

Alliance & Leicester plc

Half-yearly financial report for the six months ended 30 June 2008



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1 SUMMARY

On 14 July 2008 the recommended acquisition of Alliance & Leicester plc (Alliance & Leicester) by Banco Santander S.A. (Santander) was announced. Under the terms of the acquisition, Alliance & Leicester ordinary shareholders will receive one Santander share for every three Alliance & Leicester ordinary shares. It is anticipated that further information will be sent to shareholders in August 2008 and subject to, amongst other things, Alliance & Leicester shareholder approval being granted, the transaction is expected to complete in or around October 2008.

This proposed transaction has had no impact on Alliance & Leicester plc's reported results for the first six months of 2008.

1.1 FINANCIAL RESULTS

- Core operating profit of £22m (June 2007: £295m).
- Core operating profit excluding changes in the fair value and impairment of certain treasury investments, strategic funding and liquidity holding costs in the first six months of 2008 was £301m, higher than the £295m reported in the same period in 2007.
- Statutory profit before tax of £2m (June 2007: £290m).

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m
Core operating profit excluding the changes in the fair value and impairment of certain treasury investments, strategic funding and liquidity holding costs	301	295
Reduction in the fair value of certain treasury investments	(66)	–
Impairment of certain treasury investments	(143)	–
Strategic funding and liquidity holding costs	(70)	–
Core operating profit	22	295
Redundancy costs	(14)	(1)
Hedge ineffectiveness	(6)	(4)
Statutory profit before tax	2	290

- Retail Banking core operating profit up £4m to £211m (June 2007: £207m).
- Commercial Banking:
 - Commercial Bank core operating profit up £11m to £89m (June 2007: £78m);
 - Treasury core operating loss of £272m (June 2007: profit £24m).
- Interim cash dividend of 18.0p per share (June 2007: 18.8p).

1.2 PERFORMANCE HIGHLIGHTS

ASSET QUALITY OF OUR CUSTOMER LOANS AND ADVANCES REMAINS STRONG

- At the end of June 2008, 2,787 mortgage accounts were over 3 months in arrears (December 2007: 2,368), representing just 0.61% (December 2007: 0.49%) of the book and less than half the industry average of 1.34% (December 2007: 1.20%).
- Unsecured personal loan arrears at the end of June were only £1m higher than at the end of December 2007. The proportion of balances in arrears was 5.7% (December 2007: 5.5%) at the end of June, less than half the average for the Finance and Leasing Association.
- The proportion of commercial loan balances over 30 days in arrears was 0.31% (December 2007: 0.46%).
- Customer loans and advances impairment loss charge in the first half of 2008 was £62m (June 2007: £56m).

WE CONTINUE TO BE WELL CAPITALISED AND TO HAVE A STRONG FUNDING POSITION

- Core tier 1 capital ratio of 6.5%, total tier 1 ratio of 9.2% and a total capital ratio of 13.3% at 30 June 2008.
- Over 52% of wholesale funding had a residual maturity date of over 12 months, up from 47% in December 2007.
- We have completed funding transactions which pre-fund our medium term maturing wholesale funds, certificates of deposit and commercial paper into the third quarter of 2009.

WE HAVE FOCUSED OUR FRANCHISE GROWTH ON CURRENT ACCOUNTS AND RETAIL CUSTOMER DEPOSITS

- 154,000 new personal current accounts and 17,200 new business banking current accounts opened.
- Retail customer deposit balances up £0.8bn to £24.1bn at the end of June 2008.
- Mortgage balances reduced by £2.1bn to £40.6bn.
- Commercial lending balances increased by £0.6bn to £9.0bn.

WE CONTINUE TO IMPROVE OUR COST EFFICIENCY

- Core operating expenses reduced by £21m to £319m in the first half of 2008 compared to the same period in 2007.
- Retail Banking cost:income ratio in the first half of 2008 was 38.8% (December 2007: 41.1%).

COMMENT FROM DAVID BENNETT, GROUP CHIEF EXECUTIVE

"Alliance & Leicester's underlying business is in good shape, with strong customer lending asset quality and arrears rates running far better than market averages. We are well-capitalised and have a strong funding position. The performance of our customer-facing businesses remains robust, but our financial results have been significantly affected by treasury losses in the first four months of the year and by high funding costs."

"Alliance & Leicester's strategy and the prudent approach we have taken in response to recent financial market conditions, have enabled the Group to be resilient in the current very difficult trading environment. The Board is, however, acutely aware of the significant external risks presented by deteriorating economic conditions and continuing turbulence in financial markets. Against this background, the proposal from Santander provides greater stability and greater certainty in uncertain times."

2 GROUP CHIEF EXECUTIVE'S REVIEW

2.1 OVERVIEW

In the first half of 2008 Group core operating profit excluding the changes in the fair value and impairment of certain treasury investments, strategic funding and liquidity holding costs was £301m, compared to £295m in the same period in 2007. The changes in the fair value and impairment of certain treasury investments, the cost of the strategic funding transactions completed in the second half of 2007 and to date in 2008, and liquidity holding costs resulted in core operating profit for the Group for the first half of 2008 of £22m (June 2007: £295m).

Our Retail Banking and Commercial Bank customer facing businesses are delivering against the plans we set out in our results announcement in February 2008. Retail Banking core operating profit in the first half of 2008 was £211m, £4m higher than in the first half of 2007, and Commercial Bank core operating profit of £89m was £11m higher than in the same period in 2007. The growth in Retail Banking profit includes higher revenues from mortgages and lower operating costs. The increase in Commercial Bank profit reflects the growth in our commercial lending and business banking franchises.

2.2 BUSINESS PERFORMANCE

Alliance & Leicester continues to be a diversified business and is not dependent on the performance of any single market. In the first half of 2008, 28% of Group revenues were attributable to the mortgage and savings business. We continue to see a high proportion of our new business and customer service transacted via direct channels, with 41% of our core Retail Banking products and 26% of new business banking current accounts sold online in the first half of 2008. Around one million of our personal current account and savings account holders use our internet banking service to manage their accounts, with a 38% increase in the number of transactions completed online by our personal and commercial customers over the past 12 months.

Our customer loans and advances asset quality remains strong. Mortgage asset quality remains excellent, with 2,787 accounts over three months in arrears out of a total of 455,000. This represents 0.61% of mortgage accounts, less than half the industry average reported by the Council of Mortgage Lenders. During the first half of 2008 we repossessed just 120 properties and at the end of June had a stock of 107 repossessed properties. Our unsecured loan asset quality remains strong, with the amount of arrears just £1m higher than at the end of December 2007. Our commercial lending balances continue to perform well, with just 0.31% of balances over 30 days in arrears, compared to 0.46% at the end of 2007.

We have focused our franchise growth on current accounts and retail deposits, opening 154,000 new personal and 17,200 new business banking current accounts in the first half of 2008. We continue to offer customers better value products, with our personal current accounts and savings accounts receiving more best buy mentions than any of our high street competitors in the first half of 2008, and for the sixth consecutive year our personal and business current accounts won the Moneyfacts awards for 'Best Current Account Provider (Credit Interest)' and 'Best Business Current Account Provider' respectively. Our personal current account also won the 'Best Current Account Provider (Debit interest)' for the third consecutive year. Retail customer deposits increased by £0.8bn to £24.1bn in the first half of 2008. This increase has been through growth in 'e-Saver' and ISA accounts, where the number and frequency of withdrawals is lower than average. Commercial customer deposits fell from £7.5bn at the end of 2007 to £6.2bn.

As planned, we reduced our customer loans and advances by £1.6bn in the first half of the year, with mortgage balances reducing by £2.1bn to £40.6bn, and unsecured personal loans reducing by £0.1bn to £3.6bn. These reductions were partially offset by a £0.6bn increase in commercial lending balances.

We remain focused on improving our cost efficiency, reducing core operating costs by £21m in the first half of 2008 compared to the same period in 2007. On 4 July we announced the creation of a new Manufacturing business unit, which brings together the customer servicing functions for both Retail and Commercial Banking customers. This new business unit provides significant opportunities to achieve further efficiencies in these areas through use of best practice, common processes and the implementation of the ALNOVA banking system.

2.3 FUNDING

Funding markets in the first half of 2008 remained volatile, with the securitisation and covered bond markets effectively remaining closed. We continue to fund our customer loans and advances with customer deposits and wholesale funding with a residual maturity of over six months. In the first half of 2008 we continued to implement the strategic funding programme we started in October 2007, and have now pre-funded our medium term wholesale funding, commercial paper and certificates of deposit into the third quarter of 2009.

As part of our prudent approach in response to the continued turbulence in financial markets, we completed a number of further strategic funding transactions in the first half of the year. Strategic funding costs, together with the costs of holding liquidity, were £70m in the first half, in line with our expectations.

2.4 TREASURY INVESTMENTS

Conditions in the financial markets in the first half of 2008 led to further reductions in the fair value and impairment of our treasury investments. We hold most of our treasury investments at fair value on the balance sheet. Market conditions resulted in the fair value of

these assets reducing by £330m in the first half of 2008. There was a £66m charge to non-interest income in the Income Statement and a £189m post-tax (£264m pre-tax) charge to reserves.

Treasury's impairment loss charge in the first half of 2008 was £143m. Structured investment vehicle (SIV) impairments were £118m, with £18m of collateralised debt obligations (CDO) impairment charges and £7m of provisions against the loans which are fully funding our off balance sheet conduit.

Over 92% of our treasury investments are bank floating rate notes or AAA rated asset backed securities, on which no impairment charges have been incurred. We saw the greatest impairment within our investments in SIV capital notes, which have now been written down from an original value of £390m to £95m. The treasury investment portfolio is reducing as assets mature and redeem, and at the end of June 2008 total treasury assets were £22.6bn, £0.5bn lower than in December 2007. Treasury's trading and investment securities at the end of June 2008 were £13.6bn, £1.9bn lower than in December 2007.

2.5 CAPITAL

The Group's total capital resources were £3.0bn at the end of June, higher than our Individual Capital Guidance set by the Financial Services Authority. We are continuing to proactively manage our capital base, managing both risk weighted assets and the absolute level of capital resources. During the first half of 2008 we strengthened our capital base with the issue of £350m of lower tier 2 capital and the purchase of credit protection on a proportion of our unsecured personal loan balances.

At the end of June 2008 our core tier 1 ratio was 6.5% (December 2007: 6.9%) and our total capital ratio was 13.3% (December 2007: 11.9%).

2.6 MARKET AND ECONOMIC OUTLOOK

The outlook for the UK economy has worsened as 2008 has progressed, and the degree of uncertainty about the economic outlook has increased. Whilst our current base case economic assumptions are broadly in line with the consensus of market commentators, at this early stage in the economic cycle we see significantly more risks to the downside of our base case forecast than to the upside.

In our base case scenario, UK GDP growth in 2008 and 2009 is expected to remain positive, but significantly below long term averages. Inflation is expected to peak later this year, although this will depend on wage inflation remaining broadly stable, and unemployment is expected to increase, but to remain lower than experienced in previous periods of economic slowdown.

UK gross mortgage lending continues to remain more robust than net lending, which has fallen by over 44% in the first half of the year. The sharper fall in net lending reflects the significant decline in house purchase activity, particularly for first time buyers. The housing market remains exceptionally subdued, with new buyer enquiries and new instructions to sell continuing to fall. House Indices have shown that house prices have fallen by 8% in the first six months of 2008 and are expected to fall further in the second half of the year.

2.7 NON-EXECUTIVE DIRECTORS

It was with deep regret that we announced the unexpected death of our Chairman, Sir Derek Higgs, in April. He was a highly regarded businessman who had contributed a huge amount to UK corporate life, and who was also an excellent Chairman of our Bank. He will be sadly missed at Alliance & Leicester and elsewhere. Following his untimely death, Roy Brown, our Deputy Chairman became acting Chairman.

We further strengthened the Board in May 2008 when Angus Porter joined as a non-executive director.

2.8 OUR PEOPLE AND ORGANISATION STRUCTURE

On 4 July we announced a revised organisation structure designed to position the Group for the current and future operating environment.

The new structure creates a Manufacturing division which is responsible for the customer servicing and back office operations which support the Retail and Commercial banking activities of the Group, including the Group's IT operations. Ian Buchanan, previously our Group IT Director, has joined the Board as Group Manufacturing Director.

The revised structure also emphasises the importance we attach to the management of all the Group's risks, including the maintenance of our above average asset quality, with Richard Banks becoming Group Risk Director with overall responsibility for all of the Group's risk management processes. Bryce Glover, previously Director of Corporate Banking, has taken over as Managing Director, Commercial Bank, with Group Treasury now reporting to Chris Rhodes, Group Finance Director.

I would like to thank the staff of Alliance & Leicester for their continued dedication, team work and contribution during a period of unprecedented volatility in the market place.

2.9 RECOMMENDED ACQUISITION OF ALLIANCE & LEICESTER BY SANTANDER

In July, Santander approached the Board of Alliance & Leicester with a proposed offer to purchase the entire share capital of the Company. On 14 July, after careful consideration and discussions with our advisors, the Board took the decision to recommend the acquisition by Santander to our shareholders.

It is intended that the acquisition will be implemented by means of a Scheme of Arrangement under sections 895 to 899 of the Companies Act. It is expected the Scheme Document will be posted in August 2008 and, subject to shareholder approval at an Extraordinary General Meeting in September, the Scheme will become effective and the acquisition completed in or around October 2008.

2.10 THE FUTURE

Alliance & Leicester's strategy and the prudent approach we have taken in response to the difficult financial market conditions since late last summer, have enabled the Group to be resilient in the current very difficult trading environment. The Board is, however, acutely aware of the significant external risks and uncertainties presented by deteriorating economic conditions and the continuing turbulence in financial markets. There is a risk that the current economic and market turbulence could continue for a significant period of time, and a risk of further uncertainty and contagion impacting the valuation of Alliance & Leicester.

Against this background, the proposal from Santander provides both greater stability and greater certainty in uncertain times. In addition, there are clear benefits in being part of a global financial group in the current environment, and there is an excellent strategic fit between our business and Santander's existing UK operations.

David Bennett
Group Chief Executive

3 BUSINESS REVIEW

3.1 RETAIL BANKING REVIEW

Retail Banking core operating profit was £211m in the first half of 2008, £4m higher than in the same period in 2007. Retail Banking revenues were £3m lower than in the first half of 2007. Higher income from mortgages and current accounts was more than offset by lower savings, personal loan and Partner 4 revenues. Operating costs were £11m lower and impairment losses were £4m higher than in the same period in 2007.

Core 4

- **Current accounts**

We opened 154,000 new current accounts during the first half of 2008 and increased our active account base to 1.75m accounts. Our market share of new current account openings increased to 5.1%. Over 39% of our new current accounts were opened via either the internet or the telephone.

We continue to grow our 'Premier 21' and 'Premier 50' current account bases, with a combination of new-to-Group and existing customer upgrades. We now have over 60,000 'Premier 21' and 'Premier 50' accounts.

During the first half of 2008 there has been increased competition in the UK current account market, and to ensure we maintain our market leading position, we increased the credit interest rate on new 'Premier Direct' current accounts. The current account continues to be the key product to acquire new customers, and from which to strengthen existing customer relationships. During the first half of 2008 we increased the number of offers and incentives to existing and new 'Premier' account customers, as we strengthen customer relationships and maximise the potential cross-sales from our current account base.

On 27 July 2007 it was announced that the Office of Fair Trading ("OFT") had agreed with eight financial institutions to start proceedings in the High Court of England and Wales in a test case to determine the legal status and enforceability of certain charges relating to unauthorised overdrafts. Alliance & Leicester is not part of the proceedings but will be bound by the outcome. On 24 April 2008, a High Court judgment was announced in respect of the first stage of the process. The Court's judgment was that the institutions' current terms and conditions relating to unauthorised overdraft charges are not unenforceable penalties but are assessable for fairness under the Unfair Terms in Consumer Contracts Regulations 1999. The financial institutions are appealing the fairness ruling, and this is expected to be heard in the second half of 2008. A further Court hearing took place in July 2008 to assess whether historic charges could be challenged by customers. No judgment has been made on this to date.

Current accounts non-interest income in the first half of 2008 was higher than in same period in 2007. In the first half of 2007 there was a higher level of overdraft fee complaints paid out and a provision created relating to the payment of further overdraft fee complaints. As a result of the above test case and the Financial Services Authority waiver for personal current account claims, the provision we created in the first half of 2007 was subsequently released in the second half of 2007.

In the second half of 2007 we introduced a revised simplified overdraft charging structure which, whilst improving the customer proposition, has reduced the level of income relating to overdrawn accounts.

- **Mortgages**

The UK mortgage market experienced a significant slow down in the first half of 2008, driven by falling house prices and higher mortgage interest rates, as well as a general tightening of lenders' credit criteria. Gross lending in the first half of 2008 is estimated to be around £150bn, 16% lower than in the first half of 2007, and net lending has reduced to an estimated £30bn, 44% lower than in the first half of 2007. Our current market forecast is for gross lending in 2008 to be around £285bn, with net lending around £55bn. House price indices have shown UK house prices have fallen by over 8% in the first six months of 2008, with further falls expected in the second half of the year.

In our 2007 annual results announcement we stated that we planned to reduce our mortgage balances in 2008, as we aimed to maximise revenues and maintain the asset quality of our mortgage business. We have delivered against this goal, with revenues from mortgages significantly higher in the first half of 2008 compared to the same period in 2007, and the number of accounts in arrears just 419 higher than at December 2007. During the first half of 2008 we tightened our credit criteria across our mortgage portfolio, reducing our maximum prime mortgage from 95% loan to value (LTV) to 90% LTV, as well as tightening the criteria on our small portfolio of buy to let mortgage products.

	Prime residential £m	PlusMortgage (Note 1) £m	Buy to let £m	Other specialist lending (Note 2) £m	Total £m
A&L mortgage balances outstanding as at 1 January 2008	41,570	625	581	n/a	42,776
Gross advances	2,023	131	260	2	2,416
Redemptions, transfers and other movements	(4,552)	(2)	(10)	(2)	(4,566)
Net mortgage lending	(2,529)	129	250	n/a	(2,150)
A&L mortgage balances outstanding as at 30 June 2008	39,041	754	831	n/a	40,626

(Note 1) Secured element.

(Note 2) Loans distributed under our agreement with Lehman Brothers, not held on Alliance & Leicester's balance sheet.

Our total gross lending of £2.4bn in the first half of 2008 represents a market share of 1.6%, lower than the 3.6% achieved in 2007. Our mortgage balances reduced by £2.1bn to £40.6bn at 30 June 2008.

In February 2008 we withdrew our 'PlusMortgage' product from the market to ensure that we maintained our high credit standards and the relatively low LTV profile of our mortgage book. In the first six months of 2008 gross advances were £131m, with a further £14m of unsecured loans, reflecting all of the pipeline of applications received up to 19 February 2008. The average LTV of our 'PlusMortgage' accounts, including the unsecured element, was 106% at 30 June 2008.

Buy to let gross advances in first half of 2008 were £260m, with balances increasing to £831m. To maintain the high quality of our buy to let mortgage book, we tightened the credit criteria during the second quarter of 2008, limiting new mortgages to those with an LTV of less than 75% (previously 85%).

As a result of the slowdown in the specialist, self-certified, near-prime and sub-prime sectors of the mortgage market, we suspended our agreement with Lehman Brothers on 2 April 2008, and are not currently active in these segments. In the first half of 2008 we completed £2m of loans under the agreement with Lehman Brothers, and have no applications outstanding.

We have no sub-prime, near-prime or self-certified mortgages on our balance sheet, including our own securitisation vehicles.

Redemptions in the first half of 2008 were £4.6bn, representing an estimated market share of 3.8%, slightly higher than our 3.4% share of balances. We also retained £1.6bn of existing mortgage balances, which switched to new mortgage products in the first half of 2008. Our current mortgage portfolio continues to be available to both new and existing customers. Over the past few years customers typically sought to refinance their mortgage at the end of their concessionary period. During the first half of 2008 we saw a reduction in this activity, resulting in an increase in the average life of certain mortgage products.

• Personal loans

	Traditional personal loans £m	PlusMortgage unsecured loans £m	Total £m
Unsecured personal loan balances outstanding as at 1 January 2008	3,693	55	3,748
Gross advances	918	14	932
Redemptions and other movements	(1,040)	(1)	(1,041)
Net lending	(122)	13	(109)
Unsecured personal loan balances outstanding as at 30 June 2008	3,571	68	3,639

In the first half of 2008 our traditional personal loan gross advances of £918m were 34% lower than in the same period in 2007. The lower lending reflects a smaller market, as well as our goal of maintaining strong asset quality. Total unsecured loan balances at 30 June 2008 were £3.6bn, £0.1bn lower than at the end of 2007. Our traditional lending in 2008 represents a market share of 5.7%, which continues to be higher than our 5.1% share of balances.

During the first half of 2008 new business margins in the unsecured loan market continued to increase, although total revenues from unsecured personal loans fell as a result of a 35% reduction in sales of payment protection policies. The lower sales volume reflects reduced new business lending volumes and the impact of the media coverage of the Office of Fair Trading's review of the market for payment protection insurance. Our asset quality remains strong, with the impairment loss charge in the first half of 2008 lower than in the same period in 2007. We continue to generate 61% of our personal loans via the internet and a further 29% via the telephone, enabling us to operate from a relatively low cost model.

Our 'PlusMortgage' gross unsecured advances were £14m in the first half of 2008, with balances of £68m at 30 June 2008. The pipeline of 'PlusMortgage' applications has now been completed and we do not expect to complete any further 'PlusMortgage' loans in 2008.

- **Savings**

Personal customer deposit balances represent funds held in personal current accounts, branch, internet and telephone savings accounts, as well as offshore balances held in accounts with Alliance & Leicester International (ALIL).

Total personal customer deposit balances increased by £0.8bn to £24.1bn in the first half of 2008, with continued growth in our active current account base combined with higher balances in our ISA and 'e-Saver' products, partially offset by a reduction in ALIL's offshore balances. ALIL balances reduced primarily due to increased competition within the offshore sector, and changes to the Group's credit ratings in March and April.

We continue to focus on attracting savings balances that reduce the potential volatility in our retail funding base and minimise the cost of acquiring new balances. The growth in balances in the first half of 2008 has been primarily via our 'e-Saver' and ISA accounts, where the frequency of withdrawals are lower than average. During the first six months of 2008 we received more best buy mentions for our savings products than any of our high street competitors, primarily as a result of our competitive ISA, 'Premier Regular Saver' and 'e-Saver' products.

Partner 4

New credit card sales in the first half of 2008 were 40,000, compared to 49,000 in the first half of 2007. The majority of these cards were sold to 'Premier' current account customers.

The majority of our life assurance and general insurance product sales are mortgage related. Sales in the first half of 2008 were therefore lower than in the first half of 2007, reflecting the reduction in new mortgage lending.

The number of long term investment product sales was similar to the level achieved in the first half of 2007, although the value of new investments reduced by around 16%. Long term investment commission income has, however, fallen significantly in the first half of 2008 as a result of a changing mix in the type of investment products sold. Sales of lower margin equity ISA products increased, but this has been more than offset by a fall in the number and value of bond sales.

Distribution and customer service

Some 41% of our Core 4 product sales were sourced via the internet in the first half of 2008, the same proportion as in the first half of 2007. Around one million current and savings account holders regularly use our internet banking service to manage their accounts, with the number of transactions undertaken online 33% higher than 12 months ago.

Following the roll out of deposit-taking ATMs into all of our branches in 2007, we are continuing to migrate deposits and withdrawals from the counter to the machines, enabling our branch staff to focus on sales. An external benchmarking report in the first half of 2008 showed that we have one of the highest number of product sales per branch. Over 70% of current account customer telephone calls continue to be handled by our automated voice response system.

Asset quality

Our mortgage asset quality remains excellent. The average LTV of our new prime residential lending was 64% (2007: 67%), with just 3% of new lending having an LTV of over 90%. The indexed LTV of our prime mortgage book at the end of June 2008 was 47%, with 56% of the book continuing to have an indexed LTV of less than or equal to 50%, and just 4% over 90%.

The number of mortgage accounts over three months in arrears at the end of June 2008 was 2,787. This includes 11 buy to let and 12 'PlusMortgage' accounts. The proportion of mortgage accounts in arrears has increased from 0.49% at the end of December 2007 to 0.61%, reflecting a 24,000 reduction in the number of mortgage accounts and an increase of 419 accounts in arrears. This is still significantly lower than the Council of Mortgage Lenders industry average of 1.34% (as at 31 March 2008). Total arrears were just £10.9m, with the book value of mortgage balances in arrears £220m, and the average indexed LTV of the cases in arrears 55%.

We continue to take a prudent approach to the capitalisation of arrears, with just £166,000 of arrears capitalised in the first half of 2008. Our standard policy is only to consider capitalising arrears where the arrears are for less than three months, less than £1,000, and the customer has maintained the full monthly payment for at least the last six months.

The mortgage impairment loss charge was £7m in the first half of 2008, £3m of which relates to a number of individual mortgage cases where we believe there was fraudulent or negligent activity by third parties. These cases relate to mortgage applications received before 2007. During 2006 we amended our policies and processes to ensure similar applications have been declined.

During the first half of 2008 we repossessed 120 properties, compared to 89 in the first half of 2007. The average loss on the sale of a repossessed property, excluding those where we believe there was fraudulent or negligent activity by third parties, was £16,000 in the first half of 2008. At the end of June 2008 our stock of properties in possession was 107 (December 2007: 80), which represents only 0.02% of our total mortgage accounts, compared to the industry average of 0.13% (Council of Mortgage Lenders).

The asset quality of our unsecured personal lending remains strong. The value of our traditional unsecured personal loans in arrears increased by just £1m since the end of 2007. This increase, together with the £100m reduction in unsecured lending balances has, however, resulted in the proportion of unsecured personal loan balances over 30 days in arrears increasing to 5.7% at the end of June 2008, compared to 5.5% at the end of December 2007. The proportion of loans in arrears was over 50% better than the average for the Finance and Leasing Association members. In addition, only 49 PlusMortgage unsecured loan accounts were over 30 days in arrears, representing total balances of £0.7m.

We do not capitalise any unsecured loan arrears.

3.2 COMMERCIAL BANKING REVIEW

Commercial Banking is the combination of the Group's Commercial Bank and Treasury operations.

3.2.1 COMMERCIAL BANK

Commercial Bank delivered core operating profit of £89m, £11m higher than in the first half of 2007. This was a result of continued growth in our commercial lending balances and business banking franchise, as well as a one off benefit from the sale of a proportion of our shareholding in Mastercard Inc.

• Lending

	Net lending six months ended 30.06.08 £m	Balances as at 30.06.08 £m
Corporate lending	438	8,220
Business banking	159	790
Total	597	9,010

Commercial lending balances at the end of June 2008 were £9.0bn, £0.6bn higher than at the end of December 2007. We continue to grow our lending balances in our areas of expertise, albeit at a slower rate than in 2007. The growth in balances reflects both new lending and a lower level of redemptions, as the amount of refinancing undertaken by corporate customers has decreased rapidly in the first half of the year, in light of the more difficult general credit conditions for corporate and SME customers.

Our lending book is well diversified across a range of business sectors and customers, with asset quality continuing to be good. We continue to monitor closely all of our lending given the more uncertain economic outlook, but remain fully active in all sectors of the market place where we have proven experience. At this stage we are not seeing unusual trends in arrears levels in any sectors. A full breakdown of our lending balances by sector can be found in section 7.1.2.1.

Our lending book is well diversified in terms of the size of individual lending facilities. We have 18 loans with an outstanding balance of over £50m, with the largest being a £421m finance facility which is secured by the underlying asset as well as a cash deposit. These 18 loans total £2.2bn and are supported by £1.3bn of bank guarantees or cash deposits. A further 208 loans totalling £4.5bn, have outstanding balances of over £10m. The remaining £2.3bn of lending facilities has balances of less than £10m.

Our lending teams are very experienced, with a good knowledge of their specialist sectors. For example, Alliance & Leicester has been providing shipping and aviation finance since 1999, and our asset finance teams have typically worked in their chosen industry sectors for a number of years and know the marketplace from both a lender and borrower perspective. In our chosen markets we maintain a diverse lending book, with a strong focus on ensuring a good balance in the asset types we finance in each sector. Our shipping and aviation exposure is diverse and balanced, both in terms of the asset type and the geography of operation.

Our lending to the construction sector is primarily through the participation in large syndicated facilities, or through the provision of project finance for infrastructure and Private Finance Initiative transactions.

Our commercial property lending is well diversified in terms of the size of loan, geographic location and type of property. Our property lending is primarily focused on commercial investment property, with exposures to residential property representing around 6% of the property portfolio. Lending to the property sector at the end of June 2008 was £1.3bn, with an additional £202m of loans managed by Mitre Capital Partners. The largest loan within the property lending portfolio remains less than £45m, with 37 loans greater than £10m. For all of our larger property transactions the impact of higher interest rates has been hedged out by either ourselves or the borrower. Our exposure to property development finance and any overseas lending is primarily managed through Mitre Capital Partners. Alliance & Leicester has a 51% controlling interest in Mitre Capital Partners Limited.

- **Business banking**

In the first half of 2008 we opened 17,200 new business banking current accounts, 3% higher than in the same period in 2007. We now have a total business banking active account base of over 200,000 accounts, including 100,300 business banking current accounts, 46,500 community organisation current accounts and 54,000 deposit accounts.

Business banking customers with a turnover of less than £1m are managed through the Group's telephone and internet banking channels, whilst customers with a turnover of between £1m and £25m are supported by the Group's network of business centres across the UK. During the first half of 2008 we have continued to invest in our business centres, focusing on ensuring each of our business centres have the appropriate staff and skills, and have recently opened our twentieth business centre, in Nottingham. Our business banking customers can also use the Post Office and our retail banking branches to transact on their accounts.

Lending to business banking customers increased by £159m in the first half of 2008, and balances at 30 June 2008 were £790m. Lending is well diversified across all industrial sectors.

Business banking customer balances increased by £300m to £2.9bn in the first six months of 2008. We have seen a significant increase in competition for business banking customer deposits in the first half of the year, with the advertised rates often similar to retail customer offers. We strengthened our business banking deposit account portfolio with the launch of our 'Base Rate Beater' account in April. There is typically a time lag between the opening of a new deposit account and the initial deposit of funds, as customers usually have to give notice to withdraw funds from their existing bank, and we therefore anticipate growing balances in the second half of the year.

Total commercial customer balances at the end of June 2008, including business banking, were £6.2bn, £1.3bn lower than at the end of December 2007. The reduction is due primarily to lower corporate customer deposit balances held within Treasury. The reduction primarily reflects the credit policies of customers whose policies require them to deposit funds at AA rated institutions.

- **Money transmission**

Our money transmission business comprises a number of products, including cash sales, cash handling, bill payments, pre-paid debit cards, ATMs, international payments, benefit payments and cheque processing.

Cash sales to other financial institutions were £32.5bn in the first half of 2008, similar to the same period in 2007. Cash handling deposits were £31.3bn, the same as in the first half of 2007. We continue to look at opportunities to improve the contribution of the cash handling business, building on the new Post Office contract agreed in 2007.

Asset quality

Asset quality remains good in the Commercial Bank, with 0.31% of commercial lending balances over 30 days in arrears at the end of June 2008 (December 2007: 0.46%). The proportion of commercial loan balances (capital and arrears) that were past due or impaired at 30 June 2008 was 1.7% (December 2007: 2.2%).

3.2.2 TREASURY

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Six months ended 31.12.07 £m
Treasury underlying operating profit	7	24	21
Strategic funding costs and liquidity costs	(70)	–	(23)
Changes in the fair value of certain treasury investments	(66)	–	(32)
Impairment of certain treasury investments	(143)	–	(153)
Core operating (loss)/profit	(272)	24	(187)

Treasury made a core operating loss of £272m in the first six months of 2008, including the impact of a £143m impairment loss charge, a £66m reduction in the fair value of treasury investments and £70m of strategic funding and liquidity holding costs. The strategic funding costs were £51m, with a further £19m of liquidity holding costs. The strategic funding costs of £51m reflect the additional costs of funding in the current market compared to those in which we were operating in the first half of 2007. The liquidity holding costs of £19m reflect both the higher level of liquidity balances, and a higher cost of holding liquidity in the current market compared to that in which we were operating in the first half of 2007.

Treasury is focused on the management of the Group's liquidity and funding requirements.

Treasury investments

Trading and investment securities:

	Value as at 30.06.08 £m	Reduction in fair value during 2008 recognised in the Income Statement £m	Reduction in fair value during 2008 recognised through reserves (post-tax) £m	Impairment losses in 2008 recognised in the Income Statement £m
Floating rate notes (FRN)	9,003	–	(79)	–
Asset backed securities (ABS)	3,507	(6)	(87)	–
Collateralised debt obligations (CDO)	92	(3)	(3)	(18)
Collateralised loan obligations (CLO)	240	–	(18)	–
Structured investment vehicles (SIV)	95	(55)	–	(118)
Principal protected notes (PPN)	31	(2)	(2)	–
Other	654	–	–	–
Total	13,622	(66)	(189)	(136)

Treasury's trading and investment securities portfolio was established to enable Treasury to maximise returns whilst managing the Group's funding and liquidity requirements. As assets mature and redeem, we are reducing the size of the treasury portfolio, and during the first six months of 2008 the portfolio reduced from £15.5bn to £13.6bn.

Our trading and investment securities, excluding those designated as 'held-to-maturity' and 'loans and receivables', are held at fair value on our balance sheet, using prices obtained from dealers. As a result of the volatility in the market, the fair value of our treasury investments reduced by £330m in the six months ended 30 June 2008. There was a £66m charge to non-interest income in the Income Statement and a £189m (£264m pre-tax) charge to reserves.

The impairment loss charge of £143m represents £136m of provisions and write-offs of SIV capital notes and CDO investments, and £7m relating to the secured loans to our off balance sheet conduit.

- FRN

Country	Nominal £m	% of FRN portfolio by geography	Total fair value reduction 2007 and 2008		Total balance sheet provisions & write-offs 2007 and 2008 £m	Balance sheet value as at 30.06.08 (including accrued interest) £m	Current holding value as a % of nominal value
			Via income statement £m	Via reserves (pre-tax) £m			
UK	954	10	(2)	(24)	–	932	98
Italy	1,001	11	–	(11)	–	997	100
Spain	2,004	22	–	(47)	–	1,968	98
Rest of Europe	3,074	34	–	(71)	–	3,020	98
US	932	10	–	(49)	–	881	94
Rest of World	1,209	13	–	(12)	–	1,205	100
Total	9,174	100	(2)	(214)	–	9,003	98

Credit rating	Nominal £m	% of FRN portfolio by credit rating	Total fair value reduction 2007 and 2008		Total balance sheet provisions & write-offs 2007 and 2008 £m	Balance sheet value as at 30.06.08 (including accrued interest) £m	Current holding value as a % of nominal value
			Via income statement £m	Via reserves (pre-tax) £m			
AA and above	2,823	31	(2)	(39)	–	2,794	99
A	5,557	61	–	(139)	–	5,443	98
BBB and below	794	8	–	(36)	–	766	96
Total	9,174	100	(2)	(214)	–	9,003	98

Our FRNs are issued by banks and other financial institutions, of which 92% are rated A or above. On average the FRNs have 2.4 years to maturity. The portfolio is well diversified and to date we have not incurred any impairment loss charges on this portfolio.

- ABS

Country/Asset type	Nominal £m	% of ABS portfolio by geography	Total fair value reduction 2007 and 2008		Total balance sheet provisions & write-offs 2007 and 2008 £m	Balance sheet value as at 30.06.08 (including accrued interest) £m	Current holding value as a % of nominal value
			Via income statement £m	Via reserves (pre-tax) £m			
UK							
ABS	28	1	–	(1)	–	27	96
MBS	1,187	32	(8)	(24)	–	1,158	98
MBS non conforming	221	6	(10)	(6)	–	206	93
MBS monoline wrapped non conforming	70	2	(4)	–	–	66	94
US							
ABS	83	2	–	(7)	–	76	92
ABS (Federal guaranteed student loans)	595	16	–	(56)	–	540	91
ABS monoline wrapped	16	1	–	(2)	–	13	81
MBS (sub-prime)	5	–	–	(3)	–	3	60
MBS monoline wrapped (sub-prime)	38	1	–	(7)	–	25	66
MBS ALT-A	205	5	–	(45)	–	156	76
MBS ALT-A monoline wrapped	9	–	–	(3)	–	6	67
Rest of Europe							
ABS	91	2	–	(6)	–	86	95
MBS	855	23	(1)	(32)	–	826	97
ABS monoline wrapped	8	–	–	(1)	–	7	88
Rest of World							
ABS	28	1	–	(1)	–	26	93
MBS	279	7	(2)	(4)	–	275	99
MBS monoline wrapped	11	1	–	–	–	11	100
Total	3,729	100	(25)	(198)	–	3,507	94

Credit Rating /Asset type	Nominal £m	% of ABS portfolio by credit rating	Total fair value reduction 2007 and 2008		Total balance sheet provisions & write-offs 2007 and 2008 £m	Balance sheet value as at 30.06.08 (including accrued interest) £m	Current holding value as a % of nominal value
			Via income statement £m	Via reserves (pre-tax) £m			
AAA							
ABS	825	22	–	(71)	–	756	91
MBS	2,200	59	(11)	(51)	–	2,148	98
MBS monoline wrapped - US sub-prime	8	–	–	(1)	–	6	75
MBS monoline wrapped- other	11	1	–	–	–	11	100
MBS ALT-A	205	5	–	(45)	–	156	76
MBS ALT-A monoline wrapped	9	–	–	(3)	–	6	67
MBS non conforming	221	6	(10)	(6)	–	206	93
MBS monoline wrapped non conforming	70	2	(4)	–	–	66	94
AA							
ABS monoline wrapped	21	1	–	(3)	–	17	81
MBS	59	2	–	(6)	–	53	90
MBS monoline wrapped - US sub-prime	5	–	–	(1)	–	3	60
A							
ABS monoline wrapped	4	–	–	–	–	3	75
MBS	61	2	–	(2)	–	59	97
MBS monoline wrapped - US sub-prime	16	–	–	(3)	–	11	69
BBB and below							
MBS - US sub-prime	5	–	–	(3)	–	2	40
MBS monoline wrapped - US sub-prime	9	–	–	(3)	–	4	44
Total	3,729	100	(25)	(198)	–	3,507	94

Our ABS portfolio remains of very high quality, with 95% of assets still rated AAA. Around 48% of the portfolio relates to UK conforming RMBS and Federal Guaranteed Student Loans. Our exposure to US ALT-A securities is limited to £214m, and has been written down by over 24%, with our US sub-prime exposure less than £45m. Our ABS portfolio is on average written down by 6%, with the majority of the write downs being accounted for via the available-for-sale reserve. We have not incurred any impairment loss charges on our ABS portfolio.

- CDO

Country	Nominal £m	% of CDO portfolio by geography	Total fair value reduction 2007 and 2008		Total balance sheet provisions & write-offs 2007 and 2008 £m	Balance sheet value as at 30.06.08 (including accrued interest) £m	Original exposure to sub- prime %	Original credit enhancement %	Current holding value as a % of nominal value
			Via income statement £m	Via reserves (pre-tax) £m					
UK	20	12	–	(6)	–	14	–	27	69
Rest of Europe	5	3	–	–	–	5	–	–	96
US	136	85	(8)	(18)	(29)	73	28	24	54
Total	161	100	(8)	(24)	(29)	92	24	23	56

Credit rating	Nominal £m	% of CDO portfolio by credit rating	Total fair value reduction 2007 and 2008		Total balance sheet provisions & write-offs 2007 and 2008 £m	Balance sheet value as at 30.06.08 (including accrued interest) £m	Original exposure to sub- prime %	Original credit enhancement %	Current holding value as a % of nominal value
			Via income statement £m	Via reserves (pre-tax) £m					
AAA - Monoline wrapped	3	2	–	–	–	3	–	18	96
AAA	74	46	–	(19)	–	53	4	30	75
AA	13	8	–	(3)	(1)	8	18	21	63
A	19	12	(8)	–	–	10	2	1	53
BBB and below	52	32	–	(2)	(28)	18	62	22	35
Total	161	100	(8)	(24)	(29)	92	24	23	56

Our CDO assets have been written down to 56% of their nominal value. The write down includes a cumulative impairment loss charge of £29m, with fair value reductions of £8m via the income statement and a £17m post-tax (£24m pre-tax) charge to the available-for-sale

reserve. The original US sub-prime exposure in the CDOs was £40m. At their initial issue the CDOs had a weighted average credit enhancement/funding reserve of 23%.

- CLO

Country	Nominal £m	% of CLO portfolio by geography	Total fair value reduction 2007 and 2008		Total balance sheet provisions & write-offs 2007 and 2008 £m	Balance sheet value as at 30.06.08 (including accrued interest) £m	Current holding value as a % of nominal value
			Via income statement £m	Via reserves (pre-tax) £m			
UK	95	34	–	(7)	–	86	91
Rest of Europe	40	15	–	(8)	–	33	82
US	142	51	–	(18)	–	121	85
Total	277	100	–	(33)	–	240	87

Credit rating	Nominal £m	% of CLO portfolio by credit rating	Total fair value reduction 2007 and 2008		Total balance sheet provisions & write-offs 2007 and 2008 £m	Balance sheet value as at 30.06.08 (including accrued interest) £m	Current holding value as a % of nominal value
			Via income statement £m	Via reserves (pre-tax) £m			
AAA	204	74	–	(19)	–	181	89
AA - Monoline wrapped	19	7	–	(1)	–	18	92
AA	27	10	–	(6)	–	21	76
A	24	9	–	(5)	–	19	80
BBB and below	3	–	–	(2)	–	1	35
Total	277	100	–	(33)	–	240	87

Our CLO portfolio is of high quality, with 74% rated AAA. The CLOs have been written down to 87% of their nominal value via the available-for-sale reserve, but we have not incurred any permanent impairment of these assets.

- SIV

SIV investments	Original value of SIV capital notes as at 30.06.07 £m	Reduction in fair value during six months ended 30.06.08 recognised in the Income Statement £m	Total impairment losses in year ended 31.12.07 £m	Total impairment losses in six months ended 30.06.08 £m	Balance sheet value of investment (net of provisions) as at 30.06.08 £m

SIV investments – by balance sheet category	Balance sheet value of investment (net of provisions) as at 30.06.08 £m	Balance sheet value of investment (net of provisions) as at 30.06.07 £m	Balance sheet value of investment (net of provisions) as at 31.12.07 £m
Held-to-maturity (original investments)	65	390	213
Loans and receivables (restructured investments)	30	–	13
Total SIV investments	95	390	226

During the first half of 2008 we participated in three SIV restructurings, reducing the number of original SIVs in which we held mezzanine and capital notes to four. As a result of participating in the restructurings we took onto our balance sheet £359m of assets, representing £125m of floating rate notes, £133m of asset backed securities, £88m of CLOs and £13m of CDOs. All of these assets are included in the above analysis. We also purchased capital notes in two new SIVs as part of the restructurings.

As a result of SIVs going into enforcement or restructuring, we took a £118m impairment loss charge in the first half of 2008. As part of a SIV restructure in late 2007 we wrote a credit default swap against a portfolio of securitised assets. The reduction in the fair value of this in the first six months of 2008 was £55m, and is recognised in our Income Statement within Non-interest income.

At the end of June 2008 our total SIV investments were £95m. This investment consists of £65m of original capital notes (net of impairment provisions) in four SIVs within the 'held-to-maturity' balance sheet category, and £30m of investments in three restructured SIVs held within the 'investment securities-loans and receivables' balance sheet category.

- PPN

	Original value as at 30.06.07 £m	Total fair value reduction 2007 and 2008		Total balance sheet provisions & write-offs 2007 and 2008 £m	Balance sheet value as at 30.06.08 (including accrued interest) £m
		Via income statement £m	Via reserves (pre-tax) £m		
PPN	79	(4)	(5)	–	31

Our PPN investments reduced by £44m to £35m at the end of December 2007. During 2008 there has been a further £4m reduction in the fair value of these investments.

- Other

Our other investments include certificates of deposit, all of which are rated at least A, and £123m of commercial lending transactions completed by the Commercial Bank. £61m of these transactions include financial guarantees from monoline insurers.

- Conduit (off balance sheet)

As at 30 June 2008:

Asset Type	Credit rating	Nominal value £m	Impairment £m	Original credit enhancement %	Original sub-prime exposure %	Original vintage				
						Pre-2003 %	2004 %	2005 %	2006 %	
ABS										
US RMBS (ALT-A)	AAA	40	–	31	–	–	36	64	–	–
CLO										
	AAA	327	–							
	AA	40	–							
	A	13	–							
Total CLO		380	–	24	–	60	38	2	–	–
CDO										
ABS CDO										
	AAA	41	–							
	AA	38	(2)							
	A	6	(1)							
	B	11	(4)							
		96	(7)	28	51	63	37	–	–	–
Synthetic CDO	AAA	115	–	10	–	–	17	83	–	–
Other										
	AAA	68	–							
	A	9	–							
		77	–	48	–	33	–	18	–	49
Total CDO		288	(7)	26	17	30	19	38	–	13
Total conduit assets		708	(7)	25	7	45	30	20	–	5

The Group's off balance sheet conduit facility is currently funded by the Group via secured loans which are not fair valued, but any impairment is recognised in the Income Statement. 94.5% of the assets in the conduit are rated AA or above, with exposure to US sub-prime limited to less than £50m. The sub-prime exposure is within CDOs of ABS, all of which were 2004 or earlier vintage when issued. £76m of assets in the conduit include financial guarantees provided by monoline insurance companies.

In the first six months of 2008 we incurred a £7m impairment loss charge against the loan to the conduit, reflecting the impairment of CDOs of ABS.

- Monolines

In total, £313m of our treasury investments and conduit assets (nominal value) include financial guarantees provided by monoline insurance companies, all of which are included in the above tables.

Liquidity

In addition to funding our customer loans and advances we also hold liquidity, in the form of cash and short term deposits, to manage the day to day requirements of the business. We continue to hold a significantly higher level of liquidity than in the first half of 2007, in

recognition of the current market conditions. Cash and balances with central banks, and the value of funds due from other banks, was £6.6bn at the end of June 2008, £3.4bn higher than at the end of June 2007 and similar to the £6.3bn at the end of December 2007. The majority of these balances were funded using short term money market funds, which in the first half of 2008 cost significantly more than the rate earned on short term deposits with other financial institutions. The liquidity holding costs in the first half of the 2008 were £19m, reflecting both the higher level of liquidity balances, and a higher cost of holding liquidity in the current market compared to those in which we were operating in the first half of 2007.

Funding

Our funding structure at 30 June 2008:

	Assets £bn	Liabilities £bn	
Other assets	1.0	1.9	Shareholders' funds
		0.8	Other liabilities
Treasury investments and cash	22.6	17.8	Wholesale funds – all with a residual maturity of less than six months
		26.2	Wholesale funds – all with a residual maturity of over six months
Customer loans and advances	53.4	6.2	Commercial customer deposits
		24.1	Retail customer deposits
	77.0	77.0	

We continue to implement our policy of funding our customer loans and advances using customer deposits and wholesale funds with a residual maturity of at least six months. The short term money markets are used to manage our liquidity and fund our treasury investments. We are also continuing to target any growth in loans and advances to be primarily funded by growth in customer deposit balances.

As at 30 June 2008, our customer deposits and wholesale funds with a residual maturity of over six months exceeded our customer loans and advances, including finance leases and hire purchase contracts and operating leases, by £3.1bn (December 2007: £2.3bn). Customer deposits funded 56% of customer loans and advances.

During the first half of 2008 we established a covered bond programme to give us an additional funding facility should this market re-open in the near future.

We increased the residential mortgage assets in our Langton securitisation vehicle to £8.9bn during the first half of 2008, enabling us to complete further strategic funding transactions. At the end of June 2008 our Langton and Bracken securitisation vehicles held £17.7bn of assets.

During the first half of 2008 we completed a number of new strategic funding transactions, as well as continuing to operate in the short term money markets. As at 31 July 2008 we had pre-funded our maturing medium term wholesale funding, commercial paper and certificates of deposit into the third quarter of 2009. Whilst strategic funding costs are materially higher than they would have been in the first half of 2007, the impact has been partially offset by higher customer lending asset spreads, which are wider than 12 months ago.

3.3 CAPITAL MANAGEMENT

	As at 30.06.08 £bn	As at 30.06.07 £bn	As at 31.12.07 £bn
Basel II Risk Weighted Assets (RWA)	22.2	21.8	24.1
Total capital resources	3.0	2.8	2.9
	%	%	%
Core tier 1 ratio (Note 1)	6.5	7.7	6.9
Total Tier 1 ratio	9.2	10.4	9.4
Total capital ratio	13.3	12.8	11.9

(Note 1) The core tier 1 capital ratio is defined as core tier 1 less intangible assets and expected losses divided by risk weighted assets.

At the end of June 2008, the Group's total capital resources were £3.0bn, higher than our Individual Capital Guidance set by the Financial Services Authority. We continue to proactively manage both our risk weighted assets and the absolute level of our capital resources.

In the first half of 2008 our risk weighted assets reduced from £24.1bn to £22.2bn. The fall primarily reflects the £1.3bn reduction in our treasury investment portfolio and the purchase of credit protection against a proportion of our unsecured personal loan balances, which has reduced the average risk weight on these assets from around 100% to around 55%. In the first half of 2008 our prime residential mortgage risk weight increased slightly from around 8% to 9%.

The expected loss on our assets decreased by £10m to £118m in the first half of 2008. The reduction reflects the benefit of the credit protection purchased against a proportion of our unsecured personal loan balances. The expected loss on our mortgage book is £40m at the end of June 2008.

During the first half of 2008 we strengthened our capital base with the issue of £350m of lower tier 2 capital, and we continue to have a number of initiatives which we could implement to strengthen our capital base in the future.

At the end of June 2008 our core tier 1 ratio was 6.5% (2007: 6.9%), which we believe is an appropriate level for the mix and quality of our assets.

The reduction in the fair value of our treasury investments recognised through the available-for-sale reserve is excluded from our regulatory capital calculations. If any of these reductions related to the permanent impairment of an asset then this would be recognised via the impairment loss charge.

Basel II results in greater pro-cyclicality in capital requirements, and it is therefore prudent at this stage in the economic cycle to hold a greater buffer between our capital resources and the regulatory minimum requirement. Our Basel II capital models use a long-run average probability of default and a downturn loss given default. Our asset risk weights are calculated using these measures, looking at the individual credit quality of our loans at the current point in time. If the economic outlook weakens further, the risk weighting on all our assets is likely to increase as the internal ratings of our assets deteriorate.

We stress test our capital requirements on a monthly basis using a number of scenarios. One of the more aggressive scenarios that we run shows that a 30% fall in UK house prices over an eighteen month period, combined with a 20% rise in unemployment claimant count, would lead to our mortgage risk weight increasing from around 9% to around 17%. For the mortgage risk weight to rise above 30%, there would have to be a very extreme scenario, such as a combination of a 55% fall in UK house prices in a 12 month period and unemployment claimant count increased by around two million, to three million.

4 STRATEGIC OBJECTIVES

Looking at each of our strategic objectives in turn:

- Franchise growth, with current focus on personal and commercial current accounts and deposit balances.
 - In the first half of 2008 retail customer deposit balances increased by £0.8bn, and we opened 154,000 personal customer accounts and 17,200 business current accounts.
- Above average asset quality for our customer loans and advances.
 - Our customer loans and advances asset quality remained strong and better than industry averages.
- Improved cost efficiency, maintaining the existing target of a Group cost:income ratio of below 50% by 2010.
 - In the first half of 2008 we reduced our core operating expenses by £21m, compared to the same period in 2007.
 -
- Underlying return on equity tier 1 capital to grow back to 20%.
 - We remain committed to this medium term objective.

5 FINANCIAL OUTLOOK

The recommended acquisition of the Group by Santander will, if approved by shareholders and completed, impact the Group's financial results in the second half of 2008. In the meantime the Group will continue to focus on making progress towards the achievement of its strategic objectives.

We expect the funding markets to continue to be volatile in the second half of the year, and will therefore continue to hold a high level of liquidity on the Group's balance sheet and maintain our strong funding position.

We plan to maintain our strong customer loan asset quality in the second half of 2008. The reduction in the fair value and impairment of certain treasury investments has slowed during the first half of 2008.

Our core tier 1 ratio at the end of June 2008 was 6.5%, and after including the payment of the interim dividend the core tier 1 ratio would be 6.2%.

6 BUSINESS VOLUMES AND MARKET SHARES

		Six months ended 30.06.08	Six months ended 30.06.07	Year ended 31.12.07
RETAIL BANKING BUSINESS VOLUMES				
Current Accounts				
New accounts opened	'000	154	170	301
Total number of active accounts	m	1.75	1.68	1.72
Residential Mortgages				
Gross lending	£bn	2.4	6.2	13.0
Net lending	£bn	(2.1)	2.2	4.8
Mortgage balances	£bn	40.6	40.2	42.8
Personal Unsecured Loans				
Gross advances	£bn	0.9	1.4	2.3
Balances	£bn	3.6	3.8	3.7
Savings				
Personal customer deposit balances	£bn	24.1	23.3	23.3
RETAIL BANKING MARKET SHARES				
Current Accounts (Note 1)				
Share of new accounts opened	%	5.1	4.9	4.3
Share of total number of accounts	%	2.8	2.9	2.8
Residential Mortgages (Note 2)				
Share of gross lending	%	1.6	3.4	3.6
Share of net lending	%	n/a	4.2	4.4
Share of mortgage balances	%	3.4	3.6	3.6
Personal Unsecured Loans (Note 3)				
Share of gross advances	%	5.7	7.6	6.7
Share of balances	%	5.1	5.4	5.2
Savings (Notes 1 & 4)				
Share of new business	%	4.6	4.4	3.2
Share of household liquid assets	%	2.2	2.3	2.2
COMMERCIAL BANKING BUSINESS VOLUMES				
Lending				
Balances	£bn	9.0	7.3	8.4
Business Banking Current Accounts				
New accounts opened	'000	17.2	16.6	33.7
Total number of active accounts	'000	100.3	83.8	92.4
Money Transmission				
Sales of cash to financial institutions	£bn	32.5	32.8	68.5
Cash handled	£bn	31.3	31.3	63.3
Commercial Customer Deposit Balances	£bn	6.2	7.4	7.5

Notes: Market shares calculated using the following sources:

(Note 1) Estimate based on CACI data.

(Note 2) Estimate based on Bank of England data.

(Note 3) Estimate based on Major British Banking Group personal loans data.

(Note 4) Estimate of UK Household Liquid Assets – ONS Financial statistics series NNMQ-X.

7 FINANCIAL REVIEW

7.1 RESULTS BY CATEGORY AND BUSINESS SECTOR

The commentary and ratios below compare the results for the first half of 2008 with the same period in 2007. Statutory results, which include hedge ineffectiveness gains or losses as income, are shown in section 8.

Business unit net interest income and core operating profit for 2007 have been restated to reflect a revised capital allocation methodology implemented from 1 January 2008. There is no impact at Group level. The capital allocated to each business unit reflects the capital required for each product under Basel II.

Core operating profit for the first half of 2008 was £22m (June 2007: £295m). This excludes the £6m loss (June 2007: £4m loss) from hedge ineffectiveness and £14m (June 2007: £1m) of redundancy costs.

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Year ended 31.12.07 £m
Core operating profit excluding the changes in the fair value and impairment of certain treasury investments, strategic funding and liquidity holding costs	301	295	625
Reduction in the fair value of certain treasury investments	(66)	–	(32)
Impairment of certain treasury investments	(143)	–	(153)
Strategic funding and liquidity holding costs	(70)	–	(23)
Core operating profit	22	295	417

Results by category are set out below:

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Year ended 31.12.07 £m
Net interest income	355	412	801
Non-interest income (excluding hedge ineffectiveness)	223	316	634
Total income	578	728	1,435
Core operating expenses	(319)	(340)	(691)
Depreciation on operating lease assets	(32)	(37)	(74)
Total costs (excluding redundancy costs)	(351)	(377)	(765)
Impairment losses:			
Retail Banking	(54)	(50)	(85)
Commercial Bank	(8)	(6)	(15)
Treasury	(143)	–	(153)
	(205)	(56)	(253)
Core operating profit	22	295	417
Redundancy costs	(14)	(1)	(8)
Hedge ineffectiveness	(6)	(4)	(10)
Profit before tax	2	290	399
Tax credit/(charge)	2	(77)	(103)
Profit after tax	4	213	296
Profit/(loss) attributable to:			
Innovative tier 1 holders	9	8	17
Minority interests	–	2	3
Preference shareholders	19	19	19
Ordinary shareholders of Alliance & Leicester plc	(24)	184	257
Basic (loss)/earnings per ordinary share	(5.7p)	41.8p	59.4p
Dividend(s) per ordinary share	18.0p	18.8p	55.3p

The business comprises three segments:

- Retail Banking – this comprises the Core 4 products of current accounts, mortgages, personal loans and savings, plus the Partner 4 products of long term investments, life assurance, general insurance and credit cards.
- Commercial Banking – this comprises Commercial Bank - consisting of the core business lines of lending, business banking and money transmission; and Treasury. Treasury includes the strategic funding and liquidity holding costs.
- Group Items – this represents corporate overheads and income not allocated to business units.

The contribution to core operating profit by each business segment is set out below:

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Year ended 31.12.07 £m
Retail Banking	211	207	449
Commercial Banking:			
Commercial Bank	89	78	163
Treasury	(272)	24	(163)
	(183)	102	-
Group Items	(6)	(14)	(32)
Core operating profit	22	295	417

7.1.1 RETAIL BANKING

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Year ended 31.12.07 £m
Net interest income	309	299	599
Non-interest income	125	138	307
Total income	434	437	906
Operating expenses	(169)	(180)	(372)
Impairment losses:			
Mortgages	(7)	-	(1)
Personal loans	(36)	(42)	(68)
Current accounts	(11)	(8)	(16)
	(54)	(50)	(85)
Core operating profit	211	207	449
Cost:income ratio ^(Note 1)	38.8%	41.0%	41.1%

(Note 1) The cost:income ratio is calculated by dividing operating expenses by total income.

Retail Banking core operating profit was £211m (June 2007: £207m). Total income was £3m lower, with growth in net interest income more than offset by lower non-interest income. Operating expenses fell by £11m and the charge for impairment losses was £4m higher.

Total Retail Banking income of £434m comprised Core 4 income of £384m (June 2007: £375m) and Partner 4 income of £50m (June 2007: £62m).

Excluding the reduction in fair value of certain treasury investments and the strategic funding and liquidity holding costs recognised in total income, Retail Banking revenues represented 60% of total Group revenues. This can be broken down into 25% from current accounts and personal loans, 28% from mortgages and savings and 7% from Partner 4 products.

Net interest income

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Six months ended 31.12.07 £m	Year ended 31.12.07 £m
Net interest income	309	299	300	599
Average balances:				
Interest-earning assets (IEA)	45,652	43,076	45,903	44,501
Financed by:				
Interest-bearing liabilities	42,348	39,662	42,445	41,065
Interest-free liabilities	3,304	3,414	3,458	3,436
Average rates:	%	%	%	%
Bank base rate	5.19	5.31	5.71	5.51
Gross yield on average IEA	6.22	6.00	6.44	6.23
Cost of interest-bearing liabilities	5.24	4.99	5.56	5.29
Interest spread	0.98	1.01	0.88	0.94
Contribution of interest-free liabilities	0.38	0.39	0.42	0.41
Net interest margin on average IEA	1.36	1.40	1.30	1.35

Retail Banking net interest income of £309m was £10m higher than in the first half of 2007, with a four basis points fall in the net interest margin being more than offset by a 6% increase in average interest-earning assets.

The Retail Banking net interest margin increased from 1.30% in the second half of 2007 to 1.36% in the first half of 2008. A higher mortgage and savings margin was partially offset by a lower personal loans margin. The benefit from higher new mortgage lending spreads, together with an increase in the average lives of certain mortgage products, has been partially offset by narrower spreads on savings products.

Non-interest income

Non-interest income of £125m was £13m lower than in the first half of 2007. Higher revenue from current accounts was more than offset by lower loans and long term investment commission income.

Non-interest income from personal loans was £18m, £25m lower than in the first half of 2007, reflecting lower payment protection insurance sales. Partner 4 product revenues were £49m, £11m lower than in the first half of 2007, primarily as a result of lower long term investment product sales.

Current accounts non-interest income was £23m higher than in the first half of 2007. In the first half of 2007 we created a provision for anticipated customer complaints about overdraft fees, which was released in the second half of 2007, and incurred a high level of refunds for overdraft complaints processed during the period, resulting in a fall in current accounts non-interest income. These items were not repeated in the first half of 2008.

Operating expenses

Operating expenses of £169m were £11m lower than in the first half of 2007. The reduction reflects lower new lending business volumes and ongoing productivity improvements.

The cost:income ratio was 38.8% (June 2007: 41.0%).

Impairment losses

The impairment loss charge of £54m was £4m higher than in the first half of 2007.

Our mortgage asset quality remains excellent. The mortgage impairment loss charge was £7m (June 2007: £nil), £3m of which related to cases where we believe there may have been fraudulent or negligent activity by third parties, the remainder reflects the impact of the reduction of house prices in the first half of 2008.

The unsecured personal loan impairment loss charge reduced from £42m in the first half of 2007 to £36m, reflecting the introduction of the refined provisioning methodology in the second half of 2007. Asset quality remains very strong, with arrears balances just £1m higher than at the end of 2007.

The current accounts impairment loss charge increased by £3m in the first half of 2008 to £11m. The increase reflects the growth in our active current account base over recent periods and the introduction of a refined provisioning methodology in the first half of 2008.

Mortgage arrears

Residential mortgages - at 30 June 2008

Number of months in arrears	No. of cases in arrears	No. of cases in arrears as % of total mortgages	Book value of mortgages in arrears £m	Book value of mortgages in arrears as % of total book	Value of arrears £'000	CML average % of mortgages in arrears (Note 1)
3 – 6 Months	1,603	0.35	119.2	0.29	3,470	0.69
6 – 12 Months	799	0.18	61.4	0.15	3,403	0.38
12+ Months	278	0.06	21.2	0.05	2,693	0.14
Repossession stock	107	0.02	17.9	0.04	1,343	0.13
Total	2,787	0.61	219.7	0.53	10,909	1.34

(Note 1) Latest available data, as at 31 March 2008.

At 30 June 2008 the total number of cases greater than three months in arrears includes 12 (December 2007: nil) 'PlusMortgage' cases and 11 (December 2007: nil) buy to let cases out of a total of 12,094 cases.

Residential mortgages - at 31 December 2007

Number of months in arrears	No. of cases in arrears	No. of cases in arrears as % of total mortgages	Book value of mortgages in arrears £m	Book value of mortgages in arrears as % of total book	Value of arrears £'000	CML average % of mortgages in arrears
3 – 6 Months	1,392	0.28	91.7	0.21	2,833	0.62
6 – 12 Months	669	0.14	47.4	0.11	2,769	0.35
12+ Months	227	0.05	17.9	0.04	3,079	0.13
Repossession stock	80	0.02	12.4	0.03	1,006	0.10
Total	2,368	0.49	169.4	0.39	9,687	1.20

LTV of new prime residential lending

	Six months ended 30.06.08 %	Six months ended 30.06.07 %	Year ended 31.12.07 %
Less than or equal to 50%	30	26	25
Greater than 50% - 70%	22	24	23
Greater than 70% - 90%	45	44	44
Greater than 90% - 95%	3	6	8
Greater than 95%	–	–	–
Total	100	100	100

LTV of new buy to let lending

	Six months ended 30.06.08 %	Six months ended 30.06.07 %	Year ended 31.12.07 %
Less than or equal to 50%	7	9	12
Greater than 50% - 75%	53	62	66
Greater than 75% - 85%	40	29	22
Greater than 85%	–	–	–
Total	100	100	100

Indexed LTV of prime residential lending book

	Six months ended 30.06.08 %	Six months ended 30.06.07 %	Year ended 31.12.07 %
Less than or equal to 50%	56	58	58
Greater than 50% - 70%	21	21	22
Greater than 70% - 90%	19	18	18
Greater than 90% - 95%	3	2	1
Greater than 95%	1	1	1
Total	100	100	100

Prime residential lending by type of borrower (by value)

Borrower type ^(Note 1)	Six months ended 30.06.08 %	Six months ended 30.06.07 %	Year ended 31.12.07 %
First time buyer	19	24	25
Next time buyer	42	43	45
Remortgage	27	27	24
Further advances	12	6	6
Total	100	100	100

(Note 1) Figures exclude buy to let, 'PlusMortgage' and specialist lending.

7.1.2 COMMERCIAL BANKING

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Year ended 31.12.07 £m
Net interest income	47	107	205
Non-interest income	96	177	324
Total income	143	284	529
Operating expenses	(143)	(139)	(287)
Depreciation on operating lease assets	(32)	(37)	(74)
Impairment losses	(151)	(6)	(168)
Core operating (loss)/profit	(183)	102	-
Net interest margin	0.33%	0.94%	0.83%
Average interest-earning assets	£28,241m	£22,981m	£24,773m

7.1.2.1 COMMERCIAL BANK

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Year ended 31.12.07 £m
Net interest income	92	76	166
Non-interest income	173	178	360
Total income	265	254	526
Operating expenses	(136)	(133)	(274)
Depreciation on operating lease assets	(32)	(37)	(74)
Impairment losses	(8)	(6)	(15)
Core operating profit	89	78	163
Net interest margin	2.07%	2.20%	2.26%
Average interest-earning assets	£8,884m	£6,899m	£7,357m
Cost:income ratio ^(Note 1)	63.5%	67.1%	66.2%

(Note 1) The cost:income ratio is calculated by dividing the sum of operating expenses and depreciation on operating lease assets by total income.

Commercial Bank core operating profit increased by £11m to £89m.

Net interest income

Net interest income of £92m was £16m higher than in the first half of 2007. A 29% increase in average interest earning assets more than offset a 13 basis points fall in the net interest margin. New lending asset spreads have widened, but this has been more than offset by an increase in the cost of commercial deposits.

Non-interest income

Non-interest income of £173m was £5m lower than in the first half of 2007. Higher non-interest income from the growth in business banking accounts, together with one-off income from the sale of shares in Mastercard, were more than offset by lower revenues from money transmission and the active management of our commercial lending book.

Operating expenses

Operating expenses of £136m were £3m higher than in the first half of 2007.

Depreciation on operating lease assets

Operating lease depreciation in the first half of 2008 was £32m, compared with £37m in the first half of 2007.

Impairment losses

The impairment loss charge in the first half of 2008 was £8m (June 2007: £6m). As at 30 June 2008, 0.31% of commercial lending balances were over 30 days in arrears (December 2007: 0.46%).

Payment due status:

	As at 30.06.08 £m	As at 30.06.08 %	As at 31.12.07 £m	As at 31.12.07 %
Not impaired:				
Neither past due or impaired	8,964	98.31	8,329	97.84
Past due, but not impaired:				
Up to 3 months	92	1.02	148	1.74
3 to 5 months	5	0.05	6	0.07
Over 5 months	3	0.03	1	0.01
Individually assessed impairments	54	0.59	29	0.34
	9,118	100.00	8,513	100.00
IFRS adjustments (Note 1)	(82)		(72)	
	9,036		8,441	
Individual provisions	(11)		(14)	
Collective provisions (Note 2)	(15)		(13)	
Total commercial lending balances	9,010		8,414	

(Note 1) IFRS adjustments relate to effective interest rate calculations.

(Note 2) Collective provisions are set aside to cover losses on past due loans.

Commercial lending balances

The total commercial lending book, including lending to business banking customers, net of provisions and intercompany lending, as at 30 June 2008 was £9.0bn, and is included in the following balance sheet headings:

	As at 30.06.08 £m	As at 30.06.07 £m	As at 31.12.07 £m
Loans and advances to customers	6,858	5,147	6,221
Net investment in finance leases and hire purchase contracts	1,853	1,885	1,909
Operating lease assets	299	281	284
Total commercial lending balances	9,010	7,313	8,414

The commercial lending book continues to be well diversified across a range of business sectors as set out below:

Sector allocations based on company's Standard Industry Classification (SIC) codes	As at 30.06.08 £m	As at 30.06.08 %	As at 31.12.07 £m	As at 31.12.07 %
Shipping	1,591	18	1,495	18
Property:				
Commercial investment property	885	10	715	9
Residential investment property	60	1	64	1
Commercial Development	43	1	34	–
Residential Development	22	–	22	–
Other property (all loans <£5m)	278	3	255	3
Property – Mitre Capital Partners (Note 1)	202	2	182	2
Construction	169	2	163	2
Film	994	11	1,063	13
Other transport, storage & communication	839	9	894	10
Aviation	831	9	758	9
Wholesale & Retail trade	550	6	502	6
Manufacturing	401	5	388	4
Renting and other business activities	300	3	310	4
Recreational	175	2	243	3
Hotels & Restaurants	207	2	225	3
Health & Social work	213	2	175	2
Other	1,250	14	926	11
Total	9,010	100	8,414	100

(Note 1) Alliance & Leicester has a 51% controlling interest in Mitre Capital Partners Limited.

A number of our commercial loans are supported by bank guarantees or cash deposits. These guarantees and deposits amounted to £1,900m at 30 June 2008 as set out below:

	As at 30.06.08 £m	As at 31.12.07 £m
Lending bank guaranteed or supported by cash deposits		
Shipping	952	961
Film	897	916
Aviation	14	14
Other	37	54
Total	1,900	1,945

Our commercial lending balances are also well diversified in terms of loan size, with the majority being used to finance UK based assets.

Commercial Lending split by loan size	Balances as at 30.06.08 £m	Bank guarantees and cash deposits as at 30.06.08 £m	Balances as at 31.12.07 £m	Bank guarantees and cash deposits as at 31.12.07 £m
Loans greater than £50m	2,179	1,328	2,106	1,423
Loans greater than £10m-£50m	4,525	532	4,213	522
Loans less than £10m	2,306	40	2,095	-
Total	9,010	1,900	8,414	1,945

7.1.2.2 TREASURY

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Six months ended 31.12.07 £m	Year ended 31.12.07 £m
Net interest income	(45)	31	8	39
Non-interest income	(77)	(1)	(35)	(36)
Total income	(122)	30	(27)	3
Operating expenses	(7)	(6)	(7)	(13)
Impairment losses	(143)	-	(153)	(153)
Core operating (loss)/profit	(272)	24	(187)	(163)
Net interest margin	(0.46%)	0.39%	0.07%	0.22%
Average interest-earning assets	£19,357m	£16,082m	£18,728m	£17,416m

Net interest income

Net interest income fell by £76m compared to the first half of 2007. This primarily reflects the strategic funding costs and the costs of holding increased liquidity.

Non-interest income

Non-interest income was a loss of £77m, primarily reflecting the £66m reduction in the fair value of treasury investments.

Operating expenses

Operating expenses of £7m were £1m higher than the first half of 2007.

Impairment losses

An impairment loss charge of £143m (June 2007: £nil) included £118m for SIVs, £18m for CDOs and £7m of provisions in respect of the loans funding the Group's off balance sheet conduit.

At 30 June 2008 the Group had £92m of CDOs on balance sheet, of which £82m were held as available-for-sale (AFS) and £10m were held at fair value through profit or loss (FVTPL). A £3m reduction in the fair value of these FVTPL assets was reflected in the Income Statement. Changes in fair value in AFS assets were recognised directly in the AFS reserve, except for £18m of losses on impaired assets which were recognised in the Income Statement.

CDOs were assessed for impairment by considering the quality and vintage of the underlying assets and the level of credit support. Certain assumptions were made with regard to US house prices, arrears levels and losses on defaults. Impairment has been calculated using an assumption of a 25% peak to trough fall in US house prices and an average repossession cost of 25%. If a more pessimistic scenario were to be assumed, including a 40% fall in US house prices, then the impairment charge would increase from £18m to £27m.

A provision of £7m was also made in respect of the loans funding the Group's off balance sheet conduit. The provision reflects the impairment of some of the CDOs within the conduit. In the more pessimistic scenario noted above, the impairment provision would increase from £7m to £11m.

Treasury balance sheet

Treasury assets were £22.6bn at the end of June 2008, compared to £23.1bn at the end of December 2007, and £19.0bn at the end of June 2007.

The £0.5bn decrease in Treasury assets in the first half of 2008 reflects the reduction in the trading and investments securities portfolio as assets mature and redeem, partially offset by the increase in loans and advances to customers as a result of the provision of funding to our off balance sheet conduit. In the current volatile market place we continue to hold over £6bn of liquidity in the form of cash and balances with central banks and short term deposits with banks.

By category:

	As at 30.06.08 £m	As at 30.06.07 £m	As at 31.12.07 £m
Cash and balances with central banks	1,994	1,589	3,471
Due from other banks	4,634	1,680	2,885
Trading securities	903	1,627	1,439
Investment securities			
- available-for-sale	12,567	11,521	12,773
- held-to-maturity	65	400	213
- loans and receivables	30	150	210
- at fair value through profit or loss	57	1,057	891
Trading and investment securities	13,622	14,755	15,526
Loans and advances to customers	996	162	233
Derivative financial instruments	1,344	837	970
Total	22,590	19,023	23,085

We continue to have a high quality trading and investment securities portfolio with 93% (December 2007: 94%) of securities rated at 'A' or above:

	As at 30.06.08 %	As at 31.12.07 %
AAA	26	28
AA	26	27
A	41	39
Other	7	6
Total	100	100

The tables below analyse Group assets and liabilities into maturity groupings, based on the remaining period to contractual maturity at the balance sheet date. A customer placing a deposit may contractually be able to withdraw funds in less than one month, but this is not an accurate representation of how long the deposit is expected to remain with the Group.

During the first half of 2008 we continued to increase the proportion of our wholesale funding with a residual maturity of over 12 months. As at the end of June 2008 over 52% of wholesale funds had a residual maturity of over 12 months, compared to 47% at the end of 2007.

At 30 June 2008	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						
Cash and balances with central banks	1,993.5	–	–	–	–	1,993.5
Due from banks	4,108.6	45.4	8.6	471.8	–	4,634.4
Trading securities	–	–	29.4	48.4	825.7	903.5
Derivative financial instruments	228.2	64.4	174.6	438.8	438.2	1,344.2
Loans and advances to customers	952.5	545.8	2,259.5	5,213.6	43,311.1	52,282.5
Net investment in finance leases and hire purchase contracts	20.3	30.4	187.7	500.4	1,113.8	1,852.6
Investment securities:						
- available-for-sale	676.9	98.0	1,545.1	6,705.2	3,541.9	12,567.1
- held-to-maturity	–	–	7.9	54.3	3.0	65.2
- loans and receivables	–	–	–	–	29.6	29.6
- at fair value through profit and loss	–	4.3	–	12.8	39.7	56.8
Other assets	321.9	38.5	173.3	415.8	366.4	1,315.9
Total assets	8,301.9	826.8	4,386.1	13,861.1	49,669.4	77,045.3
Liabilities						
Due to other banks	4,542.2	3,807.6	4,814.3	7,004.2	976.3	21,144.6
Derivative financial instruments	86.0	28.8	93.3	195.8	255.8	659.7
Due to customers	26,827.7	799.5	1,882.4	660.0	55.2	30,224.8
Debt securities in issue	1,307.2	3,470.9	2,674.0	8,982.6	4,738.5	21,173.2
Other borrowed funds	–	–	–	–	971.8	971.8
Other liabilities	252.1	92.1	74.8	355.1	207.6	981.7
Total liabilities	33,015.2	8,198.9	9,538.8	17,197.7	7,205.2	75,155.8

At 31 December 2007	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						
Cash and balances with central banks	3,471.0	–	–	–	–	3,471.0
Due from banks	2,694.1	10.4	1.9	179.0	–	2,885.4
Trading securities	–	66.2	33.2	114.6	1,224.9	1,438.9
Derivative financial instruments	32.7	103.2	264.1	305.1	265.2	970.3
Loans and advances to customers	821.9	577.0	2,133.1	4,989.1	44,625.5	53,146.6
Net investment in finance leases and hire purchase contracts	26.4	51.5	207.7	578.8	1,044.8	1,909.2
Investment securities:						
available-for-sale	259.5	479.6	824.5	7,520.8	3,688.3	12,772.7
- held-to-maturity	–	16.9	–	117.1	78.9	212.9
- loans and receivables	196.9	–	–	–	13.5	210.4
- at fair value through profit and loss	–	859.8	–	15.2	16.2	891.2
Other assets	306.0	9.1	117.5	292.0	321.6	1,046.2
Total assets	7,808.5	2,173.7	3,582.0	14,111.7	51,278.9	78,954.8
Liabilities						
Due to other banks	4,382.8	4,412.7	4,435.4	6,063.0	93.0	19,386.9
Derivative financial instruments	62.2	97.3	243.9	267.6	120.2	791.2
Due to customers	26,921.4	1,577.7	1,774.3	259.5	225.4	30,758.3
Debt securities in issue	1,776.7	3,782.4	4,822.9	8,389.6	5,476.8	24,248.4
Other borrowed funds	–	–	80.8	–	630.4	711.2
Other liabilities	340.8	109.6	53.2	93.5	138.0	735.1
Total liabilities	33,483.9	9,979.7	11,410.5	15,073.2	6,683.8	76,631.1

7.1.3 GROUP ITEMS

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Year ended 31.12.07 £m
Net interest income	(1)	6	(3)
Non-interest income	2	1	3
Total income	1	7	-
Operating expenses	(7)	(21)	(32)
Core operating loss	(6)	(14)	(32)

Group Items represent corporate overheads and income not allocated to business units.

7.2 GROUP RESULTS BY INCOME STATEMENT CATEGORY

7.2.1 NET INTEREST INCOME

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Six months ended 31.12.07 £m	Year ended 31.12.07 £m
Net interest income	355	412	389	801
Average balances:				
Interest-earning assets (IEA)	73,893	66,057	72,438	69,274
Financed by:				
Interest-bearing liabilities	68,854	61,002	66,697	63,873
Interest-free liabilities	5,039	5,055	5,741	5,401
	%	%	%	%
Interest spread	0.59	0.88	0.62	0.74
Contribution of interest-free liabilities	0.38	0.38	0.44	0.42
Net interest margin on average IEA	0.97	1.26	1.06	1.16

Group net interest income of £355m was £57m lower than in the first half of 2007, reflecting the strategic funding and liquidity holding costs. The net interest margin in the first half of 2008 was 0.97%, four basis points higher than the 0.93% margin in the fourth quarter of 2007.

7.2.2 NON-INTEREST INCOME

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Year ended 31.12.07 £m
Fee and commission income	242	244	517
Fee and commission expense	(29)	(17)	(33)
Other operating (expense)/income	(32)	41	56
Operating lease income	42	48	94
Core non-interest income	223	316	634
Hedge ineffectiveness	(6)	(4)	(10)
Total	217	312	624

Core non-interest income of £223m was £93m lower than in the first half of 2007, primarily due to the £66m reduction in the fair value of certain treasury investments, lower personal loans payment protection insurance sales and lower long term investment commission income, partially offset by higher current account revenues.

Other operating (expense)/income includes the £66m reduction in the fair value of certain treasury investments and an £8m excess from the sale of credit card accounts to MBNA (June 2007: £10m). The final £8m excess will be recognised in the second half of 2008.

The £6m loss (June 2007: £4m loss) from hedge ineffectiveness is explained in section 7.3.

7.2.3 ADMINISTRATIVE EXPENSES AND DEPRECIATION

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Year ended 31.12.07 £m
Staff related expenditure	135	148	299
Post Office/cash business	48	45	94
Marketing costs	21	20	43
Premises, equipment and other	84	87	182
Outsourcing costs	8	9	15
Administrative expenses	296	309	633
Depreciation and amortisation on fixed assets other than operating lease assets	23	31	58
Core operating expenses	319	340	691
Depreciation on operating lease assets	32	37	74
Total costs excluding redundancy costs	351	377	765
Redundancy costs	14	1	8
Total costs	365	378	773
Cost:income ratio ^(Note 1)	60.6%	51.8%	53.3%

(Note 1) The cost:income ratio is calculated by dividing total costs excluding redundancy costs by total income excluding gains or losses from hedge ineffectiveness.

The Group cost:income ratio was 60.6%, compared to 51.8% in the first half of 2007 and 53.3% in 2007 as a whole. Excluding the impact on income from fair value reductions in certain treasury investments, the cost:income ratio would have been 54.4%.

The Group's core operating expenses were £319m in the first half of 2008, £21m lower than in the first half of 2007. The reduction primarily reflects lower staff numbers and reduced business volumes, particularly in mortgages and unsecured loans, as well as ongoing productivity improvements. The depreciation and amortisation charge reduced by £8m to £23m, reflecting the £9m asset write down in the first half of 2007 relating to the redevelopment of our Bootle administration centre.

7.2.4 IMPAIRMENT

The charge for impairment losses can be analysed as follows:

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Six months ended 31.12.07 £m	Year ended 31.12.07 £m
Retail Banking				
Mortgages	7	–	1	1
Personal loans	36	42	26	68
Current accounts	11	8	8	16
	54	50	35	85
Commercial Banking				
Commercial Bank	8	6	9	15
Treasury	143	–	153	153
	151	6	162	168
Total	205	56	197	253

Excluding the £143m of impairment losses in Treasury, the charge for impairment losses in the first half of 2008 was £6m higher than the first half of 2007. The Retail Banking charge increased by £4m and the Commercial Bank charge increased by £2m.

The closing balances on impairment provisions were as follows:

	As at 30.06.08 £m	As at 30.06.07 £m	As at 31.12.07 £m
Retail Banking			
Mortgages	17	13	13
Personal loans	100	132	107
Current accounts	23	13	16
	140	158	136
Commercial Banking			
Commercial Bank	26	24	27
Treasury	203	–	122
	229	24	149
Total provisions	369	182	285

Mortgage provisions increased by £4m in the first half of 2008, reflecting an increase in cases where we believe there was fraudulent or negligent activity by third parties, and the fall in house prices. Personal loan provisions reduced by £7m in the first half of 2008, reflecting the strong asset quality, the £0.1bn reduction in balances, and the ongoing impact of the refined provisioning methodology implemented in the second half of 2007. Current account provisions increased by £7m, reflecting the growth in the active accounts base over recent periods and the implementation of a refined provisioning methodology.

Commercial Bank provisions reduced by £1m to £26m, reflecting the high quality of the loan book. Provisions continue to represent 0.3% (December 2007: 0.3%) of commercial lending balances. In addition to the provisions shown above, there was a £3m (December 2007: £3m) residual value provision against operating lease assets. As at 30 June 2008, 21% (December 2007: 23%) of commercial lending balances were either bank guaranteed or supported by cash deposits.

The Treasury provision increased to £203m, and includes £28m relating to CDOs on balance sheet, £7m relating to the loans providing funding to the off balance sheet conduit, and the remainder relating to SIV capital note investments.

Of the total provisions of £369m at the end of June 2008, collective impairment provisions were £150m (December 2007: £148m) and individual impairment provisions were £219m (December 2007: £137m).

7.2.5 CAPITAL

From 1 January 2007 Alliance & Leicester has been operating under the Basel II capital regime.

7.2.5.1 CAPITAL STRUCTURE

CAPITAL RESOURCES

	As at 30.06.08 £m	As at 30.06.07 £m	As at 31.12.07 £m
Tier 1:			
Core tier 1 capital	1,663	1,849	1,846
Preference share capital	294	294	294
Innovative tier 1	302	302	311
Total tier 1 (before deductions)	2,259	2,445	2,451
Tier 1 deductions:			
Intangible assets ^(Note 1)	(161)	(86)	(116)
Expected losses ^(Note 2)	(59)	(91)	(64)
Total tier 1 deductions	(220)	(177)	(180)
Total tier 1 after deductions	2,039	2,268	2,271
Tier 2:			
Total tier 2 (before deductions)	978	613	655
Tier 2 deductions:			
Expected losses ^(Note 2)	(59)	(91)	(64)
Total tier 2 after deductions	919	522	591
Deductions from tier 1 and tier 2	–	–	(5)
Total capital resources	2,958	2,790	2,857
	%	%	%
Core tier 1 ratio ^(Note 3)	6.5	7.7	6.9
Total tier 1 ratio	9.2	10.4	9.4
Total capital ratio	13.3	12.8	11.9

(Note 1) Intangible assets include capitalised software and goodwill.

(Note 2) Under Basel II a deduction is made for the excess of expected losses over provisions for customer loans and advances that are on an IRB approach. Half of this is deducted from tier 1 capital and half from tier 2 capital.

(Note 3) The core tier 1 capital ratio is defined as core tier 1 less intangible assets and expected losses divided by risk weighted assets.

Total capital resources increased by £101m in the first half of 2008. The Group issued £350m of dated subordinated debt, included as tier 2 capital in April 2008. The excess of expected losses over provisions is lower than at the end of 2007, mainly due to the purchase of credit protection on a proportion of our unsecured personal loans. These increases in capital were partially offset by the £154m payment of the 2007 final dividend, and a £45m increase in intangible assets, arising mainly from the development of the ALNOVA banking system.

Risk weighted assets

The table below shows the Group's risk weighted assets (RWA) and operational risk under Basel II Pillar 1, and the Basel I RWA.

	As at 30.06.08 £m	As at 30.06.07 £m	As at 31.12.07 £m
Basel II – Pillar 1			
Risk weighted assets:			
Mortgages	4,259	4,684	3,980
Unsecured personal loans	1,893	3,877	3,647
Corporates	7,795	5,882	7,005
Banks	2,857	2,501	2,844
Investment in securitisations ^(Note 1)	1,686	1,157	2,974
Other ^(Note 2)	1,488	1,460	1,352
Total credit and market RWA	19,978	19,561	21,802
Operational risk ^(Note 3)	2,280	2,260	2,280
Total Basel II – Pillar 1 RWA	22,258	21,821	24,082
Total Basel I RWA	37,276	34,792	37,297

(Note 1) The definition 'Investment in securitisations' includes ABS, MBS, CDO and liquidity facilities.

(Note 2) Includes current accounts, other assets, exposures to Central Banks and market risk.

(Note 3) Notional risk weighted assets calculated at the end of each financial year.

As a result of Basel II, the Group's RWA at 30 June 2008 were 40% lower than they would have been under Basel I, reflecting our high quality assets and risk management processes.

The Group's RWA under Basel II fell by £1.8bn in the first half of 2008. Mortgage RWA increased by £0.3bn, reflecting the increase in risk weighting from 8% to 9%, partially offset by a reduction in mortgage balances. Corporates, which primarily reflects commercial lending, increased by £0.8bn, predominantly due to the growth in balances. Unsecured personal loans reduced by £1.8bn due to the purchase of credit protection.

RWA relating to the category 'investment in securitisations', including ABS, CDO and CLO, fell by £1.3bn, reflecting the restructuring of SIVs and impairment charges taken on these assets in this half year. Our total RWA also includes £182m of RWA in respect of our off balance sheet conduit.

CAPITAL REQUIREMENTS

	As at 30.06.08 £m	As at 30.06.07 £m	As at 31.12.07 £m
Pillar 1 capital requirement	1,781	1,746	1,927
Total capital resources	2,958	2,790	2,857

The Basel II - Pillar 1 capital requirement of £1,781m is 8% of total Basel II - Pillar 1 RWA of £22,258m. Our internal assessment of the Pillar 2 capital requirement is around 30% of the Group's Pillar 1 requirement, prior to any additional FSA capital guidance. Together, these make up our total Basel II capital requirement. The Group's capital base is above the Individual Capital Guidance (ICG) set by the FSA.

The Group issued its 2007 Pillar 3 disclosures on the Group website in April 2008. This includes additional information on loans and advances and capital.

7.2.5.2 RECONCILIATION OF ORDINARY SHAREHOLDERS' FUNDS TO EQUITY TIER 1 CAPITAL

	As at 30.06.08 £m	As at 30.06.07 £m	As at 31.12.07 £m
Ordinary shareholders' funds (equity)	1,294	1,859	1,716
Adjusted for:			
Pension fund ^(Note 1)	(34)	14	(29)
Cashflow hedges and available-for-sale assets ^(Note 2)	403	55	156
Minority interest	-	2	3
Interim dividend ^(Note 3)	-	(81)	-
Core tier 1 capital	1,663	1,849	1,846
Intangible assets ^(Note 4)	(161)	(86)	(116)
Equity tier 1 capital	1,502	1,763	1,730

(Note 1) Retained earnings and other reserves exclude gains or losses on cashflow hedges and available-for-sale assets. The regulatory capital rules allow the pension scheme deficit to be added back to regulatory capital and a deduction taken for an estimate of the additional contributions to be made in the next five years, less associated deferred tax. When the Scheme is in surplus, the pension fund asset is not included within capital. This adjustment is reflected in the reserves number.

(Note 2) Gains or losses on cashflow hedges and available-for-sale assets are required to be excluded from equity tier 1 capital.

(Note 3) The 2007 interim dividend was approved prior to 30.06.07. This was deducted from capital following FSA guidance effective from 29.06.07. The 2008 interim dividend was approved on 31.07.08.

(Note 4) Intangible assets, including capitalised software and goodwill, are deducted in the calculation of equity tier 1 capital.

7.2.5.3 UNDERLYING RETURN ON EQUITY TIER 1 CAPITAL

	Six months ended 30.06.08 £m	Six months ended 30.06.07 £m	Year ended 31.12.07 £m
(Loss)/profit attributable to ordinary shareholders	(23.9)	183.6	256.7
Adjusted for:			
Redundancy costs	14.4	1.1	8.4
Less associated tax credit	(4.1)	(0.3)	(2.5)
Hedge ineffectiveness	6.3	4.1	9.5
Less associated tax credit	(1.8)	(1.2)	(2.9)
Core (loss)/profit after tax	(9.1)	187.3	269.2
Average equity tier 1	1,616	1,855	1,839
Underlying return on equity tier 1	(1.1%)	20.4%	14.6%

7.2.6 PENSIONS

The net retirement benefits asset at 30 June 2008 was £38m (December 2007: £25m). This is based on the actuarial assumptions used for the 2007 full year results.

	As at 30.06.08 £m	As at 30.06.07 £m	As at 31.12.07 £m
Assets			
Funded defined benefit pension scheme	59	–	53
Liabilities			
Funded defined benefit pension scheme	–	(9)	–
Unfunded defined benefit pension scheme	(11)	(10)	(11)
Post-retirement medical benefits liability	(10)	(20)	(17)
	(21)	(39)	(28)
Total net retirement benefits asset/(liability)	38	(39)	25

7.2.7 DIVIDENDS

Our interim dividend is 18.0p (2007: 18.8p) per share.

The Board have decided not to implement the voluntary scrip dividend programme approved at the 2008 Annual General Meeting for this dividend.

7.3 HEDGE INEFFECTIVENESS

The hedge ineffectiveness loss of £6m (June 2007: £4m loss) represents the net fair value loss on derivative instruments that are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The loss is primarily due to timing differences in income recognition between the derivative instruments and the hedged assets and liabilities. The impact can be volatile, but will trend to zero over time and has been excluded in reporting the Group's underlying performance.

Alliance & Leicester plc

Condensed Interim Financial Report for the six months ended 30 June 2008

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CONDENSED CONSOLIDATED INCOME STATEMENT

	Notes	Six months ended 30.06.08 Unaudited £m	Six months ended 30.06.07 Unaudited £m	Year ended 31.12.07 Audited £m
Interest receivable and similar income		2,227.4	1,899.6	4,167.2
Interest expense and similar charges*		(1,872.3)	(1,487.3)	(3,366.1)
Net interest income		355.1	412.3	801.1
Fee and commission income		242.1	244.1	516.9
Fee and commission expense		(28.6)	(17.2)	(32.7)
Hedge ineffectiveness		(6.3)	(4.1)	(9.5)
Other operating income		10.2	89.2	150.0
Total non-interest income		217.4	312.0	624.7
Operating income		572.5	724.3	1,425.8
Administrative expenses:				
Core administrative expenses		(297.2)	(309.3)	(634.6)
Redundancy costs		(14.4)	(1.1)	(8.4)
Total administrative expenses		(311.6)	(310.4)	(643.0)
Depreciation and amortisation:				
On fixed assets excluding operating lease assets		(22.1)	(21.4)	(47.7)
On operating lease assets		(31.6)	(37.1)	(73.5)
Impairment of tangible fixed assets		-	(9.3)	(9.3)
		(53.7)	(67.8)	(130.5)
Total costs		(365.3)	(378.2)	(773.5)
Impairment losses on loans and leases		(62.2)	(56.0)	(100.2)
Impairment losses on treasury assets		(143.2)	-	(152.9)
Total impairment losses	5	(205.4)	(56.0)	(253.1)
Profit before tax	6	1.8	290.1	399.2
Tax credit/(charge)	7	2.0	(77.5)	(103.3)
Profit after tax		3.8	212.6	295.9
Profit/(loss) attributable to:				
Innovative tier 1 holders	13	8.7	8.7	17.5
Preference shareholders	14	18.7	18.7	18.7
Minority interests		0.3	1.6	3.0
Ordinary shareholders of Alliance & Leicester plc		(23.9)	183.6	256.7
(Loss)/earnings per share:				
Basic (loss)/earnings per ordinary share	8	(5.7p)	41.8p	59.4p
Diluted (loss)/earnings per ordinary share	8	(5.7p)	41.6p	59.0p

* Includes £2.5m gain (June 2007: £1.7m loss, December 2007: £10.1m loss) in respect of forward exchange losses on foreign exchange derivatives.

CONDENSED CONSOLIDATED BALANCE SHEET

	Notes	As at 30.06.08 Unaudited £m	As at 30.06.07 Unaudited £m	As at 31.12.07 Audited £m
Assets				
Cash and balances with central banks		1,993.5	1,589.1	3,471.0
Due from other banks		4,634.4	1,680.4	2,885.4
Trading securities		903.5	1,627.2	1,438.9
Derivative financial instruments		1,344.2	837.3	970.3
Loans and advances to customers		52,282.5	49,487.5	53,146.6
Net investment in finance leases and hire purchase contracts		1,852.6	1,885.3	1,909.2
Investment securities:				
– available-for-sale		12,567.1	11,521.3	12,772.7
– held-to-maturity		65.2	400.2	212.9
– loans and receivables		29.6	150.3	210.4
– at fair value through profit or loss		56.8	1,057.2	891.2
Intangible fixed assets	11	161.3	85.7	116.1
Property, plant and equipment		247.3	241.1	251.4
Operating lease assets		298.9	281.0	284.1
Deferred tax assets		219.0	6.0	4.9
Fair value macro hedges		–	–	38.0
Other assets		217.2	238.1	214.9
Prepayments and accrued income		113.4	76.0	84.0
Retirement benefit obligations		58.8	–	52.8
Total assets		77,045.3	71,163.7	78,954.8
Liabilities				
Due to other banks		21,144.6	7,978.3	19,386.9
Derivative financial instruments		659.7	813.8	791.2
Due to customers		30,224.8	30,715.0	30,758.3
Debt securities in issue		21,173.2	27,425.4	24,248.4
Other liabilities		386.2	407.7	498.4
Current tax liabilities		25.1	38.8	4.8
Fair value macro hedges		268.9	386.2	–
Accruals and deferred income		174.3	236.6	203.6
Deferred tax liabilities		106.0	–	–
Other borrowed funds	12	971.8	666.5	711.2
Retirement benefit obligations		21.2	38.6	28.3
Total liabilities		75,155.8	68,706.9	76,631.1
Equity				
Innovative tier 1	13	301.8	301.8	310.6
Preference shares	14	294.0	294.0	294.0
Minority interests		0.1	2.1	3.5
		595.9	597.9	608.1
Called up share capital	15	210.5	215.1	210.3
Share premium account	16	127.0	119.3	125.1
Capital redemption reserve	16	89.9	84.7	89.9
Reserve for share-based payments	16	26.7	23.3	26.2
Available-for-sale reserve	16	(332.6)	4.5	(142.7)
Cash flow hedging reserve	16	(70.9)	(59.5)	(13.7)
Retained earnings	16	1,243.0	1,471.5	1,420.5
Total ordinary shareholders' equity		1,293.6	1,858.9	1,715.6
Total equity and liabilities		77,045.3	71,163.7	78,954.8

CONDENSED CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE

	Six months ended 30.06.08 Unaudited £m	Six months ended 30.06.07 Unaudited £m	Year ended 31.12.07 Audited £m
Available-for-sale investments:			
Valuation (losses)/gains taken to equity	(282.1)	0.4	(219.8)
Net losses/(gains) transferred to profit on disposal	0.2	–	(0.6)
Impairment loss transferred to Income Statement	17.8	–	10.6
Cash flow hedges:			
(Losses)/gains taken to equity	(77.8)	(54.5)	14.8
Transferred to net profit	(1.6)	(2.9)	(7.4)
Actuarial gains on retirement benefit obligations	–	–	56.4
Tax on items taken directly in equity	96.4	17.1	45.7
Net expense recognised directly in equity	(247.1)	(39.9)	(100.3)
Profit after tax	3.8	212.6	295.9
Total recognised income and expense for the period	(243.3)	172.7	195.6
Total recognised income and expense for the period attributable to:			
Innovative tier 1 holders	8.7	8.7	17.5
Preference shareholders	18.7	18.7	18.7
Minority interests	0.3	1.6	3.0
Ordinary shareholders of Alliance & Leicester plc	(271.0)	143.7	156.4

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	Six months ended 30.06.08 Unaudited £m	Six months ended 30.06.07 Unaudited £m	Year ended 31.12.07 Audited £m
Cash flows from operating activities			
Profit before tax	1.8	290.1	399.2
Increase in accrued income and prepayments	(29.4)	(15.6)	(26.5)
(Decrease)/increase in accruals and deferred income	(23.3)	27.9	(1.6)
Provisions for impairment	205.4	56.0	253.1
Loans and advances written off net of recoveries	(138.1)	(44.6)	(138.9)
Depreciation and amortisation	53.7	58.9	118.2
Interest on subordinated loan added back	23.1	21.8	38.0
Provisions for liabilities and charges	(13.1)	(9.2)	(15.9)
Unamortised costs on subordinated debt	0.1	–	0.2
Other non-cash movements	(6.1)	(5.6)	(8.0)
Cash generated from operations	74.1	379.7	617.8
Interest paid on loan capital	(23.1)	(21.8)	(38.0)
Tax repaid/(paid)	25.1	(31.5)	(54.5)
Cash flows from operating profits before changes in operating assets and liabilities	76.1	326.4	525.3
Changes in operating assets and liabilities:			
Net increase in amounts due from other banks and loans and advances to customers	(952.3)	(1,782.6)	(6,706.5)
Net decrease/(increase) in debt and equity securities	244.5	(435.7)	(600.8)
Net decrease/(increase) in fair value macro hedges	306.9	204.5	(219.7)
Net increase in other assets	(5.8)	(13.6)	(4.3)
Net increase in amounts due to other banks and customers	1,224.2	504.3	11,956.2
Net increase in derivative financial instruments	(505.4)	(64.5)	(155.2)
Net (decrease)/ increase in debt securities in issue	(3,075.5)	2,010.0	(1,167.0)
Net (decrease)/increase in other liabilities	(116.4)	(93.5)	2.2
Net (decrease)/ increase in other borrowed funds	(10.3)	(30.2)	14.3
Other non-cash movements	(346.1)	4.8	(202.1)
Net cash from operating activities	(3,160.1)	629.9	3,442.4
Cash flows from investing activities			
Purchase of non-dealing securities	(923.0)	(2,272.9)	(4,222.1)
Proceeds from sale and redemption of non-dealing securities	2,525.1	1,476.4	2,699.1
Acquisition of subsidiaries, net of cash acquired	(18.5)	(173.0)	(173.0)
Disposal of subsidiaries, net of cash disposed	–	87.3	94.2
Purchase of intangible assets and property, plant and equipment	(122.7)	(79.8)	(186.6)
Proceeds from sale of property, plant and equipment	23.7	19.2	31.3
Net cash received/(used) in investing activities	1,484.6	(942.8)	(1,757.1)
Cash flows from financing activities			
Proceeds from borrowed funds	345.8	–	–
Repayments of borrowed funds	(75.0)	–	–
Issue of ordinary shares	0.9	12.5	18.4
Repurchase of ordinary shares	–	(97.5)	(193.8)
Dividends paid	(153.6)	(160.1)	(240.8)
Preference dividends paid	(18.7)	(18.7)	(18.7)
Interest paid on loan capital	(17.5)	(17.5)	(17.5)
Net cash received/(used) in financing activities	81.9	(281.3)	(452.4)
Net (decrease)/increase in cash and cash equivalents	(1,593.6)	(594.2)	1,232.9
Cash and cash equivalents at beginning of year	3,855.5	2,622.6	2,622.6
Cash and cash equivalents at end of period	2,261.9	2,028.4	3,855.5

SELECTED NOTES TO THE CONDENSED INTERIM FINANCIAL REPORT

1 GENERAL INFORMATION

The information for the year ended 31 December 2007 does not constitute statutory accounts as defined in section 240 of the Companies Act 1985. A copy of the statutory accounts for that year has been delivered to the Registrar of Companies. The auditors' report on those accounts was not qualified and did not contain statements under section 237(2) or (3) of the Companies Act 1985.

This condensed interim financial report was approved by the Group Board for issue on 31 July 2008.

2 BASIS OF PREPERATION

The condensed interim financial report for the half year ended 30 June 2008 has been prepared in accordance with IAS 34, 'Interim Financial Reporting'. The condensed interim financial report should be read in conjunction with the Annual Report and Accounts for the year ended 31 December 2007.

3 ACCOUNTING POLICIES

The accounts are prepared in accordance with International Financial Reporting Standards. The accounting policies are consistent with those used for the year ended 31 December 2007, which are available on the company's website www.alliance-leicester-group.co.uk.

IFRIC 11 'IFRS 2: Group and treasury share transactions' is mandatory for the financial year ending 31 December 2008, and has been reflected in these results. This Interpretation has not had a material impact to the Group's results.

4 OPERATING SEGMENTS

The Group adopted IFRS 8 'Operating Segments' on 1 January 2007. IFRS 8 requires operating segments to be identified on the basis of internal reports and components of the Group regularly reviewed by the Group Chief Executive to allocate resources to segments and to assess their performance.

The Group is managed as follows, in segments determined according to similar economic characteristics and customer base:

- Retail Banking – this comprises the Core 4 products of current accounts, mortgages, personal loans and savings, plus the Partner 4 products of long term investments, life assurance, general insurance and credit cards.
- Commercial Banking – this comprises Commercial Bank - consisting of the core business lines of lending, business banking and money transmission; and Treasury. Treasury includes the strategic funding and liquidity holding costs.
- Group Items – this represents corporate overheads and income not allocated to business units.

The accounting policies of the reportable segments are the same as the Group's accounting policies, as described above.

No geographical analysis is presented because substantially all of the Group's activities are in the UK. A more detailed breakdown of core operating profit by segment is given within the unaudited Interim Management Report on pages 2 to 34.

The majority of revenue for the Group is derived from interest. Net interest income is used to assess the performance of each segment. Therefore interest income is presented net of interest expense.

Period ended 30 June 2008 (Unaudited)	Retail Banking	Commercial Banking		Group Items	Other	Group
	£m	Commercial Bank £m	Treasury £m	£m	£m	£m
Net interest income	309	92	(45)	(1)	–	355
Non-interest income	125	173	(77)	2	–	223
Total external income	434	265	(122)	1	–	578
Operating expenses	(169)	(136)	(7)	(7)	–	(319)
Depreciation on operating lease assets	–	(32)	–	–	–	(32)
Impairment losses	(54)	(8)	(143)	–	–	(205)
Core operating profit/(loss)	211	89	(272)	(6)	–	22
Redundancy costs					(14)	(14)
Hedge ineffectiveness					(6)	(6)
Profit before tax						2
Tax						2
Profit after tax						4
Profit/(loss) attributable to:						
Innovative tier 1 holders						9
Preference share holders						19
Minority interests						–
Ordinary shareholders of Alliance & Leicester plc						(24)
Segment/total assets	44,429	9,010	22,590	–	1,016	77,045

Business unit net interest income and core operating profit for 2007 has been restated to reflect a revised capital allocation methodology implemented from 1 January 2008. There is no impact at Group level. The capital allocated to each business unit reflects the capital required for each product under Basel II.

Period ended 30 June 2007 (Unaudited)	Retail Banking	Commercial Banking		Group Items	Other	Group
	£m	Commercial Bank £m	Treasury £m	£m	£m	£m
Net interest income	299	76	31	6	–	412
Non-interest income	138	178	(1)	1	–	316
Total external income	437	254	30	7	–	728
Operating expenses	(180)	(133)	(6)	(21)	–	(340)
Depreciation on operating lease assets	–	(37)	–	–	–	(37)
Impairment losses	(50)	(6)	–	–	–	(56)
Core operating profit/(loss)	207	78	24	(14)	–	295
Redundancy costs					(1)	(1)
Hedge ineffectiveness					(4)	(4)
Profit before tax						290
Tax						(77)
Profit after tax						213
Profit attributable to:						
Innovative tier 1 holders						8
Preference share holders						19
Minority interests						2
Ordinary shareholders of Alliance & Leicester plc						184
Segment/total assets	44,178	7,313	19,025	–	648	71,164

Year ended 31 December 2007 (Unaudited - restated)	Retail Banking	Commercial Banking		Group Items	Other	Group
	£m	Commercial Bank £m	Treasury £m	£m	£m	£m
Net interest income	599	166	39	(3)	–	801
Non-interest income	307	360	(36)	3	–	634
Total external income	906	526	3	–	–	1,435
Operating expenses	(372)	(274)	(13)	(32)	–	(691)
Depreciation on operating lease assets	–	(74)	–	–	–	(74)
Impairment losses	(85)	(15)	(153)	–	–	(253)
Core operating profit/(loss)	449	163	(163)	(32)	–	417
Redundancy costs					(8)	(8)
Hedge ineffectiveness					(10)	(10)
Profit before tax						399
Tax						(103)
Profit after tax						296
Profit attributable to:						
Innovative tier 1 holders						17
Preference share holders						19
Minority interests						3
Ordinary shareholders of Alliance & Leicester plc						257
Segment/total assets	46,693	8,414	23,085	–	763	78,955

5 IMPAIRMENT LOSSES

30 June 2008 (Unaudited)	Retail Banking			Commercial Banking		Total £m
	Mortgages £m	Personal loans £m	Current accounts £m	Commercial Bank £m	Treasury £m	
At 1 January 2008						
Individual	1.9	–	–	13.4	121.7	137.0
Collective	11.1	107.3	16.1	13.2	–	147.7
Total	13.0	107.3	16.1	26.6	121.7	284.7
Charge for the period:						
Increase in provisions	7.7	42.6	11.7	8.3	143.2	213.5
Recoveries of amounts previously written off	(0.4)	(6.9)	(0.4)	(0.4)	–	(8.1)
Total	7.3	35.7	11.3	7.9	143.2	205.4
Amounts written off in period	(3.5)	(42.9)	(4.5)	(8.4)	(61.5)	(120.8)
Total	16.8	100.1	22.9	26.1	203.4	369.3
At 30 June 2008						
Individual	4.3	–	–	11.0	203.4	218.7
Collective	12.5	100.1	22.9	15.1	–	150.6
Total	16.8	100.1	22.9	26.1	203.4	369.3

30 June 2007 (Unaudited)	Retail Banking			Commercial Banking		Total £m
	Mortgages £m	Personal loans £m	Current accounts £m	Commercial Bank £m	Treasury £m	
At 1 January 2007						
Individual	2.0	–	–	8.6	–	10.6
Collective	11.4	126.4	10.1	9.8	–	157.7
Total	13.4	126.4	10.1	18.4	–	168.3
Charge for the period:						
Increase in provisions	0.1	49.4	8.0	6.2	–	63.7
Recoveries of amounts previously written off	(0.4)	(6.6)	(0.2)	(0.5)	–	(7.7)
Total	(0.3)	42.8	7.8	5.7	–	56.0
Amounts written off in period	(0.1)	(37.1)	(5.5)	(1.9)	–	(44.6)
Arising on acquisitions	–	–	–	2.2	–	2.2
Total	13.0	132.1	12.4	24.4	–	181.9
At 30 June 2007						
Individual	1.8	–	–	12.9	–	14.7
Collective	11.2	132.1	12.4	11.5	–	167.2
Total	13.0	132.1	12.4	24.4	–	181.9

31 December 2007 (Audited)	Retail Banking			Commercial Banking		Total £m
	Mortgages £m	Personal loans £m	Current accounts £m	Commercial Bank £m	Treasury £m	
At 1 January 2007						
Individual	2.0	–	–	8.6	–	10.6
Collective	11.4	126.4	10.1	9.8	–	157.7
Total	13.4	126.4	10.1	18.4	–	168.3
Charge for the year:						
Increase in provisions	1.6	82.8	16.6	15.9	152.9	269.8
Recoveries of amounts previously written off	(0.8)	(14.5)	(0.3)	(1.1)	–	(16.7)
Total	0.8	68.3	16.3	14.8	152.9	253.1
Amounts written off in year	(1.2)	(87.4)	(10.3)	(8.8)	(31.2)	(138.9)
Arising on acquisitions	–	–	–	2.2	–	2.2
Total	13.0	107.3	16.1	26.6	121.7	284.7
At 31 December 2007						
Individual	1.9	–	–	13.4	121.7	137.0
Collective	11.1	107.3	16.1	13.2	–	147.7
Total	13.0	107.3	16.1	26.6	121.7	284.7

6 PROFIT BEFORE TAX

Profit before tax includes the following significant items:

	As at 30.06.08 Unaudited £m	As at 30.06.07 Unaudited £m	As at 31.12.07 Audited £m
Reduction in the fair value of certain treasury investments	(66.3)	–	(32.0)
Impairment of certain treasury investments	(143.2)	–	(152.9)
Strategic funding and liquidity holding costs	(70.0)	–	(23.0)
Hedge ineffectiveness	(6.3)	(4.1)	(9.5)
Impairment of property plant and equipment	–	(9.3)	–
Redundancy	(14.4)	(1.1)	(8.4)

7 CORPORATION TAX

The tax credit for the period to 30 June 2008 was £2.0m (June 2007: £77.5m charge, December 2007: £103.3m charge).

The underlying effective tax rate in the first half of 2008 was 28.2% (June 2007: 27.6%, December 2007 27.2%).

Statutory profit before tax for the first half of 2008 was £1.8m. In calculating the underlying effective tax rate adjustments have been made for a tax credit of £1.8m in respect of the £6.3m fair value accounting volatility loss and a tax credit of £4.1m in respect of £14.4m of redundancy costs. Underlying profits have also been adjusted for the appropriation of profit of £8.7m in respect of our innovative tier 1 capital securities.

Statutory profit before tax for the first half of 2007 was £290.1m. In calculating the underlying effective tax rate adjustments have been made for a tax credit of £1.2m in respect of the £4.1m fair value accounting volatility loss and a tax credit of £0.3m in respect of £1.1m of redundancy costs. Underlying profits have also been adjusted for the appropriation of profit of £8.7m in respect of our innovative tier 1 capital securities.

Statutory profit before tax for the full year 2007 was £399.2m. In calculating the underlying effective tax rate adjustments have been made for a tax credit of £2.9m in respect of the £9.5m fair value accounting volatility loss and a tax credit of £2.5m in respect of £8.4m redundancy costs. Underlying profits have also been adjusted for the appropriation of profit of £17.5m in respect of our innovative tier 1 capital securities.

8 (LOSS)/EARNINGS PER SHARE

The basic statutory loss per ordinary share of 5.7p is calculated by dividing the Group loss attributable to ordinary shareholders of £23.9m by the weighted average number of ordinary shares in issue during the period of 422.7 million.

	Six months ended 30.06.08 Unaudited	Six months ended 30.06.07 Unaudited	Year ended 31.12.07 Audited
Group (loss)/profit attributable to ordinary shareholders	(£23.9m)	£183.6m	£256.7m
Weighted average number of ordinary shares in issue during the period	422.7m	438.8m	432.4m
Basic statutory (loss)/earnings per ordinary share	(5.7p)	41.8p	59.4p

The diluted loss per ordinary share of 5.7p is based on the total dilutive potential shares and the Group loss attributable to ordinary shareholders. The total dilutive potential shares are the weighted average number of ordinary shares, together with all dilutive financial instruments or rights that may entitle the holder to ordinary shares.

	Six months ended 30.06.08 Unaudited Number m	Six months ended 30.06.07 Unaudited Number m	Year ended 31.12.07 Audited Number m
Weighted average number of ordinary shares in issue	422.7	438.8	432.4
Weighted average diluted options outstanding	–	2.6	2.4
Total	422.7	441.4	434.8

	As at 30.06.08 Unaudited Number m	As at 30.06.07 Unaudited Number m	As at 31.12.07 Audited Number m
Total number of shares in issue	420.9	430.2	420.6

9 SECURITISATION

Loans and advances to customers include securitised residential mortgages.

Alliance & Leicester plc has established a number of securitisation structures to raise funding for the Group. Special Purpose Vehicles ('SPVs') have purchased beneficial interests in portfolios of residential mortgages that are funded by floating rate mortgage backed debt securities ('Notes'). The assets and liabilities of the SPVs have been consolidated on a line by line basis, as Alliance & Leicester plc controls the SPVs.

The Company provides subordinated loans of £467.2m (June 2007: £44.2m, December 2007: £374.6m) to its securitisation structures. The Notes are serviceable firstly from cash flows generated by the mortgage assets and thereafter from the proceeds of the subordinated loans. The Company receives the excess spread on the transactions as deferred consideration, after the SPVs have met their liabilities. The Group's maximum exposure (including subordinated loans) to the credit risk of securitised mortgages is £18,973.1m (June 2007: £698.9m, December 2007: £13,075.2m). This credit risk exposure relates to the subordinated loans, Notes purchased and retained by the Group and the risks retained upon the transfer of Notes to investors outside the Group.

Fosse Master Trust

Alliance & Leicester plc established the Fosse Master Trust securitisation structure in 2006. Notes are issued by Fosse Master Issuer plc and the proceeds loaned to Fosse Funding (No. 1) Limited, which in turn uses the funds to purchase beneficial interests in mortgages held by Fosse Trustee Limited. Alliance & Leicester plc and its subsidiaries are not obliged to support any losses that may be suffered by the Note holders and do not intend to offer such support. The Note holders only receive payments of interest and principal to the extent that Fosse Master Issuer plc has received sufficient funds from the transferred loans and after certain expenses have been met. The Company raised £2,505.4m in 2006 and a further £2,502.3m in 2007 from securitisations involving the Fosse Master Trust.

Bracken Securities plc

In October 2007 the Company securitised £10,367.0m of residential mortgage assets to Bracken Securities plc. Notes of £10,367.0m were issued by Bracken Securities plc to Alliance & Leicester plc, either for the purpose of creating collateral to be used for funding or for subsequent transfer of Notes to investors outside the Group.

Langton Master Trust

Alliance & Leicester plc established the Langton Master Trust securitisation structure on 25 January 2008. Notes are issued by Langton Securities (2008-1) plc, Langton Securities (2008-2) plc and Langton Securities (2008-3) plc to Alliance & Leicester plc, either for the purpose of creating collateral to be used for funding or for subsequent transfer of Notes to investors outside the Group. Each entity loaned the proceeds of the Notes issued to Langton Funding (No.1) Limited, which in turn used the funds to purchase a beneficial interest in the mortgages held by Langton Mortgages Trustee Limited. The Note holders only receive payments of interest and principal to the extent that the Note Issuing Entity has received sufficient funds from the transferred loans and after certain expenses have been met.

The balances of assets subject to securitisation and Notes in issue at 30 June were as follows:

Securitisation company	Date of securitisation	Gross assets securitised	As at	Gross assets securitised	As at	Gross assets securitised	As at
			30.06.08 Unaudited £m		External Notes in issue		30.06.07 Unaudited £m
Fosse Master Issuer plc	28 Nov 2006	2,013.7	2,125.6	2,324.0	2,377.2	2,145.8	2,292.1
Fosse Master Issuer plc	1 Aug 2007	2,121.1	2,440.9	–	–	2,357.4	2,568.2
Alliance & Leicester plc's retained interests		3,273.1	n/a	654.8	n/a	3,991.2	n/a
Total		7,407.9	4,566.5	2,978.8	2,377.2	8,494.4	4,860.3
Langton Securities (2008-1) plc	25 Jan 2008	1,843.7	–	–	–	–	–
Langton Securities (2008-2) plc	5 Mar 2008	2,012.9	–	–	–	–	–
Langton Securities (2008-3) plc	17 Jun 2008	3,610.6	–	–	–	–	–
A&L plc's retained interests		1,415.5	n/a	–	n/a	–	n/a
Total		8,882.7	–	–	–	–	–
Bracken Securities plc (Note 1)	11 Oct 2007	8,774.5	–	–	–	9,969.7	–
Total		25,065.1	4,566.5	2,978.8	2,377.2	18,464.1	4,860.3

(Note 1) Excludes notes sold by Bracken Securities plc, where the Company is contractually required or expected to repurchase prior to maturity.

10 COVERED BOND

Included within loans and advances to customers are £3,614.9m (June 2007: nil, December 2007: nil) of mortgage advances assigned to a bankruptcy remote special purpose entity, Alliance & Leicester Covered Bonds LLP. These loans provide security to issues of covered bonds made by Alliance & Leicester plc. These transactions do not qualify for derecognition under IAS 39. On 15 April 2008 Alliance & Leicester plc issued £500m of covered bonds, under its covered bond programme, which were held by Alliance & Leicester plc at 30 June 2008.

11 INTANGIBLE FIXED ASSETS

30 June 2008 (Unaudited)

	Goodwill £m	Software development cost £m	Intangible assets under development £m	Total £m
Cost				
At 1 January 2008	11.1	54.1	70.4	135.6
Additions	10.9	9.4	32.3	52.6
At 30 June 2008	22.0	63.5	102.7	188.2
Amortisation				
At 1 January 2008	1.8	17.7	–	19.5
Charge for the period	–	7.4	–	7.4
At 30 June 2008	1.8	25.1	–	26.9
Net book value				
At 30 June 2008	20.2	38.4	102.7	161.3
At 31 December 2007	9.3	36.4	70.4	116.1

30 June 2007 (Unaudited)

	Goodwill £m	Software development cost £m	Intangible assets under development £m	Total £m
Cost				
At 1 January 2007	4.8	38.5	19.6	62.9
Additions	6.3	6.2	23.7	36.2
At 30 June 2007	11.1	44.7	43.3	99.1
Amortisation				
At 1 January 2007	1.8	6.4	–	8.2
Charge for the period	–	5.2	–	5.2
At period end	1.8	11.6	–	13.4
Net book value				
At 30 June 2007	9.3	33.1	43.3	85.7
At 31 December 2006	3.0	32.1	19.6	54.7

31 December 2007 (Audited)	Goodwill £m	Software development cost £m	Intangible assets under development £m	Total £m
Cost				
At 1 January 2007	4.8	38.5	19.6	62.9
Additions	6.3	15.6	50.8	72.7
At 31 December 2007	11.1	54.1	70.4	135.6
Amortisation				
At 1 January 2007	1.8	6.4	–	8.2
Charge for the year	–	11.3	–	11.3
At 31 December 2007	1.8	17.7	–	19.5
Net book value				
At 31 December 2007	9.3	36.4	70.4	116.1
At 31 December 2006	3.0	32.1	19.6	54.7

12 OTHER BORROWED FUNDS

	As at 30.06.08 Unaudited £m	As at 30.06.07 Unaudited £m	As at 31.12.07 Audited £m
Dated loan capital	982.3	668.7	688.2
Total subordinated liabilities	982.3	668.7	688.2
Accrued interest	17.9	13.7	17.2
Fair value hedging adjustments	(22.3)	(12.5)	9.0
Less: unamortised issue costs	(6.1)	(3.4)	(3.2)
Total	971.8	666.5	711.2
Maturing by 2008	–	75.0	75.0
Maturing by 2013	59.3	50.5	55.0
Maturing by 2015	75.3	74.8	74.9
Maturing by 2017	118.6	101.0	110.0
Maturing by 2017	79.1	67.4	73.3
Maturing by 2023	150.0	150.0	150.0
Maturing by 2023	350.0	–	–
Maturing by 2031	150.0	150.0	150.0
Total loan capital	982.3	668.7	688.2

The following subordinated loans each exceed 10% of total subordinated liabilities. The subordinated debt was raised in order to increase the capital base of the Company.

	Terms	£m
Subordinated Notes due 2017	Floating rate	118.6
Subordinated Notes due 2023	Fixed interest rate of 5.25%	150.0
Subordinated Notes due 2023	Fixed interest rate of 9.625%	350.0
Subordinated Notes due 2031	Fixed interest rate of 5.875%	150.0

The interest rate liabilities of 5.25% on the £150m Notes due 2023, 9.625% on the £350m Notes due 2023 and 5.875% on the £150m Notes due 2031, have each been swapped into floating rates. The Subordinated Notes due 2023 and 2031 are denominated in UK Sterling. The Subordinated Notes due 2015 are denominated in US Dollars. The Subordinated Notes due 2013 and 2017 are denominated in Euros.

The Notes are subordinated to the claims of depositors and all other unsubordinated creditors.

All the Notes may be redeemed at the option of Alliance & Leicester plc, at the outstanding principal amount plus accrued interest, in the event of certain changes in UK taxation. Alliance & Leicester plc or any of its subsidiaries may also purchase the Notes in the open market. The 2013 Notes can be redeemed, at the option of Alliance & Leicester plc, at the outstanding principal amount plus accrued interest, not before November 2008. The 2015 Notes can be redeemed, at the option of Alliance & Leicester plc, at the outstanding principal amount plus accrued interest, not before September 2010. The £118.6m 2017 Notes can be redeemed, at the option of Alliance & Leicester plc, at the outstanding principal amount plus accrued interest, not before August 2012. The £79.1m 2017 Notes can be redeemed, at the option of Alliance & Leicester plc, at the outstanding principal amount plus accrued interest, not before October 2012. The £150.0m 2023 Notes can be redeemed, at the option of Alliance & Leicester plc, at the outstanding principal amount plus accrued interest, not before March 2018. The £350.0m 2023 Notes can be redeemed, at the option of Alliance & Leicester plc, at the outstanding principal amount plus accrued interest, not before October 2018. No such purchase or redemption may be made without the consent of the Financial Services Authority.

The Group has not had any defaults of principal, interest or other breaches with respect to any liabilities during the period.

13 INNOVATIVE TIER 1

On 22 March 2004, Alliance & Leicester plc issued £300m of innovative tier 1 capital securities. The tier 1 securities are perpetual securities and pay a coupon on 22 March each year, with the first coupon paid on 22 March 2005. At each payment date, Alliance & Leicester plc can decide whether to declare or defer the coupon indefinitely. If a coupon is deferred then Alliance & Leicester plc may not pay a dividend on any share until it next makes a coupon payment. Alliance & Leicester plc can be obliged to make payment only in the event of winding up.

The coupon is 5.827% per annum until 22 March 2016. Thereafter the coupon steps up to a rate, reset every five years, of 2.13% per annum above the gross redemption yield on a UK Government Treasury Security. The whole of the tier 1 securities are redeemable at the option of Alliance & Leicester plc on 22 March 2016 or on each coupon payment date thereafter. No such redemption may be made without the consent of the Financial Services Authority.

	As at 30.06.08 Unaudited £m	As at 30.06.07 Unaudited £m	As at 31.12.07 Audited £m
Cost			
At 1 January	310.6	310.6	310.6
Appropriations	8.7	8.7	17.5
Coupon paid	(17.5)	(17.5)	(17.5)
At period end	301.8	301.8	310.6

14 PREFERENCE SHARES

On 24 May 2006, Alliance & Leicester plc issued 300,000 fixed/floating rate non-cumulative callable preference shares for £1,000 each, resulting in net proceeds of £294m. The preference shares entitle the holders to a discretionary fixed non-cumulative dividend of 6.222% per annum, payable annually from 24 May 2007 until 24 May 2019, and quarterly thereafter at a rate of 1.13% per annum above three month sterling LIBOR. The preference shares are redeemable, in whole only, at the option of Alliance & Leicester plc on 24 May 2019 or on each quarterly dividend payment date thereafter. No such redemption may be made without the consent of the Financial Services Authority.

15 SHARE CAPITAL

	As at 30.06.08 Unaudited Number m	As at 30.06.07 Unaudited Number m	As at 31.12.07 Audited Number m
Authorised share capital:			
Ordinary shares of 50p	776.0	776.0	776.0
Preference shares of £1	300.0	300.0	300.0
Issued allotted and fully paid:			
Ordinary shares of 50p	420.9	430.2	420.6
Preference shares of £1	0.3	0.3	0.3

During 2008 the Group repurchased nil (2007: 19,943,838) shares with a nominal value of £nil (2007: £10.0m), at a cost of £nil (2007: £193.8m).

16 SHAREHOLDERS' EQUITY

	Share capital £m	Share premium £m	Capital redemption reserve £m	Reserve for share based payments £m	Available- for- sale £m	Cash flow hedging reserve £m	Retained earnings £m	Total shareholders' equity £m
As at 1 January 2008	210.3	125.1	89.9	26.2	(142.7)	(13.7)	1,420.5	1,715.6
Net loss for the period	-	-	-	-	-	-	(23.9)	(23.9)
Final dividend for 2007	-	-	-	-	-	-	(153.6)	(153.6)
Losses from changes in fair value	-	-	-	-	(282.1)	(77.8)	-	(359.9)
Net losses transferred to profit on disposal	-	-	-	-	0.2	-	-	0.2
Transferred to net profit	-	-	-	-	17.8	(1.6)	-	16.2
New shares issued	0.2	1.9	-	-	-	-	-	2.1
Share option costs charged to profit in the period	-	-	-	1.7	-	-	-	1.7
Transferred to equity	-	-	-	(1.2)	-	-	-	(1.2)
Deferred tax	-	-	-	-	74.2	22.2	-	96.4
As at 30 June 2008	210.5	127.0	89.9	26.7	(332.6)	(70.9)	1,243.0	1,293.6

	Share capital £m	Share premium £m	Capital redemption reserve £m	Reserve for share based payments £m	Available-for-sale £m	Cash flow hedging reserve £m	Retained earnings £m	Total shareholders' equity £m
As at 1 January 2007	219.0	105.6	79.9	21.0	4.2	(19.3)	1,557.4	1,967.8
Net profit for the period	-	-	-	-	-	-	183.6	183.6
Final dividend 2006	-	-	-	-	-	-	(160.1)	(160.1)
Gains/(losses) from changes in fair value	-	-	-	-	0.4	(54.5)	-	(54.1)
Transferred to net profit	-	-	-	-	-	(2.9)	-	(2.9)
New shares issued	0.9	13.7	-	-	-	-	-	14.6
Share buybacks	(4.8)	-	4.8	-	-	-	(109.4)	(109.4)
Share option costs charged to profit in the period	-	-	-	4.4	-	-	-	4.4
Transferred to equity	-	-	-	(2.1)	-	-	-	(2.1)
Deferred tax	-	-	-	-	(0.1)	17.2	-	17.1
As at 30 June 2007	215.1	119.3	84.7	23.3	4.5	(59.5)	1,471.5	1,858.9

	Share capital £m	Share premium £m	Capital redemption reserve £m	Reserve for share based payments £m	Available-for-sale £m	Cash flow hedging reserve £m	Retained earnings £m	Total shareholders' equity £m
As at 1 January 2007	219.0	105.6	79.9	21.0	4.2	(19.3)	1,557.4	1,967.8
Net profit for the period	-	-	-	-	-	-	256.7	256.7
Final dividend for 2006	-	-	-	-	-	-	(160.1)	(160.1)
Interim dividend for 2007	-	-	-	-	-	-	(80.7)	(80.7)
Actuarial gain on retirement benefit obligations	-	-	-	-	-	-	56.4	56.4
(Losses)/gains from changes in fair value	-	-	-	-	(219.8)	14.8	-	(205.0)
Net losses transferred to profit on disposal	-	-	-	-	(0.6)	-	-	(0.6)
Transferred to net profit	-	-	-	-	10.6	(7.4)	-	3.2
New shares issued	1.3	19.5	-	-	-	-	-	20.8
Share buybacks	(10.0)	-	10.0	-	-	-	(193.8)	(193.8)
Share option costs charged to profit in the year	-	-	-	7.6	-	-	-	7.6
Transferred to equity	-	-	-	(2.4)	-	-	-	(2.4)
Deferred tax	-	-	-	(5.0)	-	(1.8)	(15.4)	(22.2)
Current tax	-	-	-	5.0	62.9	-	-	67.9
As at 31 December 2007	210.3	125.1	89.9	26.2	(142.7)	(13.7)	1,420.5	1,715.6

17 DIVIDENDS

During the period a final dividend of 36.5p per ordinary share in respect of 2007 (2007: 36.5p) was paid amounting to £153.6m (2007: £160.1m).

An interim dividend of 18.0p has been declared by the Board.

18 CONTINGENT LIABILITIES

Litigation

On 27 July 2007 it was announced that the Office of Fair Trading ("OFT") had agreed with eight financial institutions to start proceedings in the High Court of England and Wales in a test case to determine the legal status and enforceability of certain charges relating to unauthorised overdrafts. Alliance & Leicester plc is not part of the proceedings but will be bound by the outcome.

During the test case proceedings the Financial Ombudsman Service has agreed to suspend reviews of all personal customer current account fee complaints, and the majority of county courts have agreed to stay pending any potential future litigation in relation to such matters. In addition, the Financial Services Authority ("FSA") has granted banks a waiver from processing complaints received from customers in respect of current account overdraft charges. This waiver has recently been extended to January 2009.

On 24 April 2008, a High Court judgment was announced in respect of the first stage of the process. The Court's judgment was that the institutions' current terms and conditions relating to unauthorised overdraft charges are not unenforceable penalties, but are assessable for fairness under the Unfair Terms in Consumer Contracts Regulations 1999. The financial institutions are appealing the fairness ruling, and this is expected to be heard in the second half of 2008.

A further Court hearing took place in July 2008 to assess whether historic charges could be challenged by customers. No judgment has been made on this to date.

The OFT have also indicated that they expect to engage with the financial institutions on the question of fairness, though the ultimate decision as to fairness is a matter for a Court.

It is likely that the test case process will take some time to conclude, and until the outcome of the test case is finally determined it is not possible to conclude whether the charges are fair or otherwise. On this basis, no provision for any claims that may arise has been made in these accounts. Whilst the legal proceedings continue, and given the numerous uncertainties regarding the case, there are a range of possible outcomes that could be finally determined. These would cover the period over which reimbursement would be required and the level of reimbursement. Therefore, it is not practicable, at this stage, to reliably estimate the financial impact on the Group if the Court rules against the financial institutions.

Collateral - Assets pledged as collateral security

£21,696.2m (December 2007: £17,683.0m), including amounts disclosed in Note 9 relating to credit risk exposure, of assets are pledged as collateral under repurchase agreements and loans with other banks and for security deposits relating to local futures, options stock exchange memberships and funding.

Capital commitments

	As at 30.06.08 Unaudited £m	As at 30.06.07 Unaudited £m	As at 31.12.07 Audited £m
Future capital expenditure:			
Contracted for but not provided in the accounts	32.5	15.0	1.7

The following table indicates the contractual amounts of the Group's financial instruments that commit them to extend credit to customers:

	As at 30.06.08 Unaudited £m	As at 30.06.07 Unaudited £m	As at 31.12.07 Audited £m
Contingent liabilities:			
Guarantees, liquidity facilities and irrevocable letters of credit	277.4	390.2	402.0
Commitments:			
Irrevocable undrawn loan facilities	1,971.5	1,166.0	1,699.2

Contingent liabilities and commitments are shown on a basis consistent with the regulatory reporting of these items.

Included within loans and advances to customers is £721.1m (December 2007: £26.8m) in respect of bankruptcy remote Special Purpose Vehicles (SPVs) in relation to our off balance sheet Conduit. The SPVs, owned by charitable trusts, are funded by Asset Backed Commercial Paper and invest in 'AAA' rated assets. The Group provides liquidity facilities to the SPVs, amounting to £708m at 30 June 2008 (December 2007: £698m).

Against the backdrop of continued tension in the funding markets, the liquidity facility was fully drawn in the first half of 2008. The recoverability of the loans is considered with respect to the quality of the SPV assets, and to date a £7m impairment provision is considered appropriate. The SPVs are not consolidated into the Group accounts on the basis that the SPVs are not controlled by the Group and the benefits the Group receives from the SPVs are restricted to interest and fees relating directly to the loans and liquidity facilities provided.

Alliance & Leicester International Limited, a subsidiary licensed under the Isle of Man Banking Acts 1975 to 1986, has a contingent liability to the Isle of Man Depositors Compensation Scheme.

The Company guarantees and gives commitments in respect of some of its subsidiary undertakings.

Recommended offer for the entire share capital of Alliance & Leicester plc by Santander

Santander and Alliance & Leicester plc have entered into an Implementation Agreement, which contains an agreement to pay a break fee to Santander of £12.6m (inclusive of VAT) if, before the acquisition is withdrawn or lapses or, with the consent of the Takeover Panel, is not made (i) an announcement concerning an alternative proposal is made and that alternative proposal becomes effective or is otherwise completed or (ii) the directors of Alliance & Leicester plc fail to recommend that Alliance & Leicester plc shareholders accept the acquisition or vote in favour of the resolutions required to implement the acquisition at the relevant Scheme and shareholder meetings or as applicable withdraw, qualify or adversely modify their recommendation.

19 RELATED PARTY TRANSACTIONS

The Group had no material or unusual related party transactions during the half year to 30 June 2008.

20 CASH AND CASH EQUIVALENTS

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

	Six months ended 30.06.08 Unaudited £m	Six months ended 30.06.07 Unaudited £m	Year ended 31.12.07 Audited £m
Cash and balances with central banks	1,993.5	1,589.1	3,471.0
Due to other banks	268.4	439.3	384.5
Total	2,261.9	2,028.4	3,855.5

21 EVENTS AFTER THE BALANCE SHEET DATE

In July, Santander approached the Board of Alliance & Leicester plc with a proposed offer to acquire the entire share capital of the Company. On 14 July, after careful consideration and discussions with our advisors, the Board took the decision to recommend the acquisition by Santander to our shareholders.

It is intended that the acquisition will be implemented by means of a Scheme of Arrangement under sections 895 to 899 of the Companies Act. It is expected the Scheme Document will be posted in August 2008 and, subject to the satisfaction of a number of conditions, including shareholder approval being granted at an Extraordinary General Meeting, likely to take place in September, the Scheme will become effective and the acquisition completed in or around October 2008.

This transaction has had no impact on Alliance & Leicester plc's reported results for the first six months of 2008.

22 PRINCIPAL RISKS AND UNCERTAINTIES

The Disclosure and Transparency Rules (DTR 4.2.7R) require that a description of the principal risks and uncertainties are given in the half-yearly financial report for the remaining six months of the financial year.

Alliance & Leicester plc's principal inherent risks are described in the Risk Management Policy and Control Framework section on pages 54 to 72 of the 2007 Annual Report and Accounts.

The Interim Management Report of this document comments on the primary risks and uncertainties affecting Alliance & Leicester for the remaining six months of the year. These risks and uncertainties and how Alliance & Leicester are mitigating these are summarised below.

Market and economic outlook

The outlook for the UK economy has worsened as 2008 has progressed, and the degree of uncertainty about the economic outlook has increased. Whilst our current base case economic assumptions are broadly in line with the consensus of market commentators, at this early stage in the economic cycle we see significantly more risks to the downside of our base case forecast than to the upside.

In our base case scenario, UK GDP growth in 2008 and 2009 is expected to remain positive, but significantly below long term averages. Inflation is expected to peak later this year, although this will depend on wage inflation remaining broadly stable, and unemployment is expected to increase, but to remain lower than experienced in previous periods of economic slowdown.

UK gross mortgage lending continues to remain more robust than net lending, which has fallen by over 44% in the first half of the year. The sharper fall in net lending reflects the significant decline in house purchase activity, particularly for first time buyers. The housing market remains exceptionally subdued, with new buyer enquiries and new instructions to sell continuing to fall. House prices have fallen by 6% over the past 12 months and are expected to fall further in the second half of the year.

Alliance & Leicester's strategy and the prudent approach we have taken in response to the difficult financial market conditions since late last summer, have enabled the Group to be resilient in the current very difficult trading environment. The Board is, however, acutely aware of the significant external risks and uncertainties presented by deteriorating in economic conditions and the continuing turbulence in financial markets. There is a risk that the current economic and market turbulence could continue for a significant period of time, and a risk of further uncertainty and contagion impacting the valuation of Alliance & Leicester.

Against this background, the proposal from Santander provides both greater stability and greater certainty in uncertain times. In addition, there are clear benefits in being part of a global financial group in the current environment, and an excellent strategic fit between our business and Santander's existing UK operations.

Funding and liquidity

Liquidity risk is the risk that the Group does not have sufficient financial resources available to meet its obligations as they fall due, or that the Group is unable to meet regulatory prudential liquidity ratios.

In the first half of 2008 we continued to implement the strategic funding programme we started in October 2007, and have now pre-funded our medium term wholesale funding, commercial paper and certificates of deposit into the third quarter of 2009.

In addition to funding our customer loans and advances we also hold liquidity, in the form of cash and short term deposits, to manage the day to day requirements of the business. We continue to hold a significantly higher level of liquidity than in the first half of 2007, in recognition of the current market conditions. Cash and balances with central banks, and the value of funds due from other banks, was £6.6bn at the end of June 2008, £3.4bn higher than at the end of June 2007 and similar to the £6.3bn at the end of December 2007. 56% of our customer loans and advances are funded by customer deposits.

Credit quality

Credit risk is the risk of loss arising from a customer or counter party failing to meet their financial obligations to the Group as and when they fall due.

Our customer loan asset quality remains strong. Our mortgage asset quality remains excellent. The average LTV of our new prime residential lending was 64% (2007: 67%), with just 3% of new lending having an LTV of over 90%. The proportion of mortgage accounts in arrears has increased from 0.49% at the end of December 2007 to 0.61%, reflecting a 24,000 reduction in the number of mortgage accounts and an increase of just 419 accounts in arrears. During the first half of 2008 we have tightened our mortgage credit criteria, including withdrawing our 'PlusMortgage' product and limiting new buy to let mortgages to 75% LTV. The asset quality of our unsecured personal lending remains strong. The value of our traditional unsecured personal loans in arrears increased by just £1m since the end of 2007. We continue to grow our commercial lending balances in our areas of expertise, albeit at a slower rate than in 2007. The proportion of commercial loan balances (capital and arrears) that were past due or impaired at 30 June 2008 was 1.7% (December 2007: 2.2%).

Over 92% of our treasury investments are bank floating rate notes or AAA rated asset backed securities, on which no impairment charges have been incurred. We saw the greatest impairment within our investments in SIV capital notes, which have now been written down from an original value of £390m to £95m. The treasury investment portfolio is reducing as assets mature and redeem, and at the end of June 2008 total treasury assets were £22.6bn, £0.5bn lower than in December 2007. Treasury's trading and investment securities at the end of June 2008 were £13.6bn, £1.9bn lower than in December 2007.

Capital

In order to protect the solvency of the Group, internal capital is held to provide a cushion for unexpected losses. During the first half of 2008 we strengthened our capital base with the issue of £350m of lower tier 2 capital, and we continue to have a number of initiatives which we could implement to strengthen further our capital base in the future. At the end of June 2008 our core tier 1 ratio was 6.5% (2007: 6.9%), which we believe is an appropriate level for the mix and quality of our assets.

Banco Santander

On 14 July 2008 the recommended acquisition of Alliance & Leicester by Santander was announced. Under the terms of the acquisition, Alliance & Leicester ordinary shareholders will receive one Santander share for every three Alliance & Leicester ordinary shares. It is anticipated that further information will be sent to shareholders in August 2008 and subject to, amongst other things, Alliance & Leicester shareholder approval being granted, the transaction is expected to complete in or around October 2008.

If this transaction does not complete, Alliance & Leicester will continue to pursue its strategic objectives.

DIRECTORS' RESPONSIBILITY STATEMENT

We confirm that to the best of our knowledge:

- (a) the condensed set of financial statements have been prepared in accordance with IAS 34;
- (b) the interim management report includes a fair review on the information required by Disclosure and Transparency Rules (DTR) 4.2.7R (indication of important events during the first six months and their impact on the condensed interim financial report, and description of the principal risks and uncertainties for the remaining six months of the year); and
- (c) the interim management report includes a fair review of the information required by DTR 4.2.8R (disclosure of related parties' transactions and changes therein).

By order of the Board, on 31 July 2008

David Bennett
Group Chief Executive

Chris Rhodes
Group Finance Director

INDEPENDENT REVIEW REPORT TO ALLIANCE & LEICESTER PLC

Introduction

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2008, which comprises the condensed income statement, the condensed balance sheet, the condensed statement of recognised income and expense, the condensed cash flow statement and related Notes 1 to 22. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with International Standard on Review Engagements 2410 issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Company those matters we are required to state to them in an independent review 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, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

The annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting," as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report, based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland), and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Review conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2008 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London, England
31 July 2008

9 CONTACTS

Should you have any queries please contact: -

Mark Jones	Head of Investor Relations	Tel: 0116 200 4492
Stuart Dawkins	Director of Corporate Communications	Tel: 0116 200 3088
Press Office		Tel: 0116 200 3355

This report is also available on the Alliance & Leicester corporate web site (www.alliance-leicester-group.co.uk) from 7.00 am on 1 August 2008.

A presentation of the results for analysts and investors will be given on the morning of the results announcement. A live audiocast with synchronised slides of this event will be available from 9.30 am on the Group's corporate web site (www.alliance-leicester-group.co.uk). Later in the day, an archive version of the presentation slides and audio will be available on the Alliance & Leicester corporate web site.

Alliance & Leicester plc. Registered Office: Carlton Park, Narborough, Leicester LE19 0AL.
Company No: 3263713. Registered in England.

10 SHAREHOLDER INFORMATION

Financial calendar

Ex dividend date for the interim dividend	3 September 2008
Record date for interim dividend	5 September 2008
Payment date for interim dividend	6 October 2008

Dividends

Interim dividend 2008	18.0p
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11 FORWARD LOOKING STATEMENTS

This report contains certain forward looking statements with respect to the financial condition, results of operations, and businesses of the Alliance & Leicester Group. These statements and forecasts involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future. There are a number of factors which could cause actual results or developments to differ materially from those expressed or implied by these forward looking statements and forecasts. The statements have been made with reference to forecast price changes, economic conditions, the current regulatory environment and the current interpretations of IFRS applicable to past, current and future periods. Nothing in this announcement should be construed as a profit forecast.

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