Sainsbury's Bank plc

Annual Report and Financial Statements for the year ended 28 February 2017

COMPANY NUMBER: 3279730

Contents

Financial headlines

£60m
Underlying profit before tax
(2016: £65m – Decrease of 7.7%)

£0m
Statutory profit before tax
(2016: £6m)

3.9%
Net interest margin
(2016: 4.1% – Decrease of 20bps)

0.6%
Bad debt asset ratio
(2016: 0.4% – Increase of 20bps)

72%
Cost : income ratio (underlying)
(2016: 71%)

13.3%
CET1 capital ratio
(2016: 15.8%)

113%
Net stable funding ratio
(2016: 126%)

Performance, including reference to the above headlines, is explained in the business review and financial review sections on pages 3 and 10.

Strategic Report

The Directors present their Strategic Report of Sainsbury's Bank plc (the Bank) for the year ended 28 February 2017.

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.

Business model

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

Sainsbury's Bank

Product Offering	Nature of Income	Distribution Channels
Banking Products — Loans — Credit Cards — Residential Mortgages* — Savings — ATMs	**Banking Products** — Funds raised through savings deposits and wholesale sources — Funds lent to customers or held as liquid assets — Resultant margin is income to the Bank	**Banking Products** — Telephone — Online — ATMs in Sainsbury's stores
Insurance — Car — Home — Pet — Travel — Life	**Insurance** — Products offered via introducer contracts with third party insurance partners — Income received through commission and profit share arrangements	**Insurance** — Telephone — Online
Travel Money — Foreign Exchange — Prepaid Cards — Money Transfer	**Travel Money** — Foreign currency acquired wholesale — Sold to customers at retail rate with a resulting margin — Fees earned on prepaid cards and money transfer services	**Travel Money** — Bureaux in Sainsbury's stores — Telephone — Online

*No new mortgages were originated between 2004 and 2017. The Bank re-entered the mortgages market in April 2017.

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.

The Bank is a wholly owned subsidiary of J Sainsbury plc, governed by its own Board and Executive Management Team, independent from J Sainsbury plc (see Risk overview and Governance sections on pages 4 and 7). The Bank was formerly a joint venture between J Sainsbury plc and Lloyds Banking Group plc (LBG), and is currently undertaking a programme, known as the New Bank Programme (NBP), to transition banking product services previously performed by LBG to the Bank's own infrastructure. Savings and ATMs successfully migrated to the Bank's infrastructure during the year and loans and credit cards will be introduced in the financial years ending 28 February 2018 and 28 February 2019 respectively.

The programme represents a significant investment in the future potential of the Bank which requires 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).

During the year the Bank amended its operating model for car and home insurance products from the previous model of a single third party insurance partner per product type to a panel-based multi partner approach, with the Bank also assuming control of a number of support functions previously provided by insurance partners.

In September 2016 the Bank acquired three subsidiary undertakings, collectively representing the Argos Financial Services (AFS) business, from Home Retail Group (UK) Limited, a fellow subsidiary within the J Sainsbury plc Group, as part of the wider acquisition of Home Retail Group by J Sainsbury plc. As a result the Bank now provides funding to Home Retail Group Card Services Limited via an intercompany loan and that undertaking forms part of a regulatory group with the Bank for reporting to the PRA under the Capital Requirements Regulations (CRR). Other than integration of certain reporting capabilities, governance arrangements and operations pertaining to the funding arrangements, the business models of the Bank and AFS remained independent and separate during the year.

The current financial statements continue to report the performance and position of the Bank as a standalone entity. Further disclosure on the combined Financial Services segment of the Sainsbury's Group is provided in the J Sainsbury plc Group financial statements.

Market context

Economy

The main focus of the political and economic year took place in June when the UK voted to leave the European Union. Since then the UK economy has held up better than expected. Overall the official economic data didn't register any alarm; if anything, the UK economy, which had been slowing as the EU referendum vote approached, accelerated afterwards, particularly in consumer spending and services. In the second half of 2016, the economy grew at an annualised rate of 2.6%.

The economic stability was matched by generally calm financial markets, though there was increased volatility around the time of the referendum. The Bank of England (BoE) acted decisively to calm the markets by providing additional liquidity and loosening monetary policy. Base rate was cut by 0.25%, the quantitative easing programme was restarted and additional support for banks was provided via the Term Funding Scheme. Equities and fixed income markets recovered losses quickly and it is only in foreign exchange where the Brexit effect persists, with Sterling initially falling about 15% and remaining weak.

Looking further ahead, while uncertainty remains, UK economic growth is expected to fare better in the near term and worse in later years, as household incomes will be squeezed by higher inflation and businesses will hold back on investment decisions due to uncertainty in the Brexit negotiations. The rapid growth of late 2016 was mainly built on households borrowing more and reducing savings, hence limiting the potential for a sustained growth in the future.

Credit markets continued to perform well towards the end of 2016, on the back of a resilient UK economy, swift actions by the Bank of England, and stability in the UK government. The Bank will continue to monitor any potential economic uncertainties that may arise throughout the negotiations process for the UK to leave the European Union. In addition, the outcomes of a number of elections across Europe will be monitored very closely too.

Banking

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

The personal loans market saw the addition of new entrants to the market as well as pricing activity undertaken by high street banks. For loans between £7,500 and £15,000 the headline rate dropped below 3.0% for the first time and there continues to be a large number of 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. This was coupled with strong consumer demand despite initial uncertainty post the UK vote to leave the European Union.

The credit card market continued to see intense competition through the year, as various credit card issuers provided customers with progressively better offers for balance transfer and purchase promotions. The Bank has achieved growth in new business sales and outstanding balances, whilst payment rates continue to be higher than previous years. Rewards propositions continue to be limited, with some providers continuing to modify their propositions to align with the changes to interchange regulation and evolving customer behaviour. Sainsbury's Bank remains committed to delivering compelling credit card products to its shoppers, underpinned by a strong Nectar reward proposition that has remained largely unchanged and in some cases has been enhanced.

Market rates for savings accounts fell to an all-time low as a result of the Bank of England base rate reduction to 0.25% in August 2016. Whilst demand within instant access markets remains strong, uncertainty around future rate increases has limited demand in fixed-term markets. Pricing across most savings markets remains led by smaller providers and challenger banks trying to increase consumer awareness against established banks. On the back of the ISA product expansion over the last few years, the new variants are yet to gain any significant traction and remain niche offerings.

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 experienced a varied year. External forces such as the UK vote to leave the European Union, the US election and the continued threat of terrorism impacted the market. Popular holiday destinations and therefore demand for specific currencies changed during the year. Following the EU referendum, evidence suggests that customers have become even more rate aware, often buying currency in advance to secure a known rate, and as such the landscape remains competitive.

Strategy

Aligned to the Sainsbury's Group strategy to provide great products and services at fair prices, the Bank's principal strategic purpose and objective is to provide banking products for Sainsbury's customers in the distinctive Sainsbury's way to create Group shareholder value.

Strategic outcomes have been defined in order to measure the successful and balanced delivery of the overall strategy and are measured through a series of key performance indicators, which are disclosed in the relevant section below.

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

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.

As a result, the short-term strategic focus of the Bank is to conclude the NBP transition, followed by a return to growth in the medium term. This context sets the scene for consideration of business performance and key performance indicators considered in the following sections.

The acquisition of Argos Financial Services during the year is consistent with the Bank's strategy and will provide further opportunities in respect of brand, products, systems integration and capability which are outlined in the following business review section. The planned nature, depth and pace of integration of the businesses is expected to evolve within the Bank's strategy during the 2017/18 financial year.

Business review

The year ended 28 February 2017 was significant in the Bank's strategic journey towards transitioning product and core banking capability to its own infrastructure, and becoming the bank of choice for Sainsbury's customers through enhancements to its product offering.

Having developed and invested in capability and infrastructure throughout the year, the Bank launched an innovative mortgage product after the year end in April 2017, which introduced a money off reward on shopping and a strong channel to grow the Bank's assets and customer base.

As noted in the business model section above, the Bank successfully migrated savings and ATMs to our new banking platforms during the year. The programme continues to make good progress and the Bank expects to introduce the new loans platform by the end of the financial year ended 28 February 2018.

In the last quarter, the Bank launched new home and car insurance products. The new products provide quotes from a bespoke panel of specially selected insurers, giving a greater number of Sainsbury's customers more competitive pricing. In addition, Nectar card customers are rewarded with guaranteed discount on their insurance premium.

In September 2016 the Bank acquired AFS as part of the wider acquisition of Home Retail Group plc by J Sainsbury plc and played a key role in the structuring of the transaction by successfully obtaining full UK Regulatory permissions and expanding the Bank's savings portfolio which provided around £500m of funding for the transaction.

The acquisition of AFS presents significant operational synergies. AFS manages an existing store card estate which the Bank will leverage by moving our credit cards onto the same platform. This is expected to take place during the summer of 2018.

The Bank's key performance indicators are disclosed on page 9. As a result of the strategic costs incurred on products and infrastructure which are expected to drive improved performance in future years, underlying profitability and related ratios marginally declined during the year ended 28 February 2017. Underlying profit before tax fell by almost 8% to £60m. Similarly, return on tangible equity fell to 9.4% and there was a 1% rise in the cost : income ratio to 72%.

The number of active customers grew by nearly 4% to 1.77 million. The Bank takes its responsibilities as a lender of consumer credit seriously and saw strong growth in personal lending, with 10% year-on-year growth in the number of advances to new personal loan customers.

The Bank offered Sainsbury's customers a strong range of credit cards throughout the year with the added incentive of additional Nectar points, which resulted in a 70% growth year-on-year in new card accounts and a 6% year-on-year increase in the Bank's credit cards being used in Sainsbury's stores. The Bank's credit cards were regularly featured among 'best buys' throughout the year.

In line with the strong lending performance and support in funding the AFS acquisition, new savings accounts grew by almost 60% year-on-year with strong performance across fixed-term, easy access and ISA products.

Growth in customer lending and continued investment in the transition programme saw the Common Equity Tier 1 capital ratio decrease to 13.3%. Capital and liquidity plans are robust and support future growth in secured and unsecured lending. J Sainsbury plc continues to invest in the Bank and plans to inject further capital during the year to 28 February 2018 to support lending growth, increased regulatory capital requirements and the Bank's on-going transformation. The Bank also maintained levels of liquid funds in excess of internal and regulatory requirements. The net stable funding ratio closed the year at 113%, comfortably in excess of minimum requirements.

Travel money transactions were up 25% year-on-year, despite market volatility and the impact of the UK vote to leave the European Union. The Bank opened a further 26 travel money bureaux across the UK, taking its total estate to 232 bureaux. The Bank also successfully launched a new pre-paid travel money card which offers contactless functionality and no ATM fees.

The Bank's 'free-to-use' ATM estate grew by 5% to 1,728 in the year and ATM transactions grew by almost 1% year-on-year to nearly 240m. This represents a significant UK market share with £1 for every £11 dispensed from a LINK ATM transaction coming from Sainsbury's Bank.

The Bank is committed to delivering customer service that is convenient, reliable and helpful. The Bank's website receives over 1.9 million visits every month, up 50% year-on-year. The Bank continues to report industry low levels of customer complaints, consistently recording fewer than 1.3 complaints per 1,000 customer accounts over the last two years. We have won industry awards for customer service and quality of our products including Best Balance Transfer Credit Card (The Personal Finance Awards), Best Online Personal Loan Provider (Your Money) and Trusted Personal Loan and Pet Insurance provider (Moneywise Customer Services).

As savings products migrated to the Bank's own infrastructure, September 2016 saw the opening of the Bank's first in-house contact centre. This, coupled with the developments in mortgages and insurances, resulted in colleague numbers increasing to an average of almost 1,600 colleagues during the year.

Risk overview

Effective risk management is a core component of our strategy and operations. Our Enterprise-wide Risk Management Framework (EWRMF) supports the Bank in delivering its target outcomes, enabling innovation, growth and flexibility but doing so in a safe and sustainable manner. It adopts a holistic, end-to-end view of risk across the Bank and its subsidiary undertakings ensuring that our aggregate risk exposure is understood, both now and under future plans.

The EWRMF is shaped by the 'tone from the top' from the Board and Executive Management. They define a clear risk strategy and vision that is complemented by the Bank's risk appetite (i.e. the level of risk it is willing to take to achieve its objectives). Policies, processes and methodologies are used to guide, cascade and embed the right principles and behaviours throughout the business. A range of risk management tools are then applied to identify, assess and manage the risks arising from our activities and to ensure the Bank's current and projected risk profile remains within its risk appetite.

Key enablers ensure that the EWRMF is designed, effective and widely communicated across the Bank. These include a governance framework that provides clarity over accountabilities and delegated authorities and a 'three lines of defence' operating model (outlined further in the relevant section below). The Bank's values are aligned to our desired risk culture and 'ways of working' and are reflected in performance management and remuneration assessments. For example, each colleague has specific risk objectives that are measured as part of their performance and development review.

Argos Financial Services (AFS)

Following its acquisition in September 2016, a programme of activity has commenced to integrate the AFS businesses and to ensure alignment with the Bank EWRMF. This work is sponsored by the Bank Chief Risk Officer (CRO) and will take place over 2017/18 with continued enhancement beyond this timeline as appropriate in light of the size, complexity and development of the business. In advance of the completion of this work, the risks associated with AFS are reported separately in the individual annual reports of the relevant subsidiaries.

Key uncertainties

The Bank monitors the risk environment to detect early signs of potential, important, changes and risks that could impact on its activities and risk profile, based on the following categories:

- Strategic risks (e.g. changes in the competitive environment).
- Operational risks (e.g. threats to the Bank's operational capabilities and resilience).
- Financial & Economic risks (e.g. macro-economic uncertainty arising from the Brexit negotiations).
- Regulatory risks (e.g. new regulations that the Bank is required to comply with).

As more information is known about an emerging risk, it will be subject to a full residual risk assessment and action plan, be risk accepted having regard to the mitigations proposed or deemed to be not relevant or not material to the Bank.

Primary risks

The Bank has identified a set of primary risk types (see table below) that are overseen by a dedicated second line function (see section below for explanation of the 'three lines of defence' risk model). These risks are actively managed through primary risk policies and supporting policy standards that clearly articulate the rules, boundaries and measures by which the risks are controlled and help each colleague to understand their individual responsibilities. Our risk reporting processes provide a detailed and aggregated view of these risks to facilitate an active review and management process within defined risk appetite.

Over the course of the reporting period the Bank has added a primary risk and developed a policy focusing on Financial Crime. This risk was previously encompassed within both the Conduct and Compliance Primary Risk Policy and Operational Risk Policy. While the Bank has a well-established range of effective fraud prevention and detection controls in place, the new Primary Risk Policy focusing on Financial Crime seeks to provide a broader awareness of the risk exposures to, for example, money laundering, bribery, corruption and fraud.

The Bank also identifies specific material risks within these broader risk types. For example, cyber risks and IT failure risks are considered within the broader Operational and Operational Capability risks. Each material risk is assessed on the basis of its inherent exposure, its residual exposure in the prevailing control environment and its target exposure where enhanced controls or mitigating actions are planned.

The current primary risk types and our approach to them are noted below.

Capital adequacy risk

Financial primary risk

Holding an insufficient level or quality of capital for normal or stress requirements, or an inefficient deployment of capital.

Example: Adverse changes in the economy could deplete capital resources and/or increase capital requirements.

Our approach and mitigating actions

- Capital policy aligned to risk appetite, with a range set for normal conditions along with stress minimums.
- Capital adequacy is monitored and reported on a daily basis with triggers in place for escalation.
- The annual Internal Capital Adequacy Assessment Process (ICAAP) determines the adequacy of capital resources as well as mitigating actions.

Liquidity & funding risk

Financial primary risk

Holding insufficient resources to meet obligations as they fall due or only being able to access them at an excessive cost.

Example: A sudden and significant withdrawal of savings balances due to market uncertainty.

Our approach and mitigating actions

- Liquidity & Funding policy aligned to risk appetite, with targets for key ratios and coverage of stress outflows.
- Key liquidity and funding ratios are monitored and reported on a daily basis with triggers in place for escalation.
- Regular reviews of the Internal Liquidity Adequacy Assessment Process (ILAAP), funding plan and Liquidity Contingency Plan to support resilience.

Market risk

Financial primary risk

The risk that the Bank's earnings and value would be reduced as result of adverse change to market parameters.

Example: Changes in the level and volatility of movement in interest rates and foreign exchange rates.

Our approach and mitigating actions

- The Bank has a detailed market risk policy, which sets out its market risk limit structure. Earnings and market value sensitivity is reported on a regular basis to the Asset and Liability Committee (ALCO).
- 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.

Retail credit risk

Financial primary risk

Losses arising from a retail customer failing to meet their capital or interest repayment obligations as they fall due.

Example: Adverse changes in UK macro-economic factors impacting on the credit quality of the Bank's assets.

Our approach and mitigating actions

- Credit Risk policy aligned with risk appetite limits.
- Robust credit decisioning tools use multiple sources of credit reference agency data in decisions and monitoring.
- Effective credit risk governance and committee framework.
- Regular reporting framework in place, including reference to external benchmarking.
- Stress testing applied, early warning triggers in place.

Wholesale credit risk

Financial primary risk

Losses arising from institutional counterparties failing to meet their contractual cash flow obligations.

Example: Downgrades in the credit rating of counterparties.

Our approach and mitigating actions

- Counterparty limits are in place to control exposure levels.
- Key ratios are monitored and reported on a daily basis with triggers in place for escalation.
- Regular monitoring of credit ratings migration and CDS pricing of the Bank's key counterparties.

Conduct & compliance risk

Non-financial risk

Failing to meet the letter and spirit of all relevant legislative, regulatory and customer conduct requirements.

Example: Ensuring that the Bank continues to lend responsibly and support vulnerable customers.

Our approach and mitigating actions

- Control procedures and processes developed and owned by the business, with clear reporting and escalation.
- Central team provides advice and horizon scan to support new product launches and changes in the regulations.
- 2nd line compliance oversight plan in place to test the effectiveness of the compliance control environment.
- Regular and open communication with PRA and FCA.

Financial crime risk

Non-financial risk

Knowingly or unknowingly helping parties to commit or to further potentially illegal activity.

Example: Inadequate controls and checks increasing the Bank's vulnerability to external fraud attacks or money laundering and leading to regulatory sanctions.

Our approach and mitigating actions

- Financial crime policy developed.
- Effective fraud prevention and detection controls in place.
- Financial Crime working group established to provide technical end-to-end oversight of controls and governance.
- MLRO provides regular reports on financial crime controls to Executive and Board committees.

Operational capability Risk

Non-financial risk

Disruption to systems or processes which impacts on web channels, telephony or the ATM network and ensuring adequate business continuity arrangements are in place.

Example: An IT issue leads to the Bank's customer website being unavailable for a prolonged period.

Our approach and mitigating actions

- Controls and standards are in place around supplier performance, service standards and IT security.
- Performance, including that of suppliers, is monitored on a regular basis with triggers in place for timely escalation.
- Incident management framework is in place and subjected to an annual crisis test.

Operational risk (including associated legal risk)

Non-financial risk

Losses resulting from inadequate or failed internal processes, people and systems or from external events.

Example: A failure in our payment processing activities impacting on customers or breaching Payment Services Directive.

Our approach and mitigating actions

- Risk and Control self-assessments are undertaken with remedial action plans agreed.
- On-going maintenance of risk registers, with quantification of risks following an agreed methodology.
- Processes in place to capture issues, events and losses.
- Outsourced services are managed via key Services Agreements with a range of SLAs.

Risk strategy and risk appetite

The Bank's risk strategy is consistent with the key generic and firm-specific drivers of the Bank's risk capacity, but provides additional distinctive characteristics and qualities to support the delivery of the Bank's strategic vision. It is built upon four strategic risk objectives (with associated target risk behaviours and principles):

- To enhance and protect the Sainsbury's brand.
- To embed a strong risk culture and controls.
- To facilitate safe and sustainable growth.
- To enable insightful decision-making.

The Bank's risk appetite provides a clear articulation of the level and types of risk that it is prepared to accept in order to achieve its strategic objectives. It is expressed and embedded through a 'high-level' set of key Bank-wide target outcomes and 'directional' risk appetite limits for key factors that influence the target outcomes. A clear risk appetite enables the Bank to understand potential links between different aspects of its risk profile. 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 them to understand the Bank's current and future risk profile, how it benchmarks versus others and how it supports the Bank's strategic objectives.

Three lines of defence risk model

The 'three lines of defence' operating model underpins how risk is managed within the Bank. It ensures that the business holds primary responsibility for risk supported by oversight from an independent risk management function and assurance from an independent audit function.

The role of the first line of defence is to:

- Identify, actively manage and monitor both risks and controls of the functional business areas
- Operate and test the policy standard controls of the functional business area
- Review risks and manage objectives within risk appetite and policy standard requirements

The role of the second line of defence is to:

- Develop the Risk Management Framework and methodologies
- Develop primary risk policies to assist in management of risk
- Provide oversight, support and feedback to the first line of defence
- Analyse risk across the Bank and report to stakeholders

The role of the third line of defence is to:

- Provide opinion, through review and action on the effectiveness of the management of the risk and internal control environment in both first and second line of defence.

Risk reporting

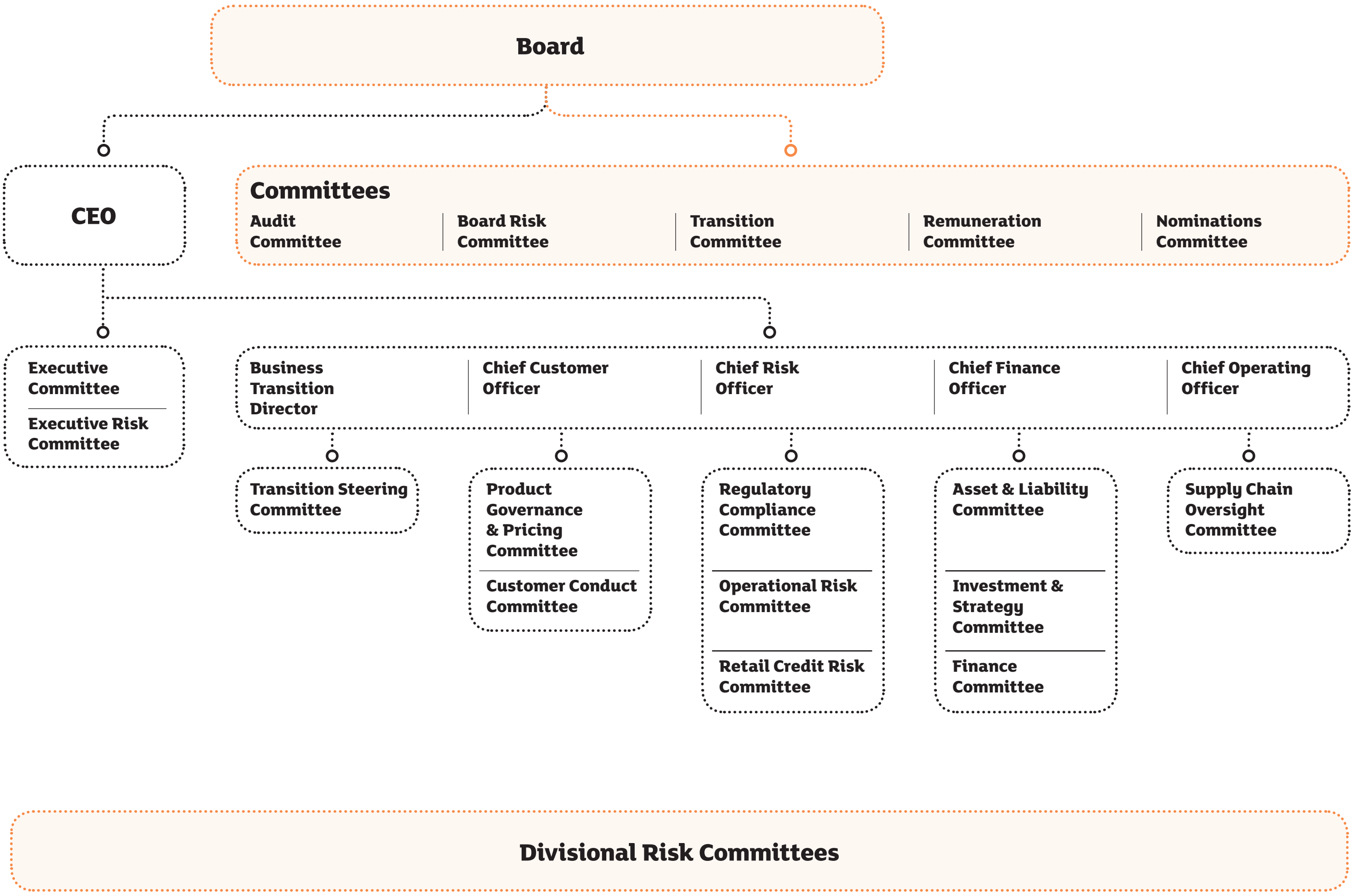
The Bank recognises that concise, accurate and timely risk information is required to promote insightful debate and challenge in making informed decisions. Where possible this information provides both a current and forward looking assessment of risk. The reporting structure enables the collation of insights on a bottom-up basis to be supplemented by a top-down overview at a Bank-wide level:

- First line risk reporting. Key risks, action plans, issues and events are reported and reviewed at Divisional Risk Committees, with policy standard owners also providing a view of control effectiveness.
- Second line risk reporting. An aggregate view of risk profiles is formed from business inputs, risk oversight and policy assurance reviews.
- Bank-wide risk reporting. Aggregate risk reports on current and future risk profiles, performance vs. risk appetite and key existing and emerging risks are reported on a regular basis to the Board, Board Risk Committee and Executive Risk Committee.

Governance

The diagram below shows the governance structure for the Bank effective throughout the accounting period.

Argos Financial Services (AFS) currently has a separate governance structure, but with direct reporting lines to the Bank's CEO. A programme of work has commenced to integrate the AFS businesses. Risk management will be co-ordinated across the Bank and AFS, with clear reporting lines to the Bank's CRO.



Board-level governance

The Board is the key governance body, holding overall accountability for the outcomes achieved, decisions made and steering of the Bank, subject to specific reserved matters which require the consent of J Sainsbury plc. The Board meets at least seven times a year and is comprised of an independent Non-Executive Chairman, other Independent Non-Executive Directors, Non-Executive Directors from J Sainsbury plc and key Executive members from the Bank.

A number of Board functions are delegated to five key sub-committees:

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. The Audit Committee meets at least four times a year. At least once a year the Audit Committee will meet without Executive Management being present. Additionally, the Audit Committee will also meet with the External Auditors and Sainsbury's Bank Director of Internal Audit without executive management present.

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. The Transition Committee meets monthly.

Nominations Committee

The Nominations Committee is responsible for reviewing the structure, size and composition of the Board. The committee is also responsible for the 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. The Nominations Committee will meet at least once per year, with additional meetings convened as required.

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 remuneration regulations 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 and senior control function colleagues and it continually reviews and assesses the impact of remuneration policies on the risk profile of the Bank and employee behaviour. RemCo also has oversight over appointment and severance terms for relevant employees. The Remuneration Committee meets at least twice per year.

Board Risk Committee

The Board Risk Committee (BRC) provides the Board with a forward-looking view to anticipate future risks together with the monitoring and oversight over existing risks. It is responsible for reviewing and reporting its conclusions to the Board on the Bank's risk appetite and the Bank's risk management framework. The Board Risk Committee meets at least on a quarterly basis.

Executive-level governance

The Board 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 CEO chairs the Executive Committee and is supported by a number of other executive-level committees to provide the appropriate checks, balances and transparency on decision making.

Each committee has a documented Terms of Reference, with delegated authority to the Chair who is the appropriate identified accountable individual in line with their Statement of Responsibilities under FCA and PRA rules (Senior Manager Regime).

CEO Executive Committee:

Executive Committee (ExCo)

The role of the ExCo is to advise and assist the CEO in overseeing the Bank's activities, performance and making significant decisions relating to the executive management of the Bank.

CRO Executive Committees:

Executive Risk Committee (ERC)

The ERC is responsible for ensuring that the EWRMF is effective in ensuring that risks are adequately and consistently managed within risk appetite. In doing so the ERC ensures that appropriate policies and methodologies are in place to manage the Bank's primary risk types.

Retail Credit Risk Committee (RCRC)

The RCRC is responsible for monitoring the performance of the retail lending book, ensuring there is an effective credit risk management framework and that the Bank is operating within its credit risk appetite.

Operational Risk Committee (ORC)

The ORC assesses the adequacy and effectiveness of the overall risk framework and control environment of the Bank. It forms a view on the aggregate operational risk position relevant for both a control awareness (CA) and control environment (CE) assessment.

Regulatory Compliance Committee (RCC)

The role of the committee is to oversee delivery of an effective Bank-wide compliance risk management framework that ensures all compliance (including Anti Money Laundering (AML) and Sanctions) and conduct risks are managed within the Bank's approved risk appetite.

CFO Executive Committees:

Asset and Liability Committee (ALCO)

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.

Investment and Strategy Committee (ISC)

The ISC advises and assists the CFO in making significant decisions relating to the Bank's strategy, strategic investments in line with the Bank's agreed strategic priorities and agreed risk appetite.

Finance Committee

The role of the committee is to ensure there are effective levels of governance in place across the Bank's finance function so that significant decisions are fully informed, transparent, recorded and reported and in line with risk appetite and relevant governance structures.

CCO Executive Committees:

Product Governance and Pricing Committee

The role of the committee is to oversee and maintain a product portfolio and pricing structure which enables the Bank to meet its commercial and strategic objectives within risk appetite parameters and to manage tactical decisions regarding pricing, product terms and conditions, and product/channel alignment.

Customer Conduct Committee

The role of the committee is to ensure that the Bank provides customers with fair outcomes in line with the FCA's requirements around Treating Customers Fairly and Conduct Risk, and the Bank's own Conduct Risk Policy framework and risk appetite.

COO Executive Committee:

Supply Chain Oversight Committee

The role of the committee is to ensure there is an effective Bank-wide supply chain performance and risk management framework that manages outsourcing, oversees delivery and makes decisions to ensure the Bank is able to robustly manage and oversee its suppliers.

Business Transition Director Executive Committee:

Transition Steering Committee (TSC)

The TSC 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.

Divisional Risk Committees
Each division across the Bank has its own Divisional Risk Committee (DRC) chaired by the relevant ExCo member. The role of the DRCs is to ensure the effectiveness of the EWRMF within the division, so that risks are effectively and consistently managed within the overall approved risk appetite.

Modern slavery statement
Sainsbury's Bank has a zero tolerance towards modern slavery and human trafficking. We are committed to acting ethically and with integrity in all of our business relationships. We will work closely with our business partners, suppliers and supply chains to ensure there is no place for modern slavery and human trafficking in any area of our business. We will regularly review our processes and controls to prevent modern slavery and human trafficking.

Our policies and procedures support and encourage colleagues to raise concerns relating to modern slavery or impacts to our supply chain at the earliest opportunity.

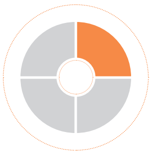
Our full modern slavery statement will be published on the Bank's website during 2017 (www.sainsburysbank.co.uk).

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 28 February 2017. This report is published in the investor relations section of the J Sainsbury plc corporate website: www.j-sainsbury.co.uk/investor-centre.

Key performance indicators

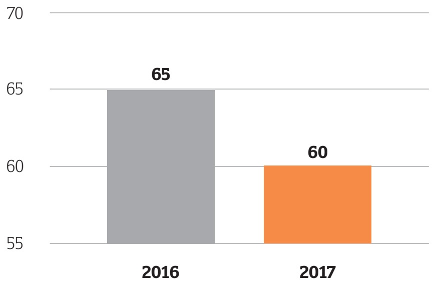
Financial performance

Our shareholders see that we drive value to the Group



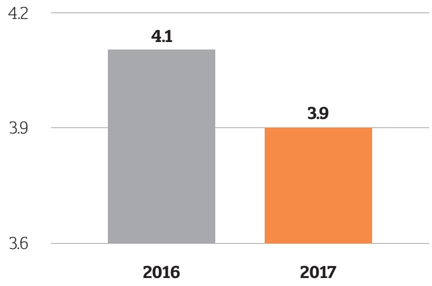
Underlying profit before tax
Definition: Profit before tax before any one-off items that are material and infrequent in nature.

Underlying profit before tax (£'m)



Net interest margin
Definition: Net interest income as a percentage of average interest-earning assets.

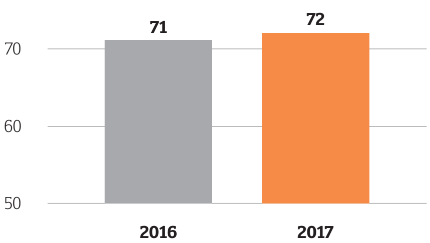
Net interest margin (%)



Efficiency

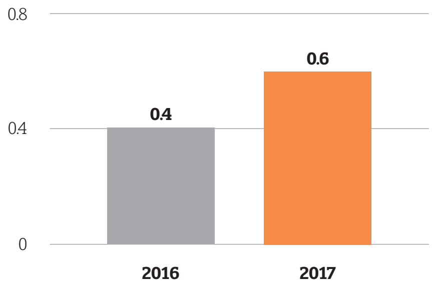
Cost : Income ratio (underlying)
Definition: Underlying operating expenses as a percentage of total income.

Cost : income ratio (%)



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

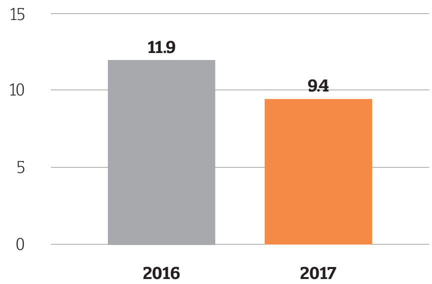
Bad debt asset ratio (%)



Value

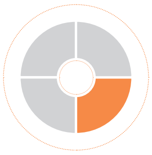
Return on tangible equity
Definition: Underlying profit after tax divided by average tangible equity (equity excluding intangible assets).

Return on tangible equity (%)



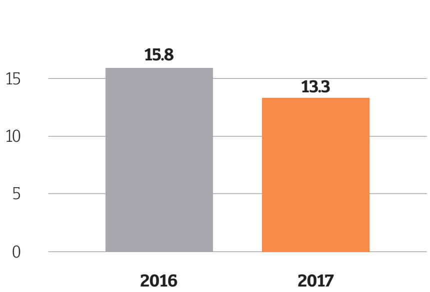
Maintaining strength and sustainability

Our regulators know that we challenge the market through healthy innovation, fair outcomes for customers and strong prudential regulation



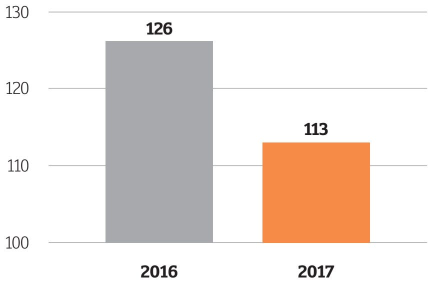
Common equity tier 1 capital ratio
Definition: Tier 1 capital as a percentage of risk-weighted assets.

Common equity tier 1 capital ratio (%)

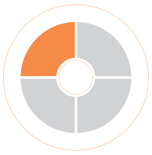


Net stable funding ratio
Definition: Amount of available stable funding (ASF) relative to the amount of required stable funding (RSF) over a one year time horizon, assuming a stressed scenario.

Net stable funding ratio (%)

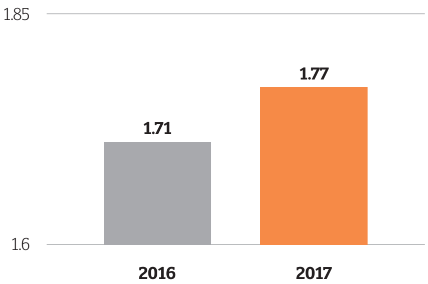


Our customers will trust us, supporting them as their needs change over time



Number of active customers
Definition: The number of customers who hold an active account (savings/loans/credit card/insurance policy).

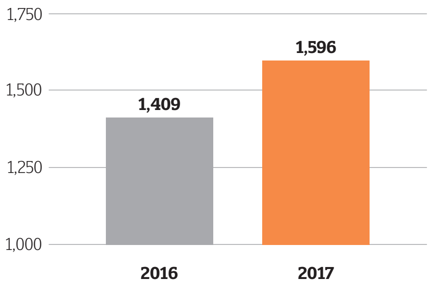
Active customers (million)



Our colleagues know that Sainsbury's Bank is a great place to work where they are fairly rewarded and get great development

Number of colleagues
Definition: The average number of full time and part time colleagues throughout the financial year.

Number of colleagues



The Bank's performance, including reference to the above KPIs, is further outlined in the business review on page 3 and the financial review below.

Financial review

The Bank's performance for the year ended 28 February 2017 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	2017 £m	2016 £m	Change %
Total income	**285**	274	4.0
Operating expenses	**(265)**	(253)	
Add: items excluded from underlying results*	**60**	59	
Underlying operating expenses	**(205)**	(194)	(5.7)
Impairment losses on financial assets	**(22)**	(15)	(46.7)
Realised gains on financial instruments	**2**	–	–
Underlying profit before taxation	**60**	65	(7.7)
Statutory profit before taxation	**–**	6	–

* Expenditure of a non-recurring nature excluded from the underlying performance relates to transitional costs connected to the migration of data and other services to the Bank's new infrastructure and operating model. 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.

Statutory profit before tax for the year ended 28 February 2017 was £nil compared to a profit of £6m in the prior year. This was driven by a 7.7% reduction in underlying profit with one-off items relating to the transition to the Bank's own core banking platforms remaining broadly flat.

Income growth driven by higher customer lending and travel money sales was offset by a reduction in credit card fee income reflective of the first full year impact of the industry wide reduction in interchange rates following the European Court ruling.

Underlying costs increased by 5.7% reflective of the building blocks being put in place in strategic areas such as mortgages and insurances and the costs associated with the new savings platform which launched in the year. The bad debt charge increased as a result of lending growth however the bad debt asset ratio remains low and reflective of the Bank's low risk appetite to credit losses. The sale of Visa Europe Limited to Visa Inc. in June 2016 resulted in a £2m gain on disposal.

Summary balance sheet	2017 £m	2016 £m	Change %
Loans and advances to customers	**3,962**	**3,353**	**18.2**
Cash and cash equivalents	**461**	**555**	**(16.9)**
Other	**1,371**	**591**	**132.0**
Total assets	**5,794**	**4,499**	**28.7**
Customer deposits	**4,101**	**3,209**	**27.8**
Wholesale funds	**820**	**546**	**50.2**
Other	**142**	**141**	**0.7**
Total liabilities	**5,063**	**3,896**	**30.0**
Net assets	**731**	**603**	**21.2**

Customer lending grew by 18.2% during the year. The Bank has consistently remained near the top of price comparison tables during the year in relation to personal loans and has launched competitive credit cards for both balance transfers and purchases which resulted in growth in active customers and overall 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 acquisition of Argos Financial Services (AFS) in September 2016 saw the Bank increase both retail and wholesale funding in order to provide funding for the storecard portfolio of Home Retail Group Card Services Limited, a wholly owned subsidiary of the Bank. The funding is provided by way of a revolving loan and contributed to the 132% increase to other assets.

J Sainsbury plc continues to support the Bank's investment in systems and the strategic acquisition of AFS, and provided additional share capital of £130m during the year.

Net interest income

Net interest income summary	2017 £m	2016 £m	Change %
Interest receivable	**224**	207	8.2
Interest payable	**(61)**	(54)	13.0
Net interest income	**163**	153	6.5
Net interest margin	**3.9%**	4.1%	(20)bps

Summary of funds lent to customers and held as liquid assets	2017 £m	2016 £m	Change %
Loans and advances to customers	**3,962**	3,353	18.2
Cash and balances with central banks	**377**	423	(10.9)
Loans and advances to banks	**26**	25	4.0
Financial investments – available for sale	**398**	317	25.6
	4,763	4,118	15.7

Summary of funds raised	2017 £m	2016 £m	Change %
Customer deposits	**4,101**	3,209	27.8
Other deposits	**509**	247	106.1
Other borrowed funds	**311**	299	4.0
	4,921	3,755	31.1

Interest receivable grew to £224m as the Bank's increased lending on personal loans and credit cards resulted in top line growth. Market rates on personal loans fell during the year and the Bank remained competitive, consistently positioning near the top of price comparison tables. Interest rates on customer deposits broadly fell in line with lending rates, however the additional funding raised in advance of the acquisition of AFS partly contributed to a 20bps reduction in net interest margin.

Fee, commission and other operating income

Fee, commission and other operating income summary	2017 £m	2016 £m	Change %
Banking income	**72**	77	(6.5)
Insurance income	**24**	24	–
Other income	**1**	1	–
Total fees and commissions receivable	**97**	102	(4.9)
Other operating income	**25**	19	31.6
Total fee, commission and other operating income	**122**	121	0.8

Growth in the Bank's travel money business, which continued to see new bureaux open in the Sainsbury's store network during the year, contributed to slight overall growth in total fee, commission and other operating income. Travel money transactions grew by 25% which is reflected in the 31.6% growth in other operating income. Insurance income was broadly flat as the Bank prepared to launch its new operation for insurances in February 2017.

As noted above, the year ended 28 February 2017 was the first full year impact of the reduction in interchange income for credit cards, an issue impacting the whole industry. This contributed to the 6.5% decrease in banking fees and commissions income.

Operating expenses and investment

Operating expenses summary	2017 £m	2016 £m	Change %
Underlying staff costs	**59**	45	31.1
Marketing costs	**24**	28	(14.3)
Other underlying operating costs (including depreciation and amortisation)	**122**	121	0.8
Underlying operating expenses	**205**	194	5.7
One-off items	**60**	59	1.7
Total operating expenses	**265**	253	4.7

In September 2016 the Bank launched its savings and core banking platforms, a significant milestone in its transition to becoming fully detached from LBG's systems. At the point of migration, the systems and software intangible assets brought into use began amortisation and this contributed to a 0.8% increase in other operating expenses. The launch saw new colleagues joining the Bank's contact centre and we continued to invest in our colleagues to support the strategic building blocks being put in place across the Bank.

The Bank's strong brand and competitive propositions, combined with increasingly financially savvy customers, enabled sales growth alongside a reduction in discretionary marketing costs.

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 run rate of one-off costs declined during the year following the successful savings migration however, as noted in the business review section on page 3, following the acquisition of AFS the Bank is now planning to deliver an integrated credit cards platform utilising the existing technology partner of AFS and has also amended plans for its data management processes. These changes resulted in a £14m write down of amounts previously capitalised as intangible assets and are included in the total one-off items of £60m.

Summary of fixed assets	2017 £m	2016 £m	Change %
Intangible assets	**146**	118	23.7
Property, plant and equipment	**44**	39	12.8
	190	157	21.0

The Bank continued to invest in assets that will result in longer-term future benefits to the Bank. Investments in the banking platforms being developed as part of the NBP, the new mortgages offering and software and systems for the recently launched new insurances operating model drove a 23.7% increase in intangible assets, net of the impairment noted above.

The Bank continued to grow its travel money and ATM estate within Sainsbury's stores, with the investment largely contributing to a 12.8% increase in property, plant and equipment year on year.

Impairment losses on financial assets

Impairment losses summary	2017 £m	2016 £m	Change %
Impairment losses on financial assets	**22**	15	46.7
Bad debt asset ratio	**0.6%**	0.4%	20bps

The growth in customer lending during the current and previous financial years saw a related increase in the bad debt charge. The bad debt asset ratio also increased by 20bps to 0.6% from historically low levels experienced during the year ended 29 February 2016. Economic conditions for consumers, which had driven significant improvements to loss rates and the bad debt asset ratio during the 2015/16 financial year, were also comparatively flat in the current financial year.

By order of the Board

David Arden
Chief Financial Officer and Company Secretary
5 May 2017

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 28 February 2017.

Board of Directors

The Directors who served during the year were:

Name	Position	Appointed/Resigned
Mr Roger Davis	(Chairman)	
Mr Peter Griffiths	(Chief Executive Officer)	
Mr David Arden		
Ms Gwyn Burr		
Ms Marcia Campbell		
Mr Alan Cook		Resigned 31 December 2016
Mr Stuart Deane		Resigned 28 September 2016
Mr Graeme Forrester		Appointed 9 January 2017
Mr David Jones		Appointed 15 August 2016
Mr Richard Keys		
Mr Mark Mullington		Resigned 31 December 2016
Ms Angie Risley		
Mr John Rogers		
Mr Michael Ross		
Mr Andrew Simmonds		

The Board comprises four Executive Directors and eight Non-Executive Directors. The position and remuneration of members serving as at 28 February 2017 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	•	
Graeme Forrester	Executive	•	
David Jones	Executive	•	
Richard Keys	Independent Non-Executive	•	
Angie Risley	Non-Executive		•
John Rogers	Non-Executive		•
Michael Ross	Independent Non-Executive	•	
Andrew Simmonds	Independent 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 regards succession at Board and senior management level as a key priority. 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 year the Bank made charitable donations in the UK of £43,823 (2016: £47,471). No political donations were made during the year (2016: £nil).

Independent auditors

Ernst & Young LLP have expressed their willingness to be appointed and succeed PricewaterhouseCoopers LLP as auditors of the Bank from the year ended 28 February 2018.

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 4 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 loss after tax for the year attributable to the shareholders is £4m (2016: profit after tax of £6m). The Directors do not recommend payment of a dividend (2016: £nil).

By order of the Board and signed on its behalf by

David Arden
Chief Financial Officer and Company Secretary
5 May 2017

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
5 May 2017

Independent Auditors' Report

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

Report on the financial statements

Our opinion

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

- give a true and fair view of the state of the Company's affairs as at 28 February 2017 and of its loss 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 28 February 2017;
- the Income statement and Statement of comprehensive income 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.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- 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; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

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 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. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.

Lindsay Gardiner
Senior Statutory Auditor
for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors
Edinburgh

5 May 2017

Financial Statements

Income statement

For the year ended 28 February 2017

	Notes	2017 £m	2016 £m
Interest receivable	2	**224**	207
Interest payable	2	**(61)**	(54)
Net interest income		**163**	153
Fees and commissions receivable	3	**97**	102
Other operating income	4	**25**	19
Total income		**285**	274
Administrative expenses	5	**(254)**	(245)
Depreciation and amortisation			
Property, plant and equipment	17	**(7)**	(7)
Intangible assets	16	**(4)**	(1)
Operating expenses		**(265)**	(253)
Impairment losses on financial assets	11	**(22)**	(15)
Gains realised on financial instruments		**2**	–
Profit before taxation	9	**–**	6
Analysed as:			
Underlying profit before tax		**60**	65
One-off items	6	**(60)**	(59)
		–	6
Taxation	10	**(4)**	–
(Loss)/profit for the financial year attributable to the owners of the Bank		**(4)**	6

The accompanying notes on pages 22 to 53 form part of these financial statements.

Statement of comprehensive income

For the year ended 28 February 2017

	Notes	2017 £m	2016 £m
(Loss)/profit for the financial year		**(4)**	6
Other comprehensive income/(expense):			
Items that may be reclassified subsequently to profit or loss:			
Available for sale financial assets fair value movements	27	**2**	1
Realised gains reclassified to the income statement on disposal	27	**(2)**	–
Tax effect of net losses	27	**–**	–
Total other comprehensive income, net of tax		**–**	1
Total comprehensive (expense)/income		**(4)**	7

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 22 to 53 form part of these financial statements.

Balance sheet
As at 28 February 2017

	Notes	2017 £m	2016 £m
Assets			
Loans and advances to customers	11	**3,962**	3,353
Cash and balances with central banks		**377**	423
Loans and advances to banks	13	**26**	25
Derivative financial instruments	14	**1**	–
Financial investments – available for sale			
Investment securities	15	**398**	317
Intangible assets	16	**146**	118
Property, plant and equipment	17	**44**	39
Other assets	19	**840**	224
Total assets		**5,794**	4,499
Liabilities			
Customer accounts	20	**4,101**	3,209
Other deposits	21	**509**	247
Other borrowed funds	22	**311**	299
Derivative financial instruments	14	**21**	18
Other liabilities	23	**106**	107
Provisions for liabilities and charges	24	**15**	16
Total liabilities		**5,063**	3,896
Equity			
Called up share capital	25	**566**	436
Retained earnings	26	**164**	166
Other reserves	27	**1**	1
Total equity		**731**	603
Total equity and liabilities		**5,794**	4,499

The financial statements on pages 17 to 53 were approved by the Board of Directors on 5 May 2017 and signed on its behalf by:

David Arden
Director and Chief Financial Officer
5 May 2017

The accompanying notes on pages 22 to 53 form part of these financial statements.

Sainsbury's Bank plc – Company number 3279730

Statement of changes in equity

For the year ended 28 February 2017

	Note	Called up share capital £m	Retained earnings £m	Other reserves £m	Total equity £m
At 1 March 2016		**436**	**166**	**1**	**603**
Loss for the financial year		**–**	**(4)**	**–**	**(4)**
Other comprehensive income/(expense):					
Available for sale financial assets fair value movements	27	**–**	**–**	**2**	**2**
Realised gains reclassified to the income statement on disposal	27	**–**	**–**	**(2)**	**(2)**
Tax effect of net losses	27	**–**	**–**	**–**	**–**
Total comprehensive expense		**–**	**(4)**	**–**	**(4)**
Transactions with owners:					
Shares issued in the year	25	**130**	**–**	**–**	**130**
Share-based payment (net of tax)		**–**	**2**	**–**	**2**
At 28 February 2017		**566**	**164**	**1**	**731**

	Note	Called up share capital £m	Retained earnings £m	Other reserves £m	Total equity £m
At 1 March 2015		299	159	–	458
Loss for the financial year		–	6	–	6
Other comprehensive income:					
Available for sale financial assets fair value movements	27	–	–	1	1
Realised gains reclassified to the income statement on disposal	27	–	–	–	–
Tax effect of net losses	27	–	–	–	–
Total comprehensive expense		–	6	1	7
Transactions with owners:					
Shares issued in the year	25	137	–	–	137
Share-based payment (net of tax)		–	1	–	1
At 29 February 2016		436	166	1	603

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 22 to 53 form part of these financial statements.

Cash flow statement

For the year ended 28 February 2017

	Notes	2017 £m	2016 £m
Profit before taxation		–	6
Non-cash items included in profit before taxation		**49**	23
Change in operating assets and liabilities		**(228)**	(457)
Income taxes received/(paid)		**13**	(2)
Cash flows used in operating activities	12	**(166)**	(430)
Purchase of equipment		**(12)**	(20)
Purchase of intangibles		**(46)**	(14)
Cash flows used in investing activities		**(58)**	(34)
Proceeds from issue of share capital		**130**	137
Cash flows generated from financing activities		**130**	137
Net change in cash and cash equivalents		**(94)**	(327)
Opening cash and cash equivalents		**555**	882
Closing cash and cash equivalents		**461**	555

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

	2017 £m	2016 £m
Cash and balances with central banks	**377**	423
Less: mandatory reserve deposit held at central banks	**(6)**	(5)
	371	418
Loans and advances to other banks:		
Repayable on demand	**26**	15
Repayable in less than three months	**–**	10
Investment securities	**64**	112
	461	555

The accompanying notes on pages 22 to 53 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 as adopted by the European Union 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.

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 other deposits.

1. Accounting policies continued

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, including amounts receivable from Group companies, 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 – fifty 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 being:

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

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

Nectar points
The costs of Nectar points, awarded as incentives to the Bank's customers, are recognised when earned by the customer or, where it is highly likely that the customer will meet associated qualifying criteria, are provided for at the point of sale as required by IAS 37 and IFRIC 13. 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.

1. Accounting policies continued

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 financial instruments

All derivative financial 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 on-going basis.

Fair value hedging matches the change in fair 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 year 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.

Share-based payments

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

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

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

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

Provisions

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

Share capital

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

c. Critical accounting estimates and judgements

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

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

Impairment of 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.

Capitalisation and carrying value of intangible assets

Capitalisation of intangible assets involves an assessment as to the appropriateness of costs that meet the qualifying criteria of IAS 38.

Intangible assets are assessed to ensure they continue to meet the criteria of IAS 38, and for indicators of impairment, at each balance sheet date or more frequently where required by changes in circumstances.

Where impairments are indicated, the carrying values of fixed assets are written down by the amount of the impairment and the charge is recognised in profit or loss in the period in which it occurs. A previously recognised impairment charge on an intangible asset may be reversed in full or in part where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value of the asset will only be increased to the carrying value at which it would have been held had the impairment not been recognised.

As described in note 16, during the year the Bank's assessment resulted in a write down of £14m in respect of previously capitalised expenditure in relation to the Bank's credit cards and core data systems, as the expenditure will no longer generate the expected future economic benefits as a result of changes to delivery plans for the relevant infrastructure. Management considers that there is minimal chance of a future reversal of the amount written off. £31m of related expenditure remains capitalised as management consider the benefits will be transferrable to the revised delivery plans for credit cards and core data systems.

1. Accounting policies continued

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 to customers, significant judgement is applied in estimating the effect of various factors, including future customer transactional and repayment behaviours, on future cash flows. Estimates are based on historical experience from similar product types. Management considers that the most material judgement is the estimated life of credit card balances which is a maximum of 60 months. To the extent that that estimated life differs by +/- 12 months, the value of loans and advances to customers on the balance sheet would be £1m higher or £1m lower respectively.

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

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.

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.

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.

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 year 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 LBG platforms prior to migration. These costs are not related to the on-going services being received from LBG 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 LBG. Further details of the provision are included in note 24.

d. Accounting developments

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

The Bank has considered a number of minor amendments to published International Financial Reporting Standards and interpretations effective for the year ended 28 February 2017 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 in future periods:

The following standards, issued by the IASB but not yet effective, are expected to impact the Bank's financial statements in future periods:

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

IFRS 9 'Financial Instruments'

IFRS 9 will replace IAS 39 'Financial Instruments: Recognition and Measurement' for accounting periods commencing on or after 1 January 2018. For Sainsbury's Bank, the effective date is the financial year commencing 1 March 2018. Any changes to recognition and measurement will be applied retrospectively by adjusting the opening balance sheet at that time. There is no requirement to restate comparative amounts.

The core areas addressed within IFRS 9 are as follows:

- Classification and measurement of financial assets and liabilities
- Impairment of financial assets
- Hedge accounting

The most significant impact on the Bank is likely to be in relation to impairment of financial assets as outlined in the relevant section below.

Classification and measurement

Under IFRS 9, existing IAS 39 classification and measurement categories are replaced with the following:

- Fair value through the income statement (FVTPL)
- Fair value through other comprehensive income (FVOCI)
- Amortised cost

Classification will be determined by the business model and contractual cash flow characteristics of the instruments. The Bank has performed an initial classification of its existing financial assets according to the IFRS 9 criteria and does not anticipate any changes in measurement approach under the new standard. The majority of the Bank's financial assets represent loans and advances to customers, currently classified as loans and receivables, and will be held at amortised cost under IFRS 9. Under IAS 39, available for sale financial assets which are currently recognised at fair value through other comprehensive income are expected to be classified as FVOCI under IFRS 9. These mainly relate to the Bank's portfolio of treasury assets which are held for liquidity management purposes.

Under IFRS 9, the financial liabilities categories are:

- FVTPL
- Amortised cost

These are consistent with the categories under IAS 39 and it is expected there will be no impact on transition to and reporting under IFRS 9.

1. Accounting policies continued

Impairment

Financial assets which are measured at amortised cost or FVOCI under IFRS 9 will be subject to the new impairment provisioning requirements of the standard, and it is this area which is expected to have the most impact on the Bank.

As described at note 1b above, the Bank's current impairment policy under IAS 39 is to recognise losses only when an impairment event has been observed, or where an impairment event has arisen but has not yet been identified through observation of a specific impairment trigger. As a result, losses are generally not recognised when credit risk deteriorates, and only materialise when the deterioration results in an impairment event.

IFRS 9 introduces a three-stage 'expected credit loss (ECL)' model which is forward looking and which generally will result in earlier recognition of credit losses. It is no longer necessary for an impairment event to have occurred before credit losses are recognised. As soon as a financial instrument is originated or purchased, 12-month expected credit losses must be recognised in profit and loss and an impairment allowance will be established (Stage 1). If the credit risk increases significantly (and the resulting credit quality is not considered to be low credit risk) full lifetime expected credit losses will be provided for (Stage 2). Under both Stage 1 and Stage 2, interest income is recognised on the gross carrying value of the financial asset. Financial assets will move into Stage 3 when they are considered to be credit impaired, i.e. when one or more events have occurred that have a detrimental impact on the estimated future cash flows of the asset. Stage 3 assets will continue to recognise lifetime expected impairment losses and interest income will be recognised on the net carrying amount (i.e. gross amount less impairment allowance) – as under IAS 39.

Implementation approach

The Bank's implementation project has been in place since early 2015 (and has been expanded to incorporate the AFS subsidiaries acquired during the year ended 28 February 2017 as part of the J Sainsbury plc acquisition of Home Retail Group plc). The primary objectives of the project are to: define accounting policies in compliance with the standard; deliver the necessary data, system and operational changes; and update the credit provisioning models and overall governance framework. The project is being jointly led by the Bank's Finance and Credit Risk functions, with support from external professional advisers. The project has a steering committee in place to provide appropriate oversight and governance; and a Technical Working Group to ensure that policy decisions and approaches are appropriate and in line with industry practice.

The Bank has defined its approach and methodology for ECL provisioning under IFRS 9, and has been developing models to comply with the new requirements.

Dependent on product type and business model, the ECL models are either being built in-house by the Bank's Credit Risk function with support from external consultants, or will be built by outsourced service providers with oversight from the Bank. All of these models will be subject to second line review and user acceptance testing during the year to 28 February 2018.

The new ECL models are likely to have a significant impact on the systems and processes of the Bank due to its extensive new requirements for data and calculations. Expanded data and calculation requirements will include:

- estimates of 12-month and lifetime expected credit losses;
- information and data to determine whether a significant increase in credit risk has occurred or reversed; and
- data for the extensive new disclosure requirements.

Estimating impairment involves judgements about whether loans will be received as due and, if not, how much will be recovered and when. The new requirements, which widen the scope of these judgements, rely on the Bank being able to make robust estimates of:

- expected credit losses (driven by the component parts: probability of default, exposure at default and loss given default); and
- the point at which there is a significant increase in credit risk.

For this reason the Bank's implementation project will clearly define key terms such as 'significant increase' and 'default' in the context of the instruments they hold. Key methodology decisions concluded to date include the definitions of default, forbearance, expected life and modifications, and modelling approaches for unsecured lending and off-balance sheet commitments. The Bank has also concluded that its portfolio of treasury assets will benefit from the 'low credit risk' exemption under the standard and will therefore not routinely need to be assessed for recognition of lifetime expected credit losses.

Key judgemental areas still to be concluded on include the determination of 'significant increase in credit risk' (which is the key concept for moving from 12-month ECL to lifetime ECL), and the approach to modelling future economic scenarios. The Bank has also been defining its target operating model, considering the changes to data, systems, governance, processes and controls that will need to be implemented as a consequence of the new approach, taking account of the changing IT landscape resulting from New Bank Programme over the next two years. These will be subject to a full parallel run for at least the six months prior to implementation on 1 March 2018.

Regulatory capital impact

The implementation of IFRS 9 and recognition of expected credit losses (ECL) is expected to negatively impact regulatory capital levels in all banks, with a disproportionately greater effect on those adopting the standardised approach to credit risk (such as the Bank). Here, the increase in impairment provisions will directly impact Common Equity Tier 1 (CET1) capital as a reduction in retained earnings.

It is not clear at this time how ECL should be allocated between specific and general credit risk adjustments and we await further clarification from emerging legislation. Specific credit risk adjustments partially mitigate the impact of higher provisioning through reduction in risk weighted assets (RWAs). General credit risk adjustments may be included within Tier 2 capital (up to a limit of 1.25% of credit risk RWAs) thus mitigating the impact on total regulatory capital.

The Basel Committee for Banking Supervision (BCBS) has proposed application of a transitional approach to the impact of IFRS 9 on regulatory capital, whereby the Day 1 impact on CET1 capital may be spread over several years. The decision whether or not to apply such an approach has been delegated to individual regulatory jurisdictions. The Bank will fully consider the impact of IFRS 9 on regulatory capital once these proposals have been finalised within the European Union.

Hedge accounting

As permitted by IFRS 9, the Bank intends to continue applying the hedge accounting requirements of IAS 39 for its macro hedging relationships until such time as the IASB has concluded its work in this respect. In line with Group policy, the Bank will adopt IFRS 9 in respect of its micro hedge accounting and will have to comply with the increased disclosure requirements introduced by IFRS 9 for all hedging (macro and micro) from 1 March 2018. Disclosures required include details of the risk exposures that the Bank hedges and for which it elects to apply hedge accounting, including:

- the Bank's risk management strategy and how it is applied to manage risk;
- how the Bank's hedging activities may affect the amount, timing and uncertainty of its future cash flows; and
- the effect that hedge accounting has had on the Bank's statement of financial position, statement of comprehensive income and statement of changes in equity.

1. Accounting policies continued

IFRS 15 'Revenue from Contracts with Customers'

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 income, and other operating income, superseding IAS 18. Income from financial instruments will continue to be recognised under IAS 39/IFRS 9. The Bank is currently reviewing the requirements of the new standard to determine its impact.

IFRS 16 'Leases'

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 currently reviewing the requirements of the new standard to determine its impact.

2. Net interest income

	2017 £m	2016 £m
Interest income on loans and receivables	**220**	206
Interest income from available for sale financial instruments	**3**	1
Other interest income	**1**	–
Interest receivable	**224**	207
Interest expense on customer accounts, deposits and borrowings	**(54)**	(48)
Interest expense on derivative liabilities	**(7)**	(6)
Interest payable	**(61)**	(54)
Net interest income	**163**	153

Net ineffectiveness recognised on fair value hedges was £0.2m (2016: £0.1m).

3. Fees and commissions receivable

	2017 £m	2016 £m
Banking income	**72**	77
Insurance income	**24**	24
Other income	**1**	1
	97	102

4. Other operating income

	2017 £m	2016 £m
Travel money income	**25**	19
	25	19

Other operating income relates to the Bank's sale of foreign currency and related products through its Travel Money business.

5. Administrative expenses

	2017 £m	2016 £m
Staff costs:		
Wages and salaries	**56**	39
Social security costs	**4**	3
Pension costs	**2**	2
Share-based payments	**2**	1
	64	45
Marketing costs	**24**	28
Other operating costs	**166**	172
	254	245

Staff costs and other operating costs include £60m (2016: £59m) of one-off items as described in note 6.

See note 7 for further details on employee arrangements.

6. One-off items

Certain items recognised in the Bank's profit before taxation are of an unusual and infrequent nature and do not relate to 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.

	2017 £m	2016 £m
Write down of intangible assets	**14**	–
New Bank Programme transition costs	**46**	59
	60	59

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. Costs which are directly attributable to the development of core banking platforms are capitalised and are not included above. Further detail on capitalised expenditure and the write down of intangible assets is provided in note 16.

7. Employees

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

	2017 Number	2016 Number
Full time	**738**	763
Part time	**858**	646
	1,596	1,409
Full time equivalent	**1,168**	1,090

Colleague costs are disclosed in administrative expenses in note 5.

Colleagues are eligible to join the defined contribution pension arrangements of J Sainsbury plc. 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 £2.4m (2016: £1.8m) and was entirely in relation to the defined contribution schemes.

8. Directors' emoluments

	2017 £m	2016 £m
Emoluments	**3.0**	2.4
Employer contribution to defined contribution pension schemes	**0.1**	0.1
Share-based payments	**0.8**	0.7
	3.9	3.2
Highest paid Director:		
Emoluments	**0.9**	0.7
Share-based payments	**0.2**	0.1
	1.1	0.8

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 year.

All Executive Directors were employed and remunerated by the Bank.

During the year six directors (2016: four) received share awards under J Sainsbury plc share incentive schemes reflective of their qualifying services. Four Directors (2016: two) 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 year 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 before taxation

	2017 £m	2016 £m
Profit before taxation is stated including the following items of income and (expense):		
Interest on impaired loan balances	**1**	1
Operating lease rentals	**(1)**	(1)
Write down of intangible assets	**(14)**	–
Auditors' remuneration:		
Statutory audit of the Bank	**(0.6)**	(0.3)
Non-audit services	**(0.2)**	(0.3)

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 (2016: £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

	2017 £m	2016 £m
UK corporation tax on profit for the year	**–**	–
Adjustments in respect of prior years	**–**	(6)
Current tax	**–**	(6)
Deferred tax charge/(credit)		
Origination and reversal of temporary differences	**–**	–
Adjustments in respect of prior years	**4**	6
Deferred tax	**4**	6
Total tax charge/(credit)	**4**	–

Differences between profit before tax multiplied by the UK corporation tax rate for the year of 20% and the income tax expense recognised in the income statement are explained below:

	2017 £m	2016 £m
Profit before taxation	**–**	6
Tax on ordinary activities at 20.00% (2016: 20.08%)	**–**	1
Effects:		
Deferred tax on group relief surrendered for nil consideration	**4**	–
Other tax adjustments	**–**	(1)
Total income tax expense recognised in the income statement	**4**	–

11. Loans and advances to customers

	2017 £m	2016 £m
Gross advances	**4,030**	3,419
Impairment	**(78)**	(79)
Adjustment in relation to fair value hedging	**10**	13
Loans and advances to customers	**3,962**	3,353
Gross advances being:		
Repayable on demand	**1,095**	826
Other loans and advances repayable:		
In 3 months or less	**286**	261
Between 3 months and 1 year	**714**	657
Between 1 and 5 years	**1,860**	1,620
After 5 years	**75**	55
	4,030	3,419

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

	2017 £m	2016 £m
Individuals:		
Home mortgages	**38**	42
Unsecured personal lending	**3,992**	3,377
Gross loans and advances to customers	**4,030**	3,419

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) and Indexed Long Term Repo Facility (ILTR). As at 28 February 2017 £378m (2016: £379m) of the personal loans portfolio was assigned to the SPE for use as collateral in securitisation transactions. £678m (2016: £468m) of the personal loans book was pledged to the Bank of England facilitating funding of £260m (2016: £240m) from the FLS and £155m (2016: £nil) from the ILTR.

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

Year ended 28 February 2017	Unsecured lending £m	Secured lending £m	Total £m
At 1 March 2016	**79**	**–**	**79**
New impairment provisions less releases	**27**	**–**	**27**
Recoveries of amounts previously written off	**(6)**	**–**	**(6)**
Amounts written off	**(23)**	**–**	**(23)**
Discount unwind on impaired loans and advances to customers	**1**	**–**	**1**
At 28 February 2017	**78**	**–**	**78**
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	**111**	**1**	**112**

Year ended 29 February 2016	Unsecured lending £m	Secured lending £m	Total £m
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 28 February 2016	79	–	79
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	105	1	106

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 before taxation to cash flows used in operating activities

	2017 £m	2016 £m
Profit before taxation	**–**	6
Non-cash items included in profit before taxation		
Impairment losses on loans and advances	**22**	15
Depreciation on property, plant and equipment	**7**	7
Amortisation of intangible assets	**4**	1
Write down of intangible assets	**14**	–
Share-based payment expense	**2**	–
	49	23
Change in operating assets and liabilities		
Net (increase) in loans and advances to customers	**(631)**	(336)
Net (increase)/decrease in derivative assets	**(1)**	1
Net (increase) in investment securities greater than 3 months	**(129)**	(204)
Net increase in derivative liabilities	**3**	12
Net (increase) in other assets	**(630)**	(30)
Net increase/(decrease) in customer accounts	**892**	(279)
Net increase in borrowed funds	**274**	375
Net (decrease)/increase in other liabilities	**(6)**	4
	(228)	(457)
Cash used in operations	**(179)**	(428)
Income taxes received/(paid)	**13**	(2)
Cash flows (used in) operating activities	**(166)**	(430)
Operational cash flows from interest		
Interest paid	**(71)**	(67)
Interest received	**232**	215

13. Loans and advances to banks

	2017 £m	2016 £m
Sterling loans and advances to banks	**26**	25
Repayable on demand (included in cash equivalents)	**26**	15
Other loans and advances repayable:		
In 3 months or less (included in cash equivalents)	**–**	10
Gross advances	**26**	25

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.

Interest rate swaps – Fair value hedges

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.

	Notional amount £m	Assets £m	Liabilities £m
Interest rate swap			
At 28 February 2017	**2,376**	**1**	**(21)**
At 29 February 2016	2,105	–	(18)

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.

Forward currency sales

To mitigate the risk of exchange rate movements resulting in unexpected fluctuations in value of the foreign currency holdings within the Bank's travel money business, the Bank transacts forward sale contracts in respect of its most material currency holdings. Fair value movements on the forward sale agreements are recognised directly in profit and loss and partly offset any gains and losses arising from foreign exchange movements on the Bank's currency holdings. Settlement dates for forward currency agreements are no more than two business days from the transaction date in order to mirror the exposure to and turnover of currency holdings. As at 28 February 2017, the Bank had transacted forward sale agreements in respect of 6.9m EUR (2016: nil) and 2.7m USD (2016: nil). The positions had no significant fair value at the year end (2016: £nil).

15. Investment securities

	2017 £m	2016 £m
Investment securities comprise the following:		
Debt securities issued by banks	**–**	50
Treasury bills	**–**	20
Gilts	**41**	31
Government backed investment securities	**96**	98
Covered bonds	**102**	40
Supranational investment securities	**95**	77
Asset backed securities	**64**	–
Investment in Visa Europe	**–**	1
	398	317
Of which:		
Maturing in 3 months or less	**64**	112
Maturing between 3 months and 1 year	**100**	48
Maturing between 1 and 5 years	**213**	151
Maturing after 5 years	**21**	6
	398	317

Investment securities include £10m (2016: £nil) pledged as collateral under sale and repurchase agreements or derivative contracts. The fair value movement during the year on investment securities classified as available for sale was a gain of £2.4m (2016: a gain of £0.6m).

16. Intangible assets

	2017 £m	2016 £m
Cost		
At 1 March	**138**	123
Additions	**46**	15
Write down	**(14)**	–
Disposals	**–**	–
As at 28/29 February	**170**	138
Accumulated amortisation		
At 1 March	**(20)**	(19)
Charge for the year	**(4)**	(1)
Disposals	**–**	–
As at 28/29 February	**(24)**	(20)
Net book value as at 28 February 2017/29 February 2016	**146**	118

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

Expenditure previously capitalised in relation to the Bank's credit cards and core data software of £14m (2016: £nil) was written down as a result of the decision to deliver an integrated credit cards operating model with Argos Financial Services, and changes to the planned delivery of data systems.

17. Property, plant and equipment

28 February 2017	Land and buildings £m	Fixtures and equipment £m	Total £m
Cost			
At 1 March 2016	**1**	**87**	**88**
Additions	**–**	**12**	**12**
Disposals	**–**	**(3)**	**(3)**
As at 28 February 2017	**1**	**96**	**97**
Accumulated depreciation			
At 1 March 2016	**–**	**49**	**49**
Charge for the year	**–**	**7**	**7**
Disposals	**–**	**(3)**	**(3)**
As at 28 February 2017	**–**	**53**	**53**
Net book value as at 28 February 2017	**1**	**43**	**44**

29 February 2016	Land and buildings £m	Fixtures and equipment £m	Total £m
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

18. Subsidiary undertakings

As part of the J Sainsbury plc acquisition of Home Retail Group plc in September 2016, the Bank acquired 100% of the ordinary share capital of three subsidiary undertakings, collectively known as Argos Financial Services:

	Country of registration or incorporation	Ownership Interest	Registered address
Home Retail Group Card Services Limited	England	100%	489-499 Avebury Boulevard, Milton Keynes, United Kingdom, MK9 2NW
Home Retail Group Insurance Services Limited	England	100%	489-499 Avebury Boulevard, Milton Keynes, United Kingdom, MK9 2NW
ARG Personal Loans Limited	England	100%	489-499 Avebury Boulevard, Milton Keynes, United Kingdom, MK9 2NW

The following companies are also subsidiary undertakings of the Bank, being the SPE structure 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 companies, the companies were 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 substantially all the benefits from their activities. The companies are therefore effectively controlled by the Bank.

	Country of registration or incorporation	Registered address
Lochside Asset Purchaser No.1 Holdings Limited	England	35 Great St. Helen's, London, EC3A 6AP
Lochside Asset Purchaser No.1 plc.	England	35 Great St. Helen's, London, EC3A 6AP

19. Other assets

	2017 £m	2016 £m
Customer funds in the course of settlement	–	2
Bank funds in course of settlement	**131**	140
Current tax asset	**3**	15
Amounts receivable from Group companies (see note 35)	**636**	7
Cash collateral paid	**22**	13
Prepayments and accrued income	**48**	47
	840	224

Other assets have no fixed maturities but are expected to be realised within 12 months, with the exception of £33m (2016: £29m) 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. See note 30 for further details on the residual contractual maturity of other assets.

20. Customer accounts

Customer accounts comprise Sterling interest bearing deposits.

	2017 £m	2016 £m
Repayable:		
On demand	**3,603**	2,817
Within 3 months	**90**	65
Between 3 months and 1 year	**192**	144
Between 1 and 5 years	**216**	183
	4,101	3,209

21. Other deposits

Other deposits comprise wholesale deposits. Other deposits are denominated in Sterling.

	2017 £m	2016 £m
Repayable:		
Within 3 months	**129**	–
Between 3 months and 1 year	**148**	28
Between 1 and 5 years	**232**	219
	509	247

22. Other borrowed funds

	2017 £m	2016 £m
Deemed loan on securitisation		
Repayable in less than 1 year	**121**	118
Repayable between 1 and 5 years	**190**	181
Other borrowed funds	**311**	299

Deemed loan on securitisation

The Bank entered into a bilateral securitisation transaction on 18 February 2015, where a £400m funding facility was obtained. The ability to draw down on this facility was due to expire in May 2017, 27 months after initial draw down. In February 2017, the Bank renewed the facility and extended the revolving period by a further 27 months.

As at 28 February 2017, 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 from Lochside Asset Purchaser No.1 plc.

During the year the contractual terms of the facility were amended to extend its term by a further two years and there were also amendments to the interest rate payable on the Senior 'A Notes' and the level of subordinated 'B Notes' held by the Bank.

Of the total £400m facility, £312m (29 Feb 2016: £300m) of Senior 'A Notes' have been issued by Lochside Asset Purchaser No.1 plc. backed by the cash flows from the relevant personal loans.

As part of the structure the Bank has acquired £88m (29 Feb 2016: £100m) of subordinated 'B Notes'. The B Notes are offset against the deemed loan from 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 after more than 12 months.

	2017 £m	2016 £m
Customer funds in course of settlement	**21**	8
Bank funds in course of settlement	**–**	1
Deferred tax liabilities	**9**	5
Accruals and deferred income	**73**	89
Cash collateral received	**3**	4
	106	107

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

	2017 £m	2016 £m
At 1 March	**5**	(1)
Movement in deferred tax liability charged to income statement	**–**	–
Adjustments in respect of prior years	**4**	6
At 28/29 February	**9**	5

Tax effect of timing differences due to:

Other temporary differences	**–**	(1)
Accelerated capital allowances	**9**	6
	9	5

24. Provisions for liabilities and charges

	Customer redress £m	FSCS £m	Onerous costs £m	Other provisions £m	Total £m
At 1 March 2016	**5**	**1**	**10**	**–**	**16**
Charge to administrative expenses	**–**	**1**	**4**	**–**	**5**
Utilised in year	**–**	**(1)**	**(5)**	**–**	**(6)**
At 28 February 2017	**5**	**1**	**9**	**–**	**15**

	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 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.

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 LBG platforms prior to migration. These costs are not related to the on-going services being received from Lloyds Banking Group plc 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.

25. Called up share capital

	2017 £m	2016 £m
Allotted, called up and fully paid:		
At 1 March	**436**	299
Issued ordinary shares	**130**	137
At 28/29 February	**566**	436

During the year the Bank issued 130m (2016: 137m) ordinary shares of £1 each at par to J Sainsbury plc.

26. Retained earnings

	2017 £m	2016 £m
At 1 March	**166**	159
(Loss)/profit for the financial year	**(4)**	6
Share-based payment (net of tax)	**2**	1
At 28/29 February	**164**	166

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.

	Total £m
At 1 March 2016	**1**
Net unrealised gains	**2**
Realised gains reclassified to the income statement on disposal	**(2)**
Tax effect on net gains	**–**
At 28 February 2017	**1**

27. Other reserves continued

	Total £m
At 1 March 2015	–
Net unrealised gains	1
Realised losses reclassified to the income statement on disposal	–
Tax effect on net gains	–
At 29 February 2016	1

These balances include tax of £0.2m in the available for sale reserve (2016: £0.1m).

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:

At 28 February 2017	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	**3,962**	**–**	**–**	**3,962**
Cash and balances with central banks	**377**	**–**	**–**	**377**
Loans and advances to banks	**26**	**–**	**–**	**26**
Derivative financial instruments	**–**	**–**	**1**	**1**
Financial investments – available for sale investment securities	**–**	**398**	**–**	**398**
Other assets	**840**	**–**	**–**	**840**
Total financial assets	**5,205**	**398**	**1**	**5,604**
Non-financial assets:				
Property, plant and equipment				**44**
Intangible assets				**146**
				5,794

	Financial liabilities at amortised cost £m	Derivatives designated as fair value hedging instruments £m	Total £m
Liabilities:			
Customer accounts	**4,101**	**–**	**4,101**
Other deposits	**509**	**–**	**509**
Other borrowed funds	**311**	**–**	**311**
Derivative financial instruments	**–**	**21**	**21**
Other liabilities	**87**	**–**	**87**
Total financial liabilities	**5,008**	**21**	**5,029**
Non-financial liabilities:			
Other liabilities			**10**
Provisions			**15**
Deferred tax			**9**
			5,063

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

At 29 February 2016	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	3,353	–	–	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
Derivative financial instruments	–	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

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:

	2017 £m	2016 £m
Commitments to extend credit	**98**	77

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:

	2017 £m	2016 £m
Due within 1 year	**1**	–
Due within 1 to 5 years	**6**	5
Due in more than 5 years	**4**	6
	11	11

30. Risk management

The Bank encounters a range of different risks and uncertainties as it undertakes its day-to-day activities and seeks to achieve its strategic objectives. Our approach to risk management and an overview of the primary risk types are described in the Risk overview section on pages 4 to 7. Further detail on credit and liquidity risk exposures are shown below, with capital adequacy discussed further in 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.

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.

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, UK government securities (gilts or Treasury bills), multilateral development bank securities, government guaranteed agency securities UK regulated covered bond programmes and asset backed securities.

Limits are established for all counterparty and asset class exposures based on their respective credit quality and market liquidity. Consideration is also given to geographical region and the strength of relevant sovereign credit ratings. Derivatives are subject to the same credit risk control procedures as are applied to other wholesale market instruments and the credit risk arising from mark to market derivative valuations is mitigated by daily margin calls, posting cash collateral to cover exposures. Daily monitoring is undertaken by the Bank's Treasury department, including early warning indicators with appropriate triggers for escalation.

At 28 February 2017, 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.

	2017 £m	2016 £m
Credit risk exposures relating to on balance sheet items		
Loans and advances to customers		
Unsecured	**3,924**	3,310
Secured	**38**	43
Cash and balances with central banks	**377**	423
Loans and advances to banks	**26**	25
Derivative financial instruments	**1**	–
Investment securities	**398**	317
Other assets	**840**	206
Credit risk exposures relating to off balance sheet items		
Loans commitments	**98**	77
Treasury bills drawn under FLS	**260**	240
Total credit risk exposures	**5,962**	4,641

Risk concentrations

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same 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 risk appetite, 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

Maximum exposure	2017 £m	2016 £m
United Kingdom	**5,839**	4,426
Europe	**96**	198
Other	**27**	17
	5,962	4,641

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 28 February 2017. Foreign currency risk is more fully described on page 45.

Industry sectors

Maximum exposure	2017 £m	2016 £m
Retail	**4,060**	3,476
Financial institutions	**1,340**	579
Government	**541**	561
Corporate	**21**	25
	5,962	4,641

Credit quality per class of financial asset

Loans and advances to customers

Loans and advances are summarised as follows:

Maximum exposure	2017 £m	2016 £m
Impaired	**112**	106
Past due but not impaired	**19**	13
Neither past due nor impaired	**3,899**	3,300
Gross	**4,030**	3,419
Less: allowance for impairment	**(78)**	(79)
hedging fair value adjustment	**10**	13
	3,962	3,353

Credit quality analysis

At 28 February 2017	Unsecured lending £m	Secured lending £m	Total £m
Impaired			
Less than 3 months, but impaired	**2**	**–**	**2**
Past due 3 to 6 months	**10**	**1**	**11**
Past due 6 to 12 months	**–**	**–**	**–**
Past due over 12 months	**–**	**–**	**–**
Recoveries	**99**	**–**	**99**
Total gross impaired loans	**111**	**1**	**112**
Past due but not impaired			
Past due up to 3 months but not impaired	**18**	**1**	**19**
Total gross past due but not impaired	**18**	**1**	**19**
Neither past due nor impaired*			
Not impaired	**3,863**	**36**	**3,899**
Total gross neither past due nor impaired	**3,863**	**36**	**3,899**
Total gross amount due	**3,992**	**38**	**4,030**

*Includes £3m of loans that would have been past due or impaired had their terms not been renegotiated.

30. Risk management continued

At 29 February 2016	Unsecured lending £m	Secured lending £m	Total £m
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 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 (2016: £7m). The fair value of collateral held against possession cases was £nil (2016: £nil).

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

Loans and advances to banks

The total gross amount of individually impaired loans and advances to banks as at 28 February 2017 was £nil (2016: £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:

	2017 £m	2016 £m
Aaa to A3	**26**	25

Debt securities, cash and balances with central banks, 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 28 February 2017 was £nil (2016: £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:

At 28 February 2017	**Cash and balances with central banks £m**	**UK government securities £m**	**Other investment securities £m**	**Total £m**
Aaa to A3	**–**	**41**	**357**	**398**
ATM cash and balances with central banks	**377**	**–**	**–**	**377**
	377	**41**	**357**	**775**

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

30. Risk management continued

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

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

At 28 February 2017	Gross assets/ (liabilities) recognised	Amounts offset £m	Net amounts recognised in the balance sheet £m	Financial instruments £m	Collateral pledged £m	Net amounts £m
Derivative financial instruments – assets	**1**	**–**	**1**	**–**	**–**	**1**
Derivative financial instruments – liabilities	**(21)**	**–**	**(21)**	**–**	**22**	**1**
	(20)	**–**	**(20)**	**–**	**22**	**2**
At 29 February 2016						
Derivative financial instruments – liabilities	(18)	–	(18)	–	17	(1)
	(18)	–	(18)	–	17	(1)

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 28 February 2017, the Bank had provided cash collateral of £22m (29 Feb 2016: £17m) against the derivative liability position, and £21m of initial margin collateralised by gilts (29 Feb 2016: £10m of initial margin was provided by way of off-balance sheet treasury bills obtained under the FLS).

Liquidity and funding risk

Liquidity risk is the risk that the Bank cannot meet its payment obligations as they fall due, or can only do so at extreme cost. The Bank seeks to ensure that it can meet its financial obligations at all times, even under liquidity stress conditions.

The annual Internal Liquidity Adequacy Assessment Process (ILAAP) enables the Bank to:

1. demonstrate that it understands the liquidity risks it is running
2. assess its liquidity needs under various stress scenarios and
3. put in place appropriate controls to mitigate liquidity risks.

In meeting its internal limits as well as PRA requirements, the Bank maintains a stock of high quality liquid assets that can be readily monetised by outright sale or repurchase agreement to meet the Bank's obligations to depositors and other creditors.

The Bank's Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are regularly monitored and forecast alongside cash flow and funding ratios. We prepare long-term and short-term forecasts to assess liquidity requirements, taking into account factors such as ATM cash management, contractual maturities and customer deposit patterns (stable or less stable deposits) as well as outflows regarding pipelines and commitments. These reports support daily liquidity management, with early warning indicators reviewed on a daily basis and appropriate triggers for escalation and action in line with the risk appetite, Liquidity and Funding Policy and Liquidity Contingency Plan. Asset encumbrance ratios and risk indicators for wholesale funding concentrations by type (total/secured/unsecured), maturity, sector, geography and counterparty are also regularly monitored and reported to ALCO.

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.

30. Risk management continued

Residual contractual maturity analysis

At 28 February 2017	Less than 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Assets						
Non-derivative assets						
Loans and advances to customers	**1,215**	**198**	**811**	**2,019**	**81**	**4,324**
Cash and balances at central banks	**377**	**–**	**–**	**–**	**–**	**377**
Loans and advances to banks	**26**	**–**	**–**	**–**	**–**	**26**
Investment securities	**10**	**60**	**112**	**205**	**18**	**405**
Other assets	**807**	**–**	**–**	**34**	**6**	**847**
	2,435	**258**	**923**	**2,258**	**105**	**5,979**
Net derivative asset cash flows	**–**	**–**	**–**	**1**	**–**	**1**
Total cash inflows	**2,435**	**258**	**923**	**2,259**	**105**	**5,980**
Liabilities						
Non-derivative liabilities						
Customer accounts	**3,720**	**40**	**197**	**219**	**–**	**4,176**
Other deposits	**13**	**118**	**152**	**244**	**–**	**527**
Other borrowed funds	**11**	**22**	**89**	**188**	**5**	**315**
Other liabilities	**87**	**–**	**–**	**–**	**–**	**87**
	3,831	**180**	**438**	**651**	**5**	**5,105**
Net derivative liability cash flows	**2**	**2**	**7**	**10**	**2**	**23**
Unrecognised loan commitments	**98**	**–**	**–**	**–**	**–**	**98**
Total cash outflows	**3,931**	**182**	**445**	**661**	**7**	**5,226**
Net liquidity	**(1,496)**	**76**	**478**	**1,598**	**98**	**754**

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						
Non-derivative assets						
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
Net derivative asset cash flows	–	–	–	–	–	–
Total cash inflows	1,616	244	794	1,929	86	4,669
Liabilities						
Non-derivative liabilities						
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
Net derivative liability 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

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 28 February 2017	Encumbered £m	Unencumbered £m	Total £m
Loans and advances to customers	**1,056**	**2,906**	**3,962**
Debt securities	**31**	**367**	**398**
Other assets	**22**	**818**	**840**
Cash and balances with central banks	**6**	**371**	**377**
	1,115	**4,462**	**5,577**

	Carrying value of encumbered assets £m	Matching liabilities, contingent liabilities or securities lent £m
Loans and advances to customers	**1,056**	**727**
Debt securities	**31**	**10**
Other assets	**22**	**21**
Cash and balances with central banks	**6**	**6**
	1,115	**764**

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

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, whilst eligible treasury assets are pledged as collateral for initial margin requirements on derivatives which are centrally cleared. 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), Indexed Long-term Repo (ILTR) and Discount Window Facility (DWF). The personal loans used to secure the funding (in notes 21 and 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.

30. Risk management continued

Market risk

Market risk is the risk that the values of the Bank's assets, liabilities, capital and earnings are exposed to the adverse change of the market risk drivers. The Bank's market risks include Interest Rate Risk in the Banking Book (IRRBB) and Foreign Exchange (FX) Risk. The Bank does not have a trading book.

Interest rate risk

IRRBB arises from interest rates movements which impact present value and timing of future cash flows resulting in changes in the underlying value of a bank's assets, liabilities and off-balance sheet instruments and hence its economic value. Interest rate movements also affect a bank's earnings by altering interest-sensitive income and expenses, affecting its net interest income.

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

- Re-pricing gap risk: the risk arising from timing differences in the interest rate changes 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 different interest rate indices (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.

Interest risk exposure is actively managed within limits that are aligned with the Bank's risk appetite by using financial instruments such as interest rate swaps and by taking into account natural hedges between assets and liabilities. The hedging strategies are implemented to ensure the Bank remains within its limits and that it takes advantage of natural hedging opportunities between fixed rate assets and liabilities with similar re-pricing characteristics.

In order to measure the exposure to interest rate risk under various interest rates shock scenarios, the Bank uses both economic value and earnings-based metrics: Market Value Sensitivity and Earnings at Risk. These metrics are monitored monthly and reported to ALCO.

For interest rate risk measurement, products are allocated within re-pricing gap analysis based on their nearest re-pricing date (all non-maturing deposits are assumed to re-price in month one) and personal loans are allocated according to behavioural repayment profile.

As at 28 February 2017 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:

	2017 £m	2016 £m
+/- 200 basis points	**(18)/3**	(16)/5
+/- 100 basis points	**(9)/3**	(8)/5

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

Foreign exchange risk

The Bank is exposed to FX 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. From February 2017 onwards the FX positions are hedged on a daily basis. Further details of the hedging arrangements in place at year end are disclosed in note 14.

31. Capital resources

The following table analyses the regulatory capital resources under both transitional and end point measures of CRD IV (for which there is no difference in the case of the Bank). CRD IV regulations are being phased in over a five-year period from 2013 – 2018. From a prudential perspective, the Bank is monitored and supervised on a consolidated basis with its subsidiary, Home Retail Group Card Services Limited, from the point of acquisition of Argos Financial Services in September 2016. The Bank has obtained an individual consolidation waiver from the PRA, which allows the Bank to monitor its capital position on a consolidated basis only. Therefore, the 28 February 2017 capital position shown below is on a regulatory consolidated basis, but the comparative shows the Bank standalone position.

	2017 £m	2016 £m
Common Equity Tier 1 (CET1) capital:		
Ordinary share capital	**566**	436
Allowable reserves	**148**	167
Regulatory adjustments	**(147)**	(118)
Total Common Equity Tier 1 (CET1) capital	**567**	485
Tier 1 capital	**567**	485
Total capital	**567**	485

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 (CET1) capital includes ordinary share capital, other reserves, losses and regulatory deductions. The Bank does not currently hold any Tier 2 capital.

31. Capital resources continued

The movement of CET1 capital during the financial year is analysed as follows:

	2017 £m	2016 £m
Common Equity Tier 1 (CET1) capital:		
At 1 March 2016/1 March 2015	**485**	354
Share capital issued	**130**	137
Verified (losses)/profit attributable to shareholders	**(4)**	6
Verified (losses) of subsidiary undertakings	**(17)**	–
Other reserve movements	**2**	2
(Increase) in intangible assets	**(29)**	(14)
As at 28 February 2017/29 February 2016	**567**	485

Reconciliation of statutory reserves to regulatory reserves

	2017 £m	2016 £m
Total shareholders' funds	**731**	603
Total shareholders' funds of subsidiary undertakings and consolidation adjustments	**(17)**	–
Intangible assets (including subsidiary undertakings)	**(147)**	(118)
CET1 capital	**567**	485

Leverage ratio (Unaudited)

The leverage ratio is defined as the ratio of Tier 1 capital to adjusted assets, which is measured below on a regulatory consolidated basis. The denominator represents the total non-risk weighted assets of the regulatory group (Bank and Home Retail Group Card Services Limited) adjusted for certain off balance sheet exposures assets and regulatory deductions and provides a non-risk-weighted 'backstop' capital measure. The leverage ratio is planned to become a Pillar 1 measure from 1 January 2018. The leverage ratio is calculated below as at 28 February 2017 – this represents both transitional and end point CRD IV measures. The Bank's leverage ratio of 8.6% exceeds the minimum Basel leverage ratio of 3%.

	2017 £m	2016 £m
Components of the leverage ratio		
Total assets as per published financial statements	**5,794**	4,499
Uplift on consolidation of subsidiary undertakings	**42**	–
Exposure value for derivatives and SFTs	**269**	6
Off balance sheet exposures: unconditionally cancellable (10%)	**633**	336
Off balance sheet: other (100%)	**20**	260
Other adjustments	**(168)**	(136)
	6,590	4,965
Tier 1 capital	**567**	485
Leverage ratio	**8.6%**	9.8%

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 year to 28 February 2017, the Bank received further injections of £130m of ordinary share capital from J Sainsbury plc to support the increased capital requirements resulting from the acquisition of Argos Financial Services and 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.

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.

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

At 28 February 2017	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivatives financial instruments	**–**	**1**	**–**	**1**
Investment securities	**398**	**–**	**–**	**398**
Total assets	**398**	**1**	**–**	**399**
Derivative financial instruments	**–**	**21**	**–**	**21**
Total liabilities	**–**	**21**	**–**	**21**

At 29 February 2016	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivatives financial instruments	–	–	–	–
Investment securities	316	–	1	317
Total assets	316	–	1	317
Derivative financial instruments	–	18	–	18
Total liabilities	–	18	–	18

The Bank's level 3 instrument related to the valuation of its share of Visa Europe Limited which was disposed of during the year. The proceeds were not materially different to the fair value recognised at 29 February 2016.

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 28 February 2017 or 29 February 2016.

	2017		2016	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Assets:				
Loans and advances to customers	**3,962**	**3,972**	3,353	3,337
Cash and balances at central banks	**377**	**377**	423	423
Loans and advances to banks	**26**	**26**	25	25
Liabilities:				
Customer accounts	**4,101**	**4,106**	3,209	3,213
Other deposits	**509**	**509**	247	245
Other borrowed funds	**311**	**310**	299	299

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:

At 28 February 2017	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Loans and advances to customers	–	**3,972**	–	**3,972**
Cash and balances at central banks	–	**377**	–	**377**
Loans and advances to banks	–	**26**	–	**26**
Total assets	–	**4,375**	–	**4,375**
Customer accounts	–	**4,106**	–	**4,106**
Other deposits	–	**509**	–	**509**
Other borrowed funds	–	**310**	–	**310**
Total liabilities	–	**4,925**	–	**4,925**

At 29 February 2016	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
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

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. 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 £2.0m (2016: £1.4m) of employee costs (note 5) related to share-based payment transactions made during the financial year. Of these, £nil (2016: £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.

34. Share-based payments continued

A reconciliation of Sharesave option movements is shown below:

	2017 Number of options million	2017 Weighted average exercise price pence	2016 Number of options million	2016 Weighted average exercise price pence
Outstanding at beginning of year	**0.5**	**215**	0.3	235
Granted	**0.3**	**185**	0.3	195
Forfeited	**(0.1)**	**230**	(0.1)	236
Exercised	**–**	**267**	–	245
Colleagues transferred from fellow Group companies	**–**	**221**	–	–
Colleagues transferred to fellow Group companies	**–**	**235**	–	–
Outstanding at end of year	**0.7**	**198**	0.5	215
Exercisable at end of year	**–**	**316**	–	270
Exercisable price range		**185 to 332**		195 to 332

The weighted average share price of J Sainsbury plc during the period for options exercised over the year was 285 pence (2016: 268 pence). The weighted average remaining contractual life of share options outstanding at 28 February 2017 was 3.0 years (2016: 3.2 years). 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:

		2017	2016
Share price at grant date (pence)		**231**	243
Exercise price (pence)		**185**	195
Expected volatility	— 3 year period (%)	**29.9**	26.6
	— 5 year period (%)	**25.5**	24.1
Option life	— 3 year period (years)	**3.2**	3.2
	— 5 year period (years)	**5.2**	5.2
Expected dividends (expressed as dividend yield %)		**4.9**	5.1
Risk-free interest rate	— 3 year period (%)	**0.8**	1.6
	— 5 year period (%)	**1.6**	2.1
	— 3 year period (pence)	**49**	48
	— 5 year period (pence)	**45**	45

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.

b. 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.

Performance is measured at the end of the three-year performance period. If the required performance conditions have been met, the awards vest and 50% 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.

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.

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

	2017 million	2016 million
Outstanding at beginning of year	**0.4**	0.3
Conditionally allocated	**0.4**	0.2
Forfeited	**(0.1)**	(0.1)
Released to participants	**–**	–
Outstanding at end of year	**0.7**	0.4

34. Share-based payments continued

The weighted average remaining contractual life of share options outstanding at 28 February 2017 was 2.0 years (2016: 2.0 years).

Details of shares conditionally allocated at 28 February 2017 are set out below:

Date of conditional award	2017 million	2016 million
16 May 2013 (2013 Future Builder)	–	0.1
15 May 2014 (2014 Future Builder)	**0.1**	0.1
14 May 2015 (2015 Future Builder)	**0.2**	0.2
12 May 2016 (2016 Future Builder)	**0.4**	–
	0.7	0.4

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:

Date of conditional award	2017	2016
Share price at grant date (pence)	**265**	276
Option life (years)	**4.2**	4.2
Fair value per option (pence)	**265**	276

During the year, a total number of 4,945 (2016: 42,458) options were exercised. The weighted average share price during the year for options exercised was 264 pence (2016: 264 pence).

c. Deferred Share Award

The Deferred Share Award targets a diverse range of financial and strategic scorecard measures. These are intended to reward the top 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% 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:

	2017 million	2016 million
Outstanding at beginning of year	**0.1**	–
Granted	**0.2**	0.1
Exercised	–	–
Outstanding at end of year	**0.3**	0.1

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

	Shares conditionally allocated 2017 million	Shares conditionally allocated 2016 million
14 May 2015	**0.1**	0.1
12 May 2016	**0.2**	–
	0.3	0.1

The weighted average remaining contractual life of share options outstanding at 28 February 2017 was 0.8 years (2016: 0.9 years). The weighted average share price during the year for options exercised was 267 pence.

34. Share-based payments continued

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% of the bonus is paid in cash and 40% awarded in shares. They are automatically released after three financial years. Shares are subject to forfeiture if the participant resigns or is dismissed.

Dividends accrue on these shares and are released at the end of the three-year retention period.

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

	2017 million	2016 million
Outstanding at beginning of year	**0.3**	–
Granted	**0.4**	0.4
Lapsed	**(0.1)**	(0.1)
Outstanding at end of year	**0.6**	0.3

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

	2017 million	2016 million
14 May 2015	**0.2**	0.3
12 May 2016	**0.4**	–
	0.6	0.3

The weighted average remaining contractual life of share options outstanding at 28 February 2017 was 1.6 years (2016: 2.1 years). The weighted average share price during the year for options exercised was 261 pence.

35. Related party transactions

a) Transactions with related entities

J Sainsbury plc

The Bank is a wholly owned subsidiary of J Sainsbury plc.

	2017 £m	2016 £m
Transactions during the year		
Services and loans provided by J Sainsbury plc:		
Management services	**36**	42
Share capital issued to J Sainsbury plc	**130**	137
Balances at end of year		
Payables:		
Management services	**3**	6

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 cash flows 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.

35. Related party transactions continued

	2017 £m	2016 £m
Transactions during the year		
Interest receivable on intercompany loan	**–**	–
Interest paid on deemed loan	**(8)**	(8)
Servicer fee received	**1**	1
Balances at end of year		
Other assets:		
Intercompany loan	**7**	7
Payables:		
Interest payable	**–**	–
Deemed loan	**311**	300
Book value of personal loans for which beneficial interest has transferred to SPE	**378**	379

For additional disclosure on the nature of the deemed loan, see note 22.

Home Retail Group Card Services Limited

Following acquisition in September 2016, the Bank provides funding to Home Retail Group Card Services Limited via an intercompany loan.

	2017 £m	2016 £m
Transactions during the year		
Services and loans provided by Sainsburys Bank plc:		
Interest receivable on intercompany loan	**3**	–
Balances at end of year		
Other assets:		
Intercompany loan	**629**	–

The loan to Home Retail Group Card Services Limited has no fixed repayment term but is repayable at the Bank's request. The loan operates as a revolving facility to fund the store card lending portfolio of Home Retail Group Card Services and the balance fluctuates in line with overall lending on that portfolio. Interest is payable three months in arrears at LIBOR plus a margin of 0.8 per cent. As at 28 February 2017 the net book value of amounts receivable from customers within Home Retail Group Card Services Limited exceeded the amount outstanding on the loan.

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 year.

Remuneration and other compensation

	2017 £m	2016 £m
Short-term employee benefits	**4.4**	3.2
Post-employment benefits	**0.1**	0.1
Termination benefits	**–**	–
Share-based payments	**1.2**	0.9
	5.7	4.2

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 28 February 2015	8	4	–
Resignations during 2015/16	(2)	(1)	–
Appointments/New accounts during 2015/16	1	1	–
Amounts advanced during the year	–	24	–
Amounts repaid during the year	–	(24)	–
At 29 February 2016	**7**	**4**	**–**
Resignations during 2016/17	**(1)**	**–**	**–**
Appointments/New accounts during 2016/17	**–**	**–**	**–**
Amounts advanced during the year	**–**	**56**	**–**
Amounts repaid during the year	**–**	**(44)**	**–**
At 28 February 2017	**6**	**16**	**–**

	Number of key management personnel	Directors £'000	Other £'000
Savings and deposit accounts			
At 28 February 2015	5	349	1
Appointments/New accounts during 2015/16	1	2	–
Amounts deposited during the year	–	134	–
Interest paid	–	4	–
Amounts withdrawn during the year	(2)	(136)	–
At 29 February 2016	**4**	**353**	**1**
Appointments/New accounts during 2016/17	**–**	**–**	**–**
Amounts deposited during the year	**–**	**69**	**–**
Interest paid	**–**	**4**	**–**
Amounts withdrawn during the year	**(1)**	**(145)**	**(1)**
At 28 February 2017	**3**	**281**	**–**

Based on the Companies Act definition of Loans to Directors, total lending outstanding at 28 February 2017 was £nil (2016: £nil).

36. Capital commitments

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

	2017 £m	2016 £m
Property, plant and equipment	**–**	5
Software development	**2**	4
	2	9

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.

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 Bank's 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 which 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 – CET1 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 tangible equity – Underlying profit after tax divided by average tangible equity (equity excluding intangible assets).

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.