability Management Committee (Group ALCO) and UK Asset and Liability Management Committee (UK ALCO) for their subsequent implementation and monitoring.

UK ALCO oversees the management of non traded market risks. UK ALCO meets monthly and reports to the UK Risk Committee. Treasury is responsible for the development and execution of strategy subject to oversight from Non Traded Market Risk.

Liquidity and funding risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due at acceptable cost. These obligations include the repayment of deposits on-demand or at their contractual maturity dates, the repayment of borrowings and loan capital as they mature, the payment of operating expenses and tax, the payment of dividends and the ability to fund new and existing loan commitments.

Liquidity within the Group is managed in accordance with the regulatory requirements of the FSA and with policies approved by the NAB Board, with oversight from UK ALCO and Group ALCO. The Bank's approach to the management and oversight of liquidity and funding risks are detailed in the Bank's internal individual Liquidity Adequacy Assessment. To meet the requirements of local regulatory authorities the liquidity of the regional bank is managed on a daily basis as a stand-alone undertaking. UK ALCO delegates daily management responsibilities to the regional treasury operating divisions.

NAB Group policies are applied over and above the requirements of local regulatory authorities, when these supplement local regulatory policy. The combination of regulatory and NAB Group policy requirements results in liquidity being managed through a combination of positive cash flow management, including under a series of assumptions to simulate stressed market conditions, the maintenance of portfolios of high quality liquid assets, and diversification of the funding base. NAB Group Policy uses liquidity scenarios to monitor both 'going concern' and 'name crisis' events. Cash flow mismatch limits have been established to limit the Group's liquidity exposure. In addition, the Bank is required to hold liquid asset portfolios to meet unexpected cash flow requirements.

A three-level contingency plan has also been established for management of an escalated liquidity requirement where the Group experiences either restricted access to wholesale funding, or a large increase in the withdrawal of funds. The plan identifies triggers on each level, details the action required, allocates the key tasks to individuals, provides a timeframe and defines a management committee to manage the action plan.

Structural interest rate risk

Structural interest rate risk comprises the sensitivity of the Group's current and future net interest income to movements in market interest rates.

These are three major contributors to interest rate risk:
- the investment of non-interest bearing deposits and equity into interest-bearing assets;
- the mismatch between repricing dates of interest-bearing assets and liabilities; and
- the inability of the pricing 'basis' for customer asset and liability products to be replicated in the financial markets.

Within the objective to secure stable and optimal net interest income over both a 12-month period and over the long term, mismatch risk can be minimised with the investment of equity and non-interest-bearing deposits targeting the stability of net interest income.

Interest rate risk is principally managed through the use of interest rate swaps. All products are used within approved mandates, with strategies subject to monthly reporting to UK ALCO and Group ALCO.

Interest rate risk management across the NAB Group is directed by NAB Group Treasury, with execution on a UK business basis via CB Group Treasury. UKRC, through UK ALCO oversight, monitors risk to ensure it remains within approved policy and limits set by the NAB Board.

43. Management of risk (continued)

Structural interest rate risk (continued)

Basis risk is managed through a combination of wholesale market basis risk products, pricing strategies and product innovation.

A key feature of the risk management and oversight framework in the NAB Group is the use of Value at Risk (VaR) as one of its principal measures for interest rate risk, along with an Earnings at Risk (EaR) measure that calculates the impact on future net interest income over the next 12 months. These limit measures are complemented by sensitivity and scenario analysis.

These risk measures and the independence of NAB Group Treasury and NAB Non-Traded Market Risk management structures have contributed to a transparent interest rate risk management framework within NAB Board approved risk appetite and limits.

Foreign exchange risk

Real foreign exchange exposures arise independently of the accounting process. Such transaction exposures arise from the risk that future cash flows will be converted to Sterling at less favourable rates than at present. The policy of NAB Group is to fully hedge these exposures at the time of commitment, if they are of a material nature. Such hedging of transaction exposures is assessed on a case-by-case basis.

The transactional currency exposures principally arise from dealings with customers and the Group maintains a matched position through transactions with a range of counterparties including NAB Group in order to comply with Group's trading policy statement.

44. Capital management overview

The Bank is governed by NAB Group's capital management policy. The objectives of the NAB Group's capital management policy are to efficiently manage the capital base to optimise shareholder returns whilst maintaining capital adequacy and satisfying key stakeholders such as regulators and ratings agencies.

The Bank's prime objectives in relation to the management of capital are to comply with the requirements set out by the Financial Services Authority (FSA), the Bank's primary prudential supervisor, to provide a sufficient capital base to cover business risks, maintain a targeted credit rating and to support future business development.

The Bank implemented Basel II requirements from 1 January 2008 in measuring operational and credit risks under the standardised approach. Under Pillar I of Basel II, the Bank calculates its minimum capital requirements based on 8% of RWAs. The FSA then applies a multiplier to this amount to cover risks under Pillar II of Basel II and generate an Individual Capital Guidance (ICG).

The ultimate responsibility for capital adequacy rests with the Board of Directors. The Bank's ALCO, which consists of the Chief Executive Officer, Executive Director, Chief Financial Officer and other senior executives, is responsible for the management of the capital process including approving policy, overseeing internal controls and setting internal limits over capital ratios.

The Bank actively manages its capital position and reports this on a regular basis to senior management via UK ALCO and other governance committees. Capital requirements are included within an annual capital management plan with initiatives being executed against this plan.

During the year the Group complied with the capital requirements set out by the FSA.

45. Basel II Capital Requirements Directive Pillar 3 Disclosure

The FSA has granted the Bank a waiver direction under BIPRU 11.2.5: (Waiver: Comparable disclosures provided on a consolidated basis by a parent undertaking established in a non EEA state).

The waiver direction can be found on the FSA website. http://www.fsa.gov.uk/pubs/waivers/bipru_waivers.pdf

In line with the FSA waiver direction, the Bank will rely on the following references to comparable National Australia Bank Limited consolidated disclosure to satisfy its Pillar 3 disclosure obligations:

National Australia Bank Limited 2011 Full Year Risk and Capital Report: http://www.nabgroup.com/0,,96819,00.html
National Australia Bank Limited 2011 Full Year Financial Results, Note 1, Section 6 (Supplementary Information): http://www.nabgroup.com/0,,103161,00.html
National Australia Bank Limited 2011 Annual Financial Report: http://www.nabgroup.com/0,,32863,00.html

With specific reference to securitisation policy, disclosure is made on pages 70 and 112 - 121 of the National Australia Bank Limited 2011 Annual Financial Report.

The first published disclosure was based on the financial position of CB PLC and NAB as at 30 September 2008. After due consideration by the CB PLC Directors, subsequent Pillar 3 disclosures would be made annually by way of the National Australia Bank Limited Risk and Capital Report. These disclosures will be in line with the FSA Waiver direction as outlined above.

The information contained in these qualitative disclosures has not been audited by the Group’s external auditors except to the extent that they are equivalent to those made under accounting requirements and is limited to those required by BIPRU 11.

46. FSA Remuneration Code Pillar 3 Disclosure

The FSA issued in December 2010 Policy Statement 10/21 'Implementing CRD3 requirements on the disclosure of remuneration', the Pillar 3 disclosures required are specified within BIPRU 11.5.18R to BIPRU 11.5.21G. The Bank will rely on the following references to comparable National Australia Bank Limited consolidated disclosures plus additional aggregate disclosures for UK Code Staff to satisfy the Pillar 3 disclosure obligations.

National Australia Bank Limited 2011 Annual Financial Report: http:/www.nabgroup.com

The remuneration report is held within the Report of the Directors on pages 15-43 of the National Australia Bank Limited 2011 Annual Financial Report.

47. Bank levy

	2011	2010
	£m	£m
Bank levy	**3**	-

In June 2010 the UK Government introduced a bank levy applicable to UK banking operations. The bank levy was applied with effect from 1 January 2011. Based on the 30 September 2011 balance sheet position, the bank levy has resulted in a charge to the income statement of £3m.

48. Events after the balance sheet date

There have been no subsequent events which have occurred since 30 September 2011 that would require disclosure in the Financial Statements of Clydesdale Bank PLC.

For more information

Website	cbonline.co.uk
Media	General media query line 0845 60 35 447 press.office@nab.co.uk
National Australia Bank	NAB Group results are available on www.nabgroup.com

Disclaimer

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