Sainsbury's Bank plc

Annual Report and Financial Statements for the year ended 29 February 2020

COMPANY NUMBER: 3279730

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Financial headlines

£5m

Statutory profit/(loss) before tax
(2019 restated[1]: loss £(34)m)

£33m

Underlying profit before tax
(2019 restated[1]: £24m)

2.5%

Net interest margin (underlying)
(2019 restated[1]: 2.7%)

0.7%

Bad debt asset ratio
(2019: 1.1%)

75%

Cost : income ratio (underlying)
(2019 restated[1]: 73%)

14.1%

CET1 capital ratio (transitional)
(2019: 13.7%)

110%

Net stable funding ratio
(2019: 115%)

Performance, including reference to the above headlines, is explained in the Business review and Financial review sections on pages 3 and 15.

The Alternative Performance measures have been defined and reconciled to the statutory disclosures on page 77.

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

Strategic Report

The Directors present their Strategic Report of Sainsbury's Bank plc ('the Bank') for the year ended 29 February 2020.

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. Our principal place of business is 3 Lochside Avenue, Edinburgh, EH12 9DJ.

Business model

We provide a range of retail banking services and related financial services wholly within the UK. We provide banking products for Sainsbury's customers in the distinctive Sainsbury's way.

Saving & lending

- Savings
- Loans
- Credit cards
- Mortgages[1]
- Argos storecards[2]

Commission-based

- Insurance
- ATMs
- Travel money

- Funds are raised through savings deposits and wholesale sources. We lend these to customers or hold them as liquid assets.
- Our net interest income is the difference between the interest we earn on lending and the interest we pay on funds raised.
- Our saving and lending products are sold and serviced online or by telephone and, in the case of storecards, in an Argos store.

1 We no longer accept new mortgage business.
2 Argos storecards are funded by Sainsbury's Bank and are operated via our subsidiary; Home Retail Group Card Services Limited.

- Insurance products are offered via introducer contracts with third party insurance partners and income is received through commission arrangements or through a panel model for Car and Home where we act as a broker to a number of underwriters. All products are available online or via telephone
- Foreign currency is acquired wholesale and sold to customers at a retail rate with resulting margin. We earn fees on prepaid cards and money transfer services. We have Travel Money Bureau in Sainsbury's supermarkets and have an online presence.
- Our ATMs have a physical presence in Sainsbury's and Argos stores.

As a bank authorised by the Prudential Regulation Authority (PRA), together with the Financial Conduct Authority (FCA), we are required to raise and hold specified minimum levels of our funding in the form of capital (see note 35), and hold specified levels of liquid assets in order to meet our financial commitments as they are expected to fall due (see liquidity risk disclosures at note 34).

Our underlying profitability reflects the difference between incomes generated from our products compared to costs arising from marketing and operating those products, supplier and head office related costs, charges arising from impairment of customer balances and other realised gains and losses – these items are explained in the Financial review on page 15.

We are a wholly owned subsidiary of J Sainsbury plc, governed by our own Board and Executive Committee, independent from J Sainsbury plc (see Risk Overview and Governance sections on pages 4 and 12).

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 ('the Group') is provided in the J Sainsbury plc Group financial statements and more information on transactions with Group companies is provided at note 39.

Market context

Economy

Overall, the UK GDP grew by 1.4% in 2019, picking up slightly from 1.3% in 2018, but remaining one of the slowest growth rates recorded since the financial crisis just over a decade ago. Despite the slowdown in the final three months of the year, amid political uncertainty over Brexit and the snap general election, there were tentative signs of an early post-election bounce.

The UK labour market has steadily improved over the past few years. The proportion of people in work has risen and reached a record level in 2019; the unemployment rate has fallen to its lowest level in over 40 years. The low rate of unemployment over the past two years has been sustained by relatively few people leaving jobs, rather than large numbers starting jobs. The unemployment rate remained at 3.8% as at December 2019.

The 2019 data was distorted by aborted Brexit deadlines in March and October. Companies rushing to stockpile goods and raw materials to avoid border disruption fuelled growth spurts in the first and third quarters, while planned factory shutdowns led to GDP falling in the second quarter and flat-lining in the fourth. Manufacturing output fell sharply in the fourth quarter, dragged down by weaker levels of production in the car industry.

Alongside Brexit deadlines, weaker levels of international trade, caused by the US-China trade war, dented economic growth in the UK. Business investment showed signs of recovering in the first three quarters of 2019, but fell in the final quarter, as heightened uncertainty around Brexit and the trade war weighed on the sentiment. Consumer spending slipped in the final months of the year, increasing pressure on the struggling high street, as sales fell short of expectations during the pivotal festive season.

Although, as 2020 commenced, there were early signs of a rebound in business confidence that could pave the way for stronger economic growth, the outlook remained fragile, as the newly elected government started to negotiate EU and US trade deals. The UK government's commitment to UK leaving the Brexit transition period at the end of December 2020, with or without a deal, revived uncertainty and the potential for severe disruption to UK and EU companies.

Since the year end, significant economic and social disruption has arisen from the COVID-19 pandemic and measures taken by the government to control the spread of the virus. A significant reduction in UK economic output is now expected over an uncertain period with large rises in unemployment as a result of business closures and knock on supply chain impacts.

Banking

Loans

The markets for unsecured Personal Lending in which we operate remained highly competitive throughout the year.

The market leading headline rate for loans between £7,500 and £15,000 remained at the previous year level of 2.8%, with an increased number of providers within 0.2% of the lowest rate. The pricing harmonisation of rates for loans between £7,500 and £15,000 and those greater than £15,000 but less than £25,000 continued this year. Market data highlighted demand for Personal Loans weakened in the early part of H2 before recovering in the traditionally higher lending month of January.

We seek to provide loans for the Sainsbury's shopper and as such the majority of our lending is to Nectar card holders who benefit from our lowest rates.

Credit Cards

The Credit Card market continued to see strong competition, with promotions becoming more stable, after a period of reduction. We have achieved sustained growth in new business sales and overall balances. Sainsbury's Bank remains committed to delivering compelling Credit Card products to its loyal shoppers, underpinned by a strong Nectar reward proposition.

Mortgages

The Mortgages market continues to be highly competitive, particularly in five-year terms as customers seek longer-term security of payment in the current macroeconomic environment. In September 2019, we announced that we were immediately stopping new mortgage sales in line with our objective to reshape the balance sheet and focus on capital efficient products with most connectivity to Sainsbury's shoppers.

Savings

In the 12 months since January 2019, there has been low growth (4%) in the overall savings market, giving a total stock of £1.1tn. During this time we have slightly increased our market share of 0.6%. The market continues to be dominated by Instant Access products, accounting for over 75% of stock.

We have seen a number of new entrants, who are offering competitive rates. It remains to be seen how much market disruption this causes.

Insurances

The Insurance market remains competitive and price continues to be the dominant decision maker for consumers. Preference for digital channels, especially price comparison sites, is now almost universal. Loyalty schemes and brand continue to have an influence on buying decisions, however price is the key driver. Customers' propensity to switch continues to grow with the market continuing to develop digital purchase and service journeys to reduce their dependency on contact centres and reduce their cost base and improve profitability.

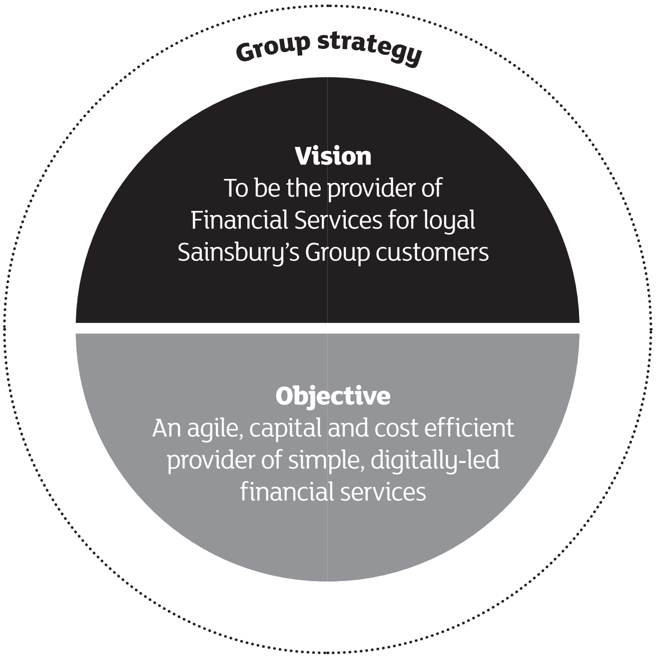
Travel Money

The Travel Money market was challenging in 2019 as Brexit discussions, parliamentary votes and a General Election created volatility in the foreign exchange market. As a result, sterling weakened as customers sought out the best possible deals, leading to intense competition and heavy discounting reducing margins in the market during the peak holiday period. In December 2019 Travelex, our currency and systems provider, suffered a global cyber security attack, which had a significant impact on our trade and removed our ability to offer an online currency ordering service for 12 weeks. This was followed in February 2020 by the spread of COVID-19, which has also seen a global travel ban introduced that is expected to impact the currency business for the foreseeable future.

Strategy

Aligned to the Sainsbury's Group strategy to grow connected services, Sainsbury's Bank's vision is to be the provider of Financial Services for loyal Sainsbury's Group customers. We aim to drive value for the Sainsbury's Group by focusing on simple, digitally-led financial services for Sainsbury's and Argos customers. We know that when customers take out a Bank product they become more loyal and go on to spend more in Sainsbury's stores.

Strategic outcomes have been defined in order to measure the successful and balanced delivery of the overall strategy.



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, provide fair outcomes for customers and strong prudential regulation

In September 2019, the Bank announced its five-year strategy, outlining its key objectives and how the strategy will be delivered. Over the next five years, the overall balance sheet for the Bank is expected to reduce as the mortgage business is run down, however this is offset partly by an increase in the Sainsbury's Bank credit card and Argos store card portfolios. The focus over the next couple of years is to reshape the balance sheet, simplify the organisation and strengthen the business.

Our performance in the year is covered in the Business review below and the Financial review on page 15.

Business review

The Bank's performance is in line with guidance, with a significantly reduced capital injection from Sainsbury's plc versus prior years. Underlying Profit has increased reflective of a modest increase in income and a reduction in impairments.

The underlying business has continued to deliver significant growth in terms of balance sheet and customer numbers. Gross customer lending increased by £319m, with growth in Mortgage balances accounting for the majority of the increase alongside increases in Credit Card balances, while Personal Loan balances were down year on year as we continued to lend selectively to Nectar card holders and enhance margin.

We have focused on delivering great value financial solutions to more Sainsbury's customers whilst we improve service and reduce operational costs. Our customer numbers have increased by 5% to 2.1 million, chiefly driven by growth in Credit Cards (+10%) and Insurance customers (+11%). Nectar is a key differentiator for Sainsbury's Bank and over 75% of our customers have a Nectar card and benefit from Nectar points and rewards across a range of products.

Underlying income is 2.2% higher, driven by sales growth in Mortgages and Credit Cards and an increase in commission income from growth in our Travel Money business and higher Insurance volumes. This was partly offset by an increase in the cost of savings as rates rose and we supported the growing mortgage book.

In balance sheet terms, we have grown our key areas of focus with our Credit Card growth of 16% being a particular area of success as this is one of our most connected product offerings for Sainsbury's Group customers. Mortgages also performed strongly, with balances ending the year at £1.9bn. In September 2019 we ceased new mortgage sales in line with our objective to reshape the balance sheet and focus on capital efficient products with most connectivity to Sainsbury's shoppers.

Our Insurance business has continued to perform well, with combined sales of Car, Home and Pet Insurance up 14%. We launched enhanced Pet Insurance in October 2019 with lifetime and time-limited Pet Insurance policies with up to £10,000 cover per year, an online portal for customers to manage their Pet Insurance policy and a 24/7 helpline for professional veterinary advice.

The cost agenda continues to be a key priority for the business and delivering sustainable costs savings will continue to be a focus in 2020/21. Our key focus areas are digitising customer journeys, efficiency in our supply chain and removing waste. A large component of our costs are colleague costs, at around 30%. Since the five-year strategy was announced in September 2019, headcount has reduced through a number of initiatives including simplifying customer journeys, stopping new mortgage lending and improving operating efficiency to reduce call centre headcount. We expect to see the full benefits of these initiatives in the coming year.

PRIORITIES

Reshape the balance sheet	Strengthen the business		Simplify the organisation
Improve margins	**Focus on:**	**Build core competency in:**	Right size the cost base
Develop AFS proposition	Operational resilience	Customer experience	Rationalise product offering
Improve card and insurance momentum	Conduct	Digital	Review vendor/supplier arrangements
New FS model with Nectar at the core	Capital efficiency	Data and analytics	Optimise cross-Group synergies
Run off mortgage book safely		Credit/Operational risk	
		Partnerships	

Delivering value for our shareholders
In order to maximise the shareholder value we made six commitments at our Capital Markets Day in September 2019 and have summarised the progress to date against each of them below.

1. **Stop putting cash into financial services.** J Sainsbury plc provided additional share capital of £35m during the first half of the year. In September 2019, the Bank committed to receiving no further cash injections from the parent. Since the Capital Markets Day announcement we have made selective balance sheet growth to ensure appropriate returns on capital and have stopped mortgage acquisition to reduce the capital demand.
2. **Improve returns.** We committed to double underlying profits and reach double digit ROCE within five years. We were on track to our guidance and plans to reach this. We will update on the impact of COVID-19 on our guidance in November.

   Note this commitment is based on consolidated financial services (including Argos Financial Services) which has a ROCE of 6.3% compared to the Bank stand-alone ROTE of 4.0%.
3. **Financial services to become cash generative.** We committed to paying dividends to our parent within five years and are taking action against our priorities to enable future cash distributions to the Group.
4. **Transform the cost base.** We committed to reducing the cost to income ratio to c50% within five years. Our operating model review was completed in 2019 and we have already taken action to implement initiatives to reduce costs, including a reduction in colleague headcount of 10% year on year (12% including contractors), and drive income growth.

   Note this commitment is based on consolidated financial services (including Argos Financial Services) which has a cost to income of 66% compared to the Bank stand-alone ratio of 75%.
5. **Reduce risk profile to the Group.** In September 2019, we announced that we were immediately stopping new mortgage sales and are now focused on core banking and commission growth to Sainsbury's and Argos customers. We continue to operate with sufficient capital and liquidity buffers to weather potential significant stress scenarios in the future.
6. **Focus on Sainsbury's customer base.** We are working to increase connectivity and value for the Group and have recently enhanced cross group workstreams to ensure delivery of this key priority. Our focus is to enhance our digital connectivity with the Group and to provide customers convenient and simple access to financial services as part of their shopping experience.

Our digital strategy in action
The Bank has been investing into digital tools as well as building data and analytics competences. We are making good progress with our refreshed strategy to offer simple, digitally-led financial services and we have seen an increase in the number of customers using our apps to manage their finances.

Our Credit Card app launched in early 2019 and now has more than 100,000 registered users. The app offers a simple and fast way to access account information and view transactions anywhere, while on the go. Customers have been using it to check their Credit Card balance, credit limit, available spend, and transactions. Our latest version of the app went live in March 2020 and customers can now benefit from a pending transactions feature, a monthly summary of transactions, the ability to manage direct debits and additional security designed to protect online customers against fraud. These changes pave the way for exciting future developments.

Our Insurance app, which launched in January 2019 for Car and Home, is amongst the first of its kind to allow policyholders to manage their Insurance via their smart device. Essentially, it allows customers to make changes to their policy and to see all the information they need in one place, giving them quick and easy access to their policies wherever and whenever they need it, and information about what to do in the event of a claim.

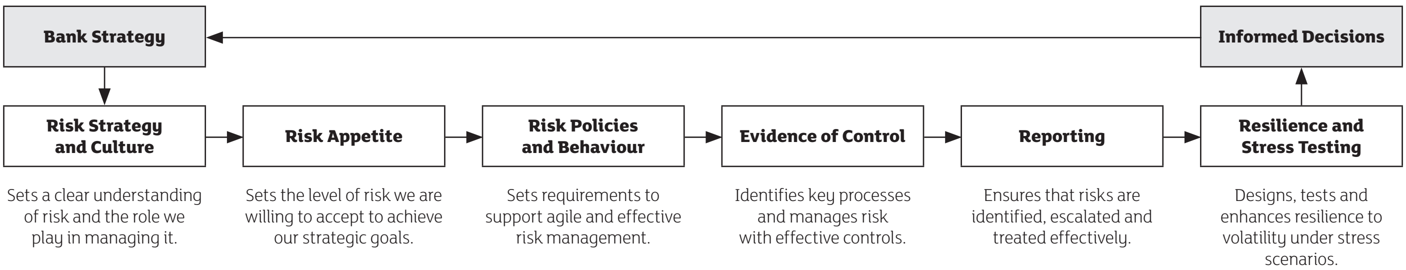
Our strategy of simple, digitally-led financial services for Sainsbury's and Argos customers will help us improve the customer's journey and customer satisfaction while we reduce operating costs. Future plans include an enhanced Credit Card app with greater functionality, enhanced digital journeys for savings and loans and further integration into the Nectar proposition.

2. Risk management objectives and policies

2.1 Risk management overview

Effective enterprise-wide risk management is a core component of our strategy and operations. We adopt a holistic, end-to-end view of risk, ensuring that the key risks arising from our activities are effectively identified, assessed and controlled. Our objective is to support the strategy of the Bank by thinking broadly about risks and managing them in an appropriate manner relative to the size and complexity of our business.

Our approach to enterprise-wide risk management includes the following key steps:



Risk strategy and culture
Our risk strategy and culture supports our business strategy and ensures it is delivered in a responsible and sustainable manner. This sets a clear, shared understanding of the risks we face and the role each of us plays in managing it. The following key aims and principles underpin our risk strategy and culture:

- **Insightful:** We identify and manage risk concentrations
- **Customer-focused:** Good customer outcomes are at the heart of what we do
- **Alert:** We anticipate market trends, we don't follow them
- **Resilient:** We fund before we lend and we control before we grow
- **Engaged:** We understand the part we play in identifying and escalating risks

Risk appetite
Our risk appetite is set and approved annually by the Board. It provides a clear articulation of the level of risk we are prepared to accept in order to achieve our strategic objectives. It is expressed and embedded through:

- A 'high-level' risk appetite statement that provides a concise set of key Bank-wide targets and limits, with a balance of current, forward-looking and stress-based metrics for financial and non-financial risks.
- 'Directional' risk appetite limits for each of the Bank's key risk types (e.g. retail credit risk, operational risk). These Directional limits are designed to provide early indications of changes in the operating environment and an outlook on whether we remain on track to meet our 'high-level' risk appetite targets.

Performance against both the 'high level' Risk Appetite and 'Directional' measures is monitored and reported to our Executive Risk Committee (ERC) on a monthly basis, and at each Board Risk Committee (BRC). Additionally, escalation processes are embedded to notify Senior Executives and Board members of any risk appetite measure operating outside of approved thresholds.

Our risk appetite enables us to make clear and transparent decisions on potential trade-offs between different aspects of our 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. This enables us to understand the Bank's current and future risk profile, how it supports our strategic objectives and how it supports the best interests of our customers and other stakeholders.

Risk policies and behaviours

We have identified a set of principal risk types to which we are exposed through our activities *(see separate section below)*. Each risk type is actively managed through a key risk policy and supporting policy standards that clearly articulate the approach and boundaries by which the risks are managed and ensure everyone understands their individual responsibilities. The policies and policy standards set out the expected behaviours and requirements to support effective, agile and consistent decision-making across the Bank.

Evidence of control

We adopt a process-centric approach to identifying, measuring and controlling our key risks, ensuring that attention is focused on what matters most. We undertake Process Risk and Control Assessments (PRCA) across all of our key activities to ensure that appropriate and effective controls are in place, and treatment plans are identified where strengthening is required. Key risk responsibilities are viewed through an enterprise-wide lens, which allows for greater ownership of top risks by subject matter experts. Each material risk is assessed on the basis of its inherent exposure, its residual exposure in the prevailing control environment and its target exposure if different from current residual levels.

Our Business Enterprise Risk Tool (BERT) is used to record and manage our key processes, the controls we have in place, any treatment plans to improve our control environment and to record our management of risk events. All colleagues have access to BERT enabling them to view risk data across the organisation.

Reporting

Our risk reporting processes are critical to understanding the specific and aggregate levels of risk to which we are exposed and the effectiveness of our controls to manage these risks. We promote insightful reporting at all levels to encourage debate on what matters most, and to ensure effective action is being taken at an appropriate level to address any current or emerging areas of concern.

Resilience plans and stress testing

Financial and operational resilience are key areas of focus. Our capital and liquidity adequacy are assessed on (at least) an annual basis through the ICAAP and ILAAP. Business recovery plans for severe incidents are reviewed on a regular basis, while our Recovery and Resolution Plans review our playbooks and recovery capacity in response to extreme but plausible threats to our viability. In line with recent regulatory guidance, we have implemented a Resilience Transformation Programme to set clear impact tolerances to disruption and embed the processes and resources required to meet them.

Risk management structure

We adopt a Three Lines of Defence framework to provide a basis for the identification and management of all risks associated with our business model and strategy. Within our Three Lines of Defence framework:

- **First Line.** Primary responsibility for the identification, management, monitoring and control of risks rests with our commercial and operational teams. The First Line teams, as subject matter experts, own the processes and controls used to manage risks within risk appetite and are responsible for the design, operation and testing of the key controls.
- **Second Line**. The independent Risk Management Division is responsible for providing risk frameworks, policies and oversight within which the First Line can manage its risks. It also provides training and support on the frameworks and the design of key controls, as well as oversight and approval of PRCAs.
- **Third Line.** Our Internal Audit Division provides independent assurance on the effectiveness of risk management and internal control processes in mitigating and reporting risks.

Argos Financial Services (AFS)

These financial statements present the standalone financial performance and position of Sainsbury's Bank and do not consolidate the Argos Financial Services (AFS) subsidiaries. However, the risks associated with AFS business are managed in line with the Group-wide risk framework, with a suite of risk appetite measures in place for AFS and tracked within the wider Group governance structure.

Key uncertainties

We regularly monitor emerging and evolving changes in the risk environment in order to promote early discussion to understand and address any threats or opportunities to our business model. We consider specific emerging threats and opportunities under the following broad themes:

- **Strategic.** Reflects both our business model and the markets in which we operate. For example, regular consideration is given to changes in the competitive market resulting from new entrants or mergers and acquisitions (M&A) activity, and any resultant impact on margins.
- **Operational.** Reflects changes in technology, the impact of internal processes or emerging external best practices. For example, we continually review the evolving nature of cyber-crime and its impact on the Bank in terms of financial losses and operational costs to protect our customers.
- **Political and Economic.** Reflects the impact of macroeconomic conditions and government policy on our markets. For example, we have reviewed the impact on UK market conditions arising from Brexit and the impact of changes in interest rates, employment market or house prices on the demand for our products.
- **Regulatory and Conduct.** Reflects continued developments within the financial services sector including PRA and FCA consultations and changes to Basel regulations. For example, the joint PRA and FCA consultation on operational resilience has influenced the scope and objectives of our Resilience Transformation Programme.

As more information is known about an emerging risk, it will be subject to a full risk assessment. Actions will then be taken to manage and control the risk, unless it is assessed as not relevant or not material to the Bank.

- **COVID-19.** Since the year end, the COVID-19 pandemic has emerged as a material risk across all of the four themes noted above. The initial impact is primarily operational. Our business resilience plans and governance processes have been employed to ensure we continue to serve our customers and provide them with the support they need while also ensuring the safety of our colleagues and complying with government and regulatory guidance. We have engaged closely with our suppliers to support these efforts. In addition, secondary impacts are likely to include higher expected credit losses (ECLs) due to a deterioration in the economic outlook and lower revenues, including from some of the operational decisions taken (for example, the temporary closure of our Travel Money bureaus). Our capital and liquidity ratios are expected to remain strong and we continue to review a range of plausible stress outcomes to ensure we remain resilient.
- **Climate change** is an emerging threat that potentially exposes us to both direct and indirect financial risks. In line with PRA guidance (SS3/19), we have developed a strategy to identify, assess and manage our exposure across the key areas of governance, risk management, scenario analysis and disclosure. A framework has been established to ensure appropriate visibility of the risks arising from climate change, while our ICAAP includes an assessment of the impact of financial risks from climate change, including the impact of extreme weather on our ability to serve our customers.

Principal risks

Credit risk

The risk that a retail customer fails to maintain their contractual obligations and repay their borrowing on time.

How it may arise

Changes in the economic conditions in the UK may impact on the ability of our customers to repay their loans leading to an increase in levels of bad debt.

How do we manage the risk?

- We lend responsibly, considering the suitability of the product to meet our customers' needs and their ability to repay any debt.
- We have policies to support vulnerable customers and those in financial difficulties.
- Credit decisioning based on information from a number of credit related sources.
- Regular stress testing is undertaken using a variety of plausible stress scenarios.

Changes in 2019/20

- Ceased new Mortgage lending in September 2019 following strategic review.
- Bank credit lending criteria continues to focus on Nectar card customers.
- Enhanced approach to assessing affordability.
- Planning for the potential impact of Brexit on future bad debt losses.

Operational risk

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

How it may arise

Inadequate processes or internal controls may result in poor customer outcomes, service disruption, reputational damage and/or financial losses.

How do we manage the risk?

- A process-centric approach to risk & control assessment, designed to focus on what matters most.
- A clear operating model to embed consistency and boost capability across the Bank.
- Aggregated reporting and insight on our risk profile to ensure the highest priority items are escalated.
- Monthly review of our top risks with a rolling agenda of deep-dives.

Changes in 2019/20

- Enhancement of key risk and control process assessments.
- Executive member review of control environment robustness.
- Review of enterprise-wide risk ownership model responsibilities.
- Enhanced MI to manage a broad range of risks across the Bank.

Financial crime risk

Our products are used to facilitate financial crime and/or our processes, systems or controls are non-compliant.

How it may arise

Failure to protect our customers may lead to financial loss, inconvenience to our customers and result in regulatory censure and loss of confidence in the Bank.

How do we manage the risk?

- Prevention and detection processes, systems and controls in place.
- Proactive engagement with industry, sharing intelligence.
- Robust horizon scanning to identify and impact assess emerging threats.
- Money Laundering Reporting Officer provides regular reports on financial crime controls to Executive and Board committees.

Changes in 2019/20

- Investment in key fraud controls through the delivery of the Fraud Resilience Programme.
- Updated Policy Standards and enhanced process level controls.
- Independent assurance testing programme for key AML and Sanctions systems initiated.

Conduct and compliance risks

The risk that our culture, behaviour or actions may lead to a failure to comply with regulators, or cause detriment to customers or the markets.

How it may arise

Failure to understand the needs of our customers or to provide them with the level of service required at all stages of the customer journey.

How do we manage the risk?

- Control procedures and processes with clear reporting and escalation procedures.
- Independent oversight of the adequacy and effectiveness of issues and events.
- Horizon scanning of emerging threats or regulatory changes.
- Regular, open engagement with our regulators.
- Continuous monitoring of control testing outcomes through PRCA oversight and risk based assurance activity.

Changes in 2019/20

- Head of Conduct Risk (SMF16) appointed to ExCo.
- Enhanced 2nd Line independent oversight.
- Policy Standards updated and controls enhanced.
- Enriched Conduct risk MI.
- Implementation of SMCR in AFS subsidiaries.
- Strengthening of Data Protection controls and processes.

Capital adequacy risk

Holding insufficient capital to absorb losses in normal and stressed conditions or the ineffective use of capital.

How it may arise

Changes in economic conditions or regulatory requirements may impact on the level of capital resources required.

How do we manage the risk?

— Target risk appetite range for level of capital held.
— Daily monitoring of capital position, with triggers in place for escalation.
— Capital adequacy target built in to our planning processes.
— Projected capital position updated for any strategic or external changes.
— The annual ICAAP determines the adequacy of the level and type of capital resources held

Changes in 2019/20

— In line with our revised strategy, no new capital injections from JS plc are planned from September 2019.
— IFRS9 'day 1' provisions increased in line with the transitional arrangements.

Liquidity, funding and market risks

The risk we are unable to meet our obligations as they fall due or are adversely hit by market rate or price movements.

How it may arise

Loss of confidence in the Bank leading to a material outflow of deposits and/or difficulties in accessing wholesale funding. Sudden changes or volatility in market values.

How do we manage the risk?

— Risk appetite limits set.
— Daily monitoring and reporting of key metrics.
— Liquidity and funding targets built into planning process.
— Liquidity Contingency Plan for action under stress.
— Hedging strategies used to reduce exposures to earnings volatility.
— The annual ILAAP determines the adequacy of liquidity and funding resources held.

Changes in 2019/20

— The Bank has commenced activity transitioning from LIBOR interest rate benchmark in line with the market and regulatory developments.
— Ceasing new Mortgage lending resulting in lower funding requirements and less hedging activity.

Wates Corporate Governance Principles
Sainsbury's Bank plc applies the Wates Corporate Governance Principles for Large Private Companies (available on the Financial Reporting Council website). The Bank was established in 1997, providing a range of retail banking and related financial services, operating solely in the UK. It develops its customer offer through sales of its core products: Personal Loans, Savings Accounts, Credit Cards, Insurance products and the provision of Travel Money and ATM services.

The Bank was originally established as a joint venture with Bank of Scotland Plc but, since 2014, has been a wholly owned subsidiary of J Sainsbury plc. Following the acquisition by J Sainsbury plc of Home Retail Group Limited in 2016, the Bank acquired three of its subsidiaries namely, Home Retail Group Card Services Limited, Home Retail Group Insurance Services Limited and Argos Personal Loans Limited. These three entities, wholly owned by the Bank, are collectively known as Argos Financial Services (AFS).

Principle 1 – Purpose and leadership
Purpose, values and culture
Aligned to J Sainsbury plc's purpose to help its customers live well for less, the Bank's strategy is to be the provider of financial services for loyal Sainsbury's Group Customers. The Bank's objectives are to be an agile, capital and cost efficient provider of simple, digitally-led financial services. The strategy and objectives were reviewed and updated by the Board in 2019, including the decision to cease new mortgage originations from September 2019.

Supporting this are the Bank's key priorities over the next five years to:
— Re-shape the Bank's balance sheet
— Simplify the organisation
— Strengthen the business

Underpinning those key priorities, the Bank sets a clear risk appetite to operate within and seeks to deliver best-in-class execution through highly engaged colleagues, working together to deliver its goals.

The Bank's strategy, objectives and priorities were communicated to colleagues through a series of roadshows led by the Bank's CEO held between October and December 2019. They were also communicated to J Sainsbury plc investors as part of the Group-wide Capital Markets Day on 25 September 2019.

Details of the Bank's broader purpose in relation to non-financial matters (Environmental, Social, Employee, Human Rights and Modern Slavery, Anti-Corruption/Anti-Bribery) are provided on pages 10 to 11.

Strategy
The Board of Directors of the Bank is the key governance body, responsible for the overall strategy, performance of the business and management of risk. It delegates responsibility for the day to day running of the business to the Chief Executive and the Executive Management Team through the apportionment of responsibility and delegated authorities. The Board holds overall accountability for the outcomes achieved, decisions made and steering the company, subject to specific reserved matters which require the consent of J Sainsbury plc.

Performance against key metrics is measured and reported to the Board and all colleagues on a regular basis. The metrics link together – as we believe that if we have highly engaged colleagues, who deliver a great service to our customers, this in turn will help us drive increased profitability and lower costs. As a financial services business in a highly regulated environment, we also need to ensure we're operating in a safe and sound way too.

Relationship with J Sainsbury plc
Since 2014, the Bank has been a wholly owned subsidiary of J Sainsbury plc, a listed retailer. J Sainsbury plc currently has one Director on the Bank Board. The J Sainsbury plc appointed director has no additional rights or powers than any other director of the Board, nor is J Sainsbury plc involved in the day-to-day management of the Bank. However, J Sainsbury plc has certain reserved powers and decisions which fall within those powers must be referred to them by the Bank Board for their consent before undertaking. Primarily, these reserved matters relate to significant change in the size and scale of the Bank's operations, changes in its capital structure including any increases or decreases to capital, significant individual contracts or legal disputes, changes to directors or officers of the Bank and share schemes.

Principle 2 – Board composition
Chair
The Bank has a separate Chairman (an Independent Non-Executive) and Chief Executive (an Executive Director) to ensure that the balance of responsibilities, accountabilities and decision making are effectively maintained. The Chairman plays a key role in creating the conditions for overall Board and individual director effectiveness. In February 2020 our current Chairman, Roger Davis, notified the Board that he intends to step down during 2020 – a search to find a replacement Chairman is underway.

Balance and diversity
Recruitment on to the Bank Board combines an assessment of both technical capability and competency skills to ensure the optimum blend of individual and aggregate capability having regards to the Bank's long-term strategic plan. Such recruitment is subject to the approval of the Nominations Committee, the Bank Board, J Sainsbury plc (as the decision falls within reserved matters) and the relevant regulatory bodies (where applicable).

Independent Non-Executive Directors bring their experience to bear from across various sectors, notably Financial Services but also from across Retail, Digital and E-Commerce. These are key areas of focus for the Bank and aligned to its strategy. Directors update their skills, knowledge and familiarity with the Bank by meeting senior management, a programme of developmental training (from both internal and external speakers) and by attending appropriate external seminars. There is an induction programme for all new Directors which is tailored to their specific needs and which provides access to all parts of the business.

Size and structure
During 2019/20, the Bank Board was streamlined to ensure the right leadership was in place to become an agile, capital and cost efficient provider of simple, digitally-led financial services to Sainsbury's and Argos customers. As a result, the following changes were made:

- A reduction in the number of Non-Executive Directors appointed by J Sainsbury plc from three to one with the previous incumbents replaced by the JS Group Chief Digital Officer;
- The Chief Risk Officer role is no longer a Statutory Director of the Bank but is a permanent attendee at the Bank Board;
- The Chief Customer Officer role was split into a Bank Customer Director and Chief Operating Officer. Neither of these new roles are Statutory Directors of the Bank; and
- The Chief Transformation Officer and HR Director were stood down as permanent attendees on the Board.

The Bank Board is now comprised of an Independent Chairman, four other Independent Non-Executive Directors, one Non-Executive Director appointed by J Sainsbury plc and two Executive Directors – the Bank's Chief Executive Officer and its Chief Financial Officer. A biography for each Board Director can be found on the J Sainsbury plc corporate website: **www.about.sainsburys.co.uk/about-us/our-management#sainsburys-bank**

The Directors have equal voting rights when making decisions, except the Chairman, who has a casting vote at the Bank Board. All Directors have access to the advice and services of the Company Secretary and may, if they wish, take professional advice at the Company's expense. Directors duties are exercised through the Board and its sub-committees per the Governance structure on page 12. Each of these is chaired by one of the Independent Non-Executive Directors.

Effectiveness
The Board last undertook a formal effectiveness review facilitated by an independent external advisor at the end of 2015 with an internally led review undertaken in early 2018. The next independent review was scheduled for 2019; however, with the changes in the composition of the Bank Board and Executive team, the next independent review had been scheduled for mid-2020 but has been deferred pending the appointment of a new Bank Chairman.

The 2015 Board Effectiveness Review was undertaken at a time when the Bank was still in the transition from being a joint venture to being a wholly owned stand-alone subsidiary of J Sainsbury plc. At the time, the Board was assessed overall as being "Effective" and "Highly Effective" in some areas. This rating reflected the fact that the Bank's overall performance in terms of meeting the demands of its key stakeholders had been sustained during a time of significant transition for the Bank. It had been particularly noted that all Board members were fully committed and engaged in challenging the oversight of the business. The main areas that required attention were around Board member induction and development, risk measures and the development of Board governance processes and initiatives, all of which have since been addressed.

Principle 3 – Director responsibilities

Accountability
Each Board Director has a clear understanding of their accountability and responsibilities via the Individual Accountability Regime which the Bank introduced in early 2016 and which has been regularly updated since then. Whilst Board oversight is always maintained, key decisions are made by the individuals and committees with the most appropriate knowledge and experience.

The Board had a programme of nine main meetings in 2019/20 and has the same number planned for 2020/21. One of the Board meetings is usually set aside each year for strategic planning with the Executive Committee and key stakeholders from across the Bank, AFS and J Sainsbury plc as appropriate.

As part of their annual review, the Bank Chairman undertakes a Fit and Proper Assessment and Attestation with each Board Director. The Senior Independent Non-Executive Director undertakes the same for the Bank Chairman.

Conflicts of interest
Any potential conflicts of interest are identified and considered as part of the recruitment process for on-boarding new Directors on to the Bank Board. Where there are any concerns raised, they are considered by the Bank's Nominations Committee and again at the Board meeting when the recommendation is brought for approval.

Once in situ, should a Director be offered the opportunity to take up a position (Executive or Non-Executive), whilst retaining their role on the Bank Board, they are required to inform the Bank Chairman and the Board would then be asked to confirm that no conflicts of interest existed or were perceived to exist before accepting the additional role. Where there are any potential conflicts, appropriate safeguards would be implemented.

Committees
The Board delegates authority for day-to-day management of the Company to the Chief Executive Officer who exercises this role via the Executive Committee which meets monthly. It is chaired by the Chief Executive and its membership is made up of the:

- Chief Executive Officer
- Chief Financial Officer
- Chief Risk Officer
- Head of Conduct Risk
- Chief Operations Officer
- Customer Director – Sainsbury's Bank
- Customer Director – Argos Financial Services
- Chief Transformation Officer – to June 2020
- HR Director

Note: The Bank's Internal Audit Director is a permanent attendee at every meeting.

The Independent Non-Executive Directors are wholly independent in that they have no material business or relationships with the Company that might influence their independence or judgement. In addition, certain governance responsibilities are delegated to other Board Committees (Audit Committee, Board Risk Committee, Remuneration Committee and Nominations Committee). Membership of these committees is entirely made up of Non-Executive Directors of the Bank with members of the Bank's Executive team and other senior colleagues in attendance. These committees support effective decision making and independent challenge.

Integrity of information
The Board receives regular and timely information at its meetings on all key aspects of the business supported by a range of Key Performance Indicators (KPIs). The Bank's various functions prepare and maintain the integrity of this information, with the financial information collated from the financial systems. This financial information is externally audited by Ernst & Young LLP on an annual basis together with a review of the Bank's Financial Control Environment and adherence to current accounting and regulatory standards.

Principle 4 – Opportunity and risk

Opportunity

The Board is responsible for the overall strategy and performance of the business and its management of risk. It undertakes a deep-dive review of the Bank's strategy on at least an annual basis, taking due account of changes in the operating environment and emerging risks and opportunities. This includes a review of long-term strategic opportunities, building upon the Bank's purpose and advantages from being part of the wider Sainsbury's Group.

Risk

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 within the risk appetite set by the Board. 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 BRC meets at least on a quarterly basis.

Responsibilities

In line with the provisions of the Senior Manager & Certification Regime (SMCR), the Bank has allocated the Senior Manager Functions and prescribed responsibilities in so far as they apply to Sainsbury's Bank plc and its AFS subsidiaries. A Management Responsibility Map (MRM) is in place to provide a description of the Bank's management and governance arrangements including the reporting lines and details of the individuals who are part of those arrangements and their prescribed responsibilities. The MRM is owned by the Board which reviews it at least twice a year.

The Bank has embedded a process-centric approach to identifying, measuring and controlling its key risks. It focuses attention on what matters most, those risks that can cause the greatest harm to our customers, reputation or finances. It provides a view on inherent risk, control effectiveness and residual risk assessments. It informs a bi-annual attestation of control effectiveness that is reviewed by the Board.

Principle 5 – Remuneration

Setting remuneration

The Board-level Remuneration Committee (RemCo) recommends to the Board the remuneration strategy for the Executive Directors, Chairman, Senior Management and Material Risk Takers. Within this framework, its remuneration policy is aligned to the long-term success of the Company as well as promoting effective risk management and compliance with applicable statutory and regulatory requirements. RemCo also has oversight over appointment and severance terms for relevant employees.

Policies

The Bank is an equal opportunities employer and promotes an environment free from discrimination, in line with Group-wide 'embrace the difference' values and its vision to be the most inclusive retailer. All decisions relating to employment practices (including remuneration) are objective, free from bias and based solely upon work criteria and individual merit.

The Directors' positions and remuneration status are set out in the Directors' Report. An independent external review is carried out annually to ensure that the remuneration policy for executives is consistent with similar size banks in the industry. Our gender pay gap figures are determined by our structure which is supported by store colleagues and is unique within the banking sector (see Non-financial reporting disclosure on page 10). Remuneration policies are reviewed annually by RemCo.

Delegating remuneration decisions

Remuneration decisions are delegated through the divisional heads to agree fair and appropriate distribution of agreed bonuses and salary increases based on the principles agreed at Remuneration Committee and the performances of teams and individuals across the business.

Subsidiary companies

The remuneration strategy and policies set by RemCo are fully applied to Argos Financial Services.

Principle 6 – Stakeholder relationships and engagement

External impacts

The Board is committed to social responsibility, community engagement and environmental sustainability. These goals are achieved through a combination of activities and commitments, including measures to support the Sainsbury's Group target to achieve Net Zero emissions from its operations by 2040. The Bank embraced the '150 Days of Community' initiative launched by Sainsbury's Group as part of its 150th anniversary celebrations in 2019, with colleagues undertaking a range of projects to support local communities.

Stakeholders

The Board promotes good conduct, accountability and transparency with all of the Bank's key stakeholders (customers, colleagues, investors, suppliers and banking regulators). Key interactions with each stakeholder group are set out in the section 172 statement below. The Board sets a clear 'tone from the top' in line with the Bank's purpose to be the provider of financial services for loyal Sainsbury's Group customers.

Workforce

The Bank aims to be a great place to work for all colleagues, enabling them to develop their skills and knowledge to be the best they can be. Colleagues are encouraged to learn from each other, their managers and through structured learning activity that develops behavioural and technical capability. Cornerstones of our approach include investing time in two-way communication between leaders and other colleagues (informing and listening) and up-skilling leaders to be effective communicators and leaders of people.

Investors in People (IIP) award accreditation to organisations who invest in training and development. Sainsbury's has a long standing relationship with IIP and has been awarded Gold in its last four assessments. The latest assessment in 2019 included the Bank for the first time.

Whistleblowing is an important part of protecting the Bank as it creates a safe way for colleagues to raise any concerns and challenge poor practice and/or behaviour. The Bank's whistleblowing policy sets out how colleagues can report concerns internally, through the Group's 'Rightline' service or through regulators.

Section 172

The Board fully recognises its obligations under the Companies Act 2006, including as set out in section 172. Its governance framework and regular programme of agenda items ensures it has due regard to:

— **The likely longer-term consequences of its decisions.** For example, the Board approves a rolling five-year strategic plan on an annual basis and regularly monitors its progress through key metrics (which form the basis of KPIs outlined on page 14) and sub-committees to provide appropriate review, balanced challenge and transparency on decision making. In FY 2019/20 the Board provided feedback, challenge and approval for the refresh of the Bank's purpose, vision and strategic objectives that were outlined at the Sainsbury's Capital Markets Day in September 2019.

— **Maintaining the reputation of the Bank (and the Sainsbury's Group brands it uses) for high standards of business conduct.** The Board promotes the values of the wider Sainsbury's Group across the organisation. These values help colleagues to know how to act at work and we believe they're right because they're also the way that many of us live outside of work too. Sainsbury's Group (including the Bank) has always had a strong sense of social, environmental and economic responsibility and an understanding that our success depends on society's success. Further details on our approach to diversity, environmental and social factors are outlined in the Non-financial reporting section on page 10.

— **The views and interests of its key stakeholders**. The Board seeks to understand the views of key stakeholders in order to inform effective decision-making and to deliver long-term success. It identifies our core stakeholders as: customers and communities; colleagues; investors; suppliers; and regulators. The interaction with each stakeholder group is set out in the following section.

By taking regard of these factors, the Board seeks to ensure that the Directors have acted both individually and collectively in a way that would, in good faith, be considered likely to promote the success of the Bank while having due regard to all its stakeholders and to the matters set out in paragraphs a to f of section 172 of the Companies Act 2006.

Key stakeholders

Customers and communities

Our customers are at the heart of what we do. Building trust is important to us and we want our customers to receive the best possible outcome by being fair and transparent with everything we do. We have developed policies for Customer Outcomes and for Treatment of Vulnerable Customers that are reviewed annually to confirm that we interact with customers appropriately and with due care and consideration. We also have a clear process for responding to customer complaints and any key themes that are identified are reviewed by the Board and senior management and discussed with our regulators.

Customer satisfaction is measured through Net Promoter Score (NPS) surveys and reported to the Board. The findings are used to improve our customers experience and engagement with knowledge being shared across all of our business.

We also recognise the importance of supporting the communities we operate in. We are proud of being part of a brand that has been present within thousands of communities for 150 years and to celebrate, we encouraged all colleagues to participate in our '150 days of community' to make a difference wherever they could. A number of our colleagues, including our CEO, volunteered to work in a Sainsbury's or Argos store for a day, helping to support our Group colleagues and to develop a greater understanding of our wider customer and community base.

Colleagues

Our Board understands the importance of colleagues that feel engaged, supported and proud to work for the organisation in order to deliver the long-term success of the business. In 2019 the Bank was included for the first time in the Investors in People (IIP) assessment for Sainsbury's Group and is proud to have been part of its continued certification as Gold standard.

Our Board promotes the Group's vision to be an inclusive employer where people love to work. A number of initiatives are adopted, such as 'Embrace the Difference' which promotes diversity in the work place, inclusion objectives, gender balance ratios and addresses unconscious bias.

Our 'Great Place to Work Group' is part of the Group-wide approach, enabling colleagues voices to be heard and providing an effective way to communicate what matters to our colleagues to make a difference in our business. Our 'We're Listening' surveys focus on sustainable engagement to understand the strength of connection our colleagues have to our business and brand over the long term. The results of these surveys are discussed by the Board.

Investors

J Sainsbury plc owns 100% of our equity capital and we also have debt investors through our Tier 2 capital issuance. Our Board sets our risk appetite to support and protect investor value and to ensure we operate within appropriate and agreed levels and types of risks.

Our strategic aim is to be the provider of Financial Services for loyal Sainsbury's Group customers. The Group's interests are represented by an appointed Non-Executive Director to ensure effective challenge and collaboration to grow our connected services. Where interests are not aligned, this is managed through disclosure and activities to minimise potential conflicts. Our strategy was presented as part of the Group's Capital Markets Day in September 2019.

Suppliers

Our Board understands the importance of our supply chain in delivering our plans and the long-term success of the business. We seek a strong degree of engagement with third party suppliers across the end-to-end supplier management process, from sourcing to procurement to relationship management to contract reviews. We recognise that when we outsource a service we do not outsource the responsibility. We ensure our suppliers are compliant with regulatory requirements and have the necessary controls in place in line with risks to make sure we continue to meet a high standard of conduct for our customers. Our Supply Chain Oversight Committee provides performance oversight of our suppliers and reports to senior management and the Board.

Continuous and proactive collaboration with our suppliers is undertaken on a regular basis. This provides a forum for developing the business relationship and to ensure we receive an effective service, identify and manage risk appropriately and operate in line with our values. A key factor in building effective relationships with our suppliers is ensuring our requirements are clear and that they are paid on time. The Bank's iSupplier internet portal provides suppliers with access to the purchase orders raised and allows them to allocate their respective invoices once they have fulfilled the order requirements.

Regulators

We are regulated by the Prudential Regulation Authority for prudential issues and by the Financial Conduct Authority for conduct of business matters. We engage with regulators on an open and proactive basis, ensuring full compliance with the letter and spirit of the rules we operate within.

We recognise the trust that customers place in the Sainsbury and Argos brands and seek to maintain that by operating in a safe and sound way. Our Head of Conduct and Compliance provides oversight of any emerging compliance risks and reports any areas of concern to the Board.

Non-financial reporting

The Bank has complied with the EU Non-Financial Reporting Directive requirements contained in sections 414CA and 414CB of the Companies Act 2006. The below disclosures are intended to help stakeholders understand the Bank's position on key non-financial matters.

Business model

The Bank seeks to provide quality financial services to Sainsbury's and Argos customers at an affordable price. The business model is outlined on page 1 of this Strategic Report.

Environmental

We are always looking for ways to manage the impact our operations have on our environment and are part of the Sainsbury's commitment to become a Net Zero operation by 2040. As part of Sainsbury's, our facilities management approach actively manages, and looks to continuously improve, our waste management and recycling. We use video and telephone conferencing facilities rather than travel to meetings, where possible. Colleagues are encouraged to use public transport and cycle to work, with shower facilities provided at our head office and larger sites. We take time to identify practical ways to reduce the environmental impact of our leaflets and Point of Sale materials in stores.

Additionally, we have invested in the new capabilities needed to help respond to the increasingly digital world our customers live in. This investment will help to drive more sustainable banking. For example, our Loans platform affords the Bank the ability to offer e-signature facility thus removing the requirement to both generate and send physical Personal Loan documentation. Our new Credit Card app also offers the ability to check your balance and get paperless statements, thus reducing the amount of physical paper statements being sent to customers.

Social

The Sainsbury's Group Values and Sustainability Plan underpin our approach to what we do, and how. By acting in the best interests of all our stakeholders, we can make a sustainable and positive contribution to our community. We also know that playing an active and supportive role in our community is really important to our colleagues. It makes us all feel good to know we're doing something for someone else.

In 2019/20, our colleagues raised over £32k for our charity partner, Maggie's. Our support has helped provide free practical, emotional and social support to people with cancer and their family and friends. We also support the fantastic fund-raising activities that Sainsbury's does each year including Comic and Sport Relief.

Further details on our interaction with our key stakeholders is outlined in the section 172 report on page 9.

Our customers
Here at Sainsbury's Bank we recognise that money influences all areas of our customers' lives. Whether it's during their daily commute to work or in planning a holiday with their family, we know how important saving money and savvy spending is to today's families. We want to help families get the most out of their life today, tomorrow and in the future.

Our publication 'Money Matters', both in print and as a blog, offers readers practical ideas about how to get the most out of their busy lives. From money-saving ideas to family travel tips, Sainsbury's Bank customers are the driving force behind every Money Matters article and blog post. It's a resource just for them – a place to discover valuable information and share ideas on how to live life to the fullest.

Employees
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. 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.

We are 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. We have a workplace adjustments process in place for our colleagues who are living with a disability or long-term health condition which operates through the Government's Access to Work scheme. Workplace adjustments can be made at any point during a colleague's employment with us.

In support of the wider objectives of the J Sainsbury plc Group, our colleagues are encouraged to participate in two all employee share plans, 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.

As part of the Sainsbury's Group, the Bank supports the Group's vision to become the 'most inclusive' retailer by embracing our differences across the Bank. The activities we're undertaking to being a more diverse and inclusive organisation are fundamentally about fairness, equality and inclusion for men and women. A balanced workforce at all levels improves culture, behaviours, outcomes, profitability and productivity. With this diversity comes a variety of ideas and views that inform decision-making and enable us to understand our customers better.

In response to colleague feedback, the Bank and Group have worked together to put an affordable colleague loan scheme in place with third party Salary Finance. Salary Finance take loan repayments directly from colleagues' pay via payroll. This means loan interest rates are often lower and a wider range of criteria can be used than most lenders when reviewing and approving loan applications. Colleagues' applications are assessed to make sure the loan is appropriate and affordable for them.

Gender pay gap
Details of the Bank's gender pay gap can be found within the Sainsbury's Group disclosures at **https://www.about.sainsburys.co.uk/~/media/Files/S/Sainsburys/Copy%20of%20Gender%20Pay%20Gap%20Report%202019.pdf**

The mean gender pay gap of 35.9% (as at April 2019) has reduced from 36.4% in April 2018 and 39.4% the year before. The gap is, in part, reflective of the structure of our business whereby in store Travel Money bureau colleagues are directly employed rather than filling our positions through a third party agency. Around 43% of Sainsbury's Bank colleagues work in these roles on hourly rates of pay and almost three quarters of these roles are held by women. In addition to the Travel Money colleague composition, Sainsbury's Bank still has more men than women in the most senior and well paid roles and more women in hourly paid positions, further impacting the pay gap.

The Bank signed up to the Women in Finance Charter in January 2018. Created by HM Treasury, this charter is designed to support and motivate finance companies to land activity that, over time, will help address gender imbalance at senior leadership levels. By December 2020, we are aiming to reach 30% female representation at a senior management level and above across our Bank. In our most recent report this has risen from 27% in September 2018 to 29% in September 2019.

Human rights and modern slavery
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 the presence of it in our supply chain at the earliest opportunity. Our full Modern Slavery statement is published on the Bank's website (**https://www.sainsburysbank.co.uk/~/media/files/pdf/modern-slavery-statement.pdf**).

Anti-corruption/Anti-bribery
As a financial services provider, the Bank is exposed to the risk of facilitating bribery or aiding corruption through the provision of financial services. This risk is managed through a clear set of policies, procedures and controls which are communicated to colleagues through regular mandatory training modules including Anti-Bribery and Corruption, Anti-Money Laundering, Conduct Rules, Conflicts of Interest and Whistleblowing. The training material is reviewed and updated to reflect changes in legislation or best practice (e.g. tailored senior management training). The Supply Chain Management team regularly monitors suppliers to ensure that processes and controls are in line with the Bank's required standards.

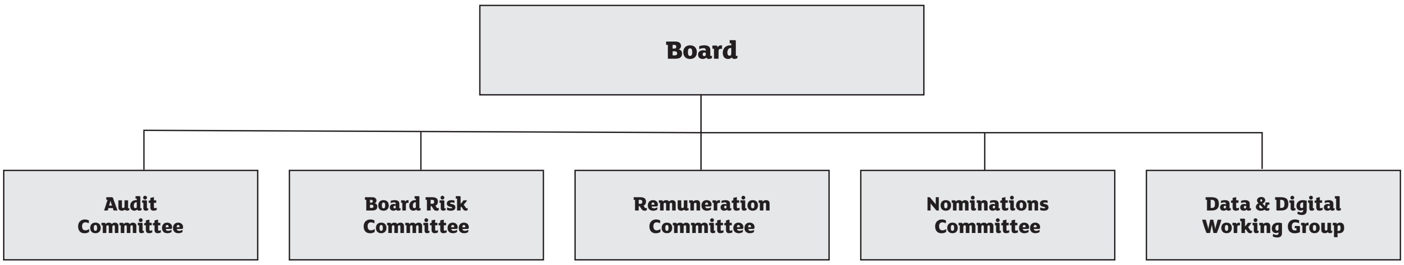
Governance

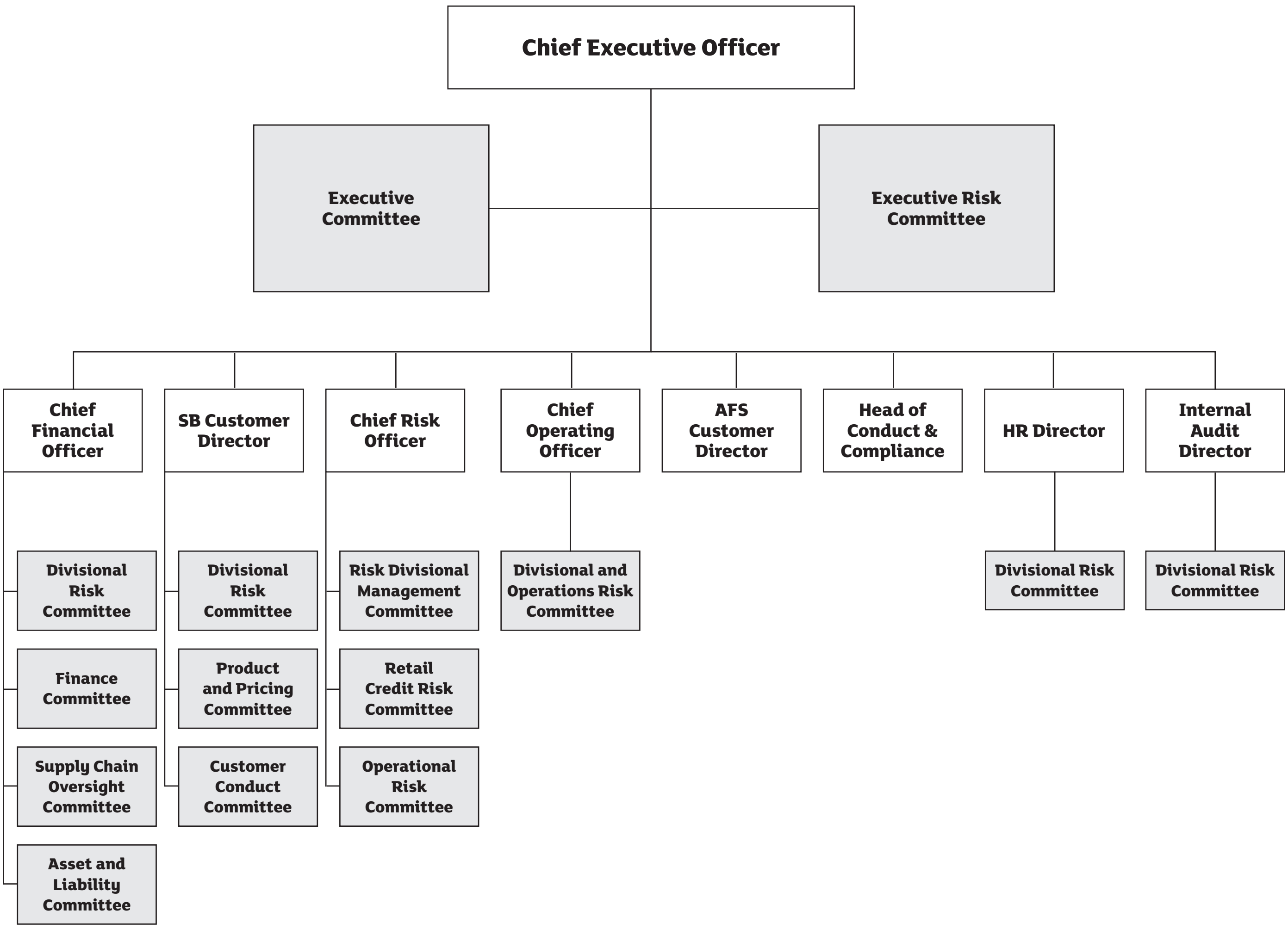
The diagram below shows the governance structure in place for Sainsbury's Bank as at 29 February 2020:

There were the following significant changes to our governance structure during the accounting period:

- The separation of the role of Chief Customer Officer into the SB Customer Director and Chief Operating Officer roles and removal of the Chief Transformation Officer role.
- The appointment of the Head of Conduct and Compliance to the Bank's Executive Committee to strengthen the business around these areas.

Board-level governance
The Board is the key governance body, holding overall accountability for the decisions made and outcomes achieved by the Bank, subject to specific reserved matters that 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. Further details on the Board composition may be found on page 19.





A number of Board functions are delegated to four key sub-committees. The role and scope of authority for each sub-committee is fully outlined in a documented Terms of Reference:

- **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 Audit Committee also reviews and challenges where necessary management's response to any major external or internal audit recommendations. 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 meet with the External Auditors and Sainsbury's Bank Director of Internal Audit.
- **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 Bank recognises the benefits of achieving a diverse Board and Executive Management Team to reflect the environment in which it operates. 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 the Remuneration Code (the Code) to the extent that the provisions apply to the Bank. RemCo is responsible for recommending, monitoring and noting the level and structure of remuneration for senior management (categorised as 'Code Staff' for the purposes of the Code) and senior risk management and compliance colleagues 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 three times 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 within the Risk Appetite set by the Board. 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 Chief Executive Officer (CEO) to deliver the Bank's strategy through the appropriate governance committees and the Executive Committee. The CEO chairs the Executive Committee (ExCo) 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 Committee 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. ExCo meets on a monthly basis.

Chief Risk Officer (CRO) Executive Committees

Executive Risk Committee (ERC)

The ERC is responsible for ensuring that the Enterprise Wide Risk Management Framework (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. The ERC meets on a monthly basis.

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. The RCRC met 12 times in the financial year.

Operational Risk Committee (ORC)

The ORC assesses and challenges the adequacy and effectiveness of the design and implementation of the Bank's Operational, Conduct & Compliance and Financial Crime Risk frameworks (the Risk frameworks). The ORC met six times in the year.

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, interest rate risk, liquidity & funding risk and capital adequacy. ALCo meets monthly.

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. The Finance Committee meets monthly.

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. The Supply Chain Committee met six times in the year.

SB Customer Director 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. The Customer Conduct Committee meets monthly.

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 DRC 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. Each DRC provides input on material risks which may affect the Group to the Executive Risk Committee.

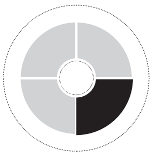
Pillar 3 Report

Further information on the risks and controls can be found in the Bank's Pillar 3 Disclosure Report for the year ended 29 February 2020. This report is published in the investor relations section of the J Sainsbury plc corporate website: **www.about.sainsburys.co.uk/investors/results-reports-and-presentations#2020**

Key performance indicators (KPIs)

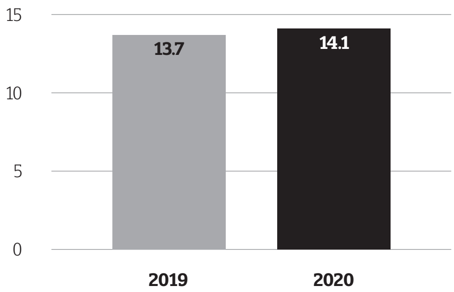
Maintain strength and sustainability

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



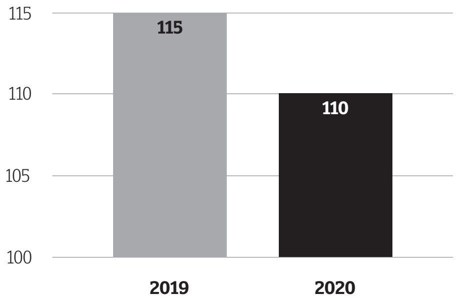
Common equity tier 1 capital ratio
Definition: Tier 1 capital as a percentage of risk-weighted assets.

Common equity tier 1 capital ratio (%)



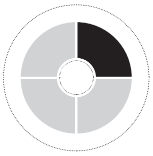
Net stable funding ratio
Definition: Amount of available stable funding (ASF) relative to the amount of required stable funding (RSF) over a one-year time horizon, assuming a stressed scenario.

Net stable funding ratio (%)



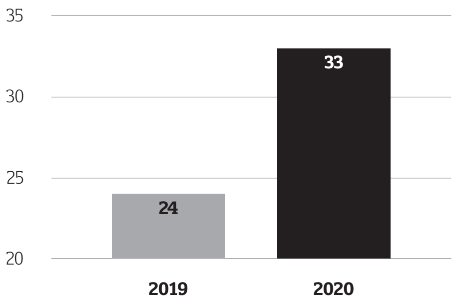
Financial performance

Our shareholders see that we drive value to the Group



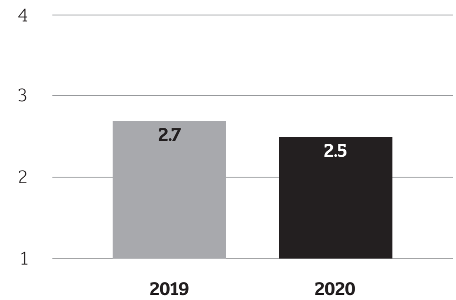
Underlying profit before tax
Definition: Profit before tax before any one-off items that are material and infrequent in nature.

Underlying profit before tax (£'m)



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

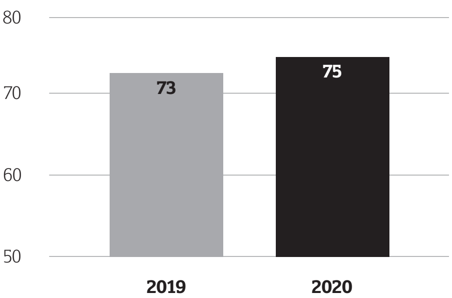
Net interest margin (%)



Efficiency

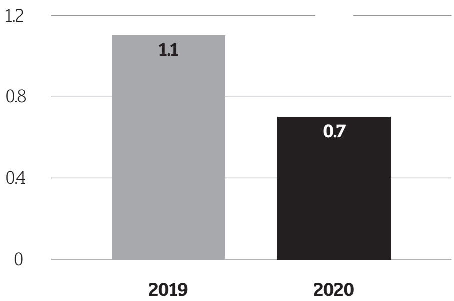
Cost : Income ratio (underlying)
Definition: Underlying operating expenses as a percentage of total income.

Cost : income ratio (%)



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

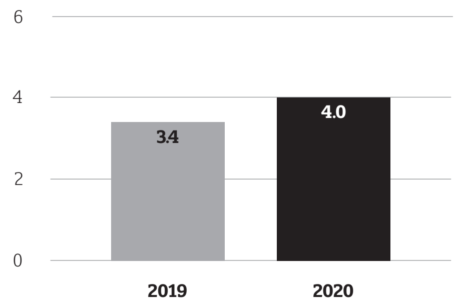
Bad debt asset ratio (%)



Value

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

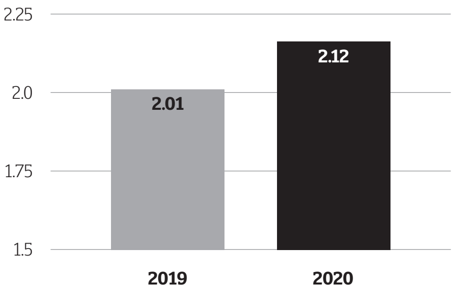
Return on tangible equity (%)



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).

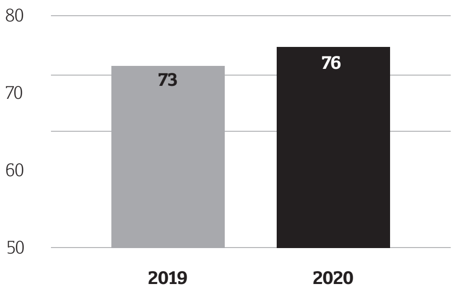
Active customers (million)



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

Colleague engagement
Definition: Percentage of our colleagues who have belief in the vision and goal of the business. This metric includes both Sainsbury's Bank and AFS colleagues.

Colleague engagement (%)



Our performance, including reference to the above KPI's is further outlined in the Business review on page 3 and the Financial review on page 15.

Financial review

The Bank's performance for the year ended 29 February 2020 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	2020 £m	2019 (restated)[1] £m	Change %
Total income	**323**	332	(3)
Less: items excluded from underlying results[2]	**–**	(16)	100
Underlying income	**323**	316	2
Operating expenses	**(268)**	(304)	(12)
Add: items excluded from underlying results[2]	**25**	72	(65)
Underlying operating expenses	**(243)**	(232)	5
Impairment losses on financial assets	**(48)**	(61)	(21)
(Losses) on financial instruments	**(2)**	(1)	100
Add: items excluded from underlying results[2]	**3**	2	50
Underlying gains on financial instruments	**1**	1	–
Underlying profit before taxation	**33**	24	38
Statutory profit/(loss) before taxation	**5**	(34)	115

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.
2 Items of an unusual and infrequent nature that do not relate to the Bank's underlying performance have been excluded in presenting underlying profit before tax. Further detail on items excluded from the underlying results is provided in note 8 to the financial statements.

Statutory profit before tax for the year ended 29 February 2020 was £5m compared to a loss of £34m in the prior year. This was driven by a 38% increase in underlying profits and a 65% reduction in non-underlying costs relating chiefly to the transition to the Bank's own core baking platforms. We completed the most complex aspect of the migration (credit cards) in June 2018 and the current year costs largely relate to the ongoing migration of the Loans back book, migrating data on to the Bank's new data lake, optimising the capability of the data lake, restructuring costs and strategic initiatives as we work to simplify the organisation.

Underlying income is 2% higher, driven by sales growth in Mortgages and Credit Cards and an increase in commission income from growth in our Travel Money business and higher Insurance volumes, partly offset by an increase in the cost of savings as rates rose.

Underlying costs increased by 5%, reflective of a full year of the costs associated with the new Credit Cards platform which launched in the prior year and the Bank's data platform going live in 2019, driving higher amortisation. Impairment losses decreased by 21% which is reflective of lower new lending on Loans, increased debt sales and improved arrears emergence on the Bank's portfolio.

Summary balance sheet	2020 £m	2019 (restated)[1] £m	Change %
Loans and advances to customers	**6,511**	6,192	5
Cash and cash equivalents	**532**	664	(20)
Other	**2,359**	1,981	19
Total assets	**9,402**	8,837	6
Customer deposits	**6,312**	5,950	6
Wholesale funds	**1,781**	1,651	8
Subordinated debt	**180**	176	2
Other	**129**	108	19
Total liabilities	**8,402**	7,885	7
Net assets	**1,000**	952	5

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

In balance sheet terms, we have grown our key areas of focus with our Credit Card growth of 16% being a particular area of success as this is one of our most connected product offerings for Sainsbury's Group customers. Mortgages also performed strongly prior to our stopping of new mortgage sales, with balances ending the year at £1.9bn.

J Sainsbury plc provided additional share capital of £35m during the first half of the year. In September 2019, the Bank committed to no further cash injections from the Group.

Net interest income

Net interest income summary	2020 £m	2019 (restated)[1] £m	Change %
Interest receivable (underlying)	**304**	282	8
Interest payable	**(115)**	(98)	17
Net interest income (underlying)	**189**	184	3
Net interest margin (underlying)	**2.5%**	2.7%	(0.2)

Summary of funds lent to customers and held as liquid assets	2020 £m	2019 £m	Change %
Unsecured loans and advances to customers	**4,636**	4,750	(2)
Secured loans and advances to customers	**1,875**	1,442	30
Cash, balances with central banks and other demand deposits	**500**	534	(6)
Financial investments	**853**	767	11
	7,864	7,493	5

Summary of funds raised	2020 £m	2019 £m	Change %
Customer deposits	**6,312**	5,950	6
Other deposits	**1,680**	1,376	22
Other borrowed funds	**101**	275	(63)
Subordinated debt	**180**	176	2
	8,273	7,777	6

Underlying interest income grew to £304m as the Bank's increased lending in both mortgages and credit cards resulted in top line growth. Mortgage balances grew by £433m and represent 29% of total lending as at 29 February 2020. We stopped accepting new mortgage applications at the end of September 2019 and the portfolio is now in run off. Unsecured lending reduced by 2% driven by lower personal loan balances as we continued to focus on lending to Nectar card holders who have lower default rates and on enhancing the new business margin. This was offset by growth in credit card balances.

Interest payable increased by 17% driven by overall average funding balances increasing from prior year in line with the mortgage led increased lending and average savings rates being 9 basis points higher following the Bank of England rate rise in August 2018.

Net interest margin decreased to 2.5%, in line with our expectation, driven by the increased proportion of secured lending and an increase in funding costs.

Fee, commission and other operating income

Fee, commission and other operating income summary	2020 £m	2019 £m	Change %
Banking income	**76**	74	3%
Insurance income	**26**	25	4%
Other income	**2**	2	–
Total fees and commissions receivable	**104**	101	3%
Total fees and commissions payable	**(10)**	(6)	67%
Other operating income	**40**	37	8%
Net fees, commission and other operating income	**134**	132	2%

Banking income grew by 3% largely driven by an increase in interchange income and late payment fees on the credit card portfolio.

Insurance income grew by 4% year on year driven by growth in new business and renewal volumes across our Car, Home and Pet Insurance products. However, the growth in sales has resulted in additional fees payable both in respect of new business acquisition and amortisation of costs deferred on acquisition in prior years.

The 8% growth in other operating income was driven by improvement in margins in the Travel Money business.

Operating expenses and investment

Operating expenses summary	2020 £m	2019 (restated)[1] £m	Change %
Underlying staff costs	**75**	74	1
Other underlying operating costs	**137**	135	1
Depreciation of property, plant and equipment	**8**	8	–
Amortisation of intangible assets	**23**	15	53
	243	232	5
Non-underlying items	**25**	72	(65)
Total operating expenses	**268**	304	(12)

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

Underlying operating expenses of £243m increased by £11m year-on-year driven by higher amortisation charge. Excluding amortisation and depreciation, underlying expenses increased by 1% year-on-year driven by higher product volume related costs, increased operational costs of our new banking platform offset by conscious cost savings and operational efficiencies.

Non-underlying costs, largely associated with the transition of Sainsbury's Bank from Lloyds Banking Group to its own banking platforms, totalled £25m in the year. The decrease from 2018/19 is reflective of the New Bank Programme ramping down with our Loans Back Book migration the significant remaining part.

Summary of fixed assets	2020 £m	2019 (restated)[1] £m	Change %
Intangible assets	**234**	224	4
Property, plant and equipment	**38**	48	(21)
	272	272	–

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

Intangible assets were £234m, an increase of £10m since prior year. This was mainly due to additions reflecting capitalisation of software development in relation to the Bank's data platforms. There was an immaterial write-off of intangibles relating to Mortgages in the year following the decision to stop new lending.

Impairment losses on financial assets

Impairment losses summary	2020 £m	2019 £m	Change %
Impairment losses on financial assets	**48**	61	(21)
Bad debt asset ratio	**0.7%**	1.1%	(0.4)

Bad debt asset ratio has reduced from 1.1% to 0.7% reflecting the growth in mortgages over the year, together with favourable pricing achieved on debt sales during the year in a strong market.

Our overall financial performance was in line with our expectations. While we expect the banking market to remain competitive we are well positioned to grow revenues and increase customer loyalty.

The outbreak of COVID-19 has resulted in a large change to our economy and future outlook with the introduction of social distancing and the subsequent UK lockdown. Although government support is expected to mitigate some of the impact of COVID-19 there is little doubt that the economic conditions have deteriorated with a longer-term deterioration expected in key economic drivers such as unemployment and GDP.

Bank profits for the year to March 2021 will be impacted by actions we have taken to date and the changed macroeconomic outlook.

- Our base case outlook includes an increase in bad debt provisions, reflecting an assumed increase in unemployment
- The business will incur additional costs and reduced revenue as a result of the actions necessary to protect colleagues and customers during the pandemic. There will be delays to restructuring activity
- Commission income will be significantly impacted for both Travel Money and ATMs. Travel Money bureau are currently closed and ATM usage is significantly below normal levels. We anticipate a slow recovery in both post lockdown.

As a consequence we expect the Bank to make a loss in the financial year to February 2021.

Whilst this represents a very challenging trading environment, the Bank is well capitalised, with capital resources of around £1bn, over £100m of surplus capital at year end, an additional £58m benefit from the Bank of England's reduction in the counter cyclical buffer requirement and £145m of additional stress buffers, together providing more than £300m of loss absorption. The Bank additionally has significant excess liquidity of around £200m. We are confident that the Bank will not require capital injections from the Group.

By order of the Board

Donald McNaughton
Company Secretary
6 May 2020

Directors' Report

The Directors have the pleasure in submitting their Annual Report and Financial Statements of Sainsbury's Bank plc ('the Bank') for the year ended 29 February 2020.

Board of Directors

The Board comprises two Executive Directors and six Non-Executive Directors. The position and remuneration of members who served during the year is described in the following table:

Name	Position	Remunerating entity	Appointment/ resignation date
Mr Roger Davis	Bank Chairman (Independent Non-Executive)	Sainsbury's Bank plc	
Mr James Brown	Chief Executive Officer	Sainsbury's Bank plc	Appointed 27 August 2019
Mr Peter Griffiths	Chief Executive Officer	Sainsbury's Bank plc	Resigned 27 August 2019
Mr Michael Larkin	Executive	Sainsbury's Bank plc	
Mr Graeme Forrester	Executive	Sainsbury's Bank plc	Resigned 28 November 2019
Mr David Jones	Executive	Sainsbury's Bank plc	Resigned 28 November 2019
Ms Gwyn Burr	Non-Executive	Sainsbury's Bank plc	Resigned 31 January 2020
Ms Angie Risley	Non-Executive	J Sainsbury plc	Resigned 31 January 2020
Mr John Rogers	Non-Executive	J Sainsbury plc	Resigned 31 October 2019
Ms Clodagh Moriarty	Non-Executive	J Sainsbury plc	Appointed 30 January 2020
Mr Peter Clarke	Senior Independent Non-Executive	Sainsbury's Bank plc	
Ms Carole Butler	Independent Non-Executive	Sainsbury's Bank plc	
Ms Marcia Campbell	Independent Non-Executive	Sainsbury's Bank plc	Resigned 27 September 2019
Mr Michael Ross	Independent Non-Executive	Sainsbury's Bank plc	
Mr Guy Thomas	Independent Non-Executive	Sainsbury's Bank plc	

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

We regard 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 our 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

We are committed to promoting a diverse and inclusive workplace at all levels, reflective of the communities in which we do business. 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 welcomed. 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. 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.

Statement of corporate governance arrangements

Refer to the governance section of the Strategic Report on page 12 for the Bank's governance arrangements.

Employee engagement

Refer to the S172(1) statement on page 9 of the Strategic Report for details on employee engagement.

Business relationships

Refer to the S172(1) statement on page 9 of the Strategic Report for details on business relationships.

Colleagues

Refer to the Non-financial reporting section on page 10 for the Bank's policies on colleagues and the employment of disabled persons.

Charitable and other donations

During the year the Bank made charitable donations in the UK of £41,429 (2019: £40,300). No political donations were made during the year (2019: £nil).

Independent auditors

Ernst & Young LLP have expressed their willingness to continue in office as auditors.

Disclosure of information to auditors

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

Financial risk management

Details of the use of financial instruments, together with risk management disclosures, can be found in note 34 and the Risk overview section in the Strategic Report on pages 4 to 10.

Future developments

The development of the Bank is set out in the Strategic Report on pages 2 to 4.

Post balance sheet events

Details of events occurring after the reporting date are discussed in note 43 to the Financial Statements.

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, including consideration of projections incorporating the impact of the COVID-19 pandemic on the Bank's capital and funding position. As part of this assessment the Board considered:

- The impact on Bank's profits from an expected reduction in income from lending, Travel Money and ATMs, combined with increased credit impairment charges;
- The sufficiency of the Bank's capital base, which is expected to be sufficient to weather even a severe COVID-19 downturn; and,
- The adequacy of the Bank's liquidity.

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 34.

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

Dividends

The profit after tax for the year attributable to the shareholders is £7m (2019: £35m loss). The Directors do not recommend payment of a dividend (2019: £nil).

By order of the Board and signed on its behalf by

Donald McNaughton
Company Secretary
6 May 2020

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 Sainsbury's Bank plc ('the Company') and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

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

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

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

Donald McNaughton
Company Secretary
6 May 2020

Independent Auditors' Report

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

Opinion

We have audited the financial statements of Sainsbury's Bank plc ('the Bank') for the year ended 29 February 2020 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement, and the related notes 1 to 43, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

In our opinion, the financial statements:

- give a true and fair view of the company's affairs as at 29 February 2020 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Overview of our audit approach

Key audit matters	— Measurement of the provision for impairment relating to loans and advances to customers; — Measurement of effective interest rate (EIR) adjustments (including the risk of management override of internal control); — Risks related to strategic change, with a focus on the cessation of mortgage sales and the impairment of intangible assets; — Risks related to processes and controls managed by third party service providers; — Impact of COVID-19.
Materiality	— Overall materiality of £3.5m which represents approximately 1% of Net Interest Margin and Net Fees and Commissions.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Measurement of the provision for impairment relating to loans and advances to customers		
Provision for impairment (2020: £183m, 2019: £180m) *Refer to note 13 of the Financial Statements* Customer receivables comprise unsecured personal loans; credit cards; and mortgages. Credit provisions represent Management's best estimate of impairment and significant judgements and estimates are made in determining the timing and measurement of expected credit loss ('ECL'). The key judgements and estimates in respect of the timing and measurement of ECL include: (a) Completeness and accuracy of data; (b) The accounting interpretations and modelling assumptions used to build the models that calculate ECL; (c) Inputs and assumptions used to estimate the impact of the multiple economic scenarios; (d) Allocation of assets to stage 1, 2 or 3 using criteria in accordance with the accounting standard; (e) Completeness and valuation of post model adjustments; and (f) Accuracy and adequacy of the financial statement disclosures.	We performed procedures to assess the design effectiveness of key controls across the processes relevant to the impairment provision calculation, involving specialists to assist us in performing our procedures where appropriate. This included model governance, data accuracy and completeness, multiple economic scenarios, and the allocation of assets into stages. We performed control testing over the key controls identified to ensure that the controls operated effectively throughout the period. This considered key elements identified in the previous paragraph. We reviewed the minutes of the model and risk committees where inputs, assumptions, and adjustments to the ECL were discussed and approved. We tested the data used in the ECL calculation on a sample basis. In order to complete this testing, we independently reconciled a sample of data feeding the model from source systems. We tested the assumptions, inputs and formulas used in a sample of ECL models. This included assessing the appropriateness of model design and formulas used, considering alternative modelling techniques and recalculating the Probability of Default, Loss Given Default and Exposure at Default for a sample of the models. We tested the assumptions and inputs used in the ECL models with the support of our internal modelling and economic specialists. In particular, we challenged the correlation and impact of the macroeconomic factors to the ECL and independently recalculated critical components of the ECL. In addition, we assessed the base and alternative economic scenarios, including challenging probability weights and comparing to other scenarios from a variety of external sources, as well as EY internally developed forecasts. We also assessed whether forecasted macroeconomic variables were appropriate such as GDP, unemployment, interest rates and House Price Index. We challenged the criteria used to allocate an asset to stage 1, 2 and 3 in accordance with IFRS 9. In addition, we tested assets in stage 1, 2, and 3 to verify that they were allocated to the appropriate stage. We challenged model overlays for appropriateness using our knowledge and experience across the industry. We assessed the appropriateness of the scenarios and calculations used in determining the overlay to be applied in response to the economic uncertainty related to Brexit. We assessed the adequacy and appropriateness of disclosures for compliance with the accounting standards. We considered the impact of the COVID-19 pandemic on the ECL as at year-end and ensured that appropriate disclosures have been made in the financial statements to consider the impact of these events.	We are satisfied that provisions for the impairment of loans and advances to customers were reasonable and recognised in accordance with IFRS based on our procedures performed. The economic uncertainty overlay was within our independently established reasonable range. Our testing of models and model assumptions identified some instances of over and under estimation. We aggregated these differences and were satisfied that the overall estimate recorded was reasonable.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Measurement of effective interest rate (EIR) adjustments (including the risk of management override of internal control)		
EIR Asset (2020: £109m, 2019: £77 million) *Refer to notes 2, 4, and 13 of the Financial Statements* Accounting standards require that interest income on personal loans, credit cards and mortgages is recognised at the effective interest rate (EIR). For products with introductory rates, such as credit cards and mortgages, where the reversionary interest rate in future years is expected to be greater, but receipt of such interest income depends on the customer remaining with the Bank, there is significant judgement involved in forecasting customer behaviour and estimating the future expected cash flows. The risks, as we see them, are that: (a) the data used in making the estimate is not complete and accurate; (b) the judgements made are not appropriate; and (c) the calculation methodology is not applied correctly.	We performed procedures to obtain an understanding of the key controls in place over the EIR process. We considered the completeness and accuracy of data inputs into the model by: i) inspecting reconciliations from the general ledger to the source systems; and subsequently from the general ledger to the data warehouse. ii) testing the data used in the EIR calculation on a sample basis. In order to complete this testing, we have independently reconciled a sample of data feeding the model from the source system. We tested the appropriateness of Management's assumptions by: i) Reviewing Management's methodology paper to assess if the variables mentioned are in accordance with the applicable accounting standards. ii) Comparing judgements to: – Observable recent customer behaviour; – Product pricing models; – Consideration of future expected changes. iii) Testing for indications of Management bias through: – Comparison of customer behaviour to observable market data. – Review of judgements made by Management for consistency with prior periods where appropriate. – Assessment of Management's sensitivity analysis to determine whether the EIR adjustments were within an appropriate range. We tested the application of the calculation methodology by: i) Engaging our modelling experts to test that the variables/assumptions stated in Management's methodology paper are modelled in Management's workings; ii) Engaging our modelling experts to review the macros that are used to input the raw data into the model files; iii) Performing sample testing on the year-end calculation of EIR, including the underlying data integrity, the clerical accuracy of the calculation, and the application of relevant assumptions; and iv) Performing sensitivity analysis on individual cohorts to validate the model moves in line with expectation.	We are satisfied that the assumptions used by Management in determining the EIR asset balance are reasonable and in accordance with IFRS. We obtained assurance over the completeness and accuracy of data used within the EIR models through performing reconciliations of the data to source systems and sample testing of data attributes. We tested that the EIR model assumptions were reasonable in the context of current market data and observable customer behaviours. We observed that the models were operating effectively in the calculation of EIR adjustments and that the results were accurately reflected in the general ledger.
Risks related to strategic change, with a focus on the cessation of mortgage sales and the impairment of intangible assets		
Intangible asset – net book value (2020: £234 million, 2019: £224 million) *Refer to note 18 of the Financial Statements* The Bank announced several strategic changes in September 2019; most notably, the decision to cease new mortgage lending and its aim to achieve a 50% cost to income ratio across the financial services group over the next five years. These changes impact numerous areas of the financial statements, many of which require management judgements. The risks, as we see them, are that: (a) The impact(s) on the financial statements as a result of decisions in strategic direction are not recorded accurately or in a timely manner; (b) The judgements made are not appropriate, including those related to future forecasts; and (c) Controls and processes do not operate effectively across the business due to changes in personnel, increasing the risk of misstatement.	We performed procedures to obtain an understanding of key controls in place over the intangible assets process, including the impairment assessment, and challenged the design and operating effectiveness of the key controls identified. We considered the valuation of capitalised amounts by challenging Management's forecasts for individual assets, as well as at a cash-generating unit (CGU) level, where applicable, to determine if there were indicators of impairment. This included procedures to assess the reasonableness of Management's forecast with respect to the impacts of Brexit and COVID-19 as at year-end. We assessed the useful economic lives assigned to a sample of intangible assets to ensure that the assigned lives are appropriate based on the asset class and the impacts of any strategic changes. We reviewed significant contracts and agreements with material third parties of the Bank and assessed the need for any onerous contract provisions to be recorded as a result of the strategic changes announced. We considered the valuation and presentation of the mortgage portfolio as at year-end. We assessed the need for provisions for redundancies and restructuring as at year-end in relation to the strategic changes announced.	We are satisfied that the assumptions made by management in the valuation of intangible assets are reasonable and that strategic changes made during the year are accurately reflected within the financial statements in accordance with IFRS. We have reviewed the presentation and disclosure regarding the mortgage portfolio within the financial statements and have concluded that this is fairly presented as at year-end.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Risks related to processes and controls managed by third party service providers		
Many of the Bank's IT systems are hosted by third parties. The Bank receives reports, prepared by independent audit firms, on the effectiveness of the third parties' control environment. In some instances, deficiencies in the control environment were identified. The risk, as we see it, is that there is insufficient oversight of the third party service providers and where control deficiencies at the third party are identified, these deficiencies are: (a) not mitigated by compensating controls within the Bank's own control environment; and (b) not appropriately quantified by the Bank.	We performed procedures to obtain an understanding of the processes which are outsourced to third parties and their impact on the financial statements. We made enquiries of Management to understand the process through which the Bank: (i) Monitors control effectiveness at third parties, and (ii) Performs control activities over the completeness and accuracy of data received from third parties. For the third party service provider control reports obtained by the Bank, we obtained and inspected the reports to understand the design and operating effectiveness of the key controls in place. We reviewed the assessment performed by Management over these reports, including: (i) The mapping of the key controls within the report to the processes in place at the Bank and identification of any complementary end user controls in place at the Bank; (ii) Management's evaluation of any ineffective controls within the control reports	We have obtained reasonable assurance over the Bank's processes and controls over the completeness and accuracy of data received from third parties. We have performed substantive testing over role-based user access controls where deficiencies were identified, obtaining reasonable assurance over the manage access process.
Impact of COVID-19		
Refer to notes 1 and 43 of the Financial Statements COVID-19 has resulted in a rapidly changing economic environment which impacts the financial position of the Bank. There is management judgement required in determining the extent of this impact and the related disclosures. The risks, as we see them, are: (a) the judgements and assumptions made in assessing the Bank's ability to continue as a going concern for a period of at least twelve months from the date of the financial statements are not appropriate; and (b) the disclosures made in regard to the impact of COVID-19 on the financial position of the Bank are inadequate or materially incorrect.	We performed procedures to obtain an understanding of Management's process for assessing the impact of COVID-19, including their going concern assessment and the subsequent event disclosures. We assessed the going concern assessment performed by Management through challenging the economic assumptions applied, involving our economic specialists where necessary, and performing stress testing over their analysis. We challenged the sensitivity analyses performed by Management for COVID-19. This included consideration of the impact on impairment provisions, EIR, and intangible assets. We have assessed the assumptions made and the calculations performed, engaging our modelling and economic specialists where necessary. We reviewed the Bank's corporate plan and forecasts, including the changes made as a result of the impact from COVID-19, and assessed the impact of these changes. We reviewed and assessed the adequacy of the subsequent event disclosures to ensure that they adequately reflect the financial impact on the Bank as a result of COVID-19, including the consideration of events as non-adjusting post balance sheet events. We reviewed and challenged the underlying assumptions of the Bank's ICAAP and ILAAP plan to determine whether the impacts of COVID-19 have been appropriately considered. In addition, we ensured that relevant practice guidance issued has been appropriately incorporated into the Bank's assessments.	We are satisfied that the assumptions made by Management in performing their going concern assessment are reasonable and with the Directors' conclusion that there is not a material uncertainty present regarding the Bank's ability to continue as a going concern. We are satisfied that the assumptions made by Management in determining the estimated financial impact to the Bank as a result of COVID-19 are reasonable and appropriately disclosed within the financial statements in accordance with IFRS.

In the prior year, our auditor's report included a key audit matter in relation to *"Appropriateness of the recognition of intangible assets capitalised in the year and the assessment of whether intangible assets are impaired".* We have updated this key audit matter as a result of the strategic changes announced by the Bank in September 2019. The key audit matter has been adjusted to the following: *Risks related to strategic change, with a focus on the cessation of mortgage sales and the impairment of intangible assets.*

We have refined our prior year key audit matter *"Deficiencies of IT General Controls at outsourced service providers"* to *"Risks related to processes and controls managed by the third party service providers"* to reflect our focus the Bank's oversight of all key third party service providers.

We have added a key audit matter in the current year for the impact of COVID-19.

An overview of the scope of our audit

Tailoring the scope
Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Bank. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Bank and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed. All audit work was performed directly by the audit engagement team.

Changes from the prior year
Due to the impact of COVID-19 and the resulting economic uncertainty, we have adjusted our planned audit procedures to increase the focus on Management's judgements as at period end, particularly those impacted by economic forecasts, Management's going concern assessment, and the subsequent event disclosures included within the notes to the Financial Statements.

Our application of materiality
We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality
The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the company to be £3.5 million (2019: £3 million), which is approximately 1% (2019: 1%) of Net Interest Margin and Net Fees and Commission. We believe that this is an appropriate basis as Net Interest Income and Net Fees and Commission Income are important financial metrics on which users of the financial statements would judge the performance of the Bank in the current year given that it is a profit orientated entity. This basis is consistent with the prior year.

During the course of our audit, we reassessed initial materiality and noted that based on the year end results, our planning materiality continued to be appropriate.

Performance materiality
The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the company's overall control environment, our judgement was that performance materiality was 50% (2019: 50%) of our planning materiality, namely £1.75m (2019: £1.5m). We have set performance materiality at this percentage due to the risk of material misstatement being higher, which is consistent with our approach in the prior year.

Reporting threshold
An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.18m (2019: £0.15m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information
The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The Directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

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 Directors' Report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception
In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or Directors' Report.

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

— 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; or
— certain disclosures of Directors' remuneration specified by law are not made; or
— we have not received all the information and explanations we require for our audit.

Responsibilities of Directors
As explained more fully in the Directors' responsibilities statement set out on page 21, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud
The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Bank and determined that the most significant are the regulations, licence conditions and supervisory requirements of the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).
- We understood how Sainsbury's Bank plc is complying with those frameworks by making enquiries of Management, internal audit, and those responsible for legal and compliance matters. We also performed a review of regulatory correspondence and reviewed minutes of the Board and Board Risk Committee meetings held; and gained an understanding of the Bank's approach to governance demonstrated by the Board's enterprise risk management framework (ERMF) and internal control processes.
- We assessed the susceptibility of the Bank's financial statements to material misstatement, including how fraud might occur, by considering the controls that the Bank has established to address risks identified by the Bank, or that otherwise seek to prevent, deter or detect fraud. We also considered performance and incentive plan targets and their potential to influence management to manage earnings.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiries of legal counsel, executive management, internal audit, and focused testing on the risk of management override of internal control as referred to in the Key Audit Matters section of this report.
- The Bank operates in the financial services industry which is a highly regulated environment. As such the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at **https://www.frc.org.uk/auditorsresponsibilities**. This description forms part of our auditor's report.

Other matters we are required to address

- We were appointed by the company on 16 August 2017 to audit the financial statements for the year ending 28 February 2018 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is three years, covering the years ending 28 February 2018 to 29 February 2020.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the company and we remain independent of the company in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee.

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

Peter Wallace
Senior Statutory Auditor
for and on behalf of Ernst & Young LLP

Statutory Auditor
Edinburgh

6 May 2020

Notes:

1. The maintenance and integrity of the **Sainsburys Bank plc** website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Financial Statements

Income statement
For the year ended 29 February 2020

	Notes	2020 £m	2019 (restated)[1] £m
Interest income	3	**304**	298
Interest expense	3	**(115)**	(98)
Net interest income		**189**	200
Fees and commissions income	4	**104**	101
Fees and commissions expense	4	**(10)**	(6)
Net fees and commissions income		**94**	95
Other operating income	5	**40**	37
Total income		**323**	332
Administrative expenses	6	**(237)**	(281)
Depreciation and amortisation			
Property, plant and equipment	19	**(8)**	(8)
Intangible assets	18	**(23)**	(15)
Operating expenses		**(268)**	(304)
Impairment losses on financial assets	13,33	**(48)**	(61)
Realised gains on financial instruments	7	**1**	1
Fair value (losses) on financial instruments	7	**(3)**	(2)
Profit/(loss) before taxation	11	**5**	(34)
Analysed as:			
Underlying profit before tax		**33**	24
Non-underlying items	8	**(28)**	(58)
		5	(34)
Taxation	12	**2**	(1)
Profit/(loss) for the financial year attributable to the owners of the Bank		**7**	(35)

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

The accompanying notes on pages 33 to 76 form part of these financial statements.

Statement of comprehensive income

For the year ended 29 February 2020

	Notes	2020 £m	2019 (restated)[1] £m
Profit/(loss) for the financial year		**7**	(35)
Other comprehensive income/(expense):			
Items that may be reclassified subsequently to profit or loss:			
Financial assets fair value movements	30	**2**	(2)
Total other comprehensive income/(expense), net of tax		**2**	(2)
Total comprehensive income/(expense)		**9**	(37)

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 33 to 76 form part of these financial statements.

Balance sheet
As at 29 February 2020

	Notes	2020 £m	2019 (restated)[1] £m
Assets			
Cash, balances with central banks and other demand deposits	15	**500**	534
Derivative financial instruments	16	**6**	8
Investment securities	17	**853**	767
Loans and advances to customers	13	**6,511**	6,192
Investments in subsidiaries	20	**325**	325
Intangible assets	18	**234**	224
Property, plant and equipment	19	**38**	48
Other assets	21	**935**	739
Total assets		**9,402**	8,837
Liabilities			
Customer accounts	22	**6,312**	5,950
Other deposits	23	**1,680**	1,376
Other borrowed funds	24	**101**	275
Subordinated liabilities	25	**180**	176
Derivative financial instruments	16	**35**	8
Other liabilities	26	**86**	93
Provisions for liabilities and charges	27	**8**	7
Total liabilities		**8,402**	7,885
Equity			
Called up share capital	28	**901**	866
Retained earnings	29	**98**	87
Other reserves	30	**1**	(1)
Total equity		**1,000**	952
Total equity and liabilities		**9,402**	8,837

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

The financial statements on pages 28 to 76 were approved by the Board of Directors on 6 May 2020 and signed on its behalf by:

Michael Larkin
Director and Chief Financial Officer

The accompanying notes on pages 33 to 76 form part of these financial statements.

Sainsbury's Bank plc – Company number 3279730

Statement of changes in equity
For the year ended 29 February 2020

	Note	Called up share capital £m	Retained earnings (restated)[1] £m	Other reserves £m	Total equity (restated)[1] £m
As at 1 March 2019		**866**	**87**	**(1)**	**952**
Profit for the financial year		**–**	**7**	**–**	**7**
Other comprehensive income:					
Financial assets fair value movements (FVOCI)	30	**–**	**–**	**2**	**2**
Total comprehensive income		**–**	**7**	**2**	**9**
Transactions with owners:					
Shares issued in the year	28	**35**	**–**	**–**	**35**
Share-based payment (net of tax)		**–**	**4**	**–**	**4**
At 29 February 2020		**901**	**98**	**1**	**1,000**

	Note	Called up share capital £m	Retained earnings (restated)[1] £m	Other reserves £m	Total equity (restated)[1] £m
Balance at 1 March 2018		756	187	1	944
Adjustment on initial application of IFRS 9			(68)		
		756	119	1	876
Loss for the financial year		–	(35)	–	(35)
Other comprehensive expense:					
Financial assets fair value movements (FVOCI)	30	–	–	(2)	(2)
Total comprehensive expense		–	(35)	(2)	(37)
Transactions with owners:					
Shares issued in the year	28	110	–	–	110
Share-based payment (net of tax)		–	3	–	3
At 28 February 2019		866	87	(1)	952

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 33 to 76 form part of these financial statements.

Cash flow statement

For the year ended 29 February 2020

	Notes	2020 £m	2019 (restated)[1] £m
Profit/(loss) before taxation		**5**	(34)
Non-cash and other items included in profit before taxation		**99**	98
Change in operating assets and liabilities		**(225)**	(112)
Income taxes paid		**2**	(7)
Cash flows (used in) operating activities	14	**(119)**	(55)
Purchase of equipment		**(3)**	(7)
Purchase of intangibles		**(34)**	(35)
Investment in subsidiary undertakings		**–**	(325)
Cash flows used in investing activities		**(37)**	(367)
Proceeds from issue of share capital	28	**35**	110
Proceeds from issue of subordinated liabilities	14	**–**	–
Interest paid on subordinated liabilities		**(11)**	(11)
Lease payments		**–**	(1)
Cash flows generated from financing activities		**24**	98
Change in cash and cash equivalents		**(132)**	(324)
Opening cash and cash equivalents		**664**	988
Closing cash and cash equivalents		**532**	664

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

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

	2020 £m	2019 £m
Cash, balances with central banks and other demand deposits	**500**	534
Less: mandatory reserve deposit held at central banks	**(18)**	(14)
	482	520
Investment securities	**50**	144
	532	664

The accompanying notes on pages 33 to 76 form part of these financial statements.

Notes to the financial statements

1. Basis of preparation

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.

These financial statements have been prepared under the historical cost convention as modified for the revaluation of financial assets and liabilities (including derivative instruments) held at fair value through profit and loss and fair value through other comprehensive income. 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 in note 2.

The financial statements have been prepared on a going concern basis. This is discussed in the Directors' Report, under the heading '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, including consideration of projections incorporating the impact of the COVID-19 pandemic on the Bank's capital and funding position. As part of this assessment the Board considered:

- The impact on Bank's profits from an expected reduction in income from lending, Travel Money and ATMs, combined with increased credit impairment charges;
- The sufficiency of the Bank's capital base, which is expected to be sufficient to weather even a severe COVID-19 downturn; and,
- The adequacy of the Bank's liquidity.

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 34.

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.

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 and IFRS 10 4(a).

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.

Classification and measurement of financial instruments

The Bank classifies all of its financial assets based on the business model for managing the assets and the assets' contractual terms, measured at either:

- Amortised cost,
- Fair value through other comprehensive income (FVOCI), or
- Fair value through profit and loss (FVPL)

To determine their classification and measurement category, IFRS 9 requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cashflow characteristics.

The business model assessment reflects how the Bank manages the risks relating to the underlying financial assets, including whether the Bank's principal objective is to collect the contractual cashflows arising from the instruments (amortised cost), to sell the financial instruments (FVPL) or a combination thereof (FVOCI).

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as how performance is reported to the entity's key management personnel, the way that risks are managed, how managers of the business are compensated and the expected frequency, value and timing of sales are also important aspects of the Bank's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

As a second step of its classification process, where the business model involves the collection of contractual cashflows, the Bank assesses the contractual cashflow characteristics of financial assets to identify whether they can be considered solely payments of principal and interest (the SPPI test).

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement fail the SPPI test. In such cases, the financial asset is required to be measured at FVTPL.

1. Basis of preparation continued

Amortised cost

Financial assets that are principally held for the collection of contractual cashflows which pass the SPPI test are classified as amortised cost. Initial recognition is at fair value and subsequent measurement is at amortised cost, using the effective interest rate method, less provision for impairment as described in the impairment section below.

Fair value through other comprehensive income

Financial assets that are held for both the purpose of collecting contractual cashflows and to sell are classified as FVOCI. Initial recognition and subsequent measurement is at fair value, with movements in fair value being recognised through OCI. Interest income is measured using the effective interest rate method and impairment gains and losses are recognised in the income statement.

Fair value through profit and loss

Financial assets that do not meet amortised cost or FVOCI criteria are classified as FVPL.

Equity instruments

Upon initial recognition, the Bank occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of Equity under IAS 32 Financial instruments: Presentation and are not held for trading. Such classification is determined on an instrument-by-instrument basis. Gains and losses on these equity instruments are never recycled to profit. Dividends are recognised in profit or loss as other operating income when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment.

Where this election is not applied equity instruments are measured at FVPL.

Financial liabilities

Other than derivative financial liabilities, all of the Bank's financial liabilities are recognised at amortised cost. Derivatives are classified as FVPL.

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

In these financial statements, the Bank has applied IFRS 16, effective for the annual period beginning on 1 March 2019, for the first time. The Bank has not adopted early any other standard, interpretation or amendment that has been issued but is not yet effective.

IFRS 16 'Leases'

The Bank adopted IFRS 16 in the current accounting period, replacing the previous accounting policies applied under IAS 17. IFRS 16 distinguishes leases and service contracts on the basis of whether an identified asset is controlled by the lessee. The previous distinction of operating leases (off balance sheet) and finance leases (on balance sheet) are removed for lessee accounting and is replaced by a model where a right-of-use asset and a corresponding liability have to be recognised for all leases by lessees (i.e. all on balance sheet) except for short-term leases and leases of low value assets.

The Bank has chosen to adopt the fully retrospective approach to transition, restating the opening balance sheet as at 1 March 2018 and comparative financial information as if IFRS 16 had always applied. Further detail on these adjustments is disclosed in note 42.

The adoption of IFRS 16 has resulted in recognition of a right-of-use asset of £5m and a lease liability of £7m replacing a lease creditor previously recognised under IAS 17 of £3m. The impact on opening retained earnings as at 1 March 2018 was £1m. There has been minimal impact on the annual profits of the Bank – the previous operating lease expense of £1m has been replaced by interest and depreciation charges of broadly the same amount.

The right-of-use asset is initially measured at cost and subsequently measured at cost less accumulated depreciation and impairment losses, adjusted for any re-measurement of the lease liability. The lease liability is initially measured at the present value of the lease payments that are not paid at that date. Subsequently, the lease liability is adjusted for interest and lease payments, as well as the impact of lease modifications, amongst others.

While the total cash outflow for leases has not changed, the classification of cash flows has been amended. Previously operating lease payments under IAS 17 were presented as operating cash flows whereas under IFRS 16 the lease payments are presented as financing cashflows.

Other standards and amendments

The Bank has considered a number of other amendments to published International Financial Reporting Standards and interpretations effective for the year ended 28 February 2020:

- Amendments to IFRS 9 – financial instruments with prepayment assumptions with negative compensation;
- IFRS 4 – Applying IFRS 9 'Financial Instruments' with IFRS 4 'Insurance Contracts';
- IAS 28 Investments in Associates;
- IAS 19 Employee Benefits on plan amendment, curtailment or settlement;
- Amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23 arising from the 2015-2017 Annual Improvements Cycle.
- IFRIC 23 uncertainty over income tax treatments.

These are either not relevant to the Bank or do not have a significant impact on the Bank's financial statements.

Standards and interpretations effective for the Company in future periods:

None of the following standards issued by the IASB but not yet effective, are expected to have a material impact on the Bank's financial statements in future periods:

- IFRS 17 'Insurance Contracts'
- Amendments to References to the Conceptual Framework in IFRS Standards
- Definition of a Business (Amendments to IFRS 3)
- Definition of Material (Amendments to IAS 1 and IAS 8)

Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7) provides reliefs that may otherwise have resulted in the Bank no longer being able to apply hedge accounting for certain hedge relationships as a result of uncertainties arising from the LIBOR benchmark reform. As a result of the reliefs the Bank expects to be able to continue existing hedge accounting and therefore the adoption will not significantly change amounts recognised in the financial statements.

2. 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 models 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.

Significant increase in credit risk

The Bank determines whether there has been a significant increase in credit risk by reference to quantitative thresholds and qualitative indicators and has also chosen to adopt the rebuttable backstop presumption that credit risk has significantly increased if contractual payments are more than 30 days past due.

Quantitative thresholds have been determined that when the lifetime PD of an instrument as at the reporting date has increased to greater than a specified multiple of the origination lifetime PD, a significant increase in credit risk is deemed to have occurred.

Qualitative tests are based around the Bank's credit origination policy rules. These rules are in place at account origination in order to decline accounts that may demonstrate risk factors outside of risk appetite that are not yet reflected in PD measures. At the reporting date, if an account satisfies any policy decline rules that it had not at the point of origination, it will be considered to have significantly increased in credit risk.

There is no probationary period applied in respect of accounts that cure from stage 2 to stage 1. Transfer criteria have been subject to extensive analysis to ensure that they appropriately reflect the flow of accounts from origination to default so as to maximise the number of accounts that flow through the stages and minimise accounts that jump from stage 1 to stage 3, or that fail to enter stage 3 from stage 2.

The Bank has applied the low credit risk exemption in respect of its high quality treasury portfolio held for liquidity purposes. This exemption permits low credit risk loans (i.e. those considered investment grade) to remain in stage 1 without an assessment of significant increase in credit risk.

Definition of default

The Bank's definition of default is used in determining those accounts classified as stage 3 (i.e. credit impaired). The Bank has chosen not to rebut the backstop presumption prescribed by IFRS 9 that where an account is 90 days or more past its due date then default has occurred.

The Bank has also defined a number of unlikeliness to pay criteria that result in an account being deemed to have defaulted. These include:

- Where operational collections activities have been exhausted on accounts that are less than 90 days past due and the account is subject to recoveries processes
- If any forbearance has been granted on the account
- Where the customer is subject to insolvency proceedings
- Where the customer is deceased

Where an account no longer meets any of the default criteria, such as by bringing payments back up to date, the Bank will continue to consider the account as being in default for a period of 24 months from the date when it last met the definition of default.

Write-off

Loans and advances to customers are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to write-off. However, financial assets that are written off could be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due. Subsequent recoveries of amounts previously written off result in impairment gains recorded in the income statement.

Expected lifetime

For the purposes of considering the lifetime probability of default, the expected lifetime of a financial asset is the contractual term where this is fixed within the contract, or in the case of revolving products such as credit cards a behavioural life is determined by reference to historic trends.

Modified financial assets

When the contractual cash flows of a financial asset have been renegotiated or modified and the financial asset was not derecognised, its gross carrying amount is recalculated as the present value of the modified contractual cash flows, discounted at the original effective interest rate with a gain or loss recognised in the income statement.

Macro-economic scenarios

IFRS 9 requires that the measurement of ECL should reflect an unbiased and probability weighted amount that is determined by evaluating a range of forward-looking economic assumptions. The Bank has engaged an external supplier to provide economic forecasts which are subject to review, challenge and approval through the Bank's governance processes. The ECL models utilise three scenarios including a 'base case' scenario considered to be the most likely outcome together with an upside and downside scenario. The base case has been assigned a probability weighting of 40% with the upside and downside scenarios each assigned 30%.

2. Critical accounting estimates and judgements continued

The key macro-economic assumptions included in the ECL calculation were:

	As at 29 February 2020			As at 28 February 2019		
	Base %	**Upside %**	**Downside %**	Base %	Upside %	Downside %
Unemployment rate	**3.9**	**3.9**	**6.1**	4.3	4.2	6.0
Consumer price growth	**2.0**	**1.4**	**2.4**	2.0	1.4	2.4
GDP	**1.6**	**2.1**	**1.1**	1.6	2.0	1.1
Mortgage debt as a percentage of household income	**99.3**	**96.5**	**103.4**	94.1	91.9	98.3
Real household disposable income	**1.5**	**2.2**	**0.2**	1.1	1.9	0.2

The above are based on five-year averages from the reporting date.

Changing the probability of the economic downside risk from 30% to 100% would result in an increase in impairment provisions of £11m (2019: £12m).

Further explanation of the inputs, assumptions and estimation techniques used at the reporting date in measuring ECLs, as well as the key sensitivities of ECLs to change in these elements, are set out at note 13.

Since the reporting date significant economic and social disruption has arisen from the COVID-19 pandemic. The Bank considered this to be a non-adjusting post balance sheet event. Further information on the impact of the COVID-19 pandemic on the Bank is set out at note 43.

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.

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 estimated life differs by +/- 12 months, the value of loans and advances to customers on the balance sheet would be £10m (2019: £9m) higher or £11m (2019: £12m) 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.

3. Net interest income

Accounting policy

Interest income and expense in the income statement is determined 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.

The effective interest rate of a financial asset is calculated on initial recognition and is applied to the gross carrying amount of the asset. For financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit impaired, then the calculation of interest income reverts to the gross basis.

Interest income calculated using the effective interest method presented in the income statement includes interest on financial assets and financial liabilities measured at amortised cost, at fair value through other comprehensive income and the effective portion of hedge accounting instruments. Interest expense presented in the statement of profit or loss includes financial liabilities measured at amortised cost and the effective portion of hedge accounting instruments.

Interest income and expense on other financial assets and financial liabilities at FVPL are presented in fair value (losses) on financial instruments (see note 7).

Interest expense on lease liabilities are included within in the below categories as appropriate (see note 32).

	2020 £m	2019 (restated)[1] £m
Interest income calculated using the effective interest rate method:		
Interest income on financial assets measured at amortised cost	**294**	288
Interest income on financial assets measured at FVOCI	**9**	8
Other interest income	**1**	2
Interest receivable	**304**	298
Interest expense on customer accounts, deposits and borrowings	**(96)**	(82)
Interest expense on subordinated liabilities	**(11)**	(11)
Interest expense on derivative liabilities	**(8)**	(5)
Interest payable	**(115)**	(98)
Net interest income	**189**	200

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

4. Net fees and commissions income

Accounting policy

Fees and commissions income
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 fees are recognised in line with the satisfaction of performance obligations. This can either be at a point in time or over time.

Banking income
The Bank earns income on Credit Card and ATM interchange fees, and from transaction-based fees which are charged to the customer's account when the transaction takes place. The revenue relating to transactions is recognised at the point in time when the transaction takes place.

Insurance income
The Bank earns commission income from the sale of insurance policies underwritten by a third party underwriter. This commission income is recognised as policies are sold, in line with the satisfaction of performance obligations to the customers.

Contract balances
Contract assets relate to the incremental costs of obtaining a contract with a customer. These costs are capitalised and deferred over the period to which performance obligations are performed and revenue is earned. Judgement is applied by management when determining what costs qualify to be capitalised, in particular whether these costs are incremental and whether they are expected to be recoverable.

4. Net fees and commissions income continued

Disaggregation of fee and commission income

In the following table, fee and commissions income from contracts with customers in scope of IFRS 15 is disaggregated by major type of service.

	2020 £m	2019 £m
Banking income	**76**	74
Insurance income	**26**	25
Other income	**2**	2
Total fees and commission income	**104**	101
Fees payable	**(10)**	(6)
Total fees and commission payable	**(10)**	(6)
Net fees and commission income	**94**	95

Contract balances

Capitalised costs incurred to obtain contracts in the year were £5m (2019: £6m) and the unamortised balance as at the reporting date, included within other assets in note 21, was £6m (2019: £5m). These costs relate to incremental costs of acquiring insurance contracts with customers.

The amount of amortisation recognised in the year relating to capitalised costs to obtain contracts with customers was £3m (2019: £2m).

5. Other operating income

Accounting policy	Margin from the sale of Travel Money, representing the difference between the purchase price and the selling price, is recognised when the sale to the customer takes place within other operating income.

	2020 £m	2019 £m
Travel Money income	**40**	37
Other operating income	**40**	37

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

6. Administrative expenses

	2020 £m	2019 (restated)[1] £m
Staff costs:		
Wages and salaries	**64**	62
Social security costs	**6**	6
Pension costs	**4**	3
Share-based payments	**4**	3
	78	74
Other operating costs	**159**	207
	237	281

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

Staff costs and other operating costs include £25m (2019: £72m) of non-underlying items as described in note 8.

See note 9 for further details on employee arrangements.

7. Gains/(losses) on financial assets and liabilities

	2020 £m	2019 £m
Realised gains on derecognition	**1**	1
Fair value (losses) on derivatives not designated in a hedging relationship	**–**	(1)
Fair value gains on hedge ineffectiveness of derivatives in hedge relationship	**(3)**	(1)
	(3)	(2)

Further detail on the Bank's hedging policies is provided in note 16.

Finance fair value movements relate to net fair value movements on derivative financial instruments not designated in a hedging relationship and any hedge ineffectiveness that is expected to amortise over the remaining life of the hedged items.

8. Non-underlying 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.

	2020 £m	2019 £m
Interest income from Group companies	**–**	16
Total non-underlying items – Income	**–**	16
New Bank Programme transition costs	**(16)**	(71)
Strategic initiatives	**(8)**	–
Recharges from Group companies	**(1)**	(1)
Total non-underlying items – Costs	**(25)**	(72)
Finance fair value movements	**(3)**	(2)
Total non-underlying items – Gains/losses on financial instruments	**(3)**	(2)
Total non-underlying items	**(28)**	(58)

During the previous year, J Sainsbury plc concluded a Group-wide transfer pricing review, which resulted in changes to the arm's length pricing of inter-company transactions. The financial impact of these changes was excluded from underlying profit in 2019. The intercompany loan to Home Retail Group Card Services Limited was restructured to equity investment (£325m) and debt, therefore the impact in 2019/20 is not comparable.

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 is provided in note 18.

Strategic initiatives represent one-off costs relating to projects – this includes severance costs and related consultancy and also revaluation of certain assets.

9. Employees

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

	2020 Number	2019 Number
Full time	**1,059**	1,144
Part time	**1,265**	1,172
	2,324	2,316
Full time equivalent	**1,738**	1,787

Colleague costs are disclosed in administrative expenses in note 6.

On a spot basis, colleague headcount, including contractors, fell 10% over the 12 months to February 2020.

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 (see note 39) representing contributions payable by the Bank was entirely in relation to the defined contribution schemes.

10. Directors' emoluments

	2020 £m	2019 £m
Emoluments	**3.1**	2.8
Employer contribution to defined contribution pension schemes	**–**	–
Share based payments	**1.7**	2.2
Compensation for loss of office	**0.4**	–
	5.2	5.0

	2020 £m	2019 £m
Highest paid Director:		
Emoluments	**0.6**	0.8
Share-based payments	**0.1**	0.9
	0.7	1.7

The Directors' positions and remuneration status are set out in the Directors' Report on page 19. 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 five Directors (2019: four) received share awards under J Sainsbury plc share incentive schemes reflective of their qualifying services. Four Directors (2019: three) exercised share options in the year including the highest paid Director. Further detail of the relevant incentive plans are outlined in note 38.

During the year five Directors (2019: two) accrued retirement benefits in respect of qualifying services under defined contribution schemes. One Director (2019: nil) was paid a sum of £0.4m following retirement in the year. There was no such payment made in the prior year.

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 19).

11. Profit/(loss) before taxation

	2020 £m	2019 (restated)[1] £m
Profit/(loss) before taxation is stated including the following items of income and (expense):		
Loss on disposal of intangible assets	**(0.4)**	–
Loss on disposal of tangible assets	**–**	(0.2)
Impairment loss	**(5.2)**	–
Auditors' remuneration:		
Statutory audit of the Bank	**(0.9)**	(0.9)
Audit-related assurance services	**–**	–

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

Impairment loss during the year ended 29 February 2020 relates to impairment losses predominantly on ATMs.

12. Taxation

Accounting policy	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.

	2020 £m	2019 £m
UK corporation tax on profit for the year	**–**	–
Adjustments in respect of prior years	**(3)**	(1)
Current tax	**(3)**	(1)
Deferred tax charge		
Origination and reversal of temporary differences	**–**	–
Adjustments in respect of prior years	**1**	2
Deferred tax	**1**	2
Total tax charge/(credit)	**(2)**	1

Differences between profit before tax multiplied by the UK corporation tax rate for the year of 19% and the income tax expense recognised in the income statement are explained below:

	2020 £m	2019 £m
Profit/(loss) before taxation	**5**	(34)
Tax on ordinary activities at 19% (2019: 19%)	**1**	(7)
Effects:		
Losses (claimed)/surrendered as group relief for nil consideration	**(1)**	7
Adjustment in respect of prior years	**(2)**	1
Net transfer pricing adjustments	**–**	–
Total income tax charge/(credit) recognised in the income statement	**(2)**	1

The main rate of UK corporation tax reduced from 20% to 19% from 1 April 2017. A further reduction in the corporation tax rate to 17%, effective from 1 April 2020, was substantively enacted in a prior period, so its effect is reflected in these financial statements. Deferred tax on temporary differences and tax losses as at the balance sheet date are calculated at the substantively enacted rates at which the temporary differences and tax losses are expected to reverse. A change to the corporation tax rate, so that it remains at 19% rather than reducing to 17% from 1 April 2020, was announced in the 2020 Budget. However, this rate change was not substantively enacted at the balance sheet date, so its effect is not reflected in these financial statements.

The effect of a 2% increase in the corporation tax rate on the deferred tax balances at the balance sheet date would increase the deferred tax asset by £194,000, which would primarily be recognised in the income statement.

13. Loans and advances to customers

Accounting policy

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.

The accounting policies for classification and measurement under IFRS are detailed in note 1.

ECL impairment model
IFRS 9 uses a 3 stage forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Bank to record an allowance for ECL for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is calculated by reference to the estimated probability of default (PD), exposure at default (EAD) and loss given default (LGD).

The probability of default represents the likelihood of a borrower defaulting either within 12 months from the balance sheet date or within the expected lifetime of the instrument.

Exposure at default represents the expected amount due from the borrower at the point of default by reference to exposure at the balance sheet date adjusted for expected future changes including repayments and utilisation of undrawn facilities.

Loss given default represents the expected percentage loss at the point of default relative to the EAD. The estimate takes into account utilisation of any expected collections and recoveries strategies, debt sale arrangements and collateral.

The 3 stage model to determine impairment allowance is summarised as follows:

- **Stage 1** – Impairment allowance on financial assets that have not significantly increased in credit risk since origination, nor are credit impaired, is calculated using the probability that a borrower will default within 12 months from the balance sheet date. Interest income is recognised on the gross carrying value of the financial asset.
- **Stage 2** – Where a financial asset exhibits a significant increase in credit risk (SICR) but is not yet considered to be credit impaired, the probability of default considered in the impairment allowance is based upon the lifetime probability of the borrower defaulting. Interest income continues to be recognised on the gross carrying value of the financial asset.
- **Stage 3** – Assets considered to be credit impaired. One or more events has occurred that has resulted in a detrimental impact on the estimated future cash flows of the asset. Stage 3 assets will continue to recognise lifetime expected impairment losses (with a 100% probability of default) and interest income will be recognised on the net carrying amount (i.e. gross amount less impairment allowance).

In determining ECL allowances, expected future recoveries are discounted to the reporting date at the original effective interest rate of the relevant instrument.

A number of inputs and variables used in the ECL calculation are not defined within IFRS 9 and involve complex modelling and application of judgement as discussed in the remainder of this section.

Undrawn commitments
Undrawn loan and credit card commitments are commitments under which the Bank is required to provide a loan with pre-specified terms to the customer. Under IFRS 9 these contracts are in scope of the ECL requirements.

The Bank is required to estimate the extent to which undrawn commitments and facilities will be utilised by borrowers.

The nominal contractual value of these commitments, where the lending agreed to be provided is on market terms, are not recorded in the statement of financial position. The nominal values of these instruments together with the corresponding ECLs are disclosed in note 33. The impairment allowance in respect of these instruments is included within provisions for liabilities and charges as there is no related asset on balance sheet against which to offset the related impairment allowance.

13. Loans and advances to customers continued

	2020 £m	2019 £m
Gross advances	**6,667**	6,373
Impairment	**(183)**	(180)
Adjustment in relation to fair value hedging	**27**	(1)
Loans and advances to customers	**6,511**	6,192
Gross advances being:		
Repayable on demand	**2,037**	1,766
Other loans and advances repayable:		
In 3 months or less	**361**	354
Between 3 months and 1 year	**760**	827
Between 1 and 5 years	**1,909**	2,167
After 5 years	**1,600**	1,259
	6,667	6,373

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

	2020 £m	2019 £m
Individuals:		
Secured lending	**1,862**	1,441
Unsecured lending	**4,805**	4,932
Gross loans and advances to customers	**6,667**	6,373

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 Term Funding Scheme (TFS) and Indexed Long Term Repo Facility (ILTR). As at 29 February 2020 £182m (2019: £334m) of the personal loans portfolio was assigned to the SPE for use as collateral in securitisation transactions. £1,586m (2019: £1,476m) of the Personal Loans book was pledged to the Bank of England facilitating funding of £950m (2019: £950m) from the TFS and £75m (2019: £75) from the ILTR.

13. Loans and advances to customers continued

Allowance for impairment losses measured under IFRS 9

Reconciliation of impairment loss allowance and gross carrying amount of loans and advances measured at amortised cost

	Non-credit-impaired				Credit-impaired			
	Stage 1		Stage 2		Stage 3		Total	
	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m
As at 1 March 2019	**5,621**	**(25)**	**586**	**(28)**	**166**	**(127)**	**6,373**	**(180)**
Transfers of financial assets:								
To Stage 1	**177**	**–**	**(174)**	**–**	**(3)**	**–**	**–**	**–**
To Stage 2	**(191)**	**11**	**195**	**(11)**	**(4)**	**–**	**–**	**–**
To Stage 3	**(33)**	**19**	**(29)**	**17**	**62**	**(36)**	**–**	**–**
Net Transfer between stages		**30**		**6**		**(36)**	**–**	**–**
Increases due to originations[1]	**1,601**	**(6)**	**63**	**(4)**	**7**	**(4)**	**1,671**	**(14)**
Decreases due to repayments	**(1,168)**	**3**	**(149)**	**2**	**(6)**	**4**	**(1,323)**	**9**
Write-offs	**(4)**	**–**	**(4)**	**1**	**(46)**	**46**	**(54)**	**47**
Changes in credit risk[2]	**–**	**(25)**	**–**	**(6)**	**–**	**(14)**	**–**	**(45)**
As at 28 February 2019	**6,003**	**(23)**	**488**	**(29)**	**176**	**(131)**	**6,667**	**(183)**

1 This also reflects assets which were originated in stage 1 and subsequently moved to stage 2 or stage 3 during the year.
2 Changes in credit risk includes changes to the allowance for credit impairment losses arising from stage transfers and other changes to risk parameters.

	Non-credit-impaired				Credit-impaired			
	Stage 1		Stage 2		Stage 3		**Total**	
	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m
As at 1 March 2018	4,365	(27)	555	(24)	144	(105)	5,064	(156)
Transfers of financial assets:								
To Stage 1	145	–	(143)	–	(2)	–	–	–
To Stage 2	(187)	12	189	(12)	(2)	–	–	–
To Stage 3	(30)	19	(28)	16	58	(35)	–	–
Net Transfer between stages		31		4		(35)		–
Increases due to originations[1]	2,323	(9)	171	(5)	7	(4)	2,501	(18)
Decreases due to repayments	(991)	3	(155)	2	(13)	3	(1,159)	8
Write-offs	(4)	–	(3)	1	(26)	18	(33)	19
Changes in credit risk[2]	–	(23)	–	(6)	–	(4)	–	(33)
As at 28 February 2019	5,621	(25)	586	(28)	166	(127)	6,373	(180)

1 This also reflects assets which were originated in stage 1 and subsequently moved to stage 2 or stage 3 during the year.
2 Changes in credit risk includes changes to the allowance for credit impairment losses arising from stage transfers and other changes to risk parameters.

14. Notes to the cash flow statement

Accounting policy	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.

Reconciliation of profit before taxation to cash flows used in operating activities

	2020 £m	2019 (restated)[1] £m
Profit/(loss) before taxation	**5**	(34)
Non-cash and other items included in profit before taxation		
Impairment losses on loans and advances	**48**	61
Depreciation on property, plant and equipment	**8**	8
Amortisation of intangible assets	**23**	15
Share-based payment expense	**4**	3
Impairment, gains, (losses) and disposals	**5**	–
Interest paid on subordinated liabilities	**11**	11
	99	98
Change in operating assets and liabilities		
Net (increase) in loans and advances to customers	**(361)**	(1,364)
Net decrease in derivative assets	**2**	7
Net (increase) in investment securities greater than 3 months	**(180)**	(95)
Net increase in derivative liabilities	**27**	3
Net decrease in other assets	**(201)**	268
Net increase in customer accounts	**362**	970
Net increase in borrowed funds	**134**	110
Net (decrease) in other liabilities including provisions	**(8)**	(11)
	(225)	(112)
Cash (used in) from operations	**(121)**	(48)
Income taxes received/(paid)	**2**	(7)
Cash flows (used in) from operating activities	**(119)**	(55)
Operational cash flows from interest		
Interest paid	**(110)**	(86)
Interest received	**288**	278
	178	192

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

Reconciliation of liabilities arising from financing activities

	2020 £m	2019 £m
Subordinated liabilities:		
At 1 March	**176**	174
Issuance of loan notes	**–**	–
Non-cash movements	**4**	2
At 29/28 February	**180**	**176**

	2020 £m	2019 (restated)[1] £m
Lease liabilities:		
At 1 March	**6**	7
Lease payments	**–**	(1)
Lease interest	**–**	–
At 29/28 February	**6**	**6**

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

14. Notes to the cash flow statement continued

Restricted cash balances

	2020 £m	2019 £m
Bank of England deposit	**18**	14
	18	14

A reserve deposit is held with the Bank of England in accordance with statutory requirements. This deposit is not available for use in day-to-day operations and has been excluded from the cash and cash equivalents balance in the cash flow statement.

15. Cash, balances with central banks and other demand deposits

	2020 £m	2019 £m
Cash and balances with central banks	**426**	504
Other demand deposits	**74**	30
	500	534

The balances with central banks are repayable on demand, with the exception of the £18m (2019: £14m) reserve deposit which is held with the Bank of England (see note 14). There was no material impairment arising on cash and other demand deposits.

16. Derivative financial instruments

Accounting policy

All derivative financial instruments are initially recognised at fair value on the contract date and are re-measured to their fair value at each subsequent reporting date. Changes in fair value of all derivative instruments are recognised immediately in the income statement. Fair values are obtained from observable market data before the application of appropriate discounting factors.

Where the overall carrying value of a derivative is positive it is held and classified on the balance sheet as an asset. Alternatively, when the overall carrying value of a derivative is negative it is held and classified as a liability.

The Bank intends to use derivatives for economic purposes only, and not for trading. Where possible it will elect to designate the derivative into an effective hedge accounting relationship, where the gains and losses on derivatives are offset by effective hedged item adjustments within 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 has adopted IFRS 9 hedge accounting requirements for its fair value hedges of investment securities and its one-for-one hedge on its Fixed Rate Debt issuance, aligning to J Sainsbury plc group policy on micro hedge requirements. The Bank continues to adopt IAS 39 for its macro portfolio fair value hedges of fixed rate personal loans and residential mortgages, as it is permitted to do under IFRS 9 and until the point that the new macro hedge accounting standard is finalised and adopted.

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 is expected to be (prospectively) and, subsequently, has been (retrospectively) effective.

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 hedged item and is recognised in the income statement, 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 amortised over the remaining life of the hedged item and to the income statement.

Micro fair value hedging – IFRS 9

The Bank has purchased a number of fixed rate debt investment securities and has issued fixed rate subordinated debt, as part of its wholesale treasury activities. These instruments are hedged via plain vanilla interest rate swaps, with the critical economic terms of both the hedging instrument and hedged item matching. The notional amount, fixed interest legs and maturity dates are economically matched. The main source of ineffectiveness within the micro hedge relationships relates to the floating leg valuation changes inherent within the hedging instrument that do not exist within the hedged item.

Portfolio fair value hedging – IAS 39

The Bank uses portfolio fair value hedging as a risk management tool for hedging interest rate risk on the Personal Loans and Mortgage portfolios. 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. Hedge effectiveness is considered to have been met where the change in fair value of the hedged item offsets the change in fair value of hedging instruments, within the 80 to 125% ratio corridor. Ineffectiveness on portfolio hedges can arise as a result of several factors, including floating leg valuation changes inherent within the hedging instrument that do not exist within the hedged item, mismatch in cash flow maturities between the hedged item and hedging instrument and basis risk between cash flows discounted using different benchmark rates e.g. LIBOR v OIS.

16. Derivative financial instruments continued

Accounting policy

In respect of all fair value hedge relationships, changes in fair value of the derivatives offset changes in the fair value of the hedged items through the income statement, with any ineffective portion also being recognised in the income statement.

Derivatives not in a hedge accounting relationship
The Bank's entire derivative portfolio is executed for economic purposes. Under IAS 39 rules, for macro portfolio hedging, some of the Bank's hedging derivatives do not qualify, or prove too onerous, to be designated into an effective hedged relationship. In those instances, the interest rate swaps are viewed as trading derivatives under IFRS 9 with any movements in fair value recognised in the income statement, without offset.

LIBOR reform
During the year to 29 February 2020, the Bank has initiated its London Interbank Offered Rate (LIBOR) transition plan and, from August 2019, hedged balance sheet interest rate exposures using swaps referencing the Sterling Overnight Index Average (SONIA) index, being a risk-free rate. At 29 February 2020, the Bank had remaining exposures to LIBOR impacted by the reform with a notional amount of £4,009m, of which £4,000m were designated in fair value hedge accounting relationships and £9m not in a hedge relationship. Of these, £2,700m are due to mature by December 2021. The Bank expects to transition the remaining £1,309m to SONIA in the next financial year. Further clarifications on hedge accounting implications for the financial statements are expected to be provided by the IASB following completion of Phase 2 of the IASB IBOR Reform project.

Fair value hedges
The amounts relating to items designated as hedging instruments and hedge ineffectiveness were as follows.

		Carrying amount		
	Notional amount £m	Assets £m	Liabilities £m	Ineffectiveness recognised in income statement £m
Interest rate swap – Hedge of loans and advances				
At 29 February 2020	**4,299**	**6**	**(35)**	**(3)**
At 28 February 2019	4,184	8	(8)	(1)

Derivatives not in fair value hedge accounting relationship are as follows

	Notional amount £m	Assets £m	Liabilities £m
Interest rate swap			
At 29 February 2020	**9**	**–**	**–**
At 28 February 2019	172	–	–

The line item in the statement of financial position where the hedging instrument is included is 'Derivative financial instruments'. The line item in the income statement that includes hedge ineffectiveness is 'Fair value (losses)/gains on financial instruments'.

The maturity profile and average price/rate of the hedging instruments in fair value hedges of interest rates were as follows:

	Maturity				
	Less than 1 month	1-3 months	3 months – 1 year	1-5 years	More than 5 years
As at February 2020					
Fair value hedges					
Nominal amount (£'m)	**–**	**270**	**1,402**	**2,618**	**9**
Average fixed interest rate	**–**	**1.0%**	**1.0%**	**0.9%**	**0.6%**
As at February 2019					
Fair value hedges					
Nominal amount (£'m)	96	157	951	2,955	25
Average fixed interest rate	0.9%	0.9%	1.1%	1%	1.2%

Foreign currency derivative assets
The Bank entered into foreign exchange derivative contracts to hedge foreign currency exposure. Foreign exchange derivative instruments included FX spot, FX forwards and FX swaps. At 29 February 2020, the Bank reported a FX derivative asset of £0.1m and a FX derivative liability of (£0.2m). All FX derivative contracts are less than one month to maturity.

16. Derivative financial instruments continued

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 three business days from the transaction date in order to mirror the exposure to and turnover of currency holdings. As at 29 February 2020, the Bank had transacted forward sale agreements in respect of 5.1m EUR (2019: 9.2m EUR), 4.1m USD (2019: 4.4m USD), 0.4m AUD (2019: 0.9m), 0.4m CAD (2019: 0.5m), 0.8m AED (2019: 1.8m), 0.6m PLN (2019: 0m), 3.0m CZK (2019: 0m), 0.3m NZD (2019: 0.5m), 3.8m THB (2019: 12.3m) and 1.4m ZAR (2019: 2.0m). The Bank also hedges a US-dollar denominated deposit placed with MasterCard.

17. Investment securities

Accounting policy

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. Investment securities are measured at amortised cost or FVOCI based on their contractual terms and the business model in which they are held.

Impairment of investment securities

As with customer lending, impairment of investment securities is determined under IFRS 9, again using a three-stage forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Bank to record an allowance for ECL for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is calculated by reference to the estimated probability of default (PD), exposure at default (EAD) and loss given default (LGD).

	2020 £m	2019 £m
Investment securities comprise the following:		
Treasury bills	**–**	60
Gilts	**51**	90
Non-UK Sovereign debt	**–**	5
Government backed investment securities	**86**	111
Covered bonds	**238**	261
Supranational investment securities	**319**	121
Asset backed securities	**109**	119
Commercial paper	**50**	–
	853	767
Of which:		
Maturing in three months or less	**50**	144
Maturing between three months and one year	**84**	212
Maturing between 1 and 5 years	**719**	402
Maturing after 5 years	**–**	9
	853	767

Investment securities include £300m (2019: £65m) pledged as collateral under sale and repurchase agreements or derivative contracts. The fair value movement during the year on investment securities was a loss of £0.1m (2019: a loss of £0.9m).

17. Investment securities continued

Reconciliation of impairment loss allowance and gross carrying amount of investment securities measured at FVOCI

	Non-credit impaired Stage 1		Total	
	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m
As at 1 March 2019	**767**	–	**767**	–
Purchases	**576**	–	**576**	–
Disposals	**(490)**	–	**(490)**	–
Write-offs	–	–	–	–
As at 29 February 2020	**853**	–	**853**	–

	Non-credit impaired Stage 1		Total	
	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m
As at 1 March 2018	**583**	–	**583**	–
Purchases	**506**	–	**506**	–
Disposals	**(322)**	–	**(322)**	–
Write-offs	–	–	–	–
As at 28 February 2019	**767**	–	**767**	–

18. Intangible assets

Accounting policy

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.

	2020 £m	2019 £m
Cost		
At 1 March	**254**	237
Additions	**33**	35
Disposals	**–**	(18)
As at 29 February	**287**	254
Accumulated amortisation		
At 1 March	**(30)**	(33)
Charge for the year	**(23)**	(15)
Disposals	**–**	18
As at 29 February	**(53)**	(30)
Net book value as at 29 February	**234**	224

19. Property, plant and equipment

Accounting policy

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.

Right-of-use assets

Right-of-use assets obtained under a lease arrangement are included in the above categories as appropriate and depreciated as described below. Accounting policies in relation to the measurement of right-of-use assets are outlined in note 32.

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 fifteen 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.

29 February 2020	**Land and buildings £m**	**Fixtures and equipment £m**	**Total £m**
Cost			
At 1 March 2019 (restated)[1]	**9**	**75**	**84**
Additions	**–**	**3**	**3**
Disposals/Write off	**–**	**(10)**	**(10)**
As at 29 February 2020	**9**	**68**	**77**
Accumulated depreciation			
At 1 March 2019 (restated)[1]	**3**	**33**	**36**
Charge for the year	**1**	**7**	**8**
Disposals	**–**	**(10)**	**(10)**
Impairment loss		**5**	**5**
As at 29 February 2020	**4**	**35**	**39**
Net book value as at 29 February 2020	**5**	**33**	**38**

28 February 2019	Land and buildings £m	Fixtures and equipment £m	Total £m
Cost			
At 1 March 2018 (restated)[1]	9	103	112
Additions	–	7	7
Disposals	–	(35)	(35)
As at 28 February 2019 (restated)[1]	9	75	84
Accumulated depreciation			
At 1 March 2018 (restated)[1]	2	60	62
Charge for the year (restated)[1]	1	7	8
Disposals	–	(34)	(34)
As at 28 February 2019 (restated)[1]	3	33	36
Net book value as at 28 February 2019 (restated)[1]	6	42	48

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

Land and buildings includes right-of-use assets of £3m (2019 restated: £4m) related to head office premises. See note 32 for further details.

20. Subsidiary undertakings

Accounting policy	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.

	2020 £m	2019 £m
At 1 March	**325**	–
Additional investments in subsidiary undertakings	**–**	325
As at 29/28 February	**325**	325

Additional investments in subsidiary undertakings in 2019 primarily relate to Home Retail Group Card Services Limited.

	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 structures 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

21. Other assets

Accounting policy	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.

	2020 £m	2019 (restated)[1] £m
Amounts receivable from Group companies (see note 39)	**558**	492
Funds in course of settlement	**174**	161
Prepayments and accrued income	**54**	59
Insurance instalment debtor	**25**	18
Current tax asset	**6**	4
Deferred tax asset	**2**	3
Cash collateral paid	**76**	2
Reverse repo	**40**	–
	935	739

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

Other assets have no fixed maturities but are expected to be realised within 12 months, with the exception of £24m (2019: £30m) included in prepayments and accrued income. This represents the present value of a rebate receivable in respect of the build of certain computer software which will be received over a period of time as the related software is utilised, which is expected to be greater than 12 months. See note 34 for further details on the residual contractual maturity of other assets.

21. Other assets continued

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

	2020 £m	2019 (restated)[1] £m
At 1 March	**3**	(8)
Movement on transition to IFRS 9	**–**	14
Movement in deferred tax liability charged to income statement	**–**	(1)
Adjustments in respect of prior years	**(1)**	(2)
At 28 February	**2**	3
Tax effect of timing differences due to:		
Other temporary differences	**12**	14
Accelerated capital allowances	**(10)**	(11)
	2	3

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

22. Customer accounts

Accounting policy	Financial liabilities comprise customer accounts, deposits from banks, subordinated liabilities and other wholesale deposits. 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 it expires.

Customer accounts comprise Sterling interest bearing deposits.

	2020 £m	2019 £m
Repayable:		
On demand	**5,492**	5,043
Within 3 months	**170**	110
Between 3 months and 1 year	**397**	361
Between 1 and 5 years	**253**	436
	6,312	5,950

23. Other deposits

Accounting policy	All financial liabilities are initially recognised at fair value and subsequently measured at amortised cost. Amortised cost is calculated by taking into account any discount or premium on issue of funds, and costs that are an integral part of the EIR. A financial liability is derecognised from the balance sheet when the Bank has discharged its obligations, the contract is cancelled or it expires.

Other deposits comprise Sterling wholesale deposits.

	2020 £m	2019 £m
Repayable:		
Within 3 months	**448**	68
Between 3 months and 1 year	**281**	99
Between 1 and 5 years	**951**	1,209
	1,680	1,376

24. Other borrowed funds

Accounting policy	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.

	2020 £m	2019 £m
Deemed loan on securitisation		
Repayable in less than 1 year	**101**	116
Repayable between 1 and 5 years	**–**	159
Other borrowed funds	**101**	275

Deemed loan on securitisation
The Bank is party to a bilateral securitisation transaction. The terms of the transaction enabled the Bank to maintain funding of up to £300m until May 2019, when the facility entered an amortisation period.

Under the facility, 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 substantially retains 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.

£101m (28 Feb 2019: £275m) of Senior 'A Notes' have been issued by Lochside Asset Purchaser No.1 plc, backed by the cashflows from the relevant personal loans. The facility will continue to pay down in line with receipts on the relevant personal loans, with final contractual redemption in February 2028.

As part of the structure the Bank has acquired £78m (2019: £78m) 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.

25. Subordinated liabilities

Accounting policy	Subordinated liabilities are initially recognised at fair value and subsequently held at amortised cost. Amortised cost is calculated by taking into account any discount or premium on issue of funds, and costs that are an integral part of the EIR. The interest payable is recognised in the income statement through interest payable.

	2020 £m	2019 £m
Fixed rate subordinated Tier 2 notes due November 2027	**175**	175
Accrued interest	**2**	2
Fair value hedge accounting adjustments	**3**	(1)
	180	176

The Bank has £175m of fixed rate reset callable subordinated Tier 2 notes in issuance (28 Feb 2019: £175m). The notes pay interest on the principal amount at a rate of 6% per annum, payable in equal instalments semi-annually in arrears, until 23 November 2022 at which time the interest rate will reset. The Bank has a call option to redeem these notes on 23 November 2022.

26. Other liabilities

Accounting policy	Other liabilities are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method. Specific policies in relation to the measurement of lease liabilities are outlined in note 32.

All other liabilities are expected to be settled within three months with the exception of lease liabilities.

	2020 £m	2019 (restated)[1] £m
Customer funds in course of settlement	**13**	21
Accruals and deferred income	**67**	66
Lease liabilities	**6**	6
	86	93

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

27. Provisions for liabilities and charges

Accounting policy	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.

	2020 £m	2019 £m
Provision on loan commitments issued	**8**	7
Other provisions	**–**	–
	8	7

Provision on loan commitments issued
The movement on the provision for loss allowance on loan commitments is set out in note 33. It primarily relates to expected credit losses on credit card commitments.

28. Called up share capital

Accounting policy	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.

	2020 £m	2019 £m
Authorised, allotted, called up and fully paid ordinary shares (£1):		
At 1 March	**866**	756
Ordinary shares issued during the financial year	**35**	110
At 29/28 February	**901**	866

During the year the Bank issued 35m (2019: 110m) ordinary shares of £1 each at par to J Sainsbury plc.

29. Retained earnings

	2020 £m	2019 (restated)[1] £m
At 1 March	**87**	187
Adjustment on initial application of IFRS 9	**–**	(68)
Adjustment on initial application of IFRS 16	**–**	–
Profit/(loss) for the financial year	**7**	(35)
Share-based payment (net of tax)	**4**	3
At 29/28 February	**98**	87

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

30. Other reserves

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

	Other reserves £m
At 1 March 2019	**(1)**
Net unrealised losses	**3**
Realised gains reclassified to the income statement on disposal	**(1)**
At 29 February 2020	**1**
At 1 March 2018	1
Net unrealised losses	(2)
Realised gains reclassified to the income statement on disposal	–
At 28 February 2019	(1)

These balances include tax of £nil in the reserve (2019: £nil).

31. Analysis of financial assets and liabilities by measurement basis

Accounting policy

Designation of financial instruments
The Bank classifies all of its financial assets based on the business model for managing the assets and the assets' contractual terms, measured at either amortised cost, FVOCI or FVPL.

The Bank classifies and measures its derivative portfolio at FVPL, as explained in note 16. The Bank may designate financial instruments at FVPL if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVPL when they are held for trading and derivative instruments or the fair value designation is applied.

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.

Financial assets and financial liabilities are measured on an ongoing 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:

	2020 £m	2019 (restated)[1] £m
Financial assets measured at fair value through profit or loss		
Mandatorily measured at FVPL:		
Derivative financial instruments	**6**	8
Travel Money, cash in ATMs and ATM cash in transit	**315**	336
	321	344
Financial assets measured at amortised cost		
Loans and advances to customers	**6,511**	6,192
Cash and balances with central banks	**347**	342
Other assets	**765**	588
	7,623	7,122
Financial assets measured at fair value through other comprehensive income		
Mandatorily measured at FVOCI:		
Investment securities	**853**	767
	853	767
Total financial assets	**8,797**	8,233
Non-financial assets:		
Investments in subsidiary undertakings	**325**	325
Property, plant and equipment	**38**	48
Intangible assets	**234**	224
Other assets	**8**	7
Total assets	**9,402**	8,837

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

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

	2020 £m	2019 (restated)[1] £m
Financial assets measured at fair value through profit or loss		
Mandatorily measured at FVPL:		
Derivative financial instruments	**35**	8
	35	8
Financial liabilities measured at amortised cost		
Customer accounts	**6,312**	5,950
Other deposits	**1,680**	1,376
Other borrowed funds	**101**	275
Subordinated debt	**180**	176
	8,273	7,777
Total financial liabilities	**8,308**	7,785
Non-financial liabilities:		
Other liabilities	**86**	93
Provisions	**8**	7
Total liabilities	**8,402**	7,885

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

32. Leases

Accounting policy

The Bank has applied the requirements of IFRS 16 using the fully retrospective transitional approach resulting in the restatement of comparatives and the opening balance sheet as at 1 March 2018. Further details on these restatements are detailed at note 42.

At inception of a contract, the Bank assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Bank uses the definition of a lease in IFRS 16.

The Bank leases office premises previously accounted for as non-cancellable operating leases. These leases do not contain significant non-lease components.

The Bank recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Bank's incremental borrowing rate. Generally, the Bank uses its incremental borrowing rate as the discount rate. The Bank determines its incremental borrowing rate by analysing its borrowings from various external sources and makes certain adjustments to reflect the terms of the lease and type of asset leased.

Lease payments included in the measurement of the lease liability comprise fixed payments.

The Bank is not party to any lease arrangements containing variable lease payments that depend on an index or a rate or amounts expected to be payable under a residual value guarantee. Lease payments in an optional renewal period are included where the Bank is reasonably certain to exercise an extension option.

Subsequently, the lease liability is adjusted for interest and lease payments. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Bank's estimate of the amount expected to be payable under the lease arrangements. When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

The Bank presents right-of-use assets in property, plant and equipment (note 19) and lease liabilities in other liabilities (note 26) in the statement of financial position.

Short-term leases and leases of low-value assets
The Bank has elected not to recognise right-of-use assets and lease liabilities for leases of low-value assets and short-term leases, including leases of IT equipment. The Bank recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

32. Leases continued

Right-of-use assets

Right-of-use assets relate to leased office premises that are presented within property, plant and equipment (see note 19).

	Office building £m
Balance at 1 March 2018	**5**
Depreciation charge for the year	**(1)**
Balance at 28 February 2019	**4**
Depreciation charge for the year	**(1)**
Balance at 29 February 2020	**3**

The residual contractual maturity of lease liabilities is disclosed in note 34.

Amounts recognised in profit or loss

	2020 £m	2019 £m
Interest on lease liabilities (note 3)	**(0.3)**	(0.3)

Amounts recognised in statement of cashflows

	2020 £m	2019 £m
Total cash outflow for leases (see note 14)	**-**	(1)

33. Loan commitments

Accounting policy

Undrawn Loan, Mortgage and Credit Card commitments are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. These contracts are in scope of the ECL requirements and accounting policies in relation to this are detailed in note 13.

The nominal contractual value of these commitments, where the lending agreed to be provided is on market terms, are not recorded in the statement of financial position.

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

	2020 £m	2019 £m
Commitments to extend credit	**80**	323

The above table does not include undrawn limits on credit cards. These are not considered a contractual commitment but because in practice the Bank does not expect to withdraw these credit limits from customers they are within the scope of impairment provisioning in the following table.

Reconciliation of impairment loss allowance of loan commitments

	Non-credit-impaired				Credit-impaired			
	Stage 1		Stage 2		Stage 3		Total	
	Undrawn commitment amount £m	Loss allowance £m	Undrawn commitment amount £m	Loss allowance £m	Undrawn commitment amount £m	Loss allowance £m	Undrawn commitment amount £m	Loss allowance £m
As at 1 March 2019	**5,427**	**(4)**	**189**	**(2)**	**35**	**(1)**	**5,651**	**(7)**
Transfers of financial assets:								
To Stage 1	117	–	(112)	–	(5)	–	–	–
To Stage 2	(94)	1	95	(1)	(1)	–	–	–
To Stage 3	(3)	–	(2)	–	5	–	–	–
Net Transfer between stages		1		(1)		–		–
New loan commitments originated and increases to existing commitments[1]	1,283	–	13	–	–	–	1,296	–
Loan commitments expired	(1,328)	1	(17)	–	(6)	–	(1,351)	1
Changes in credit risk	–	(2)	–	–	–	–	–	(2)
As at 29 February 2020	5,402	(4)	166	(3)	28	(1)	5,596	(8)

1 This also reflects commitments which were originated in stage 1 and subsequently moved to stage 2 or stage 3 during the year.

33. Loan commitments continued

	Non-credit-impaired				Credit-impaired			
	Stage 1		Stage 2		Stage 3		Total	
	Undrawn commitment amount £m	Loss allowance £m	Undrawn commitment amount £m	Loss allowance £m	Undrawn commitment amount £m	Loss allowance £m	Undrawn commitment amount £m	Loss allowance £m
As at 1 March 2018	4,691	(4)	187	(1)	33	(1)	4,911	(6)
Transfers of financial assets:								
To Stage 1	127	–	(122)	–	(5)	–	–	–
To Stage 2	(82)	1	83	(1)	(1)	–	–	–
To Stage 3	(5)	–	(3)	–	8	–	–	–
Net Transfer between stages		1		(1)		–		–
New loan commitments originated and increases to existing commitments[1]	931	(1)	44	–	–	–	975	(1)
Loan commitments expired	(235)	1	–	–	–	–	(235)	1
Changes in credit risk	–	(1)	–	–	–	–	–	(1)
As at 28 February 2019	5,427	(4)	189	(2)	35	(1)	5,651	(7)

1 This also reflects commitments which were originated in stage 1 and subsequently moved to stage 2 or stage 3 during the year.

The loss allowance on loan commitments are recognised as part of provisions for liabilities (see note 27).

34. 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 page 4. Further detail on credit and liquidity risk exposures are shown below, with capital adequacy discussed further in note 35.

Credit risk

Credit risk is central to the Bank's day-to-day activities and is managed in line with the Board approved risk appetite as detailed within the Principal risks section (page 6). Key developments over the course of the year have been further enhancements of IFRS 9 forecasting and stress testing models and increased capture of income data for AFS applicants.

Retail credit risk

Retail credit risk is the possibility of losses arising from a retail customer failing to meet their agreed repayment terms as they fall due. Retail Credit utilise automated scorecards to assess the creditworthiness and affordability criteria of new applicants and ongoing behavioural characteristics of existing customers. The outcomes from all scorecard models are monitored utilising a set of credit quality metrics to ensure actual performance is in line with agreed expectations. Additional expert underwriting of credit applications is undertaken by a specialist operational team where further consideration is appropriate.

The Retail Credit Risk Committee provides portfolio oversight control over credit strategy to maintain lending in line with the Board approved risk appetite, with additional oversight and control provided by the Executive Risk Committee and Board Risk Committee. Internal Audit provide additional assurance by undertaking regular reviews on the adequacy of credit risk policies and procedures.

Wholesale and derivative credit risk

The Bank's treasury assets portfolio is held primarily for liquidity management purposes and in the case of derivatives, for the purpose of managing market risk. The treasury assets portfolio is invested 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, covered bonds 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 and Treasury Risk teams, including early warning indicators with appropriate triggers for escalation.

At 29 February 2020, 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 13, 15, 17 and 33 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.

34. Risk management continued

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.

	2020 £m	2019 £m
Credit risk exposures relating to on balance sheet items		
Loans and advances to customers		
Unsecured	**4,636**	4,751
Secured	**1,875**	1,441
Cash and balances with central banks	**500**	534
Derivative financial instruments	**6**	8
Investment securities	**853**	767
Other assets	**935**	732
Credit risk exposures relating to off balance sheet items		
Loans commitments	**80**	323
Total credit risk exposures	**8,885**	8,556

Risk concentrations

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

The Bank is a retail-focused financial institution operating solely in the UK. In line with its risk principles, the Bank seeks to actively identify and manage risk concentrations across its business areas and activities. It has set clear targets for diversification within its asset and liability portfolios and sources of income. These are supported by a range of portfolio limits and a focus on key processes and controls across its activities, systems and supply chain.

Geographical sectors

Maximum exposure	2020 £m	2019 £m
United Kingdom	**8,500**	8,259
Europe	**201**	252
Other	**184**	45
	8,885	8,556

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.

Industry sectors

Maximum exposure	2020 £m	2019 £m
Retail	**6,591**	6,515
Financial institutions	**1,841**	1,467
Government	**453**	574
	8,885	8,556

Credit quality per class of financial asset

Loans and advances are summarised as follows:

Maximum exposure	2020 £m	2019 £m
Impaired	**176**	166
Past due but not impaired	**28**	25
Neither past due nor impaired	**6,463**	6,182
Gross amount due	**6,667**	6,373
Less: allowance for impairment	**(183)**	(180)
hedging fair value adjustment	**27**	(1)
	6,511	6,192

34. Risk management continued

Credit quality analysis

At 29 February 2020	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Impaired				
Less than 3 months, but impaired[1]	**–**	**–**	**20**	**20**
Past due 3 to 6 months	**–**	**–**	**15**	**15**
Past due 6 to 12 months	**–**	**–**	**9**	**9**
Past due over 12 months	**–**	**–**	**2**	**2**
Recoveries	**–**	**–**	**130**	**130**
Total gross impaired loans	**–**	**–**	**176**	**176**
Past due up to 3 months but not impaired	**–**	**28**	**–**	**28**
Not impaired	**6,003**	**460**	**–**	**6,463**
Total gross amount due	**6,003**	**488**	**176**	**6,667**

1 Includes £7m of loans that would have been past due had their terms not been renegotiated.

At 28 February 2019	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Impaired				
Less than 3 months, but impaired[1]	–	–	26	26
Past due 3 to 6 months	–	–	18	18
Past due 6 to 12 months	–	–	5	5
Past due over 12 months	–	–	1	1
Recoveries	–	–	116	116
Total gross impaired loans	–	–	166	166
Past due up to 3 months but not impaired	–	25	–	25
Not impaired	5,621	561	–	6,182
Total gross amount due	5,621	586	166	6,373

1 Includes £13m of loans that would have been past due 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 £19m (2019: £12m). The fair value of collateral held against possession cases was £nil (2019: £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'. A specialist debt recovery team will take steps to recover the debt, using their expertise to determine the optimum recovery strategy.

34. Risk management continued

Collateral

The Bank holds collateral against loans and advances to customers in the form of Mortgages over residential property and second charges over business assets, including commercial and residential property.

Credit quality

The Bank defines the following classifications for all credit exposures: High, Satisfactory, Low and Credit impaired. These are segmented by 12-month probability of default (PD) under IFRS 9. Unsecured lending represents credit cards and personal loan lending at 29 February 2020. Secured lending represents mortgage lending.

	IFRS 9 12-month PD
High quality:	<=3.02%
Satisfactory quality	>3.02%; < 11.11%
Low quality	>= 11.11%
Credit impaired	100%

Unsecured lending

At 29 February 2020	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
High quality	**3,948**	**112**	**–**	**4,060**
Satisfactory quality	**273**	**240**	**–**	**513**
Low quality	**4**	**60**	**–**	**64**
Credit impaired	**–**	**–**	**168**	**168**
Total gross amount due	**4,225**	**412**	**168**	**4,805**

At 28 February 2019	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
High quality	4,044	112	–	4,156
Satisfactory quality	297	250	–	547
Low quality	4	64	–	68
Credit impaired	–	–	161	161
Total gross amount due	4,345	426	161	4,932

Secured lending

At 29 February 2020	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
High quality	**1,778**	**73**	**–**	**1,851**
Satisfactory quality	**–**	**1**	**–**	**1**
Low quality	**–**	**2**	**–**	**2**
Credit impaired	**–**	**–**	**8**	**8**
Total gross amount due	**1,778**	**76**	**8**	**1,862**

At 28 February 2019	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
High quality	1,276	158	–	1,434
Satisfactory quality	–	1	–	1
Low quality	–	1	–	1
Credit impaired	–	–	5	5
Total gross amount due	1,276	160	5	1,441

An analysis by loan-to-value (LTV) ratio of the Bank's residential mortgage lending is presented below. The value of collateral used in determining the LTV ratios has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices.

At 29 February 2020	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
Less than 70%	**1,076**	**1**	**6**	**1,083**
70% to 80%	**389**	**–**	**1**	**390**
80% to 90%	**320**	**–**	**1**	**321**
90% to 100%	**68**	**–**	**–**	**68**
Greater than 100%	**–**	**–**	**–**	**–**
Total mortgages	**1,853**	**1**	**8**	**1,862**

34. Risk management continued

At 28 February 2019	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
Less than 70%	779	–	4	783
70% to 80%	314	–	–	314
80% to 90%	229	–	–	229
90% to 100%	109	–	–	109
Greater than 100%	6	–	–	6
Total mortgages	1,437	–	4	1,441

The following table shows the maximum exposure to credit risk for commitments and balances measured at amortised cost along with the related amounts which are credit impaired at the reporting date.

	2020		2019	
	Maximum exposure to credit risk £m	**Of which secured by collateral – residential property £m**	Maximum exposure to credit risk £m	Of which secured by collateral – residential property £m
Loan commitments	**5,596**	**14**	5,651	210
Of which credit impaired	**28**	**–**	35	–
Financial assets measured at amortised cost – Retail lending	**6,667**	**1,862**	6,373	1,441
Of which credit impaired	**176**	**8**	166	4
Total	**12,263**	**1,876**	12,024	1,651
Of which credit impaired	**204**	**8**	201	4

Debt securities, 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 29 February 2020 was £nil (2019: £nil). No collateral is held regarding these assets. The tables below present an analysis of the credit quality of cash and cash equivalents and the treasury assets portfolio by market value. Analysis is by rating agency designation, based on Moody's ratings:

At 29 February 2020	**Cash and balances with central banks £m**	**UK government securities £m**	**Other investment securities £m**	**Total £m**
Aaa to A3	**–**	**51**	**802**	**853**
ATM cash and balances with central banks	**426**	**–**	**–**	**426**
Other demand deposits	**74**	**–**	**–**	**74**
	500	**51**	**802**	**1,353**

At 28 February 2019	Cash and balances with central banks £m	UK government securities £m	Other investment securities £m	Total £m
Aaa to A3	–	150	617	767
ATM cash and balances with central banks	504	–	–	504
Other demand deposits	30	–	–	30
	534	150	617	1,301

Credit risk profile by external rating grades of treasury assets measured at FVOCI

	2020		2019	
External rating grades	**Non-credit impaired Stage 1 £m**	**Total gross carrying amount £m**	Non-credit impaired Stage 1 £m	Total gross carrying amount £m
Aaa to A3	**853**	**853**	767	767
	853	**853**	767	767

34. 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 29 February 2020	Gross assets/ (liabilities) recognised	Amounts offset £m	Net amounts recognised in the balance sheet £m	Related amounts not offset in the balance sheet: Financial instruments £m	Collateral pledged/ (received) £m	Net amounts £m
Derivative financial instruments – assets	**6**	**–**	**6**	**–**	**–**	**6**
Derivative financial instruments – liabilities	**(35)**	**–**	**(35)**	**–**	**27**	**(8)**
Repurchase agreements[1]	**–**	**–**	**–**	**–**	**–**	**–**
	(29)	**–**	**(29)**	**–**	**27**	**(2)**

1 Repurchase agreements are included within other deposits in note 24.

At 28 February 2019						
Derivative financial instruments – assets	8	–	8	–	2	10
Derivative financial instruments – liabilities	(8)	–	(8)	–	–	(8)
Repurchase agreements[1]	(30)	–	(30)	–	30	–
	(30)	–	(30)	–	32	2

1 Repurchase agreements are included within other deposits in note 23.

The Bank has derivatives which are governed by the International Swaps and Derivatives Association (ISDA), credit support annex (CSA) and cleared derivatives execution agreement (CDEA) whereby if the fair value exceeds a pre-agreed level, cash collateral is exchanged. The Bank's exposures are held with a central clearing counterparty, the London Clearing House (LCH), the terms of which also required an initial margin to be provided. At 29 February 2020, the Bank had paid cash collateral of £28m (2019: £2m) against the net derivative liability position, and £43m of initial margin collateralised by encumbered Gilts (2019: £35m of initial margin collateralised by encumbered Gilts). The Bank has also pledged and encumbered cash collateral of $58.4m (2019: nil) to MasterCard against the risk of issuing merchant spend credit.

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 excessive cost. The Bank seeks to ensure that financial obligations can be met at all times, even under liquidity stress conditions.

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

(1) Identify and assess its most relevant liquidity risk drivers
(2) Quantify its liquidity needs under various stress scenarios and
(3) Put in place appropriate limits and 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. Treasury 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 undrawn 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 risk appetite, Liquidity and Funding Policy and Liquidity Contingency Plan. Asset encumbrance ratios and key risk indicators for wholesale funding are also regularly monitored and reported to ALCo.

The table on the following page 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.

34. Risk management continued

Residual contractual maturity analysis

At 29 February 2020	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	**2,096**	**404**	**876**	**2,291**	**2,446**	**8,113**
Cash and balances at central banks	**500**	**–**	**–**	**–**	**–**	**500**
Investment securities	**51**	**6**	**100**	**714**	**–**	**871**
Other assets	**919**	**1**	**5**	**20**	**–**	**945**
	3,566	**411**	**981**	**3,025**	**2,446**	**10,429**
Net derivative asset cash flows	**2**	**9**	**16**	**35**	**–**	**62**
Total cash inflows	**3,568**	**420**	**997**	**3,060**	**2,446**	**10,491**
Liabilities						
Non-derivative liabilities						
Customer accounts	**5,530**	**129**	**405**	**260**	**–**	**6,324**
Other deposits	**372**	**78**	**289**	**956**	**–**	**1,695**
Other borrowed funds	**13**	**20**	**68**	**–**	**–**	**101**
Subordinated debt	**–**	**5**	**5**	**196**	**–**	**206**
Lease liabilities	**–**	**–**	**1**	**4**	**–**	**5**
Other liabilities (excluding lease liabilities)	**81**	**–**	**–**	**–**	**–**	**81**
	5,996	**232**	**768**	**1,416**	**–**	**8,412**
Net derivative liability cash flows	**4**	**7**	**29**	**50**	**2**	**92**
Unrecognised loan commitments	**80**	**–**	**–**	**–**	**–**	**80**
Total cash outflows	**6,080**	**239**	**797**	**1,466**	**2**	**8,584**
Net liquidity	**(2,512)**	**181**	**200**	**1,594**	**2,444**	**1,907**

At 28 February 2019 (restated)[1]	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	1,843	398	963	2,508	2,442	8,154
Cash and balances at central banks	534	–	–	–	–	534
Investment securities	115	37	229	409	–	790
Other assets	709	1	5	26	–	741
	3,201	436	1,197	2,943	2,442	10,219
Net derivative asset cash flows	(1)	4	–	8	–	11
Total cash inflows	3,200	440	1,197	2,951	2,442	10,230
Liabilities						
Non-derivative liabilities						
Customer accounts	5,085	76	371	446	–	5,978
Other deposits	48	22	109	1,227	–	1,406
Other borrowed funds	13	22	84	161	2	282
Subordinated debt	–	5	5	206	–	216
Lease liabilities	–	–	1	5	–	6
Other liabilities (excluding lease liabilities)	89	–	–	–	–	89
	5,235	125	570	2,045	2	7,977
Net derivative liability cash flows	1	1	7	4	–	13
Unrecognised loan commitments	323	–	–	–	–	323
Total cash outflows	5,559	126	577	2,049	2	8,313
Net liquidity	(2,359)	314	620	902	2,440	1,917

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

34. 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 2020	Encumbered £m	Unencumbered £m	Total £m
Loans and advances to customers	**1,774**	**4,737**	**6,511**
Debt securities	**339**	**514**	**853**
Other assets	**76**	**859**	**935**
Cash and balances with central banks	**18**	**482**	**500**
	2,207	**6,592**	**8,799**

	Carrying value of encumbered assets £m	Matching liabilities, contingent liabilities or securities lent £m
Loans and advances to customers	**1,774**	**1,126**
Debt securities	**339**	**299**
Other assets	**76**	**29**
Cash and balances with central banks	**18**	**–**
	2,207	**1,454**

At 28 February 2019	Encumbered £m	Unencumbered £m	Total £m
Loans and advances to customers	1,816	4,376	6,192
Debt securities	65	702	767
Other assets	2	737	739
Cash and balances with central banks	14	520	534
	1,897	6,335	8,232

	Carrying value of encumbered assets £m	Matching liabilities, contingent liabilities or securities lent £m
Loans and advances to customers	1,816	1,300
Debt securities	65	30
Other assets	2	–
Cash and balances with central banks	14	–
	1,897	1,330

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 and mortgage loans with applicable haircuts are used as collateral for the bilateral personal loans securitisation facility and the Bank of England's Term Funding Scheme (TFS) and Indexed Long-term Repo (ILTR). The personal loans used to secure the funding 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.

34. Risk management continued

Market risk

Market risk is the risk that the value 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.
- Credit spread risk: the risk of adverse effects resulting from a change in credit spreads, arising via the Bank's treasury assets portfolio

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 with similar repricing characteristics. Hedging strategies are implemented and reviewed to ensure the Bank remains within its limits.

In order to measure the exposure to interest rate risk the Bank adopts a Capital at Risk ('CaR') approach to assess the value sensitivity of the Bank's capital to movements in interest rates under various interest rates shock scenarios, as well as via an annual earnings at risk metric which measures the sensitivity of the Bank's earnings to movements in interest rates over a 12-month period. The CaR measure is an aggregate measure of five separate risk components, each being a distinct form of interest rate risk: repricing risk, basis risk, prepayment risk, MTM risk and credit spread risk.

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

	2020 £m	2019 £m
Repricing risk	**(17)**	(7)
Basis risk	**–**	–
Prepayment risk	**(2)**	(2)
Credit spread risk	**(3)**	(1)
MTM risk	**(4)**	(1)
Total CaR	**(26)**	(11)

As at 29 February 2020 earnings at risk (change in net interest income) for changes in interest rates of +/-100 basis points movements in rates are as follows:

	2020 £m	2019 £m
+/- 100 basis points	**(17)/19**	(10)/13

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 bureau in J Sainsbury's stores. The Bank also has exposures in US Dollar for the cash collateral pledged to MasterCard. The FX exposures are hedged on a daily basis for Travel Money and monthly basis for MasterCard. Further details of the hedging arrangements in place at year end are disclosed in note 16.

35. Capital resources

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 capital position shown below is on a regulatory consolidated basis. The following table analyses the regulatory capital resources under CRD IV and aligns to the phase-in approach of IFRS 9 impacts on capital, over a five-year period from 1 March 2018.

	Transitional 2019 IFRS 9 £m	**Full impact 2020 IFRS 9 £m**	Transitional 2019 IFRS 9 £m	Full impact 2019 IFRS 9 £m
Common Equity Tier 1 (CET1) capital:				
Ordinary share capital	**901**	**901**	866	866
Allowable reserves (unaudited – including subsidiary undertakings)	**93**	**93**	66	66
CET1 capital pre regulatory adjustments	**994**	**994**	932	932
Regulatory adjustments:				
Intangible assets (including subsidiary undertakings)	**(237)**	**(237)**	(225)	(225)
Additional value adjustment	**(1)**	**(1)**	(1)	(1)
Transitional adjustment	**66**	**–**	79	–
Total regulatory adjustments to CET1 capital	**(172)**	**(238)**	(147)	(226)
Tier 1 capital	**822**	**756**	785	706
Loan notes (listed)	**167**	**167**	172	172
Tier 2 capital	**167**	**167**	172	172
Total capital	**989**	**923**	957	878

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

	Transitional 2020 IFRS 9 £m	**Full impact 2019 IFRS 9 £m**	Transitional 2019 IFRS 9 £m	Full impact 2019 IFRS 9 £m
At 1 March	**785**	**706**	725	725
Ordinary share capital issued	**35**	**35**	110	110
IFRS 9 adjustment to retained earnings (including subsidiary undertakings)	**–**		(84)	(84)
Verified profit/(losses) (including subsidiary undertakings)	**20**	**20**	(24)	(24)
Transitional adjustments	**(13)**	**–**	79	–
Other reserve movements	**7**	**7**	–	–
Movement in additional value adjustments	**–**	**–**	(1)	(1)
Movement in intangible assets	**(12)**	**(12)**	(20)	(20)
As at 28 February	**822**	**756**	785	706

Reconciliation of statutory reserves to regulatory reserves

	2020 £m	2019 £m
Total shareholders' funds	**1,000**	951
IFRS 16 transitional adjustment	**–**	1
Total shareholders' funds of subsidiary undertakings and consolidation adjustments	**(6)**	(20)
Regulatory adjustments	**(172)**	(147)
CET1 capital	**822**	785

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 calculated below as at 29 February 2020. The Bank's leverage ratio of 8.1% (2019: 8.2%) exceeds the minimum Basel leverage ratio of 3%.

35. Capital resources continued

	Transitional 2020 IFRS 9 £m	Full impact 2020 IFRS 9 £m	Transitional 2019 IFRS 9 £m	Full impact 2019 IFRS 9 £m
Components of the leverage ratio				
Total assets as per published financial statements	**9,402**	**9,402**	8,832	8,832
Uplift on consolidation of subsidiary undertakings	**59**	**59**	49	49
Exposure value for derivatives and SFTs	**15**	**15**	18	18
Off balance sheet exposures: unconditionally cancellable (10%)	**906**	**906**	810	810
Off balance sheet: other (100%)	**16**	**16**	65	65
Other adjustments	**(238)**	**(238)**	(226)	(226)
	10,160	**10,160**	9,548	9,548
Tier 1 capital	**822**	**756**	785	706
Leverage ratio	**8.1%**	**7.4%**	8.2%	7.4%

Capital management
The Bank manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. During the year to 29 February 2020, the Bank received further injections of £35m of ordinary share capital from J Sainsbury plc. Capital adequacy is monitored on an ongoing 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.

36. 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 29 February 2020	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivatives designated as fair value hedging instruments	–	**6**	–	**6**
Derivatives not in fair value hedging relationships	–	–	–	–
Travel Money and ATM cash	–	**153**	–	**153**
Investment securities	**853**	–	–	**853**
Total assets	**853**	**159**	–	**1,012**
Derivatives designated as fair value hedging instruments	–	**35**	–	**35**
Derivatives not in fair value hedging relationships	–	–	–	–
Total liabilities	–	**35**	–	**35**

36. Fair value of financial instruments continued

At 28 February 2019	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivatives designated as fair value hedging instruments	–	8	–	8
Derivatives not in fair value hedging relationships	–	–	–	–
Travel Money and ATM cash	–	192	–	192
Investment securities	767	–	–	767
Total assets	767	200	–	967
Derivatives designated as fair value hedging instruments	–	8	–	8
Derivatives not in fair value hedging relationships	–	–	–	–
Total liabilities	–	8	–	8

The following table summarises the fair value of financial assets and liabilities that are not presented in the Bank's balance sheet at fair value. The fair values of financial instruments are based on market prices where available, or are estimated using other valuation techniques. Where they are short term in nature or re-price frequently, fair value approximates to carrying value. The fair value information presented does not represent the fair value of the Bank as a going concern at 29 February 2020 or 28 February 2019.

	2020		2019	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m
Assets:				
Loans and advances to customers	**6,511**	**6,515**	6,192	6,170
Cash and balances at central banks	**347**	**347**	342	342
Liabilities:				
Customer accounts	**6,312**	**6,319**	5,950	5,925
Other deposits	**1,680**	**1,680**	1,376	1,376
Other borrowed funds	**101**	**101**	275	275
Subordinated debt	**180**	**186**	176	177

The carrying value of other assets and other liabilities is a reasonable approximation of fair value.

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 29 February 2020	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Loans and advances to customers	**–**	**6,515**	**–**	**6,515**
Cash and balances at central banks	**–**	**347**	**–**	**347**
Total assets	**–**	**6,862**	**–**	**6,862**
Customer accounts	**–**	**6,319**	**–**	**6,319**
Other deposits	**–**	**1,680**	**–**	**1,680**
Other borrowed funds	**–**	**101**	**–**	**101**
Subordinated debt	**186**	**–**	**–**	**186**
Total liabilities	**186**	**8,100**	**–**	**8,286**

At 28 February 2019	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Loans and advances to customers	–	6,170	–	6,170
Cash and balances at central banks	–	342	–	342
Total assets	–	6,512	–	6,512
Customer accounts	–	5,925	–	5,925
Other deposits	–	1,376	–	1,376
Other borrowed funds	–	275	–	275
Subordinated debt	177	–	–	177
Total liabilities	177	7,576	–	7,753

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.

36. Fair value of financial instruments continued

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.

37. Parent company

The immediate and ultimate parent company and controlling party of the Bank is J Sainsbury plc, which is registered in England. Its registered office is 33 Holborn, London, EC1N 2HT. 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**

38. Share-based payments

Accounting policy

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 with a corresponding increase to equity.

Income statement

The Bank recognised £3.6m (2019: £3.3m) of employee costs (note 6) related to share-based payment transactions made during the financial year. Of these, £nil (2019: £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 on the following pages:

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.

A reconciliation of Sharesave option movements is shown below:

	2020 Number of options million	**2020 Weighted average exercise price pence**	2019 Number of options million	2019 Weighted average exercise price pence
Outstanding at beginning of year	**1.1**	**213**	1.0	189
Granted	**0.5**	**161**	0.4	260
Forfeited	**(0.3)**	**228**	(0.2)	193
Exercised	**(0.1)**	**187**	(0.1)	202
Outstanding at end of year	**1.2**	**189**	1.1	214
Exercisable at end of year	**0.1**	**185**	0.1	200
Exercisable price range		**185 to 213**		195 to 332

The weighted average share price of J Sainsbury plc during the period for options exercised over the year was 209 pence (2019: 252 pence). The weighted average remaining contractual life of share options outstanding at 29 February 2020 was 2.8 years (2019: 2.8 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:

		2020	2019
Share price at grant date (pence)		**220**	238
Exercise price (pence)		**161**	184
Expected volatility	— 3 year period (%)	**26.1**	24.5
	— 5 year period (%)	**27.8**	26.9
Option life	— 3 year period (years)	**3.2**	3.2
	— 5 year period (years)	**5.2**	5.2
Expected dividends (expressed as dividend yield %)		**2.9**	4.8
Risk-free interest rate	— 3 year period (%)	**0.6**	0.9
	— 5 year period (%)	**0.7**	1.3
Fair value per option	— 3 year period (pence)	**59**	53
	— 5 year period (pence)	**62**	62

38. Share-based payments continued

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:

	2020 million	2019 million
Outstanding at beginning of year	**1.0**	0.8
Conditionally allocated	**1.0**	0.4
Forfeited	**(0.1)**	–
Exercised	**(0.5)**	(0.2)
Outstanding at end of year	**1.4**	1.0

The weighted average remaining contractual life of share options outstanding at 29 February 2020 was 2.3 years (2019: 1.4 years).

Details of shares conditionally allocated at 29 February 2020 are set out below:

Date of conditional award	2020 million	2019 million
15 May 2014 (2014 Future Builder)	**–**	–
14 May 2015 (2015 Future Builder)	**–**	0.2
12 May 2016 (2016 Future Builder)	**0.3**	0.2
11 May 2017 (2017 Future Builder)	**0.3**	0.3
11 May 2018 (2018 Future Builder)	**0.3**	0.3
9 May 2019 (2019 Future Builder)	**0.4**	–
3 July 2019 (2019 Future Builder)	**–**	–
29 July 2019 (2019 Future Builder)	**0.1**	–
	1.4	1.0

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	2020	2019
Share price at grant date (pence)	**219**	301
Option life (years)	**4.0**	4.0
Fair value per option (pence)	**219**	301

The weighted average share price during the year for options exercised was 213 pence (2019: 301 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 are made to participants subject to performance against a basket of measures. At least 50% of the awards are based on the delivery of financial performance and returns to shareholders. The balances are 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:

	2020 million	2019 million
Outstanding at beginning of year	**0.3**	0.3
Granted	**0.3**	0.2
Exercised	**(0.2)**	(0.2)
Outstanding at end of year	**0.4**	0.3

38. Share-based payments continued

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

	Shares conditionally allocated 2020 million	Shares conditionally allocated 2019 million
11 May 2017	**–**	0.1
11 May 2018	**0.2**	0.2
9 May 2019	**0.2**	
	0.4	0.3

The weighted average remaining contractual life of share options outstanding at 29 February 2020 was 0.3 years (2019: 0.6 years). The weighted average share price during the year for options exercised was 209 pence (2019: 293 pence).

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:

	2020 million	2019 million
Outstanding at beginning of year	**1.1**	1.0
Granted	**0.6**	0.5
Exercised	**(0.4)**	(0.3)
Lapsed	**(0.2)**	(0.1)
Outstanding at end of year	**1.1**	1.1

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

	2020 million	2019 million
12 May 2016	**–**	0.3
11 May 2017	**0.4**	0.4
11 May 2018	**0.3**	0.4
9 May 2019	**0.4**	–
	1.1	1.1

The weighted average remaining contractual life of share options outstanding at 29 February 2020 was 1.5 years (2019: 1.2 years). The weighted average share price during the year for options exercised was 223 pence (2019: 242 pence).

39. Related party transactions

a) Transactions with related entities

J Sainsbury plc

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

	2020 £m	2019 £m
Transactions during the year		
Services and loans provided by J Sainsbury plc:		
Management services	**24**	31
Share capital issued to J Sainsbury plc	**35**	110
Balances at end of year		
Payables:		
Management services	**3**	5

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 IFRS 9.

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

39. Related party transactions continued

	2020 £m	2019 £m
Transactions during the year		
Interest paid on deemed loan	**(4)**	(6)
Service fee received	**1**	1
Redemption of Senior 'A Notes'	**(174)**	(37)
Redemption of subordinated 'B Notes'	**–**	(10)
Repayment of Intercompany Loan	**–**	(1)
Balances at end of year		
Other assets:		
Intercompany loan	**6**	6
Payables:		
Deemed loan	**101**	275
Book value of personal loans for which beneficial interest has transferred to SPE	**182**	334

For additional disclosure on the nature of the deemed loan, see note 24.

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.

	2020 £m	2019 £m
Transactions during the year		
Services and loans provided by Sainsbury's Bank plc:		
Interest receivable on intercompany loan	**19**	27
Management services	**1**	–
Balances at end of year		
Other assets:		
Intercompany loan	**559**	486

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 storecard 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 3%.

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

	2020 £m	2019 £m
Short-term employee benefits	**4.2**	4.1
Post-employment benefits	**0.1**	0.1
Termination benefits	**0.4**	–
Share-based payments	**1.8**	2.3
	6.5	6.5

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 38).

39. 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 2018	8	7	24
Resignations during 2018/19	(2)	–	(3)
Appointments/New accounts during 2018/19	–	–	–
Amounts advanced during the year	–	76	–
Amounts repaid during the year	(1)	(76)	(21)
At 28 February 2019	**5**	**7**	**–**
Resignations during 2019/20	**(3)**	**(6)**	**–**
Appointments/New accounts during 2019/20	**1**	**–**	**1**
Amounts advanced during the year	**–**	**11**	**28**
Amounts repaid during the year	**–**	**(10)**	**(27)**
At 29 February 2020	**3**	**2**	**2**

	Number of key management personnel	Directors £000	Other £000
Savings and deposit accounts			
At 28 February 2018	4	216	1
Resignations during 2018/19	(2)	(209)	(1)
Appointments/New accounts during 2018/19	4	535	–
Amounts deposited during the year	–	–	–
Interest paid	–	–	–
Amounts withdrawn during the year	–	(60)	–
At 28 February 2019	**6**	**482**	**–**
Resignations during 2019/20	**(4)**	**(362)**	**–**
Appointments/New accounts during 2019/20	**3**	**–**	**111**
Amounts deposited during the year	**–**	**–**	**37**
Interest paid	**–**	**1**	**1**
Amounts withdrawn during the year	**–**	**(112)**	**–**
At 29 February 2020	**5**	**9**	**149**

Based on the Companies Act definition of Loans to Directors, total lending outstanding at 29 February 2020 was £nil (2019: £nil).

40. 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:

	2020 £m	2019 £m
Property, plant and equipment	**2**	-
Software development	**5**	3
	7	3

41. Contingent liabilities

The Bank is aware of remediation activity being conducted by Lloyds Banking Group (LBG) in relation to historic customer conduct matters. Where, as a result of services provided by LBG, the relevant matters have impacted customers of the Bank, the Bank has opted for those customers to be included in the remediation exercise.

The Bank is protected from certain costs arising from such remediation activity through clauses within its contractual agreements with LBG. However, it remains possible that a liability may be incurred in respect of costs not covered by the contractual provisions. The Bank is unable to form a view as to the potential quantum of any liability as it has not yet received sufficient detail around the activities in order to assess against the relevant contractual provisions.

However, the Bank does not currently expect any of the potential liabilities to have a material adverse effect on its financial performance or position.

42. Restatement of prior periods

As described in note 32, the Bank has adopted IFRS 16 in the current financial statements, recognising a right-of-use asset and lease liability. An operating lease accrual previously held under IAS 17 has been released. In accordance with the transitional provisions the requirements of IFRS 16 have been applied fully retrospectively and comparatives for prior periods have been restated.

The effect of these changes on the relevant financial statement line items previously presented is shown in the following table:

	As previously reported £m	IFRS 16 adjustments £m	Restated £m
At 1 March 2018			
Statement of financial position			
Loans and advances to customers	4,972	–	**4,972**
Property, plant and equipment	44	5	**49**
Deferred tax liability	9	(1)	**8**
Accruals and deferred income	81	(3)	**78**
Other liabilities	117	7	**124**
Retained earnings	186	1	**187**
At 28 February 2019			
Statement of financial position			
Loans and advances to customers	6,192	–	**6,192**
Property, plant and equipment	44	4	**48**
Deferred tax asset	2	1	**3**
Accruals and deferred income	68	(2)	**66**
Other liabilities	89	4	**93**
Retained earnings	86	1	**87**
Income statement for year ended 28 February 2019			
Interest and similar charges	298	–	**298**
Interest expense and similar charges	(98)	–	**(98)**
Fees and commissions income	101	–	**101**
Net loss on financial instruments at FVTPL	(2)	–	**(2)**
Administrative expenses	(282)	1	**(281)**
Depreciation and amortisation	(22)	(1)	**(23)**
Impairment loss on financial assets	(61)	–	**(61)**
Income tax charge	(1)	–	**(1)**
Statement of cash flows for year ended 28 February 2019			
Non-cash items included in operating profit before taxation and other adjustments	97	1	**98**
Changes in operating assets and liabilities	(112)	–	**(112)**
Principal repayments on lease liabilities	–	(1)	**(1)**
Interest paid on lease liabilities	–	–	**–**

43. Events occurring after the balance sheet date

COVID-19

Subsequent to the balance sheet date, there has been a sharp deterioration in the economic outlook in the UK as a consequence of the COVID-19 pandemic and measures taken by the government to control the spread of the virus. A significant reduction in UK economic output is now expected over an uncertain period with large rises in unemployment as a result of business closures and knock on supply chain impacts. As a result of this the Bank is expected to be impacted in the year ahead by a reduction in income from Credit Cards, Loans, Travel Money and ATMs, together with increased ECLs.

Expected credit loss calculations

Refer to note 2 for details of the expected credit loss calculations. As at the balance sheet date, a multi-scenario economic model is used which includes an assessment of downside risk reflective of future economic uncertainty that existed at that time.

Due to the significant reduction in UK economic output and large rises in unemployment the Bank expects increased expected credit losses. These losses will be mitigated, to some degree, by UK government actions such as subsidies to businesses for furloughed employees and the self-employed. In order to estimate the increased credit losses resulting from this deterioration in outlook, the Bank has developed three unemployment scenarios which have been risk-weighted to determine an overlay applied to the existing IFRS 9 models. In line with guidance from the Bank of England, these scenarios assume that there will be significant economic disruption while social distancing measures are in place, followed by an expected sharp recovery when these are lifted. The three scenarios assume peak unemployment over the next 12 months of 6%, 8% and 10% respectively, with the weighted average resulting in an ECL uplift of approximately £25m.

Travel Money

Due to the impact of the travel restrictions the Bank has temporarily suspended its in-store and online Travel Money services, with the Travel Money bureau closing on 21 March 2020.

ATMs

Due to the social distancing measures implemented by the UK government in response to COVID-19, we have seen a reduction in the volume of customer transactions at our ATMs. We expect reduced volumes to continue whilst these measures remain in place.

Change in corporation tax rate

The main rate of UK corporation tax reduced from 20% to 19% from 1 April 2017. A further reduction in the corporation tax rate to 17%, effective from 1 April 2020, was substantively enacted in a prior period, so its effect is reflected in these financial statements. Deferred tax on temporary differences and tax losses as at the balance sheet date are calculated at the substantively enacted rates at which the temporary differences and tax losses are expected to reverse.
A change to the corporation tax rate, so that it remains at 19% rather than reducing to 17% from 1 April 2020, was announced in the 2020 Budget. However, this rate change was not substantively enacted at the balance sheet date, so its effect is not reflected in these financial statements.

The effect of a 2% increase in the corporation tax rate on the deferred tax balances at the balance sheet date would increase the deferred tax asset by £194,000, which is primarily recognised in the income statement.

Alternative performance measures

In the reporting of financial information, the Directors use various Alternative Performance Measures (APMs) which they believe provide additional useful information for understanding the financial performance and financial health of the Bank. These APMs should be considered in addition to, and are not intended to substitute, IFRS measurements. As they are not defined by International Financial Reporting Standards, they may not be directly comparable with other companies who use similar measures. All of the following APMs relate to the current period's results and comparative periods where provided.

The Bank also discloses a number of capital and liquidity metrics relevant to its financial position which are required under prudential rules issued by the PRA and FCA. The bases of calculation of those metrics are defined within the relevant legislation and are disclosed in the Glossary.

APM	Definition/Purpose	Reconciliation
Underlying profit before tax	Profit of loss before tax before any items recognised which, by virtue of their size and/or nature, do not reflect the Bank's underlying performance	A reconciliation of underlying profit before tax is provided in note 8 of the financial statements
Net Interest Margin (NIM)	Net interest income as a percentage of average interest-earning assets	See reconciliation below
Bad Debt Asset Ratio (BDAR)	Impairment losses as a percentage of the average net balance of loans and advances to customers	See reconciliation below
Cost: Income Ratio	Underlying operating expenses as a percentage of total income	See reconciliation below
Return on tangible equity	Underlying profit after tax divided by average tangible equity (equity excluding intangible assets)	See reconciliation below

Net Interest Margin (NIM) – Reconciliation

	Ref	2020	2019
Interest Income	IS	304	298
Non-underlying items	Note 8	–	(16)
Interest expense (restated)[1]	IS	(115)	(98)
Underlying Net Interest Income		189	184
Monthly average interest earning assets[2]		7,695	6,832
Underlying NIM		2.5%	2.7%

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

2 Monthly average interest earning assets is not presented in the financial statements. The closing balance at Feb-20 is £7,659m (2019: £7,253); (made up of £6,511m (2019: £6,192m) Loans and advances to customers, £853m (2019: £767m) investment securities, and £295m (2019: £294m) of interest bearing deposits within cash held with central banks).

Bad Debt Asset Ratio (BDAR) – Reconciliation

	Ref	2020	2019
Impairment losses	IS	48	61
Monthly average customer lending[1]		6,508	5,599
BDAR		0.7%	1.1%

1 Monthly average customer lending is not presented in the financial statements. The closing balance at Feb-20 is £6,511m (2019: £6,192m).

Cost: Income Ratio – Reconciliation

	Ref	2020	2019
Operating expenses	IS	268	304
Non-underlying items	Note 8	(25)	(72)
Underlying expenses		243	232
Total Income (restated)[1]	IS	323	332
Non-underlying items	Note 8	–	(16)
Underlying Income		323	316
Cost: Income ratio		75%	73%

1 The prior period has been restated following the retrospective adoption of IFRS 16 in the current financial period. Details of the restatement are shown in note 42.

Return on tangible equity – Reconciliation

	Ref	2020	2019
Underlying profit before tax	IS	33	24
Notional tax charge		(6)	(4)
Underlying profit after tax		27	20
Monthly average equity		881	789
Less monthly average tangible assets		(228)	(214)
Monthly average tangible equity[1]		653	575
Return on tangible equity		4.0%	3.4%

1 Monthly average tangible equity is not presented in the financial statements. The closing balance at Feb-20 is £766m (2019: £728m), made up of £1,000m (2019: £952m) Total Equity less £234m (2019: £224m) Intangible assets.

Glossary

Bad debt asset ratio – Impairment losses as a percentage of the average net 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 and pays compensation if a firm is unable to pay claims against it. The FSCS is funded by management expenses levies and, where necessary, compensation levies on authorised firms.

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

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

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

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

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

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

Leverage ratio – 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, is aggregated into a pool, which is used to back the issuance of new securities.