

# Annual Report & Consolidated Financial Statements.

Clydesdale Bank PLC.

30 September 2010.

Company Number: SC001111.





**CLYDESDALE BANK PLC**  
**ANNUAL REPORT AND CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 30 SEPTEMBER 2010**

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**CLYDESDALE BANK PLC**  
**Officers and Professional Advisers**

<b>Directors</b>	<b>Chairman:</b>	Sir Malcolm Williamson #
	<b>Non-executive:</b>	Jonathan Dawson* # Sir David Fell KCB* Richard Gregory OBE * # Roy Nicolson * # Elizabeth Padmore (appointed 6 November 2009) Peter Wood*
	<b>Executive:</b>	Lynne Peacock (Chief Executive Officer) # Cameron Clyne (appointed 8 January 2010) John Hooper # David Thorburn #

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

<b>UK Executive Committee</b>	Lynne Peacock, Chief Executive Officer David Thorburn, Executive Director John Hooper, Executive Director Margaret Butler, Quality & Efficiency Director Debbie Crosbie, Chief Information Officer Dean Cutbill, Products & Marketing Director Eric Gunn, Chief Risk Officer Steven Martin, Head of Strategic Developments Kevin Page, Operations Director Steve Reid, Retail Director Iain Smith, Chief Financial Officer Michael Webber, Head of Legal Services & Company Secretary Arthur Willett, Human Resources Director Mike Williams, Executive General Manager iFS
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<b>Secretary</b>	Michael Webber
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<b>Registered Office</b>	30 St Vincent Place Glasgow, G1 2HL
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<b>Auditor</b>	Ernst & Young LLP 1 More London Place London, SE1 2AF
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## CLYDESDALE BANK PLC

### Chairman's Statement

Sir Malcolm Williamson, Chairman



Clydesdale Bank PLC has again delivered a positive set of results, despite the ongoing challenges facing the UK economy and banking sector. During this financial year, the UK began to emerge from recession, but economic growth was slow. Against this backdrop, the Bank has continued to support its customers and to strengthen its balance sheet.

The results demonstrate the continued effectiveness of our conventional banking model. Offering a broad range of products and services to our business and retail customers, we have responded to changing customer demand efficiently. Further enhancements have been made to the iFS proposition and new customer opportunities have been identified and taken.

Capital has been increased during the year, demonstrating our continued focus on maintaining balance sheet strength. As regards funding and liquidity, the balance sheet continues to reflect prudent choices. Our emphasis on funding through customer deposits has borne good results during the year and we have continued to grow our liquid assets portfolio.

Although operating expenses continue to be tightly controlled, we increased our investment spend during the year, in order to develop our business and enhance our customer offering.

Our bad and doubtful debt position has improved this year, which is reflective of the tentative economic recovery and of the support we have continued to give our customers. Close attention has been paid to both the balance within and between the business and retail portfolios. This active portfolio management has strengthened the balance sheet over the course of the year.

We continue to perform effectively as a strong and committed Bank, dedicated to our customers and focussed on maintaining our stable approach while positioning ourselves for the future.

Sir Malcolm Williamson  
Chairman  
25 November 2010

## CLYDESDALE BANK PLC

### Business Review

Lynne Peacock, Chief Executive Officer



#### Overview

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

As the UK economy slowly emerged from recession during the year and entered a period of tentative economic growth, the Bank achieved a modest improvement in profit. It did this while balancing profit with increased security through a strengthened balance sheet driven by above system deposit growth. At the same time the Business continued to support new lending and rebalance its loan portfolio.

#### Strategic Highlights & Business Developments

The Group's pro forma operating profit for the year ended 30 September 2010, in an economy in the early stages of recovery, totalled £84 million, £12 million more than in the prior year.

The Bank has **strengthened and reshaped its balance sheet** for the future when the UK economy will return to more stable conditions. Liquidity levels were increased in the year to mitigate the risks posed by the Euro-zone sovereign debt crisis and its potential impacts on funding markets.

The Business continued to demonstrate support for its customers during 2010, with **new lending of £4.7 billion** through the iFS and Retail channels, concentrated in the SME and housing sectors. However, subdued market demand for credit, debt reduction by businesses and a **conscious effort to lower exposures in commercial property and unsecured personal loans** resulted in broadly flat lending balances.

The Bank continues to attract **trading and mid-corporate business** as the iFS strategy progresses. Focus remains on rebalancing the portfolio towards trading companies and applying the iFS approach to medium-sized private and quoted companies. The mortgage book continues to grow and increased by 4.2% in the year.

**Deposit growth of 10.5% was strong** in a highly competitive market. This growth has contributed to an improved Stable Funding Index (SFI) of 105.3%. This measure shows the proportion of lending which is funded by customer deposits and by longer term funding. The **Customer Funding Index (CFI)** has improved to 85.2% and the **Term Funding Index (TFI) of 20.1% has been maintained** in line with the risk appetite of the Bank, as maturing medium term funding is replaced. However, new medium term funding has become significantly more expensive as the markets adjust to changes in the global economy after the funding crisis.

Levels of customer engagement remained strong throughout the period despite the difficult market conditions. The Bank performed well relative to peers on satisfaction, loyalty and advocacy measures.

The **charge to provide for bad and doubtful debts was lower than in the previous year**. However, certain asset quality measures, particularly gross impaired assets, continue to reflect the current stage of the economic cycle.

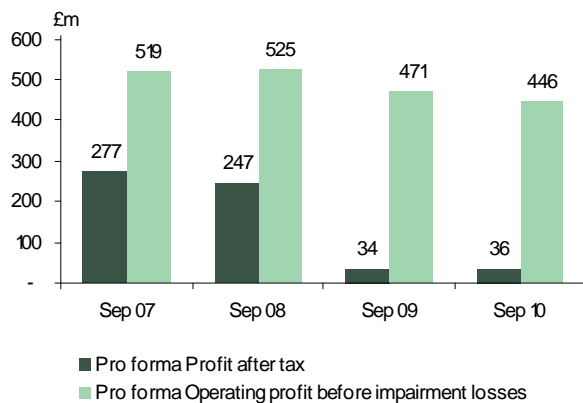


# CLYDESDALE BANK PLC

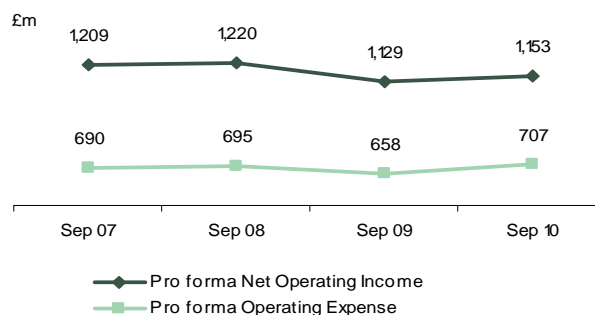
## Business Review

### Strategic Highlights & Business Developments (continued)

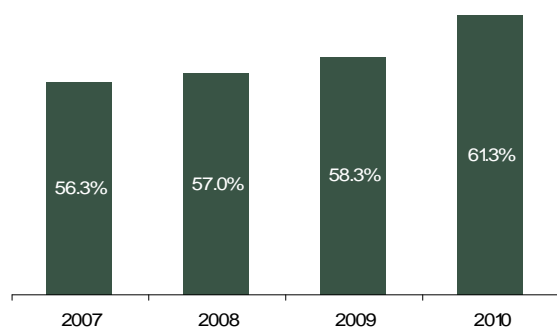
#### Pro Forma Operating Profit before Impairment Losses and Profit after Tax



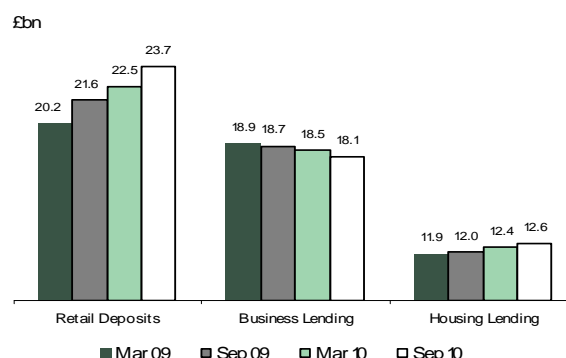
#### Pro Forma Income and Expense Trends



#### Pro Forma Cost to Income Ratio



#### Loans and Deposits Half Year Average



### Operating Environment

UK GDP grew by 0.8% in the third quarter of 2010, after second quarter growth of 1.2%. The latest Bank of England data predicts GDP growth of between 2.5% and 3% in 2011.

The latest figures from the various house price indices continue to point to an annual increase, although the monthly figures are still somewhat erratic. It is expected that house prices will remain relatively static or show a slight decline in the coming months. Commercial property prices have demonstrated some encouraging signs of improvement over the past year, but the average figures do disguise some marked regional variations and overall prices remain approximately 35% below their June 2007 peak.

Unemployment fell by 20,000 to 2.45 million in the quarter to August with an unemployment rate of 7.7%. Expectations for 2010 and 2011 are that unemployment will peak at about 8.0% which is significantly lower than in previous recessions. With reductions planned in public spending, it is likely that job cuts in this sector will place short-term pressure on the unemployment statistics.

## **CLYDESDALE BANK PLC**

### **Business Review**

#### **Operating Environment (continued)**

A package of austerity measures was announced in the UK Government's Emergency Budget in June designed to address the fiscal deficit and reduce sovereign risk. It included increases in direct and indirect taxes and the signalling of spending cuts. Most of these measures will take effect from 2011. The tax measures include a 2.5 percentage point increase in Value Added Tax (VAT) to 20% in January 2011, a bank levy and a 10 percentage point increase in Capital Gains Tax for higher rate tax payers.

On 20 October, the UK Government announced details of its Spending Review 2010 which set out plans aimed to eliminate the structural budget deficit by 2015. Of the £83 billion of public spending cuts to be enacted over the next four years, around £18 billion is likely to come from cuts in welfare costs. The Government has also published draft legislation on the bank levy which was announced as part of the Budget in June.

Inflation remains above the Bank of England target. The consumer price index annual inflation stood at 3.1% in September, unchanged from August. The increase in VAT in January 2011, as well as pressures on commodity and food prices, means that inflation is likely to remain above 2% until early 2012.

The sizeable economic stimuli in the economy, including low interest rates, quantitative easing and government spending, have had some impact on levelling off the decline in UK output. There are still, however, significant headwinds and the road to recovery remains challenging in some parts of the economy.

The UK financial markets saw the average daily spread between Base Rate and three month LIBOR at a more normal historical level of 16 basis points for the year to September 2010, compared with a peak of 86 basis points for the year to September 2009. (The 90 day rolling average spread dropped to 16 basis points for the year to September 2010 from its peak of 150 basis points in the year to September 2009).

The 'normalisation' of spreads, coupled with actions taken by the Bank in the prior year to reduce the exposure to basis risk, has resulted in a significant decrease in the cost of basis risk.

In November 2009, the UK Supreme Court decided in favour of the banks regarding certain charges in a unanimous ruling in relation to current accounts. It concluded that unarranged overdraft charges are an important part of current account services which the banks provide to their customers and that the level of those charges is not assessable for fairness. In December 2009, the Office of Fair Trading announced that it would not be taking forward its investigations into the fairness of the banks' unarranged overdraft charges. This effectively closes issues relating to past complaints about these charges and attention has now focused on future charging structures.

Market-wide issues relating to Payment Protection Insurance (PPI) claims handling and levies under the UK Financial Services Compensation Scheme are ongoing. In relation to PPI, on 8 October 2010 the British Bankers Association (BBA) filed papers with the High Court asking for a review of proposals by the Financial Services Authority contained in new rules that are due to be implemented at the end of this year. On behalf of the industry the BBA alleges that the rules require banks to apply sales standards retrospectively to a period before their introduction. Provision has been made for costs arising from claims received, although at this stage there remains uncertainty surrounding the potential impact.

#### **Customer, Employees and Community**

##### **Customer**

The Bank is committed to high standards of customer service, adding value and supporting both customers and employees. During the year, the levels of customers acquired into key retail segments continued to improve. Customer retention levels are broadly stable with underlying attrition showing an improvement.

##### **Employees**

Staff support for local charities was strong, with 20% of employees donating through the "Give As You Earn" payroll scheme. The Bank was awarded Her Majesty's Government Gold mark for payroll giving in May 2010. In addition, in the last 12 months over 3,600 volunteering days were given by our employees to support local communities and projects.



# CLYDESDALE BANK PLC

## Business Review

### Customer, Employees and Community (continued)

#### Community

The Bank recognises the importance of supporting the communities in which it operates and continues to support a range of community and charitable causes. Since the partnership with its national charity partner, Help the Hospices, was announced in February 2008, over £1.3 million has been raised through a wide variety of activities. The Bank also continues to sponsor the Clydesdale Bank Scottish Premier Football League, the contract for which was extended until the 2012/2013 season. The Bank also now supports the England and Wales Cricket Board as title sponsor for the new domestic '40-over' competition, demonstrating its continuing support of domestic cricket. This new competition provides an exciting opportunity for the Bank to be part of cricket's further development in the UK. The Bank was also proud to sponsor the Scottish Commonwealth Games Team in the 2010 Games in Delhi.

#### Awards

During this financial year, the Bank became the first high street bank to achieve the Carbon Trust Accreditation recognising the work that has been undertaken to manage the impact of our organisation on the environment. Our mortgage products were also recognised this year at the Your Mortgage Awards, where among other awards, a special award was received for 20 years of demonstrating consistency, commitment and excellence in mortgage provision. Additionally this year, the Bank was awarded Best New Banknote Series and Best Public Education Programme at the International Association of Currency Affairs (IACA) 2010 conference for our World Heritage Banknote Series.

### Pro Forma Financial Analysis

	Year to			Half Year to		
	Sep 10	Sep 09	Sep 10 v Sep 09 %	Sep 10	Mar-10	Sep 10 v Mar-10 %
	£m	£m		£m	£m	
Net interest income	960	845	13.6%	474	486	(2.5%)
Non interest income	193	284	(32.0%)	120	73	64.4%
<b>Total operating income</b>	<b>1,153</b>	<b>1,129</b>	<b>2.1%</b>	<b>594</b>	<b>559</b>	<b>6.3%</b>
Total operating expenses	(707)	(658)	(7.4%)	(355)	(352)	(0.9%)
<b>Operating profit before impairment losses</b>	<b>446</b>	<b>471</b>	<b>(5.3%)</b>	<b>239</b>	<b>207</b>	<b>15.5%</b>
Impairment losses on credit exposures (1)	(362)	(399)	9.3%	(174)	(188)	7.4%
<b>Group operating profit</b>	<b>84</b>	<b>72</b>	<b>16.7%</b>	<b>65</b>	<b>19</b>	<b>large</b>
Efficiency, quality and service initiatives	(19)	(22)	13.6%	(13)	(6)	(large)
Profit on sale of properties	3	11	(72.7%)	3	-	large
Financial Services Compensation Scheme levy	(2)	(6)	66.7%	-	(2)	large
Payment protection insurance refunds	(17)	(7)	(large)	(12)	(5)	(large)
<b>Profit on ordinary activities before tax</b>	<b>49</b>	<b>48</b>	<b>2.1%</b>	<b>43</b>	<b>6</b>	<b>large</b>
Tax expense	(13)	(14)	7.1%	(11)	(2)	(large)
<b>Profit for the period</b>	<b>36</b>	<b>34</b>	<b>5.9%</b>	<b>32</b>	<b>4</b>	<b>large</b>
<b>Average Volumes (£bn)</b>						
Gross loans and acceptances (2)	32.8	33.2	(1.2%)	32.7	32.9	(0.6%)
Interest earning assets	40.8	39.0	4.6%	41.1	40.6	1.2%
Total assets	43.9	42.1	4.3%	44.1	43.8	0.7%
Retail deposits (3)	23.1	20.9	10.5%	23.7	22.5	5.3%
<b>Performance Measures</b>						
Profit on average assets	0.08%	0.08%	0bps	0.07%	0.01%	6bps
Net interest margin	2.35%	2.17%	18bps	2.30%	2.40%	(10bps)
Cost to income ratio	61.3%	58.3%	300bps	59.8%	63.0%	(320bps)
Profit per average FTE (£'000s)	6	6		6	1	
FTEs (spot) (4)	5,554	5,725		5,554	5,481	

(1) Impairment losses on credit exposures excludes the credit risk adjustment on loans at fair value through profit or loss. This credit risk adjustment is included in Non interest income.

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

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

(4) 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 2010 was 8,355.

## CLYDESDALE BANK PLC

### Business Review

#### September 2010 v September 2009

**Profit after tax** at £36 million increased by £2 million (5.9%) over the prior year. Higher net interest income and lower charges to provide for bad and doubtful debts were partly offset by lower non-interest income and higher expenses.

**Average gross loans and acceptances** decreased by £0.4 billion (1.2%), reflecting both the decision to re-shape the loan book and the subdued demand for credit. Within this, commercial property lending reduced by 11.3% and exposure to credit card and personal lending fell by 12.5%. Lending for mortgages and trading businesses grew by 4.2% and 2.7% respectively.

During the year, the Bank continued to support customers by advancing £4.7 billion of new loans through the iFS and Retail franchises, of which £2.7 billion comprised business lending and £1.7 billion were mortgage advances.

**Average retail deposits** in a highly competitive market grew by 10.5% (£2.2 billion), which is more than double the industry average growth rate of 4.9% (Bank of England – September 2010). iFS average deposit growth was 12.7% and Retail network growth was 8.1%.

**Net interest income** increased by £115 million (13.6%). The repricing activity from 2009 and further repricing in 2010 resulted in widening of lending margins. This, together with lower basis risk costs, was partially offset by lower earnings on capital and higher funding costs.

**The net interest margin** increased by 18 basis points, driven by higher lending margins and a reduction in basis risk. These were partially offset by higher funding costs, lower deposit margins and lower earnings on capital.

**Non interest income** decreased by £91 million (32.0%). The decrease was driven by fair value adjustments including credit provisions raised on tailored business loans. The non interest income figure excludes the charge for Payment Protection Insurance (PPI) refunds to customers, which has increased by £10 million during the year. As a result of new guidance from the regulator on the handling of PPI claims, the business, in common with the industry, has seen increased refund claims activity, principally driven by the activities of claims management companies.

**Operating expenses** increased by £49 million (7.4%) over the prior year driven by £27 million higher underlying defined benefit pension costs. These costs principally increased due to lower expected returns from the pension scheme's assets, together with a lower discount rate being applied to the scheme's liabilities. Expenses, excluding pension costs, increased by £22 million (3.3%) which was broadly in line with inflation.

The **cost to income** ratio at 61.3% showed a 300 basis point increase, due primarily to the increased pension costs and lower other operating income.

The **charge to provide for bad and doubtful debts** decreased by £37 million (9.3%) over the prior year. There has been a general improvement in the UK environment and in commercial property prices over the year. The charge to provide for bad and doubtful debts normally lags behind economic growth post recession and remains under close scrutiny by management.

#### September 2010 v March 2010

The **profit after tax** for the period was £32m, £28m higher than in the March 2010 half. This reflects an increase in non-interest income and lower impairment losses on credit exposures.

**Average gross loans and acceptances** decreased by £0.2 billion (0.6%) as a result of subdued market conditions and an increasing appetite for customers to reduce their levels of borrowing, together with the managed reduction of the commercial property book. Gross new advances in the period were £2.5 billion through the iFS and Retail channels.

**Average retail deposits** grew by 5.3% (£1.2 billion) with continued momentum in iFS and a robust performance by the Retail network.

**Net interest income** decreased by £12 million (2.5%) as a result of lower earnings from capital and retail deposit margins, which were partially offset by higher lending income.

The **net interest margin** decreased by 10 basis points. This was as a result of lower earnings from capital and retail deposit margins, and margin dilution from the increase in low yielding liquid assets, partially offset by higher lending margins.

## CLYDESDALE BANK PLC

### Business Review

#### September 2010 v March 2010 (continued)

**Non interest income** increased by £47 million (64.4%). This was driven by tailored business loan revaluations, higher commission and higher fee income.

**Operating expenses** increased by £3 million (0.9%) which was less than inflation.

The **cost to income** ratio at 59.8% decreased by 320 basis points, reflecting higher net operating income and flat expenses.

The **charge to provide for bad and doubtful debts** decreased by £14 million (7.4%) when compared to the March 2010 half. This area remains under close scrutiny by management.

#### Other Items

#### Asset Quality

	As at		
	Sep 10	Mar 10	Sep 09
Specific provision for doubtful debts (£m)	74	77	64
Collective provision for doubtful debts (£m)	288	290	272
Specific provision on loans at fair value (£m)	26	19	26
Collective provision on loans at fair value (£m)	105	84	84
90+ DPD assets (£m)	265	292	284
Gross impaired assets (£m) (1)	796	713	615
90+ DPD plus gross impaired assets to gross loans and acceptances (1) (2)	3.24%	3.07%	2.71%
Specific Provision/gross impaired assets (1)	12.6%	13.5%	14.6%
Net write-offs to gross loans and acceptances (annualised) (2)	1.03%	0.96%	1.03%
Total provision as a percentage of net write-offs (3)	147%	150%	130%
Total provision to gross loans and acceptances (2) (3)	1.50%	1.43%	1.34%
Bad and doubtful debt charge to credit risk weighted assets	1.39%	1.47%	1.58%

	As at		
	Sep 10	Mar 10	Sep 09
Business lending (£m)	285	280	247
Mortgage lending (£m)	13	12	11
Other personal lending (£m)	64	75	78
<b>Impairment provisions on credit exposures (4)</b>	<b>362</b>	<b>367</b>	<b>336</b>

	Year to		Half year to	
	Sep 10	Sep 09	Sep 10	Mar 10
Business lending (£m)	294	284	155	139
Mortgage lending (£m)	8	12	3	5
Other personal lending (£m)	60	103	16	44
<b>Impairment losses on credit exposures (4)</b>	<b>362</b>	<b>399</b>	<b>174</b>	<b>188</b>

(1) Gross impaired assets for September 2010, March 2010 and September 2009 include £42m, £65m and £115m gross impaired fair value assets respectively.

(2) Gross loans and acceptances: includes gross loans and advances to customers, loans designated at fair value through profit or loss and due to customers on acceptances.

(3) Total provision to gross loans and acceptances includes the credit risk adjustments on fair value loans.

(4) Impairment provisions and impairment losses on credit exposures exclude the credit risk adjustment on loans at fair value through profit or loss.

Asset quality measures continue to reflect the current operating environment in the UK. The charge to provide for bad and doubtful debts fell during the year and the flow of new files referred for close monitoring and review remained relatively stable in both value and volume. The market, although no longer in economic recession, remains challenging for both trading and property businesses alike, and this has resulted in a further weakening of some key asset quality measures.

# CLYDESDALE BANK PLC

## Business Review

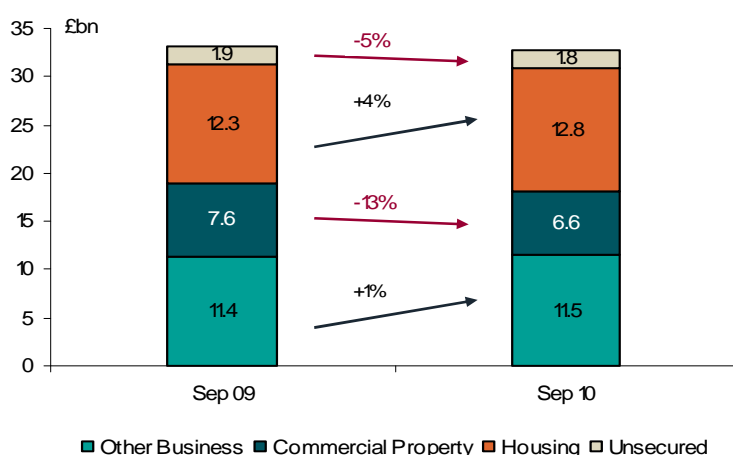
### Asset Quality (continued)

The business book continues to generate the greatest proportion of provisions and losses and, while the level of commercial property losses has slowed, trading business losses have increased, as the SME sector is affected by the prolonged slowdown. Overall, business losses were lower than in the year ended September 2009. Retail product provisions have also decreased, with the low interest rate environment assisting affordability, particularly for mortgages, where losses remain low.

As a whole, the portfolio remains well secured and diversified, both geographically and by lending type. The credit profile of new lending continues to be better than that of the existing portfolio.

As a result of the strategy to reshape the personal lending balance sheet towards secured lending over the last four years, the unsecured proportion of the portfolio has been reduced. Delinquency rates on this portfolio have remained stable.

### Lending Book (spot)



Lending on commercial property had fallen by over £1bn to £6.6bn as at end September 2010. This represents 20% of gross loans and acceptances (36% of the business book). Of this, approximately 80% is investment lending and 20% is development lending. No one loan represents more than 1.9% of the commercial property portfolio or 0.4% of the total portfolio. The portfolio is broadly spread around the UK and therefore not concentrated in any one geographical region.

The residential mortgages portfolio has proved resilient, with 90+ days past due arrears decreasing from 0.80% to 0.76% during the year. The average Loan to Value ratio (LTV) of the mortgage book has improved from 54% in September 2009 to 52% in September 2010 on an indexed basis. Over 70% of mortgages approved in the period had a loan to value ratio below 80%.

The number of owner occupied residential properties taken into possession has increased but remains at low levels relative to the portfolio size. There were 96 residential properties repossessed in the year to September 2010, compared to 78 in the preceding year. At the end of the period, a stock of 66 residential properties was held.

The business 90 days past due balances have reduced through early engagement with customers and a focus on appropriate limit management. The increase in gross impaired asset balances reflects the impact of the ongoing difficult economic and market conditions, although the rate of growth has slowed when compared to last year. Trading businesses have driven the second half growth in gross impaired assets although the balance continues to primarily consist of commercial property. Whilst there has been some stabilisation in property prices, the market for disposing of these assets is still operating below normal levels. This has resulted in assets remaining in the impaired asset category longer than has been previously experienced, with more than 44% of the current commercial property business impaired balances (as at end September 2010) being in this category prior to the start of the current financial year. Within the trading business impaired asset portfolio, over 10% comprises 'Restructured' arrangements which, if they continue to track to expectations, will migrate to full performing status over the next six months.

Asset quality measures remain under close management scrutiny to ensure that the actions in place remain appropriate.

## CLYDESDALE BANK PLC

### Business Review

#### Capital & Funding Position

	2010	2009
	£m	£m
<b>Actual capital</b>		
Core Tier 1 capital	2,479	2,187
Preference shares	100	100
Tier 1 capital	2,579	2,287
Tier 2 capital	1,462	1,398
<b>Total capital held</b>	<b>4,041</b>	<b>3,685</b>
<b>Risk Weighted Assets</b>		
	<b>28,662</b>	<b>28,049</b>
<b>Capital Ratios</b>		
Tier 1 ratio	9.0%	8.2%
Total capital ratio	14.1%	13.1%

The capital amounts above are stated after standard regulatory deductions.

Regulatory capital consists of Tier 1 capital, which includes share capital, share premium and retained earnings. 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.

Clydesdale Bank's Tier 1 capital ratio (FSA basis) improved to 9.0% as at September 2010 from 8.2% at September 2009. This was primarily due to an additional £310 million of ordinary share capital that was issued by Clydesdale Bank to its ultimate parent company. Capital requirements are kept under regular review and are subject to regulatory scrutiny.

Clydesdale Bank held a portfolio of liquid assets totalling £10.1 billion as at 30 September 2010 compared to £8.7 billion as at September 2009. This portfolio includes UK Government gilts, Bank of England Reserve Account, treasury bills, note cover required to cover Clydesdale's notes in circulation and lending to other banks. Clydesdale Bank's diverse funding mix of short and long-term wholesale funding, parent company funding, securitisation and Covered Bonds has created this strong liquidity position.

#### Clydesdale Bank PLC Diversity of Funding

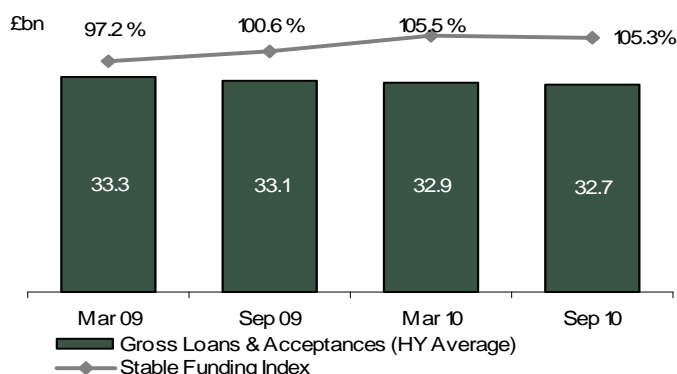
	As at Sep-10	As at Mar-10	As at Sep-09	As at Mar-09
Retail Deposits	64%	61%	59%	59%
External short-term	14%	16%	15%	14%
Subordinated debt	3%	3%	3%	3%
Structured Finance	2%	3%	3%	3%
Securitisation	5%	5%	6%	7%
Parent company	6%	6%	6%	6%
Medium Term notes	6%	6%	8%	8%
<b>CB PLC Funding</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

### Capital & Funding Position (continued)

The split of the Bank's funding portfolio remains broadly in line with prior years, with the exception of retail deposits. Strong performance in attracting customer deposits has continued which has grown the stable funding base, and positions the business well for the future.

The Stable Funding Index (SFI) compares longer term funding and customer deposits with lending, showing the proportion of lending that is funded by customer deposits or by longer term funding, which are generally held to be stable sources of funds. The Bank's SFI stood at 105.3% at the year end, having increased by 4.7% on the prior year end position.

#### Stable Funding Index



The Stable Funding Index (SFI) is the sum of the Term Funding Index (TFI) and the Customer Funding Index (CFI). TFI is defined as Term Wholesale Funding with a remaining maturity greater than 12 months, divided by Core Assets. CFI is a measure of customer deposits divided by Core Assets.

Clydesdale Bank restructured its EUR9 billion Covered Bond programme in November 2009 to a pass-through structure which enabled the two issuances under the programme to retain AAA rating from all three rating agencies.

As existing wholesale term funding matures and is replaced with more expensive new issuance, the overall margin paid on wholesale funding is increasing. In line with the market, this has been partially offset by the fall in liquidity costs as the spread between UK Base Rate and LIBOR normalises.

### Investment Spend

The Bank's investment cash spend for the September 2010 year was £90 million across the regulatory and compliance, efficiency and simplification and revenue generation categories. This compares to total cash spend of £87 million for the prior year.

The delivery of an enhanced customer proposition was advanced by a number of projects undertaken in the year. The roll-out of the simplified end-to-end Business Lending platform was completed, with 2,000 users now actively using the application across iFS, Retail and Credit. The new Debit MasterCard, which delivers improved world-wide acceptance and protection, was also successfully launched.

A programme of work to outsource the technical infrastructure and operational management of the ATM and Debit Card channels has begun. This programme will be delivered with a new third party supplier and, in addition to enhancing the customer experience, will generate more revenue.

Effort continues to be expended across a number of programmes to ensure applications are compliant with new regulatory requirements. Lastly, keeping the customer safe remains a key focus and the business has continued to enhance the fraud prevention and detection capability.



## CLYDESDALE BANK PLC

### Business Review

#### Distribution

As at 30 September 2010, the Bank's distribution network comprised 72 Financial Solutions Centres and 339 retail branches.

Business banking continued to work in partnership with its customers. Detailed sector reviews and a specialist approach have enabled the Bank to ensure that all new business written meets risk and return requirements and delivers relationship banking to customers. The corporate business continues to grow with a number of significant deals being completed, enhancing the reputation of the business as a full-service commercial bank. Sound portfolio management and re-pricing, as required to reflect any change in risk profile, has supported the strong underlying performance of the business while reducing exposure to commercial real estate.

The retail business has delivered a solid performance in what remains a challenging environment. Margins have remained strong on the good quality mortgage business that was written whilst the wealth management strategic partnership with AXA UK delivered the anticipated results and the relationship remains strong. The branch network has had a strong focus on delivering a consistently good customer experience through the Customer Promise initiative which has also seen many staff become involved in community-based activities and events. Plans to further enhance the overall small business proposition are well advanced and, when launched, will further demonstrate the Bank's commitment to this key segment.

#### CB PLC to NAB UK Region Reconciliation

The NAB Group publishes segmental financial results of which UK Banking forms one segment. The 2010 full year results were published by NAB on 27 October 2010. The segmentation is based on geographical lines, the exception being the wholesale banking business which is treated as a global business segment in its own right. Certain lines of the wholesale banking business are written on the CB PLC balance sheet and therefore this business is not included in the UK Banking results. The UK wealth management business, which operates through separate legal entities, is also included in the UK Banking results but is not part of CB PLC. Additionally, the UK Banking result excludes fair value and hedge ineffectiveness income in determining cash earnings. The table below sets out the reconciliation of the income statements of the two views.

#### Year ended 30 September 2010

	CB PLC £m	Add: Wealth Management £m	Less: Wholesale Banking £m	Fair value and hedge ineffectiveness £m	Other *	NAB UK Banking £m
Profit/(loss) on ordinary activities before tax/Cash earnings before tax	49	24	-24	74	41	164
Profit/(loss) attributable to shareholders/Cash earnings after tax	36	18	-17	52	29	118
Total assets	43,660					44,331

\* Other includes Efficiency, Quality and Service initiatives costs.



Lynne Peacock  
Chief Executive Officer  
25 November 2010

## **CLYDESDALE BANK PLC**

### **Report of the Directors**

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 2010.

#### **Activities**

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

The Bank and its subsidiaries offer access to a comprehensive range of banking and other related financial services through 72 Financial Solutions Centres and 339 retail 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 2010 amounted to £48m (2009: £43m). The profit attributable to the shareholders for the year ended 30 September 2010 amounted to £36m (2009: £34m). Preference share dividends of £12m (2009: £6m) were paid during the year. The Directors approved a preference share dividend of £6m on 16 November 2010, subject to regulatory non-objection. The Directors do not recommend the payment of a final dividend on the ordinary shares in respect of this financial year (2009: nil).

The Bank's strategic highlights and business developments are set out in the Business Review on pages 4 -13.

#### **Financial instruments**

The Group's risk management objectives and policies are discussed in Note 44.

#### **Directors and Directors' interests**

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

##### Appointments

Elizabeth Padmore was appointed as a Non-executive Director of the Company on 6 November 2009 and Cameron Clyne was appointed as an Executive Director of the Company on 8 January 2010.

##### Directors' interests

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

## **CLYDESDALE BANK PLC**

### **Report of the Directors (continued)**

#### **Employee involvement (continued)**

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

During the year, under the UK National Share Incentive Plan, the NAB gifted ordinary shares of A\$800 in total to each eligible employee based on Group performance in respect of the 2009 financial year. On 9 November 2010, the NAB notified employees that ordinary shares of A\$1,100 would be awarded based on the Group performance in respect of the 2010 financial year. 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 Bank during the year ended 30 September 2010 was £922,500 (2009: £842,800). The Bank channels its charitable donations through the Yorkshire and Clydesdale Foundation, which was established during 2008. The Foundation has made donations to many charities, including £269,000 during the year to Help the Hospices, the Bank's charity partner (2009: £271,000). During the past three years and together with staff led initiatives, over £1.3m has been raised and donated to Help the Hospices and 112 local hospices.

No political donations were made during the year (2009: £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. Remuneration policy is not the responsibility of the Board. The policy that applies to employees and Directors of the Bank is decided at the NAB Group level.

#### **Management of Risk**

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

## **CLYDESDALE BANK PLC**

### **Report of the Directors (continued)**

#### **Going concern**

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

The Bank's use of the going concern basis for preparation of the accounts is discussed in note 2 on page 27.

#### **Events after the balance sheet date**

On 19 October 2010 National Europe Holdings Limited, the immediate holding company of Clydesdale Bank PLC, incorporated and registered in England and Wales was liquidated. National Australia Group Europe Limited which is also incorporated and registered in England and Wales became from this date the immediate holding company of the Bank. The liquidation was made as part of an initiative to promote good corporate governance and provide administrative savings.

#### **Auditors**

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

#### **Directors' statement as to disclosure of information to auditors**

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

- to the best of each Director's knowledge and belief, there is no information relevant to the preparation of their report of which the Group's auditors are unaware; and
- each Director has taken all the steps a Director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Group's auditors are aware of that information.

By order of the Board



Michael Webber  
Secretary  
25 November 2010

## CLYDESDALE BANK PLC

### Statement of Directors' Responsibilities

The Directors are responsible for preparing the Directors' Report and the Financial Statements in accordance with applicable law and regulations.

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

- select suitable accounting policies in accordance with International Accounting Standard 8: *Accounting Policies, Changes in Accounting Estimates and Errors* and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and
- state that the Company has complied with IFRSs, subject to any material departures disclosed and explained in the Financial Statements.

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



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

We have audited the Financial Statements of Clydesdale Bank PLC for the year ended 30 September 2010 which comprise the Consolidated Income Statement, the Group and Bank Statements of Comprehensive Income, the Group and Bank Balance Sheets, the Group and Bank Statements of Changes in Equity, the Group and Bank Statements of Cash Flow and the related notes 1 to 47. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

### **Respective responsibilities of directors and auditors**

As explained more fully in the Directors' Responsibilities Statement set out on page 17, the directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### **Scope of the audit of the Financial Statements**

An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group and Bank's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the Financial Statements.

### **Opinion on Financial Statements**

In our opinion:

- the Financial Statements give a true and fair view of the state of the Group and Bank's affairs as at 30 September 2010 and of the Group's profit for the year then ended;
- the Group and Bank's Financial Statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the Group and Bank's Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006.



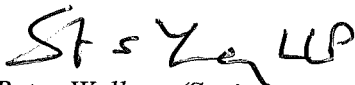
**Opinion on other matter prescribed by the Companies Act 2006**

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

**Matters on which we are required to report by exception**

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

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



*Peter Wallace (Senior statutory auditor)*

*for and on behalf of Ernst & Young LLP, Statutory Auditor*

*London*

*25 November 2010*

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

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

**CLYDESDALE BANK PLC**  
**Consolidated Financial Statements**

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**CLYDESDALE BANK PLC**  
**Consolidated Income Statement**  
**for the year ended 30 September 2010**

	Note	2010 £m	2009 £m
Interest receivable and similar income		1,392	1,722
Interest expense and similar charges		(432)	(877)
<b>Net interest income</b>	4	<b>960</b>	<b>845</b>
Gains less losses on financial instruments at fair value		(49)	9
Other operating income		225	268
<b>Non interest income</b>	5	<b>176</b>	<b>277</b>
<b>Total operating income</b>		<b>1,136</b>	<b>1,122</b>
Personnel expenses		(251)	(216)
Depreciation expense		(21)	(23)
Efficiency, quality and service initiatives		(19)	(22)
Other operating expenses		(435)	(419)
<b>Total operating expenses before impairment losses</b>	6	<b>(726)</b>	<b>(680)</b>
<b>Operating profit before impairment losses</b>		<b>410</b>	<b>442</b>
Impairment losses on credit exposures	16	(362)	(399)
<b>Group operating profit</b>		<b>48</b>	<b>43</b>
Profit on sale of land and buildings		3	11
Special Financial Services Compensation Scheme levy	35	(2)	(6)
<b>Profit on ordinary activities before tax</b>		<b>49</b>	<b>48</b>
Tax expense	7	(13)	(14)
<b>Profit for the financial year attributable to the equity holders of the parent</b>		<b>36</b>	<b>34</b>

All material items dealt with in arriving at the profit on ordinary activities for 2010 and 2009 relate to continuing activities.

**CLYDESDALE BANK PLC**  
**Statement of Comprehensive Income**  
**for the year ended 30 September 2010**

	Note	<b>Group</b>		<b>Bank</b>	
		<b>2010</b>	2009	<b>2010</b>	2009
		<b>£m</b>	£m	<b>£m</b>	£m
<b>Profit for the year</b>		<b>36</b>	34	<b>6</b>	92
<hr/>					
<b>Other comprehensive income/(losses)</b>					
Revaluation of land and buildings	8	-	(6)	-	(6)
Taxation	7	-	2	-	2
Change in available for sale investments reserve	8	(11)	19	(11)	19
Taxation	7	3	(5)	3	(5)
Change in cash flow hedge reserve	8	36	128	47	84
Taxation	7	(9)	(36)	(12)	(24)
Actuarial losses on defined benefit pension plans	8	(65)	(591)	(65)	(591)
Taxation	7	10	165	10	165
Taxation on employee share compensation	7	(1)	2	(1)	2
<hr/>					
<b>Other comprehensive losses net of tax</b>		<b>(37)</b>	(322)	<b>(29)</b>	(354)
<hr/>					
<b>Total comprehensive losses for the year net of tax</b>		<b>(1)</b>	(288)	<b>(23)</b>	(262)
<hr/>					
Attributable to:					
Equity holders of the parent		<b>(1)</b>	(288)	<b>(23)</b>	(262)
<hr/>					

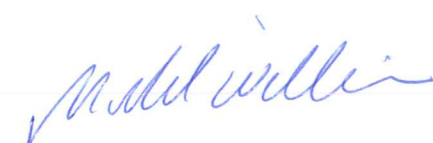
# CLYDESDALE BANK PLC

## Balance Sheet

at 30 September 2010

		Group	Bank		
		2010	2009	2010	2009
	Note	£m	£m	£m	£m
<b>Assets</b>					
Cash and balances with central banks	10	4,070	2,713	4,070	2,713
Due from other banks	11	11	340	10	339
Derivative financial instruments	12	719	942	385	424
Other financial assets at fair value	13	5,396	5,983	5,396	5,983
Investments - available for sale	14	2,262	1,541	2,262	1,541
Investments - held to maturity	14	-	639	413	945
Loans and advances to customers	15	26,981	27,147	22,176	22,393
Due from customers on acceptances		8	2	8	2
Investments in controlled entities and associates	18	2	2	639	617
Property, plant and equipment	19	157	167	157	167
Investment properties	20	77	33	-	-
Property Inventory	21	31	25	-	-
Current taxes		10	5	65	54
Deferred tax assets	22	144	147	139	146
Due from related entities	38	2,839	1,971	7,777	6,922
Other assets	23	953	713	677	403
<b>Total assets</b>		<b>43,660</b>	<b>42,370</b>	<b>44,174</b>	<b>42,649</b>
<b>Liabilities and Equity</b>					
Due to other banks	24	1,373	1,920	1,373	1,920
Derivative financial instruments	12	117	113	117	113
Other financial liabilities at fair value	13	896	597	896	597
Due to customers	25	28,434	26,656	28,434	26,656
Liabilities on acceptances		8	2	8	2
Deferred tax liabilities	22	43	50	32	28
Provisions	26	27	14	27	14
Due to related entities	38	3,386	3,321	6,011	6,326
Bonds and notes	27	4,409	5,287	2,727	2,953
Defined benefit pension liabilities	28	317	320	317	320
Other liabilities	29	2,103	1,840	1,908	1,671
<b>Total liabilities</b>		<b>41,113</b>	<b>40,120</b>	<b>41,850</b>	<b>40,600</b>
<b>Equity (parent entity interest)</b>					
Share capital	30	942	632	942	632
Share premium account	31	243	243	243	243
Merger reserve	31	338	338	338	338
Share option reserve	31	1	2	1	2
Asset revaluation reserve	31	2	2	2	2
Available for sale investments reserve	31	6	14	6	14
Cash flow hedge reserve	31	130	103	106	71
Retained earnings	31	885	916	686	747
<b>Total equity</b>		<b>2,547</b>	<b>2,250</b>	<b>2,324</b>	<b>2,049</b>
<b>Total liabilities and equity</b>		<b>43,660</b>	<b>42,370</b>	<b>44,174</b>	<b>42,649</b>

These Financial Statements were approved by the Board of Directors on 25 November 2010 and were signed on its behalf by:



Sir Malcolm Williamson  
Chairman



Lynne Peacock  
Chief Executive Officer

**CLYDESDALE BANK PLC**  
**Statement of Changes in Equity**  
**at 30 September 2010**

Group	Notes	Share Capital £m	Share premium account £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Merger reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total Equity £m
At 1 October 2008		232	243	20	7	-	338	11	1,313	2,164
Profit for the year		-	-	-	-	-	-	-	34	34
Other comprehensive income/(losses)		-	-	2	(5)	14	-	92	(425)	(322)
Total comprehensive income/(losses) for the period		-	-	2	(5)	14	-	92	(391)	(288)
Dividends paid - preference shares		-	-	-	-	-	-	-	(6)	(6)
Shares issued - ordinary		300	-	-	-	-	-	-	-	300
Shares issued - preference		100	-	-	-	-	-	-	-	100
Share options granted		-	-	15	-	-	-	-	-	15
Share options settled		-	-	(35)	-	-	-	-	-	(35)
<b>At 30 September 2009</b>		<b>632</b>	<b>243</b>	<b>2</b>	<b>2</b>	<b>14</b>	<b>338</b>	<b>103</b>	<b>916</b>	<b>2,250</b>
Profit for the year		-	-	-	-	-	-	-	36	36
Other comprehensive income/(losses)		-	-	(1)	-	(8)	-	27	(55)	(37)
Total comprehensive income/(losses) for the period		-	-	(1)	-	(8)	-	27	(19)	(1)
Dividends paid - preference shares		-	-	-	-	-	-	-	(12)	(12)
Shares issued - ordinary		310	-	-	-	-	-	-	-	310
Share options granted		-	-	17	-	-	-	-	-	17
Share options settled		-	-	(17)	-	-	-	-	-	(17)
<b>At 30 September 2010</b>	30, 31	<b>942</b>	<b>243</b>	<b>1</b>	<b>2</b>	<b>6</b>	<b>338</b>	<b>130</b>	<b>885</b>	<b>2,547</b>



**CLYDESDALE BANK PLC**  
**Statement of Changes in Equity**  
**at 30 September 2010**

Bank	Notes	Share Capital £m	Share premium account £m	Share option reserve £m	Asset revaluation reserve £m	Available for sale investments reserve £m	Merger reserve £m	Cash flow hedge reserve £m	Retained earnings £m	Total Equity £m
At 1 October 2008		232	243	20	7	-	338	11	1,086	1,937
Profit for the year		-	-	-	-	-	-	-	92	92
Other comprehensive income/(losses)		-	-	2	(5)	14	-	60	(425)	(354)
Total comprehensive income/(losses) for the period		-	-	2	(5)	14	-	60	(333)	(262)
Dividends paid - preference shares		-	-	-	-	-	-	-	(6)	(6)
Shares issued - ordinary		300	-	-	-	-	-	-	-	300
Shares issued - preference		100	-	-	-	-	-	-	-	100
Share options granted		-	-	15	-	-	-	-	-	15
Share options settled		-	-	(35)	-	-	-	-	-	(35)
<b>At 30 September 2009</b>		<b>632</b>	<b>243</b>	<b>2</b>	<b>2</b>	<b>14</b>	<b>338</b>	<b>71</b>	<b>747</b>	<b>2,049</b>
Profit for the year		-	-	-	-	-	-	-	6	6
Other comprehensive income/(losses)		-	-	(1)	-	(8)	-	35	(55)	(29)
Total comprehensive income/(losses) for the period		-	-	(1)	-	(8)	-	35	(49)	(23)
Dividends paid - preference shares		-	-	-	-	-	-	-	(12)	(12)
Shares issued - ordinary		310	-	-	-	-	-	-	-	310
Share options granted		-	-	17	-	-	-	-	-	17
Share options settled		-	-	(17)	-	-	-	-	-	(17)
<b>At 30 September 2010</b>	30, 31	<b>942</b>	<b>243</b>	<b>1</b>	<b>2</b>	<b>6</b>	<b>338</b>	<b>106</b>	<b>686</b>	<b>2,324</b>

**CLYDESDALE BANK PLC**  
**Statement of Cash Flows**  
**for the year ended 30 September 2010**

	Note	Group		Bank	
		2010 £m	2009 £m As restated	2010 £m	2009 £m As restated
<b>Operating Activities</b>					
Profit/(loss) on ordinary activities before tax		<b>49</b>	48	<b>(33)</b>	55
<i>Adjustments for:</i>					
Non cash or non operating items					
included in profit before tax	37	<b>(690)</b>	(685)	<b>(599)</b>	(692)
Changes in operating assets	37	<b>1,119</b>	(498)	<b>951</b>	1,797
Changes in operating liabilities	37	<b>1,380</b>	2,128	<b>1,413</b>	1,917
Interest received		<b>1,070</b>	2,017	<b>949</b>	1,757
Interest paid		<b>(134)</b>	(758)	<b>(206)</b>	(666)
Tax (paid)/received		<b>(10)</b>	13	<b>47</b>	40
<b>Net cash provided by operating activities</b>		<b>2,784</b>	2,265	<b>2,522</b>	4,208
<b>Cash flows from investing activities</b>					
Dividends received		-	-	<b>86</b>	193
Interest received		<b>26</b>	45	<b>26</b>	45
Purchase of available for sale investments		<b>(735)</b>	(1,508)	<b>(735)</b>	(1,510)
Purchase of shares in controlled entities		-	-	<b>(22)</b>	-
Purchase of held to maturity investments		-	(638)	<b>(160)</b>	(944)
Cash inflow from matured held to maturity investments		<b>639</b>	-	<b>639</b>	-
Proceeds from sale of investments		<b>4</b>	6	<b>4</b>	6
Purchase of property, plant and equipment (including investment property and property inventory)		<b>(73)</b>	(81)	<b>(16)</b>	(52)
Proceeds from sale of property, plant and equipment (including investment property and property inventory)		<b>17</b>	66	<b>8</b>	67
Proceeds from sale of subsidiary		-	2	-	-
<b>Net cash used in investing activities</b>		<b>(122)</b>	(2,108)	<b>(170)</b>	(2,195)
<b>Cash flows from financing activities</b>					
Interest received		<b>15</b>	-	<b>55</b>	-
Interest paid		<b>(115)</b>	(319)	<b>(133)</b>	(348)
Proceeds from ordinary shares issued	30	<b>310</b>	300	<b>310</b>	300
Proceeds from redeemable preference shares issued	30	-	100	-	100
Redemption of bonds and notes		<b>(877)</b>	(1,414)	<b>(225)</b>	(882)
Issue of bonds and notes		-	1,250	-	1,250
Share options settled		<b>(17)</b>	(35)	<b>(17)</b>	(35)
Net increase in amount due from related entities		<b>(868)</b>	(818)	<b>(855)</b>	(5,068)
Net increase/(decrease) in amount due to related entities		<b>180</b>	(1,792)	<b>(200)</b>	93
Dividends paid	9	<b>(12)</b>	(6)	<b>(12)</b>	(6)
<b>Net cash used in financing activities</b>		<b>(1,384)</b>	(2,734)	<b>(1,077)</b>	(4,596)
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>1,278</b>	(2,577)	<b>1,275</b>	(2,583)
Cash and cash equivalents at beginning of the year		<b>2,613</b>	5,190	<b>2,607</b>	5,190
<b>Cash and cash equivalents at end of the year</b>	37	<b>3,891</b>	2,613	<b>3,882</b>	2,607

Comparative balances including investments, bonds and notes and defined benefit pension obligations have been restated to provide enhanced disclosure.

# **CLYDESDALE BANK PLC**

## **Notes to the Consolidated Financial Statements**

### **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 18. 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 2010 were authorised for issue by the Board of Directors on 25 November 2010 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, 20 Waterloo Street, Glasgow, G2 6DB.

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

#### **Statement of compliance**

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

### **2. Accounting policies**

#### **Basis of preparation**

The preparation of Financial Statements in conformity with IFRS requires the use of certain critical accounting estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. Assumptions made at each balance sheet date are based on best estimates at that date. Although the Group has internal control systems in place to ensure that estimates can be reliably measured, actual amounts may differ from those estimates. It is not anticipated that such differences would be material.

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

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

#### **Significant accounting judgements and estimates**

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

##### *Going Concern*

The Bank's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review. In addition note 45 to the Financial Statements includes the Bank's objectives, policies and processes for managing its capital and note 44 to the Financial Statements includes the Bank's financial risk management objectives.

The Bank has access to financial resources, the support of its ultimate parent NAB Group and a growing customer deposit base. As a consequence, the Directors believe that the Bank is well placed to manage its business risks successfully despite the current uncertain economic outlook.

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

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### Significant accounting judgements and estimates (continued)

##### *Equity compensation*

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

##### *Fair value of financial instruments*

Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities. The valuation of financial instruments is described in more detail in note 13.

The valuation methodology has been reviewed during the year and inputs updated to reflect new observable data. The net impact on the income statement was not material.

##### *Impairment losses on loans and advances*

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

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

The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risk and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups). The impairment loss on loans and advances is disclosed in more detail in note 16.

##### *Impairment of available for sale investments*

The Bank reviews its debt securities classified as available for sale investments at each balance sheet date to assess whether they are impaired. This requires similar judgement as applied to the individual assessment of loans and advances.

The Bank also records impairment charges on available for sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is 'significant' or 'prolonged' requires judgement. In making this judgement, the Bank evaluates, among other factors, historical share price movements and the duration and extent to which the fair value of an investment is less than its cost.

##### *Liquidity*

The Bank manages its liquidity requirements using a number of complementary approaches which include the forecasting of cash inflows and outflows and maintaining an appropriate level of liquid assets. Both the forecasting of cashflows and the level of liquid assets held require the exercise of judgement. Further liquidity risk disclosures are contained in note 42.

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### Significant accounting judgements and estimates (continued)

##### *Deferred tax assets*

Deferred tax assets are recognised in respect of tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax planning strategies.

##### *Retirement benefit obligations*

The cost of the defined benefit pension plan is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. See note 28 for the assumptions used.

##### *Special Purpose Entities (SPEs)*

Controlled entities are those entities, including special purpose entities (SPEs), over which the Group has the power to govern the financial and operating policies so as to obtain benefits from their activities. Control rather than ownership interest is the sole criterion for determining a parent entity relationship.

#### Principles of consolidation

##### *Controlled entities*

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

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

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

Outside interests in the equity and results of the entities that are controlled by the Bank are shown as a separate item, "Non-controlling Interest", in the consolidated Financial Statements.

#### Foreign currency translation

##### *Functional and presentation currency*

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

##### *Transactions and balances*

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

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

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### Segment reporting

An operating segment is defined as a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other operating segments.

A geographical area 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 areas 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 transferred, between willing parties in an arm's length transaction.

Where the classification of a financial asset or liability requires it to be stated at fair value, the fair value is determined by reference to the quoted bid or offer price in the most advantageous active market to which the Group entity has immediate access, wherever possible. An adjustment for other 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 financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Group recognises profits on day one.

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

#### Assets

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

#### Cash and cash equivalents

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

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.



# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### Items classified as fair value through profit or loss

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

#### *Financial assets held for trading*

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

Assets held for trading purposes are classified as trading derivatives within the balance sheet.

#### *Financial instruments designated at fair value through profit or loss*

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

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

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

#### *Derivatives that do not qualify for hedge accounting*

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

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

In both these cases, the derivative is classified as a trading derivative.

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

#### **Derivative financial instruments and hedge accounting**

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

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

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

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### Derivative financial instruments and hedge accounting (continued)

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

##### *Fair value hedge*

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

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

##### *Cash flow hedge*

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

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

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

##### *Derivatives that do not qualify for hedge accounting*

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

- The 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.

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.

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### Available for sale investments (continued)

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

#### Held to maturity financial assets

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

#### Loans and receivables

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

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

As noted above, in certain limited circumstances the Group applies the fair value measurement option to financial assets. This option is applied to loans and advances where there is an embedded derivative within the loan contract and the Group has entered into a derivative to offset the risk introduced by the embedded derivative. The loan is designated as being carried at fair value through profit and loss to offset the movements in the fair value of the derivative within the income statement. When a loan is held at fair value, a statistical-based calculation is used to estimate expected losses attributable to adverse movements in credit risk on the assets held. This adjustment to the credit quality of the asset is then applied to the carrying amount of the loan held at fair value.

#### Repurchase and reverse repurchase agreements

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

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

#### Impairment of financial assets

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.

## CLYDESDALE BANK PLC

### Notes to the Financial Statements (continued)

#### 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 the estimated future cash flows discounted at the asset's original effective interest rate. The amount of the loss is recognised using an allowance account and the amount of the loss is included in the income statement.

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

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

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

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

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

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

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

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

##### *Renegotiated loans*

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

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### *Equity and debt instruments*

In the case of equity instruments classified as available for sale, the Group seeks evidence of a significant or prolonged decline in the fair value of the security below its cost to determine whether impairment exists. Where such evidence exists, the cumulative net loss that has been previously recognised directly in equity is removed from equity and recognised in the income statement.

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).

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

- buildings - 2%;
- leases (leasehold improvements) - up to 10%
- motor vehicles, fixtures and equipment from 20% to 33.33%

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

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

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

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### Investment properties

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

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

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

#### Property inventory

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

#### Leases

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

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

##### *As lessee*

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

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

Sale and leaseback leases entered into by the Group as lessee are primarily operating leases. 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 in the income statement.

##### *As lessor*

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

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

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### *Liabilities*

##### **Financial liabilities**

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

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

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

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

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

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

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

##### **Provisions**

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

##### **Contingent Liabilities**

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

##### **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.



# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### Restructuring costs

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

#### Surplus leased space

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

#### Dividends on ordinary and preference shares

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

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

#### Financial guarantees

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

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

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

#### Pension and post retirement costs

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

##### *Defined Contribution Pension Scheme*

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

##### *Defined Benefit Pension Scheme*

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

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### *Defined Benefit Pension Scheme (continued)*

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

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

#### **Securitisation**

Through its loan securitisation programme, the Group packages and sells loans (principally housing mortgage loans) as securities to investors through a securitisation vehicle.

All such financial instruments continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction, 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.

#### **Preference Shares**

Preference shares are classified as an equity instrument if and only if both of the following conditions are met:

(a) The instrument includes no contractual obligation:

- (i) to deliver cash or another financial asset to another entity; or
- (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

(b) If the instrument will or may be settled in the issuer's own equity instruments, it is:

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

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

#### **Income tax**

##### *Current 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. Income tax expense is recognised in the income statement except to the extent that it related to items recognised directly in equity, in which case it is recognised in equity.

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.

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### *Deferred Tax*

Deferred tax assets and liabilities are recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated Financial Statements. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. 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 tax liabilities are not recognised for temporary differences arising from investments in subsidiaries and associates where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. Deferred tax assets are not recognised for temporary differences arising from investments in subsidiaries and associates where it is probable that the difference will not reverse in the foreseeable future, and it is not probable that taxable profit will be available against which the temporary difference can be utilised.

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

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

#### **Subordinated liability and related entity balances**

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

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

#### **Debt issues**

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

#### **Equity**

##### *Share Option Reserve*

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

##### *Cash flow hedge reserve*

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

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### Offsetting Financial Instruments

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

#### Revenue and expense recognition

##### Net interest income

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

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

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

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.

##### 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.

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

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

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.

#### Accounting developments

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

##### *(i) Applied in the current financial year*

- Improvements to IFRSs 2008 (issued 22 May 2008)  
The amendment makes numerous non-urgent but necessary changes to accounting standards arising from the IASB's annual improvement project.
- Improvements to IFRSs 2009 (issued 16 April 2009)  
The amendment makes numerous non-urgent but necessary changes to accounting standards arising from the IASB's annual improvement project.

## CLYDESDALE BANK PLC

### Notes to the Financial Statements (continued)

#### 2. Accounting policies (continued)

##### Accounting developments (continued)

- Amendment to IFRS 1 and IAS 27 Cost of an Investment in a Controlled Subsidiary, Jointly-Controlled Entity or Associate, issued 22 May 2008 and effective for the financial period beginning on or after 1 January 2009. The amendment clarifies how the principles that determine whether a hedge risk or portion of cash flows is eligible for designation as a hedged item should be applied in particular situations.
- Revision to IFRS 1 First-time Adoption of International Financial Reporting Standards, issued 27 November 2009 and effective for financial reporting period beginning on or after 1 July 2009.
- Amendment to IFRS 2 Share-based Payments - Vesting Conditions and Cancellations (issued 17 January 2008)  
The amendment clarifies that vesting conditions comprise service conditions and performance conditions only and other features of a share-based payment transaction are not vesting conditions. It also clarifies that all cancellations should receive the same accounting treatment.
- Revision to IFRS 3 Business Combinations, issued 10 January 2008 and effective for financial reporting period beginning on or after 1 July 2009.
- Amendment to IFRS 7 Financial Instruments: Disclosures (issued 5 March 2009)  
The amendment requires additional disclosures regarding fair value measurement and liquidity risk. Fair value measurements are to be disclosed by source of inputs using a three level hierarchy for each class of financial instrument. In addition, a reconciliation between the beginning and ending balance for Level 3 fair value measurements is now required, as well as significant transfers between Level 1 and Level 2 fair value measurements. The amendments also clarify the requirement for liquidity risk disclosures. The liquidity risk disclosures are not significantly impacted by the amendments.
- IFRS 8 Operating Segments (issued 30 November 2006)  
This standard requires disclosure of information about the Group's operating segments and replaces the requirement to determine primary (business) and secondary (geographical) reporting segments of the Group. Adoption of this Standard did not have any effect on the financial position or performance of the Group. The Group determined that the operating segments are business banking and retail banking which are different to those previously identified under IAS 14 Segment Reporting. Additional disclosures about each of these segments are shown in Note 3, including revised comparative information.
- Revision to IAS 1 Presentation of Financial Statements (issued 6 September 2007)  
The revised standard separates owner and non-owner changes in equity. The statement of changes in equity includes only details of transactions with owners, with non-owner changes in equity presented as a single line. In addition, the standard introduces the statement of comprehensive income: it presents all items of recognised income and expense, either in one single statement, or in two linked statements. The Group has elected to present two statements.  
  
The presentation of the Consolidated Financial Statements reflects the disclosure required by IAS 1. Where necessary, comparative information has been reclassified or expanded from the previously reported Consolidated Financial Statements to take into account any presentational changes made in the Report and Accounts 2010.
- Revision to IAS 23 Borrowing Costs, issued 29 March 2007 and effective for financial periods beginning on or after 1 January 2009.
- Amendment to IAS 27, issued 10 January 2008 and effective for financial periods beginning on or after 1 July 2009.  
The amendment makes changes to accounting for non-controlling interests and control.
- Amendment to IAS 32 and IAS 1 Puttable Financial Instruments and Obligations Arising on Liquidation, issued 14 February 2008 and effective for financial periods beginning on or after 1 January 2009.
- Amendment to IAS 39 Eligible Hedged Items (issued 31 July 2008).
- Amendment to IAS 39 and IFRIC 9 Embedded Derivatives, issued 12 March 2009 and effective for financial periods beginning on or after 30 June 2009.

# CLYDESDALE BANK PLC

## Notes to the Financial Statements (continued)

### 2. Accounting policies (continued)

#### Accounting developments (continued)

- IFRIC 15 Agreements for the Construction of Real Estate, issued 3 July 2008 and effective for financial periods beginning on or after 1 January 2009.
- IFRIC 17 Distributions of Non-Cash Assets to Owners, issued 27 November 2008 and effective for financial periods beginning on or after 1 July 2009.
- IFRIC 18 Transfer of Assets from Customers, issued 29 January 2009 and effective for financial periods beginning on or after 1 July 2009.

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

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

#### *(iii) To be applied in a future reporting period*

The following standards, interpretations and amendments were available for adoption in the European Union, but not mandatory, for the 30 September 2010 reporting period. Those amendments which are applicable to the Group and which are not likely to have an impact on the Group's Financial Statements and have not yet been applied by the Group in preparing this financial report are as follows:

- Amendments to IFRS 1 Additional Exemptions for First-time Adopters, issued 23 July 2009 and effective for financial periods beginning on or after 1 January 2011.
- Amendment to IFRS 1 Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters, issued 28 January 2010 and effective for financial periods beginning on or after 1 July 2010.
- Amendment to IFRS 2 - Group Cash-settled Share-based Payment Transactions, issued 18 June 2009 and effective for financial periods beginning on or after 1 January 2010.  
The amendment clarifies the scope of IFRS 2 and supersedes IFRIC 8 and 11.
- Revision to IAS 24 Related Party Disclosures, issued 4 November 2009 and effective for financial periods beginning on or after 1 January 2011.
- Amendment to IAS 32 Classification of Rights Issue, issued 8 October 2009 and effective for financial periods beginning on or after 1 February 2011.
- Amendment to IFRIC 14 Prepayment of a Minimum Funding Requirement, issued 26 November 2009 and effective for financial periods beginning on or after 1 January 2011.
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments, issued 26 November 2009 and effective for financial periods beginning on or after 1 January 2011.

The following standards, interpretations and amendments were not available for adoption in the European Union for the 30 September 2010 reporting period. Those amendments which are applicable to the Group and, which are not likely to have an impact on the Group's Financial Statements, and have not yet been applied or early adopted by the Group in preparing this financial report are:

- Improvements to IFRSs 2010, issued 6 May 2010 and effective for various financial periods with the earliest beginning on or after 1 January 2010.
- Amendment to IFRS 7 Financial Instruments: Disclosures, issued 7 October 2010 and effective for financial periods beginning on or after 1 July 2011.
- IFRS 9 Financial Instruments, issued 12 November 2009 and effective for financial periods beginning on or after 1 January 2013.  
The Group has not yet assessed the potential impact of the standard, although changes are likely to affect the Group's accounting for financial assets.



## **CLYDESDALE BANK PLC**

### **Notes to the Consolidated Financial Statements**

#### **3. Segment information**

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

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

#### **Business Banking**

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

#### **Retail Banking**

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

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

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

The Group evaluates each operating segment's performance on the basis of cash earnings. Cash earnings represents the net profit attributable to members of the Company, adjusted for certain non-cash items, primarily fair value adjustments and efficiency initiative costs, distributions, and significant items. The segment information provided below is prepared on a going concern basis, such that operations that will not form part of the continuing Group are excluded from all periods presented.

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

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

#### **Reporting changes during the current period**

The application of IFRS 8 has resulted in changes to the reporting of segment information compared to the results reported in the 2009 Annual Report and Consolidated Financial Statements.

The Business Banking and Retail Banking segments are now separately reported whereas previously these were disclosed as Financial Services UK. In addition, following a reorganisation at NAB Group level, the nabCapital business was restructured and renamed Wholesale Banking. Part of this business is operated through Clydesdale Bank. By virtue of its residual materiality, Wholesale Banking is now included within other segments. Certain information in the comparative periods may not be directly comparable with those in the current financial period as a result of changes in internal measurement and allocation.

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 3. Segment information (continued)

#### Major Customers

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

#### Geographical areas

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

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

#### Operating Segments 2010

	Business £m	Retail £m	Central and Other Functions £m	UK Banking £m
Net interest income	404	365	193	962
Other operating income	152	143	(34)	261
Operating income	556	508	159	1,223
Operating expenses	(141)	(127)	(444)	(712)
Impairment losses on credit exposures	(269)	(55)	(23)	(347)
Group operating profit/(loss)	146	326	(308)	164
Tax expense	(41)	(91)	86	(46)
<b>Cash earnings after tax</b>	<b>105</b>	<b>235</b>	<b>(222)</b>	<b>118</b>
Non-cash earnings items after tax	(49)	-	(17)	(66)
<b>Profit/(loss) after tax</b>	<b>56</b>	<b>235</b>	<b>(239)</b>	<b>52</b>
Average assets	23,958	7,611	12,908	44,477

#### Operating Segments 2009

	Business £m	Retail £m	Central and Other Functions £m	UK Banking £m
Net interest income	297	340	245	882
Other operating income	154	145	17	316
Operating income	451	485	262	1,198
Operating expenses	(158)	(140)	(371)	(669)
Impairment losses on credit exposures	(292)	(62)	(67)	(421)
Group operating profit/(loss)	1	283	(176)	108
Tax expense	1	(79)	48	(30)
Cash earnings after tax	2	204	(128)	78
Non-cash earnings items after tax	(41)	-	17	(24)
<b>Profit/(loss) after tax</b>	<b>(39)</b>	<b>204</b>	<b>(111)</b>	<b>54</b>
Average assets	24,986	6,943	10,685	42,614

Non-cash earnings items after tax includes fair value and hedge ineffectiveness income, and Efficiency, Quality and Service initiative spend which are excluded from the UK Banking income statement.

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 3. Segment information (continued)

Reconciliations between segment and statutory results are as follows:

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

2010	UK Banking £m	Non-Cash Earnings Items £m	Other Segments and Adjustments £m	CB PLC Total £m
Net interest income	962	-	(2)	960
Other operating income	261	(74)	(11)	176
Operating income	1,223	(74)	(13)	1,136
Operating expenses	(712)	(19)	5	(726)
Impairment losses on credit exposures	(347)	-	(15)	(362)
Group operating profit/(loss)	164	(93)	(23)	48
Profit on sale of land and buildings	-	-	3	3
Special financial services compensation scheme levy	-	-	(2)	(2)
Tax expense	(46)	27	6	(13)
<b>Cash earnings after tax</b>	<b>118</b>	<b>(66)</b>	<b>(16)</b>	<b>36</b>
Non-cash earnings items after tax	(66)	66	-	-
<b>Profit/(loss) after tax</b>	<b>52</b>	<b>-</b>	<b>(16)</b>	<b>36</b>
Average assets	44,477	-	(553)	43,924

2009	UK Banking	Non-Cash Earnings Items	Other Segments and Adjustments	CB PLC Total
Net interest income	882	-	(37)	845
Other operating income	316	(11)	(28)	277
Operating income	1,198	(11)	(65)	1,122
Operating expenses	(669)	(22)	11	(680)
Impairment losses on credit exposures	(421)	-	22	(399)
Group operating profit/(loss)	108	(33)	(32)	43
Profit on sale of land and buildings	-	-	11	11
Special financial services compensation scheme levy	-	-	(6)	(6)
Tax expense	(30)	9	7	(14)
<b>Cash earnings after tax</b>	<b>78</b>	<b>(24)</b>	<b>(20)</b>	<b>34</b>
Non-cash earnings items after tax	(24)	24	-	-
<b>Profit/(loss) after tax</b>	<b>54</b>	<b>-</b>	<b>(20)</b>	<b>34</b>
Average assets	42,614	-	(502)	42,112

Other Segments and Adjustments include deductions for the Wealth Management business and certain mid corporate lending on the nabLondon balance sheet, which are therefore not part of CB PLC. These balances are offset against parts of the Wholesale Banking business written on the CB PLC balance sheet which are not included within UK Banking. Also included are reallocations of income statement items for statutory disclosure purposes.

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 4. Net interest income

	2010 £m	2009 £m
<b>Interest income</b>		
Loans and advances to other banks	20	94
Investments		
- available for sale assets	25	19
- held to maturity assets	1	11
Loans and advances to customers	1,165	1,359
Due from related entities	15	15
Other interest income	2	-
	<b>1,228</b>	<b>1,498</b>
Financial assets at fair value through profit or loss	164	224
<b>Total interest income</b>	<b>1,392</b>	<b>1,722</b>
<b>Interest expense</b>		
Due to other banks	15	61
Due to customers	300	494
Bonds and notes	64	195
Due to related entities	51	124
Other interest expense	1	-
	<b>431</b>	<b>874</b>
Financial liabilities at fair value through profit or loss	1	3
<b>Total interest expense</b>	<b>432</b>	<b>877</b>
<b>Net interest income</b>	<b>960</b>	<b>845</b>

Included within interest income is a net gain of £nil (2009: net gain of £38m) on the purchase by Clydesdale Bank PLC of notes issued by Lanark Master Trust (the Bank's own securitisation vehicle - refer note 17).

#### 5. Non interest income

	2010 £m	2009 £m
<b>Gains less losses on financial instruments at fair value</b>		
Movement in fair value of assets (see note below)	46	245
Interest rate derivatives	(121)	(248)
Foreign exchange derivatives	20	23
Other derivatives	-	4
Ineffectiveness arising from fair value hedges (note 12)	9	2
Ineffectiveness arising from cash flow hedges (note 12)	(3)	(17)
	<b>(49)</b>	<b>9</b>
<b>Other operating income</b>		
Fees and commission	227	239
Net fair value movement on investment properties	3	-
Loss on disposal of investment properties	(1)	-
Other income	(4)	29
	<b>225</b>	<b>268</b>
<b>Total non interest income</b>	<b>176</b>	<b>277</b>

Fees and commission income includes £11m (2009: £18m) in relation to financial instruments at fair value through profit or loss.

ATM disloyalty fees payable of £22m (2009: £22m) were previously disclosed in other income and have now been reallocated to fees and commission.

Other income includes costs of £17m (2009: £4m) in relation to payment protection insurance refunds.

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 5. Non interest income (continued)

Certain financial assets are designated at inception as fair value through profit or loss. These assets are predominantly fixed interest rate loans which are individually hedged and are fair valued with the movements in fair value taken through the income statement. The fair value of the loan is derived from the future loan cashflows using appropriate discount rates and includes adjustments for credit risk and credit losses. As interest rates fall, the carrying value of the loan increases. Similarly, as interest rates increase, the carrying value of the loan decreases. To the extent that the fair value of the loan reflects movements in interest rates there will be an offsetting movement in the underlying derivative. Movements in the fair value of loans that relate to changes in the creditworthiness of the loan counterparty and the margin earned on the loan are not reflected in the underlying derivative valuation.

#### 6. Operating expenses

	2010 £m	2009 £m
<b>Personnel expenses</b>		
Salaries, wages and non cash benefits	177	169
Related personnel expenses	16	17
Defined contribution pension expense	9	6
Defined benefit pension expense	25	1
Equity-based compensation	17	15
Other personnel expenses	7	8
	<b>251</b>	<b>216</b>
<b>Depreciation expense</b>		
Depreciation of property, plant & equipment (note 19)	21	23
<b>Efficiency, quality and service initiatives</b>		
Other personnel expenses	6	12
Other occupancy expenses	1	3
Other expenses	12	7
	<b>19</b>	<b>22</b>
<b>Other operating expenses</b>		
Operating lease rental	40	36
Other occupancy expenses	44	33
Related entity recharges (note 38)	254	249
Other operating expenses	97	101
	<b>435</b>	<b>419</b>
<b>Total operating expenses</b>	<b>726</b>	<b>680</b>

#### Efficiency, quality and service (EQS) initiative costs

During the year to 30 September 2009, a number of restructuring initiatives were undertaken to provide sustainable long term reductions to the cost base. The September 2010 costs mainly cover the exit costs of approximately 188 staff (2009: 385 staff), programme costs and contract convergence costs. These initiatives were approved for funding under the NAB Group EQS Scheme.

#### 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.

	2010 £'000	2009 £'000
Audit of the Financial Statements	920	812
Other fees to auditors:		
Audit of the Group pension scheme	102	64
Local statutory audits for subsidiaries	150	138
Other assurance including regulatory compliance based work	262	53
	<b>1,434</b>	<b>1,067</b>

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 7. Tax expense

#### a) Analysis of charge in the year

#### Tax charged in the income statement

	2010 £m	2009 £m
The charge for taxation comprises:		
<b>Current tax</b>		
United Kingdom Corporation Tax at 28% (Sept 2009: 28%)		
- current year	(5)	(12)
- prior year	3	-
Other overseas taxation	10	16
Total current tax	<u>8</u>	<u>4</u>
<b>Deferred tax</b>		
Origination and reversal of temporary differences		
- current year	10	11
- prior year	(5)	(1)
Total deferred income tax	<u>5</u>	<u>10</u>
<b>Income tax expense reported in income statement</b>	<u><u>13</u></u>	<u><u>14</u></u>

#### Tax relating to items charged or credited to equity

	2010 £m	2009 £m
<b>Current tax</b>		
Available for sale investments	(3)	5
Release of transitional deferred tax	(6)	(8)
<b>Deferred tax asset</b>		
Actuarial losses on defined benefit pension schemes	(10)	(165)
Employee share compensation	1	(2)
Release of transitional deferred tax	6	8
<b>Deferred tax liability</b>		
Net gain on revaluation of cash flow hedges	9	36
Asset revaluation reserve	-	(2)
<b>Tax credit in the statement of comprehensive income</b>	<u><u>(3)</u></u>	<u><u>(128)</u></u>

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 7. Tax expense (continued)

##### b) Factors affecting tax charge for the year

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

	2010 £m	2009 £m
Profit on ordinary activities before tax	<u>49</u>	<u>48</u>
Profit on ordinary activities multiplied by standard rate of Corporation Tax in the UK of 28% (Sept 2009: 28%)	<u>14</u>	<u>13</u>
Effects of:		
Expenses not deductible for tax purposes	3	5
Amounts not subject to UK Tax	-	(5)
Rate differences	(3)	-
Adjustments to tax charge in respect of previous periods	(2)	(1)
Other	1	2
<b>Total income tax expense for year</b>	<u>13</u>	<u>14</u>

Following the emergency budget on 22 June 2010, a reduction in the corporate income tax rate was announced from 28% to 24% to be phased in over four years. For the 2010 accounts all deferred tax balances have been restated to a rate of 27%. It has been estimated that a further 3% reduction in the corporation tax rate will reduce net deferred tax by £11,269,000 over the next three years. This adjustment will go through both income and reserves.

#### 8. Components of other comprehensive income

	Group		Bank	
Reserves movements	2010 £m	2009 £m	2010 £m	2009 £m
Cash flow hedges				
Gains during the year	33	111	27	67
Transfer of losses to the income statement	3	17	20	17
	<u>36</u>	<u>128</u>	<u>47</u>	<u>84</u>
Available for sale				
(Losses)/gains during the year	(10)	23	(10)	23
Transfer of gains to the income statement	(1)	(4)	(1)	(4)
	<u>(11)</u>	<u>19</u>	<u>(11)</u>	<u>19</u>
Revaluation of land and buildings				
Losses during the year	-	(6)	-	(6)
Defined benefit pensions				
Losses during the year (note 28)	<u>(65)</u>	<u>(591)</u>	<u>(65)</u>	<u>(591)</u>



# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 9. Dividends paid

	2010 £m	2009 £m
Preference dividends paid - 12% per annum payable semi-annually (6p per share)	<u>12</u>	<u>6</u>

### 10. Cash and balances with central banks

	Group		Bank	
	2010 £m	2009 £m	2010 £m	2009 £m
Cash assets	846	82	846	82
Balances with central banks	<u>3,224</u>	<u>2,631</u>	<u>3,224</u>	<u>2,631</u>
	<u>4,070</u>	<u>2,713</u>	<u>4,070</u>	<u>2,713</u>

Balances with central banks include mandatory deposits of £30m (2009: £27m) which are not available for use in the Group's day to day business. Mandatory deposits include cash ratio deposits which are non-interest bearing deposits placed with the Bank of England under the provisions of the Bank of England Act 1998.

### 11. Due from other banks

	Group		Bank	
	2010 £m	2009 £m	2010 £m	2009 £m
Transaction balances with other banks	11	16	10	15
Placements with other banks	<u>-</u>	<u>324</u>	<u>-</u>	<u>324</u>
	<u>11</u>	<u>340</u>	<u>10</u>	<u>339</u>

	Group		Bank	
	2010 £m	2009 £m	2010 £m	2009 £m
Senior investment grade	10	340	10	339
Investment grade	<u>1</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>11</u>	<u>340</u>	<u>10</u>	<u>339</u>

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 12. Derivative financial instruments

#### Use of derivatives

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

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

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

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

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

#### 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 vanilla cross currency swap takes the form of an agreement to exchange one currency for another and to re-exchange the currencies at the maturity of the swap, using the same exchange rate, with the exchange of interest payments throughout the swap period. A balance guarantee cross currency swap protects the Group if securitisation amortisation payment frequencies change.

#### 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 note 41 to the Financial Statements. The disclosures in these notes include all short-term debtors and creditors.

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 12. Derivative financial instruments (continued)

#### Risk Management

The Group's management of certain key risk factors that may impact the future results is discussed in note 44. The factors discussed should not be considered to be the complete list of all potential risks.

Derivative contracts are disclosed as follows:

#### Group

	Fair Value		Fair Value	
	Assets	Liabilities	Assets	Liabilities
	2010	2010	2009	2009
	£m	£m	£m	£m
Derivative financial assets and liabilities	719	117	942	113
Other derivative financial assets and liabilities at fair value through profit or loss (note 13)	297	58	271	1
Derivative financial assets and liabilities at fair value - related entities (note 13)	72	772	183	535
	<u>1,088</u>	<u>947</u>	<u>1,396</u>	<u>649</u>

#### Bank

	Fair Value		Fair Value	
	Assets	Liabilities	Assets	Liabilities
	2010	2010	2009	2009
	£m	£m	£m	£m
Derivative financial assets and liabilities	385	117	424	113
Other derivative financial assets and liabilities at fair value through profit or loss (note 13)	297	58	271	1
Derivative financial assets and liabilities at fair value - related entities (note 13)	72	772	183	535
	<u>754</u>	<u>947</u>	<u>878</u>	<u>649</u>

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

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

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

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

Derivative financial assets and liabilities that cannot be held in a hedge relationship are deemed to be held for trading.

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**12. Derivative financial instruments (continued)**

**Group**

	Contract Amount 2010 £m	Fair Value Assets 2010 £m	Liabilities 2010 £m	Contract Amount 2009 £m	Fair Value Assets 2009 £m	Liabilities 2009 £m
<b>Total derivatives held</b>						
<b>Foreign exchange rate related contracts</b>						
Spot, forwards and futures	4,039	56	84	4,352	115	35
Currency swaps	1,952	455	4	2,818	640	4
Options	279	6	6	276	6	6
<b>Total</b>	<b>6,270</b>	<b>517</b>	<b>94</b>	<b>7,446</b>	<b>761</b>	<b>45</b>
<b>Interest rate related contracts</b>						
Swaps	37,227	544	783	26,995	604	532
Swaptions	529	10	10	1,276	22	9
Options	2,491	16	59	1,718	7	59
<b>Total</b>	<b>40,247</b>	<b>570</b>	<b>852</b>	<b>29,989</b>	<b>633</b>	<b>600</b>
Credit derivatives	-	-	-	200	-	2
Commodity derivatives	22	1	1	26	2	2
	<b>22</b>	<b>1</b>	<b>1</b>	<b>226</b>	<b>2</b>	<b>4</b>
<b>Total derivative contracts</b>	<b>46,539</b>	<b>1,088</b>	<b>947</b>	<b>37,661</b>	<b>1,396</b>	<b>649</b>

**Bank**

	Contract Amount 2010 £m	Fair Value Assets 2010 £m	Liabilities 2010 £m	Contract Amount 2009 £m	Fair Value Assets 2009 £m	Liabilities 2009 £m
<b>Total derivatives held</b>						
<b>Foreign exchange rate related contracts</b>						
Spot, forwards and futures	4,039	56	84	4,352	115	35
Currency swaps	618	157	4	1,108	166	4
Options	279	6	6	276	6	6
<b>Total</b>	<b>4,936</b>	<b>219</b>	<b>94</b>	<b>5,736</b>	<b>287</b>	<b>45</b>
<b>Interest rate related contracts</b>						
Swaps	36,727	509	783	26,495	560	532
Swaptions	529	10	10	1,276	22	9
Options	2,491	15	59	1,718	7	59
<b>Total</b>	<b>39,747</b>	<b>534</b>	<b>852</b>	<b>29,489</b>	<b>589</b>	<b>600</b>
Credit derivatives	-	-	-	200	-	2
Commodity derivatives	22	1	1	26	2	2
	<b>22</b>	<b>1</b>	<b>1</b>	<b>226</b>	<b>2</b>	<b>4</b>
<b>Total derivative contracts</b>	<b>44,705</b>	<b>754</b>	<b>947</b>	<b>35,451</b>	<b>878</b>	<b>649</b>

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 12. Derivative financial instruments (continued)

#### Cash flow hedges

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

	Contract Amount	Fair Value		Contract Amount	Fair Value	
	2010	Assets	Liabilities	2009	Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Interest rate-related contracts	<b>12,362</b>	<b>261</b>	<b>78</b>	15,420	259	113

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

<i>Nominal values per time period</i>	2010 £m	2009 £m
0 to 6 months	3,995	6,070
6 to 12 months	2,032	2,713
1 to 2 years	4,235	4,077
2 to 5 years	<b>2,100</b>	<b>2,560</b>
	<b>12,362</b>	<b>15,420</b>

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	Forecast payable cash flows	Forecast receivable cash flows	Forecast payable cash flows
	2010 £m	2010 £m	2009 £m	2009 £m
- within one year	16	216	14	259
- between one and two years	7	123	30	148
- between two and three years	-	62	17	79
- between three and four years	-	40	1	30
- between four and five years	-	19	-	9
	<b>23</b>	<b>460</b>	<b>62</b>	<b>525</b>

	2010 £m	2009 £m
Loss from cash flow hedges recognised in the income statement due to hedge ineffectiveness (note 5)	<b>(3)</b>	<b>(17)</b>

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**12. Derivative financial instruments (continued)**

**Fair value hedges**

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

	2010 £m	2009 £m
<i>Nominal values per time period</i>		
0 to 6 months	250	-
6 to 12 months	-	-
1 to 2 years	1,650	250
2 to 5 years	-	1,650
> 5 years	758	-
	<b>2,658</b>	<b>1,900</b>

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

		2010 £m	2009 £m
<i>Nominal values per time period</i>			
0 to 6 months	Exchange rate £/Euro = 1.1244	-	175
0 to 6 months	Exchange rate £/USD = 1.5077	-	387
6 to 12 months	Exchange rate £/Euro = 1.1244	-	-
6 to 12 months	Exchange rate £/USD = 1.5077	-	-
1 to 2 years	Exchange rate £/Euro = 1.1244	-	-
1 to 2 years	Exchange rate £/USD = 1.5077	964	-
2 to 5 years	Exchange rate £/Euro = 1.1244	484	1,301
2 to 5 years	Exchange rate £/USD = 1.5077	-	612
		<b>1,448</b>	<b>2,475</b>

	2010 £m	2009 £m
<i>Gains or (losses) arising from fair value hedges (note 5)</i>		
Hedging instrument	(290)	267
Hedged item attributable to the hedged risk	299	(265)
	<b>9</b>	<b>2</b>

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 13. Financial assets and liabilities at fair value

Group and Bank	2010 £m	2009 £m
<b>Financial assets at fair value through profit or loss</b>		
Loans and advances	5,027	5,327
Securities	-	202
	<b>5,027</b>	<b>5,529</b>
<b>Other derivatives</b>		
Other derivatives financial assets (note 12)	297	271
Derivative financial assets - related entities (note 12)	72	183
	<b>369</b>	<b>454</b>
	<b>5,396</b>	<b>5,983</b>
<b>Financial liabilities at fair value through profit or loss</b>		
Due to customers - term deposits	66	61
<b>Other derivatives</b>		
Other derivative financial liabilities (note 12)	58	1
Derivative financial liabilities - related entities (note 12)	772	535
	<b>830</b>	<b>536</b>
	<b>896</b>	<b>597</b>

### Loans and advances to customers

Included in other financial assets at fair value is a portfolio of loans which have embedded derivative characteristics. These loans are hedged with interest rate derivative contracts with matching cash flows. The hedges do not achieve the criteria for hedge accounting and the loans are recorded at fair value to avoid an accounting mismatch. The maximum credit exposure of the loans is £5,027m (2009: £5,327m). The cumulative reserves movement in fair value of the loans attributable to changes in credit risk losses amounts to £131m (2009: £110m) and the change for the current period is £21m (2009: £30m).

The expected changes in fair value of the designated loans attributable to credit risk have been calculated using an established statistical based calculation used to estimate expected losses attributable to adverse movements in credit risk.

### Due to customers - Term deposits

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

The change in fair value attributable to changes in the Bank credit risk is £Nil (2009: £Nil). The Bank is contractually obligated to pay £7m (2009: £6m) less than the carrying amount at maturity to the deposit holder.



**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**14. Investments**

	<b>Group</b>		<b>Bank</b>	
	<b>2010</b>	2009	<b>2010</b>	2009
	<b>£m</b>	£m	<b>£m</b>	£m
Available for sale - listed	<b>2,256</b>	1,531	<b>2,256</b>	1,531
Available for sale - unlisted	<b>6</b>	10	<b>6</b>	10
	<b><u>2,262</u></b>	<u>1,541</u>	<b><u>2,262</u></b>	<u>1,541</u>

Included in the Available for sale ("AFS") listed securities are £1.2bn (2009: £1.4bn) investments in other banks' debt securities, which are subject to a UK Government backed guarantee plus £0.89bn in UK Government Gilts and £0.17bn in other banks' debt securities.

	<b>Group</b>		<b>Bank</b>	
	<b>2010</b>	2009	<b>2010</b>	2009
	<b>£m</b>	£m	<b>£m</b>	£m
Held to maturity - listed	<b>-</b>	639	<b>413</b>	945

The Group held to maturity investments matured in the year.

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 15. Loans and advances to customers

	Group		Bank	
	2010	2009	2010	2009
	£m	£m	£m	£m
Overdrafts	4,163	4,236	4,163	4,236
Credit cards	526	521	526	521
Lease finance	1,001	1,248	534	591
Housing loans	12,781	12,327	8,416	8,208
Other term lending - non retail	8,083	8,226	8,084	8,226
Other term lending - retail	1,069	1,247	1,069	1,247
Other lending	20	11	20	11
Gross loans and advances to customers	27,643	27,816	22,812	23,040
Unearned income	(251)	(290)	(251)	(290)
Deferred and unamortised fee income	(49)	(43)	(41)	(37)
Impairment provisions on credit exposures (note 16)	(362)	(336)	(344)	(320)
	<b>26,981</b>	<b>27,147</b>	<b>22,176</b>	<b>22,393</b>

The Group and Bank have transferred £2,066m and £1,241m respectively (2009: £2,446m and £1,420m) of housing loans through securitisation arrangements that do not qualify for derecognition from the balance sheet (note 17). The housing loans do not qualify for derecognition because the Group and Bank remain exposed to the risks and rewards of ownership on an ongoing basis. The Group and Bank continue to be exposed primarily to the liquidity risk, interest rate risk and credit risk of the housing loans. The Group is also exposed to the residual rewards of the housing loans as a result of its ability to benefit from the future performance of the housing loans through the receipt of deferred consideration.

The carrying amount of the associated liability is £1,693m (2009: £2,343m).

Included within Group and Bank loans and advances to customers are £2,230m and £1,530m respectively (2009: £2,614m and £1,763m) of housing loans assigned to a bankruptcy remote special purpose entity, Clydesdale Covered Bonds LLP. These loans provide security for issues of covered bonds made by Clydesdale Bank PLC. These transactions do not qualify for derecognition from the balance sheet. To date Clydesdale Bank PLC has issued £2,450m of covered bonds, under its covered bond programme, which are held by Clydesdale Bank PLC at 30 September 2010. As the covered bonds issued are held by Clydesdale Bank PLC no accounting entries are required in these Financial Statements.

#### Lease Finance

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

The costs of assets acquired by the Group during the year for the purpose of letting under finance leases and hire purchase contracts amounted to £17m (2009: £7m) and £393m (2009: £510m) respectively. The total closing balances of finance leases and hire purchase contracts were £37m (2009: £37m) and £882m (2009: £1,116m) respectively.

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

	Group		Bank	
	2010	2009	2010	2009
	£m	£m	£m	£m
Gross investment in finance lease receivables:				
Due within one year	422	518	228	269
Due within one to five years	558	685	286	312
Due after more than five years	21	45	20	10
Total gross investment in lease finance receivables	1,001	1,248	534	591
Deduct: Unearned future finance income on lease receivables	(82)	(90)	(82)	(90)
Net investment in lease finance	919	1,158	452	501

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 15. Loans and advances to customers (continued)

There are specific provisions of £8.9m (2009: £7.6m) in relation to finance lease receivables, with a collective provision of £1.2m (2009: £3.1m) as at 30 September 2010.

#### Maximum exposure to credit risk

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

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

#### 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.

#### Collateral and other credit enhancements obtained

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

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

The fair value of collateral that the Group and Bank holds relating to loans and advances at fair value through profit or loss (Note 13) at 30 September 2010 amounts to £58m (2009: £55m). The collateral consists of cash.

#### Distribution of loans and advances by credit quality

	Non retail		Retail	
	2010	2009	2010	2009
	£m	£m	£m	£m
<b>Group</b>				
Gross loans and advances:				
Neither past due nor impaired	12,032	12,672	13,936	13,634
Past due but not impaired	526	562	395	448
Impaired	709	487	45	13
	<u>13,267</u>	<u>13,721</u>	<u>14,376</u>	<u>14,095</u>

	Non retail		Retail	
	2010	2009	2010	2009
	£m	£m	£m	£m
<b>Bank</b>				
Gross loans and advances:				
Neither past due nor impaired	11,623	12,119	9,740	9,686
Past due but not impaired	497	487	247	285
Impaired	681	458	24	5
	<u>12,801</u>	<u>13,064</u>	<u>10,011</u>	<u>9,976</u>

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 15. Loans and advances to customers (continued)

##### **Restructured/renegotiated loans**

There have been six loans totalling £20m (2009: nil) that have had their terms renegotiated and continue to be disclosed within the impaired assets category. There are no other loans (2009: one loan of £0.5m) that would otherwise have been past due or impaired whose terms have been renegotiated.

##### **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).

##### **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 non retail credit quality of loans and advances that are neither past due nor impaired:

	2010 £m	2009 £m
<b>Group</b>		
Senior investment grade	1,902	1,211
Investment grade	1,862	1,884
Sub-investment grade	8,268	9,577
	<b>12,032</b>	<b>12,672</b>
	2010 £m	2009 £m
<b>Bank</b>		
Senior investment grade	1,837	1,153
Investment grade	1,798	1,847
Sub investment grade	7,988	9,119
	<b>11,623</b>	<b>12,119</b>

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

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

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

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.

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**15. Loans and advances to customers (continued)**

*Loans and advances which were past due but not impaired*

	Non retail		Retail	
	2010	2009	2010	2009
	£m	£m	£m	£m
<b>Group</b>				
1 to 29 days past due	370	401	120	146
30 to 59 days past due	15	15	91	104
60 to 89 days past due	4	4	56	56
Past due over 90 days	137	142	128	142
	<u>526</u>	<u>562</u>	<u>395</u>	<u>448</u>
	Non retail		Retail	
	2010	2009	2010	2009
	£m	£m	£m	£m
<b>Bank</b>				
1 to 29 days past due	327	347	74	90
30 to 59 days past due	29	13	55	64
60 to 89 days past due	12	2	36	36
Past due over 90 days	129	125	82	95
	<u>497</u>	<u>487</u>	<u>247</u>	<u>285</u>

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

**16. Impairment provisions on credit exposures**

Group	Non retail		Retail		Total
	Specific	Collective	Specific	Collective	
2010	£m	£m	£m	£m	£m
Opening balance	54	190	10	82	336
Charge/(release) for the year	266	28	80	(12)	362
Amounts written off	(262)	-	(121)	-	(383)
Recoveries of amounts written off in previous years	6	-	41	-	47
<b>Closing balance</b>	<u>64</u>	<u>218</u>	<u>10</u>	<u>70</u>	<u>362</u>

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**16. Impairment provisions on credit exposures (continued)**

<b>Group</b>	<b>Non retail</b>		<b>Retail</b>		<b>Total</b>
	<b>Specific</b>	<b>Collective</b>	<b>Specific</b>	<b>Collective</b>	
2009	£m	£m	£m	£m	£m
Opening balance	41	164	5	70	280
Charge for the year	258	26	103	12	399
Amounts written off	(245)	-	(150)	-	(395)
Recoveries of amounts written off in previous years	-	-	52	-	52
<b>Closing balance</b>	<b>54</b>	<b>190</b>	<b>10</b>	<b>82</b>	<b>336</b>

<b>Bank</b>	<b>Non retail</b>		<b>Retail</b>		<b>Total</b>
	<b>Specific</b>	<b>Collective</b>	<b>Specific</b>	<b>Collective</b>	
2010	£m	£m	£m	£m	£m
Opening balance	40	192	6	82	320
Charge/(release) for the year	267	22	78	(12)	355
Amounts written off	(260)	-	(118)	-	(378)
Recoveries of amounts written off in previous years	6	-	41	-	47
<b>Closing balance</b>	<b>53</b>	<b>214</b>	<b>7</b>	<b>70</b>	<b>344</b>

<b>Bank</b>	<b>Non retail</b>		<b>Retail</b>		<b>Total</b>
	<b>Specific</b>	<b>Collective</b>	<b>Specific</b>	<b>Collective</b>	
2009	£m	£m	£m	£m	£m
Opening balance	40	158	5	70	273
Charge for the year	239	34	98	12	383
Amounts written off	(239)	-	(149)	-	(388)
Recoveries of amounts written off in previous years	-	-	52	-	52
<b>Closing balance</b>	<b>40</b>	<b>192</b>	<b>6</b>	<b>82</b>	<b>320</b>

	<b>Group</b>		<b>Bank</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
	£m	£m	£m	£m
<b>Amounts included in</b>				
Loans and advances to customers (note 15)	<b>362</b>	<b>336</b>	<b>344</b>	<b>320</b>

<b>Non accrual loans</b>				
Loans and advances to customers	<b>754</b>	<b>500</b>	<b>705</b>	<b>492</b>
Provisions	<b>(74)</b>	<b>(64)</b>	<b>(60)</b>	<b>(51)</b>
<b>Total</b>	<b>680</b>	<b>436</b>	<b>645</b>	<b>441</b>

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 17. Securitisation

Securitised advances are subject to non-recourse finance arrangements. These loans have been transferred at principal value to Lanark Trustees Limited, a special purpose entity (SPE), from Clydesdale Bank PLC, and have been funded through the issue of amortising mortgage backed securities to wholesale market investors. The transfer did not meet the derecognition tests in IAS39. The Group's balance sheet include the results, assets and liabilities of the Lanark group of companies (securitisation SPEs), on a line by line basis.

The balance of assets and liabilities in relation to securitisation notes in issue at 30 September 2010 within the Group's balance sheet are as follows:-

	2010 £m	2009 £m
<b>Assets</b>		
Cross currency swaps on bonds and notes	251	475
Loans and advances to customers (note 15)	2,066	2,446
Accrued interest receivable	13	15
	<u>2,330</u>	<u>2,936</u>
<b>Liabilities</b>		
Bonds and notes (note 27)	1,693	2,343
Accrued interest payable	10	7
	<u>1,703</u>	<u>2,350</u>

The balance of assets and liabilities in relation to securitisation notes in issue at 30 September 2010 within the Bank's balance sheet are as follows:-

	2010 £m	2009 £m
<b>Assets</b>		
Loans and advances to customers (note 15)	1,241	1,420
Accrued interest receivable	3	3
Other assets	676	907
	<u>1,920</u>	<u>2,330</u>
<b>Liabilities</b>		
Due to related entities	1,814	2,204

At 30 September 2010 the SPEs had cash deposits with Clydesdale Bank PLC amounting to £70m (2009: £53m). This balance is restricted in use to the repayment of the debt securities issued by the SPEs and other legal obligations.

The Bank initiated two public tender offer processes during 2009 to purchase Lanark notes: one in March 2009 (where £20m and €94m and US \$99m were tendered) and one in June 2009 (where €85m and £40m were tendered). These securities are all Triple A rated and attract a 20% risk weighting on a Standardised capital basis. In September 2009 Clydesdale Bank PLC undertook a private market purchase to acquire Lanark subordinate Residential Mortgage Backed Securities (RMBS) of which £100,000 (GBP) of class Single-A rated notes, €16m (EUR) Triple-B rated notes and a further £46m (GBP) Triple-B rated notes were successfully purchased. The Single-A rated notes attract a 50% risk weighting and the Triple-B rated notes attract a 100% risk weighting on a standardised capital basis.

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

The acquisition of the "Z" notes together with the notes acquired in 2009 bring the Bank's holdings of Lanark notes to £413m (2009: £306m). The notes are classified as a held to maturity investment.



## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 18. Investments in controlled entities and associates

	Group		Bank	
	2010	2009	2010	2009
	£m	£m	£m	£m
<b>At 30 September</b>	<b>2</b>	<b>2</b>	<b>639</b>	<b>617</b>

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.

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.

Principal controlled entities at 30 September 2010	Nature of business	Country of incorporation and principal operations
Clydesdale Bank Asset Finance Limited	Leasing and hire purchase	Scotland
St Vincent Investments Limited	Investment property	Scotland
Yorkshire Bank Home Loans Limited	Mortgage finance	England
Yorkshire Bank Investments Limited	Investment holding	England

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

The following companies are SPEs established in connection with the Bank's and Group's securitisation programme (see note 17). 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.

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**19. Property, plant and equipment**

**Movements on property, plant and equipment**

Group and Bank	Freehold land and buildings	Leases of 50 years and over unexpired	Leases of under 50 years unexpired	Motor vehicles, fixtures and equipment	Total
	£m	£m	£m	£m	£m
<b>Cost or valuation</b>					
At 1 October 2009	41	3	129	143	316
Additions	-	-	13	3	16
Disposals	(5)	-	(1)	(7)	(13)
<b>At 30 September 2010</b>	<b>36</b>	<b>3</b>	<b>141</b>	<b>139</b>	<b>319</b>
<b>Accumulated depreciation</b>					
At 1 October 2009	-	2	61	86	149
Charge for the period	1	1	10	9	21
Disposals	-	-	(1)	(7)	(8)
Transfers	-	(2)	2	-	-
<b>At 30 September 2010</b>	<b>1</b>	<b>1</b>	<b>72</b>	<b>88</b>	<b>162</b>
<b>Net book value</b>					
<b>At 30 September 2010</b>	<b>35</b>	<b>2</b>	<b>69</b>	<b>51</b>	<b>157</b>
At 30 September 2009	41	1	68	57	167

**Valuations**

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

	2010 £m	2009 £m
At current year valuation	39	37
At cost	141	136
	<b>180</b>	<b>173</b>

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

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

	2010 £m	2009 £m
Cost	229	221
Accumulated depreciation	(96)	(96)
Net book value	<b>133</b>	<b>125</b>

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 19. Property, plant and equipment (continued)

##### *Land and buildings occupied for own activities*

	2010 £m	2009 £m
Net book value	<u>126</u>	<u>136</u>

Included are freehold and leasehold properties and fixtures and fittings.

#### 20. Investment properties

Group	2010 £m	2009 £m As restated	2008 £m As restated
At 1 October	33	10	-
Additions	48	25	10
Disposals	(7)	(1)	-
Increment/(deficit) on revaluation	<u>3</u>	<u>(1)</u>	<u>-</u>
	<u>77</u>	<u>33</u>	<u>10</u>

During the year 90% (2009: 73%) of the investment properties generated rental income of £0.97m (2009: £0.26m) and incurred operating expenses of £0.80m (2009: £0.13m). The operating expenses of the investment properties that did not generate rental income were £0.09m (2009: £0.05m).

The September 2009 Annual Report and Consolidated Financial Statements disclosed a balance of £44m, which included £11m related to property inventory. This has now been separately disclosed as property inventory (refer to note 21).

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

#### 21. Property Inventory

Group	2010 £m	2009 £m As restated	2008 £m As restated
<b>Cost</b>			
At 1 October	25	6	-
Additions	9	21	6
Disposals	<u>(3)</u>	<u>(2)</u>	<u>-</u>
Properties completed and under construction	<u>31</u>	<u>25</u>	<u>6</u>

Included within property inventory is property under construction of £25.1m (2009: £17.9m). The remaining properties are complete and available for sale.

At 30 September 2009 properties of £11m were included in investment properties. Properties under construction of £14m were included in other assets.

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**22. Deferred tax**

	<b>Group</b>		<b>Bank</b>	
	<b>2010</b>	2009	<b>2010</b>	2009
	<b>£m</b>	£m	<b>£m</b>	£m
<b>Deferred tax asset</b>				
Opening balance	147	-	146	(3)
Tax expense recognised in income statement	(10)	(10)	(10)	(10)
Deferred taxation recognised in equity	3	159	3	159
Transfers from deferred tax liability	4	-	-	-
Other	-	(2)	-	-
Closing balance	<u>144</u>	<u>147</u>	<u>139</u>	<u>146</u>

The deferred tax asset is attributable to the following items:

Defined benefit pension liability	90	87	90	87
Impairment reserve on credit exposures	30	37	30	37
Employee share based payments	9	10	4	10
Other	15	13	15	12
	<u>144</u>	<u>147</u>	<u>139</u>	<u>146</u>

	<b>Group</b>		<b>Bank</b>	
	<b>2010</b>	2009	<b>2010</b>	2009
	<b>£m</b>	£m	<b>£m</b>	£m
<b>Deferred tax liability</b>				
Opening balance	50	24	28	5
Tax credit recognised in income statement	(5)	-	(5)	-
Deferred taxation recognised in equity	9	34	10	23
Transfers to deferred tax asset	4	-	-	-
Other	(15)	(8)	(1)	-
Closing balance	<u>43</u>	<u>50</u>	<u>32</u>	<u>28</u>

The deferred tax liability is attributable to the following items:

Accelerated capital allowances	(7)	7	(8)	(3)
Net gain on revaluation of properties	2	3	1	3
Cash flow hedge reserve	48	40	39	28
	<u>43</u>	<u>50</u>	<u>32</u>	<u>28</u>

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**23. Other assets**

	<b>Group</b>		<b>Bank</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Prepayments and accrued income	671	415	446	246
Other	282	298	231	157
	<b>953</b>	<b>713</b>	<b>677</b>	<b>403</b>

**24. Due to other banks**

<b>Group and Bank</b>	<b>2010</b>	<b>2009</b>
	<b>£m</b>	<b>£m</b>
Transaction balances with other banks	6	5
Securities sold under agreements to repurchase	631	584
Deposits from other banks	736	1,331
	<b>1,373</b>	<b>1,920</b>

**25. Due to customers**

<b>Group and Bank</b>	<b>2010</b>	<b>2009</b>
	<b>£m</b>	<b>£m</b>
Non interest bearing demand deposits	1,205	984
Interest bearing demand deposits	16,667	15,395
Term deposits	7,078	7,176
Other wholesale deposits	3,484	3,101
	<b>28,434</b>	<b>26,656</b>

**26. Provisions**

<b>Group and Bank</b>	<b>2010</b>	<b>2009</b>
	<b>£m</b>	<b>£m</b>
<b><i>Refund of current account fees &amp; associated costs</i></b>		
Opening balance	4	3
Charge to income statement	-	2
Provisions utilised	(3)	(1)
Closing balance	1	4
<b><i>Payment Protection Insurance</i></b>		
Opening balance	4	2
Charge to income statement	11	2
Closing balance	15	4
<b><i>Other provisions</i></b>		
Opening balance	6	4
Charge to income statement	7	7
Provisions utilised	(2)	(5)
Closing balance	11	6
<b>Total provisions</b>	<b>27</b>	<b>14</b>

The payment protection insurance provision was included within other provisions in the 2009 Financial Statements.

## **CLYDESDALE BANK PLC**

### **Notes to the Consolidated Financial Statements**

#### **26. Provisions (continued)**

##### **Refund of current account fees & associated costs**

The Office of Fair Trading (OFT) continues to liaise with the industry on the issue of exception charges.

The unarranged overdraft charges legal test case concluded on 25 November 2009. The UK Supreme Court ruled that the level of the charges could not be assessed for fairness under the Unfair Terms in Consumer Contracts Regulations 1999. The waiver issued by the FSA to keep claims for refunds on hold accordingly lapsed and all claimants have been informed that the bank has no liability under the Regulations. The Financial Ombudsman Service has rejected the claims lodged unless they involve financial hardship or raise other issues. Most cases pending in the County Courts have now been dismissed, often by the Courts themselves, as the Supreme Court ruling means that there is no legal basis for the claim.

The High Court had already ruled that none of the banks' contracts contain penalties at common law and, accordingly, claims based on this allegation also fail.

As at 30 September 2010, Clydesdale Bank PLC was carrying a provision of £0.2m to cover outstanding claims and Ombudsman fees. In addition, a £0.25m provision is held to cover legal costs in relation to outstanding claims.

##### **Payment Protection Insurance**

As at 30 September 2010, Clydesdale Bank PLC (CB PLC) was carrying a provision of £15.1m to cover outstanding customer claims for refunds of premiums associated to the alleged mis-selling of Payment Protection Insurance policies (PPI). The provision is based upon known pipeline cases and is management's best estimate of expected costs

There remains significant uncertainty around the level of future claims and the Financial Statements have disclosed a contingent liability which outlines the position and the reason for non-provision (note 35).

##### **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;

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 27. Bonds and notes

	Group		Bank	
	2010	2009	2010	2009
	£m	£m	£m	£m
Medium term notes	2,250	2,465	2,250	2,465
Subordinated medium term notes	450	450	450	450
Residential mortgage backed securities	1,693	2,343	-	-
Total bonds, notes and subordinated debt	4,393	5,258	2,700	2,915
Fair value hedge adjustments	16	29	27	38
	<u>4,409</u>	<u>5,287</u>	<u>2,727</u>	<u>2,953</u>
Total bonds and notes were recorded as:				
At amortised cost	1,440	1,666	850	1,029
Designated as fair value hedges	2,969	3,621	1,877	1,924
	<u>4,409</u>	<u>5,287</u>	<u>2,727</u>	<u>2,953</u>

Details of the terms and conditions of the medium term notes issued by Clydesdale Bank PLC as at 30 September 2010 were as follows:

Issue date	Issue currency	Carrying value £m	Coupon rate %	Maturity date
<b>Medium term notes</b>				
29 June 2006	GBP	350	0.83188%	29 June 2011
30 May 2007	EUR	650	0.96300%	30 May 2012
09 December 2008	GBP	750	3.37500%	9 December 2011
11 December 2008	GBP	500	1.34250%	11 November 2011
		<u>2,250</u>		
<b>Subordinated medium term notes</b>				
16 February 2006	GBP	250	4.87500%	17 February 2016
30 March 2007	GBP	200	5.79765%	30 March 2017
		<u>450</u>		

Details of the terms and conditions of the residential mortgage backed securities issued by Lanark Master Issuer PLC as at 30 September 2010 were as follows:

<b>Class A residential mortgage backed securities</b>				
06 August 2007	GBP	590	0.87147%	22 May 2013
06 August 2007	USD	533	0.47906%	22 August 2012
06 August 2007	EUR	570	1.03100%	22 August 2012
		<u>1,693</u>		

On 22 February 2010, the Class B, C and D residential mortgage backed securities matured. Additional notes were redeemed during the year (note 17).



## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 28. Retirement benefit obligations

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

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

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

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 £0.4m (2009: £0.8m) and would have no material impact upon service costs and interest costs.

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

The principal financial assumptions used in the Schemes' valuations at 30 September 2010 were as follows:

	2010 % p.a.	2009 % p.a.
Inflation	3.20	3.10
Rate of increase for pensions in payment:		
pre 5 April 1997 benefits (Clydesdale Bank Pension Scheme)	2.25	2.20
pre 5 April 1997 benefits (Yorkshire Bank Pension Fund)	3.10	3.00
post April 1997 (both Schemes)	3.10	3.00
post April 2006 (both Schemes)	2.25	2.20
Rate of increase for pensions in deferment (Based upon the Consumer Price Index for 2010 <sup>1</sup> )	2.50	3.10
Discount rate	5.10	5.50
Post-retirement mortality:		
Current pensioners at 60 - male	25.5 years	25.5 years
Current pensioners at 60 - female	27.3 years	27.3 years
Future pensioners at 60 - male	26.5 years	26.5 years
Future pensioners at 60 - female	28.2 years	28.2 years

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

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 28. Retirement benefit obligations (continued)

Total contributions made to the Scheme during the year were £93m (2009: £32m).

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

#### Summary

	2010	2009	2008	2007	2006
	£m	£m	£m	£m	£m
<b>Clydesdale Bank</b>					
Total market value of scheme assets	1,144	1,037	1,036	1,123	889
Present value of scheme liabilities	(1,350)	(1,242)	(926)	(1,060)	(978)
Net pension (liability)/asset	(206)	(205)	110	63	(89)

#### Yorkshire Bank Pension Fund

Total market value of scheme assets	867	791	806	885	815
Present value of scheme liabilities	(973)	(896)	(667)	(789)	(838)
Net pension (liability)/asset	(106)	(105)	139	96	(23)

#### Clydesdale Bank Pension Scheme

	2010		2009	
	£m	% of fair value of scheme assets	£m	% of fair value of scheme assets
<b>Assets</b>				
Equities	596	52.10	543	52.36
Property	68	5.94	60	5.79
Government bonds	204	17.83	196	18.90
Corporate bonds	248	21.68	233	22.47
Cash	28	2.45	5	0.48
Total market value of scheme assets	1,144	100.00	1,037	100.00
Present value of scheme liabilities	(1,350)		(1,242)	
Net pension liability	(206)		(205)	

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

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**28. Retirement benefit obligations (continued)**

**Yorkshire Bank**

	<b>2010</b>		<b>2009</b>	
	<b>£m</b>	<b>% of fair value of scheme assets</b>	<b>£m</b>	<b>% of fair value of scheme assets</b>
<b>Assets</b>				
Equities	<b>462</b>	<b>53.29</b>	423	53.48
Property	<b>32</b>	<b>3.69</b>	28	3.54
Government bonds	<b>159</b>	<b>18.34</b>	154	19.47
Corporate bonds	<b>193</b>	<b>22.26</b>	183	23.14
Cash	<b>21</b>	<b>2.42</b>	3	0.37
	<b>867</b>	<b>100.00</b>	791	100.00
Total market value of scheme assets				
	<b>(973)</b>		(896)	
Present value of scheme liabilities				
	<b>(106)</b>		(105)	
Net pension liability				

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

**Expected rate of return on plan assets**

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

	<b>2010</b>	2009	2008	2007	2006
	<b>% p.a.</b>	% p.a.	% p.a.	% p.a.	% p.a.
Equities	<b>8.00</b>	8.15	8.70	8.35	8.20
Property	<b>6.55</b>	6.80	8.00	7.15	6.60
Government bonds	<b>3.55</b>	3.95	4.70	5.00	4.40
Corporate bonds	<b>4.95</b>	5.35	7.00	5.95	5.05
Cash	<b>3.55</b>	3.95	5.00	5.75	4.75

**Reconciliation of fair value of scheme assets**

	<b>Clydesdale Bank</b>		<b>Yorkshire Bank</b>		<b>Total</b>	
	<b>2010</b>	2009	<b>2010</b>	2009	<b>2010</b>	2009
	<b>£m</b>	£m	<b>£m</b>	£m	<b>£m</b>	£m
Fair value of scheme assets						
at 1 October	<b>1,037</b>	1,036	<b>791</b>	806	<b>1,828</b>	1,842
Actual return on						
scheme assets	<b>97</b>	15	<b>72</b>	11	<b>169</b>	26
Employer contributions	<b>57</b>	29	<b>36</b>	3	<b>93</b>	32
Benefits paid	<b>(47)</b>	(43)	<b>(32)</b>	(29)	<b>(79)</b>	(72)
<b>Fair value of scheme assets</b>						
<b>at 30 September</b>	<b>1,144</b>	1,037	<b>867</b>	791	<b>2,011</b>	1,828

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**28. Retirement benefit obligations (continued)**

***Reconciliation of defined benefit obligation***

	<b>Clydesdale Bank</b>		<b>Yorkshire Bank</b>		<b>Total</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Defined benefit obligation at 1 October	<b>1,242</b>	926	<b>896</b>	667	<b>2,138</b>	1,593
Interest cost	<b>67</b>	65	<b>48</b>	47	<b>115</b>	112
Current service cost	<b>20</b>	15	<b>13</b>	10	<b>33</b>	25
Benefits paid	<b>(47)</b>	(44)	<b>(32)</b>	(29)	<b>(79)</b>	(73)
Actuarial loss	<b>67</b>	279	<b>46</b>	199	<b>113</b>	478
Past service cost	<b>1</b>	1	<b>2</b>	2	<b>3</b>	3
<b>Defined benefit obligation at 30 September</b>	<b><u>1,350</u></b>	<u>1,242</u>	<b><u>973</u></b>	<u>896</u>	<b><u>2,323</u></b>	<u>2,138</u>

***Reconciliation of balance sheet liability***

	<b>Clydesdale Bank</b>		<b>Yorkshire Bank</b>		<b>Total</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Balance sheet (liability)/asset at 1 October	<b>(205)</b>	110	<b>(105)</b>	139	<b>(310)</b>	249
Employer contributions	<b>57</b>	29	<b>36</b>	3	<b>93</b>	32
Total pension expense	<b>(18)</b>	-	<b>(10)</b>	-	<b>(28)</b>	-
Statement of comprehensive income	<b>(40)</b>	(344)	<b>(27)</b>	(247)	<b>(67)</b>	(591)
<b>Balance sheet liability at 30 September</b>	<b><u>(206)</u></b>	<u>(205)</u>	<b><u>(106)</u></b>	<u>(105)</u>	<b><u>(312)</u></b>	<u>(310)</u>

**Post Retirement Medical Benefits**

**Scheme**

Balance sheet liability at 1 October	<b>(10)</b>	(10)
Benefits Paid	<b>2</b>	-
Settlement Gain	<b>1</b>	-
Statement of comprehensive income	<b><u>2</u></b>	<u>-</u>
Balance sheet liability at 30 September 2010	<b><u>(5)</u></b>	<u>(10)</u>

<b>Balance sheet liability at 30 September 2010</b>	<b><u>(317)</u></b>	<u>(320)</u>
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**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**28. Retirement benefit obligations (continued)**

**Pension expense for the year**

	Clydesdale Bank		Yorkshire Bank		Total	
	2010	2009	2010	2009	2010	2009
	£m	£m	£m	£m	£m	£m
Current service cost	20	15	13	10	33	25
Past service costs	1	1	2	3	3	4
Interest cost	67	65	48	47	115	112
Expected return on assets	(70)	(78)	(53)	(61)	(123)	(139)
Effect of transfer of defined contribution	-	(1)	-	-	-	(1)
<b>Total pension expense/(credit)</b>	<b>18</b>	<b>2</b>	<b>10</b>	<b>(1)</b>	<b>28</b>	<b>1</b>

**Statement of comprehensive income (SOCl)**

	Clydesdale Bank		Yorkshire Bank		Medical Benefits		Total	
	2010	2009	2010	2009	2010	2009	2010	2009
	£m	£m	£m	£m			£m	£m
Gain/(loss) on scheme assets	27	(63)	19	(49)	-	-	46	(112)
Experience gains/(losses) on scheme liabilities	27	(4)	18	2	-	-	45	(2)
Loss from change in actuarial assumptions								
- Defined benefit plans	(94)	(277)	(64)	(200)	-	-	(158)	(477)
- Post Retirement Medical Benefits	-	-	-	-	2	-	2	-
<b>Total amount recognised in SOCl</b>	<b>(40)</b>	<b>(344)</b>	<b>(27)</b>	<b>(247)</b>	<b>2</b>	<b>-</b>	<b>(65)</b>	<b>(591)</b>
<b>Cumulative amount recognised in SOCl</b>	<b>(282)</b>	<b>(242)</b>	<b>(120)</b>	<b>(93)</b>	<b>2</b>	<b>-</b>	<b>(400)</b>	<b>(335)</b>

**History of experience gains and losses**

Clydesdale Bank	2010	2009	2008	2007	2006
<b>Difference between the expected and actual return on scheme assets</b>					
Amount (£m)	27	(63)	(178)	27	24
Percentage of scheme assets	2.36%	-6.08%	-17.18%	2.40%	2.70%
<b>Experience gains and (losses) on scheme liabilities</b>					
Amount (£m)	27	(4)	(16)	1	-
Percentage of the present value of the scheme liabilities	2.00%	-0.32%	-1.73%	0.10%	0.00%
<b>Total amount recognised in SOCl</b>					
Amount (£m)	(40)	(344)	(6)	119	8
Percentage of the present value of the scheme liabilities	-2.96%	-27.68%	-0.65%	11.23%	0.82%

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**28. Retirement benefit obligations (continued)**

*History of experience gains and losses*

**Yorkshire Bank**

	2010	2009	2008	2007	2006
<b>Difference between the expected and actual return on scheme assets</b>					
Amount (£m)	<u>19</u>	<u>(49)</u>	<u>(141)</u>	<u>22</u>	<u>22</u>
Percentage of scheme assets	<u>2.19%</u>	<u>-6.19%</u>	<u>-17.49%</u>	<u>2.49%</u>	<u>2.70%</u>
<b>Experience gains on scheme liabilities</b>					
Amount (£m)	<u>18</u>	<u>2</u>	<u>20</u>	<u>-</u>	<u>-</u>
Percentage of the present value of the scheme liabilities	<u>1.85%</u>	<u>0.22%</u>	<u>3.00%</u>	<u>0.00%</u>	<u>0.00%</u>
<b>Total amount recognised in SOCI</b>					
Amount (£m)	<u>(27)</u>	<u>(247)</u>	<u>11</u>	<u>103</u>	<u>11</u>
Percentage of the present value of the scheme liabilities	<u>-2.77%</u>	<u>-27.57%</u>	<u>1.65%</u>	<u>13.05%</u>	<u>1.31%</u>

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 29. Other liabilities

	Group		Bank	
	2010	2009	2010	2009
	£m	£m	£m	£m
Accruals and deferred income	28	47	26	47
Notes in circulation	1,269	1,163	1,269	1,163
Accrued interest payable	702	519	476	353
Other liabilities	104	111	137	108
	<u>2,103</u>	<u>1,840</u>	<u>1,908</u>	<u>1,671</u>

### 30. Called up share capital

	2010	2009
Group and Bank	£m	£m
<b>Allotted, called up and fully paid</b>		
Ordinary shares of £1 each - equity		
At 1 October	532	232
Issued during the period	310	300
<b>At 30 September</b>	<u>842</u>	<u>532</u>
<b>Preference Shares</b>	£m	£m
Preference shares of £1 each - equity		
At 1 October	100	-
Issued during the period	-	100
<b>At 30 September</b>	<u>100</u>	<u>100</u>
<b>Share capital</b>	<u>942</u>	<u>632</u>

Following a change in law on 1 October 2009, the Company articles were amended to dispense with the requirement for authorised share capital.

On 8 December 2009, 160,000,000 ordinary shares of £1 each were issued at par, resulting in an increase of £160,000,000 in the allotted, called up and fully paid share capital. On 22 September 2010, 150,000,000 ordinary shares of £1 each were also issued at par resulting in a total increase of £310,000,000 in the allotted, called up and fully paid share capital during the year.

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



## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 31. Reserves

	Group		Bank	
	2010	2009	2010	2009
	£m	£m	£m	£m
Share premium account	243	243	243	243
Merger reserve	338	338	338	338
Share option reserve	1	2	1	2
Asset revaluation reserve	2	2	2	2
Available for sale investments reserve	6	14	6	14
Cash flow hedge reserve	130	103	106	71
Retained earnings	885	916	686	747
	<b>1,605</b>	<b>1,618</b>	<b>1,382</b>	<b>1,417</b>

#### **Merger reserve**

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

#### **Share option reserve**

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

#### **Asset revaluation reserve**

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

#### **Available for sale investments reserve**

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

#### **Cash flow hedge reserve**

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

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**32. Memorandum items**

	<b>Contract amount 2010</b>	<b>Contract amount 2009</b>
	<b>£m</b>	<b>£m</b>
		As restated
<b>Contingent liabilities</b>		
<b>Group and Bank</b>		
Guarantees and assets pledged as collateral security		
- guarantees and irrevocable letters of credit	<b>258</b>	<b>273</b>
- At call	<b>2</b>	<b>1</b>
- Due in less than three months	<b>43</b>	<b>29</b>
- Due 3 months through to 1 year	<b>41</b>	<b>46</b>
- Due 1 year through to 3 years	<b>29</b>	<b>24</b>
- Due 3 years through to 5 years	<b>6</b>	<b>5</b>
- Due after 5 years	<b>125</b>	<b>129</b>
- No specified maturity	<b>12</b>	<b>39</b>
	<b>258</b>	<b>273</b>
<b>Commitments</b>		
<b>Group</b>		
Sale and option to repurchase transactions	<b>812</b>	<b>750</b>
- Due 3 months through to 1 year	<b>-</b>	<b>250</b>
- Due 1 year through to 3 years	<b>500</b>	<b>500</b>
- Due 3 years through to 5 years	<b>312</b>	<b>-</b>
	<b>812</b>	<b>750</b>
<b>Group and Bank</b>		
Other commitments		
- undrawn formal standby facilities, credit lines and other commitments to lend at call	<b>10,788</b>	<b>9,487</b>

The comparative contingent liability balances have been restated to remove an overstatement in the previously reported figures. The 30 September 2009 balance has been restated from £673m to £273m. In addition the commitment balance has been restated to include balances from a limits capture system that have not been included in the prior year balance. The September 2009 balance has been restated from £8,595m to £9,487m.

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

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

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 33. Capital commitments

The Group and Bank had future capital expenditure which had been contracted for but not provided for in the Financial Statements of £3m (2009: £2m) at 30 September 2010.

#### 34. Lease commitments

##### Group and Bank Operating lease commitments

Payments committed to be made during the next year under non-cancellable operating leases which expire:

- within 1 year
- between 1 and 5 years
- over 5 years

<b>Land and buildings</b>	Land and buildings
<b>2010</b>	2009
<b>£m</b>	<b>£m</b>
<b>2</b>	<b>2</b>
<b>6</b>	<b>3</b>
<b>9</b>	<b>2</b>
<b>17</b>	<b>7</b>

Where the Group is the lessee the future minimum lease payments under non-cancellable operating leases are:

- within 1 year
- within 1 and 5 years
- over 5 years

<b>1</b>	<b>1</b>
<b>37</b>	<b>20</b>
<b>373</b>	<b>372</b>
<b>411</b>	<b>393</b>

#### 35. Other contingent liabilities

##### *Financial Services Compensation Scheme*

The UK Financial Services Compensation Scheme (FSCS) provides compensation to depositors in the event that a financial institution is unable to repay amounts due. Following the failure of a number of financial institutions, the FSCS has raised borrowings from the UK Government to cover compensation in relation to protected deposits. These borrowings are anticipated to be repaid from the realisation of the assets of the institutions. In the interim the FSCS has estimated levies due to 31 March 2011 from the banking industry to support interest payments on the borrowings, and an accrued expense of £5 million is presently held for the NAB Group's calculated liability for this period. If the assets of the failed institutions are insufficient to repay the Government loan additional levies will become payable in future periods.

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 35. Other contingent liabilities (continued)

##### *Payment Protection Insurance*

Following the investigation by the UK Competition Commission into the sale of Payment Protection Insurance, a report was published on 29 January 2009 concluding a lack of competition exists in the UK market as a result of various factors, including lack of transparency and barriers to entry for stand-alone providers. A range of remedies to address the issue have been imposed. Separately, on 10 August 2010 the FSA issued a policy statement in relation to redress for customers who allege that they were sold a payment protection policy in circumstances where such a sale was inappropriate. The FSA also requires firms to identify whether an unfair sales practice affected customers who have not complained or whose complaints have been rejected and to award redress to them. CB PLC is currently considering the extent to which this policy statement applies to it.

On 8 October 2010 the British Bankers Association (BBA) filed papers with the High Court asking for a review of proposals by the Financial Services Authority contained in new rules that are due to be implemented at the end of this year. On behalf of the industry the BBA alleges that the rules require banks to apply sales standards retrospectively to a period before their introduction. Provision has been made for costs arising from claims received, although at this stage there remains uncertainty surrounding the potential impact.

##### *Other*

The Bank is named in and is defending a number of legal claims 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.

#### 36. Employees

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

	2010 Number	2009 Number
Managers	1,529	1,570
Clerical staff	3,955	4,313
	<u>5,484</u>	<u>5,883</u>

All staff are contracted employees of National Australia Group Europe Limited ("NAGE") (the immediate parent company of the Bank). The numbers above disclose the staff remunerated directly by the Group but exclude employees working within other NAGE subsidiaries who provide support services to the Group. The average number of staff employed in the UK Banking operating division of National Australia Bank Limited (the ultimate parent) to 30 September was 8,268 (2009: 8,295).

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 37. Notes to the statement of cash flows

	Group		Bank	
	2010	2009	2010	2009
	£m	£m	£m	£m
	As restated		As restated	
<b>Non cash items included in profit before tax</b>				
Interest receivable	(1,392)	(1,722)	(1,255)	(1,547)
Interest payable	432	877	462	900
Depreciation (note 6)	21	23	21	23
Profit on sale of land & buildings	(2)	(11)	(3)	(11)
Profit on investments classified as held to maturity	-	-	12	-
Loss on revaluation of land and buildings	-	9	-	9
Gain on revaluation of investment properties	(3)	-	-	-
Profit on disposal of available for sale investments	-	(6)	-	(6)
Transfer from available for sale reserve	(1)	(4)	(1)	(4)
Transfer from cash flow hedge reserve	(3)	(17)	(20)	(17)
Derivative financial instruments fair value movements	(121)	(244)	(101)	(244)
Impairment losses on credit exposures (note 16)	362	399	355	383
Share of operating profit in associated undertaking	-	(2)	-	-
Dividends received from subsidiaries	-	-	(86)	(193)
Profit on disposal of subsidiary	-	(2)	-	-
Equity-based compensation expense	17	15	17	15
	<u>(690)</u>	<u>(685)</u>	<u>(599)</u>	<u>(692)</u>
<b>Changes in operating assets</b>				
Net (increase)/decrease in:				
Balances with supervisory central banks	(3)	(1)	(3)	(1)
Due from other banks	329	182	329	(325)
Derivative financial assets	344	(96)	140	90
Financial assets at fair value through profit or loss	626	(1,562)	654	(1,606)
Held to maturity investments	-	-	41	-
Loans and advances to customers	(196)	1,110	(137)	1,730
Due from customers on acceptances	(6)	1	(6)	1
Other assets	25	(132)	(67)	1,908
	<u>1,119</u>	<u>(498)</u>	<u>951</u>	<u>1,797</u>
<b>Changes in operating liabilities</b>				
Net increase/(decrease) in:				
Due to other banks	(731)	(2,039)	(731)	(2,039)
Derivative financial liabilities	4	77	4	77
Financial liabilities at fair value through profit or loss	299	44	299	44
Due to customers	1,778	4,322	1,778	4,594
Liabilities on acceptances	6	(1)	6	(1)
Provisions	13	5	13	5
Defined benefit pension obligations	(68)	(32)	(68)	(32)
Other liabilities	79	(248)	112	(731)
	<u>1,380</u>	<u>2,128</u>	<u>1,413</u>	<u>1,917</u>

Comparative balances including investments, bonds and notes and defined benefit pension obligations have been restated to provide enhanced disclosure.

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 37. Notes to the statement of cash flows (continued)

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	
	2010	2009	2010	2009
	£m	£m	£m	£m
Cash assets (excluding mandatory balances with central banks - note 10)	4,040	2,686	4,040	2,686
Other assets	125	131	116	125
Due to other banks	(189)	(5)	(189)	(5)
Due to related entities	(8)	(123)	(8)	(123)
Other liabilities	(77)	(76)	(77)	(76)
	<u>3,891</u>	<u>2,613</u>	<u>3,882</u>	<u>2,607</u>

### 38. Related party transactions

The Bank is a wholly owned controlled entity of National Australia Group Europe Limited. The ultimate parent entity of the Bank is National Australia Bank Limited. During August 2010, the Bank's immediate parent, National Europe Holdings (GB) Limited transferred ownership of Clydesdale Bank PLC to National Europe Holdings Limited, a wholly owned subsidiary of National Australia Group Europe Limited. Subsequent to the balance sheet date, during October 2010, National Europe Holdings Limited transferred ownership of Clydesdale Bank PLC to National Australia Group Europe Limited. National Europe Holdings (GB) Limited and National Europe Holdings Limited have a liquidator appointed to wind up the companies under a members voluntary liquidation. During the period 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	
	2010	2009	2010	2009
	£m	£m	£m	£m
<b>Loans</b>				
Ultimate parent	2,810	1,947	2,810	1,947
Controlled entities of the ultimate parent	-	-	4,938	4,951
	<u>2,810</u>	<u>1,947</u>	<u>7,748</u>	<u>6,898</u>
<b>Other receivables</b>				
Ultimate parent	8	5	8	5
Controlled entities of the ultimate parent	21	19	21	19
	<u>29</u>	<u>24</u>	<u>29</u>	<u>24</u>
Total amounts due from related entities	<u>2,839</u>	<u>1,971</u>	<u>7,777</u>	<u>6,922</u>
Interest income on the above amounts was as follows:				
Ultimate parent	15	15	15	15
Controlled entities of the ultimate parent	-	-	55	75
Total interest income on amounts due from related entities	<u>15</u>	<u>15</u>	<u>70</u>	<u>90</u>

#### Reverse repurchase agreements

Included in Amounts due from related entities - Ultimate parent is £2,234m (2009: £1,580m) for securities purchased under agreements to resell (Group and Bank).

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 38. Related party transactions (continued)

#### Reverse repurchase agreements (continued)

As part of the reverse repurchase agreements included in "Amounts due from related entities", the Group and Bank has received securities that it is allowed to sell or re-pledge. The fair value of the securities accepted under these terms as at 30 September 2010 amounts to £2,223m (2009: £1,582m) for the Group and Bank, of which £106m (2009: £Nil) for the Group and Bank has been sold or re-pledged to third parties in connection with financing activities or to comply with commitments under short sale transactions.

The Group is obliged to return equivalent securities on maturity of the transaction. These transactions are conducted under terms that are usual and customary to standard lending and securities borrowing activities.

Amounts due to related entities	Group		Bank	
	2010 £m	2009 £m	2010 £m	2009 £m
<b>Group</b>				
<b>Deposits</b>				
Ultimate parent	2,618	2,435	2,618	2,435
Controlled entities of the Bank	-	-	2,625	3,005
	<u>2,618</u>	<u>2,435</u>	<u>5,243</u>	<u>5,440</u>
<b>Subordinated liabilities</b>				
Ultimate parent	300	300	300	300
Controlled entities of the ultimate parent	426	426	426	426
	<u>726</u>	<u>726</u>	<u>726</u>	<u>726</u>
<b>Other payables</b>				
Ultimate parent	10	7	10	7
Controlled entities of the ultimate parent	32	153	32	153
	<u>42</u>	<u>160</u>	<u>42</u>	<u>160</u>
Total amounts due to related parties	<u>3,386</u>	<u>3,321</u>	<u>6,011</u>	<u>6,326</u>
Interest expense on the above amounts was as follows:				
Ultimate parent	45	106	45	106
Controlled entities of the ultimate parent	6	18	6	18
Controlled entities of the Bank	-	-	82	223
Total interest expense on amounts due to related entities	<u>51</u>	<u>124</u>	<u>133</u>	<u>347</u>

#### Subordinated liabilities

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

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

The rates of interest stated below apply at 30 September 2010.	2010 £m	2009 £m
6.45750% 10-year, non-call five years with a final maturity of 17 February 2019	300	300
1.33188% (2009: 1.95500%) Undated subordinated notes	100	100
	<u>400</u>	<u>400</u>
Other undated subordinated notes	326	326
Total subordinated debt	<u>726</u>	<u>726</u>



# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 38. Related party transactions (continued)

#### Securitisation

The Bank has securitised part of its residential mortgage portfolio and the cash raised via the issue of Residential Mortgaged Backed Securities (RMBS) through SPEs forms part of the Bank's medium term funding. The value of the RMBS in issue was £1,827m (2009: £2,215m).

#### Other transactions with related entities

	Group		Bank	
	2010	2009	2010	2009
	£m	£m	£m	£m
<b>Non interest income received</b>				
Controlled entities of the ultimate parent	<u>10</u>	<u>14</u>	<u>10</u>	<u>14</u>
<b>Administrative expenses</b>				
Ultimate parent	5	4	5	4
Controlled entities of the ultimate parent	<u>249</u>	<u>245</u>	<u>247</u>	<u>245</u>
	<u>254</u>	<u>249</u>	<u>252</u>	<u>249</u>

#### Compensation of key management personnel (including Directors)

	Group	
	2010	2009
	£m	£m
Salaries and other short-term benefits	10	9
Share based payments	<u>6</u>	<u>4</u>
	<u>16</u>	<u>13</u>

The above table has been prepared on a cash basis for benefits received during the year.

Directors emoluments are analysed in note 40. No other KMP compensation individually exceeded £1m in 2010 or 2009.

#### Transactions with key management personnel (KMP)

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

KMP, their close family members and any entity KMP 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.

	2010	2009
	£m	£m
Loans and advances	<u>5</u>	<u>4</u>
Deposits	<u>8</u>	<u>8</u>

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 2010 (2009: £Nil).

Included in the above are thirteen (2009: eight) loans totalling £1.4m (2009: £0.7m) made to Directors.

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 38. Related party transactions (continued)

#### *Other related party transactions*

The Group incurred costs in relation to pension scheme administration. These costs, which amounted to £0.3m in the year ended 30 September 2010 (2009: £0.4m) were charged to the Group sponsored Schemes. The Group has deposits of £4.9m (2009: £4.8m) at the year end placed by the Schemes at market rates.

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

	<b>Bank</b>	
	<b>2010</b>	2009
	<b>£m</b>	£m
Clydesdale Bank Section	<b>57</b>	29
Yorkshire Bank Section	<b>36</b>	3
	<b>93</b>	32

### 39. Share based payments

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

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

#### *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.

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 39. 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 2009 an employee share offer valued at approximately A\$800 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 11 December 2009. 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 or performance right is exchanged for one fully paid ordinary share in NAB upon exercise. 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	16-Jan-09	28-Feb-08	14-Feb-08	28-Aug-07
Risk-free interest rate (per annum)	3.47%	6.54%	6.54%	6.10%
Life of options	4 years	3.5 years	4 years	5 years
Volatility of share price	36.00%	19.00%	19.00%	15.00%
Dividend rate (per annum)	5.30%	4.50%	4.50%	4.40%
Exercise price of options	A\$19.89	-	A\$31.70	A\$43.43
Fair value of performance options	A\$3.54	-	A\$3.73	A\$2.69
Fair value of performance rights	-	A\$26.18	-	-

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 39. Share based payments (continued)

Grant date	03-Aug-07	07-Feb-07	31-Oct-06	31-Jul-06
Risk-free interest rate (per annum)	6.19%	5.90%	5.80%	5.90%
Life of options	5 years	5.5 years	4.75 years	5.5 years
Volatility of share price	15.00%	15.00%	15.00%	15.50%
Dividend rate (per annum)	4.40%	4.70%	4.90%	5.00%
Exercise price of options	A\$40.91	A\$40.91	A\$38.29	A\$35.50
Fair value of performance options	A\$2.68	A\$4.20	A\$3.73	A\$3.98
Fair value of performance rights	A\$13.57	A\$18.67	A\$19.59	A\$20.11
Grant date	03-May-06	03-May-06	06-Feb-06	06-Feb-06
Risk-free interest rate (per annum)	5.70%	5.70%	5.20%	5.20%
Life of options	5.5 years	5.5 years	5.5 years	5 years
Volatility of share price	15.00%	15.00%	15.00%	15.00%
Dividend rate (per annum)	5.00%	5.00%	5.30%	5.30%
Exercise price of options	A\$37.55	A\$34.53	A\$34.53	A\$34.53
Fair value of performance options	A\$3.75	A\$4.65	A\$3.39	A\$3.23
Fair value of performance rights	A\$19.51	A\$19.51	A\$18.23	-
Grant date	19-Dec-05	08-Jul-05	22-Feb-05	07-Feb-05
Risk-free interest rate (per annum)	5.20%	5.10%	5.40%	5.30%
Life of options	5 years	5 years	5 years	5 years
Volatility of share price	15.00%	16.00%	16.00%	16.00%
Dividend rate (per annum)	5.30%	5.80%	5.80%	5.80%
Exercise price of options	A\$31.78	A\$29.93	A\$30.41	A\$29.93
Fair value of performance options	A\$2.74	A\$2.80	A\$1.54	A\$2.80
Fair value of performance rights	A\$17.11	A\$18.31	A\$7.37	A\$17.15

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

Share options	2010		2009	
	Number	Weighted Average Exercise Price A\$	Number	Weighted Average Exercise Price A\$
Outstanding at 1 October	6,448,003	34.52	7,341,460	34.81
Granted during the year	-	-	190,338	19.89
Forfeited during the year	(1,312,145)	31.04	(1,083,795)	33.92
Outstanding at 30 September	<u>5,135,858</u>	<u>35.41</u>	<u>6,448,003</u>	<u>34.52</u>
Exercisable at 30 September	<u>2,611,492</u>		<u>2,854,300</u>	

No share options were exercised during the year (2009: Nil). For share options outstanding at 30 September 2010, the weighted average remaining contractual life is 3.69 years (2009: 3.58 years). The range of exercise prices for options outstanding at the end of the year were A\$19.89 to A\$43.43 (2009: \$19.89 - \$43.43).

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**39. Share based payments (continued)**

Performance rights	2010		2009	
	Number	Weighted Average Exercise Price A\$	Number	Weighted Average Exercise Price A\$
Outstanding at 1 October	1,520,885	1.00	1,523,791	1.00
Forfeited during the year	(248,926)	1.00	(2,906)	1.00
Outstanding at 30 September	<u>1,271,959</u>	1.00	<u>1,520,885</u>	1.00
Exercisable at 30 September	<u>721,608</u>		<u>782,137</u>	

No performance rights were exercised during the year (2009: Nil). For performance rights outstanding at 30 September 2010, the weighted average remaining contractual life is 3.66 years (2009: 3.59 years). The range of exercise prices for options outstanding at the end of the year were A\$1.00 to A\$35.50 (2009: \$1.00 to \$35.50).

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**40. Directors' emoluments**

2010

2010	Performance Related Pay						Total Emoluments £'000
	Salary and fees (1) £'000	Benefits and allowances (2) £'000	Short Term			Long Term Incentive Scheme	
			Incentive Scheme (STI) (3)			Shares £'000	
			Annual (cash) £'000	Deferred (shares) £'000	Total Short Term (PRP) £'000		
<u>Executive Directors</u>							
Lynne Peacock (4)	440	188	200	200	400	484	1,512
Cameron Clyne (6)	-	-	-	-	-	-	-
John Hooper	534	185	326	326	652	177	1,548
David Thorburn	352	89	236	249	485	106	1,032
Total Executive	1,326	462	762	775	1,537	767	4,092
<u>Non-executive Directors</u>							
Sir Malcolm Williamson	161	-	-	-	-	-	161
Jonathan Dawson	75	-	-	-	-	-	75
Sir David Fell	78	-	-	-	-	-	78
Richard Gregory OBE	93	-	-	-	-	-	93
Roy Nicolson	75	-	-	-	-	-	75
Elizabeth Padmore (6)	60	-	-	-	-	-	60
Peter Wood	68	-	-	-	-	-	68
Total Non-executive	610	-	-	-	-	-	610
Total Directors	1,936	462	762	775	1,537	767	4,702

2009

2009	Performance Related Pay						Total Emoluments £'000
	Salary and fees (1) £'000	Benefits and allowances (2) £'000	Short Term			Long Term	
			Incentive Scheme (STI) (3)			Incentive	
			Annual (cash) £'000	Deferred (shares) £'000	Total Short Term (PRP) £'000	Scheme  Shares £'000	
<u>Executive Directors</u>							
Lynne Peacock	436	205	114	114	228	790	1,659
John Hooper (6)	204	53	284	-	284	137	678
Gavin Slater (6)	156	44	87	-	87	-	287
David Thorburn	337	77	140	42	182	88	684
Total Executive	1,133	379	625	156	781	1,015	3,308
<u>Non-executive Directors</u>							
Sir Malcolm Williamson	190	-	-	-	-	-	190
Jonathan Dawson	92	-	-	-	-	-	92
Sir David Fell	77	-	-	-	-	-	77
Richard Gregory OBE	96	-	-	-	-	-	96
Roy Nicolson	75	-	-	-	-	-	75
Peter Wood	68	-	-	-	-	-	68
Total Non-executive	598	-	-	-	-	-	598
Total Directors	1,731	379	625	156	781	1,015	3,906

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 40. Directors' emoluments (continued)

In addition to amounts shown in the above table, social security costs were payable in respect of emoluments for directors amounting to £522,000 (2009: £444,000) and in respect of emoluments for the Highest Paid Director of £120,000 (2009: £205,000).

#### Notes

- (1) Salary costs include salaries paid to Executive Directors and fees paid to Non-executive Directors.  
Cameron Clyne did not receive any remuneration in respect of services to the Group. He is remunerated by the Group's ultimate parent, NAB. Details can be found in the Remuneration Report disclosed in the NAB Annual Financial Report.  
Sir Malcolm Williamson's directorship fees exclude NAB Board and Risk Committee fees (AUD \$250,000).
- (2) Benefits and allowances include cash payments in lieu of pension contributions and other taxable allowances and benefits. Retirement benefits accrued to one director under a defined benefit pension plan. Pension contributions amounting to £34,000 (2009: £26,000) were paid during the year of which contributions for the Highest Paid Director amounts to £Nil (2009: £Nil).
- (3) Performance related pay relates to the respective financial year. The cash element will be paid in the forthcoming year and the deferred amount represents shares deferred for one and two years.  
The Remuneration Report disclosed in the NAB Annual Financial Report details the actual remuneration received in the year, for certain of the Directors, including cash paid and the value of equity that vested and lapsed without providing any value. The Highest Paid Director received 18,040 shares (2009: 3,513) that vested during the period, with a fair value of £303,115 (2009: £72,865).
- (4) Lynne Peacock has elected to be paid against the UK STI multiple resulting in a below target STI outcome. Had the STI payment been calculated based on the Group STI multiple, in line with her STI plan, her STI outcome would have been above target.
- (5) The long term incentive scheme amounts represents share options, share rights and deferred shares for services rendered during the year which require the achievement of performance hurdles and/or milestones before they vest. Typically, the performance period is three years. The value attributed is the fair value of the shares at the date of granting. Three Directors (2009: Three) were entitled to receive benefits under a long term incentive scheme.  
No Director exercised share options during the year (2009: Nil).
- (6) Gavin Slater resigned as an Executive Director of the Company on 12 March 2009 and John Hooper was appointed as an Executive Director of the Company on 24 April 2009. Elizabeth Padmore was appointed as Non-executive Director on 6 November 2009 and Cameron Clyne was appointed as an Executive Director of the Company on 8 January 2010.
- (7) The table below shows the number of shares held by the Highest Paid Director for the given year, for share options, share rights, short term incentive, long term incentive and other employee share plans (including free shares, commencement shares, recognition shares).

#### 2010

	Share Options	Share Rights	Short Term Incentive Shares	Long Term Incentive Shares	Other Employee Share Plans
Outstanding at 1 October	669,022	80,586	26,330	49,293	26,352
Granted during the year	-	-	13,088	-	52
Forfeited during the year	(127,448)	(24,362)	-	-	-
Outstanding at 30 September	<u>541,574</u>	<u>56,224</u>	<u>39,418</u>	<u>49,293</u>	<u>26,404</u>

#### 2009

	Share Options	Share Rights	Short Term Incentive Shares	Long Term Incentive Shares	Other Employee Share Plans
Outstanding at 1 October	813,115	160,366	41,152	19,606	51,474
Granted during the year	190,338	-	9,229	36,397	100,052
Outstanding at 30 September	<u>1,003,453</u>	<u>160,366</u>	<u>50,381</u>	<u>56,003</u>	<u>151,526</u>

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 41. Fair values of financial instruments

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

Group	Footnote	2010		2009	
		Carrying Value £m	Fair value £m	Carrying Value £m	Fair value £m
Financial assets					
Cash and balances with supervisory central banks	(a)	4,070	4,070	2,713	2,713
Loans and advances to other banks	(b)	11	11	340	340
Derivative financial assets (on balance sheet)	(c)	719	719	942	942
Other financial assets at fair value	(d)	5,396	5,396	5,983	5,983
Investments	(i)	2,262	2,323	2,180	2,186
Loans and advances to customers	(e)	26,981	27,140	27,147	28,091
Due from customers on acceptances	(a)	8	8	2	2
Due from related entities	(f)	2,839	2,839	1,971	1,971
Other assets	(g)	650	650	368	368
Financial liabilities					
Due to other banks	(e)	1,373	1,402	1,920	1,963
Derivative financial liabilities (on balance sheet)	(c)	117	117	113	113
Other financial liabilities at fair value	(d)	896	896	597	597
Due to customers	(e)	28,434	28,496	26,656	26,755
Liabilities on acceptances	(a)	8	8	2	2
Due to related entities	(f)	3,386	3,386	3,321	3,321
Bonds and notes	(e)	4,409	4,449	5,287	5,375
Other liabilities	(h)	1,971	1,971	1,682	1,682

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

- (a) The carrying amounts of these financial assets and financial liabilities approximate fair value.
- (b) The carrying value of loans and advances 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 the balance sheet date, discounted cash flow models or option pricing models as appropriate.
- (d) The fair value of assets and liabilities designated as being carried at fair value through profit or loss are based on quoted market prices and data or valuation techniques based upon observable market data as appropriate to the nature and type of the underlying instrument.
- (e) The fair value of these financial assets and financial liabilities are obtained from discounted cash flow models.
- (f) The carrying amount of amounts due from and due to related entities is considered to approximate fair value as they are repayable on demand.
- (g) Other financial assets include accrued interest receivable.
- (h) Other financial liabilities include accrued interest payable and notes in circulation.
- (i) The fair value of investments are based on quoted closing market prices. Where investments are unlisted and quoted market prices are not available, the Group obtains fair value by means of other valuation techniques that are commonly used by market participants.



# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 41. Fair values of financial instruments (continued)

Group and Bank 2010		Level 1 £m	Level 2 £m	Level 3 £m	Total Fair Value £m
	Note				
<b>Financial assets at fair value through profit or loss</b>					
Loans and advances	13	-	5,027	-	5,027
<b>Financial assets at fair value through equity</b>					
Investments - Available for sale	14	853	1,403	6	2,262
<b>Hedging derivatives</b>					
Derivative financial assets	12	-	719	-	719
Other derivatives financial assets	12	-	297	-	297
Derivative financial assets - related entities	12	-	72	-	72
		-	1,088	-	1,088
		<u>853</u>	<u>7,518</u>	<u>6</u>	<u>8,377</u>
<b>Financial liabilities at fair value through profit or loss</b>					
Due to customers - term deposits	13	-	66	-	66
<b>Hedging derivatives</b>					
Derivative financial liabilities	12	-	117	-	117
Other derivative financial liabilities	12	-	58	-	58
Derivative financial liabilities - related entities	12	-	772	-	772
		-	947	-	947
		-	<u>1,013</u>	-	<u>1,013</u>
<b>Group and Bank 2009</b>					
	Note	Level 1 £m	Level 2 £m	Level 3 £m	Total Fair Value £m
<b>Financial assets at fair value through profit or loss</b>					
Loans and advances	13	-	5,327	-	5,327
Securities	13	202	-	-	202
		<u>202</u>	<u>5,327</u>	<u>-</u>	<u>5,529</u>
<b>Financial assets at fair value through equity</b>					
Investments - Available for sale	14	48	1,483	10	1,541
<b>Hedging derivatives</b>					
Derivative financial assets	12	-	942	-	942
Other derivatives financial assets	12	-	271	-	271
Derivative financial assets - related entities	12	-	183	-	183
		-	1,396	-	1,396
		<u>250</u>	<u>8,206</u>	<u>10</u>	<u>8,466</u>
<b>Financial liabilities at fair value through profit or loss</b>					
Due to customers - term deposits	13	-	61	-	61
<b>Hedging derivatives</b>					
Derivative financial liabilities	12	-	113	-	113
Other derivative financial liabilities	12	-	1	-	1
Derivative financial liabilities - related entities	12	-	535	-	535
		-	649	-	649
		-	<u>710</u>	-	<u>710</u>

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**41. Fair values of financial instruments (continued)**

**Movement in level 3 financial instruments measured at fair value**

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

Group and Bank	At 1 October 2008	Fair value gain/(loss) recorded in the income statement	Gains/ (losses) recorded in equity	Net purchases, sales and settlements	Reclassified to loans and receivables	Transfers from level 1 and level 2	At 30 September 2009
<i>Financial assets at fair value through profit and loss</i>							
Investments	<u>6</u>	<u>-</u>	<u>2</u>	<u>2</u>	<u>-</u>	<u>-</u>	<u>10</u>

**Transfers between level 1 and level 2**

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

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 42. Financial risk management

#### Strategy in using financial instruments

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

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

#### Fair value hedges

The Group hedges part of its existing interest rate and foreign currency risk resulting from any potential decrease in the fair value of fixed rate assets or increase in fair value of fixed rate liabilities attributable to both interest rate and foreign currency risk denominated both in local and foreign currencies using interest rate, cross currency interest rate and cross currency swaps. The net fair value of these swaps is disclosed in note 12.

#### 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 2010 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 12. The movement in fair value of derivatives deferred within the cash flow hedge reserve to hedge forecast future cash flows is disclosed in note 31.

#### 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 portion is personal lending where no such collateral can be obtained. The process for valuing collateral and other credit enhancements is described in note 15.

#### Derivatives

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

#### Credit-related commitments

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

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 42. Financial risk management (continued)

#### *Credit-related commitments (continued)*

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

#### Maximum exposure to credit risk

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

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

	Group		Bank	
	2010 £m	2009 £m	2010 £m	2009 £m
		As restated		As restated
Cash and balances with central banks	4,070	2,713	4,070	2,713
Loans and advances to other banks	11	340	10	339
Derivative financial assets	719	942	385	424
Other financial assets at fair value	5,396	5,983	5,396	5,983
Investments	2,262	2,180	2,262	2,486
Loans and advances to customers	26,981	27,147	22,176	22,393
Due from customers on acceptances	8	2	8	2
	<b>39,447</b>	<b>39,307</b>	<b>34,307</b>	<b>34,340</b>
Contingent liabilities (note 32)	258	273	258	273
Commitments (note 32)	11,600	10,237	10,788	9,487
<b>Total credit risk exposure</b>	<b>51,305</b>	<b>49,817</b>	<b>45,353</b>	<b>44,100</b>

The comparative contingent liability and commitment balances have been restated - see note 32.

The commitments balance includes sale and option to repurchase transactions and other commitments.

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 42. Financial risk management (continued)

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

	Due from other banks £m	Investments Available for sale £m	Held to maturity £m	Acceptances £m
<b>Group</b>				
<b>2010</b>				
Senior investment grade	10	2,256	-	-
Investment grade	1	6	-	8
Sub investment grade	-	-	-	-
	<b>11</b>	<b>2,262</b>	<b>-</b>	<b>8</b>
<b>Group</b>				
<b>2009</b>				
Senior investment grade	340	1,531	639	-
Investment grade	-	9	-	2
Sub investment grade	-	1	-	-
	<b>340</b>	<b>1,541</b>	<b>639</b>	<b>2</b>
<b>Bank</b>				
<b>2010</b>				
Senior investment grade	10	2,256	-	-
Investment grade	-	6	253	8
Sub investment grade	-	-	160	-
	<b>10</b>	<b>2,262</b>	<b>413</b>	<b>8</b>
<b>Bank</b>				
<b>2009</b>				
Senior investment grade	339	1,531	884	-
Investment grade	-	9	61	2
Sub investment grade	-	1	-	-
	<b>339</b>	<b>1,541</b>	<b>945</b>	<b>2</b>

See note 15 for information about the credit quality of loans and advances to customers that are neither past due nor impaired.

#### Market risk

The focus of the Bank's activity is to provide high quality banking services to its customers. This focus is relationship in nature. As a consequence, the Bank's participation in wholesale markets, along with its use of financial instruments, is to fund its banking activities and to manage the liquidity and interest rate risks arising from these activities. As a result of these activities the Group may be exposed to market risk. These risks are subsequently managed to a de minimus risk position in accordance with the Group's trading policy statement.

#### Prepayment Risk

Early repayment charges on fixed rate business loans are calculated on an economic cost basis, fully recompensing the Bank for any loss on the unwinding of the underlying hedge. Early repayment charges on fixed rate mortgages are calculated on a sliding scale basis, whereby an agreed percentage of the balance is charged dependant upon the residual time to maturity of the loan. Although interest rates have remained low during the year the level of prepayments has been lower than otherwise may have been expected due to reduced availability of credit across the market.

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 42. 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 key features of the internal interest rate risk management model:

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

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

	As at 30 September		Average value during reporting period	
	2010 £m	2009 £m	2010 £m	2009 £m
<b>Value at risk</b>				
Interest Rate Risk	<u>23</u>	<u>3</u>	<u>12</u>	<u>7</u>
<b>Earnings at risk</b>				
Interest Rate Risk	<u>7</u>	<u>13</u>	<u>6</u>	<u>7</u>
	Minimum value during reporting period		Maximum value during reporting period	
	2010 £m	2009 £m	2010 £m	2009 £m
<b>Value at risk</b>				
Interest Rate Risk	<u>2</u>	<u>2</u>	<u>25</u>	<u>13</u>
<b>Earnings at risk</b>				
Interest Rate Risk	<u>3</u>	<u>3</u>	<u>10</u>	<u>14</u>

##### Risk concentration

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

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 42. Financial risk management (continued)

#### Industry concentration of assets

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

Group 2010	Loans designated at fair value through profit or loss £m	Loans at amortised cost £m	Contingent liabilities and credit related commitments £m
Government and public authorities	13	24	1
Agriculture, forestry, fishing and mining	612	1,158	677
Financial, investment and insurance	73	202	1,245
Real estate - construction	81	630	415
Manufacturing	142	817	202
Instalment loans to individuals and other personal lending (including credit cards)	170	2,575	5,485
Real estate - mortgage	-	12,781	-
Asset and lease financing	-	1,001	-
Other commercial and industrial	3,936	8,455	3,833
	<b>5,027</b>	<b>27,643</b>	<b>11,858</b>

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

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 42. Financial risk management (continued)

#### Industry concentration of assets (continued)

Group 2009	Loans designated at fair value through profit or loss £m	Loans at amortised cost £m	Contingent liabilities and credit related commitments £m As restated
Government and public authorities	12	24	-
Agriculture, forestry, fishing and mining	527	1,065	395
Financial, investment and insurance	73	276	1,089
Real estate - construction	97	742	314
Manufacturing	140	703	109
Instalment loans to individuals and other personal lending (including credit cards)	120	2,847	5,066
Real estate - mortgage	-	12,327	-
Asset and lease financing	-	1,248	-
Other commercial and industrial	4,358	8,584	3,537
	<u>5,327</u>	<u>27,816</u>	<u>10,510</u>

	Investments			Acceptances
	Due from other banks £m	Available for sale £m	Held to maturity £m	£m
Government and public authorities	-	-	-	-
Agriculture, forestry, fishing and mining	-	-	-	-
Financial, investment and insurance	340	1,541	639	-
Real estate - construction	-	-	-	-
Manufacturing	-	-	-	2
Instalment loans to individuals and other personal lending (including credit cards)	-	-	-	-
Real estate - mortgage	-	-	-	-
Asset and lease financing	-	-	-	-
Other commercial and industrial	-	-	-	-
	<u>340</u>	<u>1,541</u>	<u>639</u>	<u>2</u>



# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 42. Financial risk management (continued)

#### Industry concentration of assets (continued)

Bank 2010	Loans designated at fair value through profit or loss £m	Loans at amortised cost £m	Contingent liabilities and credit related commitments £m
Government and public authorities	13	24	1
Agriculture, forestry, fishing and mining	612	1,158	677
Financial, investment and insurance	73	202	433
Real estate - construction	81	630	415
Manufacturing	142	817	202
Instalment loans to individuals and other personal lending (including credit cards)	170	2,575	5,485
Real estate - mortgage	-	8,416	-
Asset and lease financing	-	534	-
Other commercial and industrial	3,936	8,456	3,833
	<b>5,027</b>	<b>22,812</b>	<b>11,046</b>

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

# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 42. Financial risk management (continued)

#### Industry concentration of assets (continued)

Bank 2009	Loans designated at fair value through profit or loss £m	Loans at amortised cost £m	Contingent liabilities and credit related commitments £m As restated
Government and public authorities	12	24	-
Agriculture, forestry, fishing and mining	527	1,065	395
Financial, investment and insurance	73	276	339
Real estate - construction	97	742	314
Manufacturing	140	703	109
Instalment loans to individuals and other personal lending (including credit cards)	120	2,847	5,066
Real estate - mortgage	-	8,208	-
Asset and lease financing	-	591	-
Other commercial and industrial	4,358	8,584	3,537
	<u>5,327</u>	<u>23,040</u>	<u>9,760</u>

	Due from other banks £m	Investments Available for sale £m	Held to maturity £m	Acceptances £m
Government and public authorities	-	-	-	-
Agriculture, forestry, fishing and mining	-	-	-	-
Financial, investment and insurance	339	1,541	945	-
Real estate - construction	-	-	-	-
Manufacturing	-	-	-	2
Instalment loans to individuals and other personal lending (including credit cards)	-	-	-	-
Real estate - mortgage	-	-	-	-
Asset and lease financing	-	-	-	-
Other commercial and industrial	-	-	-	-
	<u>339</u>	<u>1,541</u>	<u>945</u>	<u>2</u>

The comparative contingent liability and commitment balances have been restated - see note 32.

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 42. Financial risk management (continued)

##### Maturity analysis of assets and liabilities

The following tables represent a breakdown of the Group's balance sheet for the last two years as at 30 September according to when the assets and liabilities are expected to be recovered or settled. Many of the longer-term monetary assets are variable rate products, with actual maturities shorter than the contractual terms. Accordingly, this information is not relied upon by the Group in its management of interest rate risk (refer to note 44 for information on interest rate sensitivity). See "Cash flows payable under financial liabilities by contractual maturities" for the Group's contractual undiscounted repayment obligations.

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

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**42. Financial risk management (continued)**

**Maturity analysis of assets and liabilities (continued)**

Group	Call	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	No specified maturity	Total
2009	£m	£m	£m	£m	£m	£m	£m
<b>As restated</b>							
<b>Assets</b>							
Cash and balances with central banks	2,713	-	-	-	-	-	2,713
Due from other banks	15	325	-	-	-	-	340
Derivative financial assets	-	10	178	727	27	-	942
Other financial assets at fair value	698	374	421	2,208	2,282	-	5,983
Investments	-	639	-	1,541	-	-	2,180
Loans and advances to customers	4,960	1,487	1,338	4,905	13,936	521	27,147
Due from customers on acceptances	-	2	-	-	-	-	2
Due from related entities	433	1	1,506	6	25	-	1,971
All other assets	131	-	-	-	-	961	1,092
<b>Total assets</b>	<b>8,950</b>	<b>2,838</b>	<b>3,443</b>	<b>9,387</b>	<b>16,270</b>	<b>1,482</b>	<b>42,370</b>
<b>Liabilities</b>							
Due to other banks	165	580	623	552	-	-	1,920
Derivative financial liabilities	-	2	13	98	-	-	113
Other financial liabilities at fair value	61	19	36	221	260	-	597
Due to customers	16,223	5,402	3,612	1,419	-	-	26,656
Liabilities on acceptances	-	2	-	-	-	-	2
Due to related entities	228	348	1,256	634	855	-	3,321
Bonds and notes	-	179	222	4,436	450	-	5,287
All other liabilities	76	-	-	-	-	2,148	2,224
<b>Total liabilities</b>	<b>16,753</b>	<b>6,532</b>	<b>5,762</b>	<b>7,360</b>	<b>1,565</b>	<b>2,148</b>	<b>40,120</b>

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**42. Financial risk management (continued)**

**Maturity analysis of assets and liabilities (continued)**

<b>Bank</b>	<b>Call</b>	<b>3 months</b>	<b>3 to 12</b>	<b>1 to 5</b>	<b>Over 5</b>	<b>No specified</b>	<b>Total</b>
<b>2010</b>	<b>£m</b>	<b>or less</b>	<b>months</b>	<b>years</b>	<b>years</b>	<b>maturity</b>	<b>£m</b>
		<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	
<b>Assets</b>							
Cash and balances with							
central banks	3,224	-	-	-	-	846	<b>4,070</b>
Due from other banks	-	10	-	-	-	-	<b>10</b>
Derivative financial assets	-	5	50	313	17	-	<b>385</b>
Other financial assets at fair value	54	204	429	2,233	2,476	-	<b>5,396</b>
Investments	-	-	-	2,669	6	-	<b>2,675</b>
Loans and advances to customers	5,202	2,142	970	3,658	9,678	526	<b>22,176</b>
Due from customers on acceptances	-	8	-	-	-	-	<b>8</b>
Due from related entities	5,522	530	1,725	-	-	-	<b>7,777</b>
All other assets	117	-	-	-	-	1,560	<b>1,677</b>
<b>Total assets</b>	<b>14,119</b>	<b>2,899</b>	<b>3,174</b>	<b>8,873</b>	<b>12,177</b>	<b>2,932</b>	<b>44,174</b>
<b>Liabilities</b>							
Due to other banks	43	617	202	511	-	-	<b>1,373</b>
Derivative financial liabilities	-	1	25	54	37	-	<b>117</b>
Other financial liabilities at fair value	2	57	62	281	494	-	<b>896</b>
Due to customers	18,132	4,995	3,614	1,693	-	-	<b>28,434</b>
Liabilities on acceptances	-	8	-	-	-	-	<b>8</b>
Due to related entities	137	1,493	800	2,426	1,155	-	<b>6,011</b>
Bonds and notes	-	-	350	1,927	450	-	<b>2,727</b>
All other liabilities	77	-	-	-	-	2,207	<b>2,284</b>
<b>Total liabilities</b>	<b>18,391</b>	<b>7,171</b>	<b>5,053</b>	<b>6,892</b>	<b>2,136</b>	<b>2,207</b>	<b>41,850</b>

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**42. Financial risk management (continued)**

**Maturity analysis of assets and liabilities (continued)**

<b>Bank 2009</b>	<b>Call £m</b>	<b>3 months or less £m</b>	<b>3 to 12 months £m</b>	<b>1 to 5 years £m</b>	<b>Over 5 years £m</b>	<b>No specified maturity £m</b>	<b>Total £m As restated</b>
<b>Assets</b>							
Cash and balances with central banks	2,713	-	-	-	-	-	2,713
Due from other banks	14	325	-	-	-	-	339
Derivative financial assets	-	10	43	344	27	-	424
Other financial assets at fair value	698	374	421	2,208	2,282	-	5,983
Investments	-	639	-	1,847	-	-	2,486
Loans and advances to customers	4,977	1,487	1,079	4,393	9,936	521	22,393
Due from customers on acceptances	-	2	-	-	-	-	2
Due from related entities	5,187	198	1,506	6	25	-	6,922
All other assets	125	-	-	-	-	1,262	1,387
<b>Total assets</b>	<b>13,714</b>	<b>3,035</b>	<b>3,049</b>	<b>8,798</b>	<b>12,270</b>	<b>1,783</b>	<b>42,649</b>
<b>Liabilities</b>							
Due to other banks	165	580	623	552	-	-	1,920
Derivative financial liabilities	-	2	13	98	-	-	113
Other financial liabilities at fair value	61	19	36	221	260	-	597
Due to customers	16,223	5,402	3,612	1,419	-	-	26,656
Liabilities on acceptances	-	2	-	-	-	-	2
Due to related entities	229	874	1,404	2,964	855	-	6,326
Bonds and notes	-	179	-	2,324	450	-	2,953
All other liabilities	76	-	-	-	-	1,957	2,033
<b>Total liabilities</b>	<b>16,754</b>	<b>7,058</b>	<b>5,688</b>	<b>7,578</b>	<b>1,565</b>	<b>1,957</b>	<b>40,600</b>

Certain prior year balances within loans and advances to customers have been reallocated to better reflect the contractual nature of the loans.

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

#### 42. Financial risk management (continued)

##### Liquidity risk

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

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

##### Cash flows payable under financial liabilities by contractual maturities

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

Group	Call	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	No specified maturity	Total
2009	£m	£m	£m	£m	£m	£m	£m
							As restated
Due to other banks	-	711	680	595	-	-	1,986
Derivative financial liabilities	-	-	-	-	-	2	2
Other financial liabilities at fair value	-	1	2	24	52	-	79
Deposits and other borrowings	15,022	6,007	3,512	1,227	-	1,016	26,784
Liability on acceptances	-	2	-	-	-	-	2
Bonds and notes	-	225	283	4,590	495	-	5,593
All other liabilities	-	-	-	-	-	1,163	1,163
Hedging derivatives	-	-	-	-	-	-	-
- contractual amounts payable	-	30	63	122	-	-	215
- contractual amounts receivable	-	(4)	(16)	(73)	-	-	(93)
	15,022	6,972	4,524	6,485	547	2,181	35,731

Refer to note 32 for off-balance sheet items disclosed by cashflow maturity.

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**42. Financial risk management (continued)**

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

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

<b>Bank</b>	<b>Call</b>	<b>3 months</b>	<b>3 to 12</b>	<b>1 to 5</b>	<b>Over 5</b>	<b>No specified</b>	<b>Total</b>
<b>2009</b>	<b>£m</b>	<b>or less</b>	<b>months</b>	<b>years</b>	<b>years</b>	<b>maturity</b>	<b>£m</b>
		<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	
							<b>As restated</b>
Due to other banks	-	711	680	595	-	-	1,986
Derivative financial liabilities	2	-	-	-	-	-	2
Other financial liabilities at fair value	-	1	2	24	52	-	79
Deposits and other borrowings	16,038	6,007	3,512	1,227	-	-	26,784
Liability on acceptances	-	2	-	-	-	-	2
Bonds and notes	-	196	49	2,431	495	-	3,171
All other liabilities	-	-	-	-	-	1,163	1,163
Hedging derivatives	-	-	-	-	-	-	-
- contractual amounts payable	-	30	63	122	-	-	215
- contractual amounts receivable	-	(4)	(16)	(73)	-	-	(93)
	<b>16,040</b>	<b>6,943</b>	<b>4,290</b>	<b>4,326</b>	<b>547</b>	<b>1,163</b>	<b>33,309</b>

The balances in the cashflow tables above will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments.

The derivative financial liabilities and deposits and other borrowings comparative balances have been restated to reallocate non-interest bearing balances from call to no specified maturity.



# CLYDESDALE BANK PLC

## Notes to the Consolidated Financial Statements

### 43. Interest rate sensitivity gap analysis

Part of the Group's return on financial instruments is obtained from controlled mis-matching 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 mis-matches on the Group's book as at 30 September 2010 and 30 September 2009. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date or the maturity date.

Group 2010	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
<b>Assets</b>										
Cash assets	0.51	3,194	-	-	-	-	-	-	846	4,040
Balances with supervisory central banks		-	-	-	-	-	-	-	30	30
Due from other banks	0.51	11	-	-	-	-	-	-	-	11
Derivative financial assets		-	-	-	-	-	-	-	719	719
Other financial assets at fair value	2.14	737	389	557	629	477	298	1,940	369	5,396
Investments										
-Available for sale	1.39	1,071	125	266	-	50	-	750	-	2,262
-Held to maturity	0.70	-	-	-	-	-	-	-	-	-
Loans and advances to customers	4.70	23,275	1,244	1,321	709	307	97	28	-	26,981
Due from customers on acceptances		8	-	-	-	-	-	-	-	8
Due from related entities		1,119	1,720	-	-	-	-	-	-	2,839
All other assets		-	-	-	-	-	-	-	1,374	1,374
<b>Total assets</b>		<b>29,415</b>	<b>3,478</b>	<b>2,144</b>	<b>1,338</b>	<b>834</b>	<b>395</b>	<b>2,718</b>	<b>3,338</b>	<b>43,660</b>
<b>Liabilities</b>										
Due to other banks	0.86	671	202	500	-	-	-	-	-	1,373
Derivative financial liabilities		-	-	-	-	-	-	-	117	117
Other financial liabilities at fair value	1.50	9	7	7	11	16	8	8	830	896
Due to customers	0.50	22,208	3,139	880	346	91	565	-	1,205	28,434
Liabilities on acceptances		8	-	-	-	-	-	-	-	8
Due to related entities		2,738	448	200	-	-	-	-	-	3,386
Bonds and notes	1.36	3,209	250	950	-	-	-	-	-	4,409
All other liabilities		-	-	-	-	-	-	-	2,490	2,490
Shareholders' equity		-	-	-	-	-	-	-	2,547	2,547
<b>Total liabilities and shareholders' equity</b>		<b>28,843</b>	<b>4,046</b>	<b>2,537</b>	<b>357</b>	<b>107</b>	<b>573</b>	<b>8</b>	<b>7,189</b>	<b>43,660</b>
Off balance sheet items		(3,296)	1,883	3,064	(188)	50	948	(2,461)	-	-
Interest rate sensitivity gap		(2,724)	1,315	2,671	793	777	770	249	(3,851)	-
<b>Cumulative gap</b>		<b>(2,724)</b>	<b>(1,409)</b>	<b>1,262</b>	<b>2,055</b>	<b>2,832</b>	<b>3,602</b>	<b>3,851</b>	<b>-</b>	<b>-</b>

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**43. Interest rate sensitivity gap analysis (continued)**

Group 2009	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
<b>Assets</b>										
Cash assets	2.56	2,631	-	-	-	-	-	-	82	2,713
Balances with supervisory central banks		-	-	-	-	-	-	-	27	27
Due from other banks	6.36	307	6	-	-	-	-	-	-	313
Derivative financial assets		-	-	-	-	-	-	-	942	942
Other financial assets at fair value	3.35	374	412	642	591	602	471	2,001	890	5,983
Investments										
-Available for sale	2.11	1,100	-	125	268	-	48	-	-	1,541
-Held to maturity	2.14	639	-	-	-	-	-	-	-	639
Loans and advances to customers	5.19	22,753	1,176	1,534	1,016	328	251	89	-	27,147
Due from customers on acceptances		-	-	-	-	-	-	-	2	2
Due from related entities		1,947	-	-	-	-	-	-	24	1,971
All other assets		-	-	-	-	-	-	-	1,092	1,092
<b>Total assets</b>		<b>29,751</b>	<b>1,594</b>	<b>2,301</b>	<b>1,875</b>	<b>930</b>	<b>770</b>	<b>2,090</b>	<b>3,059</b>	<b>42,370</b>
<b>Liabilities</b>										
Due to other banks	2.78	761	659	-	500	-	-	-	-	1,920
Derivative financial liabilities		-	-	-	-	-	-	-	113	113
Other financial liabilities at fair value	4.16	-	5	6	6	10	15	18	537	597
Due to customers	2.06	21,027	3,461	545	540	7	91	-	985	26,656
Liabilities on acceptances		-	-	-	-	-	-	-	2	2
Due to related entities		2,643	450	-	200	-	-	-	28	3,321
Bonds and notes	3.16	4,087	-	250	950	-	-	-	-	5,287
All other liabilities		-	-	-	-	-	-	-	2,224	2,224
Shareholders' equity		-	-	-	-	-	-	-	2,250	2,250
<b>Total liabilities and shareholders' equity</b>		<b>28,518</b>	<b>4,575</b>	<b>801</b>	<b>2,196</b>	<b>17</b>	<b>106</b>	<b>18</b>	<b>6,139</b>	<b>42,370</b>
Off balance sheet items		(2,878)	2,334	979	1,517	(252)	36	(1,736)	-	-
Interest rate sensitivity gap		(1,645)	(647)	2,479	1,196	661	700	336	(3,080)	-
<b>Cumulative gap</b>		<b>(1,645)</b>	<b>(2,292)</b>	<b>187</b>	<b>1,383</b>	<b>2,044</b>	<b>2,744</b>	<b>3,080</b>	<b>-</b>	<b>-</b>

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.

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**43. Interest rate risk (continued)**

**Interest rate sensitivity gap analysis (continued)**

<b>Bank 2010</b>	<b>Weighted average effective interest rate %</b>	<b>0 to 3 months £m</b>	<b>3 to 12 months £m</b>	<b>1 to 2 years £m</b>	<b>2 to 3 years £m</b>	<b>3 to 4 years £m</b>	<b>4 to 5 years £m</b>	<b>Over 5 years £m</b>	<b>Non interest bearing £m</b>	<b>Total £m</b>
<b>Assets</b>										
Cash assets	0.51	3,194	-	-	-	-	-	-	846	<b>4,040</b>
Balances with supervisory central banks		-	-	-	-	-	-	-	30	<b>30</b>
Due from other banks	0.51	10	-	-	-	-	-	-	-	<b>10</b>
Derivative financial assets		-	-	-	-	-	-	-	385	<b>385</b>
Other financial assets at fair value	2.14	737	389	557	629	477	298	1,940	369	<b>5,396</b>
Investments										
-Available for sale	1.39	1,071	125	266	-	50	-	750	-	<b>2,262</b>
-Held to maturity	0.70	413	-	-	-	-	-	-	-	<b>413</b>
Loans and advances to customers	4.70	19,999	848	793	343	148	35	10	-	<b>22,176</b>
Due from customers on acceptances		8	-	-	-	-	-	-	-	<b>8</b>
Due from related entities		6,057	1,720	-	-	-	-	-	-	<b>7,777</b>
All other assets		-	-	-	-	-	-	-	1,677	<b>1,677</b>
<b>Total assets</b>		<b>31,489</b>	<b>3,082</b>	<b>1,616</b>	<b>972</b>	<b>675</b>	<b>333</b>	<b>2,700</b>	<b>3,307</b>	<b>44,174</b>
<b>Liabilities</b>										
Due to other banks	0.86	671	202	500	-	-	-	-	-	<b>1,373</b>
Derivative financial liabilities		-	-	-	-	-	-	-	117	<b>117</b>
Other financial liabilities at fair value	1.50	9	7	7	11	16	8	8	830	<b>896</b>
Due to customers	0.50	22,208	3,139	880	346	91	565	-	1,205	<b>28,434</b>
Liabilities on acceptances		8	-	-	-	-	-	-	-	<b>8</b>
Due to related entities		5,363	448	200	-	-	-	-	-	<b>6,011</b>
Bonds and notes	1.36	1,527	250	950	-	-	-	-	-	<b>2,727</b>
All other liabilities		-	-	-	-	-	-	-	2,284	<b>2,284</b>
Shareholders' equity		-	-	-	-	-	-	-	2,324	<b>2,324</b>
<b>Total liabilities and shareholders' equity</b>		<b>29,786</b>	<b>4,046</b>	<b>2,537</b>	<b>357</b>	<b>107</b>	<b>573</b>	<b>8</b>	<b>6,760</b>	<b>44,174</b>
Off balance sheet items		<b>(3,296)</b>	<b>1,883</b>	<b>3,064</b>	<b>(188)</b>	<b>50</b>	<b>948</b>	<b>(2,461)</b>	<b>-</b>	<b>-</b>
Interest rate sensitivity gap		<b>(1,593)</b>	<b>919</b>	<b>2,143</b>	<b>427</b>	<b>618</b>	<b>708</b>	<b>231</b>	<b>(3,453)</b>	<b>-</b>
<b>Cumulative gap</b>		<b>(1,593)</b>	<b>(674)</b>	<b>1,469</b>	<b>1,896</b>	<b>2,514</b>	<b>3,222</b>	<b>3,453</b>	<b>-</b>	<b>-</b>

**CLYDESDALE BANK PLC**  
**Notes to the Consolidated Financial Statements**

**43. Interest rate risk (continued)**

**Interest rate sensitivity gap analysis (continued)**

<b>Bank 2009</b>	<b>Weighted average effective interest rate %</b>	<b>0 to 3 months £m</b>	<b>3 to 12 months £m</b>	<b>1 to 2 years £m</b>	<b>2 to 3 years £m</b>	<b>3 to 4 years £m</b>	<b>4 to 5 years £m</b>	<b>Over 5 years £m</b>	<b>Non interest bearing £m</b>	<b>Total £m</b>
<b>Assets</b>										
Cash assets	2.56	2,631	-	-	-	-	-	-	82	2,713
Balances with supervisory central banks		-	-	-	-	-	-	-	26	26
Due from other banks	6.36	307	6	-	-	-	-	-	-	313
Derivative financial assets		-	-	-	-	-	-	-	424	424
Other financial assets at fair value	3.35	374	412	642	591	602	471	2,001	890	5,983
Investments										
-Available for sale	2.11	1,100	-	125	268	-	48	-	-	1,541
-Held to maturity	2.14	945	-	-	-	-	-	-	-	945
Loans and advances to customers	5.19	19,650	754	1,030	651	133	113	62	-	22,393
Due from customers on acceptances		-	-	-	-	-	-	-	2	2
Due from related entities		6,898	-	-	-	-	-	-	24	6,922
All other assets		-	-	-	-	-	-	-	1,387	1,387
<b>Total assets</b>		<b>31,905</b>	<b>1,172</b>	<b>1,797</b>	<b>1,510</b>	<b>735</b>	<b>632</b>	<b>2,063</b>	<b>2,835</b>	<b>42,649</b>
<b>Liabilities</b>										
Due to other banks	2.78	761	659	-	500	-	-	-	-	1,920
Derivative financial liabilities		-	-	-	-	-	-	-	113	113
Other financial liabilities at fair value	4.16	-	5	6	6	10	15	18	537	597
Due to customers	2.06	21,027	3,461	545	540	7	91	-	985	26,656
Liabilities on acceptances		-	-	-	-	-	-	-	2	2
Due to related entities		5,648	450	-	200	-	-	-	28	6,326
Bonds and notes	3.16	1,753	-	250	950	-	-	-	-	2,953
All other liabilities		-	-	-	-	-	-	-	2,033	2,033
Shareholders' equity		-	-	-	-	-	-	-	2,049	2,049
<b>Total liabilities and shareholders' equity</b>		<b>29,189</b>	<b>4,575</b>	<b>801</b>	<b>2,196</b>	<b>17</b>	<b>106</b>	<b>18</b>	<b>5,747</b>	<b>42,649</b>
Off balance sheet items		(2,878)	2,334	979	1,517	(252)	36	(1,736)	-	-
Interest rate sensitivity gap		(162)	(1,069)	1,975	831	466	562	309	(2,912)	-
<b>Cumulative gap</b>		<b>(162)</b>	<b>(1,231)</b>	<b>744</b>	<b>1,575</b>	<b>2,041</b>	<b>2,603</b>	<b>2,912</b>	<b>-</b>	<b>-</b>

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements

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

Within the UK there is a 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 European Boards' Risk Committee provides review and oversight of the risk profile and risk appetite of the UK.

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

#### **Operational risk**

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

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements (continued)

#### 44. Management of risk (continued)

##### *Operational risk (continued)*

Various reports are produced at management, Board sub-committee and Board level to assist with their oversight and monitoring obligations. This incorporates regional reporting of risk profiles, key operational risk 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 Framework ("ORF") is based on a set of core principles and defines the NAB Group's standards for operational risk management and compliance. Its design recognises the importance of embedding operational risk into "business-as-usual" activities. It has particular focus on defining and implementing the right behaviour and incorporating risk considerations into the NAB Group's systems and processes.

The ORF is an essential element of the business strategy, which underpins all operational risk management activities. It includes:

- an established governance structure that is used to ensure consistent application, 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.

##### *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 CB Group. Portfolio monitoring techniques cover such areas as industry or geographic concentrations and delinquency trends. Roles and responsibilities between Group Chief Credit Officer (and associated teams) and the Regional Risk Management teams are clearly defined.

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

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

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

Single large exposure policies are in place within the CB Group. Overall composition and quality of credit portfolio exposures are monitored and periodically reported to the 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.

## CLYDESDALE BANK PLC

### Notes to the Consolidated Financial Statements (continued)

#### 44. Management of risk (continued)

##### *Non-traded market risk (continued)*

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

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

##### *Liquidity and funding risk*

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

Liquidity within the 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 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, including under a series of assumptions to simulate stressed market conditions, the maintenance of portfolios of high quality liquid assets, and diversification of the funding base. NAB Group Policy uses liquidity scenarios to monitor both 'going concern' and 'name crisis' events. Cash flow mismatch limits have been established to limit the CB Group's liquidity exposure. In addition, the Bank is required to hold liquid asset portfolios to meet unexpected cash flow requirements.

A three-level contingency plan has also been established for management of an escalated liquidity requirement where the 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. All products are used within approved mandates, with strategies subject to monthly reporting to UK ALCO and Group ALCO.

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

**44. Management of risk (continued)**

*Structural interest rate risk (continued)*

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

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

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

*Foreign exchange risk*

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

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



## **CLYDESDALE BANK PLC**

### **Notes to the Consolidated Financial Statements**

#### **45. Capital Management Overview**

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

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

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

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

#### **46. Basel II Capital Requirements Directive Pillar 3 Disclosure**

The Financial Services Authority ("FSA") has granted the Bank a waiver direction under BIPRU 11.2.6: (Waiver: Comparable disclosures provided on a consolidated basis by a parent undertaking established in a third country).

The waiver direction can be found on the FSA website. [http://www.fsa.gov.uk/pubs/waivers/bipru\\_waivers.pdf](http://www.fsa.gov.uk/pubs/waivers/bipru_waivers.pdf)

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

National Australia Bank Limited 2010 Full Year Risk and Capital Report: <http://www.nabgroup.com/0,,96819,00.html>

National Australia Bank Limited 2010 Full Year Financial Results, Note 1, Section 6 (Supplementary Information): <http://www.nabgroup.com/0,,102108,00.html>

National Australia Bank Limited 2010 Annual Financial Report: <http://www.nabgroup.com/0,,32863,00.html>

With specific reference to securitisation policy, disclosure is made on pages 64 and 161 - 168 of the National Australia Bank Limited 2010 Annual Financial Report.

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

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

## **CLYDESDALE BANK PLC**

### **Notes to the Consolidated Financial Statements**

#### **47. Events after the balance sheet date**

On 19 October 2010 National Europe Holdings Limited, the immediate holding company of Clydesdale Bank PLC, incorporated and registered in England and Wales was liquidated. National Australia Group Europe Limited which is also incorporated and registered in England and Wales became from this date the immediate holding company of the Bank. The liquidation was made as part of an initiative to promote good corporate governance and provide administrative savings.

In June 2010 the Government introduced a bank levy applicable to UK banking operations. Draft legislation published on 21 October 2010 states that banks with relevant aggregate liabilities greater than £20 billion will be liable to the levy. As such it is expected that Clydesdale Bank PLC will be subject to the charge. The bank levy applies with effect from 1 January 2011, with final legislation being published in December 2010.

## For more information

Website	<a href="http://cbonline.co.uk">cbonline.co.uk</a>
Media	General media queryline 0845 60 35 447 <a href="mailto:press.office@nab.co.uk">press.office@nab.co.uk</a>
Investor Relations	Ragnall Craighead Head of Investor Relations 0207 560 7341
National Australia Bank	NAB Group results are available on <a href="http://www.nabgroup.com.au">www.nabgroup.com.au</a>

## Disclaimer

This document contains certain forward looking statements. The words "anticipate", "believe", "expect", "project", "forecast", "estimate", "outlook", "likely", "intend", "should", "could", "may", "target", "plan" and other similar expressions are intended to identify forward looking statements. Indications of, and guidance on, future earnings and financial position and performance are also forward looking statements. Such forward looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors, many of which are beyond the control of the Group, which may cause actual results to differ materially from those expressed or implied in such statements. There can be no assurance that actual outcomes will not differ materially from these statements. Further information on important factors that could cause actual results to differ materially from those projected in such statements are contained in the Group's Annual Report & Consolidated Financial Statements.