Company Number: SC 001111

CLYDESDALE BANK PLC

ANNUAL REPORT AND CONSOLIDATED FINANCIAL STATEMENTS

30 SEPTEMBER 2008

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CLYDESDALE BANK PLC
Officers and Professional Advisers

Directors	**Chairman:**	Sir Malcolm Williamson #
	Executive:	Lynne Peacock (Chief Executive Officer) # Gavin Slater # David Thorburn
	Non-executive:	Jonathan Dawson* # Sir David Fell KCB* Richard Gregory OBE * # Roy Nicolson * # Peter Wood*
		* Member of the European Board Audit Committee # Member of the European Board Risk Committee
Executive Committee		Lynne Peacock, Chief Executive Officer Gavin Slater, Executive Director David Thorburn, Executive Director
		Tom Burns, Chief Risk Officer Margaret Butler, Quality and Efficiency Director Debbie Crosbie, Chief Information Officer Dean Cutbill, Products & Marketing Director Kevin Page, Operations Director Steve Reid, Retail Director Bruce Rose, Managing Director, Head of nabCapital UK Sue Sjuve, Group General Manager, Inclusion & Diversity Iain Smith, Chief Financial Officer Arthur Willett, Human Resources Director Mike Williams, Executive General Manager iFS
Secretary		Michael Webber
Registered Office		30 St Vincent Place Glasgow, G1 2HL
Bankers		National Australia Bank Limited
Auditor		Ernst & Young LLP Registered Auditor

CLYDESDALE BANK PLC
Chairman's Statement

Sir Malcolm Williamson, Chairman

It gives me great pleasure to present the 2008 financial statements of Clydesdale Bank. Our traditional banking model, which offers a full range of products and services to business and retail customers, has enabled the Bank to continue to generate strong profits. We have avoided sub-prime and self-certified lending which has helped keep our mortgage arrears levels at less than half the UK average.

The volatile and turbulent market conditions noted at the half year have continued in the second half of the year and beyond and, whilst we are clearly not immune from the effects of this, we have shown resilience in these conditions. The Bank's portfolio of liquid assets is considerably higher than before the market dislocation and is maintained by a diverse funding base which includes retail and a mix of short, medium, and long-term wholesale funding, parent company funding and securitisation. In October 2008 the Bank participated in the Government's Special Liquidity Scheme, which was introduced in April 2008, through a covered bond programme, and we are not ruling out further use of this or other Government funding initiatives if we believe it is beneficial. Our long term credit ratings were maintained during the year and the Bank maintained strong capital ratios. The capital ratios will be further strengthened during the course of the year.

Growth in our balance sheet has been achieved through prudent lending coupled with strong deposit growth. This enabled us to increase our net interest income in the face of higher funding and liquidity costs.

Despite the significant investment made in the business, firm cost management and ongoing efficiency improvements have ensured expenses remain in control.

We believe that our business model is sound and well diversified enough to withstand the challenges ahead, whilst at the same time we are in a position to take advantage of opportunities that may arise.

Sir Malcolm Williamson
Chairman
25 November 2008

Lynne Peacock, Chief Executive Officer

Overview

Clydesdale Bank PLC (the "Bank") together with its subsidiary undertakings (which together comprise the "Group") is the United Kingdom (UK) arm of the National Australia Bank Limited ("NAB"). The Group provides a full range of traditional banking products and services to business and retail customers through its Clydesdale Bank and Yorkshire Bank brands, together with commercial banking products from nabCapital. Over a period characterised by extreme market turbulence, the Group's business model has been very effective in delivering continued strong and sustainable growth while maintaining a diversified and cautious approach to both liquidity and funding.

Strategic Highlights and Business Developments

The Group delivered a good result with operating profit before impairment losses for the year ended 30 September 2008 of £526m increasing 1.3% over the year ended 30 September 2007. Profit after tax decreased 10.8% over September 2007. This result included extra funding and liquidity costs of £46m generated by the adverse market conditions.

The Group continues to execute the strategy originally outlined in 2005. This involves planned growth of market share in high quality assets through the Integrated Financial Solutions ("iFS") relationship proposition and secured personal lending, while reducing dependency on unsecured lending such as credit cards and personal loans.

Business conditions over the period have become increasingly challenging, with the continued dislocation in financial markets and deteriorating economic indicators. Against this backdrop, the priorities for the Group have been to improve the already strong funding and liquidity position, preserve the capital base, and grow lending prudently, particularly in the second half where lending and deposits grew broadly in step. The Group has demonstrated its resilience in exceptional market conditions. These results, underpinned by firm cost control and strong credit management, reflect a robust financial performance.

Over the year, the Bank continued to execute its strategy of planned growth in the business sector through Integrated Financial Solutions (iFS) relationship banking and maintained its growth in secured personal lending in the retail business. Over the year, average lending volumes increased from £25.8 billion to £31.2 billion.

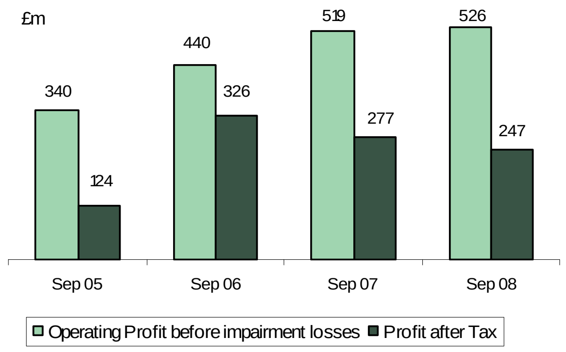
Reflecting current market conditions, iFS pursued growth selectively throughout the period, while progressively fine-tuning its risk settings in response to market conditions which deteriorated rapidly, particularly during the second half. This included a reinforced focus on the acquisition of both high quality trading business relationships and customer deposits. Over the year, iFS deposits grew by 19.5% from £7.7 billion to £9.2 billion and iFS lending grew by 24.2% from £15.7 billion to £19.5 billion.

The Retail business has proved resilient in a challenging trading environment and achieved an appropriate balance between growing deposits and securing good quality mortgage business. A strong focus on process improvement and the further enhancement of the customer experience contributed to an improvement in customer retention.

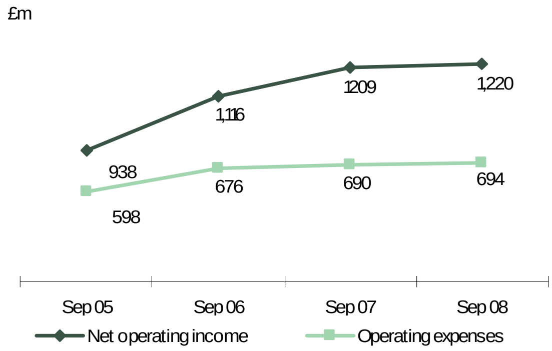
Income growth continued, with a 0.9% increase year on year. After absorbing extra funding and liquidity costs of £46 million, underlying income growth remained strong at 4.7%. These costs were the key driver of net interest margin contraction with the underlying decrease slowing, reflecting repricing actions and normalisation after a period of strong growth.

The asset quality of mortgages and unsecured lending proved sound, benefiting from improvements to credit processes over the last few years and a cautious approach to lending. As a result, the proportion of mortgages 90 days or more in arrears is less than half the UK industry average. In business banking, with an increased volume of mature loans, firm arrears management and the relationship model proved effective in controlling losses. As a result of the rapidly deteriorating UK economic conditions, gross impaired assets increased in the second half from a low historical base and reflected the growth experienced in recent years. The Bank continues to provide appropriately.

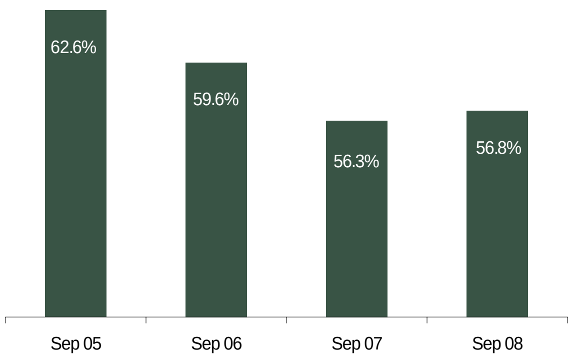
Operating profit before impairment losses and profit after tax



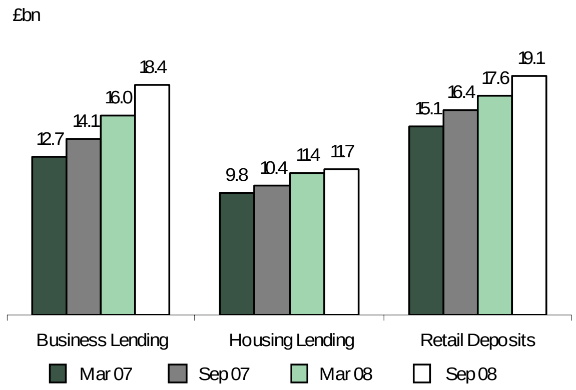
Income and Expense Trends



Cost to Income ratio



Loans and Deposits' Average Balances



Operating Environment

The weaker prospects resulting from the global credit issues continue to weigh heavily on the UK economy which is expected to experience its slowest period of growth for over 16 years. Activity fell by 0.5 % in the third quarter, ending a period of 65 consecutive quarters of growth. Surveys suggest that the economy will continue to contract in the fourth quarter with the economy experiencing a technical recession for the first time since 1989. The economy is expected to grow by just 0.8% this year before output contracts by a full percentage point in 2009. However, the effect on the wider economy of recent events in the markets has yet to be fully felt and could adversely affect growth further next year.

Increases in food and energy prices have elevated inflation to 5.2% at September 2008. Although there was a 50 basis points cut in interest rates in October and a 150 basis points cut in interest rates in November by the Bank of England, the sharp falls in energy prices and slowing economic growth will ultimately push inflation down. Further rate cuts could provide the impetus for a modest recovery from the latter part of 2009. As a result the Bank maintains a cautious approach to lending.

Funding and liquidity costs continue to be impacted by the dislocation in the market. Credit spreads for longer-term funding have widened significantly in the last year, resulting in higher costs of wholesale funding. The average spreads between base rate and 1 month and 3 month LIBOR in the year were 43 basis points and 69 basis points respectively against historic averages of 11 and 18 basis points, as increased credit and liquidity risk premiums are built in. This impact is being mitigated to some extent through moving lending from base rate to LIBOR related pricing.

In late September, after breaching regulatory requirements, Bradford & Bingley (B&B) was taken into public ownership. The cost of guaranteeing B&B's deposits will be met by the Financial Services Compensation Scheme, of which the Clydesdale Bank is a member. The 2008 results include a £6m accrual for this levy and a contingent liability for 2009.

In early October the UK government announced a series of measures designed to support the UK Banking Industry.

Operating Environment (continued)

The Office of Fair Trading (OFT) investigation into the operation of the personal current account market in the UK was published on 16 July 2008 and highlighted perceived issues of transparency and switching. The consultation period ended on 31 October 2008. In parallel with the market study, the OFT has been undertaking a cost study in relation to a number of banks to inform an assessment of whether charges are fair under the Unfair Terms in Consumer Contracts Regulations 1999.

The bank charges legal test case also continues. In July 2008, the Court heard argument on two aspects namely, whether the initial finding that current terms and conditions (T&Cs) are capable of an assessment under the Regulations applies to historic T&Cs and, secondly, whether certain historic T&Cs amounted to penalties at common law. On 8 October 2008 the Judge ruled that Clydesdale Bank PLC was entitled to a declaration that none of its T&Cs examined by the Court amount to penalties at common law.

The court is currently hearing an appeal on whether current bank charges will be assessed for fairness under the Unfair Terms in Consumer Contracts Regulations 1999. While the case continues, the FSA has extended the waiver (under the terms of which banks do not have to process claims for a return of charges where no financial hardship is involved) until January 2009.

The Competition Commission is nearing completion of its review of the Payment Protection Insurance market and is expected to make recommendations in relation to the transparency of the product and changes to the way in which it is sold.

Customer, Employee and Community

Customers
Customer retention rates improved in the Retail business; a trend reinforced by higher acquisition of customers towards the end of the period. The number of customers of both Retail and the UK business overall, increased for the first time in several years. iFS customer numbers continued to grow strongly.

We continue to embed the Financial Services Authority's (FSA) 'Treating Customers Fairly' principles throughout the business.

Employees
During the year, a three-year salary deal with the trade union Unite was successfully negotiated. This provides greater stability and assurance to both staff and the business at a time of economic uncertainty.

Community
Through our award winning payroll giving scheme, 15% of staff now give to charities through this means. From February 2008, the Group has been working with a new charity partner - Help the Hospices - which supports over 200 charities that care for terminally ill patients.

The Group continues to support the communities in which it operates through its sponsorship programme. Current sponsorships include: The Scottish Premier League football, the National Trust and Twenty20 Cricket. Initiatives supporting the goal of being carbon neutral by September 2010 continue with extensive recycling, environmental procurement policies and energy saving campaigns.

Awards
At the Credit Today Awards Ceremony in London the Banking Delivery Services team was awarded Fraud Prevention Team of the Year and the Retail Credit team won the Mortgage Lender of the Year award.

Financial Analysis

	Year to		
	Sep 08 £m	**Sep 07 £m**	**Sept 08 v Sep 07 %**
Net interest income	896	862	3.9
Non interest income	324	347	(6.6)
Total operating income	1,220	1,209	0.9
Total operating expenses	(694)	(690)	(0.6)
Operating profit before impairment losses	526	519	1.3
Impairment losses on credit exposures	(179)	(117)	(53.0)
Group operating profit	347	402	(13.7)
Significant items	3	2	50.0
Profit on ordinary activities before tax	350	404	(13.4)
Tax expense	(103)	(127)	18.9
Profit for the period	247	277	(10.8)
Average volumes	**£bn**	**£bn**	
Gross loans and acceptances (1)	31.2	25.8	20.9
Interest earning assets	35.4	29.0	22.1
Total assets	38.0	30.7	23.8
Retail deposits (2)	18.4	15.8	16.5
Performance measures (annualised)			
Profit on average assets	0.65%	0.90%	(24bps)
Net interest margin	2.53%	2.97%	(44bps)
Cost to income ratio	56.8%	56.3%	(50bps)
Profit per average FTE (3) (£'000s)	43	49	
FTEs (3) (spot)	5,658	5,681	

(1) Gross loans and acceptances includes gross loans and advances to customers, loans designated at fair value through profit and loss and due from customers on acceptances.
(2) Retail deposits include current accounts, savings accounts and term deposits.
(3) The FTE 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 Region at 30 September 2008 was 8,758.

September 2008 v September 2007

Profit after tax decreased by 10.8% over September 2007 reflecting higher charges to provide for impairment losses and flat expenses, partially offset by higher income. Over the same period, operating profits before impairment losses increased by 1.3%.

Average gross loans and acceptances increased by £5.4 billion.

Business lending volumes grew by £3.3 billion. This growth is largely driven by the continued success of iFS and its increasing customer base, although growth was slowed in the second half of the year in the light of changing market conditions. A managed and cautious approach to mortgage lending (balancing the volume and margin trade-off) has resulted in 13.4% mortgage volume growth, mainly in the offset mortgage product through the retail and direct channel network. Redemptions were also lower. Exposure to credit card and personal loan lending continued to fall as planned, with average balances declining 5.1% over the year.

Average retail deposit volumes grew by 16.5% (£2.6 billion) in a highly competitive market, reflecting continued focus on this area and the strength of the UK brands. iFS average deposit growth of 19.5% and Retail network balance growth of 7.7% represented a very creditable performance and reflect the strong positions of both the Clydesdale and Yorkshire brands.

Net interest income increased by 3.9% reflecting the strong balance sheet growth partially offset by the rising cost of funds.

Net interest margin decreased by 44 basis points from 2.97% to 2.53%. Of this, market dislocation costs accounted for 13 basis points. The underlying margin reduced by 31 basis points and was primarily driven by the cost of wholesale funding relative to deposit funding and partially by product mix.

Non interest income decreased by 6.6%. The operating lease business was disposed of in December 2007, resulting in a £22 million reduction in related income (partially offset by lower expenses). There was, however, a one-off net gain on disposal of £1 million. Underlying non interest income was flat, with increased lending related fees being offset by lower other fee income. In particular, and in line with the rest of the UK market, payment protection revenues remained under pressure. Stock-market fluctuations also affected initial investment fees, with income falling by £3 million.

September 2008 v September 2007 (continued)

Total operating expenses were 0.6% higher than the prior year with higher investment costs, including the recruitment of additional staff in iFS during the year, additional depreciation arising from investment spend in prior periods and general wage inflation. These were partially offset by back office efficiency savings and process improvements and the sale of the operating lease business, which reduced expenses by £19 million in the current year (offset by a reduction in Other Operating Income).

The **impairment losses on credit exposures** increased by £62 million against the prior year. Within this increase two connections have contributed to over one third (£21 million) of the increase in the charge. The remaining increase in provisions was driven by higher business lending volumes and the consumer slowdown as discussed earlier, and was mitigated in part by the portfolio shift away from unsecured personal lending and actions taken over the past two years. Additionally, improved arrears management has ensured that the value of accounts 90 days past due has remained stable in the mortgage and unsecured categories.

The income tax charge includes a reduction in the corporation tax rate, retrospective credits for research and development spend, and the release of provisions no longer required.

Other Items

Asset Quality

	As at		
	Sep 08	**Mar 08**	**Sep 07**
Gross impaired assets (£m)	201	87	63
Gross impaired assets to gross loans and acceptances (1)	0.61%	0.27%	0.22%
90+ days past due assets (£m)	154	123	125
90+ days past due to gross loans and acceptances (1)	0.47%	0.39%	0.44%
GIA and 90+ days past due to gross loans and acceptances (1)	1.08%	0.66%	0.66%
Total provision to gross loans and acceptances (1) (2)	1.09%	0.98%	1.02%

(1) Gross loans and acceptances: includes gross loans and advances to customers, loans designated at fair value through profit and loss and due to customers on acceptances.
(2) Total provision to gross loans and acceptances includes the credit risk adjustment on fair value loans.

In line with the current economic environment, some leading asset quality indicators have softened during the second half of the year. However, the portfolio compares well against UK peers. Overall asset quality remains strong with a portfolio that is well-secured and diversified both geographically and by lending type. The overall balance sheet risk continues to be managed by increasing secured elements of the book and managing unsecured elements as a proportion of the overall book. The mortgage book does not include any low doc (self certified) or sub prime lending.

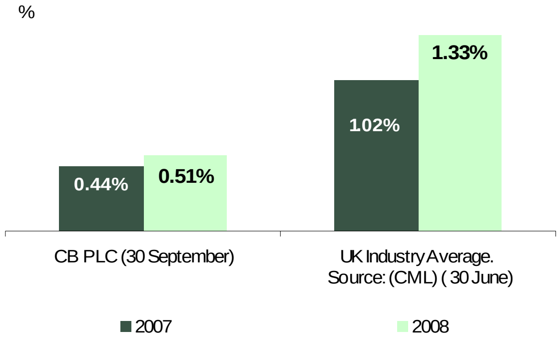
The average Loan To Value ratio (LTV) of the mortgage book is 63% on an un-indexed basis with the average LTV on applications falling to 59% in recent months. As a result loss levels remain very low as a proportion of the overall portfolio.

All asset quality measures remain under close management scrutiny and review to ensure actions in place remain appropriate in the current environment. Actions undertaken in the year have included enhanced collections strategies, increasing resourcing levels in our Business Recovery area, tightening of retail credit policy, emphasis on staff training and a continued focus on early identification and referral.

The increase of the September 2008 gross impaired asset balances over the March 2008 balances includes two connections detailed earlier which account for almost one-fifth of the increase (£21 million). The underlying increase reflects the current market conditions, primarily in business lending, the low historical base and the growth experienced by the Bank in recent years.

The ratio of 90+DPD to gross loans and acceptances increased only modestly from 0.39% to 0.47%. This increase reflects the improved management of balances in this category including an enhanced contact programme with mortgage customers. Mortgage balances 90+DPD remain well below the UK industry average.

Proportion of Mortgages in arrears by 90+ DPD by value

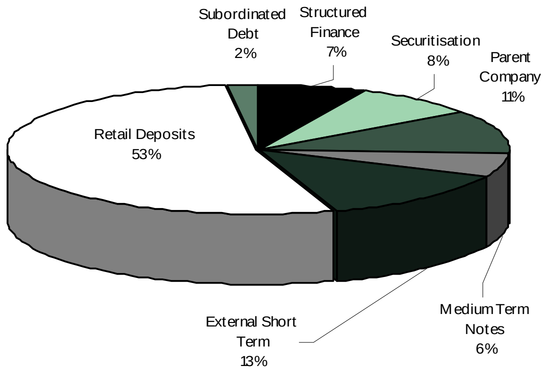


Taking gross impaired assets and 90+DPD balances together, the ratio has increased to 1.08%

The coverage ratio of total provision to gross loans and acceptances has increased from 1.02% in March 2008 to 1.09% in September 2008. This reflects additional provisioning, primarily for business lending, and is considered to be prudent in current circumstances.

Capital & Funding Position

Clydesdale Bank PLC Diversity of Funding [(1)]



The Group's position as a member of a stable and geographically diversified group has proved to be an asset in these turbulent times. The long term credit ratings of Clydesdale Bank (CB) were maintained through the period (AA- by Standard & Poors, Aa3 by Moodys and AA- by Fitch), and proved to be valuable in the attraction and retention of funds.

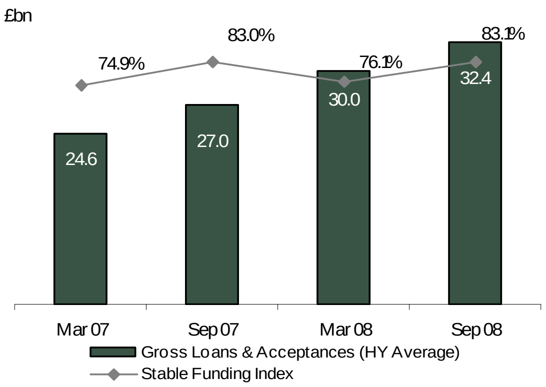
The Bank has continued to maintain strong capital ratios with a core Tier 1 ratio of 7.4% and Total Solvency of 11.3% as at 30 September 2008. These ratios include profits up to 30 September 2008. The bank is eligible to participate in the market initiatives announced by the UK Government in October. However CB's capital plans assume no capital raising from this source.

As at 30 September, the Bank held a portfolio of liquid assets totalling £6.8 billion; substantially higher than that held prior to the recent market turbulence. This portfolio included UK government gilts, balances in the Bank of England Reserve Account and funds held with the parent.

Despite volatile market conditions, the strong liquidity position was maintained. This was due in part to a diverse funding base which includes a mix of short, medium, and long-term wholesale funding, parent company funding, and securitisation. Subsequent to the year end, the bank has (following the earlier participation by most other UK banks) made use of the UK Government's Special Liquidity Scheme (SLS), which was announced in April 2008 through a covered bond programme.

The Stable Funding Index (SFI) remained within the historical range, moving from 83.0% in September 2007 to 83.1% in September 2008. The relative stability of the index reflects the continuing contribution of customer deposits to the overall funding requirement.

Stable Funding Index



The Group continues to recognise the importance of retail deposits and has launched a number of new products as a means of ensuring that strong deposit growth continues in this area. This will ensure that the Group remains well positioned to grow without increasing the refinancing risks typically associated with wholesale funding.

Investment Spend

Investment continued on systems and processes, with total cash expenditure of £89 million in 2008 compared to £103 million in 2007. Investment was directed into three broad categories; efficiency and sustainable revenue, infrastructure, and compliance.

October 2007 saw another significant milestone in the ongoing re-engineering of the business, with the Teller Programme completing its deployment into Clydesdale Bank. This concluded the Teller Project that commenced in 2005 as part of the Strategic Agenda Programme.

Investment in the front office continued, with the mobilisation of the Business Lending Programme to implement an end-to-end business lending system.

During April 2008 a suite of changes was successfully implemented to ensure continued compliance with the Consumer Credit Act. These changes are part of an overall change programme which was completed in October 2008.

On 27 May 2008, Clydesdale Bank successfully joined the UK Banking Industry Faster Payments scheme, along with ten other UK banks. CB was the first member bank to send a transaction via the new service and obtained a valid response from the receiving bank within a second. Our customers can receive Faster Payments as part of a phased rollout, which will be completed later in the year.

Development of the new second Data Centre was completed ahead of schedule with full migration concluded in July 2008.

The new Business Internet Channel was successfully piloted to external customers in July 2008. September 2008 saw another significant milestone of the programme, with 50 external customers trained and using the application. Feedback from customers on the pilot has been positive, particularly around the system's ease of use.

Previous investment in convergence continued to be exploited through various initiatives. In September 2008 the 'On-line Origination of Term Deposits' system was launched, which improves the customers' experience when applying for term deposit products.

Distribution

The network of Financial Solutions Centres (FSCs) and retail branches has remained stable over the six months to September 2008, with 77 FSCs and 342 branches.

iFS added one principal FSC and two satellite sites during the year and has continued to demonstrate strong levels of underlying growth in its core business, with a focus on sound lending priced appropriately for risk. In conjunction with Specialist & Acquisition Finance, there have been a number of successes in attracting high value trading business relationships from our competitors.

Within Retail, the branch refurbishment programme continues with improvements to nearly half of the branches. A strong focus on process improvement and further enhancement of the customer experience has contributed to improved efficiency. The launch of the new Signature Current Account is expected to continue the improving trend in customer numbers.

New look websites for Clydesdale Bank (cbonline.co.uk) and Yorkshire Bank (ybonline.co.uk) were launched during the year.

Comparison of Clydesdale Bank PLC Consolidated result with NAB Group UK Region segmental result

The NAB Group publishes segmental financial results of which the UK Region forms one segment. The 2008 full year results were published by NAB on 21 October 2008. The segmentation is based on geographical lines, the exception being the nabCapital business which is treated as a global business segment in its own right. As shown in Note 3 of these financial statements, certain of the nabCapital business is written on the CB PLC balance sheet and therefore this business is not included in the UK Region result. The UK wealth management business, which operates through separate legal entities, is also included in the UK Region results but is not part of CB PLC. The other main difference between the CB PLC and UK Region results is the inclusion of fair value and hedge ineffectiveness income which is excluded from the NAB regional cash earnings results. The table below sets out the reconciliation of the income statements of the two views:

	CB PLC £m	**Add: Wealth Management £m**	**Less: nabCapital £m**	**Fair value and hedge ineffectiveness £m**	**Other * £m**	**NAB UK Region £m**
Profit on ordinary activities before tax/Cash earnings before tax	350	50	(47)	(18)	8	343
Profit attributable to shareholders/Cash earnings after tax	247	43	(35)	(12)	6	249
Total assets	41,971					42,253

* Other includes £6m accrual for FSCS levy which was not included in the published results for UK Region.

Lynne Peacock
Chief Executive Officer
25 November 2008

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 2008

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 342 branches in the UK. Developments in the Group's existing business and future prospects are discussed below

Profits and appropriations

The Group operating profit for the year ended 30 September 2008 amounted to £347m (2007: £402m). The profit attributable to the shareholders for the year ended 30 September 2008 amounted to £247m (2007: £277m). Dividends of £95m (2007: £40m) were paid during the year. The Directors do not recommend the payment of a final dividend in respect of this financial year (2007: £95m) Refer to the Business Review on pages 4 - 11 for the Bank's Strategic Highlights and Business Developments

Financial instruments

The Group's risk management objectives and policies are discussed in the Risk Overview on pages 104 to 107

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 ar appointed in accordance with the Articles of Association and may be eligible for reappointment thereafter. No Director wa eligible for reappointment during the year.

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 NAB, which is incorporated in Australia, any interest which the Directors may have in NAB does not need to be notified to the Bank, and thus 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, a well as protecting the Group itself to the extent that it is obligated to indemnify Directors and Officers for such liability

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 yea 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 gifte per annum through the plan.

Under the UK National Share Incentive Plan, the National EVA ® Share Offer gifted ordinary shares of A$1,000 to eligible employee based on Group performance during 2007 - 2008. Participants are entitled to receive dividends and exercise voting rights in respect of these shares whilst they are members of the plan.

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 2008 was £336,000 (2007: £280,000).

In July 2008 the Yorkshire and Clydesdale Bank Foundation was launched which will continue the tradition the Bank has in supporting people and their local communities. The Foundation will provide support to registered charities, not-for-profit organisations, community and other voluntary organisations.

No political donations were made during the year (2007: £Nil).

Corporate governance

It is the Bank'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.

Events after the balance sheet date

On 17 October 2008, Clydesdale Bank PLC established a €9bn Clydesdale Bank Global Covered Bond Programme for its own account. On the same date a £1.85bn bond due in January 2012 was issued from the programme backed by a rated collateral pool of Clydesdale originated residential and buy to let mortgage assets of c£2.4bn. The bond was issued and retained by Clydesdale and will be used to participate in the Bank of England 'Special Liquidity Scheme (SLS)'.

The Covered Bond Programme is a strategic initiative to provide an additional source of funding and liquidity when required and complements Clydesdale Bank's other wholesale term funding activities.

Plans are being formed to allow the Bank to raise £700m of new capital from NAB which will further strengthen the capital ratios.

Auditors

In accordance with section 385 of the Companies Act 1985, 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
Secretary
25 November 2008

CLYDESDALE BANK PLC
Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRS) as adopted by the European Union.

Company Law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Group and Bank and of the profit or loss for that financial year. In preparing the Financial Statements, the Directors are required to:

- select suitable accounting policies 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 of IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and

- state that the company has complied with IFRS, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and of the Bank and which enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

We have audited the Group and Bank Financial Statements of Clydesdale Bank PLC for the year ended 30 September 2008 which comprise the Consolidated Income Statements, the Group and Bank Statements of Recognised Income and Expense, the Group and Bank Balance Sheets, the Group and Bank Cash Flow Statements, and the related notes 1 to 41. These Financial Statements have been prepared on the basis of the accounting policies set out therein.

This report is made solely to the Bank's members, as a body, in accordance with Section 235 of the Companies Act 1985. 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 Auditors

The Directors' Responsibilities for preparing the Annual Report and the Financial Statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Financial Statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985 and as regards the Group Financial Statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion, the information given in the Directors' Report is consistent with the Financial Statements.

In addition we report to you if, in our opinion, the Bank has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read the other information contained in Annual Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Financial Statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the Financial Statements, and of whether the accounting policies are appropriate to the Group's and Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Financial Statements.

Opinion

In our opinion:

- the Group’s Financial Statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 30 September 2008 and of its profit for the year then ended;

- the Bank’s Financial Statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, as applied in accordance with the provisions of the Companies Act 1985, of the state of the Bank's affairs as at 30 September 2008;

- the Financial Statements have been properly prepared in accordance with the Companies Act 1985 and as regard the Group’s financial statements, Article 4 of the IAS Regulation; and

- the information given in the Directors’ report is consistent with the Financial Statements.

Ernst & Young LLP
Registered Auditor
London

26 November 2008

CLYDESDALE BANK PLC
Consolidated Income Statement
for the year ended 30 September 2008

	Note	**2008** **£m**	2007 £m
Interest receivable and similar income		**2,393**	1,927
Interest expense and similar charges		**(1,497)**	(1,065)
Net interest income	4	**896**	862
Gains less losses on financial instruments at fair value		**31**	60
Other operating income		**293**	287
Non interest income	5	**324**	347
Total operating income		**1,220**	1,209
Personnel expenses		**(211)**	(211)
Depreciation expense	18	**(26)**	(42)
Other operating expenses		**(457)**	(437)
Total operating expenses	6	**(694)**	(690)
Operating profit before impairment losses		**526**	519
Impairment losses on credit exposures	15	**(179)**	(117)
Group operating profit		**347**	402
Profit on sale of land and buildings		**10**	13
Special financial services compensation scheme levy		**(6)**	-
Refund of current account fees & associated costs	23	**(1)**	(11)
Profit on ordinary activities before tax		**350**	404
Tax expense	7	**(103)**	(127)
Profit for the financial year attributable to the shareholders	28	**247**	277

All material items dealt with in arriving at the profit on ordinary activities before tax for 2008 and 2007 relate to continuing activities.

CLYDESDALE BANK PLC

Statement of Recognised Income and Expense
for the year ended 30 September 2008

	Note	Group		Bank	
		2008	2007	**2008**	2007
		£m	£m	**£m**	£m
Income and expense recognised directly in equity					
Revaluation of land and buildings	28	**(3)**	(1)	**(3)**	(1)
Net change in available for sale investments reserve	28	**3**	(3)	**3**	(3)
Net change in cash flow hedge reserve	28	**28**	(10)	**28**	(10)
Actuarial gains on defined benefit pension plans	24	**5**	222	**5**	222
Post retirement medical benefits	24	**(7)**	-	**(7)**	-
Total changes in items recognised directly in equity		**26**	208	**26**	208
Tax on items recognised directly in equity	7	**(12)**	(64)	**(12)**	(64)
Net change in items recognised directly in equity		**14**	144	**14**	144
Profit for the year		**247**	277	**143**	243
Total recognised income and expense for the year		**261**	421	**157**	387
Attributable to:					
Ordinary shareholders		**261**	421	**157**	387

CLYDESDALE BANK PLC
Balance Sheets
at 30 September 2008

		Group		Bank	
		2008	2007	**2008**	2007
	Note	**£m**	£m	**£m**	£m
Assets					
Cash and balances with central banks	9	**5,109**	2,093	**5,109**	2,293
Due from other banks	10	**522**	685	**14**	165
Derivative financial assets	11	**602**	126	**270**	80
Financial assets at fair value through profit or loss	12	**4,276**	3,053	**4,276**	3,053
Investments	13	**7**	1,714	**7**	1,314
Loans and advances to customers	14	**28,656**	25,055	**24,506**	20,806
Due from customers on acceptances		**3**	3	**3**	3
Investments in controlled entities and associates	17	**2**	2	**37**	35
Property, plant and equipment	18	**223**	255	**223**	193
Deferred tax assets	19	**-**	45	**(3)**	40
Defined benefit pension assets	24	**239**	159	**239**	159
Due from related entities	36	**1,153**	1,329	**2,434**	5,529
Other assets	20	**1,179**	1,042	**2,772**	740
Total assets	33	**41,971**	35,561	**39,887**	34,410
Liabilities					
Due to other banks	21	**3,962**	2,289	**3,962**	2,289
Derivative financial liabilities	11	**36**	22	**36**	22
Financial liabilities at fair value through profit or loss	12	**553**	442	**553**	442
Due to customers	22	**22,334**	19,319	**22,062**	18,901
Liabilities on acceptances		**3**	3	**3**	3
Current taxes		**(5)**	57	**(43)**	10
Deferred tax liabilities	19	**24**	18	**5**	-
Provisions	23	**9**	13	**9**	13
Bonds and notes	25	**5,451**	5,471	**2,585**	2,314
Due to related entities	36	**5,151**	3,915	**6,271**	6,816
Other liabilities	26	**2,289**	1,890	**2,507**	1,737
		39,807	33,439	**37,950**	32,547
Shareholders' equity					
Share capital	27	**232**	232	**232**	232
Share premium account	28	**243**	243	**243**	243
Share option reserve	28	**20**	12	**20**	12
Asset revaluation reserve	28	**7**	13	**7**	13
Available for sale investments reserve	28	**-**	(3)	**-**	(3)
Merger reserve	28	**338**	338	**338**	338
Cash flow hedge reserve	28	**11**	(9)	**11**	(9)
Retained earnings	28	**1,313**	1,160	**1,086**	1,037
Total parent shareholders' equity		**2,164**	1,986	**1,937**	1,863
Minority interests	28	**-**	136	**-**	-
Total liabilities and shareholders' equity	33	**41,971**	35,561	**39,887**	34,410

These financial statements were approved by the Board of Directors on 25 November 2008 and were signed on its behalf by:

Sir Malcolm Williamson
Director

Lynne Peacock
Director

CLYDESDALE BANK PLC
Cash Flow Statement
for the year ended 30 September 2008

	Note	Group 2008 £m	Group 2007 £m	Bank 2008 £m	Bank 2007 £m
Profit on ordinary activities before tax		**350**	404	**194**	339
Adjustments for:					
Non cash items included in profit before tax	35	**(691)**	(484)	**(534)**	(444)
Changes in operating assets	35	**(3,468)**	(6,206)	**(5,653)**	(4,847)
Changes in operating liabilities	35	**4,841**	3,093	**5,410**	3,160
Interest received		**2,052**	1,571	**1,800**	1,480
Interest paid		**(656)**	(480)	**(681)**	(623)
Tax paid		**(131)**	(66)	**(67)**	(50)
Net cash provided by/(used in) operating activities		**2,297**	(2,168)	**469**	(985)
Cash flows from investing activities					
Interest received		**55**	39	**42**	20
Purchase of property, plant and equipment		**(78)**	(56)	**(78)**	(56)
Proceeds from sale of property, plant and equipment		**90**	52	**31**	47
Net cash provided by investing activities		**67**	35	**(5)**	11
Cash flows from financing activities					
Interest received		**69**	44	**61**	227
Interest paid		**(553)**	(369)	**(410)**	(382)
(Redemption)/issue of bonds and notes		**(20)**	3,819	**271**	662
Share options settled		**-**	(20)	**-**	(20)
Net decrease/(increase) in amount due from related entities		**176**	(100)	**3,095**	(796)
Net (decrease)/increase in amount due to related entities		**1,248**	(1,038)	**(533)**	1,483
Net decrease in minority interest		**(136)**	-	**-**	-
Dividends paid		**(95)**	(40)	**(95)**	(40)
Net cash provided by financing activities		**689**	2,296	**2,389**	1,134
Net increase in cash and cash equivalents		**3,053**	163	**2,853**	160
Cash and cash equivalents at beginning of the year		**2,137**	1,974	**2,337**	2,177
Cash and cash equivalents at end of the year	35	**5,190**	2,137	**5,190**	2,337

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 17. The consolidated Financial Statements comprise the financial statements of the Group.

The consolidated Financial Statements of Clydesdale Bank PLC for the year ended 30 September 2008 were authorised for issue by the Board of Directors on 25 November 2008 and the balance sheets were signed on the Board's behalf by Sir Malcolm Williamson and Lynne Peacock.

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

Copies of the Annual Report and consolidated Financial Statements prepared in respect of the Bank may be obtained from the Corporate Affairs Department, Clydesdale Bank PLC, 30 St. Vincent Place, Glasgow, G1 2HL.

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. National Europe Holdings (GB) Limited, a company incorporated and registered in England and Wales, is the immediate holding company for the Bank.

The Group and Bank's Financial Statements have been prepared in accordance with IFRS as adopted for use in the European Union and as applied in accordance with the provisions of the Companies Act 1985. 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. It is not anticipated that such differences would be material.

The financial statements have been prepared under the historical cost convention, as modified by the application of fair value measurements.

As permitted by section 230 of the Companies Act 1985, no Income Statement is presented for the Bank.

Currency of presentation

All amounts are expressed in pounds sterling and all values are rounded to the nearest million pounds unless otherwise stated.

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. SPEs require consolidation in circumstances such as those where the Bank has 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.

2. Accounting policies (continued)

Principles of consolidation (continued)

Outside interests in the equity and results of the entities that are controlled by the Bank are shown as a separate item, "minority interest", in the consolidated financial statements.

Associates
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.

Foreign currency translation

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges. Translation differences on non-monetary items, such as equity securities held at fair value through profit or loss, are reported as part of the fair value gain or loss.

Segment reporting

A business 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 business segments.

A geographical segment is defined as a group of assets and operations engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

Fair value measurement

Fair value is defined as the amount for which an asset could be exchanged or a liability settled, 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. An adjustment for credit risk is also incorporated into the fair value.

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, 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.

The best evidence of the fair value of a derivative 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.

2. Accounting policies (continued)

Fair value measurement (continued)

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.

Assets

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.

Cash and cash equivalents are brought to account at the face value or the gross value of the outstanding balance where appropriate.

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

Upon initial recognition financial assets may be designated as fair value through profit or loss ("FVTPL"). This classification can only be used in the following circumstances:

- 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.

  Under this criterion the Group has elected to designate certain individually hedged customer loans and their underlying derivatives at FVTPL. Derivatives at FVTPL are predominantly interest rate swaps hedging fixed interest rate loans. The fair value of derivatives at FVTPL is based on the current active market rates. Significant terms and conditions affecting the timing and future cash flow of the loans are the principal amount, term, repayment frequency, and fluctuations in interest rates. Designating the loans at fair value minimises future volatility within the income statement as movement caused by interest rate fluctuations are largely offset by an equal and opposite movement in the underlying derivative financial instruments.

- If an embedded derivative is required to be separated from the host contract but cannot be reliably fair valued.

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

Purchases and sales of financial assets classified within FVTPL are recognised on trade date, being the date that the Group is committed to purchase or sell an asset.

Once a financial instrument has been designated as FVTPL it is not possible subsequently to change the designation.

The Group assesses whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. No subsequent reassessment is permitted unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is performed. The Group determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed and whether the change is significant relative to the previously expected cash flows on the contract.

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 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.

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.

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 ultimately affects profit or loss. 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 Group has classified the derivative as a trading item; or
- The derivative does not meet the criteria for hedge accounting.

In both these cases the derivative is classified as a trading derivative. Changes in the fair value of trading derivatives are recognised immediately 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. Available for sale investments primarily comprise debt and equity securities.

2. Accounting policies (continued)

Available for sale investments (continued)

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 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.

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, housing loans, lease finance and term lending.

Loans and receivables are 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.

Repurchase and reverse repurchase agreements

Securities sold subject to repurchase agreements ("repos") are valued at amortised cost and reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral. 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 valued at amortised cost and accounted for as collateralised loans. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

Impairment of financial assets

The Group assesses at each balance sheet date whether there is evidence that a financial asset or a portfolio of financial assets 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.

2. Accounting policies (continued)

Impairment of financial assets (continued)

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 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.

Financial assets at fair value through the profit or loss are not assessed for impairment as their fair value reflects the credit quality of the instrument and changes in fair value are recognised 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 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.

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.

2. Accounting policies (continued)

Impairment of financial assets (continued)

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.

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. 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. 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.

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 land, all items of property, plant and equipment are depreciated using the straight-line method, at rates appropriate to their estimated useful lives to the Group. Buildings and leasehold properties with more than thirty years to the expiry of the lease, are depreciated over the term of the lease to a maximum of fifty years. Leasehold properties with less than thirty years to the expiry of the lease are depreciated over ten years or the period of the lease, whichever is the shorter. Motor vehicles, fixtures and equipment are depreciated over their estimated useful lives, which range from three to ten years. Residual values are determined on the dates of acquisition and revaluation of assets, based on estimated realisable values, net of any realisation costs.

Gains or losses on the disposal of property, plant and equipment, which is 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 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.

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. If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount is deferred and amortised over the lease term. If it results in an operating lease, and the transaction is established at fair value, any excess of sales proceeds over the carrying amount is recognised immediately.

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 18, 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:

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

- 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

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

2. Accounting policies (continued)

Financial liabilities (continued)

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 it 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 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.

Non-lending losses

Provision for non-lending losses is raised for losses to be incurred by the Group, which do not relate directly to amounts in respect of principal and interest outstanding for loans and advances.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation as at the reporting date, taking into account the risks and uncertainties that surround the events and circumstances that affect the provision.

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

Dividends are recognised as a liability at the time the dividend is approved. Dividends that are approved after the balance sheet date are disclosed as a post balance sheet event.

2. Accounting policies (continued)

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.

Financial guarantees are recognised at the greater of the unearned revenue or any provision that arises when a claim obligation is probable.

Pension and post retirement costs

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

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.

The defined benefit schemes provide defined benefits based on years of service and career averaged revalued earnings. A liability or asset in respect of defined benefit pension plans is recognised in the balance sheet and is measured as the present value of the defined benefit obligation at the reporting date less the fair value of the superannuation fund's assets at that date and any unrecognised past service cost.

The present value of the defined benefit obligations for each scheme is discounted by the AA corporate bond rates for bonds that have maturity dates approximating to the terms of the Group's obligations.

Where pension schemes from outside the Group are merged, the net fair value of assets and liabilities of the scheme transferred is recognised in the income statement.

Pension expense attributable to the Group's defined benefit plans 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.

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, unless:

- a full or proportional share of all or specifically identified cash flows are transferred to the lender, in which case, the full amount or that proportion of the asset is derecognised; or

- substantially all the risks and returns associated with the financial instruments have been transferred, in which case, the assets are derecognised in full; or

- if a significant portion, but not all, of the risks and rewards have been transferred, the asset is derecognised entirely if the transferee has the practical ability to sell the financial asset or recognised only to the extent of the Group's continuing involvement in the asset.

2. Accounting policies (continued)

Income tax

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.

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 and date are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. A deferred tax asset or liability is not recognised if it arises from initial recognition of an asset or liability (in a transaction other than a business combination) that at the time of the transaction affects neither accounting profit nor taxable profit or loss.

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 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.

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.

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.

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.

Subordinated debt and related entity balances

Subordinated debt and related entity balances are recorded at amortised cost.

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. Embedded derivatives within debt instruments must also be separately accounted for where not closely related to the terms of the host debt instrument. These embedded derivative instruments are recorded at fair value with gains and losses on the embedded derivative recorded in the income statement.

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.

2. Accounting policies (continued)

Netting

A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet when, and only when, the Bank currently 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.

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.

Commitment fees, together with related direct costs, for loan facilities where draw down is probable are deferred and recognised as an adjustment to the effective yield on the loan once drawn. Commitment fees in relation to facilities where draw down is not probable are recognised over the term of the commitment.

2. Accounting policies (continued)

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. Interest income and expense on trading securities is reported within interest income and not included in the fair value movement on these instruments.

Hedging assets, liabilities and derivatives designated in hedge relationships recognises 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.

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.

2. Accounting policies (continued)

Accounting developments

During the year the IASB and International Financial Reporting Interpretations Committee issued the following standards and interpretations with an effective date after the date of these financial statements:

International Accounting Standards (IAS/IFRS)		***Effective Date: Annual periods beginning on or after***
Various	Improvements to IFRS (i)	1 January 2009
IFRS 1	Amendments - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (i)	1 January 2009
IFRS 2	Amendment - Vesting Conditions and Cancellations (i)	1 January 2009
IFRS 3	Revised - Business Combinations (i)	1 July 2009
IFRS 7	Amendment - Reclassification of Financial Instruments	1 July 2008
IFRS 8	Operating Segments	1 January 2009
IAS 1	Revised - Presentation of Financial Statements (i)	1 January 2009
IAS 1	Amendment - Puttable Financial Instruments and Obligations Arising on Liquidation (i)	1 January 2009
IAS 23	Revised - Borrowing costs (i)	1 January 2009
IAS 27	Amendment - Consolidated and Separate Financial Statements (i)	1 July 2009
IAS 27	Amendments - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (i)	1 January 2009
IAS 32	Amendment - Puttable Financial Instruments and Obligations Arising on Liquidation (i)	1 January 2009
IAS 39	Amendment - Reclassification of Financial Instruments (ii)	1 July 2008
IAS 39	Amendment - Eligible Hedged Items (i)	1 July 2009

2. Accounting policies (continued)

Accounting developments (continued)		***Effective Date: Annual periods beginning on or after***
International Financial Reporting Interpretations Committee (IFRIC)		
IFRIC 12	Service Concession Arrangements (i)	1 August 2008
IFRIC 13	Customer Loyalty Programmes (i)	1 July 2008
IFRIC 14	IAS 19: The limit on a defined benefit asset, minimum funding requirements and their interaction (i)	1 January 2008
IFRIC 15	Agreements for the Construction of Real Estate (i)	1 January 2009
IFRIC 16	Hedges of a Net Investment in a Foreign Operation (i)	1 October 2008

(i) This standard/interpretation has not yet been adopted by the European Union.
(ii) This amendment was issued on 13 October 2008 with a transition period whereby reclassifications can be made on or after 1 July 2008. The Group has not applied this retrospectively. Subsequent reclassifications made during periods beginning on or after 1 November 2008 shall be reclassified from that date.

With the exception of IFRIC 14, where the Directors are still considering the impact, the Directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application.

3. Nature of business and segmental reporting

For the purposes of this note a business segment is a distinguishable component of the entity that is engaged in providing groups of related products and services and that is subject to risks and returns that are different from those of other business segments. Separate financial information for each segment is reported to the UK Executive Committee for the purposes of evaluating performance.

The Group's business is organised into two main operating segments: Financial Services UK and nabCapital. Financial Services UK is the retailing arm of the Group, providing a full range of financial services to customers. nabCapital is responsible for the Group's relationships with large corporations and institutions.

Revenue and expenses directly associated with each business segment are included in determining their result. There are no material transactions between business segments. Segment revenue represents revenue directly attributable to a segment and a portion of the Group's revenue that can be allocated to a segment on a reasonable basis. Segment result represents segment revenue less segment expenses and impairment losses on credit exposures and after income taxes. The Group allocates all of its assets and liabilities to business segments.

2008	Financial Services UK £m	nabCapital £m	Total £m
Net interest income	868	28	896
Non interest income	296	28	324
Net significant revenue	3	-	3
Segment revenue	1,167	56	1,223
Segment result	303	47	350
Tax expense			(103)
Profit for the financial year			247
Total assets	40,329	1,642	41,971
Total liabilities	32,552	7,255	39,807
Other segment items			
Acquisition of property, plant & equipment	78	-	78
Depreciation of property plant & equipment	26	-	26
Share based payments	12	-	12
Impairment losses:			
Recognised in income statement	174	5	179
Amounts written off	190	-	190
Recoveries of amounts written off in previous years	56	-	56

A strategic review earlier in the financial year focused on the most appropriate platform for the relationship management of mid-tier UK corporate clients. The outcome of the review resulted in a number of nabCapital regional client portfolios being transferred to Clydesdale's Corporate & Acquisition Finance business, which is an integral part of Financial Services UK, under Clydesdale/Yorkshire branding, depending upon the region.

3. Nature of business and segmental reporting (continued)

2007	**Financial Services UK £m**	**nabCapital £m**	**Total £m**
Net interest income	832	30	862
Non interest income	314	33	347
Net significant revenue	2	-	2
Segment revenue	1,148	63	1,211
Segment result	343	61	404
Tax expense			(127)
Profit for the financial year			277
Total assets	29,761	5,800	35,561
Total liabilities	28,132	5,307	33,439
Other segment items			
Acquisition of property, plant & equipment	56	-	56
Depreciation of property plant & equipment	42	-	42
Share based payments	9	-	9
Impairment losses:			
Recognised in income statement	119	(2)	117
Amounts written off	151	-	151
Recoveries of amounts written off in previous years	44	-	44

Geographical segments

The Group has no material segments outwith the UK and thus no secondary geographical segment information is presented.

4. Net interest income

	2008 £m	2007 £m
Interest income		
Loans and advances to other banks	**97**	96
Investments	**55**	40
Loans and advances to customers	**1,844**	1,541
Due from related entities	**69**	44
	2,065	1,721
Financial assets at fair value through profit or loss	**328**	206
Total interest income	**2,393**	1,927
Interest expense		
Due to other banks	**129**	56
Due to customers	**805**	637
Bonds and notes	**322**	140
Due to related entities	**231**	228
	1,487	1,061
Financial liabilities at fair value through profit or loss	**10**	4
Total interest expense	**1,497**	1,065
Net interest income	**896**	**862**

5. Non interest income

	2008 £m	2007 £m
Gains less losses on financial instruments at fair value through profit or loss		
Foreign exchange derivatives	**9**	16
Interest rate derivatives	**(84)**	31
Other derivatives	**-**	9
Movement in fair value of assets	**80**	-
Ineffectiveness arising from hedging relationships	**26**	4
	31	60
Other operating income		
Fee and commission income	**268**	232
Operating lease income	**4**	25
Other income	**21**	30
	293	287
Total non interest income	**324**	347

Certain financial assets are designated at inception as fair value through profit or loss (FVTPL). These assets are predominantly fixed interest rate loans which are individually hedged. These will derive a positive mark to market ("MTM") value on the projected income including margin when interest rates are falling and negative MTM when interest rates are rising. Corresponding opposite movements in the underlying derivatives are shown in the interest rate derivatives line. The positive MTM in 2008 reflects the fall in the yield curve in the period.

6. Operating expenses

	2008	2007
	£m	£m
Personnel expenses		
Salaries, wages and non cash benefits	**186**	183
Related personnel expenses	**17**	18
Defined contribution pension expense	**5**	5
Defined benefit pension credit	**(21)**	(17)
Employee share compensation	**12**	11
Other personnel expenses	**12**	11
	211	211
Depreciation expense		
Depreciation of property, plant & equipment (note 18)	**26**	42
Other operating expenses		
Operating lease rental	**31**	31
Other occupancy expenses	**34**	34
Related entity recharges	**304**	286
Other operating expenses	**88**	86
	457	437
Total operating expenses	**694**	690

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.

	2008	2007
	£'000	£'000
Audit of the financial statements	**790**	790
Other fees to auditors:		
audit of the Group pension schemes	**50**	46
local statutory audits for subsidiaries	**126**	174
other assurance	**229**	90
	1,195	1,100

7. Tax expense

a) Analysis of charge in the period

Tax charged in the income statement

The charge for taxation comprises:	**2008 £m**	2007 £m
Current tax		
United Kingdom corporation tax at 29% (2007: 30%)		
- current year	**47**	81
- prior year	**-**	(6)
	47	75
Other overseas taxation	**28**	20
Total current tax	**75**	95
Deferred tax		
Origination and reversal of temporary differences		
- current year	**25**	27
- prior year	**3**	5
Total deferred income tax	**28**	32
Income tax expense reported in income statement	**103**	127

Tax relating to items charged or credited to equity

	2008 £m	2007 £m
Current tax		
Available for sale investments	**-**	(1)
Release of transitional deferred tax	**(6)**	(7)
Deferred tax asset		
Actuarial gains and losses on post retirement benefits	**-**	69
Employee share compensation	**4**	(1)
Release of transitional deferred tax	**6**	7
Deferred tax liability		
Net gain on revaluation of cash flow hedges	**8**	(3)
Tax charge in the statement of recognised income and expense	**12**	64

7. Tax expense (continued)

b) Factors affecting tax charge for the period

The tax assessed for the period reflects the standard rate of corporation tax in the UK (29%). The factors are explained below:

	2008	2007
	£m	£m
Profit on ordinary activities before tax	**350**	404
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 29% (2007: 30%)	**101**	121
Effects of:		
Expenses not deductible for tax purposes	**4**	8
Amounts not subject to UK tax	**(3)**	-
Other	**(1)**	-
Rate differences	**(1)**	(1)
Adjustments to tax charge in respect of previous periods	**3**	(1)
Total income tax charge for period	**103**	127

On 1 April 2008, the UK tax rate was reduced from 30% to 28%. The rate differences adjustment reflects the impact on the deferred tax balances held.

8. Dividends paid

	2008	2007
	£m	£m
2007 interim ordinary dividends paid - 17.24p per share	**-**	40
2007 final ordinary dividends paid - 40.95p per share	**95**	-
	95	40

9. Cash and balances with central banks

	Group		**Bank**	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Cash assets	**5,083**	2,059	**5,083**	2,259
Balances with central banks	**26**	34	**26**	34
	5,109	2,093	**5,109**	2,293

Balances with central banks are mandatory deposits which are not available for use in the Group's day to day business.

9. Cash and balances with central banks (continued)

Cash collateral on securities borrowed and reverse repurchase agreements

Group and Bank	**2008**	2007
	£m	£m
Cash collateral on reverse repo agreements	**802**	190
Other assets used as collateral:		
Operational balances with central banks	**-**	1,075
Loans at fair value through profit or loss	**39**	41
	841	1,306

As part of the reverse repurchase and securities borrowing agreements, the Group has received securities that it is allowed to sell or repledge. No securities held under the reverse repurchase agreements have 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. The associated liability to return these securities is included in derivative financial liabilities. These transactions are conducted under terms that are usual and customary to standard lending, securities borrowing and lending activities.

10. Due from other banks

	Group		**Bank**	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Transaction balances with other banks	**20**	18	**13**	11
Securities purchased under agreements to resell	**-**	485	**-**	-
Loans and advances	**500**	-	**-**	-
Placements with other banks	**2**	182	**1**	154
	522	685	**14**	165

11. Derivative financial instruments

Use of derivatives

The Group uses derivatives to hedge its own balance sheet position. 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. The principal objectives of asset and liability management are to protect levels of net interest income, while maintaining acceptable levels of interest rate liquidity risk and to facilitate the funding needs of the Group.

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. These hedge transactions within the Group are entered into with NAB. Provided IAS 39 cash flow hedging criteria are met, the fair value changes on the related hedging instruments 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 trade in any financial instruments including derivatives and therefore does not have a trading book. However, certain historical derivatives within the Group do not meet the IAS 39 hedging criteria. These derivatives are designated as trading derivatives and their movement in fair value will directly impact income. A residual volume of these derivatives exists that is gradually reducing over time as historic deals mature.

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.

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 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.

11. Derivative financial instruments (continued)

Use of derivatives (continued)

Other financial instruments
In addition to derivatives, various financial instruments, for example loans and advances, deposits, debt securities, trade debtors and creditors and accruals, arise directly from the Group's operations. Where the fair value of these differ from the book value details are given in the appropriate note to the financial statements. The disclosures in these notes include all short-term debtors and creditors.

Risk Management
The Group's management of certain key risk factors that may impact the future results is discussed in the "Risk Overview" section on pages 104 to 107. The factors discussed should not be considered to be the complete list of all potential risks.

Group

	Contract	**Fair Value**		Contract	Fair Value	
	Amount	**Assets**	**Liabilities**	Amount	Assets	Liabilities
	2008	**2008**	**2008**	2007	2007	2007
	£m	**£m**	**£m**	£m	£m	£m
Total derivatives held						
Foreign exchange rate related contracts						
Spot, forwards and futures	**3,160**	**28**	**-**	1,803	24	33
Currency swaps	**2,967**	**449**	**1**	3,170	89	1
Options	**324**	**4**	**4**	524	6	6
Total	**6,451**	**481**	**5**	5,497	119	40
Interest rate related contracts						
Forward rate agreements	**111**	**-**	**-**	49	-	-
Swaps	**28,004**	**405**	**370**	26,366	267	246
Swaptions	**532**	**6**	**7**	-	-	-
Options	**2,661**	**14**	**29**	2,635	18	24
Total	**31,308**	**425**	**406**	29,050	285	270
Credit derivatives	**200**	**-**	**3**	-	-	-
Commodity derivatives	**14**	**1**	**1**	26	1	1
	214	**1**	**4**	26	1	1
Total derivative contracts	**37,973**	**907**	**415**	34,573	405	311

11. Derivative financial instruments (continued)

Bank

	Contract Amount 2008 £m	**Fair Value Assets 2008 £m**	**Fair Value Liabilities 2008 £m**	Contract Amount 2007 £m	Fair Value Assets 2007 £m	Fair Value Liabilities 2007 £m
Total derivatives held						
Foreign exchange rate related contracts						
Spot, forwards and futures	**3,160**	**28**	**-**	1,803	24	33
Currency swaps	**1,146**	**163**	**1**	994	26	1
Options	**324**	**4**	**4**	524	6	6
Total	**4,630**	**195**	**5**	3,321	56	40
Interest rate related contracts						
Forward rate agreements	**111**	-	-	49	-	-
Swaps	**25,854**	**359**	**370**	27,366	284	246
Swaptions	**532**	**6**	**7**	-	-	-
Options	**2,661**	**14**	**29**	2,635	18	24
Total	**29,158**	**379**	**406**	30,050	302	270
Credit derivatives	**200**	**-**	**3**	-	-	-
Commodity derivatives	**14**	**1**	**1**	26	1	1
	214	**1**	**4**	26	1	1
Total derivative contracts	**34,002**	**575**	**415**	33,397	359	311

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

11. Derivative financial instruments (continued)

Derivative contracts are disclosed as follows:

Group

	Fair Value		Fair Value	
	Assets	**Liabilities**	Assets	Liabilities
	2008	**2008**	2007	2007
	£m	**£m**	£m	£m
Derivative financial assets and liabilities	**602**	**36**	126	22
Other derivative financial assets and liabilities at fair value through profit or loss (note 12)	**136**	**165**	103	166
Derivative financial assets and liabilities at fair value - related entities (note 12)	**169**	**214**	176	123
	907	**415**	405	311

Bank

	Fair Value		Fair Value	
	Assets	**Liabilities**	Assets	Liabilities
	2008	**2008**	2007	2007
	£m	**£m**	£m	£m
Derivative financial assets and liabilities	**270**	**36**	80	22
Other derivative financial assets and liabilities at fair value through profit or loss (note 12)	**136**	**165**	103	166
Derivative financial assets and liabilities at fair value - related entities (note 12)	**169**	**214**	176	123
	575	**415**	359	311

Cash flow hedges
Included in the above are the following cash flow hedge derivatives:

	Contract	**Fair Value**		Contract	Fair Value	
	Amount	**Assets**	**Liabilities**	Amount	Assets	Liabilities
	2008	**2008**	**2008**	2007	2007	2007
	£m	**£m**	**£m**	£m	£m	£m
Interest rate-related contracts	**17,086**	**193**	**156**	18,897	21	33

The cash flow hedge derivatives are taken out as sterling interest rate related swaps designed to mitigate the Group's tailored business loans exposure. These are exclusively vanilla fixed rate interest rate swaps for which the Group has the following commitments in the time bands noted:

	2008	2007
Buy	**£m**	£m
0 to 6 months	**4,571**	11,235
6 to 12 months	**1,320**	1,518
1 to 2 years	**3,783**	1,441
2 to 5 years	**7,412**	4,703
	17,086	18,897

11. Derivative financial instruments (continued)

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 2008 £m	**Forecast payable cash flows 2008 £m**	Forecast receivable cash flows 2007 £m	Forecast payable cash flows 2007 £m
- within one year	**110**	**283**	100	320
- between one and two years	**71**	**135**	109	152
- between two and three years	**64**	**123**	66	43
- between three and four years	**22**	**55**	42	-
- between four and five years	**1**	**11**	21	-
- greater than five years	**-**	**-**	-	-
	268	**607**	338	515

	2008 £m	2007 £m
Gain from cash flow hedges recognised in the income statement due to hedge ineffectiveness	**22**	-

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

Buy	**2008 £m**	2007 £m
0 to 6 months	**-**	-
6 to 12 months	**-**	9
2 to 5 years	**3,900**	2,650
over 5 years	**-**	-
	3,900	2,659

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

		2008 £m	2007 £m
Buy			
6 to 12 months	Exchange rate £/Euro = 1.2561	**493**	-
6 to 12 months	Exchange rate £/USD = 1.8049	**142**	-
6 to 12 months	Exchange rate £/JPY = 188.2534	**53**	-
1 to 2 years	Exchange rate £/Euro = 1.2561	**-**	503
1 to 2 years	Exchange rate £/USD = 1.8049	**-**	445
2 to 5 years	Exchange rate £/Euro = 1.2561	**1,299**	1,263
2 to 5 years	Exchange rate £/USD = 1.8049	**947**	959
		2,934	3,170

Gains or losses arising from fair value hedges	**2008 £m**	2007 £m
Hedging instrument	**(425)**	(106)
Hedged item attributable to the hedged risk	**429**	108
	4	2

12. Financial assets and liabilities at fair value through profit or loss

Group and Bank	**2008**	2007
	£m	£m
Financial assets at fair value		
Loans designated at fair value through profit or loss	**3,772**	2,774
Securities at fair value through profit or loss	**199**	-
Other derivative financial assets designated at fair value through profit or loss (note 11)	**136**	103
Derivative financial assets at fair value - related entities (note 11)	**169**	176
	4,276	3,053
Financial liabilities at fair value		
Deposits at fair value through profit or loss	**174**	153
Other derivative financial liabilities designated at fair value through profit or loss (note 11)	**165**	166
Derivative financial liabilities at fair value - related entities (note 11)	**214**	123
	553	442

Loans designated at fair value through profit or loss

Included in the financial assets at fair value through profit or loss (designated at initial recognition) is a portfolio of loans which is economically hedged with interest rate derivatives. 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 £3,971m (2007: £2,774m). The cumulative change in fair value of the loans attributable to changes in credit risk amounts to an adjustment of £80m (2007: £50m) and the change for the current year is £30m (2007: £7m).

The changes in fair value of the designated loans attributable to changes in credit risk have been calculated by determining the changes in credit spreads above the market interest rates, established through a statistical based calculation used to estimate expected losses attributable to adverse movements in credit risk.

Deposits at fair value through profit or loss

Where a liability is held at fair value, the movement in fair value attributable to changes in the Group's own credit quality is calculated through reference to an observable market rate where available or the derivative of a credit adjustment based on observabl market inputs. This adjustment to the credit quality of the liability is then applied to the carrying value of the liability held at fair value.

The change in fair value attributable to changes in market conditions that give rise to market risk during the period is a gain of £3m (2007: loss of £3m) and as at 30 September, accumulated losses of £3m (2007: accumulated losses of £7m). The Bank is contractually obligated to pay £3m (2007: £7m) more than the carrying amount at maturity to the deposit holder.

13. Investments

	Group		**Bank**	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Available for sale - listed	**6**	400	**6**	-
Held to maturity - listed	**1**	1,314	**1**	1,314
	7	1,714	**7**	1,314

14. Loans and advances to customers

	Group		Bank	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Overdrafts	**4,779**	3,690	**5,258**	3,930
Credit cards	**543**	565	**543**	565
Lease finance	**1,533**	1,490	**757**	730
Housing loans	**11,868**	10,963	**8,002**	7,446
Other wholesale placements	**-**	256	**-**	22
Other term lending - non retail	**9,104**	7,128	**9,104**	7,128
Other term lending - retail	**1,489**	1,570	**1,489**	1,570
Other lending	**2**	5	**3**	4
Gross loans and advances to customers	**29,318**	25,667	**25,156**	21,395
Unearned income	**(330)**	(319)	**(330)**	(308)
Deferred and unamortised fee income	**(52)**	(53)	**(47)**	(48)
Impairment losses on credit exposures (note 15)	**(280)**	(240)	**(273)**	(233)
	28,656	25,055	**24,506**	20,806

The Group and Bank have transferred £2,910m and £1,640m respectively (2007: £3,296m and £1,874m respectively) of loans or advances through securitisation arrangements that do not qualify for derecognition from the balance sheet (note 16).
The financial assets 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, rate risk and credit risk of the loans and advances. The Group is also exposed to the residual rewards of the loans and advances as a result of its ability to benefit from the future performance of the loans and advances through the receipt of deferred consideration.

The carrying amount of the associated liability is £2,891m (2007: £3,150m).

Lease Finance
The Group provides leasing facilities to industry, commerce and private individuals.

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 £28m (2007: £24m) and £1,013m (2007: £862m) respectively. The total closing balances of finance leases and hire purchase contracts were £47m (2007: £130m) and £1,335m (2007: £1,229m) respectively.

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

	Group		Bank	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Gross investment in finance lease receivables:				
Due within one year	**657**	602	**324**	311
Due within one to five years	**853**	854	**422**	409
Due after more than five years	**23**	34	**11**	10
Total gross investment in lease finance receivables	**1,533**	1,490	**757**	730
Deduct: Unearned future finance income on lease receivables	**(99)**	(102)	**(99)**	(91)
Net investment in lease finance	**1,434**	1,388	**658**	639

14. Loans and advances to customers (continued)

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:

- a floating charge over all assets and undertakings of an entity, including uncalled capital and called but unpaid capital;
- specific or interlocking guarantees;
- specific charges over defined assets of the counterparty; 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	**Non retail**		**Retail**	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Group				
Gross loans and advances:				
Neither past due nor impaired	**14,593**	12,656	**13,448**	11,946
Past due but not impaired	**638**	603	**438**	399
Impaired	**187**	59	**14**	4
	15,418	13,318	**13,900**	12,349
Bank				
Gross loans and advances:				
Neither past due nor impaired	**14,423**	12,267	**9,602**	8,166
Past due but not impaired	**548**	466	**418**	356
Impaired	**155**	132	**10**	9
	15,126	12,865	**10,030**	8,530

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 Bank's customers. The Group has a single common masterscale across all (non-retail and retail) counterparties for Probability of Default. This probability of default masterscale can be broadly mapped to external rating agencies and has performing (pre-default) and non performing (post default) grades. Impaired assets consist of retail loans (excluding credit card loans and portfolio managed facilities) which are contractually past due 90 days with security insufficient to cover principal and arrears of interest revenue; non retail loans which are contractually past due 90 days and there is sufficient doubt about the ultimate collectability of principal and interest; and impaired off-balance sheet credit exposures where current circumstances indicate that losses may be incurred. Unsecured portfolio managed facilities are classified as impaired when they become 180 days past due (if not written off).

14. Loans and advances to customers (continued)

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 credit quality of loans and advances that are neither past due nor impaired:

	Non retail		**Retail**	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Group				
Senior investment grade	**987**	856	**-**	-
Investment grade	**2,629**	2,273	**13,448**	11,946
Sub investment grade	**10,977**	9,527	**-**	-
	14,593	12,656	**13,448**	11,946
Bank				
Senior investment grade	**944**	803	**-**	-
Investment grade	**2,517**	2,141	**9,602**	8,166
Sub investment grade	**10,962**	9,323	**-**	-
	14,423	12,267	**9,602**	8,166

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 CRS 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.

There are no eCRS ratings available for Retail Loans and Advances as these loans and advances are not risk rated on this basis, rather an overall portfolio profile basis is applied.

Restructured/renegotiated loans
There are no loans that would be past due or impaired that have had their terms renegotiated.

Loans and advances which were past due but not impaired	**Non retail**		**Retail**	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Group				
1 to 29 days past due	**501**	519	**171**	200
30 to 59 days past due	**57**	31	**120**	90
60 to 89 days past due	**22**	13	**51**	24
Past due over 90 days	**58**	40	**96**	85
	638	603	**438**	399
Bank				
1 to 29 days past due	**420**	357	**171**	145
30 to 59 days past due	**50**	43	**120**	102
60 to 89 days past due	**22**	19	**51**	43
Past due over 90 days	**56**	48	**76**	65
	548	466	**418**	356

Loans and advances that are past due but are not impaired are classified as such where 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.

15. Impairment losses on credit exposures

	Non retail		Retail		
Group	**Specific**	**Collective**	**Specific**	**Collective**	**Total**
2008	**£m**	**£m**	**£m**	**£m**	**£m**
Opening balance	18	150	-	72	240
Transfer to/from specific provision	45	(45)	122	(122)	-
Charge for the year	-	59	-	120	179
Amounts written off	(17)	-	(173)	-	(190)
Recoveries of amounts written off in previous years	-	-	56	-	56
Other	(5)	-	-	-	(5)
Closing balance	41	164	5	70	280
Group					
2007					
Opening balance	10	160	-	80	250
Transfer to/from specific provision	32	(32)	83	(83)	-
Charge for the year	-	42	-	75	117
Amounts written off	(33)	-	(118)	-	(151)
Recoveries of amounts written off in previous years	9	-	35	-	44
Other	-	(20)	-	-	(20)
Closing balance	18	150	-	72	240
Bank					
2008					
Opening balance	17	144	-	72	233
Transfer to/from specific provision	44	(44)	122	(122)	-
Charge for the year	-	58	-	120	178
Amounts written off	(16)	-	(173)	-	(189)
Recoveries of amounts written off in previous years	-	-	56	-	56
Other	(5)	-	-	-	(5)
Closing balance	40	158	5	70	273

15. Impairment losses on credit exposures (continued)

Bank	**Non retail**		**Retail**		
2007	**Specific £m**	**Collective £m**	**Specific £m**	**Collective £m**	**Total £m**
Opening balance	9	152	-	80	241
Transfer to/from specific provision	31	(31)	83	(83)	-
Charge for the year	-	40	-	75	115
Amounts written off	(32)	-	(118)	-	(150)
Recoveries of amounts written off in previous years	9	-	35	-	44
Other	-	(17)	-	-	(17)
Closing balance	17	144	-	72	233

	Group		**Bank**	
	2008 £m	2007 £m	**2008 £m**	2007 £m
Amounts included in				
Loans and advances to customers (note 14)	**280**	240	**273**	233
Non accrual loans				
Loans and advances to customers	**201**	63	**198**	59
Provisions	**(46)**	(19)	**(44)**	(17)
Total	**155**	44	**154**	42

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.

16. Securitisation

The Group's and Bank's balance sheets include the results, assets and liabilities of securitisation SPEs on a line by line basis. Securitised advances are subject to non-recourse finance arrangements. These loans have been purchased at principal value by the SPEs from Clydesdale Bank PLC, and have been funded through the issue of amortising mortgage backed securities to wholesale market investors.

The balance of assets and liabilities in relation to securitisation notes in issue at 30 September 2008 within the Group's balance sheet are as follows:-

	2008	2007
	£m	£m
Assets		
Derivative financial assets	**286**	64
Loans & advances to customers (note 14)	**2,910**	3,296
Accrued interest receivable	**40**	51
Other assets	**145**	218
	3,381	3,629
Liabilities		
Bonds and notes	**2,867**	3,097
Accrued interest payable	**24**	53
	2,891	3,150

The balance of assets and liabilities in relation to securitisation notes in issue at 30 September 2008 within the Bank's balance sheet are as follows:-

	2008	2007
	£m	£m
Assets		
Derivative financial assets	**-**	64
Loans & advances to customers (note 14)	**1,640**	1,874
Accrued interest receivable	**6**	7
Other assets	**144**	102
	1,790	2,047
Liabilities		
Due to related entities	**1,337**	1,524

At 30 September 2008 the SPEs had cash deposits with Clydesdale Bank PLC amounting to £150m (2007: £173m). This balance is restricted in use to the repayment of the debt securities issued by the SPEs and other legal obligations.

17. Investments in controlled entities and associates

	Group		Bank	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
At 30 September	**2**	2	**37**	35

Principal controlled entities at 30 September 2008	Nature of business	Country of incorporation and principal operations
Clydesdale Bank Asset Finance Limited	Leasing and hire purchase	Scotland
CB Group Investments Ltd	Investment company	Cayman Islands
Clydesdale Investments UK Ltd	Investment company	England
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 16). 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

All of the above controlled entities have a 30 September financial year end. Where a controlled entity has a financial year end other than 30 September, the consolidated financial statements include interim management accounts prepared to 30 September.

The associated undertaking is The 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 £2,000,000 is held by the Bank. The associated undertaking has a 31 March year end. The investment is equity accounted.

18. Property, plant and equipment

Movements on property, plant and equipment

Group	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	Operating lease assets £m	Total £m
Cost or valuation						
At 1 October 2007	81	18	94	155	140	488
Additions	13	6	19	40	-	78
Reclassifications	-	(5)	5	-	-	-
Disposals	(18)	-	-	(14)	(124)	(156)
Transfers	(3)	(1)	-	-	(14)	(18)
Deficit on revaluation	(3)	(1)	-	-	-	(4)
At 30 September 2008	**70**	**17**	**118**	**181**	**2**	**388**
Accumulated depreciation						
At 1 October 2007	2	-	43	110	78	233
Charge for the year	1	1	10	11	3	26
Disposals	-	-	-	(11)	(65)	(76)
Transfers	(3)	-	-	-	(14)	(17)
Released on revaluation	(1)	-	-	-	-	(1)
At 30 September 2008	**(1)**	**1**	**53**	**110**	**2**	**165**
Net book value						
At 30 September 2008	**71**	**16**	**65**	**71**	**-**	**223**
At 30 September 2007	79	18	51	45	62	255

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 2007	81	18	94	155	348
Additions	13	6	19	40	78
Reclassifications	-	(5)	5	-	-
Disposals	(18)	-	-	(14)	(32)
Transfers	(3)	(1)	-	-	(4)
Deficit on revaluation	(3)	(1)	-	-	(4)
At 30 September 2008	**70**	**17**	**118**	**181**	**386**
Accumulated depreciation					
At 1 October 2007	2	-	43	110	155
Charge for the year	1	1	10	11	23
Disposals	-	-	-	(11)	(11)
Transfers	(3)	-	-	-	(3)
Released on revaluation	(1)	-	-	-	(1)
At 30 September 2008	**(1)**	**1**	**53**	**110**	**163**
Net book value					
At 30 September 2008	**71**	**16**	**65**	**71**	**223**
At 30 September 2007	79	18	51	45	193

Included in the table above are Investment Properties with a market value of £16m acquired on 30 September 2008.

18. Property, plant and equipment (continued)

Valuations

Cost and valuation of freehold and leasehold land and buildings at 30 September comprises:

	2008	2007
	£m	£m
At current year valuation	**45**	70
At cost	**160**	123
	205	193

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

	2008	2007
	£m	£m
Cost	**239**	218
Accumulated depreciation	**(96)**	(95)
Net book value	**143**	123

Land and buildings occupied for own activities

	2008	2007
	£m	£m
Net book value	**68**	105

19. Deferred tax

	Group		**Bank**	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Deferred tax asset				
Opening balance	**45**	147	**40**	145
Tax expense recognised in income statement	**(31)**	(27)	**(31)**	(26)
Deferred taxation recognised in equity	**(10)**	(75)	**(11)**	(76)
Other	**(4)**	-	**(1)**	(3)
Closing balance	**-**	45	**(3)**	40

The deferred tax asset is attributable to the following items:

Defined benefit pension asset	**(66)**	(36)	**(66)**	(36)
Impairment reserve on credit exposures	**42**	54	**42**	53
Other	**24**	27	**21**	23
	-	45	**(3)**	40

19. Deferred tax (continued)

	Group		Bank	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Deferred tax liability				
Opening balance	**18**	16	**-**	1
Tax (credit)/expense recognised in income statement	**(3)**	5	**(3)**	2
Deferred taxation recognised in equity	**8**	(3)	**8**	(3)
Other	**1**	-	**-**	-
Closing balance	**24**	18	**5**	-

The deferred tax liability is attributable to the following items:

Accelerated capital allowances	**15**	19	**(3)**	-
Net gain on revaluation of properties	**3**	3	**3**	-
Cash flow hedge reserve	**6**	(4)	**5**	-
Other	**-**	-	**-**	
	24	18	**5**	-

20. Other assets

	Group		Bank	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Prepayments and accrued income	**733**	520	**481**	340
Other	**446**	522	**2,291**	400
	1,179	1,042	**2,772**	740

21. Due to other banks

	2008	2007
Group and Bank	**£m**	£m
Transaction balances with other banks	**6**	4
Securities sold under agreements to repurchase	**2,087**	2,041
Deposits with other banks	**1,869**	244
	3,962	2,289

22. Due to customers

	Group		Bank	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Non interest bearing demand deposits	**873**	597	**873**	597
Interest bearing demand deposits	**13,403**	14,240	**13,131**	14,239
Term deposits	**6,138**	3,523	**6,138**	3,106
Other wholesale deposits	**1,920**	959	**1,920**	959
	22,334	19,319	**22,062**	18,901

23. Provisions

Group and Bank	**2008**	2007
	£m	£m
Refund of current account fees & associated costs		
At 1 October	**7**	-
Charge to income statement	**1**	11
Provisions utilised	**(5)**	(4)
At 30 September	**3**	7
Reorganisation		
At 1 October	**-**	27
Provisions utilised	**-**	(27)
At 30 September	**-**	-
Other provisions		
At 1 October	**6**	8
Provisions transferred (note 24)	**(3)**	-
Charge to income statement	**4**	3
Provisions utilised	**(1)**	(3)
Other	**-**	(2)
At 30 September	**6**	6
Total provisions	**9**	13

Refund of current account fees & associated costs
Current account providers in the UK have experienced an increased level of complaints regarding current account charges levied. Customer awareness was raised following an announcement by the Office of Fair Trading (OFT) during April 2006 of a formal investigation into the fairness of charges arising on the late payment of credit card accounts having regard to the provisions of the Unfair Terms in Consumer Contracts Regulations 1999.

This generated industry wide requests from customers of UK banks and financial services organisations for refunds of current account charges. In light of the growing number of claims and the legal uncertainty that exists the Bank (with seven other current account providers, together accounting for about 90 per cent of personal current accounts in the UK) decided to seek clarification through the Courts. The OFT agreed to this course and proceedings were issued on 27 July 2007 in the High Court in England and Wales. An initial judgement given on 24 April 2008 held that the terms in question fail to be assessed for fairness under the Regulations and that none of the terms examined by the Court were capable of giving rise to an unenforceable penalty at common law. The Banks are appealing the decision and in July 2008 the Court heard argument on two aspects namely, whether the initial finding that current terms and conditions are capable of an assessment under the Regulations applies to historic terms and conditions and, secondly, whether certain historic terms and conditions amount to penalties at common law. On 8 October 2008 the Judge ruled that Clydesdale Bank PLC was entitled to a declaration that none of its terms and conditions examined by the Court amount to penalties at common law.

The appeal against the finding made by the Court in April to the effect that the terms and conditions are capable of being assessed for fairness under the Regulations has been held and is awaiting judgement. In the meantime, the FSA has extended the waiver (under the terms of which banks do not have to process claims for a return of charges where no financial hardship is involved) until January 2009.

Reorganisation
Following a review of operations a reorganisation provision was recognised during the year ended 30 September 2005. The provision covered the costs associated with the streamlining of operations, reductions in staffing levels and the reconfiguration of distribution networks. The programme in relation to these activities has been completed and the provision was fully utilised by 30 September 2007.

23. Provisions (continued)

Other
This category includes:
- Provision for costs arising in respect of a number of legal actions and claims arising in the ordinary course of the Bank's business
- Provision for future employer related taxes in relation to share based remuneration
- Provision for mis-selling of Payment Protection Insurance which is under review by Regulators, specifically the FSA and Competition Commission

24. Retirement benefit obligations

The Group is a sponsoring employer in two funded defined benefit pension schemes, the Clydesdale Bank Pension Scheme and the Yorkshire Bank Pension Fund (the "Schemes"). The assets of the Schemes are held in separate trustee administered funds.

As at 30 September 2007, all the assets and the liabilities of the National Australia Bank UK Retirement Benefits Plan were transferred into the Clydesdale Bank Pension Scheme.

The Group closed the defined benefit schemes to new members in 2004, with the terms for existing staff remaining unchanged. Since that time the principal scheme available to new members is the defined contribution scheme, "Total Pension". The scheme is funded by contributions from employees and the Group, with Group contributions in the range of 3% to 11%. Following a review of arrangements in April 2006, the benefits to members have been enhanced with contributions now in the range of between 5% and 10%. 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 Schemes. 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%.

The Bank 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 £0.9m (2007: £0.3m) and would have no material impact upon service costs and interest costs.

The last full valuations of the Schemes were carried out at 30 September 2004 and have been updated to 30 September 2008 by qualified independent actuaries. The latest triennial valuation is expected to be completed by 31 December 2008.

The principal financial assumptions used in the Schemes' valuations at 30 September 2008 were as follows:

	2008	2007
	% p.a.	% p.a.
Inflation	**3.60**	3.25
Rate of increase for pensions in payment:		
pre 5 April 1997 benefits (Clydesdale Bank Pension Scheme)	**2.50**	2.50
pre 5 April 1997 benefits (Yorkshire Bank Pension Fund)	**3.50**	3.25
post April 1997 (both Schemes)	**3.50**	3.25
post April 2006 (both Schemes)	**2.50**	2.50
Rate of increase for pensions in deferment	**3.60**	3.25
Discount rate	**7.20**	5.95
Post-retirement mortality:		
Current pensioners at 60 - male	**25.5 years**	25.2 years
Current pensioners at 60 - female	**27.3 years**	28.2 years
Future pensioners at 60 - male	**26.5 years**	26.1 years
Future pensioners at 60 - female	**28.2 years**	29.1 years

24. Retirement benefit obligations (continued)

Of the total contributions made to the Schemes of £80m (2007: £46m), £16m (2007: £13m) were made by fellow group undertakings in respect of employees originally employed by the Group and entitled to continue as members of the Schemes.

The total contributions to the Schemes in 2009 are expected to be nil. The Group prepaid contributions of £40m in respect of the year ending 30 September 2009.

The fair value of the Schemes' 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 Schemes' liabilities, which are derived from cash flow projections over long periods and thus inherently uncertain, were:

Summary

	2008	2007	2006	2005	2004
	£m	£m	£m	£m	£m
Clydesdale Bank Pension Scheme					
Total market value of scheme assets	**1,036**	1,123	889	759	627
Present value of scheme liabilities	**(926)**	(1,060)	(978)	(1,030)	(880)
Net pension asset/(liability)	**110**	63	(89)	(271)	(253)
Yorkshire Bank Pension Fund					
Total market value of scheme assets	**806**	885	815	713	590
Present value of scheme liabilities	**(667)**	(789)	(838)	(824)	(729)
Net pension asset/(liability)	**139**	96	(23)	(111)	(139)

Clydesdale Bank Pension Scheme

	2008		2007	
	£m	**% of fair value of scheme assets**	£m	% of fair value of scheme assets
Assets				
Equities	**498**	**48.07**	631	56.18
Property	**44**	**4.25**	55	4.90
Government bonds	**451**	**43.53**	432	38.47
Corporate bonds	**29**	**2.80**	-	-
Cash	**14**	**1.35**	5	0.45
Total market value of scheme assets	**1,036**	**100.00**	1,123	100.00
Present value of scheme liabilities	**(926)**		(1,060)	
Net pension asset	**110**		63	

24. Retirement benefit obligations (continued)

Yorkshire Bank Pension Fund

	2008		2007	
	£m	**% of fair value of scheme assets**	£m	% of fair value of scheme assets
Assets				
Equities	**388**	**48.14**	498	56.27
Property	**34**	**4.22**	44	4.97
Government bonds	**350**	**43.43**	340	38.42
Corporate bonds	**23**	**2.85**	-	-
Cash	**11**	**1.36**	3	0.34
Total market value of scheme assets	**806**	**100.00**	885	100.00
Present value of scheme liabilities	**(667)**		(789)	
Net pension asset	**139**		96	

The Schemes have not invested in any of the Group's own financial instruments nor in properties or other assets used by the Group.

Expected rate of return on plan assets

The expected return on assets assumption has been determined by looking at the assets expected to be held over the following year and considering the expected returns for each asset class. During September 2008, the Pension Schemes Trustees advised the Group of their intention to rebalance the Return Seeking elements of the portfolios towards the long-term strategic asset allocation of 60%, and to introduce greater credit exposure into the bond holdings. It is expected that these changes will be implemented by 31 December 2008.

	2008	2007	2006	2005	2004
	% p.a.	% p.a.	% p.a.	% p.a.	% p.a.
Equities	**8.70**	8.35	8.20	8.10	8.70
Property	**8.00**	7.15	6.60	6.55	7.10
Government bonds	**4.70**	5.00	4.40	4.30	4.90
Corporate bonds	**7.00**	5.95	5.05	5.00	5.50
Cash	**5.00**	5.75	4.75	4.50	4.75

Reconciliation of fair value of scheme assets

	Clydesdale Bank		**Yorkshire Bank**		**Total**	
	2008	2007	**2008**	2007	**2008**	2007
	£m	£m	**£m**	£m	**£m**	£m
Fair value of scheme assets at 1 October	**1,123**	889	**885**	815	**2,008**	1,704
Actual return on scheme assets	**(100)**	88	**(80)**	79	**(180)**	167
Employer contributions	**53**	27	**27**	19	**80**	46
Benefits paid	**(40)**	(39)	**(26)**	(28)	**(66)**	(67)
Effect of scheme merger	-	158	-	-	-	158
Fair value of scheme assets at 30 September	**1,036**	1,123	**806**	885	**1,842**	2,008

24. Retirement benefit obligations (continued)

Reconciliation of defined benefit obligation

	Clydesdale Bank		Yorkshire Bank		Total	
	2008	2007	**2008**	2007	**2008**	2007
	£m	£m	**£m**	£m	**£m**	£m
Defined benefit obligation at 1 October	**1,060**	978	**789**	838	**1,849**	1,816
Interest cost	**62**	48	**46**	42	**108**	90
Service cost	**16**	17	**11**	16	**27**	33
Benefits paid	**(40)**	(39)	**(26)**	(28)	**(66)**	(67)
Actuarial gain	**(172)**	(93)	**(153)**	(82)	**(325)**	(175)
Transition of restructuring reserves	**-**	-	**-**	3	**-**	3
Effect of scheme merger	**-**	149	**-**	-	**-**	149
Defined benefit obligation at 30 September	**926**	1,060	**667**	789	**1,593**	1,849

Reconciliation of balance sheet asset/(liability)

	Clydesdale Bank		Yorkshire Bank		Total	
	2008	2007	**2008**	2007	**2008**	2007
	£m	£m	**£m**	£m	**£m**	£m
Balance sheet asset/(liability) at 1 October	**63**	(89)	**96**	(23)	**159**	(112)
Employer contributions	**53**	27	**27**	19	**80**	46
Total pension expense	**-**	6	**5**	-	**5**	6
Statement of recognised income and expense	**(6)**	119	**11**	103	**5**	222
Transition of restructuring reserves	**-**	-	**-**	(3)	**-**	(3)
Balance sheet asset at 30 September	**110**	63	**139**	96	**249**	159

Post Retirement Healthcare Schemes		
Balance sheet liability at 1 October 2007	**-**	-
Transferred from provisions (note 23)	**(3)**	-
Statement of recognised income and expense	**(7)**	-
Balance sheet liability at 30 September 2008	**(10)**	-
Balance sheet asset at 30 September 2008	**239**	159

24. Retirement benefit obligations (continued)
Pension expense for the year

	Clydesdale Bank		Yorkshire Bank		Total	
	2008	2007	**2008**	2007	**2008**	2007
	£m	£m	**£m**	£m	**£m**	£m
Current service cost	**16**	17	**11**	16	**27**	33
Interest cost	**62**	48	**46**	42	**108**	90
Expected return on assets	**(78)**	(62)	**(61)**	(57)	**(139)**	(119)
Effect of scheme merger	**-**	(9)	**-**	-	**-**	(9)
Total pension (credit)/expense	**-**	(6)	**(4)**	1	**(4)**	(5)

24. Retirement benefit obligations (continued)

Statement of recognised income and expense (SORIE)

	Clydesdale Bank		Yorkshire Bank		Total	
	2008	2007	**2008**	2007	**2008**	2007
	£m	£m	**£m**	£m	**£m**	£m
Gain on scheme assets	**(178)**	26	**(141)**	23	**(319)**	49
Experience losses on scheme liabilities	**(16)**	1	**20**	-	**4**	1
Gain/(loss) from change in actuarial assumptions - Defined benefit plans	**188**	92	132	80	**320**	172
Total amount recognised in SORIE	**(6)**	119	**11**	103	**5**	222
Cumulative amount recognised in SORIE	**100**	107	**156**	143	**256**	250

History of experience gains and losses
Clydesdale Bank

	2008	2007	2006	2005
Difference between the expected and actual return on scheme assets				
Amount (£m)	**(178)**	27	24	84
Percentage of scheme assets	**-17.18%**	2.40%	2.70%	11.07%
Experience gains and losses on scheme liabilities				
Amount (£m)	**(16)**	1	-	(1)
Percentage of the present value of the scheme liabilities	**-1.73%**	0.10%	0.00%	0.10%
Total amount recognised in SORIE				
Amount (£m)	**(6)**	119	8	(20)
Percentage of the present value of the scheme liabilities	**-0.65%**	11.23%	0.82%	1.94%

24. Retirement benefit obligations (continued)

History of experience gains and losses
Yorkshire Bank

	2008	2007	2006	2005
Difference between the expected and actual return on scheme assets				
Amount (£m)	**(141)**	22	22	77
Percentage of scheme assets	**-17.49%**	2.49%	2.70%	10.80%
Experience gains and losses on scheme liabilities				
Amount (£m)	**20**	-	-	(8)
Percentage of the present value of the scheme liabilities	**3.00%**	0.00%	0.00%	0.97%
Total amount recognised in SORIE				
Amount (£m)	**11**	103	11	29
Percentage of the present value of the scheme liabilities	**1.65%**	13.05%	1.31%	3.52%

25. Bonds and notes

	Group		**Bank**	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Medium term notes	**2,133**	1,992	**2,133**	1,874
Subordinated medium term notes	**450**	441	**450**	441
Residential mortgage backed securities	**2,860**	3,039	**-**	-
Total bonds, notes and subordinated debt	**5,443**	5,472	**2,583**	2,315
Hedge adjustments	**9**	-	**3**	-
Net discounts	**(1)**	(1)	**(1)**	(1)
	5,451	5,471	**2,585**	2,314
Total bonds and notes were recorded as:				
At amortised cost	**1,018**	1,039	**1,018**	1,039
Designated as fair value hedges	**4,433**	4,432	**1,567**	1,275
	5,451	5,471	**2,585**	2,314

25. Bonds and notes (continued)

Details of the terms and conditions of the medium term notes issued by Clydesdale Bank PLC as at 30 September 2008 were as follows:

Issue date	Issue currency	Fair Value £m	Coupon rate %	Maturity date
Medium term notes				
22 December 2005	GBP	450	6.08500%	22 December 2008
29 June 2006	GBP	350	6.36125%	29 June 2011
15 September 2006	EUR	472	5.03300%	15 September 2009
22 May 2007	GBP	40	5.76875%	22 May 2009
30 May 2007	EUR	589	5.03800%	30 May 2012
02 May 2008	JPY	53	1.22480%	30 April 2009
09 June 2008	GBP	29	6.25688%	9 December 2009
31 July 2008	GBP	150	6.28313%	30 October 2009
Subordinated medium term notes				
16 February 2006	GBP	250	4.87500%	17 February 2016
30 March 2007	GBP	200	5.75000%	30 March 2017

Details of the terms and conditions of the residential mortgage backed securities issued by Lanark Master Issuer PLC as at 30 September 2008 were as follows:

Class A residential mortgage backed securities				
06 August 2007	GBP	19	5.62875%	22 August 2012
06 August 2007	GBP	650	5.72875%	22 May 2013
06 August 2007	USD	124	2.86188%	22 August 2012
06 August 2007	USD	555	2.91188%	22 August 2012
06 August 2007	USD	527	2.95188%	22 August 2012
06 August 2007	EUR	25	5.01400%	22 August 2012
06 August 2007	EUR	668	5.10400%	22 August 2012
Class B residential mortgage backed securities				
06 August 2007	USD	26	2.98188%	22 February 2010
06 August 2007	EUR	107	5.18400%	22 February 2010
Class C residential mortgage backed securities				
06 August 2007	GBP	24	5.99875%	22 February 2010
06 August 2007	USD	12	3.11188%	22 February 2010
06 August 2007	EUR	21	5.38400%	22 February 2010
Class D residential mortgage backed securities				
06 August 2007	GBP	69	6.32875%	22 February 2010
06 August 2007	EUR	35	5.71400%	22 February 2010

26. Other liabilities

	Group		Bank	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Accruals and deferred income	**95**	85	**83**	26
Notes in circulation	**1,211**	1,166	**1,211**	1,166
Accrued interest payable	**719**	444	**467**	252
Other liabilities	**264**	195	**746**	293
	2,289	1,890	**2,507**	1,737

27. Called up share capital

	Number
Authorised	
Ordinary shares of £1 each - equity	**254,785,000**
Allotted, called up and fully paid	**£m**
Ordinary shares of £1 each - equity	
At 30 September 2008 and 2007	**232**

28. Reserves

	Group		Bank	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Share premium account	**243**	243	**243**	243
Share option reserve	**20**	12	**20**	12
Asset revaluation reserve	**7**	13	**7**	13
Available for sale investments reserve	**-**	(3)	**-**	(3)
Merger reserve	**338**	338	**338**	338
Cash flow hedge reserve	**11**	(9)	**11**	(9)
Retained earnings	**1,313**	1,160	**1,086**	1,037
	1,932	1,754	**1,705**	1,631

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

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

Merger reserve
The merger reserve arises 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.

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

28. Reserves (continued)

Minority interests
Minority interests represented the share of subsidiary equity controlled by parties outside of the Group. In March 2008 the underlying transactions were terminated and the minority interest repaid.

Movements in reserves

Group	Share premium account £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Cash flow hedge reserve £m	Retained earnings £m
At 1 October 2006	243	22	17	-	(2)	766
Profit for the year ended 30 September 2007	-	-	-	-	-	277
Actuarial gains on defined benefit pension schemes	-	-	-	-	-	222
Share options granted	-	9	-	-	-	-
Share options settled	-	(20)	-	-	-	-
Revaluation of land and buildings	-	-	(1)	-	-	-
Net change in available for sale investments reserve	-	-	-	(3)	-	-
Net change in cash flow hedge reserve	-	-	-	-	(10)	-
Transfers from/to asset revaluation reserve	-	-	(3)	-	-	3
Tax on items recognised directly in equity	-	1	-	-	3	(68)
Dividends paid	-	-	-	-	-	(40)
At 30 September 2007	**243**	**12**	**13**	**(3)**	**(9)**	**1,160**
Profit for the year ended 30 September 2008	-	-	-	-	-	247
Actuarial gains on defined benefit pension schemes	-	-	-	-	-	5
Post retirement medical benefits	-	-	-	-	-	(7)
Share options granted	-	12	-	-	-	-
Share options settled	-	-	-	-	-	-
Revaluation of land and buildings	-	-	(3)	-	-	-
Net change in available for sale investments reserve	-	-	-	3	-	-
Net change in cash flow hedge reserve	-	-	-	-	28	-
Transfers from/to asset revaluation reserve	-	-	(3)	-	-	3
Tax on items recognised directly in equity	-	(4)	-	-	(8)	-
Dividends paid	-	-	-	-	-	(95)
At 30 September 2008	**243**	**20**	**7**	**-**	**11**	**1,313**

28. Reserves (continued)

Movements in reserves **Bank**	**Share premium account £m**	**Share option reserve £m**	**Asset revaluation reserve £m**	**Available for sale investments reserve £m**	**Cash flow hedge reserve £m**	**Retained earnings £m**
At 1 October 2006	243	22	17	-	(2)	677
Profit for the year ended 30 September 2007	-	-	-	-	-	243
Actuarial gains on defined benefit pension schemes	-	-	-	-	-	222
Share options granted	-	9	-	-	-	-
Share options settled	-	(20)	-	-	-	-
Revaluation of land and buildings	-	-	(1)	-	-	-
Net change in available for sale investments reserve	-	-	-	(3)	-	-
Net change in cash flow hedge reserve	-	-	-	-	(10)	-
Transfers (from)/to asset revaluation reserve	-	-	(3)	-	-	3
Tax on items recognised directly in equity	-	1	-	-	3	(68)
Dividends paid	-	-	-	-	-	(40)
At 30 September 2007	**243**	**12**	**13**	**(3)**	**(9)**	**1,037**
Profit for the year ended 30 September 2008	-	-	-	-	-	143
Actuarial gains on defined benefit pension schemes	-	-	-	-	-	5
Post retirement medical benefits	-	-	-	-	-	(7)
Share options granted	-	12	-	-	-	-
Revaluation of land and buildings	-	-	(3)	-	-	-
Net change in available for sale investments reserve	-	-	-	3	-	-
Net change in cash flow hedge reserve	-	-	-	-	28	-
Transfers from/to asset revaluation reserve	-	-	(3)	-	-	3
Tax on items recognised directly in equity	-	(4)	-	-	(8)	-
Dividends paid	-	-	-	-	-	(95)
At 30 September 2008	**243**	**20**	**7**	**-**	**11**	**1,086**

29. Memorandum items

Contingent liabilities **Group and Bank**	**Contract amount 2008 £m**	**Risk weighted amount 2008 £m**	Contract amount 2007 £m	Risk weighted amount 2007 £m
Guarantees and assets pledged as collateral security				
- guarantees and irrevocable letters of credit	**828**	**189**	779	146
Other contingent liabilities	**-**	**-**	1	1
	828	**189**	780	147
- At call	**70**		2	
- Due in less than three months	**46**		37	
- Due after 3 months through to 1 year	**440**		440	
- Due after 1 year through to 3 years	**18**		30	
- Due after 3 years through to 5 years	**8**		7	
- Due after 5 years	**116**		121	
- No specified maturity	**130**		143	
	828		780	
Commitments				
Group				
Sale and option to resell transactions	**2,000**	**-**	2,000	-
- At call	**-**		-	
- Due in less than three months	**1,000**		-	
- Due after 3 months through to 1 year	**-**		-	
- Due after 1 year through to 3 years	**-**		-	
- Due after 3 years through to 5 years	**1,000**		2,000	
- Due after 5 years	**-**		-	
- No specified maturity	**-**		-	
	2,000		2,000	
Group and Bank				
Other commitments				
- undrawn formal standby facilities, credit lines and other commitments to lend	**11,940**	**373**	11,312	328
- At call	**10,708**		10,153	
- Due in less than three months	**-**		-	
- Due after 3 months through to 1 year	**-**		-	
- Due after 1 year through to 3 years	**-**		-	
- Due after 3 years through to 5 years	**-**		-	
- Due after 5 years	**1,232**		1,159	
- No specified maturity	**-**		-	
	11,940		11,312	

The tables above give the contract amounts and risk-weighted amounts of off balance sheet transactions for the Group and Bank. The contract amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the FSA guidelines.

29. Memorandum items (continued)

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.

30. Capital commitments

The Group and Bank had future capital expenditure which had been contracted for but not provided for in the financial statements of £9m (2007: £3m) at 30 September 2008.

31. Lease commitments

Group and Bank **Operating lease commitments**	**Land and buildings 2008 £m**	Land and buildings 2007 £m
Payments committed to be made during the next year under non-cancellable operating leases which expire:		
- within 1 year	**2**	-
- between 1 and 5 years	**4**	7
- over 5 years	**3**	23
	9	30
Where the Group is the lessee the future minimum lease payments under non-cancellable operating leases are:		
- within 1 year	**23**	29
- within 1 and 5 years	**81**	103
- over 5 years	**206**	247
	310	379

32. Other contingent liabilities

The Bank is defending a legal claim in relation to bank charges as referred to in note 23. The Bank is unable to predict with any accuracy the outcome of this legal action and is thus unable to reliably estimate any potential liability that may arise. No recognition has therefore been made, contingent or actual, within the financial statements for an adverse outcome to the legal action.

Apart from the bank charges claim, 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.

In late September, after breaching regulatory requirements, Bradford & Bingley (B&B) was taken into public ownership. The cost of guaranteeing B&B's deposits will be met by the Financial Services Compensation Scheme, of which Clydesdale Bank is a member. Recognition of £6m has been made in the current year for the annual levy in respect of this item.

The Bank is also contingently liable for possible further compensation scheme costs. At this stage these costs cannot be suitably estimated.

The Competition Commission is nearing completion of its review of the Payment Protection Insurance market and is expected to make recommendations in relation to the transparency of the product and changes to the way in which it is sold.

33. Assets and liabilities denominated in foreign currency

	Group		Bank	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Assets				
Sterling	**38,189**	31,064	**35,997**	29,868
Currencies other than sterling	**3,782**	4,497	**3,890**	4,542
Total assets	**41,971**	35,561	**39,887**	34,410
Liabilities				
Sterling	**38,291**	31,106	**36,119**	29,894
Currencies other than sterling	**3,680**	4,455	**3,768**	4,516
Total liabilities and shareholders' funds	**41,971**	35,561	**39,887**	34,410

The above table cannot be considered to reflect exposure to foreign exchange risk as it does not take into account off balance sheet items.

34. Employees

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

	2008 Number	2007 Number
Managers	**1,545**	1,476
Clerical staff	**4,191**	4,233
	5,736	5,709

All staff are contracted employees of NAGE. 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.

35. Notes to the statement of cash flows

	Group		Bank	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Non cash items included in profit before tax				
Interest receivable	**(2,393)**	(1,927)	**(2,042)**	(1,603)
Interest payable	**1,497**	1,065	**1,307**	804
Depreciation (note 6)	**26**	42	**23**	21
Actuarial gains on defined benefit pension plans	**5**	222	**5**	222
Post retirement medical benefit	**(7)**	-	**(7)**	-
Profit on sale of land & buildings	**(10)**	(13)	**(10)**	(13)
Impairment losses on credit exposures (note 15)	**179**	117	**178**	115
Share based payments expense	**12**	10	**12**	10
	(691)	(484)	**(534)**	(444)
Changes in operating assets				
Net (increase)/decrease in:				
Balances with supervisory central banks	**8**	(7)	**8**	(7)
Due from banks	**163**	(190)	**151**	325
Derivative financial assets	**(476)**	(113)	**(190)**	(67)
Financial assets at fair value through profit or loss	**(1,223)**	(759)	**(1,223)**	(759)
Investments	**1,707**	(1,510)	**1,307**	(1,311)
Loans and advances to customers	**(3,780)**	(3,391)	**(3,878)**	(2,884)
Due from customers on acceptances	**-**	2	**-**	2
Other assets	**133**	(238)	**(1,828)**	(146)
	(3,468)	(6,206)	**(5,653)**	(4,847)
Changes in operating liabilities				
Net increase/(decrease) in:				
Due to other banks	**1,671**	907	**1,671**	907
Derivative financial liabilities	**14**	(10)	**14**	(10)
Financial liabilities at fair value through profit or loss	**111**	147	**111**	147
Due to customers	**3,015**	2,238	**3,161**	2,227
Liabilities on acceptances	**-**	(2)	**-**	(2)
Provisions	**(4)**	(22)	**(4)**	(22)
Defined benefit pension obligations	**(80)**	(271)	**(80)**	(271)
Other liabilities	**114**	106	**537**	184
	4,841	3,093	**5,410**	3,160

Cash and cash equivalents

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

	Group		Bank	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Cash assets (excluding balances with central banks - note 9)	**5,083**	2,059	**5,083**	2,259
Other assets	**343**	310	**343**	310
Due to other banks	**(8)**	(6)	**(8)**	(6)
Due to related entities	**(161)**	(173)	**(161)**	(173)
Other liabilities	**(67)**	(53)	**(67)**	(53)
	5,190	2,137	**5,190**	2,337

36. Related party transactions

The Bank is a wholly owned controlled entity of NAGE. The ultimate parent entity of the Bank is NAB.

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, forward 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, forward exchange and interest rate cover and various administrative services. Fees may be charged for these services.

Amounts due from related entities	**Group**		**Bank**	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Loans				
Ultimate parent	**1,140**	1,306	**1,140**	1,306
Controlled entities of the ultimate parent	**-**	13	**-**	13
Controlled entities of the Bank	**-**	-	**1,281**	4,200
	1,140	1,319	**2,421**	5,519
Other receivables				
Ultimate parent	**1**	5	**1**	5
Controlled entities of the ultimate parent	**12**	5	**12**	5
	13	10	**13**	10
Total amounts due from related entities	**1,153**	1,329	**2,434**	5,529
Interest income on the above amounts was as follows:				
Ultimate parent	**69**	44	**69**	44
Controlled entities of the Bank	**-**	-	**109**	167
Total interest income on amounts due from related entities	**69**	44	**178**	211

36. Related party transactions (continued)

Amounts due to related entities	**Group**		**Bank**	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Deposits				
Ultimate parent	**4,486**	3,274	**4,486**	3,284
Controlled entities of the ultimate parent	**158**	140	**158**	140
Controlled entities of the Bank	**-**	-	**1,120**	2,891
	4,644	3,414	**5,764**	6,315
Subordinated liabilities				
Controlled entities of the ultimate parent	**426**	426	**426**	426
Other payables				
Ultimate parent	**21**	50	**21**	50
Controlled entities of the ultimate parent	**60**	25	**60**	25
	81	75	**81**	75
Total amounts due to related parties	**5,151**	3,915	**6,271**	6,816
Interest expense on the above amounts was as follows:				
Ultimate parent	**195**	182	**195**	182
Controlled entities of the ultimate parent	**36**	46	**36**	46
Controlled entities of the Bank	**-**	-	**1**	18
Total interest expense on amounts due to related entities	**231**	228	**232**	246

Subordinated liabilities

Subordinated liabilities comprise entirely of undated loan capital which is provided to the Bank by NAGE. Interest on the loans is payable at rates related to the London Interbank Offered Rate ("LIBOR"). The 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 are disclosed below:

	2008	2007
	£m	£m
6.27125% (2007: 6.23375%) Undated subordinated notes	**100**	100
6.59563% (2007: 6.53063%) Undated subordinated notes	**50**	50
6.47375% (2007: 6.26625%) Undated subordinated notes	**50**	50
6.68563% (2007: 6.62063%) Undated subordinated notes	**50**	50
	250	250
Other undated subordinated notes	**176**	176
Total subordinated debt	**426**	426

The rates of interest stated above apply at 30 September 2008.

Securitisation

At 30 September 2008, the Bank borrowed a net £2,910m (2007: £3,296m) from its securitisation SPEs (note 16), being the net proceeds from securitisation transactions in the prior year.

36. Related party transactions (continued)

Other transactions with related entities

	Group		Bank	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Non interest income received				
Controlled entities of the ultimate parent	**25**	21	**25**	21
Administrative expenses				
Ultimate parent	**4**	4	**4**	4
Controlled entities of the ultimate parent	**300**	282	**300**	282
	304	286	**304**	286

Other related party transactions

Compensation of key management personnel (including directors)

	Group	
	2008	2007
	£m	£m
Salaries and other short-term benefits	**8**	10
Share based payments	**4**	2
	12	12

Transactions with key management personnel

For the purposes of IAS24 "Related Party Disclosures" key management personnel comprise Directors of the Bank, members of the UK Executive Committee, the European Risk Management Committee and FSA approved persons with a control function of 1 to 20.

Key management and their close family members 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.

	2008	2007
	£m	£m
Loans and advances	**4**	6
Deposits	**9**	11

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 2008 (2007: £Nil).

Included in the above are six (2007: five) loans totalling £1.3m (2007: £0.6m) made to directors.

36. Related party transactions (continued)

Other related party transactions
The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.6m in the year ended 30 September 2008 (2007: £0.6m) were charged to the Group sponsored Schemes. The Group has deposits of £3.6m (2007: £6.5m) at the year end placed by the Schemes at market rates.

The following payments were made to superannuation funds sponsored by the Bank:

	Bank	
	2008	2007
	£m	£m
Clydesdale Bank Pension Fund	**41**	13
Yorkshire Bank Pension Fund	**23**	10
	64	23

37. 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.

Above Target 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, with the employee able to choose a longer holding period of up to 10 years.

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.

37. Share based payments (continued)

Mid Year and Year End Share Offers
Under the UK National Share Incentive Plan, the National EVA ® Share Offer gifts up to A$1,000 of ordinary shares to each employee when the Group's performance is on target.

In 2007 an employee share offer valued at approximately A$1,000 per employee was made, based on the Group's achievements as measured against a scorecard of objectives for the Group. Shares under the year end offer were allocated on 10 December 2007. These shares are held by the trustees for three years, or until the employee ceases their 'relevant employment', i.e. ceases employment with either a company in the Group or a company that was in the Group when the shares were allocated to the employee.

The shares are registered in the name of the trustee who holds them on behalf of the participating employee for the duration of the restriction period. Participating employees receive dividends and may exercise, through the trustee, voting rights (which are the equivalent to those for other ordinary NAB shares) in respect of the shares, but otherwise cannot deal with the shares until the restriction period concludes. If a participating employee leaves the Group prior to the end of the three year restriction period due to voluntary resignation the shares may be transferred to the employee or sold. If employment is terminated during the restriction period for a reason justifying dismissal the shares are forfeited.

Executive Share Option Plan and Performance Rights Plan
The Group operates a long term incentive programme primarily targeted at key executive positions, delivering performance options and performance rights, linked to the share price of NAB.

The plans provide for the Board of NAB to grant performance options and performance rights to executives of the Group to subscribe for fully paid ordinary shares in NAB. Each performance option and performance right entitles the holder to subscribe for one fully paid ordinary share in NAB. The performance options and performance rights cannot be transferred and are not quoted on a recognised stock market. No payment is required from executives at the time of the grant. There are no voting rights or dividends associated with the performance options or performance rights.

The exercise price per performance option is the market price of NAB fully paid ordinary shares as at the date the performance option was granted or such other relevant date determined by the Board of NAB.

The holder of performance rights must pay a nominal exercise price in order to exercise those rights. The total exercise price payable on the exercise of any performance rights on a particular day is A$1, irrespective of the number of rights exercised that day.

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 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.

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

Grant date	28-Feb-08	14-Feb-08	28-Aug-07	03-Aug-07	07-Feb-07
Risk-free interest rate (per annum)	6.54%	6.54%	6.10%	6.19%	5.90%
Life of options	3.5 years	4 years	5 years	5 years	5.5 years
Volatility of share price	19.00%	19.00%	15.00%	15.00%	15.00%
Dividend rate (per annum)	4.50%	4.50%	4.40%	4.40%	4.70%
Exercise price of options	-	A$31.70	A$43.43	A$40.91	A$40.91
Fair value of performance options	-	A$3.73	A$2.69	A$2.68	A$4.20
Fair value of performance rights	A$26.18	-	-	A$13.57	A$18.67

37. Share based payments (continued)

Grant date	31-Oct-06	31-Jul-06	03-May-06	03-May-06	06-Feb-06
Risk-free interest rate (per annum)	5.80%	5.90%	5.70%	5.70%	5.20%
Life of options	4.75 years	5.5 years	5.5 years	5.5 years	5.5 years
Volatility of share price	15.00%	15.50%	15.00%	15.00%	15.00%
Dividend rate (per annum)	4.90%	5.00%	5.00%	5.00%	5.30%
Exercise price of options	A$38.29	A$35.50	A$37.55	A$34.53	A$34.53
Fair value of performance options	A$3.73	A$3.98	A$3.75	A$4.65	A$3.39
Fair value of performance rights	A$19.59	A$20.11	A$19.51	A$19.51	A$18.23

Grant date	06-Feb-06	19-Dec-05	08-Jul-05	22-Feb-05	07-Feb-05
Risk-free interest rate (per annum)	5.20%	5.20%	5.10%	5.40%	5.30%
Life of options	5 years	5 years	5 years	5 years	5 years
Volatility of share price	15.00%	15.00%	16.00%	16.00%	16.00%
Dividend rate (per annum)	5.30%	5.30%	5.80%	5.80%	5.80%
Exercise price of options	A$34.53	A$31.78	A$29.93	A$30.41	A$29.93
Fair value of performance options	A$3.23	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

The movement in share options and performance rights granted since March 2003 and exercised during the year was as follows:

Share options	**2008**		2007	
	Number	**Weighted Average Exercise Price A$**	Number	Weighted Average Exercise Price A$
Outstanding at 1 October	**7,169,809**	**34.89**	4,791,870	31.42
Granted during the year	**171,651**	**31.70**	5,229,519	36.03
Forfeited during the year	-	-	(1,996,080)	29.03
Exercised	-	-	(855,500)	36.14
Outstanding at 30 September	**7,341,460**	**34.81**	7,169,809	34.89
Exercisable at 30 September	**3,612,109**		2,601,509	

No share options were exercised during the year (2007: 855,500). For share options outstanding at 30 September 2008, the weighted average remaining contractual life is 3.05 years (2007: 3.03 years). The range of exercise prices for options outstanding at the end of 2008 and 2007 were A$26.59 to A$43.43.

37. Share based payments (continued)

Performance rights	2008 Number	2008 Weighted Average Exercise Price A$	2007 Number	2007 Weighted Average Exercise Price A$
Outstanding at 1 October	**1,522,101**	**1.00**	1,180,631	1.00
Granted during the year	**1,690**	**1.00**	558,408	1.00
Forfeited during the year	**-**		(216,938)	1.00
Outstanding at 30 September	**1,523,791**	**1.00**	1,522,101	1.00
Exercisable at 30 September	**633,151**		384,225	

No performance rights were exercised during the year (2007: Nil). For performance rights outstanding at 30 September 2008, the weighted average remaining contractual life is 3.59 years (2007: 3.59 years). The exercise price for outstanding options is A$1.00 for the total rights exercised by an individual on the same day.

38. Directors' emoluments

	2008 £m	2007 £m
Aggregate emoluments	**5**	4

No Director (2007: one) exercised share options in the year and three Directors (2007: three) became entitled to receive shares under long-term incentive schemes operated by the Bank's ultimate parent undertaking. One Director (2007: Nil) accrued retirement benefits under a money purchase pension scheme.

The aggregate emoluments of the highest paid Director in respect of those duties relevant to the Bank were £2.3m (2007: £2.1m). The Bank's pension contributions amounted to £Nil (2007: £Nil). The Director exercised no share options in the year (2007: Nil) and was entitled to receive shares under the long term incentive scheme.

39. Fair values of financial instruments

Financial instruments include both financial assets and financial liabilities and also derivatives. The 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.

Group	Footnote	Carrying Value 2008 £m	Fair value 2008 £m	Carrying Value 2007 £m	Fair value 2007 £m
Financial assets					
Cash and balances with supervisory central banks	(a)	**5,109**	**5,109**	2,093	2,093
Loans and advances to other banks	(b)	**522**	**522**	685	685
Derivative financial assets (on balance sheet)	(c)	**602**	**602**	126	126
Financial assets at fair value through profit or loss	(d)	**4,276**	**4,276**	3,053	3,053
Investments	(e)	**7**	**7**	1,714	1,714
Loans and advances to customers	(b)	**28,656**	**28,656**	25,055	25,055
Due from customers on acceptances	(a)	**3**	**3**	3	3
Due from related entities	(f)	**1,153**	**1,153**	1,329	1,329
Other assets	(g)	**708**	**708**	503	503

39. Fair values of financial instruments (continued)

	Footnote	**Carrying Value 2008 £m**	**Fair value 2008 £m**	Carrying Value 2007 £m	Fair value 2007 £m
Financial liabilities					
Due to other banks	(a)	**3,962**	**3,962**	2,289	2,289
Derivative financial liabilities (on balance sheet)	(c)	**36**	**36**	22	22
Financial liabilities at fair value through profit or loss	(d)	**553**	**553**	442	442
Due to customers	(a)	**22,334**	**22,334**	19,319	19,319
Liabilities on acceptances	(a)	**3**	**3**	3	3
Bonds and notes	(h)	**5,451**	**5,451**	5,471	5,471
Due to related entities	(f)	**5,151**	**5,151**	3,915	3,915
Other liabilities	(i)	**1,930**	**1,930**	1,610	1,610

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

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

(b) The carrying value of loans and advances is net of allowance for impairment losses and unearned income. The fair values 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 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 available for sale investments and held to maturity investments is based on market values, where available.

(f) The carrying amount of amounts due from and due to related entities is considered to approximate fair value.

(g) Other financial assets include accrued interest receivable.

(h) The carrying value of bonds and notes reflects their fair value. This is based on quoted closing market prices as at balance sheet date where available, otherwise an appropriate discounted cash flow model is used.

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

40. 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 11.

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 2008 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 11. The movement in fair value of derivatives deferred within the cash flow hedge reserve to hedge forecast future cash flows is disclosed in note 28.

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, but a significant portion is personal lending where no such collateral can be obtained.

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 the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct borrowing.

40. 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 in 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, countries and asset class. This credit equivalent is derived by taking into account the residual maturity of each instrument and then adding the fair value of all contracts which have a positive fair value. Futures and option contracts which are traded on a recognised exchange and which are subject to margin payments are considered to have no credit exposure. Internal credit assessment applies a conservative methodology to determine potential counterparty exposure. 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**	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Cash and balances with central banks	**5,109**	2,093	**5,109**	2,293
Loans and advances to other banks	**522**	685	**14**	165
Derivative financial assets	**602**	126	**270**	80
Financial assets at fair value through profit or loss	**4,276**	3,053	**4,276**	3,053
Investments	**7**	1,714	**7**	1,314
Loans and advances to customers	**28,656**	25,055	**24,506**	20,806
Due from customers on acceptances	**3**	3	**3**	3
	39,175	32,729	**34,185**	27,714
Contingent liabilities (note 29)	**828**	780	**828**	780
Commitments (note 29)	**13,940**	13,312	**11,940**	11,312
Total credit risk exposure	**53,943**	46,821	**46,953**	39,806

The credit quality of financial assets other than 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**
	£m	**£m**	**£m**	**£m**
Group				
2008				
Senior investment grade	519	-	-	-
Investment grade	3	7	-	3
Sub investment grade	-	-	-	-
	522	7	-	3

40. Financial risk management (continued)

Maximum exposure to credit risk (continued)

	Due from other banks	Investments Available for sale	Investments Held to maturity	Acceptances
	£m	£m	£m	£m
Group				
2007				
Senior investment grade	534	50	854	-
Investment grade	151	350	460	3
Sub investment grade	-	-	-	-
	685	400	1,314	3
Bank				
2008				
Senior investment grade	14	-	-	-
Investment grade	-	7	-	3
Sub investment grade	-	-	-	-
	14	7	-	3
Bank				
2007				
Senior investment grade	165	-	854	-
Investment grade	-	-	460	3
Sub investment grade	-	-	-	-
	165	-	1,314	3

See note 14 for information about the credit quality of loans and advances to customers that are neither past due nor impaired.

Market risk

The Group takes on exposure to market risks. Market risks arise from open positions in interest rate, currency, commodity, credit spread and equity products, all of which are exposed to general and specific market movements. The Group applies a "value at risk" methodology to estimate the market risk of positions held and the maximum losses expected, based upon a number of statistical assumptions for various changes in market conditions. The Board sets limits on the value at risk that may be accepted, which is monitored on a daily basis.

Market risk of derivative financial instruments held or issued is the risk that the value of derivatives will be adversely affected by changes in the market value of the underlying instrument, reference rate or index. Not all risks associated with intermediation can be effectively hedged. The residual market exposures are managed within established limits approved by the Board. An independent unit monitors compliance within delegated limits on a daily basis.

Prepayment Risk

The level of prepayment risk is not considered material at present. 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. Current analysis of the fixed rate mortgage book shows that if 10% of the book repaid on 1st October this could result in a total cost of less than £0.1m. In other words, early repayment charges would offset the vast majority of any costs incurred from the unwinding of hedges.

40. Financial risk management (continued)

Market risk - Non-trading / Banking positions

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 IRRBB regulatory capital calculation incorporates repricing, yield curve, basis, and optionality risk, embedded gains/losses and any inter-risk and/or inter-currency diversification.

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 Bearing Interest" (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 Group Non-Traded Market Risk, in consultation with Group Treasury. Material changes require the approval of the Group/regional Asset and Liability Committee and are advised to the local regulatory authorities.

	As at 30 September		Average value during reporting period	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Value at risk				
Interest Rate Risk	**14**	10	**11**	7
Earnings at risk				
Interest Rate Risk	**4**	1	**3**	2

	Minimum value during reporting period		Maximum value during reporting period	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Value at risk				
Interest Rate Risk	**4**	4	**23**	10
Earnings at risk				
Interest Rate Risk	**1**	1	**5**	4

The IRRBB models, methodologies and risk and control framework were revised as at 30 September 2008, including the implementation of a new Basel II regulatory compliant IRRBB risk measurement system. All numbers reported prior to 30 September are based off legacy IRRBB risk measurement systems, models, methodologies and risk and control frameworks.

Risk concentration
Concentration of risk is managed by client/ counterparty, by geographical region and by industry sector.

40. Financial risk management (continued)

Industry concentration of assets

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

Group 2008	**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	10	31	35
Agriculture, forestry, fishing and mining	327	901	251
Financial, investment and insurance	57	471	2,414
Real estate - construction	44	1,157	267
Manufacturing	99	673	245
Instalment loans to individuals and other personal lending (including credit cards)	95	2,864	4,822
Real estate - mortgage	-	11,868	1,232
Asset and lease financing	-	1,533	-
Other commercial and industrial	3,140	9,820	5,502
	3,772	29,318	14,768

		Investments		
	Due from other banks £m	**Available for sale £m**	**Held to maturity £m**	**Acceptances £m**
Government and public authorities	-	-	-	-
Agriculture, forestry, fishing and mining	-	-	-	-
Financial, investment and insurance	522	7	-	-
Real estate - construction	-	-	-	-
Manufacturing	-	-	-	3
Instalment loans to individuals and other personal lending (including credit cards)	-	-	-	-
Real estate - mortgage	-	-	-	-
Asset and lease financing	-	-	-	-
Other commercial and industrial	-	-	-	-
	522	7	-	3

40. Financial risk management (continued)

Industry concentration of assets (continued)

Group 2007	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	169	32	33
Agriculture, forestry, fishing and mining	207	880	241
Financial, investment and insurance	48	426	2,307
Real estate - construction	27	738	255
Manufacturing	76	467	234
Instalment loans to individuals and other personal lending (including credit cards)	109	2,136	4,608
Real estate - mortgage	-	10,963	1,178
Asset and lease financing	-	1,490	-
Other commercial and industrial	2,138	8,535	5,236
	2,774	25,667	14,092

	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	685	400	1,314	3
Real estate - construction	-	-	-	-
Manufacturing	-	-	-	-
Instalment loans to individuals and other personal lending (including credit cards)	-	-	-	-
Real estate - mortgage	-	-	-	-
Asset and lease financing	-	-	-	-
Other commercial and industrial	-	-	-	-
	685	400	1,314	3

40. Financial risk management (continued)

Industry concentration of assets (continued)

Bank 2008	**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	10	31	35
Agriculture, forestry, fishing and mining	327	901	251
Financial, investment and insurance	57	473	414
Real estate - construction	44	1,157	-
Manufacturing	99	673	245
Instalment loans to individuals and other personal lending (including credit cards)	95	3,343	4,822
Real estate - mortgage	-	8,002	1,232
Asset and lease financing	-	757	-
Other commercial and industrial	3,140	9,819	5,769
	3,772	25,156	12,768

		Investments		
	Due from other banks £m	**Available for sale £m**	**Held to maturity £m**	**Acceptances £m**
Government and public authorities	-	-	-	-
Agriculture, forestry, fishing and mining	-	-	-	-
Financial, investment and insurance	14	7	-	-
Real estate - construction	-	-	-	-
Manufacturing	-	-	-	3
Instalment loans to individuals and other personal lending (including credit cards)	-	-	-	-
Real estate - mortgage	-	-	-	-
Asset and lease financing	-	-	-	-
Other commercial and industrial	-	-	-	-
	14	7	-	3

40. Financial risk management (continued)

Industry concentration of assets (continued)

Bank 2007	**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	169	37	33
Agriculture, forestry, fishing and mining	207	880	241
Financial, investment and insurance	48	426	307
Real estate - construction	27	738	255
Manufacturing	76	467	234
Instalment loans to individuals and other personal lending (including credit cards)	109	2,136	4,608
Real estate - mortgage	-	7,446	1,178
Asset and lease financing	-	730	-
Other commercial and industrial	2,138	8,535	5,258
	2,774	21,395	12,114

	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	165	-	1,314	3
Real estate - construction	-	-	-	-
Manufacturing	-	-	-	-
Instalment loans to individuals and other personal lending (including credit cards)	-	-	-	-
Real estate - mortgage	-	-	-	-
Asset and lease financing	-	-	-	-
Other commercial and industrial	-	-	-	-
	165	-	1,314	3

40. 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 when the assets and liabilities are expected to be recovered or settled. The majority 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 (refer to note 41 for information on interest rate sensitivity). See below "Cash flows payable under financial liabilities by contractual maturities" for the Group's contractual undiscounted repayment obligations.

Group 2008	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	5,109	-	-	-	-	-	5,109
Due from other banks	-	522	-	-	-	-	522
Derivative financial assets	602	-	-	-	-	-	602
Financial assets at fair value through profit or loss	378	238	121	1,649	1,890	-	4,276
Investments	-	6	-	-	1	-	7
Loans and advances to customers	5,138	-	4,900	3,263	15,355	-	28,656
Due from customers on acceptances	-	3	-	-	-	-	3
Due from related entities	349	804	-	-	-	-	1,153
All other assets	1	-	-	-	-	1,642	1,643
Total assets	11,577	1,573	5,021	4,912	17,246	1,642	41,971
Liabilities							
Due to other banks	101	2,549	312	1,000	-	-	3,962
Derivative financial liabilities	36	-	-	-	-	-	36
Financial liabilities at fair value through profit or loss	553	-	-	-	-	-	553
Due to customers	14,006	5,070	2,603	651	4	-	22,334
Liabilities on acceptances	-	3	-	-	-	-	3
Bonds and notes	(4)	450	564	3,991	450	-	5,451
Due to related entities	1,427	784	1,042	50	1,848	-	5,151
All other liabilities	2,066	-	-	-	-	251	2,317
Total liabilities	18,185	8,856	4,521	5,692	2,302	251	39,807

40. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Group 2007	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	2,093	-	-	-	-	-	2,093
Due from other banks	18	667	-	-	-	-	685
Derivative financial assets	126	-	-	-	-	-	126
Financial assets at fair value through profit or loss	103	101	103	1,159	1,586	1	3,053
Investments	-	1,263	50	399	2	-	1,714
Loans and advances to customers	3,690	9	5,055	3,584	12,717	-	25,055
Due from customers on acceptances	-	3	-	-	-	-	3
Due from related entities	459	861	9	-	-	-	1,329
All other assets	310	-	-	-	-	1,193	1,503
Total assets	6,799	2,904	5,217	5,142	14,305	1,194	35,561
Liabilities							
Due to other banks	47	229	13	2,000	-	-	2,289
Derivative financial liabilities	22	-	-	-	-	-	22
Financial liabilities at fair value through profit or loss	193	24	43	31	151	-	442
Due to customers	14,551	3,085	1,171	505	7	-	19,319
Liabilities on acceptances	-	3	-	-	-	-	3
Bonds and notes	(5)	-	200	4,176	1,100	-	5,471
Due to related entities	363	788	807	676	1,281	-	3,915
All other liabilities	53	-	-	-	-	1,925	1,978
Total liabilities	15,224	4,129	2,234	7,388	2,539	1,925	33,439

40. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Bank 2008	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	5,109	-	-	-	-	-	5,109
Due from other banks	-	14	-	-	-	-	14
Derivative financial assets	270	-	-	-	-	-	270
Financial assets at fair value through profit or loss	378	238	121	1,649	1,890	-	4,276
Investments	-	6	-	-	1	-	7
Loans and advances to customers	5,617	-	4,572	2,840	11,477	-	24,506
Due from customers on acceptances	-	3	-	-	-	-	3
Due from related entities	349	804	-	-	-	1,281	2,434
All other assets	1	-	-	-	-	3,267	3,268
Total assets	11,724	1,065	4,693	4,489	13,368	4,548	39,887
Liabilities							
Due to other banks	101	2,549	312	1,000	-	-	3,962
Derivative financial liabilities	36	-	-	-	-	-	36
Financial liabilities at fair value through profit or loss	553	-	-	-	-	-	553
Due to customers	13,734	5,070	2,603	651	4	-	22,062
Liabilities on acceptances	-	3	-	-	-	-	3
Bonds and notes	(4)	450	564	1,125	450	-	2,585
Due to related entities	1,427	784	1,042	50	1,848	1,120	6,271
All other liabilities	2,066	-	-	-	-	412	2,478
Total liabilities	17,913	8,856	4,521	2,826	2,302	1,532	37,950

40. Financial risk management (continued)

Maturity analysis of assets and liabilities (continued)

Bank 2007	**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	2,293	-	-	-	-	-	2,293
Due from other banks	18	147	-	-	-	-	165
Derivative financial assets	80	-	-	-	-	-	80
Financial assets at fair value through profit or loss	103	101	103	1,159	1,586	1	3,053
Investments	-	1,262	50	-	2	-	1,314
Loans and advances to customers	3,930	-	4,759	3,071	9,046	-	20,806
Due from customers on acceptances	-	3	-	-	-	-	3
Due from related entities	3,158	861	10	-	-	1,500	5,529
All other assets	310	-	-	-	-	857	1,167
Total assets	9,892	2,374	4,922	4,230	10,634	2,358	34,410
Liabilities							
Due to other banks	47	229	13	2,000	-	-	2,289
Derivative financial liabilities	22	-	-	-	-	-	22
Financial liabilities at fair value through profit or loss	193	24	43	31	151	-	442
Due to customers	14,550	3,085	997	262	7	-	18,901
Liabilities on acceptances	-	3	-	-	-	-	3
Bonds and notes	(5)	-	200	1,669	450	-	2,314
Due to related entities	2,983	794	806	952	1,281	-	6,816
All other liabilities	53	-	-	-	-	1,707	1,760
Total liabilities	17,843	4,135	2,059	4,914	1,889	1,707	32,547

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities when they fall due. Liquidity risk arises from the possibility that market conditions prevailing at some point in the future will require the Group to sell positions at a value which is below their underlying worth, or may result in the inability to exit from the positions. The liquidity of a derivative, or an entire market, can be reduced substantially as a result of external economic or market events, market size or the actions of individual participants. In order to counter such risk, the Group concentrates its derivative activity in highly liquid markets.

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 prudential limits that are in addition to regulatory requirements.

40. Financial risk management (continued)

Cash flows payable under financial liabilities by contractual maturities

Group 2008	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	-	1,539	420	2,397	-	-	4,356
Derivative financial liabilities	36	-	-	-	-	-	36
Financial liabilities at fair value through profit or loss	379	8	20	26	201	-	634
Deposits and other borrowings	14,007	5,124	2,659	700	5	-	22,495
Liability on acceptances	-	3	-	-	-	-	3
Bonds and notes	-	648	830	4,367	511	-	6,356
All other liabilities	-	-	-	-	-	1,211	1,211
Hedging derivatives	-	4,571	1,320	11,195	-	-	17,086
	14,422	11,893	5,249	18,685	717	1,211	52,177

Group 2007	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	47	256	92	2,210	-	-	2,605
Derivative financial liabilities	22	-	-	-	-	-	22
Financial liabilities at fair value through profit or loss	193	28	55	34	205	-	515
Deposits and other borrowings	14,551	3,111	1,198	538	9	-	19,407
Liability on acceptances	-	3	-	-	-	-	3
Bonds and notes	(5)	71	408	4,702	1,134	-	6,310
All other liabilities	-	-	-	-	-	1,166	1,166
Hedging derivatives	-	11,235	1,518	6,144	-	-	18,897
	14,808	14,704	3,271	13,628	1,348	1,166	48,925

40. Financial risk management (continued)

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

Bank 2008	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	-	1,539	420	2,397	-	-	4,356
Derivative financial liabilities	36	-	-	-	-	-	36
Financial liabilities at fair value through profit or loss	379	8	20	26	201	-	634
Deposits and other borrowings	13,735	5,124	2,659	700	5	-	22,223
Liability on acceptances	-	3	-	-	-	-	3
Bonds and notes	-	648	830	1,501	511	-	3,490
All other liabilities	-	-	-	-	-	1,211	1,211
Hedging derivatives	-	4,571	1,320	11,195	-	-	17,086
	14,150	11,893	5,249	15,819	717	1,211	49,039

Bank 2007	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	47	256	92	2,210	-	-	2,605
Derivative financial liabilities	22	-	-	-	-	-	22
Financial liabilities at fair value through profit or loss	193	28	55	34	205	-	515
Deposits and other borrowings	14,551	3,107	1,015	279	9	-	18,961
Liability on acceptances	-	3	-	-	-	-	3
Bonds and notes	(5)	32	290	1,879	484	-	2,680
All other liabilities	-	-	-	-	-	1,166	1,166
Hedging derivatives	-	11,235	1,518	6,144	-	-	18,897
	14,808	14,661	2,970	10,546	698	1,166	44,849

The balances in the above table 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.

41. Interest rate risk

Interest rate sensitivity gap analysis

Part of the Group's return on financial instruments is obtained from controlled mismatching of the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature. The tables below summarise these repricing mismatches on the Group's non-trading book as at 30 September 2008 and 30 September 2007. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date or the maturity date.

Group 2008	**Weighted average effective interest rate %**	**0 to 3 months £m**	**3 to 12 months £m**	**1 to 2 years £m**	**2 to 3 years £m**	**3 to 4 years £m**	**4 to 5 years £m**	**Over 5 years £m**	**Non interest bearing £m**	**Total £m**
Assets										
Cash assets	5.10	4,930	-	-	-	-	-	-	153	5,083
Balances with supervisory central banks		-	-	-	-	-	-	-	26	26
Due from other banks	7.43	522	-	-	-	-	-	-	-	522
Derivative financial assets		-	-	-	-	-	-	-	602	602
Financial assets at fair value through profit or loss	6.84	554	104	276	426	388	542	1,680	306	4,276
Investments -Available for sale	5.73	-	-	-	-	-	-	-	7	7
Loans and advances to customers	6.94	23,091	1,567	1,502	1,061	820	372	243	-	28,656
Due from customers on acceptances		-	-	-	-	-	-	-	3	3
Due from related entities		1,140	-	-	-	-	-	-	13	1,153
All other assets		-	-	-	-	-	-	-	1,643	1,643
Total assets		30,237	1,671	1,778	1,487	1,208	914	1,923	2,753	41,971
Liabilities										
Due to other banks	4.11	3,650	312	-	-	-	-	-	-	3,962
Derivative financial liabilities		-	-	-	-	-	-	-	36	36
Financial liabilities at fair value through profit or loss	3.78	-	8	10	11	13	18	114	379	553
Due to customers	3.79	18,702	2,335	224	189	4	3	4	873	22,334
Liabilities on acceptances		-	-	-	-	-	-	-	3	3
Bonds and notes	5.93	5,001	-	-	250	200	-	-	-	5,451
Due to related entities		5,095	-	-	-	-	-	-	56	5,151
All other liabilities		-	-	-	-	-	-	-	2,317	2,317
Shareholders' equity		-	-	-	-	-	-	-	2,164	2,164
Total liabilities and shareholders' equity		32,448	2,655	234	450	217	21	118	5,828	41,971
Off balance sheet items		(2,602)	1,872	143	1,122	1,061	(187)	(1,409)	-	-
Interest rate sensitivity gap		(4,813)	888	1,687	2,159	2,052	706	396	(3,075)	-
Cumulative gap		(4,813)	(3,925)	(2,238)	(79)	1,973	2,679	3,075	-	-

41. Interest rate risk (continued)

Interest rate sensitivity gap analysis (continued)

Group 2007	**Weighted average effective interest rate %**	**0 to 3 months £m**	**3 to 12 months £m**	**1 to 2 years £m**	**2 to 3 years £m**	**3 to 4 years £m**	**4 to 5 years £m**	**Over 5 years £m**	**Non interest bearing £m**	**Total £m**
Assets										
Cash assets	5.68	1,975	-	-	-	-	-	-	84	2,059
Balances with supervisory central banks		-	-	-	-	-	-	-	34	34
Due from other banks	6.10	685	-	-	-	-	-	-	-	685
Derivative financial assets		-	-	-	-	-	-	-	126	126
Financial assets at fair value through profit or loss	8.09	55	80	142	232	300	406	1,689	149	3,053
Investments										
-Available for sale	4.84	400	-	-	-	-	-	-	-	400
-Held to maturity	6.15	1,314	-	-	-	-	-	-	-	1,314
Loans and advances to customers	7.07	19,113	1,672	1,740	765	629	612	524	-	25,055
Due from customers on acceptances		-	-	-	-	-	-	-	3	3
Due from related entities		1,311	-	-	-	-	-	-	18	1,329
All other assets		-	-	-	-	-	-	-	1,503	1,503
Total assets		24,853	1,752	1,882	997	929	1,018	2,213	1,917	35,561
Liabilities										
Due to other banks	5.24	2,276	13	-	-	-	-	-	-	2,289
Derivative financial liabilities		-	-	-	-	-	-	-	22	22
Financial liabilities at fair value through profit or loss	4.43	(2)	3	4	5	6	7	304	115	442
Due to customers	3.23	16,377	1,912	248	136	5	3	41	597	19,319
Liabilities on acceptances		-	-	-	-	-	-	-	3	3
Bonds and notes	6.30	5,021	-	-	-	250	200	-	-	5,471
Due to related entities		3,780	56	-	-	-	-	-	79	3,915
All other liabilities		-	-	-	-	-	-	-	1,978	1,978
Shareholders' equity		-	-	-	-	-	-	-	2,122	2,122
Total liabilities and shareholders' equity		27,452	1,984	252	141	261	210	345	4,916	35,561
Off balance sheet items		(1,362)	1,664	726	1,347	(442)	(641)	(1,292)	-	-
Interest rate sensitivity gap		(3,961)	1,432	2,356	2,203	226	167	576	(2,999)	-
Cumulative gap		(3,961)	(2,529)	(173)	2,030	2,256	2,423	2,999	-	-

A negative interest rate sensitivity gap exists when more liabilities than assets reprice during a given period. Although a negative gap position tends to benefit net interest income in a declining interest rate environment, the actual effect will depend on a number of factors, including the extent to which repayments are made earlier or later than the contracted date and variations in interest rate sensitivity within repricing periods and among currencies.

41. Interest rate risk (continued)

Interest rate sensitivity gap analysis (continued)

Bank 2008	**Weighted average effective interest rate %**	**0 to 3 months £m**	**3 to 12 months £m**	**1 to 2 years £m**	**2 to 3 years £m**	**3 to 4 years £m**	**4 to 5 years £m**	**Over 5 years £m**	**Non interest bearing £m**	**Total £m**
Assets										
Cash assets	5.10	4,930	-	-	-	-	-	-	153	5,083
Balances with supervisory central banks		-	-	-	-	-	-	-	26	26
Due from other banks	7.43	14	-	-	-	-	-	-	-	14
Derivative financial assets		-	-	-	-	-	-	-	270	270
Financial assets at fair value through profit or loss	6.84	554	104	276	426	388	542	1,680	306	4,276
Investments		-	-	-	-	-	-	-	7	7
Loans and advances to customers	5.73	19,747	1,340	1,284	907	701	318	208	1	24,506
Due from customers on acceptances	6.94	-	-	-	-	-	-	-	3	3
Due from related entities		622	-	-	-	-	-	-	1,812	2,434
All other assets		-	-	-	-	-	-	-	3,268	3,268
Total assets		25,867	1,444	1,560	1,333	1,089	860	1,888	5,846	39,887
Liabilities										
Due to other banks	4.11	3,650	312	-	-	-	-	-	-	3,962
Derivative financial liabilities		-	-	-	-	-	-	-	36	36
Financial liabilities at fair value through profit or loss	3.78	-	8	10	11	13	18	114	379	553
Due to customers	3.79	18,430	2,335	224	189	4	3	4	873	22,062
Liabilities on acceptances		-	-	-	-	-	-	-	3	3
Bonds and notes	5.93	2,135	-	-	250	200	-	-	-	2,585
Due to related entities		5,892	-	-	-	-	-	-	379	6,271
All other liabilities		-	-	-	-	-	-	-	2,478	2,478
Shareholders' equity		-	-	-	-	-	-	-	1,937	1,937
Total liabilities and shareholders' equity		30,107	2,655	234	450	217	21	118	6,085	39,887
Off balance sheet items		(2,602)	1,872	143	1,122	1,061	(187)	(1,409)	-	-
Interest rate sensitivity gap		(6,842)	661	1,469	2,005	1,933	652	361	(239)	-
Cumulative gap		(6,842)	(6,181)	(4,712)	(2,707)	(774)	(122)	239	-	-

41. Interest rate risk (continued)

Interest rate sensitivity gap analysis (continued)

Bank 2007	**Weighted average effective interest rate %**	**0 to 3 months £m**	**3 to 12 months £m**	**1 to 2 years £m**	**2 to 3 years £m**	**3 to 4 years £m**	**4 to 5 years £m**	**Over 5 years £m**	**Non interest bearing £m**	**Total £m**
Assets										
Cash assets	5.68	2,175	-	-	-	-	-	-	84	2,259
Balances with supervisory central banks		-	-	-	-	-	-	-	34	34
Due from other banks	6.10	165	-	-	-	-	-	-	-	165
Derivative financial assets		-	-	-	-	-	-	-	80	80
Financial assets at fair value through profit or loss	8.09	55	80	142	232	300	406	1,689	149	3,053
Investments	6.15	1,314	-	-	-	-	-	-	-	1,314
Loans and advances to customers	7.07	15,872	1,389	1,444	635	522	508	436	-	20,806
Due from customers on acceptances		-	-	-	-	-	-	-	3	3
Due from related entities		2,311	-	-	-	-	-	500	2,718	5,529
All other assets		-	-	-	-	-	-	-	1,167	1,167
Total assets		21,892	1,469	1,586	867	822	914	2,625	4,235	34,410
Liabilities										
Due to other banks	5.24	2,276	13	-	-	-	-	-	-	2,289
Derivative financial liabilities		-	-	-	-	-	-	-	22	22
Financial liabilities at fair value through profit or loss	4.43	(2)	3	4	5	6	7	304	115	442
Due to customers	3.23	16,022	1,871	243	133	5	3	40	584	18,901
Liabilities on acceptances		-	-	-	-	-	-	-	3	3
Bonds and notes	6.30	2,314	-	-	-	-	-	-	-	2,314
Due to related entities		6,720	-	-	-	-	-	-	96	6,816
All other liabilities		-	-	-	-	-	-	-	1,760	1,760
Shareholders' equity		-	-	-	-	-	-	-	1,863	1,863
Total liabilities and shareholders' equity		27,330	1,887	247	138	11	10	344	4,443	34,410
Off balance sheet items		(1,362)	1,664	726	1,347	(442)	(641)	(1,292)	-	-
Interest rate sensitivity gap		(6,800)	1,246	2,065	2,076	369	263	989	(208)	-
Cumulative gap		(6,800)	(5,554)	(3,489)	(1,413)	(1,044)	(781)	208	-	-

Management of risk

Effective management of risk is a key capability for a successful financial services provider, and is fundamental to the Clydesdale Bank Group's ("CB Group") strategy, as well as that of its ultimate parent entity National Australia Bank Limited ("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 CB 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 CB Group change.

In line with the NAB Group Risk Charter, the CB 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 CB Group manages risk within an established '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 Managing Director and Group Chief Executive, serves as the principal risk strategy and policy decision making body within the NAB Group, and provides the Board with assurance in the performance of the overall risk management framework. This committee is supported by five sub-committees - NAB Group Credit Risk Committee, NAB Group Market Risk Committee, NAB Group Operational Risk and Compliance Committee, NAB Group Asset and Liability Committee, and NAB Group Economic Capital Committee - each with a specialised focus.

Within the UK there is also a regional Risk Management Committee comprised of senior regional executives, which serves to provide a leadership focus on key risk issues from a regional perspective.

In addition, the NAB Group has four regional risk management teams including one in the UK. The UK 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 behaviours.

Operational risk and compliance

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.

The NAB Group continues to place significant focus on improving its operational risk management processes and systems. One area of improvement has been the governance process supporting operational risk management, including in particular, revisions to the Group Operational Risk and Compliance Committee charter and structures and the reporting and escalation of risks and issues.

Operational risk and compliance (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 and 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 and Compliance Framework ("ORCF") 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 and compliance into "business-as-usual" activities. It has particular focus on defining and implementing the right behaviours and incorporating risk considerations into the NAB Group's systems and processes.

The ORCF 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, management 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 risk management process to facilitate the identification, quantification and management of risks.

The CB Group is committed to sound risk management and compliance and is investing significantly in improving its capabilities in these areas.

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 CB Group. Group Credit Policy & Counterparty Credit and Group Portfolio & Models, 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 CB 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 NAB Group Credit Policy & Counterparty Credit and Group Portfolio & Models 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, NAB Group Credit Policy & Counterparty Credit and Group Portfolio & Models 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 CB 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.

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.

The management of interest rate risk in the UK resides with UK ALCO.

Risk oversight is the responsibility of the Group Non-Traded Market Risk team. This team was established in January 2005, to strengthen the risk governance framework via introducing standards of independence and control resilience consistent with traded market risk, with teams in place across the UK business.

UK ALCO meets monthly and reports to the Group Risk Management Committee and the Board Risk Committee.

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 CB 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 NAB Group ALCO.

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, 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 CB Group's liquidity exposure. In addition, regional banks are required to hold liquid asset portfolios to meet any unexpected cash flow requirement.

A three-level contingency plan has also been established for management of an escalated liquidity requirement where the CB 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 CB 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 and caps/floors. All products are used within approved mandates, with strategies subject to monthly reporting to NAB Group ALCO and UK 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. UK ALCO, via Risk Committee oversight, monitors risk to ensure it remains within approved policy and limits set by the NAB Board.

Structural interest rate risk (continued)

Basis risk is more difficult to manage, given limited market liquidity in basis risk products. To mitigate this risk, NAB Group Treasury and the NAB Group Non-Traded Market Risk team closely monitor pricing strategies, product innovation and marketing, since these play an important role in reducing the mismatch attributable to repricing characteristics of customer assets and liabilities.

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. Such cash flows could result from the repatriation of profits or capital back to the Company. 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 CB Group maintains a matched position through transactions with NAB Group.

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 and is progressively moving towards advanced approaches. 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 a Final Individual Capital Guidance (ICG).

The ultimate responsibility for capital adequacy rests with the Board of Directors. The Bank's Asset and Liabilties Committee (ALCO), which consists of an 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 ALCO and other governance committees. Capital requirements are included within an annual capital management plan with initiatives being executed against this plan.

The Clydesdale Bank Group has fully complied with the FSA's capital requirements throughout the year, and the Group's consolidated capital ratios are as follows:

Regulatory capital

	2008	2007
	£m	£m
Actual capital		
Tier 1 capital	2,049	1,790
Tier 2 capital	1,092	1,110
Investments in subsidiaries	(2)	(2)
	3,139	2,898
Risk weighted assets	27,687	22,944

	2008	2007
	%	%
Tier 1 ratio	**7.4%**	7.8%
Total capital	**11.3%**	12.6%

Regulatory capital consists of Tier 1 capital, which includes share capital, share premium and retained earnings and includes profits up to 30 September 2008. The other component of regulatory capital is Tier 2 capital, which includes subordinated long term debt, provisions and revaluation reserves. FSA adjustments have been included in both tier 1 and tier 2 capital.
The September 2007 risk weighted assets and resultant ratios are calculated on a Basel I basis. The September 2008 risk weighted assets are derived from Basel II Pillar 1 requirements.

Basel II Pillar 3 disclosure
Following initial discussions with the Financial Services Authority, Clydesdale Bank PLC has submitted a waiver application. If accepted, the Group's disclosure obligations under Pillar 3 of the Banking Consolidation Directive will be satisfied by the Risk and Capital Report issued by the ultimate parent undertaking, National Australia Bank Limited. This document can be viewed on the National Australia Bank website (www.nabgroup.com).