
Sainsbury's Bank plc

**Annual Report and Financial Statements
for the year ended 29 February 2016**

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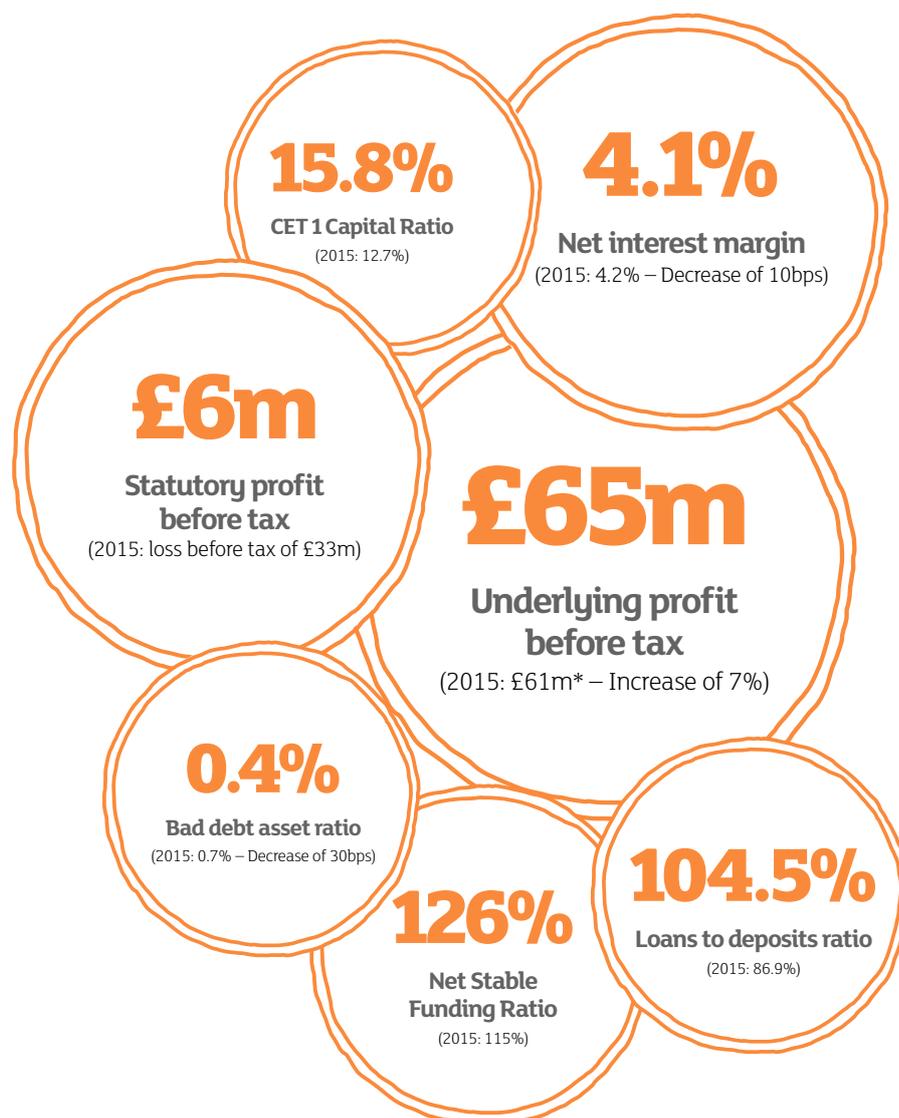
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Financial highlights



* To enable comparison of underlying performance, the prior period underlying profit for the 14 months ended 28 February 2015 has been adjusted to 12/14ths.

Strategic report

The Directors present their strategic report of Sainsbury's Bank plc ('the Bank') for the year ended 29 February 2016.

The Bank is a company limited by shares, registered in England and domiciled in the United Kingdom. Its registered office is 33 Holborn, London, EC1N 2HT.

The Bank changed its accounting reference date in the prior period from 31 December to 28 February in line with the J Sainsbury plc group of companies. Consequently the comparative figures presented within these financial statements cover the 14 month period from 1 January 2014 to 28 February 2015. These comparative figures have been converted to an annualised basis (pro rata 12/14ths) within the strategic report, where appropriate, to enable year-on-year comparison of the Bank's financial performance.

Business model

The Bank provides a range of retail banking services and related financial services wholly within the UK.

As an entity authorised by the Prudential Regulation Authority (PRA), the Bank is required to raise and hold specified minimum levels of its funding in the form of capital (see note 31), and hold specified levels of liquid assets in order to meet its financial commitments as they are expected to fall due (see note 30).

The Bank's underlying profitability reflects the difference between the income generated from its products compared to costs arising from marketing and operating its products, supplier and head office related costs, charges arising from impairment of customer balances and other realised gains and losses.

J Sainsbury plc acquired 100% of the Bank's share capital on 31 January 2014. Prior to the acquisition the Bank was a joint venture between J Sainsbury plc and Lloyds Banking Group. Whilst the Bank's board (see directors report on page 13) has always been responsible for its strategy and decision making, support operations have historically been outsourced to Lloyds Banking Group (LBG) including provision and support of IT platforms and the provision of call centre staff and operations to support the Bank's products. The Bank is currently undertaking a programme, known as the New Bank Programme (NBP), to build its own infrastructure for Banking products and to build a new bank by managing the exit from existing LBG services and transitioning to a new platform and operating model, whilst minimising any impact on customers.

The programme represents a significant investment in the future potential of the Bank which will see increased costs in the short term as the new platforms are built and operations transitioned to the new operating model. The investment is being supported by additional equity share capital invested by J Sainsbury plc (see note 25).

Sainsbury's Bank

	Banking Products	Insurance	Travel Money
Product Offering	<ul style="list-style-type: none"> Loans Credit Cards Residential Mortgages* Savings ATMs 	<ul style="list-style-type: none"> Car Home Pet Travel Life 	<ul style="list-style-type: none"> Foreign Exchange Prepaid Cards Money Transfer
Nature of Income	<ul style="list-style-type: none"> Funds raised through savings deposits and wholesale sources Funds lent to customers or held as liquid assets Resultant margin is income to the Bank 	<ul style="list-style-type: none"> Products offered via introducer contracts with third party insurance partners Income received through commission and profit share arrangements 	<ul style="list-style-type: none"> Foreign currency acquired wholesale Sold to customers at retail rate with a resulting margin Fees earned on prepaid cards and money transfer services
Distribution Channels	<ul style="list-style-type: none"> Telephone Online ATMs in Sainsbury's stores 	<ul style="list-style-type: none"> Telephone Online 	<ul style="list-style-type: none"> Bureaux in Sainsbury's Stores Telephone Online

*No new mortgages have been originated since 2004.

Market Context

Economy

Overall the UK economy continued to grow in 2015/16 as evidenced by growth in gross domestic product (GDP). Demand for credit was resilient throughout, and in turn these improvements in the UK economy resulted in greater liquidity entering the market.

Future growth rates will depend on a number of factors; these include commodity and energy prices and the economic growth rates of the UK's trading partners, especially those in the Eurozone, the US and China. In particular, continued weakness in oil prices is keeping downward pressure on inflation experienced by businesses and households, which in turn should continue to provide a net stimulus to the UK economy. There was a pickup in financial market volatility at the beginning of 2016 due to global growth concerns and the upcoming EU referendum.

The UK is experiencing a period of stable low interest rates with the Bank of England (BoE) holding rates at 50bps throughout the year. Despite the decision by the US Federal Reserve to raise interest rates in December 2015, financial markets don't expect the BoE to follow until the middle of 2017.

Long term wholesale funding spreads increased towards the end of 2015. However, due to the nature of the Bank's book this has not had a material impact on our cost of funding as a majority of our wholesale funding is fixed until 2017, or later.

The Bank continues to monitor any potential economic uncertainties that may arise as a result of the forthcoming EU referendum.

Banking

The markets for unsecured personal lending in which the Bank operates remained highly competitive throughout the period.

The personal loans market saw a continuation of numerous competitors at the top of the best buy tables. This has been coupled with strong growth demand as consumer confidence improves.

For loans between £7,500 and £15,000 the scale of interest rate drops has slowed from previous years but there are now more providers within 0.2% of the lowest rate. Loans of less than £7,500 and greater than £15,000 have seen larger rate drops and again strong competition. The Bank has also extended its larger loans offering increasing from £25,000 to £35,000 during the year.

The UK credit cards market saw slower growth than previous years in terms of balances and new business sales. Changes to the interchange regulation and customer changing attitudes to debt have resulted in higher payment rates across the industry and a number of issuers have chosen to change or exit their reward propositions both at acquisition and on their existing customer book. Sainsbury's Bank remains committed to delivering strong reward to our shoppers and has retained or in some cases extended existing Nectar propositions.

Market rates for savings accounts remained low and continued to fall during the period, indicating that consumer demand remains very strong and is under-served by the current environment. The introduction of the Personal Savings Allowance, flexible ISA and innovative finance ISA may act as a stimulus going forward, however the extent of their impact remains to be seen. The outlook for the savings market is linked to uncertainty over the timing of any potential changes to the BoE base rate.

Insurance and Travel Money

The insurance market continues to exhibit a propensity for customers to frequently switch providers based on price, and this is most pronounced in the car and home insurance markets. Loyalty schemes and brand appear to have only limited impact on loyalty, with price being the over-riding factor for consumers. The market remains competitive with a number of participants competing for business on price.

The travel money market was mixed during the year. Whilst there was an overall increase in the number of overseas holidays related to consumer confidence, fewer customers are taking cash and instead are opting to spend on debit or credit cards, as well as prepaid cards. The market also saw new entrants and an increase in the number of sales being run by competitors.

Strategy

Following the acquisition by J Sainsbury plc in 2014, the Bank is developing a strategy which is aligned to the Sainsbury's group strategy to provide great products and services at fair prices. As well as being the grocer of choice, Sainsbury's also aim to be the financial services brand of choice for their customers and to expand their offer in this area. To complement this vision, the Bank is working towards four strategic outcomes:



- **Our customers** will trust us, supporting them as their needs change over time
- **Our shareholders** see that we drive value to the Group
- **Our colleagues** know that Sainsbury's Bank is a great place to work where they are rewarded fairly and get great development
- **Our regulators** know that we challenge the market through healthy innovation, fair outcomes for customers and strong prudential regulation

Business Review

Total accounts held by customers now stand at nearly 1.7 million, a steady increase of 2% year-on-year.

The Bank performed strongly in the competitive personal loans market, with 15% year-on-year growth in the number of advances to new customers. In contrast, sales of new credit cards declined by 44% driven by competition in the balance transfer market. However, overall balances increased and, against a backdrop of other credit card providers reducing or removing rewards from their products, Sainsbury's Bank has maintained its Nectar loyalty reward, as well as increasing points offers (for a limited period) to new Card customers.

The Bank's portfolio of Insurance products continued to perform well resulting in new business growth of over 10% year-on-year. This year we saw a particularly strong performance in Home Insurance where sales of new policies increased by more than 25% year-on-year. The Bank also introduced a double Nectar points offer to new Travel Insurance customers taking out an Annual Trip policy which, in its first month, resulted in a 10% uplift in sales year-on-year.

We now have 207 Travel Money bureaux and have enjoyed a strong performance in this area, with a 30% increase in transactions year-on-year.

The Bank's free-to-use ATM estate grew by over four per cent to 1,646. ATM transactions grew by nearly 2% year-on-year to over 240 million transactions, and £1 of every £11 dispensed from a LINK ATM Transaction is from Sainsbury's Bank.

Given the Bank's strong trading performance and the trust people have in the Sainsbury's brand, we have decided to launch new mortgage products in 2017. We believe these products will complement our existing portfolio and we expect customers to respond well. The investment required to prepare for this, combined with the impact of reduced interchange fees on Credit Cards, is expected to lead to a reduction in the Bank's underlying profit of around 10% in the year to 28 February 2017.

The New Bank Programme continues to progress and this year we took delivery of the new technology platform, which is a key milestone in building a standalone bank and creating long-term shareholder value. Although the build of the platform is materially complete, testing continues and we plan to migrate Savings customers by late Summer 2016. The migration of Cards and Loans customers is currently being re-planned, particularly in the light of the Group's potential acquisition of Home Retail Group plc. We expect total transition costs to remain at the top of the £340 million – £380 million range.

Sainsbury's Bank continues to report industry-low levels of customer complaint, consistently recording fewer than 1.3 complaints per 1,000 customer accounts over the last two years.

The Bank continues to closely monitor regulatory developments and implemented interim reporting of the Liquidity Coverage Ratio (LCR) to the PRA during the year and subsequently completed an Internal Liquidity Adequacy Assessment Process (ILAAP) under new the regulations.

The Bank welcomed the December 2015 consultations from the Bank of England introducing a framework of capital requirements for UK banks and their approach to setting a minimum requirement for own funds and eligible liabilities (MREL). The Bank manages a prudent capital position and leverage ratio which is compliant with existing regulatory requirements.

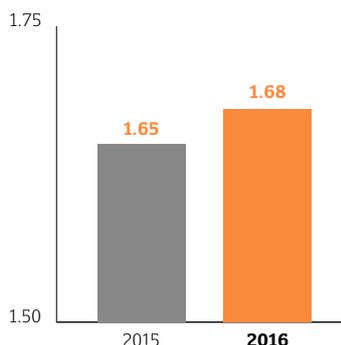
Further detail on key regulatory ratios in relation to the Bank's capital and liquidity, and other financial and non-financial key performance indicators are included in the subsequent section. Further analysis of the Bank's financial performance can be noted in the Financial Review on page 11.

Key Performance Indicators

In the short term, the delivery of the NBP introduces additional operational risks associated with the transition which could have an impact on people, processes, regulatory compliance and technical infrastructure. Oversight and management of these transitional risks is being maintained through the Bank's existing risk framework. In order to complement management of the transitional risks, success against strategic principles is measured against three criteria:

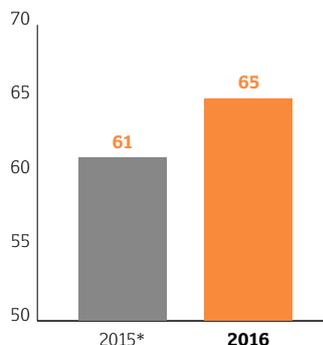
Short term performance criteria	Relevance
Maintenance of "Business as Usual"	The Bank has a strong customer base within its core products of unsecured Personal Loans, Credit Cards, Savings accounts, Insurances, Travel Money and ATMs. It is critical to the success of the Bank to protect its relationship with its customers and maintain business as usual performance alongside the development and delivery of its new operational capability.
Delivery of the New Bank Programme	The NBP will deliver the infrastructure critical for the long term success of the Bank. The Directors ensure a balanced approach in assessing performance to ensure the programme is delivered in a safe and robust way that protects existing customers and meets the requirements for future success.
Development of the business to support the longer term strategy	The Bank's longer term strategy is to develop its product set, distribution plans and customer proposition in order to provide return on the NBP investment.

Number of Active Accounts held by customers (million)



Marginal increase in customer numbers principally driven by growth in personal loans.

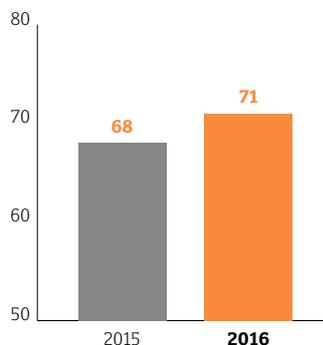
Underlying profit before tax (£m)



7% growth in underlying profitability. For further detail, see the financial review section on pages 11 - 12.

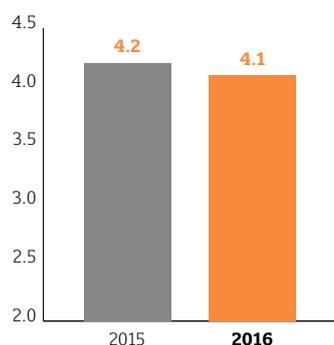
* After adjusting underlying profit before tax for the 14 month period to 28 February 2015 by 12/14 to enable comparison.

Underlying cost: income ratio (%)



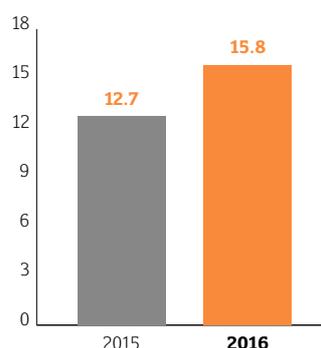
Increase resulting from changes to recognition in Travel Money costs and income (see page 12) and on-going investment in capability, representing strategic development of the business and delivery of NBP.

Net interest margin (%)



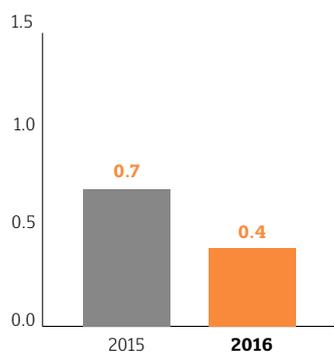
10 bps decrease in NIM related to the diversification of funding sources. For further detail, see the financial review on page 11.

Common Equity Tier 1 Capital Ratio (%)



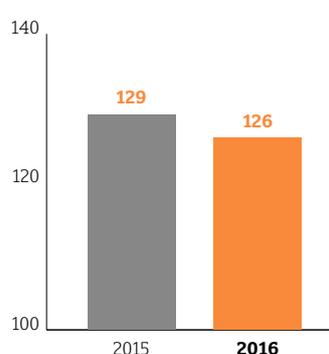
The CET1 ratio has increased as a result of higher proportional increases in retained earnings and share capital relative to risk weighted assets. This is within regulatory limits, risk appetite and the planned delivery of the NBP.

Bad debt asset ratio (%)



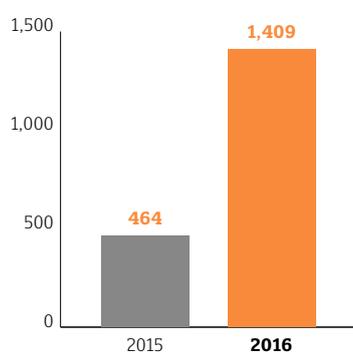
The decline in BDAR is driven by favourable economic conditions. For further detail, see the financial review on page 12.

Net Stable Funding Ratio (%)



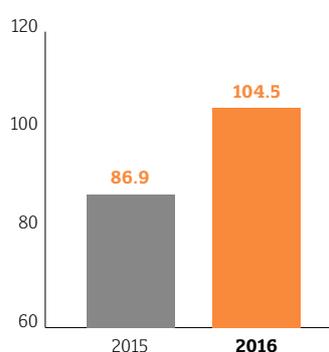
The NSFR can fluctuate dependent on timings of residual maturity of relevant components; however the ratio remains comfortably within the Bank's risk appetite limits.

Number of colleagues



Colleague numbers have increased as a result of strategic changes to the Travel Money operation and on-going investment in capability as part of the NBP.

Loans to deposits ratio (%)



The increase reflects diversification of the Bank's funding with a greater mix of wholesale funds.

Principal risks and uncertainties

The principal risks to the Bank are:

- Retail credit risk
- Wholesale credit risk
- Liquidity & funding risk
- Market risk
- Capital adequacy risk
- Operational risk
- Operational capability risk
- Compliance & conduct risk

The principal risks and uncertainties table sets out these risks in more detail and also provides examples of relevant controls and mitigating factors. It should be noted that the risk assessment and mapping employed by the Bank goes beyond this assessment and captures less material risks that may still impact the business and require monitoring for future changes in materiality. In addition, the Bank continues to monitor uncertainties, such as the EU referendum to assess whether they give rise to material new risks to the business.

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

Principal risk	Nature of risk	Key controls and mitigating factors
Retail credit risk	<p>The risk that a retail customer fails to repay the interest or capital on a loan.</p> <p>The Bank is exposed to UK economic conditions. Adverse changes in unemployment, indebtedness, consumer confidence, and house prices all have the potential to impact the underlying modelling assumptions and thus credit quality of the Bank's stock assets and new lending activity.</p>	<ul style="list-style-type: none"> — Dedicated credit risk team who report directly to the Chief Risk Officer (CRO). — Strong Risk appetite and Credit Risk policy approach drive a relatively resilient credit portfolio. — Credit decisioning tools use multiple sources of credit reference agency data in decisioning and monitoring. — Regular reporting framework in place to identify performance which is at risk of being outwith risk appetite. Tracking includes reference to external benchmarking. — Robust analytical approach to changes in credit decisioning criteria. — Strong credit risk governance and committee framework which oversees credit risk. — Regular stress testing using tools which allow us to model economic scenarios more accurately.
Wholesale credit risk	<p>The Bank is exposed to losses where institutional counterparties fail or do not meet their contractual cash flow obligations.</p>	<ul style="list-style-type: none"> — The Bank's exposure to wholesale credit risk is reported to the Asset and Liability Committee (ALCO), the Board Risk Committee (BRC), Audit Committee and the Board, including reference to relevant economic releases and industry consensus. — Daily reporting to the Group Treasurer and Treasury Risk (2nd line) on early warning indicators that provide relevant market and macro-economic updates. — Regular monitoring of credit ratings migration and CDS pricing of the Bank's key counterparties. — Any changes to risk appetite or credit lines approved by ALCO, BRC and Board. — The Bank has adequate counterparty limits to control its exposure.
Liquidity & funding risk	<p>The risk of the Bank being unable to meet its obligations as they are expected to fall due.</p>	<ul style="list-style-type: none"> — The Bank undergoes an annual Internal Liquidity Adequacy Assessment Process (ILAAP) which is provided to the PRA. Through this process the Bank assesses its Liquidity Requirements. — The Bank aims to maintain sufficient liquidity to cover its self-assessed peak stress requirement for a 90 day period whilst ensuring it meets regulatory requirements for minimum holdings of eligible assets. — Early warning indicators are reviewed daily by senior management and an escalation process is in place. — The Bank has a Contingency Funding Plan, soon to be replaced by a Liquidity Contingency Plan, which is subject to regular review and testing. — The Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are regularly monitored and forecast alongside other cash flow and liquidity ratios. Actual and forward looking forecasts for these ratios are reported to the Treasurer and Treasury Risk weekly and also to ALCO, BRC and the Board. — The Bank has a detailed funding plan to ensure it maintains a robust profile of diversified funding, both retail and wholesale.
Market risk	<p>The risk that the Bank's earnings and value would be reduced as result of adverse change to market parameters (including changes and increase in interest rate volatility and foreign exchange rates).</p>	<ul style="list-style-type: none"> — The Bank has a detailed market risk policy, which sets out its market risk limit structure. — Regular reporting to ALCO on earnings and market value sensitivity. — All new banking products or amendments to the terms of existing products are reviewed from an interest rate risk perspective to ensure compliance with existing risk appetite.

Capital adequacy risk	The risk that the Bank holds regulatory capital that is of insufficient quantity and quality to enable it to absorb losses.	<ul style="list-style-type: none"> — The management of capital is governed through the ALCO, BRC, and Board with a capital adequacy policy in place that articulates risk appetite and limit structure. — Capital adequacy is monitored and reported on a daily basis with early warning indicators and Red, Amber, Green (RAG) status utilised to ensure appropriate and timely escalation. — The Bank undertakes an annual Internal Capital Adequacy Assessment Process (ICAAP) that assesses the material risks faced by the Bank through stress testing and scenario analysis. This is a key risk management tool in determining the adequacy of capital resources as well as mitigating actions. Output is subject to review and approval by the Executive Committee (Exco), BRC and Board. Findings are also utilised to inform risk appetite and acceptable levels of earnings volatility.
Operational risk	Represents the general risk of loss stemming from failed processes, systems, human error or fraud.	<ul style="list-style-type: none"> — Operational risk team in place to provide a second line of defence reporting to the CRO as part of the Enterprise Risk team. — On-going assessment undertaken where the adequacy of the control framework is considered and action plans agreed. — On-going maintenance of risk registers with appropriate oversight through the Bank's governance structures. Risk registers include quantification of risks following an agreed methodology. — Process in place for capturing operational risk losses and ensuring action is taken to mitigate the possibility of reoccurrence. — Formal engagement with strategic partners to understand the impact of change. Project lifecycle methodology in place and all projects are managed accordingly to the level of assessed risk and appetite. — Outsourced services primarily provided by LBG are managed under a Transitional Services Agreement (TSA).
Operational capability risk	The risk of disruption to systems or processes which leads to an impact on the Bank's telephony, Web or ATM channels.	<ul style="list-style-type: none"> — The Bank has identified operational capability as a specific risk to ensure there is appropriate focus on maintaining acceptable channel performance in current and stress conditions. — Performance, including that of suppliers, is monitored on a regular basis with early warning indicators and Red, Amber, Green (RAG) status utilised to ensure appropriate and timely escalation. — Controls and standards are in place around supplier performance, service standards and IT security. — An Incident management framework is in place as part of wider Business Continuity Management framework which is subject to an annual crisis test.
Compliance & conduct risk	The risk of the Bank failing to meet the requirements of legislation, regulatory and customer conduct requirements as defined by the PRA, FCA and any other requirements from relevant regulatory bodies.	<ul style="list-style-type: none"> — Business management is responsible for effectively implementing a suite of policies, standards and toolkits developed by the Compliance and Conduct team to manage their risks. This is achieved through control procedures and processes developed and owned by the business. — Compliance team provide direct advice and horizon scanning for the business to support design and implementation of new product launches and changes in the regulatory framework. — 2nd line compliance oversight plan in place to test the design and operational effectiveness of the compliance control environment. — Reporting and escalation of compliance issues through the Bank's governance structures. — Regular and open communication with PRA/FCA on all areas of Bank activity, but with particular focus on compliance and conduct related themes relating to fair customer outcomes; co-ordinated through the Bank's compliance regulatory liaison team.

Risk management and governance

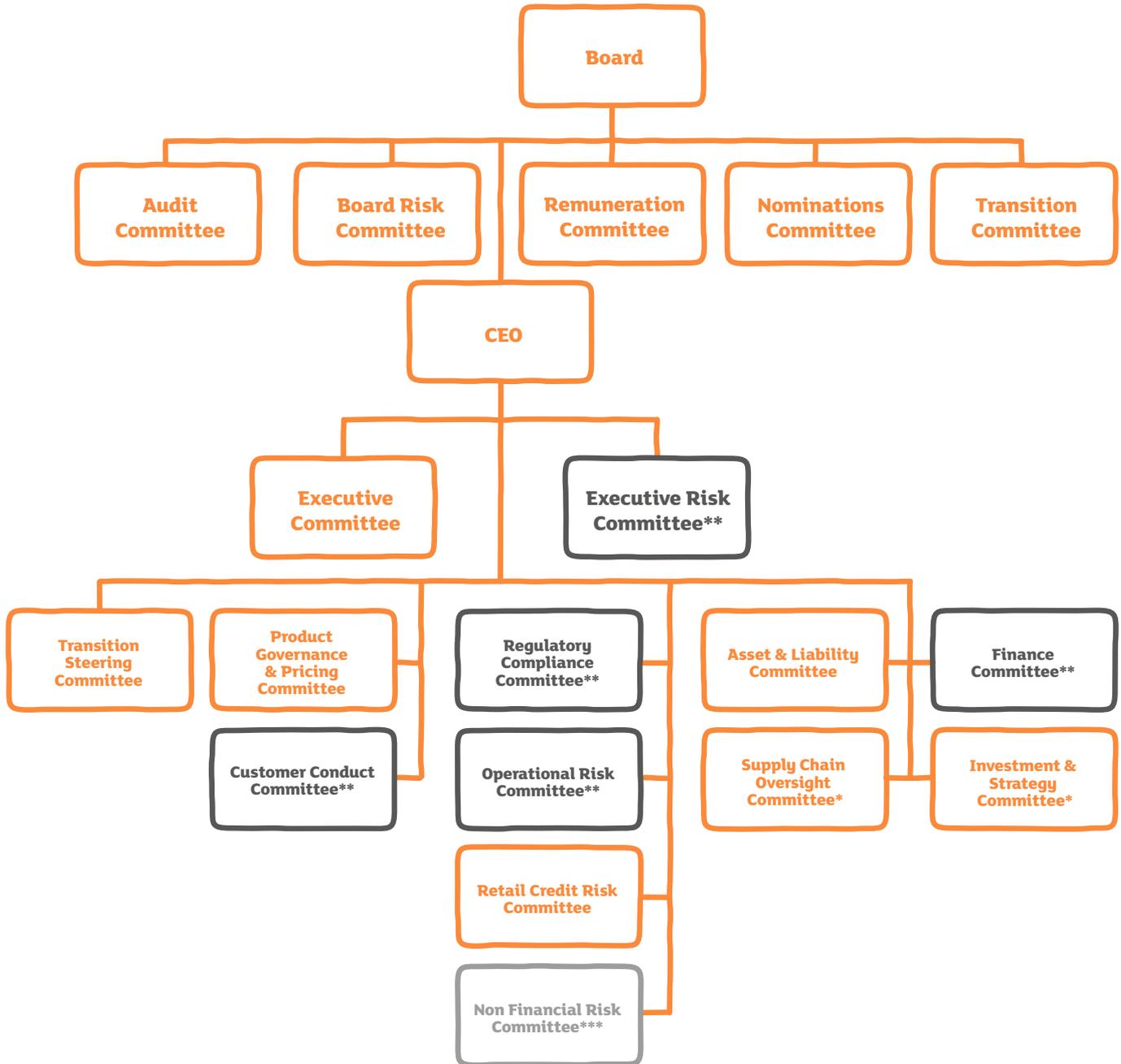
The Bank aims to manage all risks that arise from its activities, covering the principal risks outlined above as well as the additional operational risks associated with its transition to a new stand-alone operating model following the transfer to full ownership by J Sainsbury plc in 2014.

The Bank has established an Enterprise Wide Risk Management Framework (EWRMF) to manage risks across its operations. The EWRMF comprises the governance, risk appetite, policies, controls, processes and systems that the Bank utilises to manage risk.

i) Governance structure

Following the introduction of the Individual Accountability Regime from March 2016, the Bank has made some changes to its governance structure to ensure that it is reflective of individual accountability going forward. As these changes were implemented after year end, the section below entitled ‘Governance structure during the financial year ended 29 February 2016’ sets out how the governance framework operated during the 2015/16 financial year.

The diagram below shows the current governance structure with changes arising as the result of the implementation of the Individual Accountability Regime identified.



*Committee name was changed in March 2016 as described in the Changes to governance from March 2016 section below:

**Created as a result of governance changes from March 2016 onwards.

***Disbanded as a result of governance changes from March 2016.

Changes to governance from March 2016

The Bank retains all of its Board level governance committees that were in place during 2015/16. The collective governance level of the Bank has been restructured and each committee will now be the responsibility of the appropriate Senior Manager under FCA and PRA rules (Senior Managers Regime). We have introduced a new Executive Risk Committee, which is responsible for the monitoring and oversight of the risk profile of the Bank at an aggregate level, having regard to the risk appetite of the Bank. The governance of the Bank is described in the Bank's Responsibility Map submitted to the regulator in March 2016 and is the responsibility of the Chief Executive Officer.

The following committees which existed throughout the year to 29 February 2016 are now held as part of the remit of individual members of the Executive Committee in line with their Statement of Responsibilities under the Senior Managers Regime:

- Chief Operations Officer – Transition Steering Committee
- Chief Trading Officer – Product & Pricing Committee (renamed Product Governance & Pricing Committee)
- Chief Risk Officer – Retail Credit Risk Committee
- Chief Financial Officer – Asset & Liability Committee, Change & Investment Committee (renamed Investment & Strategy Committee), the Outsourcing Oversight Committee (renamed the Supply Chain Oversight Committee)

The following new committees were effective from March 2016 onwards and are held part of the remit of individual members of the Executive Committee in line with their Statement of Responsibilities under the Individual Accountability Regime:

- Chief Trading Officer – Customer Conduct Committee
- Chief Risk Officer – Operational Risk Committee and Regulatory Compliance Committee
- Chief Financial Officer – Finance Committee

The Non-Financial Risk Committee was disbanded as part of the changes to the governance structure however its responsibilities have been taken over by other committees.

Governance structure during the financial year ended 29 February 2016

During the financial year ended 29 February 2016, the governance framework in place at the Bank segregated vertically into three levels:

- A. Board level governance
- B. Collective management level governance
- C. Executive level governance

A. Board level governance

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

The Board

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

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

Audit Committee

The Audit Committee's key responsibility is to advise the Board on the Bank's financial statements, including systems and controls and related policy issues together with relationships with external auditors. The Committee is also responsible for reviewing and approving the internal audit plan and budget, and for ensuring that the function is adequately resourced.

Transition Committee

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

Nominations Committee

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

Remuneration Committee

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

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

Board Risk Committee

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

B. Collective management level governance

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

Product and Pricing Committee

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

Transition Steering Committee

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

Non-Financial Risk Committee

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

Retail Credit Risk Committee

The Retail Credit Risk Committee (RCRC) is responsible for monitoring the performance of the retail lending book and the credit card portfolio, ensuring there is an effective credit risk management framework and making those decisions needed to ensure that the Bank is operating within its risk appetite. This Committee receives regular reports about the performance of all retail credit portfolios. This includes the credit cards and loans application process as well as collections and recoveries performance.

Asset and Liability Committee

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

Change and Investment Committee

The Change and Investment Committee (CIC) is responsible for the management of the Bank's BAU change portfolio ensuring appropriate prioritisation of projects, tracking of progress versus plan and risk management of the portfolio.

Outsourcing Oversight Committee

The Outsourcing Oversight Committee (OOC) is responsible for ensuring that the outsourcing component of operational and conduct risk is managed in line with the approved risk appetite and a consistent approach is taken to managing supplier relationships across the Bank, including the performance and delivery of critical third party supply arrangements including the delivery of fair outcomes for customers.

C. Executive level governance

The CEO has established the Executive Committee (ExCo) to assist in his delegated responsibilities from the Board as described above. The ExCo is responsible for the day-to-day running and leadership of the Bank including the development of business strategy and business plans for Board approval.

ii) Risk appetite and policies

The Bank's risk appetite is shaped by the Board, who provide a clear articulation of the level and types of risk that the Bank is prepared to accept in order to achieve its desired strategic outcomes. It is expressed and embedded through a 'high-level' Risk Appetite Statement that is set and reviewed on an annual basis by the Board and through 'directional' limits that are set for each of the Bank's principal risks (the principal risks and examples of relevant controls are detailed within in the Principal risks and uncertainties section of the Bank's Annual Report and Financial Statements). The 'high-level' risk appetite statement represented an enhancement to the previous Risk Appetite Statement and was established in March 2016. Prior to this and for the 2015-2016 financial year the risk appetite was expressed through directional limits for each of the Bank's principal risks.

The Bank's risk appetite enables it to make clear and transparent decisions on potential trade-offs between different aspects of its risk profile. It ensures that strategic planning is a product of both commercial and risk considerations. In this way strategic decisions are made in the full context of those factors likely to be of interest to a range of stakeholders, enabling the Board to understand the Bank's current and future risk profile, how it benchmarks versus others and how it supports the Bank's strategic objectives.

Risk appetite is complemented by a clear risk strategy that guides and cascades the right principles and behaviours throughout the business. It is supported and embedded through effective governance, a 'three lines of defence' operating model, Bank-wide policies and procedures and appropriate training and incentives to support the desired culture and behaviours.

iii) Risk model

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

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

Pillar 3 report

Further information on the risks and controls can be found in the Bank's Pillar 3 Disclosure Report for the year ended 29 February 2016. This report is published in the investor relations section of the J Sainsbury's corporate website: www.j-sainsbury.co.uk/investor-centre.

Financial review

The Bank's performance for the year ended 29 February 2016 and financial position at the end of that period are presented in the income statement and balance sheet. A summarised income statement and balance sheet are presented below:

Summary income statement	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m	14 months to 28 Feb 2015 (annualised)** £m	Change** %
Total income	274	300	257	6.6
Operating expenses	(253)	(306)	(262)	
Add: items excluded from underlying results*	59	104	89	
Underlying operating expenses	(194)	(202)	(173)	(12.1)
Impairment losses on financial assets	(15)	(26)	(22)	31.8
Losses realised on financial instruments	–	(1)	(1)	–
Underlying profit before taxation	65	71	61	6.6
Statutory profit/(loss) before taxation	6	(33)	(28)	121.4

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

** To enable comparison, the prior period results for the 14 months ended 28 February 2015 have been adjusted to 12/14ths when calculating year-on-year movements. There were no material differences to underlying performance when comparing the pro-rata method above to the actual underlying performance for the 12 months ended 28 February 2015. For details on items excluded from underlying performance, see operating expenses and investment below.

Statutory profit before tax was £6m compared to a loss of £33m in the prior period (£28m* on an annualised basis). This movement primarily relates to a reduction in one-off items related to the New Bank Programme, the timing of which are driven by the varying nature of programme activity and are expected to fluctuate over time.

On a comparable annualised basis, underlying profit before tax of £65m represents a 6.6% increase on the prior period. This was principally the result of strong performance from banking products where overall lending increased and impairment losses moved favourably, combined with growth in Travel Money operations.

Summary balance sheet	29 Feb 2016 £m	28 Feb 2015 £m	Change %
Loans and advances to customers	3,353	3,032	10.6
Cash and cash equivalents	555	882	(37.1)
Other	591	323	83.0
Total assets	4,499	4,237	6.2
Customer deposits	3,209	3,488	(8.0)
Wholesale funds	546	171	219.3
Other	141	120	17.5
Total liabilities	3,896	3,779	3.1
Net assets	603	458	31.7

Customer lending grew by 10.6% during the period. The Bank has consistently remained near the top of price comparison tables during the year in relation to Personal Loans which has resulted in increased lending. The mix of liquid assets held has also diversified during the year which has resulted in a shift from items classified as 'cash and cash equivalents' to 'investment securities', which are included in the other asset category above.

The Bank has also increased its levels of wholesale funding relative to customer deposits as the Bank has sought to diversify its overall funding sources. The loans to deposits ratio increased from 86.9% to 104.5% which remains within the Bank's risk appetite for this ratio.

Net interest income

Net interest income summary	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 (annualised)* £m	Change* %
Interest receivable	207	204	1.5
Interest payable	(54)	(50)	(8.0)
Net interest income	153	154	(0.6)
Net interest margin	4.1%	4.2%	(10)bps

* To enable comparison, the prior period results for the 14 months ended 28 February 2015 have been adjusted to 12/14ths when calculating year-on-year movements.

Summary of funds lent to customers and held as liquid assets

	29 Feb 2016 £m	28 Feb 2015 £m	Change %
Loans and advances to customers	3,353	3,032	10.6
Cash and balances with central banks	423	696	(39.2)
Loans to Banks	25	138	(81.9)
Financial investments – available for sale	317	53	498.1
	4,118	3,919	5.1

Summary of funds raised

	29 Feb 2016 £m	28 Feb 2015 £m	Change %
Customer deposits	3,209	3,488	(8.0)
Other deposits	247	23	973.9
Other borrowed funds	299	148	102.0
	3,755	3,659	2.6

Whilst headline rates on personal loans continued to fall year on year, the 10.6% growth in loans and advances to customers resulted in an increase of 1.5% to interest receivable to £207m. Interest rates on customer deposits broadly fell in line with lending rates, however the strategic diversification of the Bank's funding sources to other deposits and other borrowed funds has resulted in a slight decline in net interest margin by 10 basis points.

Fee, commission and other operating income

Fee, commission and other operating income summary	12 months to	14 months to	Change*
	29 Feb 2016	28 Feb 2015 (annualised)*	
	£m	£m	%
Banking income	77	76	1.3
Insurance income	24	23	4.3
Other income	1	4	(75.0)
Total fees and commissions receivable	102	103	(1.0)
Other operating income	19	–	–
Total fee, commission and other operating income	121	103	17.5

* To enable comparison, the prior period results for the 14 months ended 28 February 2015 have been adjusted to 12/14ths when calculating year-on-year movements.

The change in Travel Money operating arrangements and growth in the number of bureaux were the key drivers in changes to the mix of fee, commission and other operating income year on year. In March 2015, the Bank changed its contractual arrangements with Travelex which has resulted in the Bank directly buying and selling the currencies within its in-store bureaux. Previously the currency stock was provided by Travelex with the Bank receiving a related commission income. As a result of the change, the Bank now recognises currency margin within other operating income and related costs, such as staff costs, within operating expenses. This has resulted in the decrease of £3m in other fee and commission income and increase of £19m in other operating income.

Operating expenses and investment

Operating expenses summary	12 months to	14 months to	Change*
	29 Feb 2016	28 Feb 2015 (annualised)*	
	£m	£m	%
Staff costs	45	28	60.7
Marketing costs	28	29	(3.4)
Other underlying operating costs (including depreciation and amortisation)	121	116	4.3
Underlying operating expenses	194	173	12.1
One-off items**	59	89	(33.7)
Total operating expenses	253	262	(3.4)

* To enable comparison, the prior period results for the 14 months ended 28 February 2015 have been adjusted to 12/14ths when calculating year-on-year movements.

** Whilst for consistency the 12/14ths basis for comparison has been maintained, the actual one-off items for the 12 month period ended 28 February 2015 were £53m.

The Bank experienced a 60.7% increase in staff costs year on year, principally related to the significant increase in staff numbers resulting from the change to the operating arrangements for Travel Money, as described above. The change in Travel Money arrangements has also contributed to a 4.3% increase in other underlying operating costs. Further increases in the cost base arose as the Bank continued to invest in operating capability, including additional staff and systems operating expenditure, as it moves towards migration and future operation on its new banking platforms.

One-off items relate to transitional costs connected to the NBP, principally comprising contractor and service provider costs connected to the migration of data and other services to the Bank's new infrastructure and operating model. The timing of those costs is related to the particular activities being undertaken in the programme at any point in time and is expected to fluctuate. The year on year decrease is attributable to a higher level of costs incurred immediately following the acquisition of the Bank by J Sainsbury plc in February 2014.

Summary of fixed assets	29 Feb 2016	28 Feb 2015	Change
	£m	£m	
Intangible assets	118	104	13.5
Property, plant and equipment	39	27	44.4
	157	131	19.8

The Bank continued to invest in assets that will result in longer term future benefits to the Bank. The 13.5% increase in intangible assets primarily relates to investment in the banking platforms being developed as part of the NBP. Increases in tangible assets reflect investment in the Bank's premises, ATM estate and Travel Money bureaux.

Impairment losses on financial assets

Impairment losses summary	12 months to	14 months to	Change*
	29 Feb 2016	28 Feb 2015 (annualised)*	
	£m	£m	%
Impairment losses on financial assets	15	22	(31.8)
Bad debt asset ratio	0.4%	0.7%	(30)bps

* To enable comparison, the prior period results for the 14 months ended 28 February 2015 have been adjusted to 12/14ths when calculating year-on-year movements.

The bad debt asset ratio continued to fall, ending the year at 0.4% and actual impairment costs fell by 31.8% on a comparable annualised basis. This ratio remains comfortably within the Bank's appetite for credit risk. The movement can principally be attributed to low market interest rates and improving economic conditions. The Bank continues to carefully monitor the impairment provision assumptions alongside external economic conditions including the interest rate environment where a future increase in interest rates could increase pressure on customers' budgets.

By order of the Board

David Arden
Chief Financial Officer and Company Secretary
18 May 2016

Directors' report

The Directors have pleasure in submitting their annual report and the financial statements of Sainsbury's Bank plc ('the Bank') for the year ended 29 February 2016.

Board of Directors

The Directors at 29 February 2016 were:

Mr Roger Davis	(Chairman)
Mr Peter Griffiths	(Chief Executive Officer)
Mr David Arden	
Ms Gwyn Burr	
Ms Marcia Campbell	
Mr Alan Cook	
Mr Stuart Deane	Appointed 11 March 2015
Mr Richard Keys	
Mr Mark Mullington	
Ms Angie Risley	Appointed 8 January 2016
Mr John Rogers	
Mr Michael Ross	Appointed 24 June 2015
Mr Andrew Simmonds	
Ms Sarah Warby	Resigned 26 November 2015

The Board comprises four executive Directors and nine non-executive Directors. The position and remuneration of members serving as at 29 February 2016 is described in the following table:

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

Unless otherwise stated above, all of the Directors in office at the date of this report served throughout the period, and up to the date of approval of these financial statements.

Board selection criteria

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

Board diversity

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

Directors' indemnities

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

Colleagues

We aim to make our Bank a great place to work for all colleagues. We want our people to develop their skills and knowledge to be the best they can be, learning from each other, their managers and through structured learning activity that develops behavioural and technical capability. We want our colleagues to stay with us because they feel valued and stimulated. How it feels to work at our Bank makes us different because our values guide everything we do. Cornerstones of our approach include investing time in two-way communication between leaders and other colleagues – informing and listening – and building trust through clear accountabilities and leadership. We check in with our colleagues regularly to gather their feedback on what we do well and how we can improve how it feels to work for the Bank.

The Bank is committed to an equal opportunities policy for recruitment and selection, through training and development and to performance reviews and promotion. The Bank has well developed policies for the fair and equal treatment of all colleagues and the employment of disadvantaged persons. During the year, a number of training courses have been held to ensure that our policies are understood throughout the organisation.

In support of the wider objectives of the J Sainsbury plc group, the Bank's colleagues are encouraged to participate in two all employee share plans for colleagues, namely the Savings-Related Share Option Plan ('Sharesave') and the All-Employee Share Ownership Plan, of which the Sainsbury's Share Purchase Plan ('SSPP') is a part.

Charitable and other donations

During the period the Bank made charitable donations in the UK of £47,471 (2015: £54,837). No political donations were made during the period (2015: nil).

Independent auditors

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

Disclosure of information to auditors

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

Going concern

The Directors have considered the appropriateness of the going concern basis of preparation of the financial statements taking into account the Bank's current and projected performance.

The risk management framework as described in the strategic report on page 8 is considered adequate in managing liquidity and other key risks in the current environment. The Bank continues to maintain its strong capital and liquidity position and has also been subject to review and challenge by the PRA as part of its remit as lead regulator of the Bank. Further information on the key financial risks of the business can be found in note 30.

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

Dividends

The profit after tax for the period attributable to the shareholders is £6m (2015: loss of £25m). The Directors do not recommend payment of a dividend (2015: £nil).

By order of the Board and signed on its behalf by

David Arden

Chief Financial Officer and Company Secretary

18 May 2016

Statement of Directors' responsibilities

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

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

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

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

The Directors are responsible for the maintenance and integrity of the Annual Report and Financial Statements and Pillar 3 disclosures included on the J Sainsbury plc website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board and signed on its behalf by

David Arden
Chief Financial Officer and Company Secretary
 18 May 2016

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

Report on the financial statements

Our opinion

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

- give a true and fair view of the state of the company's affairs as at 29 February 2016 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited

The financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), comprise:

- the Balance sheet as at 29 February 2016;
- the Income statement and Balance sheet for the year then ended;
- the Cash flow statement for the year then ended;
- the Statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

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

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

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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

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

We have no exceptions to report arising from this responsibility.

Directors' remuneration

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

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' responsibilities set out on page 15, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

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

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

What an audit of financial statements involves

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

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

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

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

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

Lindsay Gardiner (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
18 May 2016

Income statement

For the year ended 29 February 2016

	Note	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m
Interest receivable	2	207	238
Interest payable	2	(54)	(58)
Net interest income		153	180
Fees and commissions receivable	3	102	120
Other operating income	4	19	–
Total income		274	300
Administrative expenses	5	(245)	(299)
Depreciation and amortisation			
Property, plant and equipment	17	(7)	(5)
Intangible assets	16	(1)	(2)
Operating expenses		(253)	(306)
Impairment losses on financial assets	11	(15)	(26)
Losses realised on financial instruments		–	(1)
Profit/(loss) before taxation	9	6	(33)
Analysed as:			
Underlying profit before tax		65	71
One-off items	6	(59)	(104)
		6	(33)
Taxation	10	–	8
Profit/(loss) for the financial period attributable to the owners of the Bank		6	(25)

The accompanying notes on pages 22 to 55 form part of these financial statements.

Statement of comprehensive income

For the year ended 29 February 2016

	12 months to 29 Feb 2016	14 months to 28 Feb 2015
	Note	£m
Profit/(loss) for the financial period		6
Other comprehensive income:		
Items that may be reclassified subsequently to profit or loss:		
Movement on revaluation of available-for-sale financial assets	27	1
Total other comprehensive income for the year, net of tax		1
Total comprehensive income/(expense)		7

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 22 to 55 form part of these financial statements.

Balance sheet

As at 29 February 2016

	Note	29 Feb 2016 £m	28 Feb 2015 £m
Assets			
Loans and advances to customers	11	3,353	3,032
Cash and balances with central banks		423	696
Loans and advances to banks	13	25	138
Derivative financial instruments	14	–	1
Financial investments – available for sale			
Investment securities	15	317	53
Intangible assets	16	118	104
Property, plant and equipment	17	39	27
Other assets	19	224	186
Total assets		4,499	4,237
Liabilities			
Customer accounts	20	3,209	3,488
Other deposits	21	247	23
Other borrowed funds	22	299	148
Derivative financial instruments	14	18	6
Other liabilities	23	107	100
Provisions for liabilities and charges	24	16	14
Total liabilities		3,896	3,779
Equity			
Called up share capital	25	436	299
Retained earnings	26	166	159
Other reserves	27	1	–
Total equity		603	458
Total equity and liabilities		4,499	4,237

The financial statements on pages 17 to 55 were approved by the Board of Directors on 18 May 2016 and signed on its behalf by:

David Arden
Director and Chief Financial Officer

The accompanying notes on pages 22 to 55 form part of these financial statements.

Sainsbury's Bank plc – Company number 3279730

Statement of changes in equity

For the year ended 29 February 2016

	Notes	Called up share capital £m	Retained earnings £m	Other reserves £m	Total £m
At 1 March 2015		299	159	–	458
Profit for the financial period		–	6	–	6
Other comprehensive income:					
Available for sale financial assets fair value movements (net of tax)	27	–	–	1	1
Total comprehensive income		–	6	1	7
Transactions with owners:					
Shares issued in the period	25	137	–	–	137
Share based payment (net of tax)		–	1	–	1
At 29 February 2016		436	166	1	603
At 1 January 2014		170	184	(1)	353
Loss for the financial period		–	(25)	–	(25)
Other comprehensive income:					
Available for sale financial assets fair value movements (net of tax)	27	–	–	1	1
Total comprehensive expense		–	(25)	1	(24)
Transactions with owners:					
Shares issued in the period	25	129	–	–	129
At 28 February 2015		299	159	–	458

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 22 to 55 form part of these financial statements.

Cash flow statement

For the year ended 29 February 2016

	Note	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m
Profit/(loss) before taxation		6	(33)
Non-cash items included in profit before taxation		23	36
Change in operating assets and liabilities		(457)	(1,025)
Income taxes paid		(2)	(6)
Cash flows used in operating activities	12	(430)	(1,028)
Purchase of equipment		(20)	(14)
Purchase of intangibles		(14)	(102)
Cash flows used in investing activities		(34)	(116)
Proceeds from issue of share capital		137	129
Repayment of dated and undated loan capital		–	(110)
Interest paid on other borrowed funds		–	(1)
Cash flows generated from financing activities		137	18
Net decrease in cash and cash equivalents		(327)	(1,126)
Opening cash and cash equivalents		882	2,008
Closing cash and cash equivalents		555	882

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

	29 Feb 2016 £m	28 Feb 2015 £m
Cash and balances with central banks	423	696
Less: mandatory reserve deposit held at central banks	(5)	(5)
	418	691
Loans and advances to other banks:		
Repayable on demand	15	16
Repayable in less than three months	10	122
Investment securities	112	53
	555	882

The accompanying notes on pages 22 to 55 form part of these financial statements.

Notes to the financial statements

1. Accounting policies

a. Statement of compliance

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

b. Basis of preparation

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

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

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

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

Subsidiaries

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

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

Securitisation transactions

The Bank has securitised certain personal loans by the transfer of the loans to SPEs controlled by the Bank. The securitisation supports the issuance of debt by the SPEs to investors who gain the security of the cash flows from the securitised loans. The Bank continues to recognise the loans on its own balance sheet after the transfer because it retains the risks and rewards of ownership through the contractual arrangements with the SPEs. The proceeds received from the transfer are accounted for as a deemed loan repayable to the SPEs. Where the Bank is required to hold subordinated loan notes as part of the contractual arrangements, these are netted against the deemed loan and not presented as a separate asset because their recoverability is linked to the collectability of the purchased receivables which also remain as an asset on the Bank's balance sheet.

Designation of financial instruments

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

Non-derivative financial assets where there is no active market and which have fixed or determinable payments are classified as 'loans and receivables'. No assets are held for trading. Derivative instruments are automatically classified as 'at fair value through profit or loss' unless they form part of an

effective hedging relationship. No financial assets are designated as 'held to maturity'. All other financial assets are classified as 'available for sale'. All other financial liabilities are classified as 'at amortised cost'.

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

Loans and advances including impairment

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

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

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

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

Investment securities including impairment

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

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

1. Accounting policies (continued)

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

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

Sale and repurchase agreements

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

Derecognition of financial assets

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

Other assets

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

Property, plant and equipment

Land and buildings

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

Fixtures and equipment

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

Depreciation

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

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

Capital work in progress is not depreciated.

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

Intangible assets

Computer Software

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

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

Cost includes the purchase price after deducting discounts and rebates, and other directly attributable costs of preparing the asset for its intended use.

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

Operating leases

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

Income recognition

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

Fees and commissions, that are not integral to the effective interest rate calculation primarily relate to Credit Card and ATM interchange fees, and insurance introduction commission receivable from insurance partners. These are recognised in the income statement on an accruals basis as services are provided. Where in the case of insurance commissions the income comprises an initial commission and profit share both are recognised on completion of the service to the extent reliably measurable. Where there is a risk of potential claw back, an appropriate element of the commission receivable is deferred and amortised over the claw back period. Where the relevant contract requires the Bank to perform future services in respect of the income receivable, initial commission is recognised on completion of the service provided, with an element deferred to reflect services yet to be performed in future periods.

Margin from the sale of travel money, representing the difference between the cost price and the selling price, is recognised when the sale to the customer takes place within other operating income.

Taxation

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

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

1. Accounting policies (continued)

Nectar points

The costs of Nectar points, awarded as incentives to the Bank's customers, are recognised when earned by the customer or, where it is highly likely that the customer will meet associated qualifying criteria, are provided for at the point of sale as required by IAS 37 and IFRIC 13. The cost of points is recognised within administrative expenses or as a deduction from non-interest income depending on whether the Bank is acting as a principal or agent.

Cash and cash equivalents

For the purpose of the Cash Flow Statement cash and cash equivalents comprises cash in hand, deposits at central banks (less mandatory deposits) and deposits with banks with an original maturity of three months or less, together with Treasury Bills and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Other borrowed funds

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

Financial liabilities

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

Other liabilities

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

Foreign currencies

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

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

Derivative instruments

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

Fair value hedging

The Bank designates certain derivatives as fair value hedges where the derivative financial instrument hedges the change in fair value of the particular risks inherent in recognised assets or liabilities (fair value hedges). The Bank currently utilises fair value hedging against certain investment securities, and also against its portfolio of personal loans (see below).

To qualify for hedge accounting, the Bank documents, at the inception of the hedge, the hedging risk management strategy, the relationship between the hedging instrument and the hedged item or transaction and the nature of the risks being hedged. The Bank also documents the assessment of the effectiveness of the hedging relationship, to show that the hedge has been and will be highly effective on an ongoing basis.

Fair value hedging matches the change in value of designated hedged items against the corresponding change in value of the hedging derivative. The designated hedged item can be a recognised asset or liability, a firm commitment or an identified portion of an asset.

The effective part of any gain or loss on the hedged item adjusts the balance of the item and is recognised through profit or loss offsetting the gain or loss on the hedging derivative.

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

Portfolio fair value hedging

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

Portfolio fair value hedging allows the designation of the whole or part of a portfolio of assets or liabilities with similar risk exposures. The hedged item can be designated based on expected maturities to match the hedging derivative maturity.

Marketing expenditure

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

Share-based payments

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

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

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

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

Provisions

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

Share capital

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

1. Accounting policies (continued)

c. Critical accounting estimates and judgements

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

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

Impairment of investment securities

Investment securities classified as available for sale are continually reviewed at the specific investment level for impairment. Impairment is recognised when there is objective evidence that a specific financial asset is impaired.

Objective evidence of impairment might include a significant or prolonged decline in market value below the original cost of a financial asset and, in the case of debt securities, non-receipt of due interest or principal repayment, a breach of covenant within the security's terms and conditions or a measurable decrease in the estimated future cash flows since their initial recognition.

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

Impairment losses on loans and advances

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

Effective interest rate

In calculating the effective interest rate of a financial instrument the Bank takes into account all amounts that are integral to the yield of a financial instrument as well as incremental transaction costs. In the case of loans and advances significant judgement is applied in estimating the effect of various factors on future cash flows.

Deferred tax

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

Determining fair values

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

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

Cash and cash equivalents

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

Loans and advances to customers

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

Loans and advances to banks and deposits by banks

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

Customer accounts and other borrowings

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

Investment securities

Fair value is based on market prices or broker/dealer valuations. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Derivatives

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

Qualifying hedge relationships

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

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

Commission claw back

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

Customer redress provision

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

Further details of the provision are included in note 24.

1. Accounting policies (continued)

Financial Services Compensation Scheme

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

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

Further details of the FSCS and the provision are included in note 24.

Supplier arrangements

Accounting for contracts with suppliers may require the exercise of judgement in relation to the timing of recognition of any material rebates or discounts receivable. Further detail on material judgements exercised in this regard as at the period end is provided in notes 16 and 19.

Onerous costs

As part of the transition to its new flexible banking platform, the Bank is unable to avoid certain contractual costs associated with the continued use of certain Lloyds Banking Group platforms prior to migration. These costs are not related to the ongoing services being received from Lloyds Banking Group and have been provided for based on latest estimations of expected amounts payable. The provision is sensitive to changes in the timescales for delivery of the new flexible banking platforms and any variability in the relevant cost base of Lloyds Banking Group. Further details of the provision are included in note 24.

d. Accounting developments

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

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

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

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

Standards and interpretations effective for the Company for the year beginning 1 March 2016

- Amendments to IFRS 11 'Accounting for Acquisitions of Interests in Joint Operations'*
- Amendments to IAS 1 'Disclosure Initiative'*
- Amendments to IAS 16 and IAS 38 'Clarification of Acceptable Methods of Depreciation and Amortisation'*
- Amendments to IAS 16 and IAS 41 'Agriculture: Bearer Plants'*
- Amendments to IFRS 10 and IAS 28 'Sale or contribution of assets between an investor and its associate or joint venture'
- Amendments to IFRS 10, IFRS 12 and IAS 28 'Investment entities: Applying the consolidation exception'
- IFRS 14 'Regulatory Deferral Accounts'.
- Annual improvements to IFRSs 2012-2014 Cycle*

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

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

Standards and interpretations effective for the Company in future periods:

- IFRS 9 'Financial Instruments'.
- IFRS 15 'Revenue from Contracts with Customers'.
- IFRS 16 'Leases'.

IFRS 9 will supersede IAS 39 in its entirety, and is effective for accounting periods commencing on or after 1 January 2018. The new standard is broadly split into 3 areas:

- *Classification and measurement.* New classification and measurement criteria require financial instruments to be classified into one of three categories being amortised cost, fair value through other comprehensive income or fair value. Classification will be determined by the business model and contractual cash flow characteristics of the instruments.
- *Expected credit losses (ECL).* The requirement to recognise impairment losses based on ECL methodology are a change to the current requirements whereby losses are only recognised once an impairment event has happened.
- *Hedge accounting.* The general hedge accounting mechanisms of IAS 39 have been retained, however greater flexibility has been introduced over the instruments eligible for hedge accounting and effectiveness testing has been more closely aligned with the underlying risk management practices of the entity.

The most significant impact on the Bank is likely to be in relation to impairment methodology as a result of the move to expected credit losses. The Bank continues to assess the full impact of IFRS 9 and has established a project team to ensure the Bank is ready to implement the new standard in advance of its effective date.

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes a number of existing standards and interpretations from its effective date for accounting periods beginning on or after 1 January 2018. IFRS 15 introduces principals to recognise revenue by allocation of the transaction price to performance obligations.

IFRS 15 will apply to the Bank's fee and commission, and other operating income, superseding IAS 18. It is effective for accounting periods beginning on or after 1 January 2018. Income from financial instruments will continue to be recognised under IAS 39 / IFRS 9. The Bank is reviewing the requirements of the new standard to determine its impact.

IFRS 16 will replace IAS 17 in its entirety and is effective for accounting periods beginning on or after 1 January 2019. It will result in most leases being recognised on balance sheet. The Bank is reviewing the requirements of the new standard to determine its impact.

2. Net interest income

	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m
Interest income on loans and receivables	206	235
Interest income from available for sale financial instruments	1	3
Interest receivable	207	238
Interest expense on loans and receivables	(48)	(53)
Interest expense on derivative liabilities	(6)	(5)
Interest payable	(54)	(58)
Net interest income	153	180

Net ineffectiveness recognised on fair value hedges was £0.1m (2015: £0.1m).

3. Fees and commissions receivable

	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m
Banking income	77	89
Insurance income	24	27
Other income	1	4
	102	120

4. Other operating income

	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m
Travel money income	19	–
	19	–

Other operating income relates to the Bank's sale of foreign currency and related products through its Travel Money business from March 2015 onwards. During the 14 months to 28 February 2015 the Bank received commission income on travel money sales under previous contractual arrangements.

5. Administrative expenses

	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m
Staff costs:		
Wages and salaries	39	29
Social security costs	3	2
Pension costs	2	2
Share based payments	1	–
	45	33
Marketing costs	28	34
Other operating costs	172	232
	245	299

£3m of secondee and temporary contractor costs that were presented as other staff costs in the period to 28 February 2015 have been presented as other operating costs above.

Other operating costs include £59m (2015:£104m) of one-off items as described in note 6.

See note 7 for further details on employee arrangements.

Notes to the financial statements

Continued

6. One-off items

Certain items recognised in the Bank's reported profit or loss before tax can vary significantly from year to year and therefore create volatility in reported profit before tax which does not reflect the Bank's underlying performance. The Directors believe that the 'underlying profit before tax' measure presented provides a clear and consistent presentation of the underlying performance of the Bank. Underlying profit is not defined by IFRS and therefore may not be directly comparable with the 'adjusted' profit measures of other companies.

The adjusted one off items are considered infrequent in nature and do not relate to the Bank's underlying performance.

	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m
New Bank Programme transition costs	59	104
	59	104

New Bank Programme transition costs principally comprise contractor and service provider costs relating to the migration of data and other services to the Bank's new infrastructure and operating model.

7. Employees

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

	12 months to 29 Feb 2016 Number	14 months to 28 Feb 2015 Number
Full time	763	431
Part time	646	33
	1,409	464
Full time equivalent	1,090	455

Colleague costs are disclosed in other administrative expenses in note 5.

In March 2015 the Bank's Travel Money colleagues who were previously employed by Travelex transferred to the Bank under Transfer of Undertakings (Protection of Employment) (TUPE) regulations.

Colleagues are eligible to join the defined contribution pension arrangements. These plans are also used where colleagues have been automatically enrolled into a pension. Contributions paid by the Bank are based on grade and the amount that the colleague chooses to pay or whether they have been automatically enrolled.

The pension cost recharge for the year represents contributions payable by the Bank and amounted to £1.8m (2015: £1.5m) and was entirely in relation to the defined contribution schemes.

8. Directors' emoluments

	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m
Emoluments	2.4	2.3
Employer contribution to defined contribution pension schemes	0.1	0.2
Share based payments	0.7	0.3
Loss of office	–	0.1
	3.2	2.9
Highest paid director:		
Emoluments	0.7	0.7
Employer contribution to defined contribution pension schemes	–	0.1
Share based payments	0.1	0.1
	0.8	0.9

The directors' positions and remuneration status are set out in the directors' report on page 13. The emoluments set out above include those directors who held office during the period.

All executive directors were employed and remunerated by the Bank.

During the period 4 directors (2015: 4) received share awards under J Sainsbury plc share incentive schemes reflective of their qualifying services. 2 Directors (2015: nil) exercised share options in the year including the highest paid director. Further detail of the relevant incentive plans are outlined in note 34.

Payments were made to independent Non-Executive Directors who served during the period and are included in the above details. There was no recharge to the Bank in respect of emoluments for Non-Executive Directors who were employed by J Sainsbury plc as their emoluments are deemed to be wholly attributable to services to the parent company. Accordingly, the above details include no emoluments in respect of these Non-Executive Directors (also see directors report on page 13).

9. Profit/loss before taxation

	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m
Profit/(loss) before taxation is stated including the following items of income and (expense):		
Interest on impaired loan balances	1	2
Operating lease rentals	(1)	(2)
Loss on disposal of property plant and equipment	–	(1)
Auditors' remuneration:		
Statutory audit of the Bank	(0.3)	(0.2)
Non-audit services	(0.3)	(0.1)

Non-audit services primarily relate to advice on colleague related matters. In addition to the above, also included in other operating costs is £0.3m (2015: £0.3m) payable to LBG in respect of a review by their auditors, PricewaterhouseCoopers LLP, of controls undertaken on the Bank's behalf by LBG under contractual arrangements.

10. Taxation

	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m
UK corporation tax on profit/(loss) for the year	–	(7)
Adjustments in respect of prior years	(6)	–
Current tax	(6)	(7)
Deferred tax charge/(credit)		
Origination and reversal of temporary differences	–	(1)
Adjustments in respect of prior years	6	–
Deferred tax	6	(1)
Total tax charge/(credit)	–	(8)

The taxation credit for the period of £0.4m (2015: £7.5m) represents (6.32%) of pre-tax profits (2015: 22.93% of pre-tax losses). The tax rate applicable to the Bank during the period reduced from 21% to 20% on 1 April 2015. Differences to the UK corporation tax rate for the year of 20.08% are explained below:

	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m
Profit/(loss) before taxation	6	(33)
Tax on ordinary activities at 20.08% (2015: 21.42%)	1	(7)
Effects:		
Other tax adjustments	(1)	(1)
Total income tax expense/(credit) recognised in the income statement	–	(8)

Notes to the financial statements

Continued

11. Loans and advances to customers

	29 Feb 2016 £m	28 Feb 2015 £m
Gross advances	3,419	3,114
Impairment	(79)	(87)
Adjustment in relation to fair value hedging	13	5
Loans and advances to customers	3,353	3,032
Gross advances being:		
Repayable on demand	826	834
Other loans and advances repayable:		
In 3 months or less	261	234
Between 3 months and 1 year	657	596
Between 1 and 5 years	1,620	1,404
After 5 years	55	46
	3,419	3,114

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

	29 Feb 2016 £m	28 Feb 2015 £m
Individuals:		
Home Mortgages	42	50
Unsecured Personal Lending	3,377	3,064
Gross loans and advances to customers	3,419	3,114

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

As at 29 February 2016 £379m (2015: £191m) of the personal loans portfolio was assigned to the SPE for use as collateral in securitisation transactions.

£468m (2015: £487m) of the personal loans book was pledged to the FLS facilitating £240m (2015: £240m) of drawings.

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

	Unsecured lending £m	Secured lending £m	Total £m
Year ended 29 February 2016			
At 1 March 2015	87	–	87
New impairment provisions less releases	17	–	17
Recoveries of amounts previously written off	(2)	–	(2)
Amounts written off	(22)	–	(22)
Discount unwind on impaired loans and advances to customers	(1)	–	(1)
At 29 February 2016	79	–	79
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	105	1	106
14 months ended 28 February 2015			
At 1 January 2014	82	–	82
New impairment provisions less releases	28	–	28
Recoveries of amounts previously written off	(2)	–	(2)
Amounts written off	(19)	–	(19)
Discount unwind on impaired loans and advances to customers	(2)	–	(2)
At 28 February 2015	87	–	87
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	106	1	107

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

12. Notes to the cash flow statement

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

	12 months to 29 Feb 2016 £m	14 months to 28 Feb 2015 £m
Profit/(Loss) before taxation	6	(33)
Non-cash items included in profit before taxation		
Impairment losses on loans and advances	15	26
Depreciation on property, plant and equipment	7	5
Amortisation of intangible assets	1	2
Loss on disposal of fixed assets	–	1
Loss on disposal of investment securities	–	1
Interest on borrowed funds	–	1
	23	36
Change in operating assets and liabilities		
Net (increase) in loans and advances to customers	(336)	(466)
Net decrease in derivative assets	1	1
Net (increase)/decrease in investment securities greater than 3 months	(204)	32
Net increase/(decrease) in derivative liabilities	12	(1)
Net (increase) in other assets	(30)	(39)
Net (decrease) in customer accounts	(279)	(36)
Net increase/(decrease) in borrowed funds	375	(581)
Net increase in other liabilities	4	65
	(457)	(1,025)
Cash used in operations	(428)	(1,022)
Income taxes paid	(2)	(6)
Cash flows (used in)/from operating activities	(430)	(1,028)
Operational cash flows from interest		
Interest paid	(67)	(63)
Interest received	215	239

13. Loans and advances to banks

	29 Feb 2016 £m	28 Feb 2015 £m
Sterling loans and advances to banks	25	138
Repayable on demand (included in cash equivalents)	15	16
Other loans and advances repayable:		
In 3 months or less (included in cash equivalents)	10	122
Gross advances	25	138

Notes to the financial statements

Continued

14. Derivative financial instruments

As part of its asset and liability management the Bank uses derivatives for hedging purposes in order to reduce its exposure to market risks. The Bank executes interest rate swaps to hedge interest rate risk arising from fixed rate exposures in its retail personal loan book and certain treasury investment securities, which are predominantly funded by variable rate linked liabilities.

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

Fair value hedges

	Notional amount £m	Assets £m	Liabilities £m
Interest rate swap			
At 29 February 2016	2,105	–	(18)
At 28 February 2015	1,657	1	(6)

The cash flows on the hedging instruments (interest rate swap derivatives) substantially match the cash flow profile of the hedged items (personal loans and treasury investment securities). The changes in fair value of the derivatives are hedged against changes in the fair value of the hedged items, with any ineffective portion going to profit or loss.

15. Investment securities

	29 Feb 2016 £m	28 Feb 2015 £m
Investment securities comprise the following:		
Debt securities issued by Banks	50	–
Treasury Bills	20	53
Gilts	31	–
Government backed investment securities	98	–
Covered bonds	40	–
Supranational investment securities	77	–
Investment in Visa Europe	1	–
	317	53
Of which:		
Maturing in three months or less	112	40
Maturing between three months and one year	48	13
Maturing between 1 and 5 years	151	–
Maturing after 5 years	6	–
	317	53

Investment securities include £nil (2015: £nil) pledged as collateral under sale and repurchase agreements or OTC derivative contracts.

The fair value movement during the period on investment securities classified as available for sale was a gain of £0.6m (2015: a gain of £0.6m).

16. Intangible assets

	29 Feb 2016 £m	28 Feb 2015 £m
Cost		
At 1 March/1 January	123	21
Additions	15	102
Disposals	–	–
As at 29/28 February	138	123
Accumulated amortisation		
At 1 March/1 January	(19)	(17)
Charge for the year	(1)	(2)
Disposals	–	–
As at 29/28 February	(20)	(19)
Net book value as at 29 February 2016 / 28 February 2015	118	104

Intangible assets comprise acquired computer software. Additions in the period relate primarily to the development of new banking platforms as part of the New Bank Programme, as described further in the strategic report. Included in the above is a £29m reduction to costs (2015: £nil) in respect of a rebate receivable in respect of the construction of the banking platforms. Further detail is provided in note 19.

17. Property, plant and equipment

	Land and buildings £m	Fixtures and equipment £m	Total £m
12 months ended 29 February 2016			
Cost			
At 1 March 2015	1	69	70
Additions	–	20	20
Disposals	–	(2)	(2)
As at 29 February 2016	1	87	88
Accumulated depreciation			
At 1 March 2015	–	(43)	(43)
Charge for the year	–	(7)	(7)
Disposals	–	1	1
As at 29 February 2016	–	(49)	(49)
Net book value as at 29 February 2016	1	38	39
Capital work in progress included above	–	–	–
14 months ended 28 February 2015			
Cost			
At 1 January 2014	–	57	57
Additions	1	14	15
Disposals	–	(2)	(2)
As at 28 February 2015	1	69	70
Accumulated depreciation			
At 1 January 2014	–	(39)	(39)
Charge for the year	–	(5)	(5)
Disposals	–	1	1
As at 28 February 2015	–	(43)	(43)
Net book value as at 28 February 2015	1	26	27
Capital work in progress included above	1	–	1

18. Subsidiary undertakings

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

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

19. Other assets

	29 Feb 2016 £m	28 Feb 2015 £m
Customer funds in the course of settlement	2	10
Bank funds in course of settlement	140	121
Current tax asset	15	7
Deferred tax asset (see note 23)	–	1
Amounts receivable from group companies (see note 35)	7	3
Cash collateral paid	13	5
Prepayments and accrued income	47	39
	224	186

Other assets have no fixed maturities but are expected to be realised within 12 months, with the exception of £29m (2015: £nil) included in prepayments and accrued income. This represents the present value of a rebate receivable in respect of the build of certain computer software (see note 16) which will be received over a period of time once the related software is brought into use, which is expected to be greater than 12 months (2015: £1m deferred tax asset recoverable after more than 12 months). See note 30 for further details on the residual contractual maturity of other assets.

In the prior period financial statements, amounts shown above as amounts receivable from group companies and prepayments and accrued income were presented separately on the face of the balance sheet under the heading of prepayments and accrued income.

Notes to the financial statements

Continued

20. Customer accounts

Customer accounts comprise Sterling interest bearing deposits.

	29 Feb 2016 £m	28 Feb 2015 £m
Repayable:		
On demand	2,817	3,020
Within 3 months	65	75
Between 3 months and 1 year	144	209
Between 1 and 5 years	183	184
	3,209	3,488

21. Other deposits

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

	29 Feb 2016 £m	28 Feb 2015 £m
Repayable:		
Within 3 months	–	3
Between 3 months and 1 year	28	17
Between 1 and 5 years	219	3
	247	23

22. Other borrowed funds

	29 Feb 2016 £m	28 Feb 2015 £m
Deemed loan on securitisation		
Repayable in less than 1 year	118	70
Repayable between 1 and 5 years	181	78
Other borrowed funds	299	148

Deemed Loan on securitisation

As at 29 February 2016, the beneficial interest in certain personal loans advanced to customers has been assigned to Lochside Asset Purchaser No.1 plc for the purposes of raising funds through the issue of collateralised loan notes. As the Bank retains substantially all risks and rewards of ownership of the relevant loans through contractual arrangements with Lochside Asset Purchaser No.1 plc, the loans continue to be recognised on the balance sheet of the Bank with a corresponding deemed loan recognised to Lochside Asset Purchaser No.1 plc.

Of the total £400m facility, £300m (28 Feb 2015: £150m) of Senior 'A Notes' have been issued by Lochside Asset Purchaser No.1 plc backed by the cashflows from the relevant personal loans.

As part of the structure the Bank has acquired £100m (28 Feb 2015: £50m) of subordinated 'B Notes'. The B Notes are offset against the deemed loan to Lochside Asset Purchaser No.1 plc and are not presented as a separate asset because their recoverability is linked to the collectability of the purchased receivables which also remain as an asset on the Bank's balance sheet.

23. Other liabilities

All other liabilities are expected to be settled within 3 months, with the exception of deferred tax which is expected to settle in more than 12 months.

	29 Feb 2016 £m	28 Feb 2015 £m
Customer funds in course of settlement	8	26
Bank funds in course of settlement	1	–
Deferred tax liabilities	5	–
Accruals and deferred income	89	73
Cash collateral received	4	–
Other liabilities	–	1
	107	100

23. Other liabilities (continued)

The deferred tax liability (asset – see note 19) is in respect of temporary differences which will reverse and result in a lower tax charge in future years is as follows:

	29 Feb 2016 £m	28 Feb 2015 £m
At 1 March	(1)	–
Movement in deferred tax asset charged to income statement	–	(1)
Adjustments in respect of prior years	6	–
At 29 / 28 February	5	(1)
Tax effect of timing differences due to:		
Other temporary differences	(1)	(1)
Accelerated capital allowances	6	–
	5	(1)

24. Provisions for liabilities and charges

	Customer redress £m	FSCS £m	Onerous costs £m	Other provisions £m	Total £m
At 1 March 2015	5	1	7	1	14
Charge to administrative expenses	–	2	6	–	8
Unused amounts reversed	–	–	–	(1)	(1)
Utilised in year	–	(2)	(3)	–	(5)
At 29 February 2016	5	1	10	–	16
	Customer redress £m	FSCS £m	Onerous costs £m	Other provisions £m	Total £m
At 1 January 2014	6	2	–	3	11
Charge to administrative expenses	–	2	7	1	10
Unused amounts reversed	(1)	–	–	–	(1)
Utilised in year	–	(3)	–	(3)	(6)
At 28 February 2015	5	1	7	1	14

Customer redress provisions

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

Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) is funded by levies on authorised financial services firms, based on their level of deposits taken at 31 December each year. The Bank, as a regulated deposit taker, is subject to levies imposed by the FSCS whose costs are made up of management expenses and compensation payments. The Bank's share of the repayments is based on its share of industry protected deposits as at 31 December preceding the relevant regulatory year. The provision is recognised on the first day of the regulatory year being 1 April.

The closing provision at 29 February 2016 represents the estimated share of levies that will be raised by the FSCS including the interest on the loan in respect of the levy years, 2015/16 and is based on an estimate of the interest that the FSCS will pay on the loan and an estimate of the Bank's market participation in the relevant periods. Hence, the provision is based on the interest estimated on the current borrowings from HM Treasury.

Onerous costs

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

Other provisions

Other provisions previously related to the cost of bonus Nectar points and, previously, to ATM cash retracts. There are no amounts required to be provided in respect of these items as at 29 February 2016.

Notes to the financial statements

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25. Called up share capital

	'A' ordinary shares of £1 £m	'B' ordinary shares of £1 £m	Ordinary shares of £1 £m	Total £m
Allotted, called up and fully paid:				
At 1 March 2015	–	–	299	299
Issued ordinary shares	–	–	137	137
At 29 February 2016	–	–	436	436
At 1 January 2014	85	85	–	170
Reclassification	(85)	(85)	170	–
Issued ordinary shares	–	–	129	129
At 28 February 2015	–	–	299	299

Prior to 1 February 2014 share capital was divided into class 'A' and class 'B' Ordinary shares which ranked pari passu in all respects. From 1 February 2014, the Bank altered its Articles of Association to change the status of its share capital to one class of ordinary shares.

During the year the Bank issued 137m (2015: 129m) ordinary shares of £1 each at par to J Sainsbury plc. Of this, £nil (2015: £50m) was issued in exchange for repayment of subordinated undated loan capital.

26. Retained earnings

	29 Feb 2016 £m	28 Feb 2015 £m
At 1 March 2015/1 January 2014	159	184
Profit/(loss) for the financial period	6	(25)
Share based payment (net of tax)	1	–
At 29 February 2016/28 February 2015	166	159

27. Other reserves

Other reserves comprise the unhedged fair value movements for available for sale securities. The available for sale reserve will unwind in line with the maturity profile of the underlying investment securities.

	Available for sale reserve £m	Total £m
At 1 March 2015	–	–
Net unrealised gains	1	1
At 29 February 2016	1	1
At 1 January 2014	(1)	(1)
Realised losses transferred to the income statement on disposal	1	1
Net unrealised losses	–	–
At 28 February 2015	–	–

These balances include tax of £0.1m in the available for sale reserve (2015: £nil).

28. Analysis of financial assets and liabilities by measurement basis

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

	Loans and receivables £m	Available for sale securities £m	Derivatives designated as fair value hedging instruments £m	Total £m
At 29 February 2016				
Assets:				
Loans and advances to customers	3,353	–	–	3,353
Cash and balances with central banks	423	–	–	423
Loans and advances to banks	25	–	–	25
Derivative financial instruments	–	–	–	–
Financial investments – Available for sale				
Investment securities	–	317	–	317
Other assets	206	–	–	206
Total financial assets	4,007	317	–	4,324
Non-financial assets:				
Other assets				18
Property, plant and equipment				39
Intangible assets				118
				4,499
		Financial liabilities at amortised cost £m	Derivatives designated as fair value hedging instruments £m	Total £m
Liabilities:				
Customer accounts		3,209	–	3,209
Other deposits		247	–	247
Other borrowed funds		299	–	299
Derivatives		–	18	18
Other liabilities		100	–	100
Total financial liabilities		3,855	18	3,873
Non-financial liabilities:				
Other liabilities				2
Provisions				16
Deferred tax				5
				3,896

Notes to the financial statements

Continued

28. Analysis of financial assets and liabilities by measurement basis (continued)

At 28 February 2015	Loans and receivables £m	Available for sale securities £m	Derivatives designated as fair value hedging instruments £m	Total £m
Assets:				
Loans and advances to customers	3,032	–	–	3,032
Cash and balances with central banks	696	–	–	696
Loans and advances to banks	138	–	–	138
Derivative financial instruments	–	–	1	1
Financial investments – Available for sale				
Investment securities	–	53	–	53
Other assets	174	–	–	174
Total financial assets	4,040	53	1	4,094
Non-financial assets:				
Other assets				12
Property, plant and equipment				27
Intangible and tax assets				104
				4,237

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

29. Loan and operating lease commitments

Loan commitments

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

	29 Feb 2016 £m	28 Feb 2015 £m
Commitments to extend credit	77	79

Operating lease commitments

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

	29 Feb 2016 £m	28 Feb 2015 £m
Due within one year	–	–
Due within 1-5 years	5	4
Due in more than 5 years	6	7
	11	11

30. Risk management

Through its normal operations, the Bank is exposed to a number of risks, the most significant of which are credit risk, operational risk, operational capability risk, capital adequacy risk, compliance and conduct risk, liquidity & funding risk and market risk. The overall risk management framework is described in detail in the strategic report. Further disclosure on capital resources is provided at note 31.

Credit risk

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

Wholesale and derivative credit risk

The Bank invests its liquidity resources in eligible investment securities that qualify for the regulatory Liquidity Coverage Ratio (LCR) and internal Operational Liquidity Pool (OLP). These investments include the Bank of England's (BoE) reserve account, certificate of deposits, UK government securities (gilts or Treasury bills), multilateral development bank securities, government guaranteed agency securities and UK regulated covered bond programmes. Limits have been established for all counterparties exposure based on their respective credit quality and market liquidity. The counterparties and their limits are recommended by Treasury and subsequently approved by the Asset and Liability Committee (ALCO), acting on its delegated authority by Board Risk Committee (BRC). Unmargined mark-to-market derivatives credit exposure are subject to the same credit risk control procedures as are applied to other wholesale credit counterparties and instruments.

Retail credit risk

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

At 29 February 2016, the maximum credit exposure of the Bank in the event of other parties failing to perform their obligations is equal to the sum of loans and advances to customers, loans and advances to banks, investment securities and credit lines and other commitments to lend. These are set out in notes 11, 13, 15 and 29 respectively. No account is taken of any collateral held and the maximum exposure to loss is considered to be the instrument's balance sheet carrying amount.

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

	29 Feb 2016 £m	28 Feb 2015 £m
Credit risk exposures relating to on balance sheet items		
Loans and advances to customers		
Unsecured	3,310	2,982
Secured	43	50
Cash and balances with central banks	423	696
Loans and advances to banks	25	138
Derivative financial instruments	–	1
Investment securities	317	53
Other assets	206	174
Credit risk exposures relating to off balance sheet items		
Loans commitment and other related liabilities	77	79
Treasury bills drawn under FLS	240	240
Total credit risk exposures	4,641	4,413

Risk concentrations

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

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

30. Risk management (continued)**Geographical sectors**

	29 Feb 2016 £m	28 Feb 2015 £m
Maximum exposure		
United Kingdom	4,426	4,337
Europe	198	76
Other	17	–
	4,641	4,413

Concentration by location for loans and advances is measured based on the location of the Bank's operations, which has a high correlation with the location of the borrower. Concentration by location for investment securities is measured based on the location of the issuer of the security. The analysis reflects the credit risk associated with the balance and is not reflective of a currency exposure. The Bank had no significant foreign currency exposure as at 29 February 2016. Foreign currency risk is more fully described on page 47.

Industry sectors

	29 Feb 2016 £m	28 Feb 2015 £m
Maximum exposure		
Corporate	25	–
Government	561	777
Financial institutions	579	474
Retail	3,476	3,162
	4,641	4,413

Credit quality per class of financial asset**Loans and advances to customers**

Loans and advances are summarised as follows:

	29 Feb 2016 £m	28 Feb 2015 £m
Impaired	106	107
Past due but not impaired	13	16
Neither past due nor impaired	3,300	2,991
Gross	3,419	3,114
Less: allowance for impairment	(79)	(87)
hedging fair value adjustment	13	5
	3,353	3,032

30. Risk management (continued)**Credit quality analysis**

	Unsecured lending £m	Secured lending £m	Total £m
At 29 February 2016			
Impaired			
Less than 3 months, but impaired	2	–	2
Past due 3 to 6 months	8	–	8
Past due 6 to 12 months	–	1	1
Past due over 12 months	–	–	–
Recoveries	95	–	95
Total gross impaired loans	105	1	106
Past due but not impaired			
Past due up to 3 months but not impaired	12	1	13
Total gross past due but not impaired	12	1	13
Neither past due nor impaired*			
Not impaired	3,260	40	3,300
Total gross neither past due nor impaired	3,260	40	3,300
Total gross amount due	3,377	42	3,419

* Includes £2m of loans and advances that would have been past due or impaired had their terms not been renegotiated.

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

* Includes £2m of loans and advances that would have been past due or impaired had their terms not been renegotiated.

Mortgages held over residential properties represent the only collateral held by the Bank for retail exposures. The market value of collateral held for impaired loans and loans past due but not impaired was £7m (2015: £8m). The fair value of collateral held against possession cases was £nil (2015: £nil).

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

30. Risk management (continued)**Loans and advances to banks**

The total gross amount of individually impaired loans and advances to banks as at 29 February 2016 was £nil (2015: £nil). No collateral is held regarding these assets. The table below presents an analysis of lending to banks by rating agency designation, based on Moody's ratings:

	29 Feb 2016 £m	28 Feb 2015 £m
Aaa to A3	25	138

Debt securities, cash and balances with central banks, UK government securities and other eligible investment securities

The total gross amount of individually impaired debt securities, cash and balances with central banks, UK government securities (gilts and Treasury bills) and other eligible investment securities as at 29 February 2016 was £nil (2015: £nil). No collateral is held regarding these assets. The tables below present an analysis of the credit quality of money market funds included within cash and cash equivalents. The credit quality of UK government securities (gilts and Treasury bills) and investment securities by market value is also included. Analysis is by rating agency designation, based on Moody's ratings:

	Cash and balances with central banks £m	UK government securities £m	Other investment securities £m	Total £m
At 29 February 2016				
Aaa to A3	–	52	265	317
ATM cash and balances with central banks	423	–	–	423
	423	52	265	740

	Cash and balances with central banks £m	UK government securities £m	Other investment securities £m	Total £m
At 28 February 2015				
Aaa to A3	–	53	–	53
ATM cash and balances with central banks	696	–	–	696
	696	53	–	749

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

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

	Gross assets/ (liabilities) recognised £m	Amounts offset £m	Net amounts recognised in the balance sheet £m	Related amounts not offset in the balance sheet		
				Financial instruments £m	Collateral pledged £m	Net amounts £m
At 29 February 2016						
Derivative financial instruments – liabilities	(18)	–	(18)	–	17	(1)
	(18)	–	(18)	–	17	(1)
At 28 February 2015						
Derivative financial instruments – assets	1	–	1	–	(1)	–
Derivative financial instruments – liabilities	(6)	–	(6)	–	6	–
	(5)	–	(5)	–	5	–

The Bank has derivatives which are governed by the International Swaps and Derivatives Association (ISDA) and their associated credit support annex (CSA) bilateral agreements whereby if the fair value exceeds a pre-agreed level, cash collateral is exchanged. In September 2015, the Bank began moving its bilateral agreements to a central clearing counterparty, the London Clearing House (LCH), the terms of which also require an initial margin to be provided. At 29 February 2016, the Bank had provided cash collateral of £17m (28 Feb 2015: £5m) against the derivative liability position, and £10m (28 Feb 2015: £nil) of initial margin by way of off-balance sheet treasury bills obtained under the FLS (see note 11).

Operational risk

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

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

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

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

30. Risk management (continued)

Operational capability risk

The Bank has identified operational capability as a specific risk to ensure there is appropriate focus on maintaining acceptable channel performance in current and stress conditions. The Bank has assessed its key channels as telephony, the web and ATMs.

Performance is monitored on a regular basis with early warning indicators and Red, Amber, Green (RAG) status utilised to ensure appropriate and timely escalation. Controls and standards are in place around supplier performance, service standards and IT security. In addition to this an incident management process exists as part of a wider business continuity management framework. This is subject to an annual crisis test.

Capital adequacy risk

The Bank holds regulatory capital to ensure it is able to absorb losses both in current and stressed conditions. The management of capital is governed through the ALCO, BRC and Board with a capital adequacy policy in place that articulates risk appetite and limit structure.

Capital adequacy is monitored and reported on a daily basis with early warning indicators and Red, Amber, Green (RAG) status utilised to ensure appropriate and timely escalation.

The Bank undertakes an annual Internal Capital Adequacy Assessment Process (ICAAP) that assesses the material risks faced by the Bank through stress testing and scenario analysis. This is a key risk management tool in determining the adequacy of capital resources as well as mitigating actions. Output is subject to review and approval by the Executive Committee (Exco), BRC and Board. Findings are also utilised to inform risk appetite and acceptable levels of earnings volatility.

Compliance and conduct risk

Compliance and conduct risk is the risk of the consequences from the Bank failing to meet the requirements of legislation and regulatory requirements as defined by any relevant regulatory bodies. This can encompass legal and compliance risk, prudential risk and conduct with customers.

The Bank's aim is to meet all legal and regulatory requirements and minimise any reputational impact by maintaining an effective control framework. Compliance and conduct advice and guidance is provided to the business structured predominately through a prescribed policy framework, implemented by the business and supported by effective second line monitoring and assurance.

Conduct risk is the risk that our actions or decisions could result in unfair outcomes causing loss or detriment for our customers. Keeping the trust of our customers is very important to the Bank. The Bank therefore has a low risk appetite to conduct risk and is committed to managing the business in a way that ensures it mitigates the risk of customer detriment.

As the Bank is predominantly an outsourced business, this also applies to our third party suppliers. Management of our compliance and conduct risk was regularly reported through the Bank's governance arrangements.

Liquidity and funding risk

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

The Bank has completed an Internal Liquidity Adequacy Assessment Process (ILAAP) which allows the Bank to demonstrate that it understands the liquidity risks it is running and has appropriate controls in place to mitigate them. The ILAAP is also used to scale the limits that are applied to liquidity and funding and these are informed by a number of stress scenarios that assess the survival period of the Bank.

In meeting internal limits as well as PRA requirements, the Bank maintains a stock of high quality liquid assets that can be readily sold, or form part of a sale and repurchase agreement, to meet the Bank's obligations to depositors and other creditors. The portfolio of assets is managed on a daily basis and within the framework as outlined in the ILAAP and by the PRA.

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

Risk indicators for wholesale funding concentrations by type (total/secured/unsecured), maturity, sector, geography and counterparty; and asset encumbrance ratios are reported to ALCO.

30. Risk management (continued)

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

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

Residual contractual maturity analysis

At 29 February 2016	Less than 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Assets						
<i>Non-derivative assets</i>						
Loans and advances to customers	939	184	745	1,753	61	3,682
Cash and balances at central banks	423	–	–	–	–	423
Loans and advances to banks	25	–	–	–	–	25
Investment securities	52	60	49	155	6	322
Other assets	177	–	–	21	19	217
	1,616	244	794	1,929	86	4,669
<i>Derivative assets</i>						
Fair value hedges						
Outflow	–	–	–	(1)	–	(1)
Inflow	–	–	–	1	–	1
Net derivative cash flows	–	–	–	–	–	–
Total cash inflows	1,616	244	794	1,929	86	4,669
Liabilities						
<i>Non-derivative liabilities</i>						
Customer accounts	2,863	55	149	187	–	3,254
Other deposits	–	1	32	236	–	269
Other borrowed funds	16	21	87	185	–	309
Other liabilities	100	–	–	–	–	100
	2,979	77	268	608	–	3,932
<i>Derivative liabilities</i>						
Fair value hedges						
Outflow	2	3	12	18	1	36
Inflow	(1)	(2)	(6)	(8)	–	(17)
Net derivative cash flows	1	1	6	10	1	19
Unrecognised loan commitments	77	–	–	–	–	77
Total cash outflows	3,057	78	274	618	1	4,028
Net liquidity	(1,441)	166	520	1,311	85	641

30. Risk management (continued)

Residual contractual maturity analysis (continued)

At 28 February 2015	Less than 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Assets						
<i>Non-derivative assets</i>						
Loans and advances to customers	852	175	702	1,572	19	3,320
Cash and balances at central banks	696	–	–	–	–	696
Loans and advances to banks	48	75	–	–	–	123
Investment securities	–	40	13	–	–	53
Other assets	174	–	–	–	–	174
	1,770	290	715	1,572	19	4,366
<i>Derivative assets</i>						
Fair value hedges						
Outflow	–	–	(2)	(3)	–	(5)
Inflow	–	–	2	2	–	4
Net derivative cash flows	–	–	–	(1)	–	(1)
Total cash inflows	1,770	290	715	1,571	19	4,365
Liabilities						
<i>Non-derivative liabilities</i>						
Customer accounts	3,402	55	214	187	–	3,858
Other deposits	–	4	16	3	–	23
Other borrowed funds	7	14	52	83	–	156
Other liabilities	101	–	–	–	–	101
	3,510	73	282	273	–	4,138
<i>Derivative liabilities</i>						
Cash flow hedges						
Outflow	1	2	7	9	–	19
Inflow	(1)	(1)	(4)	(4)	–	(10)
Net derivative cash flows	–	1	3	5	–	9
Unrecognised loan commitments	79	–	–	–	–	79
Total cash outflows	3,589	74	285	278	–	4,226
Net liquidity	(1,819)	216	430	1,293	19	139

Asset Encumbrance

An asset is defined as encumbered if it has been pledged as collateral against a recognised or off balance sheet liability and therefore is no longer available for disposal or as collateral to support liquidity or funding requirements of the Bank. The encumbrance levels of assets and related recognised or off balance sheet liabilities are shown in the following tables:

At 29 February 2016	Encumbered £m	Unencumbered £m	Total £m
Loans and advances to customers	847	2,506	3,353
Other assets	17	207	224
Cash and balances with central banks	5	418	423
	869	3,131	4,000

	Carrying value of encumbered assets £m	Matching liabilities, contingent liabilities or securities lent £m
Loans and advances to customers	847	540
Other assets	17	18
Cash and balances with central banks	5	5
	869	563

30. Risk management (continued)**Asset Encumbrance (continued)**

At 28 February 2015	Encumbered £m	Unencumbered £m	Total £m
Loans and advances to customers	678	2,354	3,032
Other assets	5	181	186
Cash and balances with central banks	5	691	696
	688	3,226	3,914

	Carrying value of encumbered assets £m	Matching liabilities, contingent liabilities or securities lent £m
Loans and advances to customers	678	390
Other assets	5	6
Cash and balances with central banks	5	5
	688	401

The main sources of encumbrance in the Bank relate to margin requirements for derivative transactions and collateral relating to secured funding transactions. Cash collateral is advanced and received as variation margin on derivatives transactions. Eligible personal loans with applicable haircuts are used as collateral for the bilateral personal loans securitisation facility and the Bank of England's Funding for Lending Scheme (FLS) and Discount Window Facility (DWF). The personal loans used to secure the funding (in note 22) are held within Loans and advances to customers. There are assets which would not normally be considered available for encumbrance in the normal course of the Bank's business including intangible assets, property, plant and equipment, prepayments and accruals and deferred tax assets. These are included within the carrying value of unencumbered assets.

Market risk

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

Interest rate risk

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

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

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

Overall risk appetite for interest rate risk is set by the Board Risk Committee. Lower level limits are monitored by the ALCO to ensure that risk is maintained within the overall risk appetite of the Bank. Hedging strategies are implemented to ensure the Bank remains within risk limits. Where possible, the Bank matches offsetting interest rate positions to manage interest rate risk. The Bank manages the interest rate risk net exposure by transacting interest rate swaps. The Bank uses market recognised software through a third party vendor to assist in the measurement and monitoring of interest rate risk.

Hedges are primarily transacted to manage the interest rate risk of the personal loan portfolio. The interest rate swaps pay a fixed rate of interest to manage the re-pricing risk of the fixed rate personal loan portfolio.

30. Risk management (continued)

The primary measures used by the Bank to capture interest rate risk include analysis of the impact of small and extreme changes in interest rates on the market value of the Bank's assets and liabilities and on the Bank's earnings. As at 29 February 2016, the market value sensitivity (change in equity) and earnings at risk (change in net interest income) for changes in interest rates of +/-200 basis points and +/-100 basis points movements in rates are as follows:

	29 February 2016		28 February 2015	
	Change on net interest income £m	Change in equity £m	Change on net interest income £m	Change in equity £m
+/- 200 basis points	(16)/5	(13)/4	(17)/18	(12)/12
+/- 100 basis points	(8)/5	(6)/4	(8)/8	(8)/8

The above analysis assumes that interest rates would floor at 0% and would not result in negative rates becoming applicable.

Foreign exchange risk

Foreign exchange risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank was previously primarily exposed to foreign exchange risks from currency cash flows arising from its investment security denominated in Euro, which was disposed of during the period to 28 February 2015. Prior to disposal, these currency cash flows were fully hedged into sterling with currency swaps. The currency swap has since been unwound on disposal of the related instrument.

Since March 2015 the Bank is exposed to foreign exchange risk through its holding of cash denominated in foreign currencies, primarily Euro and US Dollar, within its travel money bureaux in J Sainsbury's stores.

Due to the relative low value of foreign currencies held, and frequent turnover of the currencies in stock, the Bank does not consider the foreign exchange risks arising during the year and at the balance sheet date to be material.

31. Capital resources

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

	29 Feb 2016 £m	28 Feb 2015 £m
Common Equity Tier 1 (CET 1) capital:		
Ordinary share capital	436	299
Allowable reserves	167	159
Regulatory adjustments	(118)	(104)
Total Common Equity Tier 1 (CET 1) capital	485	354
Tier 1 Capital	485	354
Total capital	485	354

Regulatory capital is calculated under the Capital Requirements Regulations and Capital Requirements Directive (collectively known as CRD IV) as enacted in the UK. Common Equity Tier 1 (CET 1) capital includes ordinary share capital, other reserves, losses and regulatory deductions. The Bank does not currently hold any Tier 2 capital.

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

	29 Feb 2016 £m	28 Feb 2015 £m
At 1 March 2015 / 1 January 2014	354	305
Share capital issued	137	129
Verified profit attributable to shareholders ¹	6	45
Other reserve movements	2	–
Losses recognised	–	(25)
(Increase) in intangible assets	(14)	(100)
As at 29 February 2016 / 28 February 2015	485	354

Reconciliation of statutory reserves to regulatory reserves

	29 Feb 2016 £m	28 Feb 2015 £m
Total shareholders' funds	603	458
Intangible assets	(118)	(104)
CET 1 capital	485	354

1. It is now standard industry practice to include annual profits in reserves for the period to which they relate, providing these have been verified prior to the date the financial statements are signed. Losses are recognised as a deduction from CET 1 capital as they arise. £45m included in the period to 28 February 2015 relates to Bank audited profits to December 2013 which were not recognised in regulatory reserves for the financial statements in respect of that financial year, as was standard industry practice at that time.

31. Capital resources (continued)**Leverage ratio (Unaudited)**

The leverage ratio is defined as the ratio of Tier 1 capital to adjusted assets. The denominator represents the total non-risk weighted assets adjusted for certain off balance sheet exposures assets and regulatory deductions and provides a non-risk-weighted 'backstop' capital measure. The leverage ratio is planned to become a Pillar 1 measure from 1 January 2018. The leverage ratio is calculated below as at 29 February 2016 - this represents both transitional and end point CRD IV measures. The Bank's leverage ratio of 9.8% exceeds the minimum Basel leverage ratio of 3%.

	29 Feb 2016 £m	28 Feb 2015 £m
Components of the leverage ratio		
Total assets as per published financial statements	4,499	4,237
Removal of accounting value of derivatives and SFTs	–	(1)
Exposure value for derivatives and SFTs	6	5
Off balance sheet exposures: unconditionally cancellable (10%)	336	313
Off balance sheet: other (100%)	260	318
Other adjustments	(136)	(104)
	4,965	4,768
Tier 1 capital	485	354
Leverage ratio	9.8%	7.4%

Capital management

The Bank manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. During the period to 29 February 2016, the Bank received planned injections of £137m of ordinary share capital to support the forecast costs and deductible intangible assets generated through the development of flexible banking platforms. Capital adequacy is monitored on an on-going basis by senior management, the ALCO, the Executive Risk Committee and the Board Risk Committee. Our submissions to the PRA in the year have shown that the Bank has complied with all externally imposed capital requirements.

The Bank will disclose Pillar 3 information as required by the Capital Requirements Regulations and PRA prudential sourcebook on the J Sainsbury plc external website in June 2016.

32. Fair value of financial instruments**Fair value hierarchy**

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

Level 1

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

Level 2

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

Level 3

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

32. Fair value of financial instruments (continued)

The below table provides an analysis of the relevant fair value hierarchy for items recognised at fair value:

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 29 February 2016				
Derivatives financial instruments	–	–	–	–
Investment Securities	316	–	1	317
Total assets	316	–	1	317
Derivative financial instruments	–	(18)	–	(18)
Total liabilities	–	(18)	–	(18)
At 28 February 2015				
Derivatives financial instruments	–	1	–	1
Investment Securities	53	–	–	53
Total assets	53	1	–	54
Derivative financial instruments	–	(6)	–	(6)
Total liabilities	–	(6)	–	(6)

The Bank's level 3 instrument relates to the valuation of its share of Visa Europe Limited.

The acquisition of Visa Europe Limited by Visa Inc was announced in November 2015 and is expected to complete around the second quarter of 2016. Under the terms of the acquisition, the Bank's share of the sale proceeds will comprise upfront consideration and preferred stock in Visa Inc. The preferred stock is convertible into Class A common stock, at a future date, subject to the satisfaction of certain conditions and remains subject to potential reduction for certain litigation losses incurred by Visa Europe. The Bank may also be entitled to additional cash consideration three years after the completion of the sale.

The valuation recognised by the Bank is equal to its expected up-front cash proceeds as indicated by Visa Europe Limited. No amounts have been recognised in respect of the preferred stock as a result of the uncertainties referred to above. Similarly, no amount has been recognised in respect of the additional cash consideration payable three years post completion as a result of a lack of available information to reliably measure that amount.

The most significant unobservable input to the valuation is the discount applied to the value of the preferred stock to reflect the risks of future reduction in conversion to Visa Inc. Class A common stock and restrictions on transferability.

The following table summarises the fair value of financial assets and liabilities that are not presented in the Bank's balance sheet at fair value. The fair values of financial instruments are based on market prices where available, or are estimated using other valuation techniques. Where they are short term in nature or re-price frequently, fair value approximates to carrying value. The fair value information presented does not represent the fair value of the Bank as a going concern at 29 February 2016 or 28 February 2015.

	29 Feb 2016		28 Feb 2015	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Assets:				
Loans and advances to customers	3,353	3,337	3,032	3,024
Cash and balances at central banks	423	423	696	696
Loans and advances to banks	25	25	138	138
Liabilities:				
Customer accounts	3,209	3,213	3,488	3,490
Other deposits	247	245	23	23
Other borrowed funds	299	299	148	148

32. Fair value of financial instruments (continued)

The fair value hierarchy classification adopted by the Bank in respect of assets not presented in the Bank's balance sheet at fair value is shown in the following table:

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 29 February 2016				
Loans and advances to customers	–	3,337	–	3,337
Cash and balances at central banks	–	423	–	423
Loans and advances to banks	–	25	–	25
Total assets	–	3,785	–	3,785
Customer accounts	–	3,213	–	3,213
Other deposits	–	245	–	245
Other borrowed funds	–	299	–	299
Total liabilities	–	3,757	–	3,757
At 28 February 2015				
Loans and advances to customers	–	3,024	–	3,024
Cash and balances at central banks	–	696	–	696
Loans and advances to banks	–	138	–	138
Total assets	–	3,858	–	3,858
Customer accounts	–	(3,490)	–	(3,490)
Other deposits	–	(23)	–	(23)
Other borrowed funds	–	(23)	–	(23)
Total liabilities	–	(3,513)	–	(3,513)

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

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

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

33. Parent company

The immediate and ultimate parent company and controlling party of the Bank is J Sainsbury plc, which is registered in England and Wales. J Sainsbury plc forms the only group into which the financial statements of the Bank are consolidated. Copies of the parent company's financial statements may be obtained from www.j-sainsbury.co.uk.

34. Share-based payments

The Bank recognised £1.4m (2015: £0.4m) of employee costs (note 5) related to share-based payment transactions made during the financial year. Of these, £nil (2015: £nil) were cash-settled.

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

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

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

At 29 February 2016, employees held 57 five-year savings contracts (2015: 46) in respect of options over 0.1m shares (2015: 0.05m) and 273 three-year savings contracts (2015: 156) in respect of options over 0.4m shares (2015: 0.25m). A reconciliation of option movements is shown below:

	2016 Number of options million	2016 Weighted average exercise price pence	2015 Number of options million	2015 Weighted average exercise price pence
Outstanding at beginning of year	0.3	235	0.1	293
Granted	0.3	195	0.2	213
Forfeited	(0.1)	236	–	306
Exercised	–	245	–	255
Outstanding at end of year	0.5	215	0.3	235
Exercisable at end of year	–	270	–	249

The weighted average share price of J Sainsbury plc during the period for options exercised over the year was 268 pence (2015: 335 pence). The weighted average remaining contractual life of share options outstanding at 29 February 2016 was 3.2 years (2015: 3.4 years).

Details of options at 29 February 2016 are set out below:

Date of grant	Date of expiry	Exercise price pence	Options outstanding 2016 million	Options outstanding 2015 million
12 December 2014 (3 year period)	31 August 2018	213	0.2	0.2
12 December 2014 (5 year period)	31 August 2020	213	–	0.1
17 December 2014 (3 year period)	31 August 2019	195	0.2	–
17 December 2014 (5 year period)	31 August 2021	195	0.1	–
			0.5	0.3

Options granted during the year were valued using the Black-Scholes option-pricing model. No performance conditions were included in the fair value calculations. The fair value per option granted during the year and the assumptions used in the calculation are as follows:

	2016	2015
Share price at grant date (pence)	243	265
Exercise price (pence)	195	213
Expected volatility – 3 year period (%)	26.6	21.9
– 5 year period (%)	24.1	21.2
Option life – 3 year period (years)	3.2	3.2
– 5 year period (years)	5.2	5.2
Expected dividends (expressed as dividend yield %)	5.1	5.6
Risk-free interest rate – 3 year period (%)	1.6	1.6
– 5 year period (%)	2.1	2.1
Fair value per option – 3 year period (pence)	48	43
– 5 year period (pence)	45	41

The expected volatility is based on the standard deviation of J Sainsbury plc's share price for the period immediately prior to the date of grant of award, over the period identical to the vesting period of the award, adjusted for management's view of future volatility of the share price.

The resulting fair value is expensed over the service period of three or five years, as appropriate, on the assumption that 25 per cent of options will be cancelled over the service period as employees leave the SAYE scheme.

34. Share based payments (continued)**Long-Term Incentive Plan 2006**

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

The awards granted between 2006 and 2011 will vest if the threshold levels of two co-dependent Group performance conditions – Return on Capital Employed ('ROCE') and growth in cash flow per share at the J Sainsbury plc group level, are achieved over the three-year performance period. The award granted in 2012 and 2013 is assessed against Group ROCE, cumulative underlying cash flow from operations and relative sales measured against the IGD Index, with an Earnings Per Share gateway. The award granted in 2014 is assessed against Group ROCE, cumulative underlying cash flow from operations and relative sales measured against the IGD Index. The award granted in 2015 is assessed against Group ROCE, cumulative underlying cash flow from operations less capital expenditure, Earnings Per Share and cost savings. The core award can grow by up to four times, dependent on the level of performance. Straight-line vesting will apply if performance falls between two points. Awards are structured as nil cost options.

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

To achieve the maximum multiplier of four, the following criteria are required to be met:

Date of conditional award	Targets to achieve maximum multiplier	
	Cash flow per share %	Return on capital employed %
19 May 2011	12	15

Date of conditional award	Group targets to achieve maximum multiplier				
	Cumulative underlying cash flow £m	Return on capital employed %	Relative Sales	Cost Savings £m	Earnings per Share Pence
16 May 2013	6,500m	12	Index +1% pa	–	–
15 May 2014	6,750m	12	Index +1% pa	–	–
14 May 2015	5,150m	12	–	600	30

A reconciliation of the number of shares conditionally allocated is shown below:

	2016 million	2015 million
Outstanding at beginning of year	0.3	0.3
Conditionally allocated	0.2	0.2
Forfeited	(0.1)	(0.1)
Released to participants	–	(0.1)
Outstanding at end of year	0.4	0.3

The weighted average remaining contractual life of share options outstanding at 29 February 2016 was 2.0 years (2015: 1.9 years).

Details of shares conditionally allocated at 29 February 2016 are set out below:

Date of conditional award	2016 million	2015 million
16 May 2013	0.1	0.1
15 May 2014	0.1	0.2
14 May 2015	0.2	–
	0.4	0.3

Options to acquire the award of shares were valued using the Black-Scholes option-pricing model. No performance conditions were included in the fair value calculations. The fair value per option granted during the year and the assumptions used in the calculation are as follows:

	2016	2015
Share price at grant date (pence)	276	334
Option life (years)	4.2	4.2
Fair value per option (pence)	276	334

34. Share based payments (continued)

During the year, a total number of 0.04 million options were exercised. The weighted average share price during the year for options exercised was 264 pence (2015: 321 pence).

c. Deferred Share Award

The Deferred Share Award targets a diverse range of business critical financial and strategic scorecard measures. These are intended to reward the top 40 managers in the Group, including Executive Directors, for driving the short-term objectives that will directly lead to building the sustainable, long-term growth of the Group. Awards are structured as nil cost options.

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

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

A reconciliation of the number of shares granted over the year is shown below:

	2016 million	2015 million
Outstanding at beginning of year	–	0.1
Granted	0.1	–
Exercised	–	(0.1)
Outstanding at end of year	0.1	–

The number of shares allocated at the end of the year is set out below:

	Shares conditionally allocated 2016 million	Shares conditionally allocated 2015 million
14 May 2015	0.1	–
	0.1	–

The weighted average remaining contractual life of share options outstanding at 29 February 2016 was 0.9 years (2015: 1.0 years).

d. Bonus Share Award

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

60 per cent of the bonus is paid in cash and 40 per cent converted into shares, which are automatically released after three financial years. The share element of the bonus arrangement is called the Bonus Share Award. Bonus Shares are subject to forfeiture if the participant resigns or is dismissed for cause prior to their release date. Dividends accrue on these shares and are released at the end of the three year retention period. The Group's top 40 managers do not receive Bonus Share Awards as they receive Deferred Share Awards.

A reconciliation of the number of shares granted over the year is shown below:

	2016 million	2015 million
Outstanding at beginning of year	–	–
Granted	0.4	–
Lapsed	(0.1)	–
Outstanding at end of year	0.3	–

The number of shares conditionally allocated at the end of the year is set out below:

	2016 million	2015 million
14 May 2015	0.3	–
	0.3	–

The weighted average remaining contractual life of share options outstanding at 29 February 2016 was 2.1 years (2015: 1.1 years).

Notes to the financial statements

Continued

35. Related party transactions

a. Transactions with Related Entities

The Bank is a wholly owned subsidiary of J Sainsbury plc. The Bank has a subsidiary undertaking, Lochside Asset Purchaser No.1 plc as described in note 18.

J Sainsbury plc

	29 Feb 2016 £m	28 Feb 2015 £m
Transactions during the period		
<i>Services and loans provided by J Sainsbury plc:</i>		
Management services	42	98
Interest expense paid in respect of interest bearing loans	–	1
Subordinated dated loan capital repaid in the period	–	60
Subordinated undated loan capital repaid in the period	–	50
Share capital issued to J Sainsbury plc	137	129
Balances at end of period		
<i>Payables:</i>		
Management services	6	13

Lochside Asset Purchaser No.1 plc

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

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

	29 Feb 2016 £m	28 Feb 2015 £m
Transactions during the period		
Interest receivable on intercompany loan	–	–
Interest paid on deemed loan	(8)	–
Servicer fee received	1	–
Balances at end of period		
<i>Other Assets:</i>		
Intercompany loan	7	3
<i>Payables:</i>		
Interest payable	–	–
Deemed Loan	300	150
Book value of personal loans for which beneficial interest has transferred to SPE	379	191

For additional disclosure on the nature of the deemed loan and offsetting arrangements, see notes 22 and 30.

b. Transactions with key management personnel

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

Remuneration and other compensation

	29 Feb 2016 £m	28 Feb 2015 £m
Short term employee benefits	3.2	2.9
Post-employment benefits	0.1	0.2
Termination benefits	–	0.1
Share-based payments	0.9	0.4
	4.2	3.6

Short term employee benefits represent salary, bonus and benefits in kind. Post-employment benefits relate to employer's contributions to money purchase pension schemes operated by J Sainsbury plc. Share based payments relates to share schemes operated by J Sainsbury plc (see note 34).

35. Related party transactions (continued)

Product transactions

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

	Number of key management personnel	Directors £'000	Other £'000
Mortgages, credit cards and term loans			
At 1 January 2014	4	1	–
Resignations during 2014 / 15	–	–	–
Appointments/ New accounts during 2014 / 15	4	1	1
Amounts advanced during the period	–	70	1
Amounts repaid during the period	–	(68)	(2)
At 28 February 2015	8	4	–
Resignations during 2015 / 16	(2)	(1)	–
Appointments/ New accounts during 2015 / 16	1	1	–
Amounts advanced during the period	–	24	–
Amounts repaid during the period	–	(24)	–
At 29 February 2016	7	4	–

	Number of key management personnel	Directors £'000	Other £'000
Savings and deposit accounts			
At 1 January 2014	3	395	–
Resignations during 2014 / 15	–	–	–
Appointments/ New accounts during 2014 / 15	2	–	1
Amounts deposited during the period	–	76	–
Interest paid	–	6	–
Amounts withdrawn during the period	–	(128)	–
At 28 February 2015	5	349	1
Appointments/ New accounts during 2015 / 16	1	2	–
Amounts deposited during the period	–	134	–
Interest paid	–	4	–
Amounts withdrawn during the period	(2)	(136)	–
At 29 February 2016	4	353	1

Based on the Companies Act definition of Loans to Directors, total lending outstanding at 29 February 2016 was £nil (2015: £nil).

36. Capital commitments

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

	29 Feb 2016 £m	28 Feb 2015 £m
Property, plant and equipment	5	1
Software development	4	13
	9	14

37. Contingent liabilities

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

38. Events after the balance sheet date

On 14 March 2016, the Bank received notification from HMRC that they would no longer challenge that certain services received by the Bank, which had been subject to standard rated VAT, were in fact exempt from VAT. The effect of this decision was such that £10m of VAT previously suffered will become repayable to the Bank and recognised as a reduction in one-off items within operating expenses.

As the inflow of economic benefits was not virtually certain at the balance sheet date, in accordance with IAS 37, the amount receivable and related reduction in costs were not recognised in the financial statements as at 29 February 2016.

Glossary

Bad debt asset ratio – Impairment losses as a percentage of the average balance of loans and advances to customers.

Tier 1 capital – A measure of the Banks financial strength as defined by the PRA. It captures Common Equity Tier 1 capital plus other Tier 1 securities in issue, but is subject to a deduction in respect of material holdings in financial companies.

Common equity tier 1 capital ratio – Tier 1 capital as a percentage of risk-weighted assets.

Cost: income ratio (underlying) – Underlying operating expenses as a percentage of total income.

Debt securities – Assets held by the Bank representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.

Earnings at risk – Approach set out for the quantification of interest rate risk expressed as the impact of the sensitivity analysis on the change to net interest income.

Effective interest rate – The effective interest rate method calculates the amortised cost of a financial asset or financial liability, and allocates the interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset or financial liability.

Encumbered Asset – An asset is defined as encumbered if it has been pledged as collateral against an existing or off-balance sheet liability and therefore is no longer available for disposal or as collateral to support liquidity or funding requirements of the Bank.

Fair value – The amount for which an asset could be exchanged, or a liability settled, between willing parties in an arm's length transaction.

Financial Services Compensation Scheme (FSCS) – The UK's independent statutory compensation fund for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS is funded by management expenses levies and, where necessary, compensation levies on authorised firms.

Full time equivalent – The hours worked by part time employees are accumulated along with the number of full time employees and counted as full time equivalents. This is a more consistent measure of the amount of time worked than employee numbers which will fluctuate as the mix of part time and full time employees changes.

Funding for Lending Scheme (FLS) – A Bank of England run scheme designed to encourage banks to increase lending to businesses by lowering interest rates and increasing access to credit. This was facilitated by BoE lending to the banks at cheaper than market rates for up to four years.

Impaired loans – Impaired loans are loans for which all the full contractual cash flows are no longer expected to be collected or collection of such cash flows will not be as they are contractually due.

Impairment losses – An impairment loss is the reduction in value that arises after the impairment review of an asset that determines that the asset's value is lower than its carrying value.

Interest rate risk – The risk of a reduction in the value of earnings or assets resulting from an adverse movement in interest rates.

Loans past due – These are loans for which a customer has failed to make payment as and when they are contractually due.

Leverage ratio – CET 1 capital divided by the exposure measure. This is a new balance sheet metric introduced by the PRA.

Liquidity Coverage Ratio (LCR) – Percentage of the stock of highly liquid assets such as cash to net cash outflow over a 30 day period.

Loans to deposits ratio – The ratio of loans and advances to customers net of allowance for impairment losses divided by customer deposits.

Master netting agreement – An agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

Net interest margin – Net interest margin is net interest income as a percentage of average interest-earning assets.

Net stable funding ratio – Amount of available stable funding (ASF) relative to the amount of required stable funding (RSF) over a one year time horizon, assuming a stressed scenario.

Pillar 3 – The third pillar of the Basel III framework which aims to encourage market discipline by setting out disclosure requirements for Banks on their capital, risk exposures and risk assessment processes. These disclosures are aimed at improving the information made available to the market.

Repurchase agreements – An agreement where one party, the seller, sells a financial asset to another party, the buyer, at the same time the seller agrees to reacquire and the buyer to resell the asset at a later date. From the seller's perspective such agreements are repurchase agreements (repos) and they are reverse repurchase agreements (reverse repos) from the buyer's perspective.

Return on capital employed – Earnings before interest & tax as a percentage of capital employed.

Securitisation – This is a process, by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities.