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Contents to Financial Statements

Independent Auditors' Report to the Members of Santander UK plc

We have audited the financial statements of Santander UK plc for the year ended 31 December 2009 which comprise the Consolidated Income Statement, the Consolidated and Company Statements of Comprehensive Income, the Consolidated and Company Balance Sheets, the Consolidated and Company Statements of Changes in Equity, the Consolidated and Company Cash Flow Statements, the Accounting Policies and the related Notes 1 to 51. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of directors and auditors

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

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion:

> the financial statements give a true and fair view of the state of the group's and the parent company's affairs as at 31 December 2009 and of the group's profit for the year then ended;

> the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;

> the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and

> the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in the Accounting Policies section of the financial statements, the group in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB). In our opinion the group financial statements comply with IFRSs as issued by the IASB.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

> adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or

> the financial statements are not in agreement with the accounting records and returns; or

> certain disclosures of directors' remuneration specified by law are not made; or

> we have not received all the information and explanations we require for our audit.

Caroline Britton

Caroline Britton (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditors
London, UK
27 April 2010

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Consolidated Income Statement

For the years ended 31 December 2009, 2008 and 2007

	Notes	2009 £m	2008 £m	2007 £m
Interest and similar income	2	**7,318**	7,915	7,043
Interest expense and similar charges	2	**(3,906)**	(6,143)	(5,544)
Net interest income		**3,412**	1,772	1,499
Fee and commission income	3	**986**	768	785
Fee and commission expense	3	**(162)**	(97)	(90)
Net fee and commission income		**824**	671	695
Dividend income		**-**	-	1
Net trading and other income	4	**460**	561	587
Total operating income		**4,696**	3,004	2,782
Administration expenses	5	**(1,848)**	(1,343)	(1,369)
Depreciation and amortisation	6	**(260)**	(202)	(205)
Total operating expenses excluding provisions and charges		**(2,108)**	(1,545)	(1,574)
Impairment losses on loans and advances	8	**(842)**	(348)	(344)
Provisions for other liabilities and charges		**(56)**	(17)	-
Total operating provisions and charges		**(898)**	(365)	(344)
Profit before tax		**1,690**	1,094	864
Taxation charge	9	**(445)**	(275)	(179)
Profit for the year		**1,245**	819	685
Attributable to:				
Equity holders of the parent		**1,190**	811	685
Non-controlling interest		**55**	8	-

The Notes on pages 124 to 188 are an integral part of these Consolidated Financial Statements.

All profits during the year were generated from continuing operations.

Consolidated Statement of Comprehensive Income

For the years ended 31 December 2009, 2008 and 2007

	Notes	2009 £m	2008 £m	2007 £m
Profit for the year		**1,245**	819	685
Other comprehensive income:				
Actuarial losses on retirement benefit obligations	36	**(606)**	(44)	(113)
(Losses)/gains on available-for-sale securities	18	**(6)**	8	19
Exchange differences on translation of foreign operations		**(4)**	28	(1)
Tax on items taken directly to equity		**171**	8	9
Net loss recognised directly in equity		**(445)**	-	(86)
Gains on available-for-sale securities transferred to profit or loss on sale		**(2)**	-	(1)
Tax on items transferred to profit or loss		**1**	-	-
Net transfers to profit		**(1)**	-	(1)
Total other comprehensive expense for the year before tax		**(618)**	(8)	(96)
Tax relating to components of other comprehensive income		**172**	8	9
Total comprehensive income for the year		**799**	819	598
Attributable to:				
Equity holders of the parent		**744**	811	598
Non-controlling interest		**55**	8	-

Consolidated Balance Sheet

As at 31 December 2009 and 2008

	Notes	2009 £m	2008(1) £m
Assets			
Cash and balances at central banks	11	**4,163**	4,017
Trading assets	12	**33,290**	26,264
Derivative financial instruments	13	**22,827**	35,125
Financial assets designated at fair value	14	**12,358**	11,377
Loans and advances to banks	15	**9,151**	16,001
Loans and advances to customers	16	**186,804**	180,176
Available for sale securities	18	**797**	2,663
Loans and receivables securities	19	**9,898**	14,107
Macro hedge of interest rate risk		**1,127**	2,188
Investment in associated undertakings	21	**75**	35
Intangible assets	22	**1,446**	1,347
Property, plant and equipment	23	**938**	854
Operating lease assets	24	**312**	348
Current tax assets		**85**	212
Deferred tax assets	25	**946**	1,274
Other assets	26	**1,074**	1,322
Total assets		**285,291**	297,310
Liabilities			
Deposits by banks	27	**5,811**	14,488
Deposits by customers	28	**143,893**	130,245
Derivative financial instruments	13	**18,963**	27,810
Trading liabilities	29	**46,152**	40,738
Financial liabilities designated at fair value	30	**4,423**	5,673
Debt securities in issue	31	**47,758**	58,511
Other borrowed funds	32	**1,352**	2,076
Subordinated liabilities	33	**5,597**	6,787
Other liabilities	34	**2,323**	2,342
Provisions	35	**91**	207
Current tax liabilities		**300**	518
Deferred tax liabilities	25	**336**	405
Retirement benefit obligations	36	**1,070**	813
Total liabilities		**278,069**	290,613
Equity			
Share capital	39	**2,709**	1,148
Share premium account	39	**1,857**	3,121
Retained earnings		**1,911**	1,678
Other reserves		**29**	39
		6,506	5,986
Non-controlling interests	38	**716**	711
Total shareholders' equity		**7,222**	6,697
Total liabilities and equity		**285,291**	297,310

(1) Amended for the transfer of Alliance & Leicester plc to the Company as described in Note 47.

The Notes on pages 124 to 188 are an integral part of these Consolidated Financial Statements.

The Financial Statements on pages 102 to 188 were approved and authorised for issue by the Board on 27 April 2010 and signed on its behalf by:

Antonio Lorenzo
Chief Financial Officer

Company Registered Number: 2294747

Consolidated Statement of Changes in Equity

For the years ended 31 December 2009, 2008 and 2007

	Notes	Share Capital £m	Share Premium £m	Other reserves: Available for sale reserve £m	Other reserves: Foreign currency translation reserve £m	Retained earnings £m	Total £m	Non-controlling interest £m	Total £m
1 January 2007		148	1,857	1	(6)	1,116	3,116	-	3,116
Total comprehensive income (gross)		-	-	18	(1)	572	589	-	589
Tax relating to components of other comprehensive income		-	-	(6)	-	15	9	-	9
Dividends declared	40	-	-	-	-	(370)	(370)	-	(370)
Arising through business part-disposal		-	-	-	-	-	-	98	98
31 December 2007		148	1,857	13	(7)	1,333	3,344	98	3,442
1 January 2008		148	1,857	13	(7)	1,333	3,344	98	3,442
Total comprehensive income (gross)		-	-	8	28	767	803	8	811
Tax relating to components of other comprehensive income		-	-	(3)	-	11	8	-	8
Dividends declared	40	-	-	-	-	(450)	(450)	-	(450)
Issued share capital	39	1,000	-	-	-	-	1,000	-	1,000
Capital contribution	39	-	1,264	-	-	17	1,281	-	1,281
Assumed through business combinations	38	-	-	-	-	-	-	605	605
31 December 2008[(1)]		1,148	3,121	18	21	1,678	5,986	711	6,697
1 January 2009		**1,148**	**3,121**	**18**	**21**	**1,678**	**5,986**	**711**	**6,697**
Total comprehensive income (gross)		**-**	**-**	**(8)**	**(4)**	**584**	**572**	**55**	**627**
Tax relating to components of other comprehensive income		**-**	**-**	**2**	**-**	**170**	**172**	**-**	**172**
Dividends declared	40	**-**	**-**	**-**	**-**	**(521)**	**(521)**	**(50)**	**(571)**
Reclassification of RCIs	39	**297**	**-**	**-**	**-**	**-**	**297**	**-**	**297**
Transfer to share capital	39	**1,264**	**(1,264)**	**-**	**-**	**-**	**-**	**-**	**-**
31 December 2009		**2,709**	**1,857**	**12**	**17**	**1,911**	**6,506**	**716**	**7,222**

(1) Amended for the transfer of Alliance & Leicester plc to the Company as described in Note 47.

Consolidated Cash Flow Statement

For the years ended 31 December 2009, 2008 and 2007

	Notes	**2009 £m**	2008[1] £m	2007 £m
Net cash flow from/(used in) operating activities				
Profit for the year		**1,245**	819	685
Adjustments for:				
Non cash items included in net profit		**(24)**	1,297	1,307
Change in operating assets		**7,776**	(30,381)	(12,411)
Change in operating liabilities		**(2,351)**	209	696
Income taxes received/(paid)		**2**	43	(5)
Effects of exchange rate differences		**(3,719)**	6,569	396
Net cash flow from/(used in) operating activities	41	**2,929**	(21,444)	(9,332)
Net cash flow from/(used in) investing activities				
Acquisition of businesses, net of cash acquired	41	**-**	18,667	-
Dividends received from associates		**-**	2	-
Investment in associates		**(35)**	(8)	(8)
Disposal of subsidiaries, net of cash disposed	41	**-**	1,605	5
Disposal of non-controlling interest in subsidiaries		**-**	-	203
Purchase of tangible and intangible fixed assets		**(463)**	(278)	(407)
Proceeds from sale of tangible and intangible fixed assets		**60**	15	8
Purchase of non-trading securities		**(1,133)**	(891)	-
Proceeds from sale of non-trading securities		**3,004**	290	3
Net cash flow from/(used in) investing activities		**1,433**	19,402	(196)
Net cash flow (used in)/from financing activities				
Issue of ordinary share capital		**-**	1,000	-
Issue of loan capital		**1,556**	-	13,363
Preference dividend paid		**(19)**	-	-
Interest paid on Tier 1		**(17)**	-	-
Repayment of loan capital		**(5,895)**	(7,786)	(8,587)
Dividends paid		**(246)**	(595)	-
Net cash flow (used in)/from financing activities		**(4,621)**	(7,381)	4,776
Net decrease in cash and cash equivalents		**(259)**	(9,423)	(4,752)
Cash and cash equivalents at beginning of the year		**27,675**	34,056	39,082
Effects of exchange rate changes on cash and cash equivalents		**(1,052)**	3,042	(274)
Cash and cash equivalents at the end of the year	41	**26,364**	27,675	34,056

(1) Amended for the transfer of Alliance & Leicester plc to the Company as described in Note 47.

The Notes on pages 124 to 188 are an integral part of these Consolidated Financial Statements.

Company Balance Sheet

As at 31 December 2009 and 2008

	Notes	2009 £m	2008 £m
Assets			
Cash and balances at central banks	11	**3,266**	2,456
Derivative financial instruments	13	**2,539**	2,735
Financial assets designated at fair value	14	**37,145**	47,525
Loans and advances to banks	15	**109,658**	116,486
Loans and advances to customers	16	**131,749**	123,319
Available for sale securities	18	**30**	25
Loans and receivables securities	19	**2**	-
Investment in subsidiary undertakings	20	**7,038**	5,147
Investment in associated undertakings	21	**76**	741
Intangible assets	22	**552**	484
Property, plant and equipment	23	**561**	569
Current tax assets		**-**	194
Deferred tax assets	25	**428**	458
Other assets	26	**651**	987
Total assets		**293,695**	301,126
Liabilities			
Deposits by banks	27	**116,414**	124,846
Deposits by customers	28	**159,187**	155,466
Derivative financial instruments	13	**3,353**	5,393
Trading liabilities	29	**-**	739
Other borrowed funds	32	**539**	905
Subordinated liabilities	33	**5,580**	7,030
Other liabilities	34	**1,611**	1,283
Provisions	35	**74**	99
Current tax liabilities		**92**	128
Deferred tax liabilities	25	**-**	6
Retirement benefit obligations	36	**922**	797
Total liabilities		**287,772**	296,692
Equity			
Share capital	39	**2,709**	1,148
Share premium account	39	**1,857**	1,857
Retained earnings		**1,350**	1,422
Available for sale reserve		**7**	7
Total shareholders' equity		**5,923**	4,434
Total liabilities and equity		**293,695**	301,126

The Notes on pages 124 to 188 are an integral part of these Consolidated Financial Statements.

The Financial Statements on pages 102 to 188 were approved and authorised for issue by the Board on 27 April 2010 and signed on its behalf by:

Antonio Lorenzo
Chief Financial Officer

Company Registered Number: 2294747

Company Statement of Comprehensive Income

For the years ended 31 December 2009, 2008 and 2007

	Notes	2009 £m	2008 £m	2007 £m
Profit for the year		**747**	1,328	351
Other comprehensive income/(expenses):				
Actuarial losses on retirement benefit obligations	36	**(414)**	(43)	(116)
(Losses)/gains on available-for-sale securities	18	**-**	(4)	18
Tax on items taken directly to equity		**116**	12	10
Net loss recognised directly in equity		**(298)**	(35)	(88)
Gains on available-for-sale securities transferred to profit or loss on sale		**-**	-	(1)
Tax on items transferred to profit		**-**	-	-
Net transfers to profit		**-**	-	(1)
Total other comprehensive expense for the year before tax		**(414)**	(47)	(99)
Tax relating to components of other comprehensive income		**116**	12	10
Total comprehensive income for the year		**449**	1,293	262
Attributable to:				
Equity holders of the parent		**449**	1,293	262

Company Statement of Changes in Equity

For the years ended 31 December 2009, 2008 and 2007

	Notes	Share Capital £m	Share Premium £m	Available for sale reserve £m	Retained earnings £m	Total £m
1 January 2007		148	1,857	-	694	2,699
Total comprehensive income (gross)		-	-	17	235	252
Tax relating to components of other comprehensive income		-	-	(6)	16	10
Dividends declared	40	-	-	-	(370)	(370)
31 December 2007		148	1,857	11	575	2,591
1 January 2008		148	1,857	11	575	2,591
Total comprehensive income (gross)		-	-	(4)	1,285	1,281
Tax relating to components of other comprehensive income		-	-	-	12	12
Issued share capital	39	1,000	-	-	-	1,000
Dividends declared	40	-	-	-	(450)	(450)
31 December 2008		1,148	1,857	7	1,422	4,434
1 January 2009		**1,148**	**1,857**	**7**	**1,422**	**4,434**
Total comprehensive income (gross)		**-**	**-**	**-**	**333**	**333**
Tax relating to components of other comprehensive income		**-**	**-**	**-**	**116**	**116**
Capital contribution	39	**1,264**	**-**	**-**	**-**	**1,264**
Dividends declared	40	**-**	**-**	**-**	**(521)**	**(521)**
Reclassification of Reserve Capital Instruments	39	**297**	**-**	**-**	**-**	**297**
31 December 2009		**2,709**	**1,857**	**7**	**1,350**	**5,923**

Company Cash Flow Statement

For the years ended 31 December 2009, 2008 and 2007

	Notes	**2009 £m**	2008 £m	2007 £m
Net cash flow (used in)/from operating activities				
Profit for the year		**747**	1,328	351
Adjustments for:				
Non cash items included in net profit		**(207)**	2,038	446
Change in operating assets		**1,103**	(80,636)	(8,761)
Change in operating liabilities		**(6,166)**	128,109	13,865
Income taxes received		**21**	80	48
Effects of exchange rate differences		**(268)**	897	-
Net cash flow (used in)/from operating activities	41	**(4,770)**	51,816	5,949
Net cash flow (used in)/from investing activities				
Increase in investment in subsidiaries		**-**	(598)	(418)
Investment in associates		**(35)**	(708)	(8)
Disposal of subsidiaries, net of cash disposed		**-**	111	415
Disposal of non-controlling interest in subsidiaries		**-**	-	203
Purchase of tangible and intangible fixed assets		**(209)**	(174)	(181)
Proceeds from sale of tangible and intangible fixed assets		**18**	11	-
Purchase of non-trading securities		**(9)**	(9)	-
Proceeds from sale and redemption of non-dealing securities		**3**	8	3
Net cash flow (used in)/from investing activities		**(232)**	(1,359)	14
Net cash flow (used in)/from financing activities				
Issue of ordinary share capital		**-**	1,000	-
Issue of loan capital		**-**	-	65
Repayment of loan capital		**(557)**	(253)	(641)
Dividends paid		**(246)**	(595)	-
Net cash flow (used in)/from financing activities		**(803)**	152	(576)
Net (decrease)/increase in cash and cash equivalents		**(5,805)**	50,609	5,387
Cash and cash equivalents at beginning of the year		**61,203**	10,594	5,207
Effects of exchange rate changes on cash and cash equivalents		**-**	-	-
Cash and cash equivalents at the end of the year	41	**55,398**	61,203	10,594

The Notes on pages 124 to 188 are an integral part of these Consolidated Financial Statements.

Accounting Policies

International Financial Reporting Standards

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') as approved by the International Accounting Standards Board ('IASB'), and interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') of the IASB that, under European Regulations, are effective and available for early adoption at the reporting date. Santander UK plc (formerly Abbey National plc) (the 'Company') and its subsidiaries (together the 'Group') have complied with IFRS as issued by the IASB in addition to complying with its legal obligation to comply with IFRS as adopted for use in the European Union.

Disclosures required by IFRS 7 'Financial Instruments: Disclosure' relating to the nature and extent of risks arising from financial instruments can be found in the Risk Management section on pages 49 to 85 which form part of these Consolidated Financial Statements.

Recent developments

In 2009, the Group adopted the following new or revised IFRS:

a) IAS 23 'Borrowing Costs' - On 29 March 2007, the IASB issued an amendment to IAS 23 'Borrowing costs' which removes the option to expense borrowing costs incurred during the acquisition, construction or production of a qualifying asset. The adoption of the amendment to IAS 23 did not have a material impact on the Group's profit or loss or financial position.

b) IAS 1 'Presentation of Financial Statements' - On 6 September 2007, the IASB issued an amendment to IAS 1 'Presentation of Financial Statements' which changes the way in which non-owner changes in equity are required to be presented. As a result, a 'Statement of Changes in Equity' has been included as a separate primary financial statement showing changes in equity during the periods presented. In addition, the Statement of Recognised Income and Expense has been replaced with a 'Statement of Comprehensive Income'. The adoption of the amendment to IAS 1 did not have any impact on the Group's profit or loss or financial position.

c) IFRS 2 'Share based payments - vesting conditions and cancellations' - On 17 January 2008, the IASB issued an amendment to IFRS 2 'Share based payments' which requires share option awards lapsing due to a failure to meet the service condition to be treated as cancellations rather than forfeitures. The adoption of the amendment to IFRS 2 did not have a material impact on the Group's profit or loss or financial position.

d) IFRS 7 'Financial Instruments: Disclosures - Improving Disclosures about Financial Instruments' - On 5 March 2009, the IASB issued an amendment to IFRS 7 'Financial Instruments: Disclosures' which requires enhanced disclosures about fair value measurements and liquidity risk. Among other things, the amendment (1) requires disclosure of any change in the method for determining fair value and the reasons for the change; (2) establishes a three-level hierarchy for making fair value measurement disclosures; (3) requires disclosure for each fair value measurement in the balance sheet of which level in the hierarchy was used, and any transfers between levels, with additional disclosures whenever level 3 of the hierarchy is used including a measure of sensitivity to a change in input data; (4) clarifies that the current maturity analysis for non-derivative financial liabilities should include issued financial guarantee contracts; and (5) amends the required disclosure of a maturity analysis for derivative financial liabilities. The disclosures required by the amendment to IFRS 7 may be found on pages 177 to 185 and pages 59 and 60.

Future developments

The Group has not yet adopted the following new or revised IFRS or IFRIC interpretations, which have been issued but which are not yet effective for the Group:

a) IFRS 3 'Business Combinations' - On 10 January 2008, the IASB issued an amendment to IFRS 3 'Business Combinations' which clarifies and changes certain elements of accounting for a business combination, including measurement of contingent consideration, step acquisition and intangible assets and also widens the scope of this standard. There are also associated amendments to IAS 27, IAS 28 and IAS 31. The amendment to IFRS 3 is effective for periods beginning on or after 1 July 2009.

b) IFRS 9 'Financial Instruments' - On 12 November 2009, the IASB issued IFRS 9 'Financial Instruments', which significantly overhauls the accounting requirements for financial instruments under IFRS. IFRS 9 is mandatory for annual periods beginning on or after 1 January 2013, with early application permitted. IFRS 9 requires that a financial asset be classified into one of three categories for measurement and income recognition: (1) Amortised cost, (2) Fair value through profit or loss (FVTPL) and (3) Fair value through other comprehensive income. The standard requires reclassification between amortised cost and FVTPL (or vice versa) if a financial asset no longer meets the criteria for its original classification. IFRS 9 replaces the existing classification and measurement requirements in IAS 39 for financial assets. It changes the manner in which entities classify and measure investments in debt and equity securities, loan assets, trade receivables and derivative financial assets by requiring entities to classify financial assets as being measured at either amortized cost or fair value depending on the entity's business model and the contractual cash flow characteristics of the asset. The Group is currently evaluating the requirements of IFRS 9.

Accounting Policies continued

Basis of preparation

The Financial Statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, financial assets and financial liabilities held at fair value through profit or loss and all derivative contracts, and on the going concern basis as disclosed in the Directors' statement of going concern set out in the Directors' Report on pages 89 and 90.

As described in Note 47, the Group has accounted for the transfer of Alliance & Leicester plc retrospectively from 10 October 2008, the date on which Alliance & Leicester plc was acquired by the Company's parent Banco Santander, S.A..

As described in Note 48, the Group has finalised the purchase price allocation in respect of the acquisition of Bradford & Bingley's savings business. As permitted by IFRS 3 "Business Combinations", the final allocation has been accounted for retrospectively from September 2008, the date on which Bradford & Bingley's savings business was acquired.

IAS 1 'Presentation of Financial Statements' requires the presentation of a balance sheet as at the beginning of the earliest period when a company applies an accounting policy retrospectively. In respect of both the above matters, for the Group, this balance sheet would be as at 31 December 2006. However, the retrospective accounting for the transfer of Alliance & Leicester plc and the finalisation of the purchase price allocation in respect of the acquisition of Bradford & Bingley's savings business had no impact on the balance sheet as at 31 December 2006, and so that balance sheet has not been represented in these Consolidated Financial Statements.

Consolidation

a) Subsidiaries
Subsidiaries, which are those companies and other entities (including Special Purpose Entities) over which the Group, directly or indirectly, has power to govern the financial and operating policies, are consolidated. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. The Company recognises investments in subsidiaries at cost less impairment.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured at the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition, plus directly attributable acquisition costs. The excess of the cost of acquisition over the fair value of the tangible and intangible net assets of the subsidiary acquired is recorded as goodwill. Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The accounting reference date of the Company and its subsidiary undertakings is 31 December, with the exception of those leasing, investment, insurance and funding companies which, because of commercial considerations, have various accounting reference dates. The Financial Statements of these subsidiaries have been consolidated on the basis of interim Financial Statements for the period to 31 December.

Transactions between entities under common control are outside the scope of IFRS 3 – Business Combinations, and there is no other guidance for such situations under IFRS. Business combinations between entities under common control transacted for non-cash consideration are accounted for by the Group in a manner consistent with group reconstruction relief under UK GAAP.

b) Associates
Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost. Under this method, the Group's share of the post-acquisition profits or losses of associates is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the cost of the investment. The Company recognises investments in associates at cost less impairment.

Associates are entities in which the Group has between 20% and 50% of the voting rights, or over which the Group has significant influence, but which it does not control. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group has significant influence over another entity. Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The Group's investment in associates includes goodwill on acquisition. When the Group's share of losses in an associate equals or exceeds its interest in the associate the Group does not recognise further losses unless the Group has incurred obligations or made payments on behalf of the associates.

Foreign currency translation

Items included in the Financial Statements of each entity of the Group are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity ('the functional currency'). The Consolidated Financial Statements are presented in pounds sterling, which is the functional currency of the parent.

Income statements and cash flows of foreign entities are translated into the Group's reporting currency at average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December. Exchange differences arising from the translation of the net investment in foreign entities are taken to shareholders' equity. When a foreign entity is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Foreign currency transactions are translated into the functional currency of the entity involved at the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement unless deferred in equity under the cash flow hedge.

The amount of exchange rate differences recognised in profit or loss on items not at fair value through profit and loss was £2,570m income (2008: £5,850m charge, 2007: £505m charge). This was offset by income/charges on items held at fair value.

Revenue recognition

(a) Interest income and expense
Income on financial assets that are classified as loans and receivables or available-for-sale, and interest expense on financial liabilities other than those at fair value through profit and loss are determined using the effective interest method. The effective interest rate is the rate that discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument excluding future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of the financial instrument and all other premiums or discounts. Interest income on assets classified as loans and receivables or available-for-sale, interest expense on liabilities classified at amortised cost and interest income and expense on hedging derivatives are recognised in interest and similar income and interest expense and similar charges in the income statement.

(b) Fee and commissions income
Fees and commissions that are not an integral part of the effective interest rate are recognised when the service has been provided. For retail products, fee and commission income consists principally of collection services fees, commission on foreign currencies, and fees for non-banking financial products. Revenue from these income streams is recognised as earned when the service is provided.

For insurance products, fee and commission income consists principally of commissions earned on the sale of building and contents insurance, life protection insurance and payment cover insurance.

Asset management fee and commission income comprises portfolio and other management advisory and service fees, investment fund management fees, and fees for private banking, financial planning and custody services. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts. Asset management fees related to investment funds are recognised rateably over the period the service is provided. The same principle is applied for private banking, financial planning and custody services that are continuously provided over an extended period of time.

(c) Dividend income
Except for equity securities classified as trading assets or financial assets held at fair value through profit or loss, described below, dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for equity securities.

(d) Net trading and other income
Net trading and other income comprises all gains and losses from changes in the fair value of financial assets and liabilities held at fair value through profit or loss (including financial assets and financial liabilities held for trading and designated as fair value through profit or loss), together with related interest income, expense and dividends. It also includes income from operating lease assets, and profits/(losses) on the sales of fixed assets and subsidiary undertakings.

Changes in the fair value of financial assets and liabilities held for trading, including trading derivatives, are recognised in the income statement as net trading and other income together with dividends and interest receivable and payable. Changes in the fair value of assets and liabilities designated as fair value through profit or loss are recognised in net trading and other income together with dividends, interest receivable and payable and changes in fair value of derivatives managed in conjunction with these assets and liabilities. Changes in fair value of derivatives in a designated hedging relationship are recognised in net trading and other income along with the fair value of the hedged item.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, including computer software, which are assets that necessarily take a substantial period of time to develop for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognised in profit or loss in the period in which they occur.

Pensions and other post retirement benefits

Group companies have various pension schemes. The schemes are generally funded through payments to insurance companies or trustee-administered funds as determined by periodic actuarial calculations. A defined benefit plan is a pension plan that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service or compensation. A defined contribution plan is a pension plan under which the Group pays fixed contributions as they fall due into a separate entity (a fund) and will have no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees benefits relating to employee service in the current and prior periods.

Accounting Policies continued

The liability recognised in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date, less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. Full actuarial valuations of the Group's principal defined benefit schemes are carried out every year. The Group is responsible for the actuarial valuations and in doing so considers or relies in part on a report of a third party expert. The present value of the defined benefit obligation is determined by the estimated future cash outflows using interest rates of high quality corporate bonds, which have terms to maturity closest to the terms of the related liability, adjusted where necessary to match those terms.

The Group's consolidated income statement includes the current service cost of providing pension benefits, the expected return on schemes' assets net of expected administration costs, and the interest cost on the schemes' liabilities. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are taken directly to reserves and recognised in the statement of comprehensive income. Past-service costs are charged immediately to the income statement, unless the changes are conditional on the employees remaining in service for a specified period of time, known as the vesting period. In this case, the past-service costs are amortised on a straight-line basis over the average period until the benefits become vested.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. Once the contributions have been paid, the Group has no further payment obligations. The regular contributions constitute net periodic costs for the year in which they are due and as such are included in staff costs. Curtailment gains and losses on sold businesses that meet the definition of discontinued operations are included in operating expenses in profit or loss for the year from discontinued operations.

Post-retirement medical benefit liabilities are determined using the Projected Unit Credit Method, with actuarial valuations updated at each year-end. The expected benefit costs are accrued over the period of employment using an accounting methodology similar to that for the defined benefit pension scheme.

Share-based payments

The Group engages in cash-settled and equity-settled share-based payment transactions in respect of services received from certain of its employees. Shares of the Group's parent, Banco Santander, S.A. are purchased in the open market by the Group (for the Executive Share Option Scheme, the Employee Sharesave scheme and awards granted under the Medium Term Incentive Plan) or are purchased by Banco Santander, S.A. or another group company (for awards granted under the Long Term Incentive Plan) to satisfy share options as they vest. The Executive Share Option scheme, the Employee Sharesave scheme and awards granted under the Medium Term Incentive Plan are accounted for as cash-settled share-based payment transactions. Awards granted under the Long Term Incentive Scheme are accounted for as equity-settled share-based payment transactions. Prior to the acquisition of the Company by Banco Santander, S.A., share options were satisfied by issue of new shares of the Company. These options were accounted for as equity settled share-based payments. The fair value of the services received is measured by reference to the fair value of the shares or share options initially on the date of the grant and then subsequently at each reporting date. The cost of the employee services received in respect of the shares or share options granted is recognised in the income statement within administration expenses, over the period that the services are received, which is the vesting period. A liability equal to the portion of the goods or services received is recognised at the current fair value determined at each balance sheet date for cash-settled, share-based payments. A liability equal to the amount to be reimbursed to Banco Santander, S.A. is recognised at the current fair value determined at the grant date for equity-settled share based payments. The fair value of the options granted under the Executive Share Option scheme, the Employee Sharesave scheme and awards granted under the Medium Term Incentive Plan is determined using an option pricing model, which takes into account the exercise price of the option, the current share price, the risk free interest rate, the expected volatility of the Banco Santander, S.A. share price over the life of the option, the dividend growth rate and other relevant factors.

The fair value of the awards granted for the Long Term Incentive Plan were valued at the grant date using an option pricing model, which takes into account the expected life of the options, interest rates, volatility of the Banco Santander, S.A. share price over the life of the option, exercise price, market price and dividends. Except for those that include terms related to market conditions, vesting conditions included in the terms of the grant are not taken into account in estimating fair value.

Non-market vesting conditions are taken into account by adjusting the number of shares or share options included in the measurement of the cost of employee service so that ultimately, the amount recognised in the income statement reflects the number of vested shares or share options.

Goodwill and other intangible assets

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary, associate, or business at the date of acquisition. Goodwill on the acquisition of subsidiaries and businesses is included in Intangible assets. Goodwill on acquisitions of associates is included as part of Investment in associates. Goodwill is tested for impairment at each balance sheet date, or more frequently when events or changes in circumstances dictate, and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity or business include the carrying amount of goodwill relating to the entity or business sold.

Other intangible assets are recognised if they arise from contracted or other legal rights or if they are capable of being separated or divided from the Group and sold, transferred, licensed, rented or exchanged. The value of such intangible assets is amortised on a straight-line basis over the useful economic life of the assets in question, which ranges from 9 to 20 years. Other intangible assets are reviewed annually for impairment indicators and tested for impairment where indicators are present.

Software development costs are capitalised when they are associated with identifiable and unique software products that are expected to provide future economic benefits and the cost of these products can be measured reliably. Internally developed software meeting these criteria and externally purchased software are classified in intangible assets on the balance sheet and amortised on a straight-line basis over their useful life of 3-7 years, unless the software is an integral part of the related computer hardware, in which case it is treated as property, plant and equipment as described below. Costs associated with maintaining software programmes are expensed as incurred.

Property, plant and equipment

Property, plant and equipment include owner-occupied properties, office fixtures and equipment and computer software. Property, plant and equipment are carried at cost less accumulated depreciation and accumulated impairment losses. A review for indications of impairment is carried out at each reporting date. Gains and losses on disposal are determined by reference to the carrying amount and are reported in net trading and other income. Repairs and renewals are charged to the income statement when the expenditure is incurred.

Software development costs are capitalised when they are associated with identifiable and unique software products that are expected to provide future economic benefits and the cost of these products can be measured reliably. Internally developed software meeting these criteria and externally purchased software are classified in property, plant and equipment on the balance sheet where the software is an integral part of the related computer hardware. Costs associated with maintaining software programmes are expensed as incurred. Classes of property, plant and equipment are depreciated on a straight-line basis over their useful life as follows:

Owner-occupied properties	Not exceeding 50 years
Office fixtures and equipment	3 to 15 years
Computer software	3 to 7 years

Depreciation is not charged on freehold land and assets under construction.

Financial assets

The Group classifies its financial assets as: financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets. Management determines the classification of its investments at initial recognition. Financial assets that are classified at fair value through profit or loss, which have not been designated as such or are not accounted for as derivatives, or assets classified as available-for-sale, may subsequently in rare circumstances, be reclassified from the fair value through profit or loss category to the loans and receivables, available-for-sale or held to maturity categories. In order to meet the criteria for reclassification, the asset must no longer be held for the purpose of selling or repurchasing in the near term and must also meet the definition of the category into which it is to be reclassified had it not been required to classify it at fair value through profit or loss at initial recognition. The reclassified value is the fair value of the asset at the date of reclassification. The Group has not utilised this option and therefore has not reclassified any assets from the fair value through profit or loss category that were classified as such at initial recognition.

(a) Financial assets at fair value through profit or loss
Financial assets are classified as fair value through profit or loss if they are either held for trading or otherwise designated at fair value through profit or loss on initial recognition. A financial asset is classified as held for trading if it is a derivative or it is acquired principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking.

In certain circumstances financial assets other than those that are held for trading are designated at fair value through profit or loss where this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets or recognising the gains or losses on them on a different basis, where the assets are managed and their performance evaluated on a fair value basis, or where a financial asset contains one or more embedded derivatives which are not closely related to the host contract.

Trading assets, derivative financial instruments and financial assets designated at fair value are classified as fair value through profit or loss, except where in a hedging relationship. They are derecognised when the rights to receive cash flows from the asset have expired or when the Group has transferred substantially all the risks and rewards of ownership.

(b) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments, that are not quoted in an active market and which are not classified as available-for-sale or fair value through profit or loss. They arise when the Group provides money or services directly to a customer with no intention of trading the loan. Loans and receivables are initially recognised at fair value including direct and incremental transaction costs. They are subsequently valued at amortised cost, using the effective interest method. They are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all of the risks and rewards of ownership. Loans and receivables consist of Loans and advances to banks, Loans and advances to customers and Loan and receivable securities.

Accounting Policies continued

(c) Available-for-sale financial assets
Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale and are not categorised into any of the other categories described. They are initially recognised at fair value including direct and incremental transaction costs. They are subsequently held at fair value. Gains and losses arising from changes in fair value are included as a separate component of equity until sale when the cumulative gain or loss is transferred to the income statement. Interest is determined using the effective interest method.

Income on investments in equity shares and other similar interests is recognised in the income statement as and when dividends are declared and interest is accrued. Impairment losses and foreign exchange translation differences on monetary items are recognised in the income statement. The investments are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership. Available-for-sale securities are classified as available-for-sale.

(d) Held to maturity investments
Held to maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity. Held to maturity investments are initially recognised at fair value including direct and incremental transaction costs. They are subsequently valued at amortised cost, using the effective interest method. They are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all of the risks and rewards of ownership. Were the Group to sell other than an insignificant amount of held to maturity assets, the entire category would be tainted and reclassified as available-for-sale.

The Group does not hold any held to maturity financial assets.

Valuation of financial instruments

Financial instruments that are classified at fair value through profit or loss ('FVTPL'), including those held for trading purposes, or available-for-sale, and all derivatives, are stated at fair value. The fair value of such financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing, knowledgeable parties, other than in a forced or liquidation sale.

Initial measurement
The best evidence of the fair value of a financial instrument at initial recognition is the transaction price unless the instrument is evidenced by comparison with other observable current market transactions in the same instrument or based on a valuation technique whose variables include significant data from observable markets. Any difference between the transaction price and the value based on a valuation technique where the inputs are not based on data from observable current markets is not recognised in profit or loss on initial recognition. Subsequent gains or losses are only recognised to the extent that they arise from a change in a factor that market participants would consider in setting a price.

Subsequent measurement
The Group applies the following fair value hierarchy that prioritises the inputs to valuation techniques used in measuring fair value. The hierarchy establishes three categories for valuing Financial Instruments, giving the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The three categories are: quoted prices in active markets (Level 1), internal models based on observable market data (Level 2) and internal models based on other than observable market data (Level 3). If the inputs used to measure an asset or a liability fall to different levels within the hierarchy, the classification of the entire asset or liability will be based on the lowest level input that is significant to the overall fair value measurement of the asset or liability.

The Group categorises assets and liabilities measured at fair value within the fair value hierarchy based on the inputs to the valuation techniques as follows:

Level 1: Unadjusted quoted prices for identical assets or liabilities in an active market that the Group has the ability to access at the measurement date. Level 1 positions include debt securities, equity securities, exchange traded derivatives and short positions in securities.

Level 2: Quoted prices in markets that are not active, quoted prices for similar assets or liabilities, recent market transactions, inputs other than quoted market prices for the asset or liability that are observable either directly or indirectly for substantially the full term, and inputs to valuation techniques that are derived principally from or corroborated by observable market data through correlation or other statistical means for substantially the full term of the asset or liability. Level 2 positions include loans and advances to banks, loans and advances to customers, equity securities, exchange rate derivatives, interest rate derivatives, equity and credit derivatives, debt securities, deposits by banks, deposits by customers and debt securities in issue.

Level 3 Inputs to the pricing or valuation techniques that are significant to the overall fair value measurement of the asset or liability are unobservable. Level 3 positions include equity securities, exchange rate derivative, equity and credit derivatives, loans and advances to customers, debt securities, and debt securities in issue.

Accounting Policies continued

The Group assesses active markets for equity instruments based on the average daily trading volume both in absolute terms and relative to the market capitalisation for the instrument. The Group assesses active markets for debt instruments based on both the average daily trading volume and the number of days with trading activity. The Group assesses active markets for exchange traded derivatives based on the average daily trading volume both in absolute terms and relative to the market capitalisation for the instrument. Market activity and liquidity is discussed in the relevant monthly Risk Forum as well as being part of the daily update given by each business at the start of the trading day. This information, together with the observation of active trading and the magnitude of the bid-offer spreads allow consideration of the liquidity of a financial instrument.

All underlying assets and liabilities are reviewed to consider the appropriate adjustment to mark the mid price reported in the trading systems to a realisable value. This process takes into account the liquidity of the position in the size of the adjustment required. These liquidity adjustments are presented and discussed at the monthly Risk Forum.

In determining the appropriate measurement levels, the Group performs regular analyses on the assets and liabilities. All underlying assets and liabilities are regularly reviewed to determine whether a position should be regarded as illiquid; the most important practical consideration being the observability of trading. Where the bid-offer spread is observable, this is tested against actual trades. Changes in the observability of significant valuation inputs during the reporting period may result in a reclassification of certain assets and liabilities within the fair value hierarchy.

Financial instruments valued using observable market prices
If a quoted market price in an active market is available for an instrument, the fair value is calculated based on the market price.

Financial instruments valued using a valuation technique
In the absence of a quoted market price in an active market, management uses internal models to make its best estimate of the price that the market would set for that financial instrument. In order to make these estimations, various techniques are employed, including extrapolation from observable market data and observation of similar financial instruments with similar characteristics. Wherever possible, valuation parameters for each product are based on prices directly observable in active markets or that can be derived from directly observable market prices. Valuation parameters for each type of financial instrument are discussed in Note 49 of the Consolidated Financial Statements.

Unrecognised gains as a result of the use of valuation models using unobservable inputs ('Day One profits')
The timing of recognition of deferred day one profit and loss is determined individually. It is deferred until either the instrument's fair value can be determined using market observable inputs or is realised through settlement. The financial instrument is subsequently measured at fair value, adjusted for the deferred day one profit and loss. Subsequent changes in fair value are recognised immediately in the consolidated income statement without immediate reversal of deferred day one profits and losses.

"Regular way" purchases of financial assets

A regular way purchase is a purchase of a financial asset under a contract whose terms require delivery of the asset within the timeframe established generally by regulation or convention in the market place concerned.

Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; all other regular way purchases are recognised on trade date. The assets are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership.

Offsetting financial assets and liabilities

Financial assets and liabilities including derivatives are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Sale and repurchase agreements (including stock borrowing and lending)

Securities sold subject to a linked repurchase agreement ('repos') are retained in the Financial Statements as trading assets and the counterparty liability is included in amounts 'Deposits by banks' or 'Deposits by customers' within trading liabilities as appropriate. Securities purchased under agreements to resell ('reverse repos') are recorded as 'Loans and advances to banks' or 'Loans and advances to customers' within trading assets as appropriate. The difference between the sale and repurchase price is treated as trading income in the income statement. Securities lent to counterparties that are collateralised by cash are also retained in the balance sheet. Securities borrowing and lending transactions collateralised with other securities are not recognised in the balance sheet.

Derivative financial instruments

Transactions are undertaken in derivative financial instruments ('derivatives'), which include interest rate, cross currency, equity, residential property and other index-related swaps, forwards, caps, floors, swaptions, as well as credit default and total return swaps, equity index contracts and exchange traded interest rate futures and equity index options.

Derivatives are contracts or agreements whose value is derived from one or more underlying indices or asset values inherent in the contract or agreement, which require no or little initial net investment and are settled at a future date.

Accounting Policies continued

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and option pricing models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative, except where netting is permitted.

Certain derivatives embedded in other financial instruments, such as the conversion option in a convertible bond, are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the hybrid contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement. Contracts containing embedded derivatives are not subsequently reassessed for separation unless there has been a change in the terms of the contract which significantly modifies the cash flows, or where assets have been reclassified where they are reassessed at the time of reclassification.

Hedge accounting

The Group designates certain derivatives as hedging instruments of the fair value of recognised assets or liabilities or firm commitments (fair value hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

At the time a financial instrument is designated as a hedge, the Group formally documents the relationship between the hedging instrument(s) and hedged item(s). Documentation includes risk management objectives and the strategy in undertaking the hedge transaction, together with the methods that will be used to assess the effectiveness of the hedging relationship. Accordingly, the Group formally assesses, both at the inception of the hedge and on an ongoing basis, whether the hedging derivatives have been and will be highly effective in offsetting changes in the fair value of the hedged items. A hedge is normally regarded as highly effective if, at inception and throughout its life, the Group can expect, and actual results indicate, that changes in the fair value of the hedged items are effectively offset by changes in the fair value of the hedging instrument, and actual results are within a range of 80% to 125%.

The Group discontinues hedge accounting when it is determined that: a derivative is not, or has ceased to be, highly effective as a hedge; when the derivative expires, or is sold, terminated or exercised; or when the hedged item matures or is sold or repaid. On discontinuance of hedge accounting amortisation of the adjustment to the hedged item is included in net trading and other income.

The hedge adjustment for fair value hedges is classified in the balance sheet in the same category as the hedged item, unless it relates to a macro hedging relationship where the hedge adjustment is recognised as a macro hedge on the face of the balance sheet. For fair value hedges, changes in the fair value of the hedging instrument and hedged item are recognised in net trading and other income. Hedge ineffectiveness represents the amount by which the changes in the fair value of the hedging derivative differ from changes in the fair value of the hedged item. Such gains and losses are recorded in current period earnings within net trading and other income.

Gains and losses on components of a hedging derivative that are excluded from assessing hedge effectiveness are also included in net trading and other income.

Securitisation transactions

The Group has entered into certain arrangements where undertakings have issued mortgage-backed securities or have entered into funding arrangements with lenders in order to finance specific loans and advances to customers. As the Group has retained substantially all the risks and rewards of the underlying assets, all such financial instruments continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction.

Impairment of financial assets

At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset or group of financial assets classified as available-for-sale or loans and receivables have become impaired. Evidence of impairment may include indications that the borrower or group of borrowers have defaulted, are experiencing significant financial difficulty, or the debt has been restructured to reduce the burden to the borrower.

(a) Financial assets carried at amortised cost
Retail assets
Impairment losses are assessed individually for the financial assets that are individually significant and individually or collectively for assets that are not individually significant. Balance sheet provisions are maintained at the level that management deems sufficient to absorb probable incurred losses in the Group's loan portfolio from homogeneous portfolios of assets and individually identified loans.

A provision for observed losses is established for all past due loans after a specified period of repayment default where it is probable that some of the capital will not be repaid or recovered through enforcement of any applicable security. Once a loan misses a payment (breach of contractual terms) an assessment of the likelihood of collecting the principal and overdue payments is made. This assessment is generally made using statistical techniques based on historic experience. These determinations are supplemented by various formulaic calculations and the application of management judgement.

For individually assessed assets, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of the estimated future cash flows from the asset or group of assets discounted at the original effective interest rate of the asset.

In making collective assessment for impairment, financial assets are assessed for each portfolio segmented by similar risk characteristics. For each risk segment, future cash flows from these portfolios are estimated through the use of historical loss experience. The historical loss experience is adjusted for current observable data, including estimated current property prices, to reflect the effects of current conditions not affecting the period of historical experience. The loss is discounted at the effective interest rate, except where portfolios meet the criteria for short-term receivables. The unwind of the discount over time is reported through interest receivable within the income statement, with the provision on the balance sheet increasing.

Loans that are part of a homogeneous pool of similar loans are placed on default status based on the number of months in arrears, which is determined through the number of missed payments or the number of months in collection. Loans that are not part of a homogeneous pool of similar loans are analysed based on the number of months in arrears on a case-by-case basis and are placed on default status when the probability of default is likely.

Generally, the length of time before an asset is placed on default status for provisioning is when one payment is missed. Repayment default periods vary depending on the nature of the collateral that secures the advances. On advances secured by residential or commercial property, the default period is three months. For advances secured by consumer goods such as cars or computers, the default period is less than three months, the exact period being dependent on the particular type of loan in this category.

On unsecured advances, such as personal term loans, the default period is generally four missed payments (three months in arrears). Exceptions to the general rule exist with respect to revolving facilities, such as bank overdrafts, which are placed on default upon a breach of the contractual terms governing the applicable account, and on credit card accounts where the default period is three months.

A provision for inherent losses is made for loan losses that have been incurred but have not been separately identified at the balance sheet date because the loan is not yet past due. An example of this situation is where a borrower has not yet missed a payment but is experiencing financial difficulties at the reporting date, e.g. due to loss of employment or divorce. In these circumstances, an inherent loss had been incurred at the reporting date. The provision for inherent losses is determined on a portfolio basis based on management's best estimate of the current position based on past experience adjusted by current trends. These statistical techniques involve the following (i) estimation of a period of time called the emergence period, which is discussed below, (ii) assessment of the number of accounts that go into arrears over the emergence period, and (iii) application of the provision methodology outlined for observed provisions to these accounts identified as impaired as a result of this exercise. Accounts that suffered credit deterioration after the reporting date are accordingly excluded from the statistical analysis.

The emergence period

This is the period which the Group's statistical analysis shows to be the period in which losses that had been incurred but have not been separately identified at the balance sheet date, become evident as the loans turn into past due. Based on the Group's statistical analysis at 31 December 2009, the emergence period was two to three months for unsecured lending and twelve months for secured lending. The longer emergence period for secured lending reflects the fact that a customer is more likely to default on unsecured debt before defaulting on secured lending. The factors considered in determining the length of the emergence period for unsecured lending are recent changes in customers' debit/credit payment profiles and credit scores. The factors considered for secured lending are the frequency and duration of exceptions from adherence to the contractual payment schedule.

Once a financial asset or a group of financial assets has been written down as a result of an impairment loss, the assets are not placed onto a non-accrual status. Subsequent interest income continues to be recognised on an effective interest rate basis though on the asset value after provisions have been deducted.

Impairment losses are recognised in the income statement and the carrying amount of the financial asset or group of financial assets is reduced by establishing an allowance for impairment losses. If in a subsequent period the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. For secured loans, a write-off is only made when all collection procedures have been exhausted and the security has been sold. For unsecured loans, a write-off is only made when all internal avenues of collecting the debt have been exhausted and the debt is passed over to external collection agencies. Write-offs are charged against previously established provisions for impairment.

Recoveries of loan losses are not included in the loan loss allowance, but are taken to income and offset against charges for loan losses. Loan loss recoveries are classified in the income statement as 'Impairment losses on loans and advances'.

Corporate assets

Impairments for these assets are assessed on both an individual and a collective basis. For individual assets impairment reviews are conducted monthly for those assets on the Group's 'Watchlist' of new, emerging and serious circumstances relating to the portfolio, with a particular focus on the following scenarios: (1) where an asset has a payment default which has been outstanding for 90 days or more; (2) where non-payment defaults have occurred and/or where it has become evident that some sort of workout or rescheduling exercise is to be undertaken; or (3) where, for example with Real Estate Finance, it has become evident that the value of the Group's security is no longer considered adequate.

In such situations the file is transferred to the Corporate Banking Workouts team within Credit Risk. As part of their assessment, a full review of the expected future cash flows in relation to the relevant asset, appropriately discounted, will be undertaken and the result compared to the current net book value of the asset. Any shortfall evidenced as a result of such a review, particularly where the shortfall is likely to be permanent, will lead to a suitable impairment recommendation.

Accounting Policies continued

Collective impairments are also looked at for portfolios where it is felt that market events, either specific or general, are likely to determine that losses are already inherent in a portfolio notwithstanding that these events may not have manifested themselves in specific defaults or other triggers that would lead to an individual impairment assessment. The amount of any such collective impairment will, for each portfolio concerned, represent management's best estimate of likely loss levels and will take into account inter alia estimates of future actual default rates and likely recovery levels.

Once a financial asset or a group of financial assets has been written down as a result of an impairment loss, the assets are not placed onto a non-accrual status. Subsequent interest income continues to be recognised on an effective interest rate basis though on the asset value after provisions have been deducted.

For secured loans, a write-off is made when all collection procedures have been exhausted and the security has been sold. For unsecured loans, a write-off is made when all avenues for collecting the debt have been exhausted. There may be occasions where a write-off occurs for other reasons, for example, following a consensual restructure of the debt or where the debt is sold for strategic reasons into the secondary market at a value lower than the face value of the debt. Write-offs are charged against previously established provisions for impairment.

Loans and receivables securities
Loans and receivables securities are assessed individually for impairment. An impairment loss is incurred if there is objective evidence that an event has occurred since initial recognition of the assets that has an impact in the estimated future cash flows of the loans and receivables securities.

(b) Available-for-sale financial assets
The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In assessing whether assets are impaired, a significant or prolonged decline in the fair value of the security below its cost is considered evidence. The cumulative loss is measured as the difference between the acquisition cost and the current fair value, less any impairment loss previously reported in the income statement and is removed from equity and recognised in the income statement.

If in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase is due to an event occurring after the impairment loss was recognised in the income statement (with objective evidence to support this), the impairment loss is reversed through the income statement.

Impairment of non-financial assets

At each balance sheet date, or more frequently when events or changes in circumstances dictate, property plant and equipment (including operating lease assets) and intangible assets (including goodwill) are assessed for indicators of impairment. If indications are present, these assets are subject to an impairment review. The impairment review comprises a comparison of the carrying amount of the asset or cash generating unit with its recoverable amount: the higher of the asset's or cash-generating unit's fair value less costs to sell and its value in use. Net selling price is calculated by reference to the amount at which the asset could be disposed of in a binding sale agreement in an arm's length transaction evidenced by an active market or recent transactions for similar assets, less costs to sell. Value in use is calculated by discounting the expected future cash flows obtainable as a result of the asset's continued use, including those resulting from its ultimate disposal, at a market based discount rate on a pre tax basis.

The carrying values of fixed assets and goodwill are written down by the amount of any impairment and the loss is recognised in the income statement in the period in which it occurs. Impairment of a cash generating unit is allocated first to goodwill and then to other assets held within the unit on a pro-rata basis. An impairment loss recognised in an interim period is not reversed at the balance sheet date. A previously recognised impairment loss relating to a fixed asset may be reversed in part or in full when a change in circumstances leads to a change in the estimates used to determine the fixed asset's recoverable amount. The carrying amount of the fixed asset will only be increased up to the amount that would have been had the original impairment not been recognised. Impairment losses on goodwill are not reversed. For conducting impairment reviews, cash generating units are the lowest level at which management monitors the return on investment on assets.

Leases

The Group as lessor - Operating lease assets are recorded at deemed cost and depreciated over the life of the asset after taking into account anticipated residual values. Operating lease rental income and depreciation is recognised on a straight-line basis over the life of the asset. Amounts due from lessees under finance leases and hire purchase contracts are recorded as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases and hire purchase contracts.

The Group as lessee - The Group enters into operating leases for the rental of equipment or real estate. Payments made under such leases are charged to the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

If the lease agreement transfers the risk and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and depreciated over the lower of the estimated useful life and the life of the lease. The corresponding rental obligations are recorded as borrowings. The aggregate benefit of incentives, if any, is recognised as a reduction of rental expense over the lease term on a straight-line basis.

Income taxes, including deferred taxes

The tax expense represents the sum of the income tax currently payable and deferred income tax.

Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

The liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred income tax is provided in full, using the liability method, on income tax losses available to carry forward and on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Consolidated Financial Statements. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which the assets may be utilised as they reverse. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill and the initial recognition of other assets (other than in a business combination) and liabilities in a transaction that affects neither the taxable profit nor the accounting profit. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on rates enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity. Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the Group is able to control reversal of the temporary difference and it is probable that it will not reverse in the foreseeable future.

The Company reviews the carrying amount of deferred tax assets at each balance sheet date and reduces it to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks, treasury bills and other eligible bills, loans and advances to banks and short-term investments in securities.

Financial liabilities

Financial liabilities are initially recognised when the Group becomes contractually bound to the transfer of economic benefits in the future.

(a) Financial liabilities at fair value through profit or loss

Financial liabilities are classified as fair value through profit or loss if they are either held for trading or otherwise designated at fair value through profit or loss on initial recognition. A financial liability is classified as held for trading if it is a derivative or it is incurred principally for the purpose of selling or being unwound in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking.

In certain circumstances financial liabilities other than those that are held for trading are designated at fair value through profit or loss where this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets and liabilities or recognising the gains or losses on them on a different basis, or where a financial liability contains one or more embedded derivatives which are not closely related to the host contract. These liabilities are initially recognised at fair value and transaction costs are taken directly to the income statement. Gains and losses arising from changes in fair value are included directly in the income statement.

Derivative financial instruments, Trading liabilities and Financial liabilities designated at fair value are classified as fair value through profit or loss.

(b) Other financial liabilities

All other financial liabilities are initially recognised at fair value net of transaction costs incurred. They are subsequently stated at amortised cost and the redemption value recognised in the income statement over the period of the liability using the effective interest method.

Deposits by banks, Deposits by customers, Debt securities in issue (unless designated at fair value), Other borrowed funds and Subordinated liabilities are classified as amortised cost.

Accounting Policies continued

Equity index-linked deposits

Contracts involving the receipt of cash on which customers receive an index-linked return are accounted for as equity index-linked deposits, and classified as deposits by customers within trading liabilities. Equity index-linked deposits are managed within the equity derivatives trading book as an integral part of the equity derivatives portfolio. There are two principal product types.

(a) Capital at Risk

These products are designed to replicate the investment performance of an equity index, subject to a floor. In the event the index falls under a certain predetermined level, customers forfeit a predetermined percentage of principal up to a predetermined amount.

(b) Capital Guaranteed/Protected:

These products give the customers a limited participation in the upside growth of an equity index. In the event the index falls in price, a cash principal element is guaranteed/protected.

Equity index-linked deposits are remeasured at fair value at each reporting date with changes in fair values recognised in the income statement. The equity index-linked deposits contain embedded derivatives. These embedded derivatives, in combination with the principal cash deposit element, are designed to replicate the investment performance profile tailored to the return agreed in the contracts with customers. Other than new capital guaranteed products, which are treated as deposits by customers with any associated embedded derivatives bifurcated, embedded derivatives are not separated from the host instrument and are not separately accounted for as a derivative instrument, as the entire contract embodies both the embedded derivative and the host instrument and is remeasured at fair value at each reporting date. As such, there is no requirement to bifurcate the embedded derivatives in the equity index-linked deposits.

Borrowings

Borrowings, including subordinated liabilities, are recognised initially at fair value, being the proceeds (fair value of consideration received) net of transaction costs incurred. Borrowings are subsequently stated at amortised cost or fair value dependent on designation at initial recognition.

Preference shares which carry a contractual obligation to transfer economic benefits are classified as other financial liabilities and are presented in other borrowed funds. The dividends on these preference shares are recognised in the income statement as interest expense on an amortised cost basis using the effective interest method.

Share capital

Incremental external costs directly attributable to the issue of new shares are deducted from equity net of related income taxes.

Provisions

Provisions are recognised for present obligations arising as consequences of past events where it is more likely than not that a transfer of economic benefits will be necessary to settle the obligation, and it can be reliably estimated. When a leasehold property ceases to be used in the business, provision is made where the unavoidable costs of the future obligations relating to the lease are expected to exceed anticipated rental income. The net costs are discounted using market rates of interest to reflect the long-term nature of the cash flows.

Provision is made for the anticipated cost of restructuring, including redundancy costs, when an obligation exists. An obligation exists when the Group has a detailed formal plan for restructuring a business, and has raised valid expectations in those affected by the restructuring and has started to implement the plan or announce its main features.

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

Financial guarantee contracts

The Group accounts for guarantees that meet the definition of a financial guarantee contract at fair value on initial recognition. In subsequent periods, these guarantees are measured at the higher of the initial fair value less cumulative amortisation and the amount that would be recognised as a provision as described in the Accounting Policies above.

Dividends

Dividends on ordinary shares are recognised in equity in the period in which the right to receive payment is established.

Critical accounting policies and areas of significant management judgement

The preparation of the Group's Consolidated Financial Statements requires management to make estimates and judgements that affect the reported amount of assets and liabilities at the date of the Financial Statements and the reported amount of income and expenses during the reporting period. Management evaluates its estimates and judgements on an ongoing basis. Management bases its estimates and judgements on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

The following estimates and judgements are considered important to the portrayal of the Group's financial condition.

(a) Provisions for loans and advances

The Group estimates provisions for loans and advances to customers, treasury asset portfolio securities and loans and advances to banks with the objective of maintaining balance sheet provisions at the level believed by management to be sufficient to absorb actual losses ('observed provisions') and inherent losses ('incurred but not yet observed provisions') in the Group's loan portfolio from homogeneous portfolios of assets and individually identified loans in connection with loans and advances to banks and loans and advances to customers. The calculation of provisions on impaired loans and advances is based on the likelihood of the asset being written off (or repossessed in the case of mortgage loans) and the estimated loss on such a write-off. These assessments are made using statistical techniques based on historic experience. These determinations are supplemented by various formulaic calculations and the application of management judgement.

The Group considers accounting estimates related to provisions for loans and advances 'critical accounting estimates' because: (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and advances are based on recent performance experience, and (ii) any significant difference between the Group's estimated losses (as reflected in the provisions) and actual losses would require the Group to take provisions which, if significantly different, could have a material impact on its future income statement and its balance sheet. The Group's assumptions about estimated losses are based on past performance, past customer behaviour, the credit quality of recent underwritten business and general economic conditions, which are not necessarily an indication of future losses.

Provisions for loans and advances, less amounts released and recoveries of amounts written off in previous years are charged to the line item 'Impairment losses on loans and advances' in the income statement. The provisions are deducted from the 'Loans and advances to banks' and the 'Loans and advances to customers' line items on the balance sheet. If the Group believes that additions to the provisions for such credit losses are required, then the Group records additional provisions for credit losses, which would be treated as a charge in the line item 'Impairment losses on loans and advances' in the income statement. The Consolidated Financial Statements for the year ended 31 December 2009 include a net provision charge (i.e. after recoveries) for loans and advances in connection with retail lending for an amount equal to £711m, and corporate lending for an amount equal to £36m. The provision charges for retail and corporate lending increased from 2008 largely due to worsening market conditions.

In calculating the retail and corporate lending provisions, principally within the Retail Banking and Corporate Banking segments, a range of outcomes was calculated based principally on management's conclusions regarding the current economic outlook relative to historic experience. Had management used different assumptions regarding the current economic outlook, a larger or smaller provision for loans and advances would have resulted that could have had a material impact on the Group's reported profit on continuing operations before tax in 2009. Specifically, if management's conclusions as to the current economic outlook were different, but within the range of what management deemed to be reasonably possible economic outlooks, the provision charge for loans and advances in the Retail Banking segment could have decreased in 2009 from an actual provision charge of £711m (2008: £322m, 2007: £344m) by up to £127m (2008: £78m, 2007: £163m), with a potential corresponding increase in the Group's profit before tax in 2009 of up to 8% (2008: 7%, 2007: 19%), or increased by up to £115m (2008: £66m, 2007: £52m), with a potential corresponding decrease in the Group's profit before tax in 2009 of up to 7% (2008: 6%, 2007: 6%). The provision charge for loans and advances in the Corporate Banking segment could have decreased in 2009 from an actual provision charge of £36m by up to £15m, with a potential corresponding increase in the Group's profit before tax in 2009 of up to 1%, or increased by up to £10m, with a potential corresponding decrease in the Group's profit before tax in 2009 of up to 1%.

The actual provision charge for retail lending of £711m (2008: £322m, 2007: £344m) and corporate lending of £36m (2008: £26m, 2007: £nil) in 2009 was based on what management estimated to be the most probable economic outlook within the range of reasonably possible assumptions.

The provision charge for the Treasury asset portfolio acquired on 10 October 2008 of £93m (2008: £nil) was based on management's assessment of impairment of each individual asset based on data available at 31 December 2009. A detailed analysis of the Treasury asset portfolio by type of instrument, credit structure, credit rating and geography can be found in the Risk Management Report on pages 77 to 85.

(b) Valuation of financial instruments

The Group considers that the accounting estimate related to the valuation of financial assets and financial liabilities including derivatives where quoted market prices are not available is a 'critical accounting estimate' because: (i) it is highly susceptible to change from period to period because it requires management to make assumptions about interest rates, volatility, exchange rates, the credit rating of the counterparty, valuation adjustments and specific features of the transactions; and (ii) the impact that recognising a change in the valuations would have on the assets reported on its balance sheet as well as its net profit/(loss) could be material.

Accounting Policies continued

Changes in the valuation of financial assets and financial liabilities including derivatives where quoted market prices are not available are accounted for in the line item 'Net trading and other income' in the income statement and the 'Trading assets', 'Financial assets designated at fair value', 'Trading liabilities', 'Financial liabilities designated at fair value' and 'Derivative financial instruments' line items in the Group's balance sheet.

The Group trades in a wide variety of financial instruments in the major financial markets and therefore considers a range of interest rates, volatility, exchange rates, counterparty credit ratings, valuation adjustments and other similar inputs, all of which vary across maturity bands. These are chosen to best reflect the particular characteristics of each transaction. Had management used different assumptions regarding the interest rates, volatility, exchange rates, the credit rating of the counterparty, and valuation adjustments, a larger or smaller change in the valuation of financial assets and financial liabilities including derivatives where quoted market prices are not available would have resulted that could have had a material impact on the Group's reported profit before tax in 2009. Detailed disclosures on financial instruments, including sensitivities, can be found in Note 49 on page 173. Further information about sensitivities (including value-at-risk) to market risk arising from financial instrument trading activities can be found in the Risk Management Report on page 72.

(c) Provisions for misselling

The Group estimates provisions for misselling with the objective of maintaining reserve levels believed by management to be sufficient to absorb current estimated probable losses in connection with compensation from customers who claim reimbursement of bank charges, and misselling of endowment policies, payment protection insurance policies, and other products. The calculation of provisions for misselling is based on the estimated number of claims that will be received, of those, the number that will be upheld, and the estimated average settlement per case. These assessments are based on management's estimate for each of these three factors. In certain instances, the extent to which the Group is required to uphold claims is driven by binding legal decisions or precedents, as described in Note 37.

The Group considers accounting estimates related to misselling provisions 'critical accounting estimates' because: (i) they are highly susceptible to change from period to period per the three factors above, and (ii) any significant difference between the Group's estimated losses as reflected in the provisions and actual losses would require the Group to take provisions which, if significantly different, could have a material impact on its future income statement and its balance sheet. The Group's assumptions about estimated losses are based on past claims uphold rates, past customer behaviour, and past average settlements, which are not necessarily an indication of future losses.

Provisions for misselling are charged to the line item 'Provisions for other liabilities and charges' in the income statement. The provision is included in the 'Provisions' line item on the balance sheet. If the Group believes that additions to the misselling provision are required, then the Group records additional provisions, which would be treated as a charge in the line item 'Provisions for other liabilities and charges' in the income statement.

The Consolidated Financial Statements for the year ended 31 December 2009 include a provision charge for misselling in the Retail Banking segment for an amount equal to £10m (2008: £40m release, 2007: £nil). The balance sheet provision decreased from £141m in 2008 to £43m in 2009, reflecting settlement of claims principally relating to Payment Protection Insurance.

In calculating the misselling provision within the Retail Banking segment, management's best estimate of the provision was calculated based on conclusions regarding the number of claims that will be received, of those, the number that will be upheld, and the estimated average settlement per case. Had management used different assumptions regarding these factors, a larger or smaller provision for misselling would have resulted in the Retail Banking segment that could have had a material impact on the Group's reported profit on continuing operations before tax in 2009. Specifically, if management's conclusions as to the number of claims that will be received, of those, the number that will be upheld, and the estimated average settlement per case were different, but within the range of what management deemed to be reasonably possible, the provision charge for misselling in the Retail Banking segment could have decreased in 2009 by up to £7m (2008: £8m, 2007: £29m), with a potential corresponding increase in the Group's profit before tax in 2009 of up to 0.4% (2008: 1%, 2007: 3%), or increased by up to £8m (2008: £9m, 2007: £19m), with a potential corresponding decrease in the Group's profit before tax in 2009 of up to 0.5% (2008: 1%, 2007: 2%). The actual charge in 2009 was based on what management estimated to be the most probable number of claims that will be received, of those, the number that will be upheld, and the estimated average settlement per case within the range of reasonably possible outcomes.

(d) Pensions

The Group operates a number of defined benefit pension schemes as described in Note 36 to the Consolidated Financial Statements. The assets of the schemes are measured at their fair values at the balance sheet date. The liabilities of the schemes are estimated by projecting forward the growth in current accrued pension benefits to reflect inflation and salary growth to the date of pension payment, discounted to present value using the interest rate applicable to high-quality AA rated corporate bonds of the same currency and term as the scheme liabilities. Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). An asset is only recognised to the extent that the surplus can be recovered through reduced contributions in the future or through refunds from the scheme. In determining the value of scheme liabilities, assumptions are made by management as to mortality, price inflation, discount rates, pensions increases, and earnings growth. Financial assumptions are based on market conditions at the balance sheet date and can generally be derived objectively. Demographic assumptions require a greater degree of estimation and judgement to be applied to externally derived data.

The Group considers accounting estimates related to pension provisions 'critical accounting estimates' because: (i) they are highly susceptible to change from period to period, and (ii) any significant difference between the Group's estimates of the scheme liabilities and actual liabilities could significantly alter the amount of the surplus or deficit recognised in the balance sheet and the pension cost charged to the income statement. The Group's assumptions principally about mortality, but also about price inflation, discount rates, pensions increases, and earnings growth are based on past experience and current economic trends, which are not necessarily an indication of future experience. Pension costs are charged to the line item 'Administration expenses', with the interest cost on liabilities and the expected return on scheme assets included within 'Net trading and other income' in the income statement. The provision is included in the Retirement benefit obligations line item in the balance sheet. If the Group believes that increases to the pensions cost are required, then the Group records additional costs that would be treated as a charge in the line item Administration expenses in the income statement.

The Consolidated Financial Statements for the year ended 31 December 2009 include current year defined benefit service cost of £44m and a pension scheme deficit of £1,060m. The current year service cost of £44m (2008: £55m, 2007: £67m) decreased, reflecting reductions in active scheme membership, salary reviews, changes in pension increases, changes in mortality assumptions, changes in price inflation assumptions and changes in discount rate. The current year pension scheme deficit of £1,060m (2008: £803m, 2007: £979m) increased as a result of a reduction of 100 basis points in the net discount rate (i.e. the discount rate less the inflation rate) used to value the defined benefit scheme liabilities. The increase in assumed inflation also impacted the expected rate of pension increase, in turn leading to a further increase in scheme liabilities. These increases were partly offset by employer contributions made and improvements in asset values.

In calculating the current year service cost and deficit, a range of outcomes was calculated based principally on management's estimates regarding mortality, price inflation, discount rates, pensions increases, and earnings growth. Had management used different assumptions principally regarding mortality, but also price inflation, discount rate, pensions increases, and earnings growth, a larger or smaller charge for pension costs would have resulted that could have had a material impact on the Group's reported profit before tax in 2009. Specifically, if management's conclusions as to mortality, price inflation, discount rates, pensions increases, and earnings growth were different, but within the range of what management deemed to be reasonably possible conclusions, the charge for pension costs could have decreased in 2009 from an actual pension charge of £44m (2008: £55m, 2007: £67m) by up to £9m (2008: £8m, 2007: £13m), with a potential corresponding increase in the Group's profit before tax in 2009 of up to 1% (2008: 1%, 2007: 2%), or increased by up to £6m (2008: £8m, 2007: £7m), with a potential corresponding decrease in the Group's profit before tax in 2009 of up to 0.4% (2008: 1%, 2007: 1%). The actual current year service pension charge of £44m (2008: £55m, 2007: £67m) in 2009 was based on what management estimated to be the most probable mortality, price inflation, discount rates, pensions increases, and earnings growth within the range of reasonably possible values. Detailed disclosures on the pension deficit including sensitivities can be found in Note 36 on page 153.

(e) Deferred tax

The Group recognises deferred tax assets with respect to tax losses carried forward to the extent that it is probable that future taxable profits will be available against which the unused tax losses and unused tax credits can be utilised. At 31 December 2009 and 2008 the Group has recognised such deferred tax assets in full. As at 31 December 2009 this amounted to £297m (2008: £368m). The value of the deferred tax asset is based on management's best estimate of the amount that will be recoverable in the foreseeable future. This estimate is based on management's assessment of future taxable profits that are expected to arise over this period.

The Group considers accounting estimates in respect of £297m (2008: £368m) of the deferred tax assets relating to the Alliance & Leicester group 'critical accounting estimates' because: (i) they are highly susceptible to change from period to period as the assumptions about future taxable profits represent forward-looking estimates which are inherently vulnerable to changes in economic and market conditions, and (ii) any significant shortfall between the Group's estimated taxable profits and actual taxable profits could require the Group to take charges which, if significant, could have a material impact on its future income statement and its balance sheet. The Group's assumptions about estimated future taxable profits are based on assumptions about future performance within the Group of which Alliance & Leicester plc is a part, and general economic conditions, which are not necessarily an indication of future performance.

Changes to the value of deferred tax assets are charged to the line item 'Taxation charge' in the income statement. Changes in deferred tax assets are deducted from the 'Deferred tax assets' line item on the balance sheet. The Consolidated Financial Statements for the year ended 31 December 2009 do not include a charge for changes in the value of deferred tax assets arising in connection with the non recoverability of taxable losses. If management estimates of future tax profits were not met, it is possible that the deferred tax asset would still be recovered, but over a longer period, therefore it is not possible to quantify reliably a meaningful sensitivity or range of possible outcomes. Under current UK tax legislation, the tax losses in respect of which deferred tax assets have been recognised do not expire.

It is management's view that the recoverable value of the deferred tax asset will be unaffected by the scheme allowed by Part VII of the Financial Services and Markets Act 2000 under which the Company intends to transfer Alliance & Leicester plc's business into Santander UK plc later this year, as described in Note 46.

Notes to the Financial Statements

1. Segments

The principal activity of the Group is financial services. The Group's business is managed and reported on the basis of the following segments:

> Retail Banking;
> Corporate Banking;
> Global Banking & Markets;
> Private Banking; and
> Group Infrastructure.

In 2009, the Bradford & Bingley off-shore deposit-taking business was managed and reported as part of Private Banking rather than Retail Banking. The segmental analysis of the Group's results for 2008 has been amended to reflect this change. In addition, in 2009, the Group's transfer pricing arrangements were updated to reflect the greater benefit of retail deposits in a period of higher funding costs. Prior years' segmental analyses have been adjusted for consistency. In this report, the Retail Banking, Corporate Banking, Global Banking & Markets, Private Banking and Group Infrastructure segments are referred to as the Personal Financial Services ('PFS') businesses.

The Group's segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. The Group has five segments. Retail Banking offers a range of personal banking, savings and mortgage products and services, under the brands Santander and Alliance & Leicester. Corporate Banking offers banking services principally to small and mid-sized UK companies under the brands Santander and Alliance & Leicester. Global Banking & Markets provides financial markets sales, trading and risk management services, as well as manufacturing retail structured products. It also contains operations in run down. Private Banking offers specialist banking services and offered self-invested pension plans and WRAP products. Group Infrastructure consists of Asset and Liability Management activities, Group Capital, Funding and the Treasury asset portfolio of the Alliance & Leicester group.

The segment information below is presented on the basis used by the Company's board of directors (the 'Board') to evaluate performance, in accordance with IFRS 8. The Board reviews discrete financial information for each of its segments, including measures of operating results and assets. The segments are managed primarily on the basis of their results, which are measured on a 'trading' basis. The trading basis differs from the statutory basis (described in the Accounting Policies section on pages 109 to 123) as a result of the application of various adjustments. Management considers that the trading basis provides the most appropriate way of reviewing the performance of the business. The adjustments are:

> **Alliance & Leicester pre-acquisition trading basis results** – Following the transfer of Alliance & Leicester plc to the Company in January 2009, the statutory results for the year ended 31 December 2009 include the consolidated results of the Alliance & Leicester group, whereas the statutory results for the year ended 31 December 2008 do not. In order to enhance the comparability of the results for the two periods, management reviews the 2008 results including the pre-acquisition results of the Alliance & Leicester group for that period.
> **Reorganisation and other costs** – These comprise implementation costs in relation to the cost reduction projects including integration-related expenses, as well as certain remediation administration expenses and credit provisions. Management needs to understand the underlying drivers of the cost base that will remain after these exercises are complete, and does not want this view to be clouded by these costs, which are managed independently.
> **Depreciation of operating lease assets** - The operating lease businesses are managed as financing businesses and, therefore, management needs to see the margin earned on the businesses. Residual value risk is separately managed. As a result, the depreciation is netted against the related income.
> **Profit on part sale of PFS subsidiaries** - These profits are excluded from the results to allow management to understand the underlying performance of the business. In 2009, there were no such profits. In 2008, the profit on the sale of the Porterbrook businesses was excluded. In 2007, the profit on the sale of 49% of James Hay, Cater Allen and Abbey Sharedealing, and small recoveries on certain other transactions were similarly excluded.
> **Hedging and other variances** - The Balance Sheet and Income Statement are subject to mark-to-market volatility including that arising from the accounting for elements of derivatives deemed under IFRS rules to be ineffective as hedges. Volatility also arises on certain assets previously managed on a fair value basis, and hence classified as fair value through profit or loss under IFRS, that are now managed on an accruals basis. Where appropriate, such volatility is separately identified to enable management to view the underlying performance of the business. In addition, other variances include the reversal of coupon payments on certain equity instruments which are treated as interest expense in the trading results but are reported below the profit after tax line for statutory purposes.
> **Capital and other charges** – These principally comprise internal nominal charges for capital invested in the Group's businesses. Management implemented this charge to assess the effectiveness of capital investments.

Transactions between the business segments are on normal commercial terms and conditions. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Internal charges and transfer pricing adjustments have been reflected in the performance of each business. Revenue sharing agreements are used to allocate external customer revenues to a business segment on a reasonable basis. Funds are ordinarily reallocated between segments, resulting in funding cost transfers disclosed in total trading income. Interest charged for these funds is based on the Group's cost of capital.

Notes to the Financial Statements continued

Interest receivable and interest payable have not been reported separately. The majority of the revenues from the segments presented below are from interest and the Board relies primarily on net interest revenues to both assess the performance of the segment and to make decisions regarding allocation of segmental resources.

Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balance sheet.

a) Segmental information

2009	Retail Banking £m	Corporate Banking £m	Global Banking & Markets £m	Private Banking £m	Group Infra-structure £m	Total £m	Adjust-ments £m	Group Total £m
Net interest income	3,257	294	-	130	(340)	3,341	71	3,412
Non-interest income	707	163	380	34	33	1,317	(33)	1,284
Total trading income	**3,964**	**457**	**380**	**164**	**(307)**	**4,658**	**38**	**4,696**
Administration expenses	(1,312)	(168)	(101)	(66)	(145)	(1,792)	(56)	(1,848)
Depreciation & amortisation	(130)	(13)	(3)	(2)	(4)	(152)	(108)	(260)
Total trading expenses	**(1,442)**	**(181)**	**(104)**	**(68)**	**(149)**	**(1,944)**	**(164)**	**(2,108)**
Impairment losses on loans and advances	(712)	(31)	-	(2)	(57)	(802)	(40)	(842)
Provisions for other liabilities and charges	-	-	-	-	-	-	(56)	(56)
Trading profit/(loss) before tax	**1,810**	**245**	**276**	**94**	**(513)**	**1,912**	**(222)**	**1,690**
Adjust for:								
Reorganisation and other costs	(79)	-	-	-	(107)	(186)		
Hedging and other variances	(11)	-	-	-	(25)	(36)		
Capital and other charges	(180)	(86)	-	8	258	-		
Profit/(loss) before tax	**1,540**	**159**	**276**	**102**	**(387)**	**1,690**		
Average number of staff	18,985	522	115	819	289	20,730		
Total assets	**175,816**	**21,816**	**53,260**	**176**	**34,223**	**285,291**		

Adjustments comprise:	Net interest income £m	Non interest income £m	Administration expenses £m	Depreciation and amortisation £m	Impairment on loans and advances £m	Provisions for other liabilities and charges £m	Profit before tax £m
Reorganisation and other costs	-	-	(56)	(34)	(40)	(56)	(186)
Depreciation on operating lease assets	-	74	-	(74)	-	-	-
Hedging and other variances	71	(107)	-	-	-	-	(36)
	71	(33)	(56)	(108)	(40)	(56)	(222)

Changes in interest and exchange rates mean that period on period comparisons of gross interest and other trading income and expense are not meaningful and therefore management only consider these items on a net basis. Similarly, management consider the trading income generated by each segment on the basis of the margin earned on the customer relationship. There is therefore no split that is meaningful of trading income between external customers and intra-Group. No analysis of total trading income from external customers and intra-Group is therefore presented.

2008	Retail Banking £m	Corporate Banking £m	Global Banking & Markets £m	Private Banking £m	Group Infra-structure £m	Total £m	Adjust-ments £m	Group Total £m
Net interest income	2,282	134	-	99	(126)	2,389	(617)	1,772
Non-interest income	836	264	326	37	42	1,505	(273)	1,232
Total trading income	3,118	398	326	136	(84)	3,894	(890)	3,004
Administration expenses	(1,274)	(219)	(104)	(63)	(169)	(1,829)	486	(1,343)
Depreciation & amortisation	(84)	(20)	(3)	(1)	(3)	(111)	(91)	(202)
Total trading expenses	(1,358)	(239)	(107)	(64)	(172)	(1,940)	395	(1,545)
Impairment losses on loans and advances	(442)	(44)	-	(3)	-	(489)	141	(348)
Provisions for other liabilities and charges	-	-	-	-	-	-	(17)	(17)
Trading profit/(loss) before tax	1,318	115	219	69	(256)	1,465	(371)	1,094
Adjust for:								
A&L pre-acquisition trading basis results	(300)	(34)	-	(8)	178	(164)		
Reorganisation and other costs	(121)	-	-	-	(42)	(163)		
Profit on part sale of PFS subsidiaries	-	40	-	-	-	40		
Hedging and other variances	-	-	-	-	(84)	(84)		
Capital and other charges	(103)	(14)	-	16	101	-		
Profit/(loss) before tax	794	107	219	77	(103)	1,094		
Average number of staff	13,475	226	300	638	190	14,829		
Total assets	166,681	20,057	52,558	179	57,835	297,310		

Notes to the Financial Statements continued

Adjustments comprise:	Net interest income £m	Non interest income £m	Administration expenses £m	Depreciation and amortisation £m	Impairment on loans and advances £m	Provisions for other liabilities and charges £m	Profit before tax £m
A&L pre-acquisition trading basis results	(617)	(330)	552	48	183	-	(164)
Reorganisation and other costs	-	(16)	(66)	(22)	(42)	(17)	(163)
Depreciation on operating lease assets	-	117	-	(117)	-	-	-
Profit on part sale of PFS subsidiaries	-	40	-	-	-	-	40
Hedging and other variances	-	(84)	-	-	-	-	(84)
	(617)	(273)	486	(91)	141	(17)	(371)

The comparative trading basis segmental results analyses above for the year ended 31 December 2008 include the pre-acquisition trading basis results for the Alliance & Leicester group for the reasons described in the section entitled 'Alliance & Leicester pre-acquisition trading basis results' on the previous page.

The Alliance & Leicester group was not part of the Group at that time, and the inclusion of these pre-acquisition trading basis results in the 2008 comparatives in the internal segmental information reviewed by the Board is intended only to enhance the comparability of the results for the two periods. These pre-acquisition trading basis results do not form part of the statutory results of the Group for the year ended 31 December 2008. The inclusion of these results in the internal segmental information reviewed by the Board is not intended to imply that the Alliance & Leicester group was part of the Group at that time, and should not be interpreted as attempting to do so.

Details of the pre-acquisition financial information included above, by segment, are as follows:

Alliance & Leicester group full year trading basis results for the year ended 31 December 2008

	Retail Banking £m	**Corporate Banking £m**	**Private Banking £m**	**Group Infra-structure £m**	**Total £m**
Net interest income	592	147	10	(132)	**617**
Non-interest income	211	131	2	(14)	**330**
Total trading income	**803**	**278**	**12**	**(146)**	**947**
Administration expenses	(344)	(174)	(4)	(30)	**(552)**
Depreciation & amortisation	(26)	(20)	-	(2)	**(48)**
Total operating expenses excluding provisions and charges	**(370)**	**(194)**	**(4)**	**(32)**	**(600)**
Impairment losses on loans and advances	(133)	(50)	-	-	**(183)**
Total operating provisions and charges	**(133)**	**(50)**	**-**	**-**	**(183)**
Trading profit/(loss) before tax	**300**	**34**	**8**	**(178)**	**164**

2007	Retail Banking £m	Corporate Banking £m	Global Banking & Markets £m	Private Banking £m	Group Infra-structure £m	Total £m	Adjust-ments £m	Group Total £m
Net interest income	1,538	(31)	-	70	(78)	1,499	-	1,499
Non-interest income	635	132	260	34	55	1,116	167	1,283
Total trading income	2,173	101	260	104	(23)	2,615	167	2,782
Administration expenses	(937)	(30)	(105)	(59)	(105)	(1,236)	(133)	(1,369)
Depreciation & amortisation	(59)	-	(2)	(2)	-	(63)	(142)	(205)
Total trading expenses	(996)	(30)	(107)	(61)	(105)	(1,299)	(275)	(1,574)
Impairment losses on loans and advances	(239)	29	-	(2)	-	(212)	(132)	(344)
Trading profit/(loss) before tax	938	100	153	41	(128)	1,104	(240)	864
Adjust for:								
Reorganisation and other costs	(139)	-	(6)	(1)	(132)	(278)		
Profit on part sale of PFS subsidiaries	-	5	-	-	105	110		
Hedging and other variances	-	-	-	-	(72)	(72)		
Capital and other charges	(89)	(11)	-	19	81	-		
Profit/(loss) before tax	710	94	147	59	(146)	864		
Average number of staff	13,269	166	389	858	221	14,903		
Total assets	114,306	9,357	54,029	211	21,720	199,623		

Adjustments comprise:	Non interest income £m	Administration expenses £m	Depreciation and amortisation £m	Impairment on loans and advances £m	Provisions for other liabilities and charges £m	Profit before tax £m
Reorganisation and other costs	-	(133)	(13)	(132)	-	(278)
Depreciation on operating lease assets	129	-	(129)	-	-	-
Profit on part sale of PFS subsidiaries	110	-	-	-	-	110
Hedging and other variances	(72)	-	-	-	-	(72)
	167	(133)	(142)	(132)	-	(240)

Notes to the Financial Statements continued

b) Geographical information

			Group
	2009	2008	2007
	£m	£m	£m
Total operating income			
United Kingdom	**4,625**	2,974	2,678
Other	**71**	30	104
	4,696	3,004	2,782

	2009	2008
	£m	£m
Total assets other than financial instruments, current tax assets and deferred tax assets		
United Kingdom	**2,842**	2,704
Other	**4**	2
	2,846	2,706

2. Net interest income

			Group
	2009	2008	2007
	£m	£m	£m
Interest and similar income:			
Loans and advances to banks	**155**	448	227
Loans and advances to customers	**6,823**	7,394	6,747
Other interest-earning financial assets	**340**	73	69
Total interest and similar income	**7,318**	7,915	7,043
Interest expense and similar charges:			
Deposits by banks	**193**	218	200
Deposits by customers	**2,256**	3,155	2,905
Debt securities in issue and other borrowed funds	**865**	2,218	1,955
Other interest-bearing financial liabilities	**592**	552	484
Total interest expense and similar charges	**3,906**	6,143	5,544
Net interest income	**3,412**	1,772	1,499

3. Net fee and commission income

			Group
	2009	2008	2007
	£m	£m	£m
Fee and commission income:			
Retail products	**674**	461	450
Insurance products	**158**	155	201
Asset management	**154**	152	134
Total fee and commission income	**986**	768	785
Fee and commission expense:			
Other fees paid	**162**	97	90
Total fee and commission expense	**162**	97	90
Net fee and commission income	**824**	671	695

4. Net trading and other income

			Group
	2009	2008	2007
	£m	£m	£m
Net trading and funding of other items by the trading book	**187**	54	260
Income from operating lease assets	**95**	223	245
Income on assets designated at fair value through profit or loss	**95**	916	368
Expense on liabilities designated at fair value through profit or loss	**(117)**	(435)	(382)
Gains/(losses) on derivatives managed with assets/liabilities held at fair value through profit or loss	**230**	(396)	(19)
Profit on sale of a non-controlling interest in subsidiary undertakings	**-**	-	105
Profit on sale of subsidiary undertakings	**-**	40	7
Profit/(loss) on sale of fixed assets	**2**	(17)	5
Hedge ineffectiveness and other	**(32)**	176	(2)
	460	561	587

Notes to the Financial Statements continued

5. Administration expenses

			Group
	2009 £m	2008 £m	2007 £m
Staff costs:			
Wages and salaries	**697**	545	529
Social security costs	**71**	45	42
Pensions costs: - defined contribution plans	**20**	8	7
- defined benefit plans	**55**	47	62
Other personnel costs	**62**	50	77
	905	695	717
Property, plant and equipment expenses	**227**	182	191
Information technology expenses	**311**	201	195
Other administration expenses	**405**	265	266
	1,848	1,343	1,369

Included in wages and salaries is £5m (2008: £7m, 2007: £3m) which arose from equity-settled share-based payments, of which £nil (2008: £nil, 2007: £3m) related to option-based schemes. Also included in wages and salaries was £5m (2008: release of £28m, 2007: £8m) which arose from cash-settled share-based payments.

6. Depreciation and amortisation

			Group
	2009 £m	2008 £m	2007 £m
Depreciation of property, plant and equipment excluding operating lease assets	**163**	78	76
Depreciation of operating lease assets	**75**	117	129
Amortisation of intangible fixed assets	**22**	7	-
	260	202	205

7. Audit and other services

The fees for audit and other services payable to the Company's auditors, Deloitte LLP, are analysed as follows:

			Group
	2009 £m	2008 £m	2007 £m
Audit fees:			
- Fees payable to the Company's auditor for the audit of the Group's annual accounts	**1.9**	1.6	1.2
- Fees payable to the Company's auditor and its associates for the audit of the Company's subsidiaries pursuant to legislation	**2.3**	1.6	1.6
Total audit fees	**4.2**	3.2	2.8
Non-audit fees:			
Other assurance services			
- Other services pursuant to legislation	**1.2**	0.7	1.4
- Tax compliance services	**-**	-	-
- Other assurance	**0.4**	0.8	0.6
Total assurance services fees	**1.6**	1.5	2.0
Other services			
- Tax services	**0.7**	0.4	-
- Other services	**-**	-	0.1
Total other services	**0.7**	0.4	0.1
Total non-audit fees	**2.3**	1.9	2.1

Other services pursuant to legislation relate to services carried out by the auditors in relation to statutory and regulatory filings of the Company and its associates. Of this category, £1.1m (2008: £0.6m, 2007: £1.2m) accords with the definition of 'Audit fees' per US Securities and Exchange Commission guidance. The remaining £0.1m (2008: £0.1m, 2007: £0.2m) accords with the definition of 'Other services' per that guidance.

Other assurance relates to services performed in connection with securitisation and debt issuances. Of this category, £nil (2008: £0.2m, 2007: £0.1m) accords with the definition of 'Audit fees' per US Securities and Exchange Commission guidance. Of the remaining balance £0.3m (2008: £0.3m, 2007: £0.2m) accords with the definition of 'Audit related fees' per that guidance and £0.1m (2008: £0.3m, 2007: £0.3m) accords with the definition of 'Other services' per that definition.

No information technology, internal audit, valuation and actuarial, litigation, recruitment and remuneration or corporate finance services were provided by the external auditors during these years. A framework for ensuring auditors' independence has been adopted which defines unacceptable non-audit assignments, pre-approval of acceptable non-audit assignments and procedures for approval of acceptable non-audit assignments by the Audit and Risk Committee. All services provided by the Group's external auditors are either pre-approved or approved by the Audit and Risk Committee.

8. Impairment losses/(recoveries) on loans and advances

			Group
	2009	2008	2007
	£m	£m	£m
Impairment losses on loans and advances	**897**	394	388
Recoveries of loans and advances	**(55)**	(46)	(44)
	842	348	344

9. Taxation charge

			Group
	2009	2008	2007
	£m	£m	£m
Current tax:			
UK corporation tax on profit of the year	**124**	218	122
Adjustments and reclassifications in respect of prior periods	**(117)**	(65)	(31)
Total current tax	**7**	153	91
Deferred tax:			
Current year	**388**	95	68
Adjustments and reclassifications in respect of prior periods	**50**	27	20
Total deferred tax	**438**	122	88
Tax on profit for the year	**445**	275	179

UK corporation tax is calculated at 28% (2008: 28.5%, 2007: 30%) of the estimated assessable profits for the year. The standard rate of UK corporation tax was reduced from 30% to 28% with effect from 1 April 2008. Taxation for other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the Company as follows:

			Group
	2009	2008	2007
	£m	£m	£m
Profit before tax	**1,690**	1,094	864
Tax calculated at a tax rate of 28% (2008: 28.5%, 2007: 30%)	**473**	310	259
Non taxable gain on sale of subsidiary undertakings	**(5)**	(11)	(33)
Non deductible preference dividends paid	**8**	8	9
Effect of non-allowable provisions and other non-equalised items	**51**	19	(10)
Non-taxable dividend income	**(4)**	(5)	(3)
Effect of non-UK profits and losses	**(8)**	(8)	(11)
Utilisation of capital losses for which credit not previously recognised	**(3)**	-	(11)
Effect of change in tax rate on deferred tax provision	**-**	-	(10)
Adjustment to prior year provisions	**(67)**	(38)	(11)
Income tax expense	**445**	275	179

In addition to the income tax expense charged to profit or loss, a deferred tax asset of £172m (2008: £8m, 2007: £9m) has been recognised in equity in the year. Further information about deferred income tax is presented in Note 25.

10. Profit/(loss) on ordinary activities after tax

The profit after tax of the Company attributable to the shareholders was £747m (2008: £1,328m, 2007: £351m). As permitted by Section 408 of the UK Companies Act 2006, the Company's profit and loss account has not been presented in these Consolidated Financial Statements.

11. Cash and balances with central banks

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Cash in hand	**710**	804	**308**	347
Balances with central banks	**3,453**	3,213	**2,958**	2,109
	4,163	4,017	**3,266**	2,456

For regulatory purposes, certain minimum cash balances are required to be maintained with the Bank of England. At 31 December 2009, these amounted to £184m (2008: £171m).

Notes to the Financial Statements continued

12. Trading assets

	Group 2009 £m	2008 £m
Balances with central banks	-	2,498
Loans and advances to banks	5,252	4,947
Loans and advances to customers	10,628	1,310
Debt securities	15,932	16,801
Equity securities	1,478	708
	33,290	26,264

Debt securities can be analysed by type of issuer as follows:

	Group 2009 £m	2008 £m
Issued by public bodies:		
- Government securities	2,856	3,139
Issued by other issuers:		
- Bank and building society certificates of deposit: Government guaranteed	205	3,119
- Bank and building society certificates of deposit: Other	1,730	5,266
- Floating rate notes	3,038	4,724
- Floating rate notes: Government guaranteed	8,090	553
- Other debt securities: Other	13	-
	15,932	16,801

Debt securities and equity securities can be analysed by listing status as follows:

	Group 2009 £m	2008 £m
Debt securities:		
- Listed in the UK	12,803	9,576
- Listed elsewhere	3,129	7,225
- Unlisted	-	-
	15,932	16,801
Equity securities:		
- Listed in the UK	1,183	317
- Listed elsewhere	295	391
	1,478	708

The Company has no trading assets (2008: nil).

13. Derivative financial instruments

All derivatives are required to be held at fair value through profit or loss. Derivatives are classified as held for trading unless they are designated as being in a hedge relationship. Derivatives are held for trading or for risk management purposes. The Group chooses to designate certain derivatives as in a hedging relationship if they meet specific criteria.

Derivatives held for trading purposes
Global Banking & Markets is the only area of the Group actively trading derivative products and is additionally responsible for implementing Group derivative hedging with the external market. For trading activities, its objectives are to gain value by:

> Marketing derivatives to end users and hedging the resulting exposures efficiently; and
> The management of trading exposure reflected on the Group's balance sheet.

Trading derivatives include interest rate, cross currency, equity, property and other index related swaps, forwards, caps, floors, swaptions, as well as credit default and total return swaps, equity index contracts and exchange traded interest rate futures and equity index options.

Derivatives held for risk management purposes
The main derivatives are interest rate and cross-currency swaps, which are used to hedge the Group's exposure to interest rates and exchange rates. These risks are inherent in non-trading assets, liabilities and positions, including fixed-rate lending and structured savings products within the relevant operations throughout the Group, including medium-term note issues, capital issues and fixed-rate asset purchases.

Notes to the Financial Statements continued

The derivatives table in the Market Risk discussion within the Group Infrastructure section of the Risk Management Report summarises activities undertaken by the Group, the related risks associated with such activities and the types of derivative used in managing such risks. Such risks may also be managed using natural offsets within other on-balance sheet instruments as part of an integrated approach to risk management.

Derivative products which are combinations of more basic derivatives (such as swaps with embedded option features), or which have leverage features, may be used in circumstances where the underlying position being hedged contains the same risk features. In such cases, the derivative used will be structured to match the risks of the underlying asset or liability. Exposure to market risk on such contracts is therefore hedged. The fair values of derivative instruments held both for trading and hedging purposes are set out in the following tables. The tables below show the contract or underlying principal amounts, positive and negative fair values of derivatives analysed by contract. Contract or notional amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts of risk. The fair values represent the amount at which a contract could be exchanged in an arm's length transaction, calculated at market rates at the balance sheet date.

Derivatives classified as held for trading or held for risk management purposes that have not been designated as in a hedging relationship are classified as derivatives held for trading in the table below. Derivatives that have been designated as in a hedging relationship are classified as derivatives held for hedging below.

			Group
2009 **Derivatives held for trading**	**Contract/ notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**
Exchange rate contracts:			
- Cross-currency swaps	**113,036**	**3,101**	**409**
- Foreign exchange swaps and forwards	**22,496**	**164**	**112**
	135,532	**3,265**	**521**
Interest rate contracts:			
- Interest rate swaps	**554,709**	**14,905**	**13,226**
- Caps, floors and swaptions	**80,075**	**1,767**	**737**
- Futures (exchange traded)	**89,379**	**4**	**-**
- Forward rate agreements	**77,170**	**56**	**61**
	801,333	**16,732**	**14,024**
Equity and credit contracts:			
- Equity index and similar products	**4,736**	**881**	**1,311**
- Equity index options (exchange traded)	**71,662**	**563**	**871**
- Credit default swaps and similar products	**3,737**	**31**	**48**
	80,135	**1,475**	**2,230**
Total derivative assets and liabilities held for trading	**1,017,000**	**21,472**	**16,775**

			Group
2009 **Derivatives held for fair value hedging**	**Contract/ notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**
Exchange rate contracts:			
- Cross-currency swaps	**6,515**	**860**	**-**
Interest rate contracts:			
- Interest rate swaps	**45,093**	**495**	**2,185**
Equity and credit contracts:			
- Equity index and similar products	**-**	**-**	**3**
Total derivative assets and liabilities held for fair value hedging	**51,608**	**1,355**	**2,188**
Total recognised derivative assets and liabilities	**1,068,608**	**22,827**	**18,963**

			Company
2009 **Derivatives held for trading**	**Contract/ notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**
Exchange rate contracts:			
- Cross-currency swaps	**19,983**	**123**	**2,810**
Interest rate contracts:			
- Interest rate swaps	**57,029**	**1,093**	**1**
- Caps, floors and swaptions	**146**	**2**	**-**
	57,175	**1,095**	**1**
Equity and credit contracts:			
- Equity index and similar products	**273**	**38**	**190**
Total derivative assets and liabilities held for trading	**77,431**	**1,256**	**3,001**

Notes to the Financial Statements continued

2009 **Derivatives held for fair value hedging**	Contract/ notional amount £m	Fair value assets £m	Company Fair value liabilities £m
Exchange rate contracts:			
- Cross-currency swaps	**1,846**	**796**	**-**
Interest rate contracts:			
- Interest rate swaps	**4,797**	**487**	**352**
Total derivative assets and liabilities held for fair value hedging	**6,643**	**1,283**	**352**
Total recognised derivative assets and liabilities	**84,074**	**2,539**	**3,353**

2008 **Derivatives held for trading**	Contract/ notional amount £m	Fair value assets £m	Group Fair value liabilities £m
Exchange rate contracts:			
- Cross-currency swaps	33,507	8,236	551
- Foreign exchange swaps and forwards	19,563	1,421	1,129
	53,070	9,657	1,680
Interest rate contracts:			
- Interest rate swaps	471,976	16,887	16,658
- Caps, floors and swaptions	44,529	1,782	1,842
- Futures (exchange traded)	55,534	232	-
- Forward rate agreements	250,324	604	599
	822,363	19,505	19,099
Equity and credit contracts:			
- Equity index and similar products	16,245	1,597	3,659
- Equity index options (exchange traded)	11,564	843	803
- Credit default swaps and similar products	1,854	111	179
	29,663	2,551	4,641
Total derivative assets and liabilities held for trading	905,096	31,713	25,420

2008 **Derivatives held for fair value hedging**	Contract/ notional amount £m	Fair value assets £m	Group Fair value liabilities £m
Exchange rate contracts:			
- Cross-currency swaps	2,595	1,136	-
Interest rate contracts:			
- Interest rate swaps	85,183	2,276	2,390
Total derivative assets and liabilities held for fair value hedging	87,778	3,412	2,390
Total recognised derivative assets and liabilities	992,874	35,125	27,810

2008 **Derivatives held for trading**	Contract/ notional amount £m	Fair value assets £m	Company Fair value liabilities £m
Exchange rate contracts:			
- Cross-currency swaps	22,004	1,611	3,334
Interest rate contracts:			
- Interest rate swaps	56,457	490	162
- Caps, floors and swaptions	246	3	-
	56,703	493	162
Equity and credit contracts:			
- Equity index and similar products	685	8	176
Total derivative assets and liabilities held for trading	79,392	2,112	3,672

2008 **Derivatives held for fair value hedging**	Contract/ notional amount £m	Fair value assets £m	Company Fair value liabilities £m
Exchange rate contracts:			
- Cross-currency swaps	1,570	-	1,394
Interest rate contracts:			
- Interest rate swaps	5,141	623	327
Total derivative assets and liabilities held for fair value hedging	6,711	623	1,721
Total recognised derivative assets and liabilities	86,103	2,735	5,393

Notes to the Financial Statements continued

Net gains or losses arising from fair value hedges included in net trading and other income

			Group
	2009 £m	2008 £m	2007 £m
Net gains/(losses):			
- on hedging instruments	**647**	39	(413)
- on hedged items attributable to hedged risks	**(579)**	53	449
	68	92	36

The Group hedges its exposures to various risks, including interest rate risk and foreign currency risk, in connection with certain mortgage assets, covered bond issuances, and subordinated and senior debt securities in issue. The gains/(losses) arising on these assets and liabilities are presented in the table above on a combined basis.

14. Financial assets designated at fair value

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Loans and advances to banks	**-**	-	**160**	162
Loans and advances to customers	**6,379**	6,687	**45**	44
Debt securities	**5,979**	4,690	**36,940**	47,319
	12,358	11,377	**37,145**	47,525

Financial assets are designated at fair value through profit or loss where this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis, or where a contract contains one or more embedded derivatives.

The following assets have been designated at fair value through profit or loss:

- Loans and advances to customers, representing certain loans secured on residential property to housing associations. These would otherwise have been measured at amortised cost with the associated derivatives used to economically hedge the risk held for trading and measured at fair value through profit or loss.
- Debt securities representing holdings of asset-backed securities of £5,929m (2008: £4,690m) and collateralised synthetic obligations of £50m (2008: £nil):
  - At the date of their acquisition, the asset-backed securities were managed, and their performance was evaluated, on a fair value basis in accordance with a documented investment strategy, and information about them was provided internally on that basis to the Group's key management personnel. Almost all of these securities are now managed on an accruals basis, but are not eligible for reclassification under IAS 39.
  - The collateralised synthetic obligations contain embedded derivatives which would otherwise require bifurcation and separate recognition as derivatives. The collateralised synthetic obligations were initially recognised in 2009 upon the consolidation of the assets of the Group's Conduit vehicles as described in 'Exposure to Off-Balance Sheet Entities sponsored by the Group - Secured Loan to Conduit' in the Risk Management Report.

The maximum exposure to credit risk on loans and advances designated as held at fair value through profit or loss at the balance sheet date was £6,261m (2008: £6,335m) for the Group and £204m (2008: £206m) for the Company. The maximum exposure was mitigated by the Group having a charge over the residential properties in respect of lending to housing associations. Of the movement in the fair value of the loans and advances to banks, loans and advances to customers and debt securities an amount of £247m (2008: £474m) was due to changes in credit spreads.

Debt securities can be analysed by listing status as follows:

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Listed in the UK	**-**	-	**18,463**	26,978
Listed elsewhere	**3,224**	4,120	**18,016**	20,341
Unlisted	**2,755**	570	**461**	-
	5,979	4,690	**36,940**	47,319

15. Loans and advances to banks

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Placements with other banks	**1,605**	6,648	**995**	970
Amounts due from parent	**5,995**	9,353	**1**	1,004
Amounts due from associated undertakings	**1,551**	-	**1**	334
Amounts due from subsidiaries	**-**	-	**108,661**	114,178
	9,151	16,001	**109,658**	116,486

Notes to the Financial Statements continued

During the year, no impairment losses were incurred (2008: £nil, 2007: £nil).

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Repayable:				
On demand	**1,457**	3,555	**5,551**	7,826
In not more than 3 months	**5,055**	1,985	**46,580**	50,759
In more than 3 months but not more than 1 year	**2,390**	8,980	**14,552**	6,135
In more than 1 year but not more than 5 years	**95**	61	**21,951**	18,263
In more than 5 years	**154**	1,420	**21,024**	33,503
	9,151	16,001	**109,658**	116,486

16. Loans and advances to customers

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Advances secured on residential properties	**160,802**	152,493	**122,746**	115,474
Corporate loans	**12,173**	13,284	**-**	24
Finance leases	**1,602**	1,792	**-**	-
Other secured advances	**3,819**	4,209	**3,759**	4,133
Other unsecured advances	**5,250**	6,747	**5,036**	3,082
Amounts due from fellow group subsidiaries	**4,457**	2,652	**71**	-
Amounts due from subsidiaries	**-**	-	**1,036**	1,328
Loans and advances to customers	**188,103**	181,177	**132,648**	124,041
Less: loan loss allowances	**(1,299)**	(1,001)	**(899)**	(722)
Loans and advances to customers, net of loan loss allowances	**186,804**	180,176	**131,749**	123,319

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Repayable:				
On demand	**997**	636	**534**	523
In not more than 3 months	**6,591**	6,712	**1,575**	1,418
In more than 3 months but not more than 1 year	**4,909**	5,974	**3,311**	2,532
In more than 1 year but not more than 5 years	**26,411**	25,585	**14,653**	13,248
In more than 5 years	**149,195**	142,270	**112,575**	106,320
Loans and advances to customers	**188,103**	181,177	**132,648**	124,041
Less loan loss allowances	**(1,299)**	(1,001)	**(899)**	(722)
Loans and advances to customers, net of loan loss allowances	**186,804**	180,176	**131,749**	123,319

The Group's leasing subsidiaries enter into finance lease and hire purchase arrangements with customers, as follows.

Gross investment in finance leases and hire purchase contracts receivable	**2009 £m**	2008 £m
Within 1 year	**240**	333
Between 1-5 years	**543**	699
In more than 5 years	**1,570**	1,557
	2,353	2,589
Unearned future finance income on finance leases and hire purchase contracts	**(751)**	(797)
Net investment in finance leases and hire purchase contracts	**1,602**	1,792

The net investment in finance leases and hire purchase contracts is analysed as follows:	**2009 £m**	2008 £m
Within 1 year	**246**	231
Between 1-5 years	**435**	484
In more than 5 years	**921**	1,077
Net investment in finance leases and hire purchase contracts	**1,602**	1,792

Included in the carrying value of Net investment in finance leases and hire purchase contracts is £13m (2008: £48m) residual value at the end of the current lease terms, which will be recovered through re-letting or sale.

Included within loans and advances to customers are £15,150m (2008: £24,101m) of mortgage advances assigned to bankruptcy remote special purpose entities, Abbey Covered Bonds LLP and Alliance & Leicester Covered Bonds LLP. These loans provide security to issues of covered bonds made by the Company and Alliance & Leicester plc.

Notes to the Financial Statements continued

Loans and advances to customers have the following interest rate structures:

	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
Fixed rate	**77,427**	90,214	**62,222**	66,682
Variable rate	**110,676**	90,963	**70,426**	57,359
Less: loan loss allowances	**(1,299)**	(1,001)	**(899)**	(722)
	186,804	180,176	**131,749**	123,319

Movement in loan loss allowances:

Group

2009	**Loans secured on residential property £m**	**Corporate Loans £m**	**Finance leases £m**	**Other secured advances £m**	**Other unsecured advances £m**	**Total £m**
As at 1 January 2009						
- Individually assessed	**174**	**13**	**-**	**37**	**227**	**451**
- Collectively assessed	**184**	**289**	**1**	**11**	**65**	**550**
	358	**302**	**1**	**48**	**292**	**1,001**
Charge/(release) to the income statement:						
- Individually assessed	**223**	**172**	**5**	**30**	**539**	**969**
- Collectively assessed	**(13)**	**(117)**	**-**	**1**	**(12)**	**(141)**
	210	**55**	**5**	**31**	**527**	**828**
Write offs	**(84)**	**-**	**(4)**	**(17)**	**(425)**	**(530)**
At 31 December 2009:						
- Individually assessed	**313**	**185**	**1**	**50**	**341**	**890**
- Collectively assessed	**171**	**172**	**1**	**12**	**53**	**409**
	484	**357**	**2**	**62**	**394**	**1,299**

Group

2008	Loans secured on residential property £m	Corporate Loans £m	Finance leases £m	Other secured advances £m	Other unsecured advances £m	Total £m
As at 1 January 2008:						
- Individually assessed	74	-	-	32	250	356
- Collectively assessed	102	-	-	8	85	195
	176	-	-	40	335	551
Charge/(release) to the income statement:						
- Individually assessed	132	13	-	14	239	398
- Collectively assessed	21	13	-	3	(41)	(4)
	153	26	-	17	198	394
Write offs	(32)	-	-	(9)	(262)	(303)
Acquired through business combinations	61	276	1	-	21	359
At 31 December 2008:						
- Individually assessed	174	13	-	37	227	451
- Collectively assessed	184	289	1	11	65	550
	358	302	1	48	292	1,001

Group

2007	Loans secured on residential property £m	Corporate Loans £m	Finance leases £m	Other secured advances £m	Other unsecured advances £m	Total £m
As at 1 January 2007:						
- Individually assessed	45	-	1	73	243	362
- Collectively assessed	60	-	-	3	111	174
	105	-	1	76	354	536
Charge/(release) to the income statement:						
- Individually assessed	38	-	-	(17)	346	367
- Collectively assessed	42	-	-	5	(26)	21
	80	-	-	(12)	320	388
Write offs	(9)	-	(1)	(24)	(339)	(373)
At 31 December 2007:						
- Individually assessed	74	-	-	32	250	356
- Collectively assessed	102	-	-	8	85	195
	176	-	-	40	335	551

Notes to the Financial Statements continued

Company

	Loans secured on residential property £m	Amounts due from subsidiaries £m	Finance leases £m	Other secured advances £m	Other unsecured advances £m	Total £m
As at 1 January 2009	**297**	**113**	**-**	**42**	**270**	**722**
Charge/(release) to the income statement	**182**	**(15)**	**-**	**31**	**421**	**619**
Write offs	**(84)**	**-**	**-**	**(18)**	**(340)**	**(442)**
At 31 December 2009	**395**	**98**	**-**	**55**	**351**	**899**
As at 1 January 2008	176	136	-	11	331	654
Charge/(release) to the income statement	153	(23)	-	32	197	359
Write offs	(32)	-	-	(1)	(258)	(291)
At 31 December 2008	297	113	-	42	270	722
As at 1 January 2007	105	161	1	4	352	623
Charge/(release) to the income statement	80	(25)	-	8	316	379
Write offs	(9)	-	(1)	(1)	(337)	(348)
At 31 December 2007	176	136	-	11	331	654

Recoveries:

Group

	Loans secured on residential property £m	Corporate Loans £m	Finance leases £m	Other secured advances £m	Other unsecured advances £m	Total £m
2009	**1**	**23**	**1**	**-**	**30**	**55**
2008	1	-	-	12	33	46
2007	2	-	-	6	36	44

17. Securitisation of assets

Loans and advances to customers include portfolios of residential mortgage loans, which are subject to non-recourse finance arrangements. These loans have been purchased by, or assigned to, special purpose securitisation companies, and have been funded primarily through the issue of mortgage-backed securities. No gain or loss has been recognised as a result of these sales. These securitisation companies are consolidated and included in the Group financial statements as subsidiaries.

Master Trust Structures

The Group makes use of a type of securitisation known as a master trust structure. In this structure, a pool of assets is assigned to a trust company by the asset originator, initially funded by the originator. A funding entity acquires beneficial interests in a share of the portfolios of assets with funds borrowed from qualifying special purpose entities, which at the same time issue asset-backed securities to third-party investors or the Group. The purpose of the special purpose entities is to obtain diverse, low cost funding through the issue of asset-backed securities, or to use the asset-backed securities as collateral for raising funds. The share of the pool of assets not purchased from the trust company by the funding entity is known as the beneficial interest of the originator.

Using this structure, the Group has assigned portfolios of residential mortgages and their related security to Holmes Trustees Limited, a trust company that holds the portfolios of mortgages on trust for the Company and Holmes Funding Limited and Holmes Funding 2 Limited. In June 2009, two new entities were incorporated (Holmes Master Issuer 2 plc and Holmes Funding 2 Limited) in order to enable the separation of the intercompany issuances from the third party issuances. Holmes Funding Limited and Holmes Funding 2 Limited acquire beneficial interests in the portfolios of mortgages with funds borrowed from the securitisation companies Holmes Financing (No.s 1, 9, and 10) plc, Holmes Master Issuer plc and Holmes Master Issuer 2 plc.

In January 2009 the remaining mortgages backed securities in Holmes Financing (No. 8) plc were redeemed. The remaining share of the beneficial interest in residential mortgage loans held by Holmes Trustees Limited belongs to Santander UK plc and amounts to £13.0bn at 31 December 2009. Mortgage backed notes totalling £3.0bn equivalent were redeemed during the year. In April 2008 the remaining mortgage backed securities in issue in Holmes Financing (No. 6) plc and Holmes Financing (No. 7) plc were redeemed.

Alliance & Leicester plc established the Fosse Master Trust securitisation structure in 2006. Notes were issued by Fosse Master Issuer plc to third party investors and the proceeds loaned to Fosse Funding (No. 1) Limited, which in turn used the funds to purchase beneficial interests in mortgages held by Fosse Trustee Limited. Mortgage backed notes totalling £0.6bn equivalent were redeemed during the year.

Alliance & Leicester plc established the Langton Master Trust securitisation structure on 25 January 2008. Notes were 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.

Notes to the Financial Statements continued

The Company and its subsidiaries are under no obligation to support any losses that may be incurred by the Holmes, Fosse and Langton securitisation companies or holders of the securities and do not intend to provide such further support. Holders of the securities are only entitled to obtain payment of principal and interest to the extent that the resources of the Holmes, Fosse and Langton securitisation companies are sufficient to support such payments, and the holders of the securities have agreed in writing not to seek recourse in any other form.

The Company and its subsidiaries receive payments from the securitisation companies in respect of fees for administering the loans, and payment of deferred consideration for the sale of the loans. The Company and its subsidiaries have no right or obligation to repurchase the benefit of any securitised loan, except if certain representations and warranties given by the Company or its subsidiaries at the time of transfer are breached.

In April and December 2008, Holmes Funding Limited acquired, at book value, additional beneficial interests in the trust property vested in Holmes Trustees Limited. These further beneficial interests of £8.2bn and £13.4bn, respectively, were acquired through borrowing from Holmes Master Issuer plc, which funded its advances to Holmes Funding Limited through the issue of mortgage backed securities. All of the mortgage backed securities issued in 2008 were acquired by the Company. It is intended that any future issues will continue to be made from Holmes Master Issuer plc or Holmes Master Issuer 2 plc.

Bracken Securities plc
In October 2007 Alliance & Leicester plc securitised £10,367m of residential mortgage assets to Bracken Securities plc. Notes of £10,367m 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 Alliance & Leicester group.

Outstanding balances of assets securitised and non-recourse finance under the Holmes structure at 31 December 2009 were:

Securitisation company	Closing date of securitisation	Gross assets securitised £m	Non-recourse finance £m	Issued to Santander UK plc as collateral £m
Holmes Financing (No. 1) plc	26 July 2000	275	275	-
Holmes Financing (No. 9) plc	8 December 2005	1,053	1,658	-
Holmes Financing (No. 10) plc	8 August 2006	1,526	1,639	-
Holmes Master Issuer plc – 2006/1	28 November 2006	1,767	2,015	-
Holmes Master Issuer plc – 2007/1	28 March 2007	3,392	4,985	-
Holmes Master Issuer plc – 2007/2	20 June 2007	4,319	5,263	-
Holmes Master Issuer plc – 2007/3	21 December 2007	7,259	-	8,914
Holmes Master Issuer plc – 2008/1	10 April 2008	8,240	-	9,103
Holmes Master Issuer plc – 2008/2	19 December 2008	12,758	-	13,209
Beneficial interest in mortgages held by Holmes Trustees Ltd		12,980	-	-
		53,569	15,835	31,226

The gross assets securitised represent the interest in the trust property held by Holmes Funding Limited related to the debt issued by the securitisation companies. The beneficial interest in the mortgages held by Holmes Trustees Limited represents the proportion of the funds required to be retained in the trust as part of the master trust structure.

The Holmes securitisation companies have placed cash deposits totalling £1.8bn, which have been accumulated to finance the redemption of a number of securities issued by the Holmes securitisation companies. The Holmes securitisation companies' contractual interest in advances secured on residential property is therefore reduced by this amount. The Company and its subsidiaries do not own directly, or indirectly, any of the share capital of any of the securitisation companies.

The Fosse, Bracken and Langton securitisation companies have cash deposits totalling £115m, which have been accumulated to finance the redemption of a number of securities issued by the Fosse, Bracken and Langton securitisation companies. The Fosse, Bracken and Langton securitisation companies' contractual interest in advances secured on residential property is therefore reduced by this amount. The Company and its subsidiaries do not own directly, or indirectly, any of the share capital of any of the above securitisation companies or their parents.

In March 2010 the Group issued through the Fosse Master Trust the first publicly-placed mortgage-backed securitisation transaction from a UK bank since 2007; other recent transactions from UK banks had included an investor put. The transaction was denominated in both pounds sterling and euro and raised approximately £1.4bn.

Outstanding balances of assets securitised and non-recourse finance under the Fosse, Bracken and Langton structures at 31 December 2009 were:

Securitisation company	Closing date of securitisation	Gross assets securitised £m	Non-recourse finance £m	Issued to A&L plc as collateral £m
Fosse Master Issuer plc	28 November 2006	1,859	1,924	-
Fosse Master Issuer plc	1 August 2007	2,050	2,080	-
Fosse Master Issuer plc	21 August 2008	287	314	-
Bracken Securities plc	11 October 2007	6,736	-	6,909
Langton Securities (2008-1) plc	25 January 2008	1,227	-	1,228
Langton Securities (2008-2) plc	5 March 2008	2,210	-	2,211
Langton Securities (2008-3) plc	17 June 2008	3,521	-	3,522
Beneficial interest in mortgages held by Fosse Master Trust Ltd		2,251	-	-
Beneficial interest in mortgages held by Langton Master Trust Ltd		1,572	-	-
		21,713	4,318	13,870

Notes to the Financial Statements continued

18. Available-for-sale securities

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Debt securities	**747**	2,618	-	-
Equity securities	**50**	45	**30**	25
	797	2,663	**30**	25

Maturities of debt securities:

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Due in less than 3 months	**91**	1,644	-	-
Due in more than 3 months but less than 1 year	**405**	970	-	
Due in more than 1 year but less than 5 years	**251**	4	-	-
Due in more than one year but not more than 5 years	**-**	-	-	-
	747	2,618	-	-

Equity securities do not bear interest. Equity securities can be analysed by listing status as follows:

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Listed in the UK	**11**	10	-	-
Unlisted	**39**	35	**30**	25
	50	45	**30**	25

The movement in available-for-sale securities can be summarised as follows:

	Group £m	**Company £m**
At 1 January 2009	**2,663**	**25**
Additions	**1,133**	**8**
Redemptions and maturities	**(3,001)**	**(3)**
Amortisation of discount	**8**	**-**
Movement in fair value	**(6)**	**-**
At 31 December 2009	**797**	**30**

	Group £m	Company £m
At 1 January 2008	40	28
Additions	1,222	9
Acquired through business combinations	1,658	-
Redemptions and maturities	(286)	(8)
Amortisation of discount	21	-
Movement in fair value	8	(4)
At 31 December 2008	2,663	25

	Group £m	Company £m
At 1 January 2007	23	12
Redemptions and maturities	(2)	(2)
Movement in fair value	19	18
At 31 December 2007	40	28

19. Loan and receivable securities

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Loan and receivable securities	**9,898**	14,107	**2**	-

These assets were acquired as part of the transfer of Alliance & Leicester plc to the Group. Upon initial recognition by the Group, the securities were classified as 'loans and receivables' as the Group identified that a rare circumstance of extreme market illiquidity existed at that time. The Group has the intention to hold the assets for the foreseeable future or until maturity.

Notes to the Financial Statements continued

In 2009, the Group recognised additional securities as a result of the requirement to consolidate the assets of the Group's Conduit vehicles, rather than recognising the Group's loans to the Conduit vehicles and treating the assets of the Conduit vehicles as off-balance sheet, as described in "Exposure to Off-Balance Sheet Entities sponsored by the Group - Secured Loan to Conduit" in the Risk Management Report on page 84. Upon initial recognition by the Group, these securities were classified as 'loans and receivables'.

Detailed analysis of these securities is contained in the Risk Management Report.

20. Investment in subsidiary undertakings

Investments in subsidiaries are held at cost subject to impairment. The movement in investments in subsidiary undertakings was as follows:

			Company
	Cost £m	**Impairment £m**	**Net book value £m**
At 1 January 2009	**5,252**	**(105)**	**5,147**
Additions	**2,136**	**(211)**	**1,925**
Disposals within the Group/repayment of investment	**(45)**	**11**	**(34)**
At 31 December 2009	**7,343**	**(305)**	**7,038**

	Cost £m	Impairment £m	Net book value £m
At 1 January 2008	5,213	(160)	5,053
Additions	133	-	133
Disposals within the Group	(94)	-	(94)
Write-back of impairments/repayment of investment	-	55	55
At 31 December 2008	5,252	(105)	5,147

On 9 January 2009, in order to optimise the capital, liquidity funding and overall financial efficiency of the Santander group, Banco Santander, S.A. transferred all of its Alliance & Leicester plc (wholly owned by Banco Santander, S.A. and the Company) shares to the Company in exchange for 12,631,375,230 newly issued ordinary shares of the Company (the 'Transfer'). The result of this was to increase the Company's holding of 35.6% of Alliance & Leicester plc's equity voting interests to 100%. Accordingly, the Company is now the immediate parent company of Alliance & Leicester plc. As described more fully in Note 47, the transfer of Alliance & Leicester plc has been accounted for by the Company with effect from 10 October 2008, the date on which Banco Santander, S.A. acquired control of Alliance & Leicester plc.

The ordinary shares of the Company issued as consideration for Banco Santander, S.A.'s holding of Alliance & Leicester plc shares have been recognised at their nominal value, which is the same as the fair value of the shares issued by Banco Santander, S.A. in exchange for the shares of Alliance & Leicester plc plus acquisition costs, and the net assets of Alliance & Leicester plc have been accounted for by the Company at the fair values recognised by Banco Santander, S.A. at the time of its acquisition of Alliance & Leicester plc on 10 October 2008. The acquisition price was £1,281m.

In September 2008, following the announcement by HM Treasury to take Bradford & Bingley plc into public ownership, the retail deposits, branch network and its related employees, and offshore entities transferred, under the provisions of the UK Banking (Special Provisions) Act 2008, to the Company. All of Bradford & Bingley plc's customer loans and treasury assets, which include all its mortgage assets, were taken into public ownership. The only entities acquired by the Company were offshore entities, for which consideration of £208m was paid.

On 17 December 2007, the Company sold 100% of its shareholdings in James Hay, Cater Allen and Abbey Sharedealing to Santander Private Banking UK Limited, at the time of the transaction a 100% owned direct subsidiary of the Company, for a total cash consideration of £414m. The companies sold were Cater Allen Limited, Abbey Stockbrokers Limited, Abbey Stockbrokers (Nominees) Limited, James Hay Holdings Limited, James Hay Wrap Managers Limited, James Hay Insurance Company Limited, James Hay Administration Company Limited, James Hay Pension Trustees Limited and Sarum Trustees Limited. Subsequently, on 17 December 2007, the Company sold 49% of its shareholding in Santander Private Banking UK Limited to Santander PB UK (Holdings) Limited, a direct subsidiary of Banco Santander, S.A. for a total cash consideration of £203m.

The principal subsidiaries of the Company at 31 December 2009 are shown below. The Directors consider that to give full particulars of all subsidiary undertakings would lead to a statement of excessive length. In accordance with Section 410(2) of the UK Companies Act 2006, the following information relates to those subsidiary undertakings whose results or financial position, in the opinion of the Directors, principally affect the results of the Group. Full particulars of all subsidiary undertakings will be annexed to the Company's next annual return in accordance with Section 410(3)(b) of the UK Companies Act 2006.

Principal subsidiary	**Nature of business**	**% Interest held**	**Country of incorporation or registration**
Abbey National International Limited*	Personal finance	100	Jersey
Abbey National North America LLC*	Funding	100	United States
Abbey National Treasury Services plc	Treasury operations	100	England & Wales
Alliance & Leicester plc	Bank, deposit taker	100	England & Wales
Alliance & Leicester International Limited*	Offshore deposit taking	100	Isle of Man
Bradford & Bingley International Limited	Bank, deposit taker	100	Isle of Man
Cater Allen International Limited*	Securities financing	100	England & Wales
Cater Allen Limited*	Bank, deposit taker	51	England & Wales

* Held indirectly through subsidiary companies.

Notes to the Financial Statements continued

All the above companies are included in the Consolidated Financial Statements. The Company holds directly or indirectly 100% of the issued ordinary share capital of its principal subsidiaries, except for Cater Allen Limited as described above. All companies operate principally in their country of incorporation or registration. Abbey National Treasury Services plc also has a branch office in the US and the Cayman Islands. The Company has a branch in the Isle of Man. Alliance & Leicester plc has a branch in the Isle of Man. The ability of Alliance & Leicester International Limited to pay dividends to the Company is restricted by regulatory capital requirements. Abbey National International Limited had a branch in the Isle of Man, which was closed on 1 April 2010.

21. Investment in associated undertakings

The movement in interests in associated undertakings was as follows:

	Group £m	**Company £m**
At 1 January 2009	**35**	**741**
Additional investment	**35**	**35**
Share of results	**5**	**-**
Transfer to investment in subsidiary	**-**	**(700)**
At 31 December 2009	**75**	**76**

	Group £m	Company £m
At 1 January 2008	29	33
Additional investments	8	708
Share of results	(2)	-
At 31 December 2008	35	741

The principal associated undertakings at 31 December 2009 and 2008 were:

2009 Name and nature of business	**Country of registration**	**Assets £m**	**Liabilities £m**	**Income £m**	**Profit/(loss) £m**	**% interest held**
PSA Finance plc, personal finance	England and Wales	**3**	**-**	**-**	**-**	**50.0**
Santander Consumer (UK) plc, consumer finance	England and Wales	**2,361**	**(2,215)**	**(134)**	**123**	**49.9**

2008 Name and nature of business	Country of registration	Assets £m	Liabilities £m	Income £m	Profit/(loss) £m	% interest held
PSA Finance plc, personal finance	England and Wales	4	-	1	1	50.0
Santander Consumer (UK) plc, consumer finance	England and Wales	714	(647)	73	(2)	49.9

All associated undertakings have a year-end of 31 December and are unlisted.

22. Intangible assets

a) Goodwill

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Cost				
At 1 January	**1,281**	112	**419**	-
Acquisitions	**4**	1,169	**-**	419
At 31 December	**1,285**	1,281	**419**	419
Accumulated impairment				
At 1 January and 31 December	**22**	22	**-**	-
Net book value	**1,263**	1,259	**419**	419

On 9 January 2009, in order to optimise the capital, liquidity funding and overall financial efficiency of the Santander group, Banco Santander, S.A. transferred all of its Alliance & Leicester plc (wholly owned by Banco Santander, S.A. and the Company) shares to the Company in exchange for 12,631,375,230 newly issued ordinary shares in the Company (the 'Transfer'). The result of this was to increase the Company's holding of 35.6% of Alliance & Leicester plc's equity voting interests to 100%. Accordingly, the Company is now the immediate parent company of Alliance & Leicester plc. As described more fully in Note 47, the transfer of Alliance & Leicester plc has been accounted for by the Company with effect from 10 October 2008, the date on which Banco Santander, S.A. acquired control of Alliance & Leicester plc.

Notes to the Financial Statements continued

The ordinary shares of the Company issued as consideration for Banco Santander, S.A.'s holding of Alliance & Leicester plc shares have been recognised at their nominal value, which is the same as the fair value of the shares issued by Banco Santander, S.A. in exchange for the shares of Alliance & Leicester plc plus acquisition costs, and the net assets of Alliance & Leicester plc have been accounted for by the Company at the fair values recognised by Banco Santander, S.A. at the time of its acquisition of Alliance & Leicester plc on 10 October 2008. The acquisition price was £1,281m. In connection with the acquisition, goodwill of £774m was recognised, which is attributable to the anticipated increase in revenues arising from a strengthened market position and greater critical mass, and the anticipated future operating cost synergies arising from the elimination of duplicated back office and support functions. Adjustments to the value of goodwill arising from the final allocation of the aggregate purchase price as at the acquisition date are set out in Note 48.

In September 2008, following the announcement by HM Treasury to take Bradford & Bingley plc into public ownership, the retail deposits, branch network and its related employees transferred, under the provisions of the Banking (Special Provisions) Act 2008, to the Company. All of Bradford & Bingley plc's customer loans and treasury assets, which include all its mortgage assets, were taken under public ownership. The transfer to the Company consisted of the £20.0bn retail deposit base with 2.7 million customers, as well as Bradford & Bingley plc's direct channels including 197 retail branches, 141 agencies (distribution outlets in third party premises) and related employees. The acquisition price was £612m, including the transfer of £208m of capital from Bradford & Bingley plc relating to offshore entities. In connection with the acquisition, goodwill of £395m was recognised at a Group level, which is attributable to the anticipated increase in revenues arising from a strengthened market position and greater critical mass, and the anticipated future operating cost synergies arising from the elimination of duplicated back office and support functions. Adjustments to the value of goodwill arising from the finalisation of the allocation of the aggregate purchase price as at the acquisition date are set out in Note 48.

Prior to their acquisition by the Company, the retail deposits, branch network and related employees of Bradford & Bingley plc were not managed or reported on a stand-alone basis. As a result, it is not practicable to prepare separate combined financial information for this business and the Group for the year ended 31 December 2008 as though the acquisition date for the business combination had been 1 January 2008.

Impairment of goodwill

During the year there was no impairment of goodwill (2008: £nil, 2007: £nil). Impairment testing in respect of goodwill is performed annually, more frequently if there are impairment indicators present, and comprises a comparison of the carrying amount of the cash-generating unit with its recoverable amount: the higher of the cash-generating unit's net selling price and its value in use. Net selling price is calculated by reference to the amount at which the asset could be disposed of in a binding sale agreement in an arm's length transaction evidenced by an active market or recent transactions for similar assets. Value in use is calculated by discounting the expected future cash flows obtainable as a result of the asset's continued use, including those resulting from its ultimate disposal, at a market based discount rate on a pre-tax basis.

The following cash-generating units include in their carrying values goodwill that comprises the goodwill reported by the Group. The cash-generating unit does not carry on its balance sheet any other intangible assets with indefinite useful lives.

		Goodwill					
Business Division	**Cash Generating Unit**	**2009 £m**	2008 £m	**Basis of valuation**	**Key assumptions**	**Discount rate**	**Growth rate**
Retail Banking	Alliance & Leicester	**774**	774	Value in use: cash flow	3 year plan	10.1%	10%
Retail Banking	Cater Allen Private Bank	**90**	90	Value in use: cash flow	3 year plan	10.1%	10%
Retail Banking	Bradford & Bingley savings business	**395**	395	Value in use: cash flow	3 year plan	10.1%	5%

b) Other intangibles

	Group 2009 £m	Company 2009 £m
Cost		
At 1 January 2009	**95**	**72**
Additions	**120**	**82**
Disposals	**(3)**	**(3)**
At 31 December 2009	**212**	**151**
Accumulated amortisation / impairment		
At 1 January 2009	**7**	**7**
Charge for the year	**22**	**11**
At 31 December 2009	**29**	**18**
Net book value	**183**	**133**

Notes to the Financial Statements continued

	Group 2008 £m	Company 2008 £m
Cost		
At 1 January 2008	-	-
Additions	81	68
Acquired through business combinations	21	4
Disposals	(7)	-
At 31 December 2008	95	72
Accumulated amortisation / impairment		
At 1 January 2008	-	-
Charge for the year	7	7
At 31 December 2008	7	7
Net book value	88	65

Other intangible assets of the Group and the Company consist of computer software.

23. Property, plant and equipment (excluding operating lease assets)

Group

	Owner-occupied properties £m	**Office fixtures and equipment £m**	**Computer software £m**	**Total £m**
Cost:				
At 1 January 2009	**340**	**570**	**385**	**1,295**
Additions	**126**	**120**	**16**	**262**
Disposals	**(1)**	**(51)**	**(14)**	**(66)**
At 31 December 2009	**465**	**639**	**387**	**1,491**
Accumulated depreciation:				
At 1 January 2009	**24**	**312**	**105**	**441**
Charge for the year	**21**	**81**	**61**	**163**
Disposals	**-**	**(51)**	**-**	**(51)**
At 31 December 2009	**45**	**342**	**166**	**553**
Net book value	**420**	**297**	**221**	**938**

Group

	Owner-occupied properties £m	Office fixtures and equipment £m	Computer software £m	Total £m
Cost:				
At 1 January 2008	74	479	359	912
Acquired through business combinations	257	60	-	317
Additions	11	59	39	109
Disposals	(2)	(28)	(13)	(43)
At 31 December 2008	340	570	385	1,295
Accumulated depreciation:				
At 1 January 2008	18	283	83	384
Charge for the year	7	49	22	78
Disposals	(1)	(20)	-	(21)
At 31 December 2008	24	312	105	441
Net book value	316	258	280	854

Company

	Owner-occupied properties £m	**Office fixtures and equipment £m**	**Computer software £m**	**Total £m**
Cost:				
At 1 January 2009	**112**	**498**	**315**	**925**
Additions	**11**	**101**	**15**	**127**
Disposals	**-**	**(2)**	**(15)**	**(17)**
At 31 December 2009	**123**	**597**	**315**	**1,035**
Accumulated depreciation:				
At 1 January 2009	**22**	**299**	**35**	**356**
Charge for the year	**8**	**52**	**60**	**120**
Disposals	**-**	**(2)**	**-**	**(2)**
At 31 December 2009	**30**	**349**	**95**	**474**
Net book value	**93**	**248**	**220**	**561**

Notes to the Financial Statements continued

	Owner-occupied properties £m	Office fixtures and equipment £m	Computer software £m	Company Total £m
Cost:				
At 1 January 2008	68	453	279	800
Acquired through business combinations	34	10	-	44
Additions	11	56	39	106
Disposals	(1)	(21)	(3)	(25)
At 31 December 2008	112	498	315	925
Accumulated depreciation:				
At 1 January 2008	15	271	13	299
Charge for the year	7	45	22	74
Disposals	-	(17)	-	(17)
At 31 December 2008	22	299	35	356
Net book value	90	199	280	569

At 31 December 2009, capital expenditure contracted, but not provided for was £1m (2008: £3m, 2007: £nil) in respect of property, plant and equipment. Of the carrying value at the balance sheet date £99m (2008: £107m) related to assets under construction.

The cost of office fixtures and equipment held under finance leases was £26m (2008: £26m). At the balance sheet date, the Group had contracted with lessees for the following future minimum lease payments in leases relating to freehold properties:

	Group		Company	
Leases which expire	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Within 1 year	**1**	-	**1**	-
Between 1-5 years	**2**	3	**1**	2
In more than 5 years	**3**	5	**3**	5
	6	8	**5**	7

24. Operating lease assets

	Group 2009 £m	Group 2008 £m
Cost		
At 1 January	**348**	3,474
Additions	**81**	88
Acquired through business combinations	**-**	348
Disposals	**(101)**	-
Disposals of subsidiary undertaking	**-**	(3,562)
At 31 December	**328**	348
Depreciation and impairment		
At 1 January	**-**	1,310
Charge for the year	**75**	117
Disposals	**(59)**	-
Disposals of subsidiary undertaking	**-**	(1,427)
At 31 December	**16**	-
Net book value	**312**	348

The operating lease assets of the Group consist of commercial vehicles. The Group's trains and related assets were sold in 2008 as described in Note 41. The Company has no operating lease assets.

Future minimum lease receipts under non-cancellable operating leases are due over the following periods:

	Group 2009 £m	Group 2008 £m
In no more than 1 year	**72**	81
In more than 1 year but no more than 5 years	**99**	133
In more than 5 years	**26**	17
	197	231

Notes to the Financial Statements continued

25. Deferred tax

Deferred taxes are calculated on temporary differences under the liability method using the tax rates expected to apply when the liability is settled or the asset is realised. The movement on the deferred tax account was as follows:

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
At 1 January	**869**	121	**452**	614
Income statement credit/(charge)	**(438)**	(122)	**(149)**	(174)
Credited/(charged) to equity	**172**	8	**116**	12
Acquired through business combinations	**7**	416	**9**	-
Disposal of subsidiary undertaking	**-**	446	**-**	-
At 31 December	**610**	869	**428**	452

Deferred tax assets and liabilities are attributable to the following items:

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Deferred tax liabilities				
Accelerated tax depreciation	**(236)**	(193)	**-**	-
Other temporary differences	**(100)**	(212)	**-**	(6)
	(336)	(405)	**-**	(6)

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Deferred tax assets				
Pensions and other post retirement benefits	**306**	244	**264**	224
Accelerated book depreciation	**178**	271	**55**	66
IAS 32 & IAS 39 transitional adjustments	**78**	95	**72**	76
Provision for loan impairment and other provisions	**13**	22	**-**	-
Other temporary differences	**74**	228	**37**	46
Tax losses carried forward	**297**	414	**-**	46
	946	1,274	**428**	458

The aggregate current and deferred tax relating to items charged or credited to equity is:

	Group			Company		
	2009 £m	2008 £m	2007 £m	**2009 £m**	2008 £m	2007 £m
Pensions and other post retirement benefits	**119**	291	300	**173**	289	301

The deferred tax assets scheduled above have been recognised in both the Company and the Group on the basis that sufficient future taxable profits are forecast within the foreseeable future, in excess of the profits arising from the reversal of existing taxable temporary differences, to allow for the utilisation of the assets as they reverse. Under current UK tax legislation, the tax losses in respect of which deferred tax assets have been recognised do not expire. The benefit of the tax losses carried forward in the Company may only be realised by utilisation against the future taxable profits of the Company.

The deferred tax charge in the income statement comprises the following temporary differences:

	Group		
	2009 £m	2008 £m	2007 £m
Accelerated tax depreciation	**(133)**	24	1
Pensions and other post-retirement benefits	**(104)**	(63)	(4)
Provision for loan impairment and other provisions	**-**	-	-
IAS 32 & IAS 39 transition adjustments	**(11)**	(20)	(23)
Tax losses carried forward	**(63)**	(100)	(48)
Other temporary differences	**(127)**	37	(14)
	(438)	(122)	(88)

26. Other assets

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Trade and other receivables	**881**	1,061	**515**	831
Prepayments	**75**	122	**48**	47
Accrued income	**30**	30	**-**	-
General insurance assets	**88**	109	**88**	109
	1,074	1,322	**651**	987

27. Deposits by banks

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Items in the course of transmission	**652**	1,100	**570**	895
Sale and repurchase agreements	**-**	8,816	**-**	3,620
Amounts due to subsidiaries	**-**	-	**115,564**	120,285
Amounts due to fellow subsidiaries	**1,846**	1,443	**20**	-
Amounts due to ultimate parent	**644**	667	**29**	-
Other deposits	**2,669**	2,462	**231**	46
	5,811	14,488	**116,414**	124,846

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Repayable:				
On demand	**3,716**	2,375	**3,333**	2,907
In not more than 3 months	**1,916**	8,519	**23,732**	17,600
In more than 3 months but not more than 1 year	**24**	661	**10,203**	18,575
In more than 1 year but not more than 5 years	**155**	2,933	**71,927**	53,245
In more than 5 years	**-**	-	**7,219**	32,519
	5,811	14,488	**116,414**	124,846

28. Deposits by customers

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Retail deposits	**127,992**	120,483	**89,436**	85,150
Amounts due to subsidiaries	**-**	-	**64,531**	67,801
Amounts due to fellow subsidiaries	**473**	-	**79**	-
Wholesale deposits by customers	**15,428**	9,762	**5,141**	2,515
	143,893	130,245	**159,187**	155,466
Repayable:				
On demand	**105,157**	102,170	**77,240**	67,856
In no more than 3 months	**7,046**	9,202	**15,611**	14,204
In more than 3 months but no more than 1 year	**18,059**	14,982	**12,028**	13,506
In more than 1 year but not more than 5 years	**13,017**	3,165	**13,029**	8,804
In more than 5 years	**614**	726	**41,279**	51,096
	143,893	130,245	**159,187**	155,466

Retail deposits and wholesale deposits by customers are interest-bearing.

29. Trading liabilities

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Deposits by banks	**40,824**	34,341	**-**	-
Deposits by customers	**4,115**	4,622	**-**	-
Short positions in securities and unsettled trades	**1,071**	751	**-**	739
Debt securities in issue	**142**	1,024	**-**	-
	46,152	40,738	**-**	739

The total fair value of equity index-linked deposits included above at the balance sheet date was £2,144m (2008: £2,205m).

Notes to the Financial Statements continued

30. Financial liabilities designated at fair value

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Deposits by banks	**45**	153	**-**	-
Deposits by customers	**12**	252	**-**	-
Debt securities in issue - US$4bn Euro Commercial Paper Programme	**662**	-	**-**	-
- US$20bn Euro Medium Term Note Programme	**3,577**	4,274	**-**	-
- Other bonds	**127**	994	**-**	-
	4,423	5,673	**-**	-

Financial liabilities are designated at fair value through profit or loss where this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets and liabilities or recognising the gains or losses on them on a different basis. The 'fair value option' has been used where deposits by banks, deposits by customers and debt securities in issue would otherwise be measured at amortised cost, and the associated derivatives used to economically hedge the risk are held at fair value.

Of the movements in the fair value of the above debt securities in issue £27m (2008: £88m) result from changes in the Group's own credit risk. This was calculated by applying current spreads at the next call date or maturity date to the nominal value of the debt security to determine the extra cost of the debt for the remaining period of the debt security were it to have been issued at current spreads.

The amount that would be required to be contractually paid at maturity of the deposits by banks, deposits by customers, and debt securities in issue above is £129m (2008: £53m) higher than the carrying value.

US$4bn Euro Commercial Paper Programme

Abbey National Treasury Services plc may from time to time issue the commercial paper under the US$4bn Euro Commercial Paper Programme that may be denominated in any currency as agreed between Abbey National Treasury Services plc and the relevant dealer. The Notes rank at least pari passu with all other unsecured and unsubordinated obligations of Abbey National Treasury Services plc. The payments of all amounts due in respect of the Notes have been unconditionally and irrevocably guaranteed by the Company.

The Notes are issued in bearer form, subject to a minimum maturity of 1 day and a maximum maturity of 364 days. The Notes may be issued on a discounted basis or may bear fixed or floating rate interest or a coupon calculated by reference to an index or formula. The maximum aggregate nominal amount of all Notes outstanding from time to time under the Programme will not exceed US$4bn (or its equivalent in other currencies). The Notes are not listed on any stock exchange.

US$20bn Euro Medium Term Note Programme

Abbey National Treasury Services plc and the Company may from time to time issue notes denominated in any currency as agreed between the relevant Issuer and the relevant dealer under the US$20bn Euro Medium Term Note Programme. The payment of all amounts payable in respect of the Senior Notes is unconditionally and irrevocably guaranteed by the Company. The Programme provides for issuance of Fixed Rate Notes, Floating Rate Notes, Index Linked Notes, Credit Linked Notes, Equity Linked Notes and any other structured Notes, and also Dual Currency Notes, Zero Coupon/Discount Notes and Non-Interest Bearing Notes.

The maximum aggregate nominal amount of all Notes outstanding under the Programme may not exceed US$20bn (or its equivalent in other currencies) subject to any modifications in accordance with the terms of the Programme agreement. Notes may be issued in bearer or registered form and can be listed on the London Stock Exchange or any other or further stock exchange(s) or may be unlisted, as agreed.

31. Debt securities in issue

	Group	
	2009	2008
	£m	£m
Bonds and medium term notes:		
- Euro 25bn Global Covered Bond Programme	**5,268**	3,963
- Euro 10bn Global Covered Bond Programme	**-**	2,800
- US$20bn euro Medium Term Note Programme (see Note 30)	**1,566**	3,313
- US$40bn euro Medium Term Note Programme	**5,876**	9,683
- US$20bn Commercial Paper Programme	**6,366**	4,234
- Euro 2bn structured notes	**600**	-
- Certificates of deposit in issue	**9,188**	9,214
	28,864	33,207
Securitisation programmes:		
- Holmes	**14,704**	20,269
- Fosse	**4,103**	4,331
Other debt securities in issue	**87**	704
	47,758	58,511

Notes to the Financial Statements continued

The Company did not have any outstanding debt securities in issue as at 31 December 2008 and 2009.

Euro 25bn Global Covered Bond Programme
Abbey National Treasury Services plc issues the Covered Bonds under the euro 25bn Global Covered Bond Programme that may be denominated in any currency as agreed between Abbey National Treasury Services plc and the relevant dealers under the Programme. The Programme provides that Covered Bonds may be listed or admitted to trading, on the official list of the UK Listing Authority and on the London Stock Exchange's Regulated Market or any other stock exchanges or regulated or unregulated markets. Abbey National Treasury Services plc may also issue unlisted Covered Bonds and/or Covered Bonds not admitted to trading on any regulated or unregulated market.

The payments of all amounts due in respect of the Covered Bonds have been unconditionally guaranteed by the Company. Abbey Covered Bonds LLP ("LLP"), together with the Company have guaranteed payments of interest and principal under the Covered Bonds pursuant to a guarantee which is secured over its portfolio of mortgages and its other assets. Recourse against the LLP under its guarantee is limited to its portfolio of mortgages and such assets.

Covered Bonds may be issued in bearer or registered form. The maximum aggregate nominal amount of all Covered Bonds from time to time outstanding under the Programme will not exceed euro 25bn (or its equivalent in other currencies), subject to increase in accordance with the Programme.

On 2 July 2008, the size of the global covered bond programme established in 2005 was increased from euro 12bn to euro 25bn. On 8 July 2008, the Group issued a series of Covered Bonds totalling approximately £13bn. All notes were denominated in sterling and were subscribed for by the Company.

On 11 November 2008, Abbey National Treasury Services plc was admitted to the register of issuers and the Programme and the Covered Bonds issued previously under the Programme were admitted to the register of regulated covered bonds, pursuant to Regulation 14 of the Regulated Covered Bonds Regulations 2008 (SI 2008/346).

Euro 10bn Global Covered Bond Programme
Alliance & Leicester plc previously issued certain Covered Bonds under the euro 10bn Global Covered Bond Programme. On 17 November 2009, the outstanding Covered Bonds issued under the Programme were redeemed and the Programme was discontinued.

The Programme provided that Covered Bonds may be listed or admitted to trading, on the official list of the UK Listing Authority and on the London Stock Exchange's Regulated Market or any other stock exchanges or regulated or unregulated markets. The Programme also provided for the issue of unlisted Covered Bonds and/or Covered Bonds not admitted to trading on any regulated or unregulated market.

Alliance & Leicester Covered Bonds LLP ("LLP") guaranteed payments of interest and principal under the Covered Bonds pursuant to a guarantee which was secured over its portfolio of mortgages and its other assets. Recourse against LLP under its guarantee was limited to its portfolio of mortgages and such assets.

US$40bn Euro Medium Term Note Programme
In January 2009, it was decided that no further issuance would be made under the US$40bn Euro Medium Term Note Programme. Outstanding notes will remain in issue until maturity.

Alliance & Leicester plc issued both senior notes and subordinated notes and from time to time issued notes denominated in any currency as agreed with the relevant dealer under the US$40bn Euro Medium Term Notes Programme. The notes are direct, unsecured and unconditional obligations of Alliance & Leicester plc. The Programme provided for issuance of Fixed Rate Notes, Floating Rate Notes, Index Linked Notes, Dual Currency Notes and Zero-Coupon Notes. The notes are listed on the London Stock Exchange or may be listed on any other or further stock exchange(s) or may be unlisted, as agreed.

The notes were issued in bearer form. The maximum aggregate nominal amount of all notes from time to time outstanding under the Programme did not exceed US$40bn (or its equivalent in other currencies), subject to any modifications in accordance with the terms of the Programme agreement.

US$20bn Commercial Paper Programme
Abbey National North America LLC may from time to time issue unsecured notes denominated in United States dollars as agreed between Abbey National North America LLC and the relevant dealers under the US$20bn US commercial paper programme. The Notes will rank at least pari passu with all other unsecured and unsubordinated indebtedness of Abbey National North America LLC and the Company. The payments of all amounts due in respect of the Notes have been unconditionally and irrevocably guaranteed by the Company.

The Notes are not redeemable prior to maturity or subject to voluntary prepayment. The maximum aggregate nominal amount of all Notes from time to time outstanding under the Programme will not exceed US$20bn (or its equivalent in other currencies).

Euro 2bn structured notes
Abbey National Treasury Services plc may from time to time issue structured notes denominated in any currency as agreed between Abbey National Treasury Services plc and the relevant dealers under the euro 2bn structured note programme. Structured notes are direct, unsecured and unconditional obligations of Abbey National Treasury Services plc that rank pari passu without preference among themselves and, subject as to any applicable statutory provisions or judicial order, at least equally with all other present and future unsecured and unsubordinated obligations of Abbey National Treasury Services plc. The payments of all amounts due in respect of the structured notes have been unconditionally and irrevocably guaranteed by the Company.

Notes to the Financial Statements continued

The structured note programme provides for the issuance of Commodity Linked Notes, Credit Linked Notes, Currency Linked Notes, Equity Linked Notes, Equity Index Linked Notes, Fixed Rate Notes, Floating Rate Notes, Fund Linked Notes, Inflation Linked Notes, Property Linked Notes, Zero Coupon/Discount Notes and any other structured notes as agreed between Abbey National Treasury Services plc and the relevant dealers. Structured notes may be issued in bearer or registered (or inscribed) form and may be listed on the London Stock Exchange or any other or further stock exchange(s) or may be unlisted, as agreed between Abbey National Treasury Services plc and the relevant dealers. Structured notes issued in bearer form may also be issued in new global note form.

The maximum aggregate nominal amount of all structured notes from time to time outstanding under the Programme will not exceed euro 2bn (or its equivalent in other currencies).

Securitisation Programmes

The Group has provided prime retail mortgage-backed securitised products to a diverse investor base through its mortgage backed funding programmes, as described in Note 17. Funding has historically been raised via mortgage-backed notes, both issued to third parties and retained (the latter being central bank eligible collateral, both via the Bank of England's Special Liquidity Scheme facility and for contingent funding purposes in other Bank of England, European Central Bank, Swiss National Bank and US Federal Reserve facilities).

An analysis of the above debt securities in issue by issue currency is as follows:

			Group	
Issue currency	Interest rate	Maturity	**2009 £m**	2008 £m
Euro	0.00% - 3.99%	Up to 2010	**2,452**	4,818
		2011 - 2019	**5,415**	3,898
		2020 - 2029	**1,600**	-
		2040 - 2059	**3,976**	-
	4.00% - 4.99%	Up to 2010	**-**	525
		2011 - 2019	**-**	193
		2020 - 2029	**1,362**	1,469
	5.00% - 7.99%	Up to 2010	**276**	406
		2011 - 2029	**-**	2,982
		2030 - 2039	**-**	2,722
		2040 - 2059	**-**	2,105
US dollar	0.00% - 3.99%	Up to 2010	**14,676**	9,184
		2011 – 2019	**618**	95
		2020 – 2029	**3,841**	-
		2030 - 2039	**556**	-
		2040 - 2059	**3,194**	-
	4.00% - 5.99%	Up to 2010	**20**	985
		2011 - 2019	**49**	743
		2020 - 2029	**-**	4,340
		2030 - 2039	**-**	4,916
		2040 - 2059	**-**	1,650
	7.00% - 8.99%	Up to 2010	**-**	221
Pounds sterling	0.00% - 3.99%	Up to 2010	**963**	3,930
		2011 - 2019	**1,643**	1,411
		2020 - 2029	**838**	-
		2040 - 2059	**3,739**	-
	5.00% - 5.99%	Up to 2010	**155**	2,485
		2011 - 2019	**815**	18
	6.00% - 6.99%	Up to 2010	**471**	1,407
		2011 - 2019	**351**	976
		2020 - 2029	**-**	856
		2030 – 2039	**-**	3,460
		2040 – 2060	**-**	1,388
	7.00% - 8.99%	2011 – 2040	**-**	73
Other currencies	0.00% - 5.99%	Up to 2010	**337**	852
		2011 - 2019	**47**	40
		2020 - 2029	**352**	337
	6.00% - 6.87%	2011 - 2019	**12**	11
		2011 – 2040	**-**	15
			47,758	58,511

Notes to the Financial Statements continued

32. Other borrowed funds

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
£300m Step Up Callable Perpetual Reserve Capital Instruments	-	356	-	356
£175m Fixed/Floating Rate Tier One Preferred Income Capital Securities	195	205	195	205
US$1,000m Non-Cumulative Trust Preferred Securities	813	1,171	-	-
£325m sterling Preference Shares	344	344	344	344
	1,352	2,076	539	905

During the year the £300m Step Up Callable Perpetual Reserve Capital Instruments were reclassified to equity as described in Note 39.

£175m Fixed/Floating Rate Tier One Preferred Income Capital Securities
The Tier One Preferred Income Capital Securities were issued on 9 August 2002 by the Company. The Tier One Preferred Income Capital Securities are redeemable by the Company in whole but not in part on 9 February 2018 or on any coupon payment date thereafter, subject to the prior approval of the UK Financial Services Authority. The Tier One Preferred Income Capital Securities bear interest at a rate of 6.984% per annum, payable semi-annually in arrears. From (and including) 9 February 2018, the Tier One Preferred Income Capital Securities will bear interest, at a rate reset semi-annually of 1.86% per annum above the six-month sterling LIBOR rate, payable semi-annually in arrears. Interest payments may be deferred in limited circumstances, such as when the payment would cause the Company to become insolvent or breach applicable Capital Regulations.

The Tier One Preferred Income Capital Securities are not redeemable at the option of the holders and the holders do not have any rights against other Group companies. Where interest payments have been deferred, the Company may not declare or pay dividends on or redeem or repurchase any junior securities until it next makes a scheduled payment on the Tier One Preferred Income Capital Securities and the Reserve Capital Instruments.

The Tier One Preferred Income Capital Securities are unsecured securities of the Company and are subordinated to the claims of unsubordinated creditors and subordinated creditors holding loan capital of the Company. Upon the winding up of the Company, holders of Tier One Preferred Income Capital Securities will rank pari passu with the holders of the most senior class or classes of preference shares (if any) of the Company then in issue and in priority to all other Company shareholders.

US$1,000m Non-Cumulative Trust Preferred Securities
Abbey National Capital Trust I and Abbey National Capital LP I are 100% owned finance subsidiaries of the Company. On 7 February 2000, Abbey National Capital Trust I issued US$1bn of 8.963% Non-cumulative Trust Preferred Securities, which have been registered under the US Securities Act of 1933, as amended. Abbey National Capital Trust I serves solely as a passive vehicle holding the partnership preferred securities issued by Abbey National Capital LP I and each has passed all the rights relating to such partnership preferred securities to the holders of trust preferred securities issued by Abbey National Capital Trust I. All of the trust preferred securities and the partnership preferred securities have been fully and unconditionally guaranteed on a subordinated basis by the Company. The terms of the securities do not include any significant restrictions on the ability of the Company to obtain funds, by dividend or loan, from any subsidiary. After 30 June 2030, the distribution rate on the preferred securities will be 2.825% per annum above the three-month US dollar LIBOR rate for the relevant distribution period.

The trust preferred securities are not redeemable at the option of the holders and the holders do not have any rights against other Group companies. The partnership preferred securities may be redeemed by the partnership, in whole or in part, on 30 June 2030 and on each distribution payment date thereafter. Redemption by the partnership of the partnership preferred securities may also occur in the event of a tax or regulatory change. Generally, holders of the preferred securities will have no voting rights.

Upon the return of capital or distribution of assets in the event of the winding up of the partnership, holders of the partnership preferred securities will be entitled to receive, for each partnership preferred security, a liquidation preference of US $1,000, together with any due and accrued distributions and any additional amounts, out of the assets of the partnership available for distribution.

£325m sterling Preference Shares

Size of shareholding	Shareholders	Preference shares of £1 each
1-100	1	100
101-1,000	52	38,160
1,001+	1,908	324,961,740
	1,961	325,000,000

Holders of sterling preference shares are entitled to receive a biannual non-cumulative preferential dividend payable in sterling out of the distributable profits of the Company. The rate per annum will ensure that the sum of the dividend payable on such date and the associated tax credit (as defined in the terms of the sterling preference shares) represents an annual rate of 8 5/8% per annum of the nominal amount of shares issued in 1997, and an annual rate of 10 3/8% for shares issued in 1995 and 1996.

Notes to the Financial Statements continued

On a return of capital or on a distribution of assets on a winding up, the sterling preference shares shall rank pari passu with any other shares that are expressed to rank pari passu therewith as regards participation in assets, and otherwise in priority to any other share capital of the Company. On such a return of capital or winding up, each sterling preference share shall, out of the surplus assets of the Company available for distribution amongst the members after payment of the Company's liabilities, carry the right to receive an amount equal to the amount paid up or credited as paid together with any premium paid on issue and the full amount of any dividend otherwise due for payment. Other than as set out above, no sterling preference share confers any right to participate on a return of capital or a distribution of assets of the Company.

Holders of the sterling preference shares are not entitled to receive notice of or attend, speak and vote at general meetings of the Company unless the business of the meeting includes the consideration of a resolution to wind up the Company or any resolution varying, altering or abrogating any of the rights, privileges, limitations or restrictions attached to the sterling preference shares or if the dividend on the sterling preference shares has not been paid in full for the three consecutive dividend periods immediately prior to the relevant general meeting. In any such case, the sterling preference shareholders are entitled to receive notice of and attend the general meeting at which such resolution is proposed and will be entitled to speak and vote on such a resolution but not on any other resolution.

33. Subordinated liabilities

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Dated subordinated liabilities:				
5.00% Subordinated bond 2009 (euro 511m)	**-**	515	**-**	515
4.625% Subordinated notes 2011 (euro 500m)	**478**	515	**478**	515
10.125% Subordinated guaranteed bond 2023	**220**	231	**-**	-
11.50% Subordinated guaranteed bond 2017	**226**	238	**-**	-
11.59% Subordinated loan stock 2017	**-**	-	**226**	221
10.18% Subordinated loan stock 2023	**-**	-	**220**	217
7.57% Subordinated notes 2029 (US$1,000m)	**805**	1,141	**805**	1,142
6.50% Subordinated notes 2030	**174**	194	**174**	194
8.9% Subordinated notes 2030 (US$1,000m)	**-**	-	**813**	1,170
5.25% Subordinated notes 2015	**210**	215	**210**	215
Subordinated floating rate EURIBOR notes 2015	**445**	485	**445**	485
Subordinated floating rate EURIBOR notes 2016	**-**	-	**65**	65
5.875% Subordinated notes 2031	**80**	97	**-**	-
5.25% Subordinated notes 2023	**119**	122	**-**	-
Subordinated floating rate EURIBOR notes 2017	**134**	145	**-**	-
Subordinated floating rate US$ LIBOR notes 2015	**92**	102	**-**	-
Subordinated floating rate EURIBOR notes 2017	**88**	97	**-**	-
9.625% Subordinated notes 2023	**382**	399	**-**	-
	3,453	4,496	**3,436**	4,739
Undated subordinated liabilities:				
10.0625% Exchangeable subordinated capital securities	**204**	204	**204**	204
5.56% Subordinated guaranteed notes (Yen 15,000m)	**123**	143	**123**	143
5.50% Subordinated guaranteed notes (Yen 5,000m)	**41**	47	**41**	47
Fixed/Floating rate subordinated notes (Yen 5,000m)	**39**	45	**39**	45
7.50% 10 Year step-up perpetual subordinated notes	**344**	354	**344**	354
7.50% 15 Year step-up perpetual subordinated notes	**497**	514	**497**	514
7.38% 20 Year step-up perpetual subordinated notes	**209**	223	**209**	223
7.13% 30 Year step-up perpetual subordinated notes	**311**	348	**311**	348
7.13% Fixed to floating rate perpetual subordinated notes	**376**	413	**376**	413
	2,144	2,291	**2,144**	2,291
Total subordinated liabilities	**5,597**	6,787	**5,580**	7,030

The subordinated floating rate notes pay a rate of interest related to the LIBOR of the currency of denomination.

The 10.0625% exchangeable subordinated capital securities are exchangeable into fully paid 10.375% non-cumulative non-redeemable sterling preference shares of £1 each, at the option of the Company. Exchange may take place on any interest payment date providing that between 30 and 60 days notice has been given to the holders. The holders will receive one new sterling preference share for each £1 principal amount of capital securities held. Note 32 details the rights attaching to these shares, as they are the same.

The 5.56% Subordinated guaranteed notes are redeemable at par, at the option of the Company, on 31 January 2015 and each fifth anniversary thereafter.

The 5.50% Subordinated guaranteed notes are redeemable at par, at the option of the Company, on 27 June 2015 and each fifth anniversary thereafter.

The Fixed/Floating rate subordinated notes are redeemable at par, at the option of the Company, on 27 December 2016 and each interest payment date anniversary thereafter.

The 7.50% 10 Year step-up perpetual subordinated notes are redeemable at par, at the option of the Company, on 28 September 2010 and each fifth anniversary thereafter.

Notes to the Financial Statements continued

The 7.50% 15 Year step-up perpetual subordinated notes are redeemable at par, at the option of the Company, on 28 September 2015 and each fifth anniversary thereafter.

The 7.38% 20 Year step-up perpetual subordinated notes are redeemable at par, at the option of the Company, on 28 September 2020 and each fifth anniversary thereafter.

The 7.13% 30 Year step-up perpetual subordinated notes are redeemable at par, at the option of the Company, on 30 September 2030 and each fifth anniversary thereafter.

The 7.13% Fixed to Floating rate perpetual subordinated notes are redeemable at par, at the option of the Company, on 28 September 2010 and each fifth anniversary thereafter.

In common with other debt securities issued by Group companies, the subordinated liabilities are redeemable in whole at the option of the Company, on any interest payment date, in the event of certain tax changes affecting the treatment of payments of interest on the subordinated liabilities in the UK, at their principal amount together with any accrued interest.

In 2009, the 5.00% subordinated bonds 2009 (euro 511m) were redeemed in full.

Subordinated liabilities including convertible debt securities in issue are repayable:

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
In no more than 3 months	**-**	515	**-**	515
In more than 3 months but no more than 1 year	**-**	-	**-**	-
In more than 1 year but no more than 5 years	**478**	515	**478**	515
In more than 5 years	**2,975**	3,466	**2,958**	3,709
Undated	**2,144**	2,291	**2,144**	2,291
	5,597	6,787	**5,580**	7,030

34. Other liabilities

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Trade and other payables	**2,263**	2,303	**1,611**	1,283
Deferred income	**60**	39	**-**	-
	2,323	2,342	**1,611**	1,283

Trade and other payables include £37m (2008: £40m) of finance lease obligations mainly relating to a lease and leaseback of Group property.

The maturity of net obligations under finance leases are as follows:

	Group	
	2009 £m	2008 £m
Leases which expire		
Within 1 year	**5**	4
Between 1-5 years	**20**	21
In more than 5 years	**12**	15
	37	40

Future minimum lease payments are:

	Group	
	2009 £m	2008 £m
Leases which expire		
Within 1 year	**7**	6
Between 1-5 years	**25**	27
In more than 5 years	**13**	17
	45	50

At the balance sheet date, the Group had contracted with lessees for the following future minimum lease payments on sub-leases:

	Group	
	2009 £m	2008 £m
Leases which expire		
Within 1 year	**-**	1
Between 1-5 years	**-**	2
	-	3

During the year, £3m (2008: £nil) was incurred as a finance lease interest charge.

Notes to the Financial Statements continued

35. Provisions

	Missellingㅤ£m	Other £m	Group Total £m
At 1 January 2009	**141**	**66**	**207**
Additional provisions	**13**	**46**	**59**
Provisions released	**(3)**	**-**	**(3)**
Used during the year	**(108)**	**(81)**	**(189)**
Reclassifications	**-**	**17**	**17**
At 31 December 2009	**43**	**48**	**91**
To be settled:			
Within 12 months	**43**	**47**	**90**
In more than 12 months	**-**	**1**	**1**
	43	**48**	**91**

	Misselling £m	Other £m	Company Total £m
At 1 January 2009	**41**	**58**	**99**
Additional provisions	**9**	**35**	**44**
Acquired through business combinations	**16**	**14**	**30**
Provisions released	**(3)**	**-**	**(3)**
Used during the year	**(20)**	**(76)**	**(96)**
At 31 December 2009	**43**	**31**	**74**
To be settled:			
Within 12 months	**43**	**30**	**73**
In more than 12 months	**-**	**1**	**1**
	43	**31**	**74**

	Misselling £m	Other £m	Group Total £m
At 1 January 2008	95	36	131
Additional provisions	-	58	58
Acquired through business combinations	100	-	100
Provisions released	(40)	(1)	(41)
Disposal of subsidiary undertakings	-	(2)	(2)
Used during the year	(14)	(25)	(39)
At 31 December 2008	141	66	207
To be settled:			
Within 12 months	136	63	199
In more than 12 months	5	3	8
	141	66	207

	Misselling £m	Other £m	Company Total £m
At 1 January 2008	95	5	100
Additional provisions	-	56	56
Provisions released	(39)	-	(39)
Used during the year	(14)	(4)	(18)
At 31 December 2008	42	57	99
To be settled:			
Within 12 months	37	57	94
In more than 12 months	5	-	5
	42	57	99

The charge disclosed in the income statement in respect of provisions for other liabilities and charges of £56m (2008: £17m), comprises the additional provisions of £59m (2008: £58m), less the provisions released of £3m (2008: £41m) in the table above.

The misselling provision comprises various claims with respect to product misselling. In calculating the misselling provision, management's best estimate of the provision was calculated based on conclusions regarding the number of claims that will be received, of those, the number that will be upheld, and the estimated average settlement per case. Further information on misselling provisions can be found in 'Critical Accounting Policies' within the Accounting Policies on page 122.

Other provisions comprise amounts in respect of litigation and related expenses, restructuring expenses and other post retirement benefits.

36. Retirement benefit obligations

The amounts recognised in the balance sheet were as follows:

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Assets/(Liabilities)				
Funded defined benefit pension scheme	**1**	4	**-**	-
Funded defined benefit pension scheme	**(1,048)**	(796)	**(922)**	(797)
Unfunded defined benefit pension scheme	**(13)**	(11)	**-**	-
Net defined benefit obligation	**(1,060)**	(803)	**(922)**	(797)
Post-retirement medical benefits (unfunded)	**(10)**	(10)	**-**	-
Total net liabilities	**(1,070)**	(813)	**(922)**	(797)

Defined Contribution Pension schemes

The Group operates a number of defined contribution pension schemes. The Stakeholder scheme introduced in 2001 was the principal scheme until 1 December 2009 when the Santander Retirement Plan, an occupational defined contribution scheme was introduced, into which eligible employees were enrolled automatically. From 1 April 1998, employees of the Alliance & Leicester group were eligible to join a defined contribution section of the Alliance & Leicester Pension Scheme.

The assets of the schemes are held and administered separately from those of the Company. In the case of the Stakeholder scheme the assets are held in an independently administered fund, and in the case of the Santander Retirement Plan and the Alliance & Leicester Pension Scheme, the assets are held in separate trustee-administered funds.

An expense of £20m (2008: £8m, 2007: £7m) was recognised for defined contribution plans in the year, and is included in staff costs classified within administration expenses in the Income Statement. None of this amount was recognised in respect of key management personnel for the years ended 31 December 2009, 2008 and 2007.

Defined Benefit Pension schemes

The Group operates a number of defined benefit pension schemes. The Abbey National Amalgamated Pension Fund, Abbey National Group Pension Scheme, Abbey National Associated Bodies Pension Fund, the National & Provincial Building Society Pension Fund, the Scottish Mutual Assurance Staff Pension Scheme, the Scottish Provident Institution Staff Pension Fund and the Alliance & Leicester Pension Scheme are the principal pension schemes within the Group, covering 27% (2008: 38%, 2007: 45%) of the Group's employees, and are all funded defined benefit schemes. All are closed schemes, and under the projected unit method, the current service cost when expressed as a percentage of pensionable salaries will gradually increase over time.

Formal actuarial valuations of the assets and liabilities of the schemes are carried out on a triennial basis (and currently a biennial basis for the Alliance & Leicester Pension Scheme) by an independent professionally qualified actuary and valued for accounting purposes at each balance sheet date. The latest formal actuarial valuation was made as at 31 March 2007 for the Abbey National Amalgamated Pension Fund, Abbey National Group Pension Scheme, Abbey National Associated Bodies Pension Fund and the National & Provincial Building Society Pension Fund; as at 31 December 2006 for the Scottish Mutual Assurance Staff Pension Scheme and the Scottish Provident Institution Staff Pension Fund; and as at 31 March 2008 for the Alliance & Leicester Pension Scheme.

The total amount charged to the income statement, including amounts classified as redundancy costs, was determined as follows:

	Group		
	2009 £m	2008 £m	2007 £m
Current service cost	**44**	55	67
Past service cost	**50**	16	14
Gain on settlements or curtailments	**-**	(2)	(10)
Expected return on pension scheme assets	**(285)**	(237)	(194)
Interest cost	**326**	264	220
	135	96	97

The net liability recognised in the balance sheet is determined as follows:

	Group				
	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Present value of defined benefit obligation	**(6,308)**	(5,175)	(4,581)	(4,264)	(4,354)
Fair value of plan assets	**5,248**	4,372	3,602	3,230	2,974
Net defined benefit obligation	**(1,060)**	(803)	(979)	(1,034)	(1,380)

	Company				
	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Present value of defined benefit obligation	**(4,805)**	(3,944)	(4,559)	(4,241)	(3,822)
Fair value of plan assets	**3,883**	3,147	3,577	3,208	2,582
Net defined benefit obligation	**(922)**	(797)	(982)	(1,033)	(1,240)

Notes to the Financial Statements continued

Movements in the defined benefit obligations during the year were as follows:

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Balance at 1 January	**(5,175)**	(4,581)	**(3,944)**	(4,559)
Current service cost	**(44)**	(55)	**(26)**	(42)
Interest cost	**(326)**	(264)	**(249)**	(262)
Employee contributions	**(11)**	(7)	**(6)**	(7)
Past service cost	**(50)**	(16)	**(35)**	(16)
Actuarial (loss)/gain	**(935)**	818	**(723)**	793
Actual benefit payments	**233**	148	**178**	147
Settlement/curtailment	**-**	2	**-**	2
Assumed through business combinations	**-**	(1,220)	**-**	-
Balance at 31 December	**(6,308)**	(5,175)	**(4,805)**	(3,944)

Movements in the present value of fair value of scheme assets during the year were as follows:

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Balance at 1 January	**4,372**	3,602	**3,147**	3,577
Expected return on scheme assets	**285**	237	**209**	236
Actuarial gain/(loss) on scheme assets	**329**	(862)	**309**	(836)
Company contributions paid	**484**	323	**390**	310
Employee contributions	**11**	7	**6**	7
Actual benefit payments	**(233)**	(148)	**(178)**	(147)
Acquired through business combinations	**-**	1,213	**-**	-
Balance at 31 December	**5,248**	4,372	**3,883**	3,147

The amounts recognised in the Consolidated Statement of Comprehensive Income for each of the five years indicated were as follows:

	Group				
	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Actuarial (gain)/loss on scheme assets	**(329)**	862	(33)	9	(282)
Experience (gain)/loss on scheme liabilities	**(34)**	51	80	(25)	-
Loss/(gain) from changes in actuarial assumptions	**969**	(869)	66	(203)	436
Actuarial loss/(gain)/ on scheme liabilities	**935**	(818)	146	(228)	436
Total net actuarial loss/(gain)	**606**	44	113	(219)	154

	Company				
	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Actuarial (gain)/loss on scheme assets	**(309)**	836	(33)	-	(242)
Experience (gain)/loss on scheme liabilities	**(33)**	51	81	(20)	7
Loss/(gain) from changes in actuarial assumptions	**756**	(844)	68	(160)	387
Actuarial loss/(gain) on scheme liabilities	**723**	(793)	149	(180)	394
Total net actuarial loss/(gain)	**414**	43	116	(180)	152

The actual gain/(loss) on scheme assets was £614m (2008: £(625)m, 2007: £227m). Cumulative net actuarial losses of £768m (2008: £162m, 2007: £118m) were recognised in the Consolidated Statement of Comprehensive Income. The Group's pension schemes did not directly hold any equity securities of the Company or any of its related parties at 31 December 2009, 2008 and 2007. In addition, the Group does not hold insurance policies over the schemes, and has not entered into any significant transactions with the schemes.

The assets of the funded plans are held independently of the Group's assets in separate trustee administered funds. The principal duty of the trustees is to act in the best interests of the members of the schemes. Ultimate responsibility for investment strategy rests with the trustees of the schemes who are required under the Pensions Act 2004 to prepare a statement of investment principles.

The trustees of the Group's schemes have developed the following investment principles:

- To maintain a portfolio of suitable assets of appropriate quality, suitability and liquidity which will generate income and capital growth to meet, together with new contributions from members and the employers, the cost of current and future benefits which the pension scheme provides, as set out in the trust deed and rules.
- To limit the risk of the assets failing to meet the liabilities, over the long-term and on a shorter-term basis as required by prevailing legislation.
- To minimise the long-term costs of the pension scheme by maximising the return on the assets whilst having regard to the objectives shown above.

Notes to the Financial Statements continued

Asset allocation strategies were reviewed in 2008 and 2009, and automatic rebalancing to the central benchmark positions was suspended as a result of the unprecedented volatility in asset markets during this period. Future allocation strategies will be set to allow for a more dynamic approach. Implementation of these strategies began in 2009 and will continue during 2010 whilst taking into account market conditions.

Previously, the statement of investment principles for the main schemes (other than the Alliance & Leicester Pension Scheme) had set the long-term target allocation of plan assets during 2006-2008 as 48% Equities, 30% Bonds and 22% Gilts. The statement of investment principles for the Alliance & Leicester Pension Scheme had set the long-term target allocation of plan assets at 25% Equities, 25% alternative return-seeking assets (including Property), 25% Bonds and 25% Gilts for 2009 and 2008. Movement towards this long-term target commenced during 2009, and progress will depend upon market conditions.

The categories of assets in the scheme by value and as a percentage of total scheme assets, and the expected rates of return are as follows:

Group and Company

	Fair value of scheme assets		**Expected rate of return**	Fair value of scheme assets		Expected rate of return
	2009 £m	**2009 %**	**2009 %**	2008 £m	2008 %	2008 %
UK equities	**1,045**	**20**	**8.1**	911	21	8.2
Overseas equities	**1,027**	**20**	**8.5**	821	19	8.5
Corporate bonds	**1,503**	**29**	**6.2**	1,155	26	5.7
Government Fixed Interest	**686**	**13**	**3.9**	657	15	4.6
Government Index Linked	**664**	**13**	**3.9**	616	14	4.4
Property funds	**58**	**1**	**6.3**	64	1	6.4
Cash	**177**	**3**	**4.1**	24	1	5.3
Other	**88**	**1**	**8.3**	124	3	8.3
	5,248	**100**	**6.4**	4,372	100	6.7

Other assets consist of asset-backed securities, annuities, funds and derivatives that are used to protect against exchange rate, inflation and interest rate movements.

The expected return on plan assets is determined by considering the expected returns available on the assets underlying the current investment policy, as follows:

>	Equities	Long-term median real rate of return experienced after considering projected movements in asset indices
>	Corporate bonds	Gross redemption yields as at the balance sheet date, less a margin for default risk
>	Government bonds	Gross redemption yields as at the balance sheet date
>	Property funds	Average of returns for UK equities and government bonds
>	Cash	Expected long term bank rate, after considering projected inflation rate

The following tables summarise the fair values at 31 December 2009 and 2008 of the financial asset classes accounted for at fair value, by the valuation methodology used by the investment managers of the schemes assets to determine their fair value. The table also discloses the percentages that the recorded fair values of financial assets represent of the schemes' total financial assets that are recorded at fair value.

At 31 December 2009

Category of plan assets	**Quoted prices in active markets**		**Internal models based on market observable data**		**Total**	
	£m	**%**	**£m**	**%**	**£m**	**%**
UK equities	**1,045**	**21**	**-**	**-**	**1,045**	**21**
Overseas equities	**1,028**	**20**	**-**	**-**	**1,028**	**20**
Corporate bonds	**1,503**	**30**	**-**	**-**	**1,503**	**30**
Government Fixed Interest	**686**	**14**	**-**	**-**	**686**	**14**
Government Index Linked	**663**	**13**	**-**	**-**	**663**	**13**
Other	**-**	**-**	**88**	**2**	**88**	**2**
Total	**4,925**	**98**	**88**	**2**	**5,013**	**100**

At 31 December 2008

Category of plan assets	Quoted prices in active markets		Internal models based on market observable data		Total	
	£m	%	£m	%	£m	%
UK equities	911	21	-	-	911	21
Overseas equities	821	19	-	-	821	19
Corporate bonds	1,155	27	-	-	1,155	27
Government Fixed Interest	657	15	-	-	657	15
Government Index Linked	616	15	-	-	616	15
Other	-	-	124	3	124	3
Total	4,160	97	124	3	4,284	100

Notes to the Financial Statements continued

Plan assets are stated at fair value based upon quoted prices in active markets with the exception of those classified under "Other". Assets in the "Other" category comprise investments in absolute return funds and foreign exchange, equity and interest rate derivatives valued by investment managers by reference to market observable data. Private equity funds were valued by reference to their latest published accounts whilst the insured annuities were valued by scheme actuaries based on the liabilities insured

Actuarial assumptions

The principal actuarial assumptions used were as follows:

	Group and Company		
	2009 %	2008 %	2007 %
To determine benefit obligations:			
- Discount rate for scheme liabilities	**5.8**	6.4	5.8
- General price inflation	**3.4**	3.0	3.5
- General salary increase	**3.4**	3.5	4.0
- Expected rate of pension increase	**3.3**	3.0	3.5
To determine net periodic benefit cost:			
- Discount rate	**6.4**	5.8	5.2
- Expected rate of pension increase	**3.0**	3.5	3.0
- Expected rate of return on plan assets	**6.4**	6.7	6.1
Medical cost trend rates:			
– Initial rate	**5.5**	6.0	6.5
– Ultimate rate	**4.5**	4.5	4.5
– Year of ultimate rate	**2013**	2013	2013

	Years	Years	Years
Longevity at 60 for current pensioners, on the valuation date:			
– Males	**27.6**	27.5	27.2
– Females	**30.0**	29.9	29.8
Longevity at 60 for future pensioners currently aged 40, on the valuation date:			
– Males	**29.7**	29.6	29.3
– Females	**31.3**	31.2	31.1

The rate used to discount the retirement benefit obligation is determined to reflect duration of the liabilities based on the annual yield at 31 December of the sterling 15+ year AA Corporate Bond iBoxx Index, representing the market yield of high quality corporate bonds on that date, adjusted to match the terms of the scheme liabilities. The inflation assumption is set based on the Bank of England projected inflation rates over the duration of scheme liabilities weighted by projected scheme cash flows.

The mortality assumption used in preparation of the valuation was the Continuous Mortality Investigation Table PXA 92MCC 2009 with a future improvement underpin of 1% for males and 0.5% for females. The table above shows that a participant retiring at age 60 as at 31 December 2009 is assumed to live for, on average, 27.6 years in the case of a male and 30.0 years in the case of a female. In practice, there will be variation between individual members but these assumptions are expected to be appropriate across all participants. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 40 now, when they retire in 20 years time at age 60.

The Group determined its expense measurements above based upon long-term assumptions taking into account target asset allocations of assets set at the beginning of the year, offset by actual returns during the year. Year-end obligation measurements are determined by reference to market conditions at the balance sheet date. Assumptions are set in consultation with third party advisors and in-house expertise.

The following table shows the effect of changes in actuarial assumptions on the principal pension schemes of the Group:

		Increase/(decrease)	
		2009 £m	2008 £m
Discount rate	Change in pension obligation at year end from a 25 bps increase	**(345)**	(263)
	Change in 2010 pension cost from a 25 bps increase	**(6)**	(6)
General price inflation	Change in pension obligation at year end from a 25 bps increase	**332**	255
	Change in 2010 pension cost from a 25 bps increase	**21**	17
Expected rate of return on plan assets	Change in 2010 pension cost from a 25 bps increase	**13**	11
Mortality	Change in pension obligation from each additional year of longevity assumed	**141**	102

The Group currently expects to contribute £128m to its defined benefit pension schemes in 2010.

Notes to the Financial Statements continued

The benefits expected to be paid in each of the next five years, and in the aggregate for the five years thereafter are:

	£m
Year ending 31 December:	
2010	248
2011	264
2012	282
2013	301
2014	322
Five years ended 2019	1,975

Participation of Group companies in the principal pension schemes is governed by the Pensions Acts 1995 and 2004. Under the 1995 Pensions Act, a company ceasing to participate in a pension scheme is required under section 75 to pay a deficit reduction contribution certified by the scheme actuary, of any deficit relating to its employees, assessed on the basis of the cost of securing accrued benefits with an insurance company unless other arrangements are agreed with the trustees.

As part of revised arrangements relating to the funding of the Group's defined benefit pension schemes, £814m (2008: £970m) of securities classified as available-for-sale have been pledged during the year to cover the Group's obligations.

Post Retirement Medical Benefit Plans

The Group also operates unfunded post retirement medical benefit plans for certain of its former employees. The post retirement medical benefit plans in operation are accounted for in the same manner as defined benefit pension plans.

Formal actuarial valuations of the liabilities of the schemes are carried out on a triennial basis by an independent professionally qualified actuary and updated for accounting purposes at each balance sheet date. The latest formal actuarial valuation was made as at 31 December 2006 and updated to 31 December 2009 by a qualified independent actuary.

Actuarial assumptions used for the Group's post retirement medical benefit plans are the same as those used for the Group's defined benefit pension schemes. There was an actuarial loss during the year of £1m (2008: £1m) on the Group's post-retirement medical benefits liability. A one percentage point movement in medical cost trends would increase or decrease the post-retirement medical benefit liability and interest cost by £1m (2008: £1m).

37. Contingent liabilities and commitments

The estimated maximum exposure in respect of contingent liabilities and commitments granted is:

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Guarantees given to subsidiaries	**-**	-	**156,580**	109,022
Guarantees given to third parties	**194**	571	**-**	-
Formal standby facilities, credit lines and other commitments with original term to maturity of:				
- One year or less	**5,570**	2,263	**3,423**	1,883
- More than one year	**4,982**	8,267	**1,738**	3,688
	10,746	11,101	**161,741**	114,593

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Other contingent liabilities	**8**	8	**8**	8

Unauthorised overdraft fees

The Company, along with seven other financial institutions, has been involved in legal proceedings with the Office of Fair Trading ("OFT"), regarding the legal status and enforceability of unarranged overdraft fees (the "OFT Proceedings"). The OFT Proceedings were concerned with whether certain of the financial institutions' terms and conditions are subject to the fairness test in the Unfair Terms in Consumer Contract Regulations 1999 (the "Regulations") and whether they are capable of being 'penalties' at common law.

In April 2008 the High Court confirmed that the Company's then current terms and conditions were not capable of being penalties at common law. This finding was not appealed by the OFT. The High Court also found that the relevant terms were assessable for fairness under the Regulations. On 26 February 2009, the Court of Appeal dismissed the appeal against the High Court's judgment made by the relevant financial institutions and held that unarranged overdraft fees were assessable for fairness under the Regulations.

The House of Lords gave the relevant financial institutions permission to appeal this judgment. The hearing before the House of Lords took place on 23 to 25 June 2009. The Supreme Court (previously The House of Lords) gave its judgment on 25 November 2009 and ruled that the level of the unauthorised overdraft fees of the relevant financial institutions could not be assessed for fairness under the Regulations (to the extent that the terms pursuant to which the fees are levied are in plain and intelligible language), although they may be assessed for fairness on some other basis.

On 22 December 2009, the OFT announced that it would not be continuing with its investigation into the fairness of unarranged overdraft fees.

Notes to the Financial Statements continued

The Company has rejected the vast majority of complaints which remained in respect of unarranged overdraft fees after the Supreme Court decision, and it is understood that the Financial Ombudsman Service has also rejected the vast majority of complaints that it had had on hold since the commencement of the OFT Proceedings. The Company has started to invite County Courts to dismiss those claims against them which have been stayed since the commencement of the OFT Proceedings and which relate to the issues covered in the OFT Proceedings. It is presently anticipated that the Company will continue with this approach.

Financial Services Compensation Scheme

The Financial Services Compensation Scheme ('FSCS'), the UK's statutory fund of last resort for customers of authorised financial services firms, pays compensation if a firm is unable to meet its obligations as they fall due. As a result of the failure of a number of deposit-taking institutions during the second half of 2008, the FSCS now stands as a creditor of Bradford & Bingley plc and the administrations of Heritable Bank, Kaupthing Singer & Friedlander and Landsbanki 'Icesave'. The FSCS has borrowed from HM Treasury to fund the compensation costs associated with those failures. These borrowings are currently on an interest-only basis until 31 March 2012.

The FSCS fulfils its obligations by raising management expenses levies and compensation levies on the industry. In relation to compensation relating to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits, subject to a threshold set by the Financial Services Authority establishing the maximum that FSCS can levy for compensation in any one year. The limit on the FSCS management expenses for the three years from September 2008 in relation to the above-mentioned failures has been capped at £1bn per annum. The FSCS has the power to raise levies on firms who have ceased to participate in the scheme and are in the process of ceasing to be authorised (so called 'exit levies') for the amount that the firm would otherwise have been asked to pay during the relevant levy year. The Group has an accrual for its share of management expenses levies for the 2009/10 and 2010/11 levy years as at 31 December 2009 of £101m (2008: £84m).

The FSCS will receive funds from asset sales, surplus cashflow, or other recoveries from each of the above-named banks. These recoveries will be used to reduce the principal amount outstanding on the FSCS's borrowings. Only after the interest only period, which is expected to end on 31 March 2012, will a schedule for repayment of any remaining principal outstanding (after recoveries) on the borrowings be agreed between the FSCS and HM Treasury. It is expected that, from that point, the FSCS will begin to raise compensation levies (principal repayments) relating to the above-named banks. No provision for compensation levies, which could be significant, has been made in these Consolidated Financial Statements.

Overseas tax claim

Abbey National Treasury Services plc has received a demand from an overseas tax authority relating to the repayment of certain tax credits and related charges. Following modifications to the demand, its nominal amount stands at £74m at the balance sheet exchange rate (2008: £80m). At 31 December 2009, additional interest in relation to the demand could amount to £34m at the balance sheet exchange rate (2008: £34m). Abbey National Treasury Services plc received legal advice that it had strong grounds to challenge the validity of the demand. In September 2006, Abbey National Treasury Services plc won its case at the first stage of the litigation process. In January 2007, the tax authority appealed this decision. However, in December 2006, a ruling was published of a similar case unconnected to the Group but which might affect Abbey National Treasury Services plc's position. In this instance, the courts ruled against the taxpayer.

Regulatory

The Group engages in discussion, and fully co-operates with the UK Financial Services Authority in their enquiries, including those exercised under statutory powers, regarding its interaction with past and present customers and policyholders both as part of the UK Financial Services Authority's general thematic work and in relation to specific products and services.

Other

As part of the sale of subsidiaries, and as is normal in such circumstances, the Group has given warranties and indemnities to the purchasers.

Obligations under stock borrowing and lending agreements

Obligations under stock borrowing and lending agreements represent contractual commitments to return stock borrowed. These obligations totalling £37,525m at 31 December 2009 (2008: £19,934m) are offset by a contractual right to receive stock under other contractual agreements.

Other off-balance sheet commitments

The Group has commitments to lend at fixed interest rates which expose it to interest rate risk.

Operating lease commitments

	Group £m	Company £m
Rental commitments under operating leases expiring:		
- No later than 1 year	**115**	**94**
- Later than 1 year but no later than 5 years	**383**	**322**
- Later than 5 years	**470**	**412**
	968	**828**

At 31 December 2009, the Group held various leases on land and buildings, many for extended periods, and other leases for equipment, which require the following aggregate minimum lease payments:

	Group	Company
Year ended 31 December:	**£m**	**£m**
2010	**115**	**94**
2011	**112**	**95**
2012	**103**	**87**
2013	**87**	**72**
2014	**81**	**68**
Total thereafter	**470**	**412**

Under the terms of these leases, the Group has the opportunity to extend its occupation of properties by a minimum of three years subject to 12 months' notice and lease renewal being available from external landlords during the term of the lease. At expiry, the Group has the option to reacquire the freehold of certain properties.

Group rental expense comprises:

			Group
	2009	2008	2007
	£m	£m	£m
In respect of minimum rentals	**116**	107	96
Less: sub-lease rentals	**-**	(1)	-
	116	106	96

Appropriate provisions are maintained to cover the above matters.

38. Non-controlling interests

		Group
	2009	2008
	£m	£m
Non-controlling interest in subsidiary	**125**	106
£300m Innovative Tier 1 Capital Securities	**297**	311
£300m fixed/floating rate non-cumulative callable preference shares	**294**	294
	716	711

Non-controlling interests represent the 49% shareholding in Santander Private Banking UK Limited not owned by the Company, Innovative Tier 1 capital securities issued by Alliance & Leicester plc, a subsidiary of the Company, and preference shares issued by Alliance & Leicester plc.

£300m Innovative Tier 1 Capital Securities

The Tier 1 securities issued by Alliance & Leicester plc are perpetual securities and pay a coupon on 22 March each year. 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 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 Tier 1 securities are redeemable at the option of Alliance & Leicester plc on 22 March 2016 or on each payment date thereafter. No such redemption may be made without the consent of the UK Financial Services Authority. In 2009, 2008 and 2007 the coupon was paid.

£300m fixed/floating rate non-cumulative callable preference shares

On 24 May 2006, Alliance & Leicester plc issued £300m fixed/floating rate non-cumulative callable preference shares, resulting in net proceeds of £294m. The preference shares entitle the holders to a fixed non-cumulative dividend, at the discretion of Alliance & Leicester plc, of 6.22% 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 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 UK Financial Services Authority.

Movements in non-controlling interests were as follows:

		Group
	2009	2008
	£m	£m
At 1 January	**711**	98
Share of profit	**55**	8
Distributions	**(50)**	-
Acquired through business combinations	**-**	605
At 31 December	**716**	711

Notes to the Financial Statements continued

39. Share capital

	Group and Company	
	2009	2008
	£m	£m
Ordinary share capital	**2,412**	1,148
£300m Step-up Callable Perpetual Reserve Capital Instruments	**297**	-
	2,709	1,148

Share capital consists of ordinary shares and the £300m Step-up Callable Perpetual Reserve Capital Instruments. The Company's preference shares are classified as Other Borrowed Funds under IFRS.

Issued and fully paid share capital	Ordinary shares of 10 pence each £m	Preference shares of £1 each £m	Preference shares of US$0.01 each £m	Preference shares of euro0.01 each £m	Total £m
At 1 January 2008	148	325	-	-	473
Shares issued	1,000	-	-	-	1,000
At 31 December 2008	**1,148**	**325**	**-**	**-**	**1,473**
Shares issued	**1,264**	**-**	**-**	**-**	**1,264**
At 31 December 2009	**2,412**	**325**	**-**	**-**	**2,737**

	Group	
Share Premium	**2009 £m**	2008 £m
At 1 January	**3,121**	1,857
Capital contribution	**-**	1,264
Transfer to ordinary shares	**(1,264)**	-
At 31 December	**1,857**	3,121

	Company	
Share Premium	**2009 £m**	2008 £m
At 1 January and 31 December	**1,857**	1,857

The Company has one class of ordinary shares which carry no right to fixed income.

On 12 October 2008, Banco Santander, S.A. agreed to inject capital of £1bn into the Company fulfilling its agreed commitment to the UK Government's banking support scheme announced on 8 October 2008. Consequently, on 12 October 2008, the Company issued ten billion ordinary shares of £0.10 each at par, to Banco Santander, S.A..

On 9 January 2009, in order to optimise the capital, liquidity funding and overall financial efficiency of the enlarged Santander group, Banco Santander, S.A. transferred all of its Alliance & Leicester plc shares to the Company in exchange for 12,631,375,230 newly issued ordinary shares of the Company of £0.10 each. As described earlier, the Group accounted for the transfer of Alliance & Leicester plc with effect from 10 October 2008 in a manner consistent with the requirements of group reconstruction relief under UK GAAP. The fair value of Alliance & Leicester plc's tangible and intangible net assets transferred was accounted for by the Group as a capital contribution on 10 October 2008. This was transferred to ordinary share capital on 9 January 2009 when the shares were actually issued. The Company accounted for the transfer of Alliance & Leicester plc with effect from 9 January 2009.

£300m Step-up Callable Perpetual Reserve Capital Instruments

During the year, the Group changed its accounting for its £300m Step-up Callable Perpetual Reserve Capital Instruments in order to align its accounting with that of its subsidiary Alliance & Leicester plc. The effect of this change was to reclassify the balance as equity rather than liabilities, and to account for the coupon as dividends rather than interest expense. The change was adjusted prospectively from 1 January 2009 as the effect was qualitatively and quantitatively immaterial to the prior years' financial statements, liquidity and regulatory measures taken as a whole.

The Reserve Capital Instruments were issued in 2001 by the Company. Reserve Capital Instruments are redeemable by the Company on 14 February 2026 or on any coupon payment date thereafter, subject to the prior approval of the UK Financial Services Authority and provided that the auditors have reported to the trustee within the previous six months that the solvency condition is met. The Reserve Capital Instruments bear interest at a rate of 7.037% per annum, payable annually in arrears, from 14 February 2001 to 14 February 2026. Thereafter, the reserve capital instruments will bear interest at a rate, reset every five years, of 3.75% per annum above the gross redemption yield on the UK five year benchmark gilt rate. Interest payments may be deferred by the Company.

The Reserve Capital Instruments are not redeemable at the option of the holders and the holders do not have any rights against other Group companies. Upon the occurrence of certain tax or regulatory events, the Reserve Capital Instruments may be exchanged, their terms varied, or redeemed. Where interest payments have been deferred, the Company may not declare or pay dividends on or redeem or repurchase any junior securities until it next makes a scheduled payment on the Reserve Capital Instruments and Tier One Preferred Income Capital Securities.

The Reserve Capital Instruments are unsecured securities of the Company and are subordinated to the claims of unsubordinated creditors and subordinated creditors holding loan capital of the Company. Upon the winding up of the Company, holders of Reserve Capital Instruments will rank *pari passu* with the holders of the most senior class or classes of preference shares (if any) of the Company then in issue and in priority to all other Company shareholders.

40. Dividends

Analysis of dividends paid is as follows:

	Group			Company		
	2009 Pence per Share	2008 Pence per Share	2007 Pence per Share	**2009 Pence per Share**	2008 Pence per Share	2007 Pence per Share
Ordinary shares (equity):						
2007 interim	**-**	13.46	-	**-**	13.46	-
2007 interim	**-**	11.44	-	**-**	11.44	-
2008 interim	**-**	15.14	-	**-**	15.14	-
2009 interim	**0.93**	-	-	**0.93**	-	
	0.93	40.04	-	**0.93**	40.04	-

The dividend of 0.93 pence per ordinary share equated to a total ordinary dividend payment of £225m. In addition, £21m of dividends were paid on the Step-up Callable Perpetual Reserve Capital Instruments during 2009.

41. Cash flow statement

a) Reconciliation of profit after tax to net cash inflow/(outflow) from operating activities:

	Group			Company		
	2009 £m	2008 £m	2007 £m	**2009 £m**	2008 £m	2007 £m
Profit for the year	**1,245**	819	685	**747**	1,328	351
Non-cash items included in net profit						
Decrease/(increase) in prepayments and accrued income	**262**	(126)	(105)	**1,024**	(902)	(353)
(Decrease)/increase in accruals and deferred income	**(2,171)**	346	531	**(2,016)**	1,260	411
Depreciation and amortisation	**260**	202	205	**132**	81	72
Profit on sale of subsidiary and associated undertakings	**-**	(40)	-	**-**	-	-
Amortisation of premiums/(discounts) on debt securities	**(8)**	(21)	-	**-**	-	-
Provisions for liabilities and charges	**56**	17	-	**41**	16	-
Provision for impairment	**897**	394	388	**830**	302	346
Corporation tax charge	**445**	275	179	**288**	126	69
Other non-cash items	**235**	250	109	**(506)**	1,155	(99)
	1,221	2,116	1,992	**540**	3,366	797

	Group			Company		
Changes in operating assets and liabilities	**2009 £m**	2008 £m	2007 £m	**2009 £m**	2008 £m	2007 £m
Net (increase)/ decrease in trading assets	**(1,636)**	9,398	(695)	**-**	-	-
Net decrease/(increase) in derivative assets	**12,298**	(23,096)	(1,615)	**196**	(2,046)	(43)
Net (increase)/decrease in financial assets designated at fair value	**(981)**	465	(3,107)	**10,218**	(39,863)	(7,434)
Net (increase)/decrease in loans and advances to banks & customers	**(3,008)**	(16,959)	(8,908)	**(10,146)**	(38,835)	(1,641)
Net decrease/(increase) in other assets	**1,103**	(189)	1,914	**835**	108	357
Net increase/(decrease) in deposits by banks and customers	**6,647**	(3,652)	4,104	**(2,731)**	123,614	13,813
Net (decrease)/increase in derivative liabilities	**(8,847)**	16,979	(287)	**(2,041)**	4,342	370
Net increase/(decrease) in trading liabilities	**5,533**	(14,054)	(2,850)	**(739)**	739	-
Net (decrease)/increase in financial liabilities designated at fair value	**(1,238)**	(3,284)	(619)	**-**	-	-
Net (decrease)increase in debt issued	**(3,077)**	5,027	368	**1**	-	(3)
Net (decrease)/increase in other liabilities	**(1,369)**	(807)	(20)	**(656)**	(586)	(315)
Effects of exchange rate differences	**(3,719)**	6,569	396	**(268)**	897	-
Net cash flow from/(used in) operating activities before tax	**2,927**	(21,487)	(9,327)	**(4,791)**	51,736	5,901
Income tax received/(paid)	**2**	43	(5)	**21**	80	48
Net cash flow from/(used in) operating activities	**2,929**	(21,444)	(9,332)	**(4,770)**	51,816	5,949

b) Analysis of the balances of cash and cash equivalents in the balance sheet

	Group			Company		
	2009 £m	2008 £m	2007 £m	**2009 £m**	2008 £m	2007 £m
Cash and balances with central banks	**4,163**	4,017	1,038	**3,266**	2,456	1,032
Debt securities	**1,966**	5,208	5,819	**-**	-	-
Loans and advances to banks	**4,881**	5,763	-	**-**	-	-
Net trading other cash equivalents	**8,827**	532	24,989	**-**	-	-
Net non trading other cash equivalents	**6,527**	12,155	2,210	**52,132**	58,747	9,562
Cash and cash equivalents	**26,364**	27,675	34,056	**55,398**	61,203	10,594

Notes to the Financial Statements continued

c) Sale of subsidiaries

			Group
	2009	2008	2007
Net assets disposed of:	**£m**	£m	£m
Operating lease assets	-	2,134	-
Current tax accounts	-	8	-
Other assets	-	60	-
Deposits by banks	-	(8)	-
Other liabilities	-	(163)	-
Other provisions	-	(2)	-
Current tax liabilities	-	(19)	-
Deferred tax liabilities	-	(446)	-
Retirement benefit obligations	-	1	-
	-	1,565	-
Profit/(loss) on disposal	-	40	-
	-	1,605	-
Satisfied by:			
Cash and cash equivalents	-	1,605	-
Less: Cash and cash equivalents in subsidiary sold	-	-	-
Net cash inflow of sale	-	1,605	-

On 8 December 2008, the Group completed the disposal of Porterbrook, its rolling stock leasing business, by the sale of 100% of Porterbrook Leasing Company Limited and its subsidiaries to a consortium of investors including Antin Infrastructure Partners (the BNP Paribas sponsored infrastructure fund), Deutsche Bank and Lloyds Banking Group plc, for a cash consideration of approximately £1.6bn, with the Group providing £0.6bn medium term, senior loan funding to the acquisition vehicle.

In addition, as described in Note 20, on 17 December 2007, the Company sold 49% of its shareholding in Santander Private Banking UK Limited to a direct subsidiary of Banco Santander, S.A. for a total cash consideration of £203m. Further, in 2007, recoveries of £5m were received in respect of subsidiaries sold in 2003.

d) Acquisitions of subsidiaries and businesses

2008			Group
Net assets acquired:	**Alliance & Leicester £m**	**Bradford & Bingley savings business £m**	**Total £m**
Assets			
Cash and balances at central banks	666	18,613	19,279
Derivative financial instruments	2,111	-	2,111
Financial assets designated at fair value	492	-	492
Loans and advances to banks	423	1,549	1,972
Loans and advances to customers	50,349	-	50,349
Available-for-sale securities	1,658	3	1,661
Loans and receivables securities	14,253	-	14,253
Intangible assets	17	4	21
Property, plant and equipment	273	44	317
Other assets	2,051	449	2,500
Liabilities			
Deposits by banks	(10,216)	-	(10,216)
Deposits by customers	(39,765)	(20,434)	(60,199)
Derivative financial instruments	(933)	-	(933)
Financial liabilities designated at fair value	(1,421)	-	(1,421)
Debt securities in issue	(17,146)	-	(17,146)
Subordinated liabilities	(1,296)	-	(1,296)
Other liabilities	(1,009)	(11)	(1,020)
Net identified assets and liabilities	**507**	**217**	**724**
Goodwill	774	395	1,169
Consideration	**1,281**	**612**	**1,893**
Satisfied by:			
Cash and cash equivalents	-	612	612
Less: Cash and cash equivalents in businesses acquired	(666)	(18,613)	(19,279)
Net cash (inflow) acquired	**(666)**	**(18,001)**	**(18,667)**

On 9 January 2009, in order to optimise the capital, liquidity funding and overall financial efficiency of the enlarged Santander group, Banco Santander, S.A. transferred all of its Alliance & Leicester plc shares to the Company in exchange for 12,631,375,230 newly issued ordinary shares of the Company. There was no other consideration. Accordingly, the Company is now the immediate parent company of Alliance & Leicester plc.

The transfer of Alliance & Leicester plc to the Company from Banco Santander, S.A. in exchange for ordinary shares of the Company represents a combination of entities under common control. Transactions between entities under common control are outside the scope of IFRS 3 – Business Combinations, and there is no other guidance for such situations under IFRS. In the absence of authoritative guidance under IFRS, the transfer has been accounted for by the Group in a manner consistent with group reconstruction relief under UK GAAP. As a result, the transfer of Alliance & Leicester plc has been accounted for by the Group with effect from 10 October 2008, the date on which Banco Santander, S.A. acquired Alliance & Leicester plc. For further information see Note 47.

In September 2008, following the announcement by HM Treasury to take Bradford & Bingley plc into public ownership, the retail deposits, branch network and its related employees transferred, under the provisions of the UK Banking (Special Provisions) Act 2008, to the Company. All of Bradford & Bingley plc's customer loans and treasury assets, including all its mortgage assets, were taken into public ownership. The transfer to the Company consisted of the £20bn retail deposit base with 2.7 million customers, as well as Bradford & Bingley plc's direct channels including 197 retail branches, 141 agencies (distribution outlets in third party premises) and related employees. The acquisition price was £612m, including the transfer of £208m of capital relating to offshore entities.

42. Collateral pledged and received

The Group provides assets as collateral in the following areas of the business.

The Company and certain of its subsidiaries enter into securitisation transactions whereby portfolios of residential mortgage loans are purchased by or assigned to special purpose securitisation companies, and have been funded through the issue of mortgage backed securities. Holders of the securities are only entitled to obtain payments of principal and interest to the extent that the resources of the securitisation companies are sufficient to support such payments and the holders of the securities have agreed in writing not to seek recourse in any other form. At 31 December 2009 £58,479m (2008: £63,451m) of residential mortgage loans were so assigned.

The Company and certain of its subsidiaries have also established covered bond programmes, whereby securities are issued to investors and are secured by a pool of ring-fenced residential mortgages. At 31 December 2009 £15,150m (2008: £24,101m) of residential mortgage loans had been so secured.

Collateral is also provided in the normal course of derivative business to counterparties. At 31 December 2009 £2,035m (2008: £1,842m) of such collateral in the form of cash had been provided.

As part of structured transactions entered into by subsidiaries of the Company, assets are pledged or received as collateral. At 31 December 2009 £253m (2008: £844m) of assets had been received (2008: pledged) in relation to these transactions.

Subsidiaries of the Company enter into sale and repurchase agreements and similar transactions of equity and debt securities, which are accounted for as secured borrowings. Upon entering into such transactions, the subsidiaries provide collateral equal to 100%-131% of the borrowed amount. The carrying amount of assets that were so provided at 31 December 2009 was £42,389m (2008: £51,267m).

Subsidiaries of the Company also enter into purchase and resale agreements and similar transactions of equity and debt securities, which are accounted for as collateralised loans. Upon entering into such transactions, the subsidiaries receive collateral equal to 100%-105% of the loan amount. The level of collateral held is monitored daily and if required, further calls are made to ensure the market values of collateral remains equal to the loan balance. The subsidiaries are permitted to sell or repledge the collateral held. At 31 December 2009, the fair value of such collateral was £42,039m (2008: £29,782m) of which £42,039m (2008: £29,782m) was sold or repledged. The subsidiaries have an obligation to return the collateral that it has sold or pledged with a fair value of £42,039m (2008: £29,782m).

As part of revised arrangements relating to the funding of the Group's defined benefit pension schemes, £814m (2008: £970m) of securities classified as available-for-sale have been pledged during the year to cover the Group's obligations.

43. Share-based compensation

Santander UK schemes

The Group granted share options to executive officers and employees under the Executive Share Option scheme, Sharesave scheme and the Employee Share Option scheme prior to being acquired by Banco Santander, S.A. on 12 November 2004. Options granted under the Executive Share Option scheme are generally exercisable between the third and tenth anniversaries of the grant date, provided that certain performance criteria are met. Under the Sharesave scheme, eligible employees can elect to exercise their options either three, five or seven years after the grant date. All of the share options prior to 12 November 2004 relate to shares in the Company. After 12 November 2004, all share options relate to shares in Banco Santander, S.A.. On 12 November 2004 all holders of options in ordinary shares of the Company were given the option to exercise their options, to cancel their options in return for a cash payment or to transfer their options to options in shares of Banco Santander, S.A.. The options over Banco Santander, S.A. shares are accounted for as cash settled share-based transactions. On acquisition of the Company by Banco Santander, S.A. there was no fair value adjustment of options modified to rights over Banco Santander, S.A. shares. From 12 November 2004 the Group has purchased Banco Santander, S.A. shares on the open market in order to settle these share based compensation obligations.

Notes to the Financial Statements continued

The Group introduced its second Sharesave Scheme under Banco Santander, S.A. ownership. The HM Revenue & Customs approved Sharesave Scheme was launched in September 2009. Employees were given the option of saving between £5 and £250 per month for a three or five year savings period. The option price was set at a 20% discount on the average middle market quotation of Banco Santander, S.A. shares over the first three dealing days in September 2009.

The total carrying amount at the end of the period for liabilities arising from share-based payment transactions was £7m (2008: £3m, 2007: £68m), none of which had vested as at 31 December 2009 (2008: nil). Cash received from the exercise of share options and the actual tax benefits realised from tax deductions were £1m (2008: £14m, 2007: £6m) and £nil (2008: £4m, 2007: £2m), respectively.

The fair value of each option for 2009, 2008 and 2007 has been estimated at the date of acquisition or grant using a partial differential equation model with the following assumptions:

	2009	2008	2007
Risk free interest rate	**2.5%-3.5%**	2.9%-6.5%	5.0%-5.8%
Dividend growth, based solely upon average growth since 1989	**10%**	10%	10%
Volatility of underlying shares based upon historical volatility over five years	**29.0%-34.4%**	20.2%-29.6%	19.80%-26.90%
Expected lives of options granted under:			
- Employee Sharesave 3, 5 & 7 year schemes	**3, 5 & 7 years**	3, 5 & 7 years	3, 5 & 7 years
- Executive Share Option scheme	**10 years**	10 years	10 years
- Medium term incentive plan	**-**	-	3 years
- Long term incentive plans	**3 years**	3 years	3 years

With the exception of those that include terms related to market conditions, vesting conditions included in the terms of the grant are not taken into account in estimating fair value. Non-market vesting conditions are taken into account by adjusting the number of shares or share options included in the measurement of the cost of the employee service so that ultimately, the amount recognised in the income statement reflects the number of vested shares or share options. Where vesting conditions are related to market conditions, the charges for the services received are recognised regardless of whether or not the market related vesting conditions are met, provided that the non-market vesting conditions are met. Share price volatility has been based upon the range of implied volatility for the Banco Santander, S.A. shares at the strikes and tenors in which the majority of the sensitivities lie.

The following table summarises the movement in the number of share options between those outstanding at the beginning and end of the year, together with the changes in weighted average exercise price over the same period.

	Executive Share Option scheme		Employee Sharesave scheme	
	Number of options '000s	**Weighted average exercise price £**	**Number of options '000s**	**Weighted average exercise price £**
2009				
Options outstanding at the start of the year	**12**	**4.54**	**6,142**	**7.00**
Options granted during the year	**-**	**-**	**4,528**	**7.26**
Options exercised during the year	**-**	**-**	**(679)**	**3.85**
Options forfeited during the year	**-**	**-**	**(1,278)**	**7.48**
Options outstanding at the end of the year	**12**	**4.54**	**8,713**	**7.24**
Options exercisable at the end of the year	**12**	**4.54**	**8,713**	**7.24**
2008				
Options outstanding at the start of the year	144	4.15	5,684	3.18
Options granted during the year	-	-	5,197	7.69
Options exercised during the year	(11)	4.14	(4,507)	3.07
Options forfeited during the year	(121)	4.11	(231)	5.91
Options expired during the year	-	-	(1)	8.07
Options outstanding at the end of the year	12	4.54	6,142	7.00
Options exercisable at the end of the year	12	4.54	-	-

	Executive Share Option scheme		Employee Sharesave scheme	
	Number of options '000s	**Weighted average exercise price £**	**Number of options '000s**	**Weighted average exercise price £**
2007				
Options outstanding at the start of the year	178	4.11	7,638	3.32
Options exercised during the year	(34)	3.96	(1,501)	3.81
Options forfeited during the year	-	-	(419)	3.25
Options expired during the year	-	-	(34)	5.92
Options outstanding at the end of the year	144	4.15	5,684	3.18
Options exercisable at the end of the year	144	4.15	-	-

The intrinsic value of the options exercised and the fair value of the options vested during the year were £3m (2008: £31m, 2007: £3m) and £5m (2008: £6m, 2007: £3m), respectively.

Executive Share Option scheme

The following table summarises information about the options outstanding at 31 December 2009.

	Options outstanding			Options exercisable	
Range of exercise prices	Number '000s	Weighted average remaining contractual life years	Weighted average exercise price £	Number '000s	Weighted average exercise price £
Between £4 and £5	**12**	**4**	**4.54**	**12**	**4.54**

The following table summarises information about the options outstanding at 31 December 2008.

	Options outstanding			Options exercisable	
Range of exercise prices	Number '000s	Weighted average remaining contractual life years	Weighted average exercise price £	Number '000s	Weighted average exercise price £
Between £4 and £5	12	5	4.54	12	4.54

Employee Sharesave scheme

Under the Employee Sharesave scheme, the weighted-average exercise prices of options are less than the market prices of the shares on the relevant grant dates.

The Group introduced its second Sharesave Scheme under Banco Santander, S.A. ownership. The HM Revenue & Customs approved Sharesave Scheme was launched in September 2009. Employees were given the option of saving between £5 and £250 per month for a three or five year savings period. The option price was set at a 20% discount on the average middle market quotation of Banco Santander, S.A. shares over the first three dealing days of September 2009.

Medium Term Incentive Plan

See Note 45 for details of conditional share grants awarded to certain Executive Directors, Other Key Management Personnel and other nominated individuals under the Medium Term Incentive Plan.

2008	Number of awards granted 000s
Conditional awards outstanding at the beginning of the year	2,220
Conditional awards forfeited during the year	(29)
Conditional awards vested during the year	(2,191)
Conditional awards outstanding at the end of the year	-

2007	Number of awards granted 000s
Conditional awards outstanding at the beginning of the year	2,537
Conditional awards forfeited during the year	(317)
Conditional awards outstanding at the end of the year	2,220

Awards with a value of £nil vested during the year (2008: £19m, 2007: £nil), as the scheme matured in 2008.

Long Term Incentive Plan

See Note 45 for details of conditional share grants awarded to certain Executive Directors, Other Key Management Personnel and other nominated individuals under the Long Term Incentive Plan.

2009	Number of awards granted 000s
Conditional awards outstanding at the beginning of the year	**4,680**
Conditional awards granted during the year	**2,274**
Conditional awards exercised during the year	**(1,243)**
Conditional awards outstanding at the end of the year	**5,711**

2008	Number of awards granted 000s
Conditional awards outstanding at the beginning of the year	3,092
Conditional awards granted during the year	1,803
Conditional awards forfeited during the year	(215)
Conditional awards outstanding at the end of the year	4,680

The weighted average grant-date fair value of conditional awards granted during the year was £3.85 (2008: £4.24). At 31 December 2009, the weighted average remaining contractual life was two years (2008: two years).

Notes to the Financial Statements continued

Alliance & Leicester schemes

During the year ended 31 December 2009, the Alliance & Leicester group had four share-based payment arrangements, including Share Incentive Plan (SIP) partnership shares. The Share Incentive Plan (SIP) was available to all employees. Prior to Alliance & Leicester plc's acquisition by Banco Santander, S.A., participants could elect to invest up to £125 per month from pre-tax salary to purchase shares at the prevailing market price. Shares can be released from Trust after five years free of income tax and national insurance contributions. On the acquisition of Alliance & Leicester plc by Banco Santander, S.A., Alliance & Leicester plc shares held in the SIP were converted to Banco Santander shares on the same three for one basis as was applicable to all other shareholders upon acquisition by Banco Santander S.A. These will remain in the SIP Trust under the terms of the SIP rules. 195,454 SIP partnership shares were issued during 2008 prior to acquisition, at the then prevailing market rate of Alliance & Leicester plc shares, at a weighted average price of 428p per share. All were converted to Banco Santander, S.A. shares on acquisition. No Banco Santander SIP shares have been issued since acquisition.

Options held under the ShareSave Plan, share option plan and senior manager deferred bonus scheme became exercisable on 7 October 2008 and lapsed, if unexercised, on 7 April 2009.

Restricted share plan shares vested and were converted to Banco Santander, S.A. shares on acquisition in accordance with the scheme rules. Under the senior manager deferred bonus scheme, new Alliance & Leicester plc shares were issued to satisfy deferred bonus scheme options that remained unexercised prior to 7 April 2009, after which all options lapsed.

The following table summarises the movement in the number of options between those outstanding at the beginning and end of the year, together with the changes in weighted average exercise price over the same period:

2009	**ShareSave No. of shares**	**Share option plan No. of shares**	**Senior manager deferred bonus[1] No. of shares**
Outstanding at 1 January	**564,675**	**2,232,426**	**64,726**
Lapsed	**(564,675)**	**(2,232,426)**	-
Exercised	-	-	**(64,726)**
Outstanding at 31 December 2009	-	-	-
Weighted average exercise price in 2009	-	-	**285.5p**

2008	ShareSave No. of shares	Share option plan No. of shares	Senior manager deferred bonus[1] No. of shares
Outstanding and exercisable at 31 December 2008	564,675	2,232,426	64,726
Weighted average exercise price in 2008	630.2p	n/a	285.5p
Range of exercise prices for options	632p - 815p	544p – 1,093p	n/a
Weighted average fair value options	n/a	84p	1,553p[2]

1. The figures in the table relate to the level of bonus deferred, i.e. excluding the matching element.
2. The option value includes the deferred share and the fair value of the matched element less the cash bonus foregone.

For these schemes, the estimated fair value is calculated as the value of the share price option plus the present value of any deferred dividends.

The assumptions used in the model are as follows:

Input	**Assumption**
Share price	Price at date of grant
Exercise price	Per scheme rules
Expected volatility	Estimated by calculating the annualised, exponential weighted monthly volatility of share price over prior two years
Option life	Per scheme rules
Risk free rate	Generated from LIBOR swap curve

44. Directors' emoluments and interests

Ex gratia pensions paid to former Directors of the Company in 2009, which have been provided for previously, amounted to £22,341 (2008: £22,341, 2007: £21,524). In 1992, the Board decided not to award any new such ex gratia pensions.

There were no loans, quasi loans and credit transactions entered into or agreed by the Company or its subsidiaries with persons who are or were Directors, Other Key Management Personnel and each of their connected persons during the year except as described below:

Other Key Management Personnel* - Loans	**Number of persons**	**Aggregate amount outstanding £000**
2009	**2**	**835**
2008	2	647

* Other Key Management Personnel are defined as the Executive Committee of the Company and the Board and Executive Committee of its parent company, Banco Santander, S.A. who served during the year. The above excludes any overdraft facilities provided to Directors, Other Key Management Personnel and their connected persons in the ordinary course of business.

Secured and unsecured loans are made to Directors, Other Key Management Personnel and their connected persons in the ordinary course of business, with terms prevailing for comparable transactions and on the same terms and conditions as applicable to other employees within the Group. Such loans do not involve more than the normal risk of collectability or present any unfavourable features.

45. Related party disclosures

Transactions with Directors, Other Key Management Personnel and each of their connected persons

Directors, Other Key Management Personnel and their connected persons have undertaken the following transactions with the Group in the course of normal banking and life assurance business.

2009	Number of directors and Other Key Management Personnel[1]	Amounts in respect of directors, Other Key Management Personnel[1] and their connected persons £000
Secured loans, unsecured loans and overdrafts		
Loans outstanding at 1 January	5	647
Net movements in the year	(1)	191
Loans outstanding at 31 December	4	838
Deposit, bank and instant access accounts and investments		
Deposits, bank instant access accounts and investments at 1 January	16	4,463
Net movements in the year	(1)	2,916
Deposit, bank and instant access accounts and investments at 31 December	15	7,379
Life assurance policies		
Life assurance policies at 1 January	1	1,026
Net movements in the year	2	862
Life assurance policies at 31 December	3	1,888

2008	Number of directors and Other Key Management Personnel[1]	Amounts in respect of directors, Other Key Management Personnel[1] and their connected persons £000
Secured loans, unsecured loans and overdrafts		
Loans outstanding at 1 January	1	806
Net movements in the year	4	(159)
Loans outstanding at 31 December	5	647
Deposit, bank and instant access accounts and investments		
Deposits, bank instant access accounts and investments at 1 January	12	5,565
Net movements in the year	4	(1,102)
Deposit, bank and instant access accounts and investments at 31 December	16	4,463
Life assurance policies		
Life assurance policies at 1 January	2	1,600
Net movements in the year	(1)	(574)
Life assurance policies at 31 December	1	1,026

(1) Other Key Management Personnel are defined as the Executive Committee of the Company and the Board and Executive Committee of its parent company, Banco Santander, S.A., who served during the year.

In 2009, one Director undertook sharedealing transactions through the Group's execution only stockbroker (2008: two Directors) with an aggregate net value of £269,561 (2008: £680,096). Any transactions were on normal business terms and standard commission rates were payable.

Secured and unsecured loans are made to Directors, Other Key Management Personnel and their connected persons, in the ordinary course of business, with terms prevailing for comparable transactions and on the same terms and conditions as applicable to other employees within the Group. Such loans do not involve more than the normal risk of collectability or present any unfavourable features. Amounts deposited by Directors, Other Key Management Personnel and their connected persons earn interest at the same rates as those offered to the market or on the same terms and conditions applicable to other employees within the Group.

Life assurance policies and investments are entered into by Directors, Other Key Management Personnel and their connected persons on normal market terms and conditions, or on the same terms and conditions as applicable to other employees within the Group.

Remuneration of Key Management Personnel

The remuneration of the Directors, and Other Key Management Personnel of the Group, is set out in aggregate for each of the categories specified in IAS 24 Related Party Disclosures. Further information about the aggregate remuneration of the Directors is provided in the 'Directors' Remuneration' table in the Directors' Report on page 92.

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Key management compensation	2009 £	2008 £	2007 £
Short-term employee benefits	**12,172,113**	13,016,060	11,602,405
Post employment benefits	**319,319**	306,902	77,814
Other long term benefits	**-**	-	-
Termination benefits	**1,162,500**	-	-
Share-based payments	**2,192,509**	1,572,973	1,101,786
	15,846,441	14,895,935	12,782,005

Medium-Term Incentive Plan

Under the Medium-Term Incentive Plan granted on 20 October 2005, certain Executive Directors, Other Key Management Personnel and other nominated individuals were granted a conditional award of shares in Banco Santander, S.A.. The amount of shares participants would receive at the end of the three-year period depended on the performance of the Group in this period. The performance conditions were linked to the Group's three-year plan. Performance was measured in two ways, half of the award depended on the Group achieving an attributable profit target for the 2007 financial year, and the remainder depended on the achievement of a revenue target for the 2007 financial year. Both performance conditions were achieved, resulting in a full award of shares to participants in March 2008.

Long-Term Incentive Plan

In 2009, four Executive Directors (2008: two) and six Other Key Management Personnel (2008: six) were granted conditional awards of shares in Banco Santander, S.A. under the Santander Long-Term Incentive Plan for a total fair value of £1,605,268 (2008: £1,325,592) based on a price of euro 8.14 (2008: euro 11.96). The value attributable to the current year of these conditional awards is included in share based payments above. Under the Santander Long-Term Incentive Plans granted on 1 July 2009, 21 June 2008 and 31 December 2007, certain Executive Directors, Key Management Personnel (as defined in Note 44 to the Consolidated Financial Statements) and other nominated individuals were granted conditional awards of shares in Banco Santander, S.A.. The amount of shares participants will receive depends on the performance of Banco Santander, S.A. during this period. All awards under the Santander Long-Term Incentive Plan will depend on Santander's Total Shareholder Return performance against a competitor benchmark group. Awards made prior to 2009 also depend on Santander's Earnings Per Share performance against a competitor benchmark group. 90.79% of the 40% of the 2007 conditional award of shares vested in July 2009. Subject to performance conditions being met, the remaining 60% of the 2007 conditional award will vest in July 2010, 100% of the 2008 conditional award will vest in July 2011 and 100% of the 2009 conditional award will vest in July 2012.

Parent undertaking and controlling party

The Company's immediate and ultimate parent and controlling party is Banco Santander, S.A.. The smallest and largest group into which the Group's results are included is the group accounts of Banco Santander, S.A., copies of which may be obtained from Santander Shareholder Department, 2 Triton Square, Regent's Place, London NW1 3AN.

Transactions with related parties

Transactions with related parties during the year and balances outstanding at the year end:

Group	Interest, fees and other income received			Interest, fees and other expenses paid			Amounts owed by related parties		Amounts owed to related parties	
	2009 £m	2008 £m	2007 £m	**2009 £m**	2008 £m	2007 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Parent company	**(99)**	(537)	(293)	**47**	509	327	**7,809**	11,021	**(2,965)**	(2,337)
Fellow subsidiaries	**(563)**	(383)	(171)	**412**	377	24	**7,113**	6,214	**(4,567)**	(1,767)
Associates	**(26)**	(23)	(19)	**1**	2	5	**2,092**	632	**(13)**	(150)
	(688)	(943)	(483)	**460**	888	356	**17,014**	17,867	**(7,545)**	(4,254)

Company	Interest, fees and other income received			Interest, fees and other expenses paid			Amounts owed by related parties		Amounts owed to related parties	
	2009 £m	2008 £m	2007 £m	**2009 £m**	2008 £m	2007 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Parent company	**(32)**	(55)	(91)	**5**	-	-	**1**	1,004	**(632)**	(230)
Subsidiaries	**(4,229)**	(6,654)	(2,072)	**6,399**	8,312	4,532	**149,175**	165,557	**(184,460)**	(198,369)
Fellow subsidiaries	**(224)**	(261)	(106)	**307**	253	17	**71**	352	**(1,839)**	(320)
Associates	**-**	(2)	-	**-**	-	-	**1**	334	**-**	(2)
	(4,485)	(6,972)	(2,269)	**6,711**	8,565	4,549	**149,248**	167,247	**(186,931)**	(198,921)

The balances above include debt securities in issue and non-controlling interests held by related parties. In addition, transactions with pension schemes operated by the Group are described in Note 36.

During the year, euro 315m of the Group's holdings of AAA rated prime mortgage backed securities were sold to the issuer, Banco Santander Totta, S.A.. Although Banco Santander Totta, S.A. is a related party of the Group, the transactions are considered to be commercial deals, with a normal sharing of profits.

On 17 December 2007, the Company sold 100% of its shareholdings in James Hay, Cater Allen and Abbey Sharedealing to Santander Private Banking UK Limited, at the time of the transaction a 100% owned direct subsidiary of the Company, for a total cash consideration of £414m. The companies sold were Cater Allen Limited, Abbey Stockbrokers Limited, Abbey Stockbrokers (Nominees) Limited, James Hay Holdings Limited, James Hay Wrap Managers Limited, James Hay Insurance Company Limited, James Hay Administration Company Limited, James Hay Pension Trustees Limited and Sarum Trustees Limited. Subsequently, on 17 December 2007, the Company sold 49% of its shareholding in Santander Private Banking UK Limited to Santander PB UK (Holdings) Limited, a direct subsidiary of Banco Santander, S.A. for a total cash consideration of £203m.

The above transactions were made in the ordinary course of business and substantially on the same terms as for comparable transactions with third party counterparties.

As described in Note 47, on 9 January 2009, in order to optimise the capital, liquidity funding and overall financial efficiency of the Santander group, Banco Santander, S.A. transferred all of its Alliance & Leicester plc shares to the Company in exchange for newly issued ordinary shares of the Company. Accordingly, the Company is now the immediate parent company of Alliance & Leicester plc.

46. Events after the balance sheet date

On 25 February 2010 it was announced that Alliance & Leicester plc intends to transfer its business into the Company later this year under a scheme allowed by Part VII of the Financial Services and Markets Act 2000. This transfer is subject to UK Financial Services Authority support and the Court approval. The transfer will provide benefits for Alliance & Leicester plc customers and for the Company. For Alliance & Leicester plc customers this includes access to Santander UK's full product range plus use of over 1,300 branches, four times as many branches currently available for Alliance & Leicester plc customers. By rationalising systems and improving the sales and risk management processes through having a single view of customers' dealings, the Company will also benefit from the significant synergies that were announced to the market at the time of the acquisition of Alliance & Leicester plc by Banco Santander, S.A. in 2008.

On 26 February 2010 it was announced that as the Alliance & Leicester plc preference shares will not transfer to the Company under the proposed Part VII Transfer, Alliance & Leicester plc and Santander UK plc have agreed that the holders of the Alliance & Leicester plc preference shares should be given the opportunity to exchange their Alliance & Leicester plc preference shares for new preference shares to be issued by the Company. It is intended that the exchange will be carried out by a scheme of arrangement under Part 26 of the Companies Act 2006, which, if approved by the Court as well as holders of the Alliance & Leicester plc preference shares and the Company (as holder of the ordinary shares of Alliance & Leicester plc), the Alliance & Leicester plc preference shares would be substituted with a new issue of preference shares by Santander UK plc on substantially similar terms.

In March 2010 the Group issued through the Fosse Master Trust the first publicly-placed mortgage-backed securitisation transaction from a UK bank since 2007. The transaction was denominated in both pounds sterling and euro and raised approximately £1.4bn.

47. Transfer of Alliance & Leicester plc

On 9 January 2009, in order to optimise the capital, liquidity funding and overall financial efficiency of the enlarged Santander group, Banco Santander, S.A. transferred all of its Alliance & Leicester plc shares to the Company in exchange for 12,631,375,230 newly issued ordinary shares of the Company. There was no other consideration. Accordingly, the Company is now the immediate parent company of Alliance & Leicester plc.

The transfer of Alliance & Leicester plc to the Company from Banco Santander, S.A. in exchange for ordinary shares of the Company represents a combination of entities under common control. Transactions between entities under common control are outside the scope of IFRS 3 – Business Combinations, and there is no other guidance for such situations under IFRS. In the absence of authoritative guidance under IFRS, the transfer has been accounted for by the Group in a manner consistent with group reconstruction relief under UK GAAP. As a result, the transfer of Alliance & Leicester plc has been accounted for by the Group with effect from 10 October 2008, the date on which Banco Santander, S.A. acquired Alliance & Leicester plc.

The consolidated financial statements and related notes of the Group for the year ended 31 December 2008 have been updated to reflect this treatment, as follows.

Updated consolidated income statement for the year ended 31 December 2008

The effect of the acquisition of Alliance & Leicester plc on the Group's consolidated income statement for the period from 10 October 2008 to 31 December 2008 is both quantitatively and qualitatively immaterial. The inclusion of Alliance & Leicester plc for the period from 10 October 2008 to 31 December 2008 would have resulted in: (a) a decrease in the profit before tax and profit after tax of the Group by 1% and 2% respectively; (b) no change in compliance with regulatory measures and loan covenants; and; (c) an immaterial impact on key financial trends and performance indicators. Consequently, the Group has concluded that it will not recast the consolidated income statement, or the consolidated statement of comprehensive income for the year ended 31 December 2008, to reflect the application of group reconstruction relief.

Notes to the Financial Statements continued

Updated consolidated balance sheet at 31 December 2008

The updated consolidated balance sheet of the Group set out below is based on the original audited consolidated balance sheet of the Group at 31 December 2008 and the audited consolidated balance sheet of the Alliance & Leicester group at 31 December 2008 which have been prepared in accordance with IFRS as issued by the IASB in addition to being consistent with IFRS as adopted for use in the European Union. Inter-company balances between Group companies and Alliance & Leicester group companies have been eliminated. Finally, the acquisition adjustments originally recognised by Banco Santander, S.A. have been applied.

As at 31 December 2008

	Santander UK Group[1] £m	Alliance & Leicester Group £m	Inter-company eliminations £m	Acquisition adjustments £m	Total £m
Assets					
Cash and balances at central banks	2,464	1,553	-	-	**4,017**
Trading assets	26,264	-	-	-	**26,264**
Derivative financial instruments	32,281	2,876	(32)	-	**35,125**
Financial assets designated at fair value	11,314	63	-	-	**11,377**
Loans and advances to banks	24,226	1,239	(9,464)	-	**16,001**
Loans and advances to customers	129,023	51,402	-	(249)	**180,176**
Available-for-sale securities	1,005	1,658	-	-	**2,663**
Loans and receivables securities	-	14,250	(146)	3	**14,107**
Macro hedge of interest rate risk	1,475	713	-	-	**2,188**
Investments in associated undertakings	735	-	-	(700)	**35**
Intangible assets	556	17	-	774	**1,347**
Property, plant and equipment	581	223	-	50	**854**
Operating lease assets	-	348	-	-	**348**
Current tax assets	195	17	-	-	**212**
Deferred tax assets	560	626	-	88	**1,274**
Other assets	1,063	259	-	-	**1,322**
Total assets	**231,742**	**75,244**	**(9,642)**	**(34)**	**297,310**
Liabilities					
Deposits by banks	3,337	11,516	(365)	-	**14,488**
Deposits by customers	99,246	39,765	(8,766)	-	**130,245**
Derivative financial instruments	26,309	1,533	(32)	-	**27,810**
Trading liabilities	40,738	-	-	-	**40,738**
Financial liabilities designated at fair value	4,945	728	-	-	**5,673**
Debt securities in issue	41,178	17,477	(144)	-	**58,511**
Other borrowed funds	2,076	-	-	-	**2,076**
Subordinated liabilities	5,826	1,436	(335)	(140)	**6,787**
Other liabilities	1,770	631	-	(59)	**2,342**
Provisions	107	34	-	66	**207**
Current tax liabilities	517	1	-	-	**518**
Deferred tax liabilities	86	278	-	41	**405**
Retirement benefit obligations	796	17	-	-	**813**
Total liabilities	**226,931**	**73,416**	**(9,642)**	**(92)**	**290,613**
Equity					
Share capital	1,148	328	-	(328)	**1,148**
Share premium account	1,857	724	-	540	**3,121**
Preference shares and innovative Tier 1	-	605	-	(605)	**-**
Retained earnings	1,678	210	-	(210)	**1,678**
Other reserves	22	(39)	-	56	**39**
	4,705	1,828	-	(547)	**5,986**
Non-controlling interest	106	-	-	605	**711**
Total shareholders equity	**4,811**	**1,828**	-	**58**	**6,697**
Total liabilities and equity	**231,742**	**75,244**	**(9,642)**	**(34)**	**297,310**

(1) The Santander UK Group figures include final acquisition adjustments for Bradford & Bingley savings business as described in Note 48.

Updated consolidated cash flow statement for the year ended 31 December 2008

The updated consolidated cash flow statement of the Group set out below is based on the original audited consolidated cash flow statement of the Group for the year ended 31 December 2008 and the post-acquisition consolidated cash flows of the Alliance & Leicester group for the period from 10 October to 31 December 2008 which have been prepared in accordance with IFRS as issued by the IASB in addition to being consistent with IFRS as adopted for use in the European Union. Inter-company transactions between Group companies and Alliance & Leicester group companies have been eliminated.

Notes to the Financial Statements continued

For the year ended 31 December 2008

	Santander UK Group £m	Alliance & Leicester Group £m	Inter-company eliminations £m	Acquisition adjustments £m	Total £m
Net cash flow (used in)/from operating activities					
Profit for the year	819	-	-	-	**819**
Adjustments for:					
Non cash items included in net profit	1,297	-	-	-	**1,297**
Change in operating assets	(40,978)	1,463	9,134	-	**(30,381)**
Change in operating liabilities	8,135	1,539	(9,465)	-	**209**
Income taxes received/(paid)	43	-	-	-	**43**
Effects of exchange rate differences	8,569	(2,000)	-	-	**6,569**
Net cash flow (used in)/from operating activities	(22,115)	1,002	(331)	-	**(21,444)**
Net cash flows from/(used in) investing activities					
Acquisition of businesses, net of cash acquired	18,001	-	-	666	**18,667**
Dividends received from associates	2	-	-	-	**2**
Investment in associates	(708)	-	700	-	**(8)**
Disposal of subsidiaries, net of cash disposed	1,605	-	-	-	**1,605**
Purchase of tangible and intangible fixed assets	(278)	-	-	-	**(278)**
Proceeds from sale of tangible and intangible fixed assets	15	-	-	-	**15**
Purchase of non-trading securities	(1,222)	-	331	-	**(891)**
Proceeds from sale of non-trading securities	290	-	-	-	**290**
Net cash flow from/(used in) investing activities	17,705	-	1,031	666	**19,402**
Net cash flow (used in)/from financing activities					
Issue of ordinary share capital	1,000	701	(700)	-	**1,001**
Repayment of loan capital	(7,787)	-	-	-	**(7,787)**
Dividends paid	(595)	-	-	-	**(595)**
Net cash flow (used in)/from financing activities	(7,382)	701	(700)	-	**(7,381)**
Net (decrease)/increase in cash and cash equivalents	(11,792)	1,703	-	666	**(9,423)**
Cash and cash equivalents at beginning of the year	34,056	666	-	(666)	**34,056**
Effects of exchange rates on cash and cash equivalents	3,042	-	-	-	**3,042**
Cash and cash equivalents at the end of the year	25,306	2,369	-	-	**27,675**

Acquisition adjustments

The initial computation of the purchase price, the allocation of the purchase price to the net assets of Alliance & Leicester plc based on fair values estimated by Banco Santander, S.A. at 10 October 2008, and the resulting amount of goodwill were:

	£m	£m	£m
Purchase price:			
Fair value of shares issued by Banco Santander, S.A. in exchange for Alliance & Leicester plc			1,281
Less:			
Alliance & Leicester's shareholders' funds at 10 October 2008		523	
Fair value adjustments:			
- Loans and advances to customers	(249)		
- Loans and receivables securities	3		
- Property, plant and equipment	50		
- Subordinated liabilities	140		
- Other liabilities	59		
- Provisions	(66)		
- Deferred tax (tax effect of the above adjustments)	47		
		(16)	
			507
Goodwill			**774**

The acquisition of Alliance & Leicester plc strengthened the Group's market position and critical mass. Intangible assets in respect of brands, customer relationships (known as core deposit intangibles) and customer lists were identified. The values of these intangible assets were determined to be immaterial; accordingly, no separate intangible assets for these items were recognised. No other intangible assets were identified, including any relating to key employees, patents or intellectual property rights.

The computation of the purchase price was based on the fair value (i.e. the published price) of 140,950,944 new Banco Santander, S.A. shares of euro 0.50 par value each, with a share premium of euro 10.73 per share that were issued in exchange for Alliance & Leicester plc common shares on 10 October 2008. The share capital, share premium and pre-acquisition reserves (retained earnings and other reserves) of Alliance & Leicester plc have also been eliminated on acquisition. The Company's existing holding of 35.6% of Alliance & Leicester plc's equity voting interests at 31 December 2008 was also eliminated.

Financial effect of the Transfer

The amounts of total operating income and profit before tax of Alliance & Leicester included in the Group's income statement for the year ended 31 December 2009 were £1,253m and £420m, respectively.

Notes to the Financial Statements continued

48. Acquisition of the Bradford & Bingley savings business, and transfer of Alliance & Leicester plc – initial accounting

Bradford & Bingley savings business

The Consolidated Balance Sheet as at 31 December 2008 reflected the acquisition of the Bradford & Bingley savings business with effect from September 2008, under the purchase method of accounting. The total cost of the acquisition was allocated to the assets acquired and the liabilities assumed based upon their estimated fair values at the date of the acquisition. The preliminary allocation resulted in an excess of fair value of acquired net assets over cost. The estimated purchase price allocation was preliminary and has now been completed.

The following table presents the preliminary and final allocations of the aggregate purchase price at the acquisition date:

Net assets acquired:	Revised allocation £m	Initial allocation £m	Change £m
Assets			
Cash and balances at central banks	18,613	18,613	-
Loans and advances to banks	1,549	1,624	(75)
Available-for-sale securities	3	3	-
Intangible assets	4	4	-
Property, plant and equipment	44	44	-
Other assets, tax assets and lease assets	449	428	21
Liabilities			
Deposits by customers	(20,434)	(20,434)	-
Other liabilities, tax liabilities and lease obligations	(11)	(11)	-
Net identified assets and liabilities	**217**	**271**	**(54)**
Goodwill	395	341	54
Consideration	**612**	**612**	**-**

The adjustment since the initial allocation wrote off the value of the £75m investment in Bradford & Bingley plc subordinated debt held by Bradford & Bingley International Limited to reflect its impairment as a result of the outcome of discussions between the Company and HM Treasury. The tax effect of the adjustment was £21m.

Alliance & Leicester plc

The Consolidated Balance Sheet as at 31 December 2008 did not originally reflect the transfer of Alliance & Leicester plc to the Company. As described in Note 47, the transfer has now been reflected with effect from 10 October 2008. The amended Consolidated Balance Sheet as at 31 December 2008 reflecting the transfer with effect from 10 October 2008 was included in the Group's 2009 Half Yearly Financial Report published on 28 August 2009. In that Financial Report, the total cost of the acquisition was allocated to the assets acquired and the liabilities assumed based upon their estimated fair values at the effective date of the transfer. The preliminary allocation resulted in an excess of fair value of acquired net assets over cost. The estimated purchase price allocation was preliminary and has now been completed by Banco Santander, S.A.. Banco Santander S.A.'s final acquisition accounting has been reflected by the Group, in accordance with group reconstruction relief.

The following table presents the preliminary and final allocations of the aggregate purchase price at 10 October 2008:

Net assets acquired:	Revised allocation £m	Initial allocation £m	Change £m
Assets			
Cash and balances at central banks	666	666	-
Derivative financial instruments	2,111	2,111	-
Financial assets designated at fair value	492	492	-
Loans and advances to banks	423	423	-
Loans and advances to customers	50,349	50,598	(249)
Available-for-sale securities	1,658	1,658	-
Loans and receivables securities	14,253	14,253	-
Intangible assets	17	17	-
Property, plant and equipment	273	273	-
Other assets, tax assets and lease assets	2,051	1,963	88
Liabilities			
Deposits by banks	(10,216)	(10,216)	-
Deposits by customers	(39,765)	(39,765)	-
Derivative financial instruments	(933)	(933)	-
Financial liabilities designated at fair value	(1,421)	(1,421)	-
Debt securities in issue	(17,146)	(17,146)	-
Subordinated liabilities	(1,296)	(1,296)	-
Other liabilities, tax liabilities, provisions and retirement benefit obligations	(1,009)	(956)	(53)
Net identified assets and liabilities	**507**	**721**	**(214)**
Goodwill	774	560	214
Consideration	**1,281**	**1,281**	**-**

The adjustment to reduce Loans and advances to customers by £249m reflected the final assessment of the losses in the Retail and Corporate Banking portfolios, which were higher than originally estimated.

The adjustment to increase Other liabilities by £53m represents the updated view of the cost of settling misselling claims with respect to products sold by Alliance & Leicester prior to its acquisition. The adjustment to increase Other assets by £88m represents the deferred tax effect of the above adjustments.

49. Financial instruments

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The Accounting Policies section describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following tables analyse the Group's financial instruments into those measured at fair value and those measured at amortised cost in the balance sheet:

Group

31 December 2009	Held at fair value				Held at amortised cost		Non-financial assets / liabilities	Total
	Trading	Derivatives held for hedging	Designated at fair value through P&L	Available-for-sale	Loans and receivables	Financial liabilities at amortised cost		
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Cash & balances at central banks	-	-	-	-	4,163	-	-	4,163
Trading assets	33,290	-	-	-	-	-	-	33,290
Derivative financial instruments	21,472	1,355	-	-	-	-	-	22,827
Financial assets designated at FV	-	-	12,358	-	-	-	-	12,358
Loans and advances to banks	-	-	-	-	9,151	-	-	9,151
Loans and advances to cust.s	-	-	-	-	186,804	-	-	186,804
Available-for-sale securities	-	-	-	797	-	-	-	797
Loans and receivables securities	-	-	-	-	9,898	-	-	9,898
Macro hedge of interest rate risk	-	-	-	-	1,127	-	-	1,127
Investment in associates	-	-	-	-	-	-	75	75
Intangible assets	-	-	-	-	-	-	1,446	1,446
Property, plant and equipment	-	-	-	-	-	-	938	938
Operating lease assets	-	-	-	-	-	-	312	312
Current tax assets	-	-	-	-	-	-	85	85
Deferred tax assets	-	-	-	-	-	-	946	946
Other assets	-	-	-	-	999	-	75	1,074
	54,762	1,355	12,358	797	212,142	-	3,877	285,291
Liabilities								
Deposits by banks	-	-	-	-	-	5,811	-	5,811
Deposits by customers	-	-	-	-	-	143,893	-	143,893
Derivative financial liabilities	16,775	2,188	-	-	-	-	-	18,963
Trading liabilities	46,152	-	-	-	-	-	-	46,152
Financial liabilities at FVTPL	-	-	4,423	-	-	-	-	4,423
Debt securities in issue	-	-	-	-	-	47,758	-	47,758
Other borrowed funds	-	-	-	-	-	1,352	-	1,352
Subordinated liabilities	-	-	-	-	-	5,597	-	5,597
Other liabilities	-	-	-	-	-	2,263	60	2,323
Provisions	-	-	-	-	-	-	91	91
Current tax liabilities	-	-	-	-	-	-	300	300
Deferred tax liabilities	-	-	-	-	-	-	336	336
Retirement benefit obligations	-	-	-	-	-	-	1,070	1,070
	62,927	2,188	4,423	-	-	206,674	1,857	278,069

Company

31 December 2009	Held at fair value				Held at amortised cost		Non-financial assets / liabilities	Total
	Trading	Derivatives held for hedging	Designated at fair value through P&L	Available-for-sale	Loans and receivables	Financial liabilities at amortised cost		
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Cash & balances at central banks	-	-	-	-	3,266	-	-	3,266
Derivative financial instruments	1,256	1,283	-	-	-	-	-	2,539
Financial assets designated at FV	-	-	37,145	-	-	-	-	37,145
Loans and advances to banks	-	-	-	-	109,658	-	-	109,658
Loans and advances to cust.s	-	-	-	-	131,749	-	-	131,749
Available-for-sale securities	-	-	-	30	-	-	-	30
Loans and receivables securities	-	-	-	-	2	-	-	2
Investment in associates	-	-	-	-	-	-	76	76
Investment in subsidiaries	-	-	-	-	-	-	7,038	7,038
Intangible assets	-	-	-	-	-	-	552	552
Property, plant and equipment	-	-	-	-	-	-	561	561
Deferred tax assets	-	-	-	-	-	-	428	428
Other assets	-	-	-	-	513	-	138	651
	1,256	1,283	37,145	30	245,188	-	8,793	293,695

Notes to the Financial Statements continued

31 December 2009	**Held at fair value**				**Held at amortised cost**			Company
	Trading	**Derivatives held for hedging**	**Designated at fair value through P&L**	**Available-for-sale**	**Loans and receivables**	**Financial liabilities at amortised cost**	**Non-financial assets / liabilities**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Liabilities								
Deposits by banks	-	-	-	-	-	**116,414**	-	**116,414**
Deposits by customers	-	-	-	-	-	**159,187**	-	**159,187**
Derivative financial liabilities	**3,001**	**352**	-	-	-	-	-	**3,353**
Other borrowed funds	-	-	-	-	-	**539**	-	**539**
Subordinated liabilities	-	-	-	-	-	**5,580**	-	**5,580**
Other liabilities	-	-	-	-	-	**1,611**	-	**1,611**
Provisions	-	-	-	-	-	-	**74**	**74**
Current tax liabilities	-	-	-	-	-	-	**92**	**92**
Retirement benefit obligations	-	-	-	-	-	-	**922**	**922**
	3,001	**352**	-	-	-	**283,331**	**1,088**	**287,772**

31 December 2008	Held at fair value				Held at amortised cost			Group
	Trading	Derivatives held for hedging	Designated at fair value through P&L	Available-for-sale	Loans and receivables	Financial liabilities at amortised cost	Non-financial assets / liabilities	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Cash & balances at central banks	-	-	-	-	4,017	-	-	4,017
Trading assets	26,264	-	-	-	-	-	-	26,264
Derivative financial instruments	31,713	3,412	-	-	-	-	-	35,125
Financial assets designated at FV	-	-	11,377	-	-	-	-	11,377
Loans and advances to banks	-	-	-	-	16,001	-	-	16,001
Loans and advances to customers	-	-	-	-	180,176	-	-	180,176
Available-for-sale securities	-	-	-	2,663		-	-	2,663
Loans and receivables securities	-	-	-	-	14,107	-	-	14,107
Macro hedge of interest rate risk	-	-	-	-	2,188	-	-	2,188
Investment in associates	-	-	-	-	-	-	35	35
Intangible assets	-	-	-	-	-	-	1,347	1,347
Property, plant and equipment	-	-	-	-	-	-	854	854
Operating lease assets	-	-	-	-	-	-	348	348
Current tax assets	-	-	-	-	-	-	212	212
Deferred tax assets	-	-	-	-	-	-	1,274	1,274
Other assets	-	-	-	-	1,200	-	122	1,322
	57,977	3,412	11,377	2,663	217,689	-	4,192	297,310
Liabilities								
Deposits by banks	-	-	-	-	-	14,488	-	14,488
Deposits by customers	-	-	-	-	-	130,245	-	130,245
Derivative financial liabilities	25,420	2,390	-	-	-	-	-	27,810
Trading liabilities	40,738	-	-	-	-	-	-	40,738
Financial liabilities at FVTPL	-	-	5,673	-	-	-	-	5,673
Debt securities in issue	-	-	-	-	-	58,511	-	58,511
Other borrowed funds	-	-	-	-	-	2,076	-	2,076
Subordinated liabilities	-	-	-	-	-	6,787	-	6,787
Other liabilities	-	-	-	-	-	2,303	39	2,342
Provisions	-	-	-	-	-	-	207	207
Current tax liabilities	-	-	-	-	-	-	518	518
Deferred tax liabilities	-	-	-	-	-	-	405	405
Retirement benefit obligations	-	-	-	-	-	-	813	813
	66,158	2,390	5,673	-	-	214,410	1,982	290,613

Notes to the Financial Statements continued

31 December 2008	Held at fair value: Trading	Held at fair value: Derivatives held for hedging	Held at fair value: Designated at fair value through P&L	Held at fair value: Available-for-sale	Held at amortised cost: Loans and receivables	Held at amortised cost: Financial liabilities at amortised cost	Non-financial assets / liabilities	Company Total
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Cash & balances at central banks	-	-	-	-	2,456	-	-	2,456
Derivative financial instruments	2,112	623	-	-	-	-	-	2,735
Financial assets designated at FV	-	-	47,525	-	-	-	-	47,525
Loans and advances to banks	-	-	-	-	116,486	-	-	116,486
Loans and advances to cust.s	-	-	-	-	123,319	-	-	123,319
Available-for-sale securities	-	-	-	25	-	-	-	25
Investment in associates	-	-	-	-	-	-	741	741
Investment in subsidiaries	-	-	-	-	-	-	5,147	5,147
Intangible assets	-	-	-	-	-	-	484	484
Property, plant and equipment	-	-	-	-	-	-	569	569
Current tax assets	-	-	-	-	-	-	194	194
Deferred tax assets	-	-	-	-	-	-	458	458
Other assets	-	-	-	-	940	-	47	987
	2,112	623	47,525	25	243,201	-	7,640	301,126
Liabilities								
Deposits by banks	-	-	-	-	-	124,846	-	124,846
Deposits by customers	-	-	-	-	-	155,466	-	155,466
Derivative financial liabilities	3,672	1,721	-	-	-	-	-	5,393
Trading liabilities	739	-	-	-	-	-	-	739
Other borrowed funds	-	-	-	-	-	905	-	905
Subordinated liabilities	-	-	-	-	-	7,030	-	7,030
Other liabilities	-	-	-	-	-	1,283	-	1,283
Provisions	-	-	-	-	-	-	99	99
Current tax liabilities	-	-	-	-	-	-	128	128
Deferred tax liabilities	-	-	-	-	-	-	6	6
Retirement benefit obligations	-	-	-	-	-	-	797	797
	4,411	1,721	-	-	-	289,530	1,030	296,692

The following tables analyse the fair value of financial instruments not measured at fair value in the balance sheet:

2009	Carrying value £m	Fair value £m	Group Surplus/(deficit) £m
Assets			
Cash and balances at central banks	**4,163**	**4,163**	**-**
Loans and advances to banks	**9,151**	**9,151**	**-**
Loans and advances to customers	**186,804**	**192,164**	**5,360**
Loans and receivables securities	**9,898**	**9,447**	**(451)**
Liabilities			
Deposits by banks	**5,811**	**5,811**	**-**
Deposits by customers	**143,893**	**144,608**	**(715)**
Debt securities in issue	**47,758**	**47,483**	**275**
Other borrowed funds	**1,352**	**1,729**	**(377)**
Subordinated liabilities	**5,597**	**6,173**	**(576)**

2009	Carrying value £m	Fair value £m	Company Surplus/(deficit) £m
Assets			
Cash and balances at central banks	**3,266**	**3,266**	**-**
Loans and advances to banks	**109,658**	**111,131**	**1,473**
Loans and advances to customers	**131,749**	**136,518**	**4,769**
Liabilities			
Deposits by banks	**116,414**	**119,341**	**(2,927)**
Deposits by customers	**159,187**	**159,814**	**(627)**
Other borrowed funds	**539**	**565**	**(26)**
Subordinated liabilities	**5,580**	**6,494**	**(914)**

Notes to the Financial Statements continued

2008	Carrying value £m	Fair value £m	Group Surplus/(deficit) £m
Assets			
Cash and balances at central banks	4,017	4,017	-
Loans and advances to banks	16,001	16,202	201
Loans and advances to customers	180,176	186,233	6,057
Loans and receivables securities	14,107	13,010	(1,097)
Liabilities			
Deposits by banks	14,488	14,473	15
Deposits by customers	130,245	130,818	(573)
Debt securities in issue	58,511	57,530	981
Other borrowed funds	2,076	926	1,150
Subordinated liabilities	6,787	5,137	1,650

2008	Carrying value £m	Fair value £m	Company Surplus/(deficit) £m
Assets			
Cash and balances at central banks	2,456	2,456	-
Loans and advances to banks	116,411	116,777	366
Loans and advances to customers	123,319	128,148	4,829
Liabilities			
Deposits by banks	124,846	126,612	(1,766)
Deposits by customers	155,466	156,016	(550)
Other borrowed funds	905	485	420
Subordinated liabilities	7,030	4,708	2,322

The surplus/(deficit) in the table above represents the surplus/(deficit) of fair value compared to the carrying amount of those financial instruments for which fair values have been estimated. The carrying value above of any financial assets and liabilities that are designated as hedged items in a portfolio (or macro) fair value hedge relationship excludes gains and losses attributable to the hedged risk, as this is presented as a single separate line item on the balance sheet.

Fair value measurement

The fair value of financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. If a quoted market price is available for an instrument, the fair value is calculated based on the market price. Where quoted market prices are not available, fair value is determined using pricing models which use a mathematical methodology based on accepted financial theories, depending on the product type and its components. Further information on fair value measurement can be found in the Group's Accounting Policies from pages 109 to 123 and the Valuation techniques section below on page 179 to the Consolidated Financial Statements.

Fair value management

The fair value exposures, as tabled above, are managed by using a combination of hedging derivatives and offsetting on balance sheet positions. The approach to specific categories of financial instruments is described below.

Assets:

Cash and balances at central banks

The carrying amount of cash and balances at central banks is deemed a reasonable approximation of the fair value.

Loans and advances to banks

The fair value of loans and advances to banks has been estimated using the same valuation technique for financial instruments accounted for at fair value as described in the Valuation techniques section below on page 179 to the Consolidated Financial Statements.

Loans and advances to customers

Loans and advances to personal customers are made both at variable and at fixed rates. As there is no active secondary market in the UK for such loans and advances, there is no reliable market value available for such a significant portfolio.

a) Variable rate

The Directors believe that the carrying value of the variable rate loans may be assumed to be their fair value.

b) Fixed rate

Certain of the loans secured on residential properties are at a fixed rate for a limited period, typically two to five years from their commencement. At the end of this period these loans revert to the relevant variable rate. The excess of fair value over carrying value of each of these loans has been estimated by reference to the market rates available at the balance sheet date for similar loans of maturity equal to the remaining fixed period.

Loan and receivable securities
These debt securities are valued with the assistance of valuations prepared by an independent, specialist valuation firm.

Liabilities:
Deposits by banks
The carrying amount is deemed a reasonable approximation of the fair value, because they are short term in nature.

Deposits by customers
The majority of deposit liabilities are payable on demand and therefore can be deemed short term in nature with the fair value equal to the carrying value. However, given the long-term and continuing nature of the relationships with the Group's customers, the Directors believe there is significant value to the Group in this source of funds. Certain of the deposit liabilities are at a fixed rate until maturity. The deficit of fair value over carrying value of these liabilities has been estimated by reference to the market rates available at the balance sheet date for similar deposit liabilities of similar maturities.
The fair value of such deposits liabilities has been estimated using the same valuation technique for financial instruments accounted for at fair value as described in the Valuation techniques section below on page 179 to the Consolidated Financial Statements.

Debt securities in issue and subordinated liabilities
Where reliable prices are available, the fair value of debt securities in issue and subordinated liabilities has been calculated using quoted market prices. Other market values have been determined using the same valuation technique for financial instruments accounted for at fair value as described in the Valuation techniques section below on page 179 to the Consolidated Financial Statements.

Intra Group balances
Included in the asset and liability categories on the Company balance sheet are outstanding intra group balances. The fair value of these balances has been determined using the same valuation technique for financial instruments accounted for at fair value as described in the Valuation techniques section below on page 179 to the Consolidated Financial Statements.

Fair value valuation bases
The following tables summarise the fair values at 31 December 2009 and 2008 of the financial asset and liability classes accounted for at fair value, analysed by the valuation methodology used by the Group to determine their fair value. The tables also disclose the percentages that the recorded fair values of financial assets and liabilities represent of the total assets and liabilities, respectively, that are recorded at fair value in the balance sheet:

At 31 December 2009

Balance sheet category		Quoted prices in active markets		Internal models based on: Market observable data		Internal models based on: Significant unobservable data		Total		Valuation technique
		£m	%	£m	%	£m	%	£m	%	
Assets										
Trading assets	Loans and advances to banks	-	-	5,252	8	-	-	5,252	8	A
	Loans and advances to customers	-	-	10,628	15	-	-	10,628	15	A
	Debt securities	15,932	23	-	-	-	-	15,932	23	-
	Equity securities	1,471	2	-	-	7	-	1,478	2	B
Derivative assets	Exchange rate contracts	-	-	4,088	6	37	-	4,125	6	A
	Interest rate contracts	4	-	17,223	25	-	-	17,227	25	A & C
	Equity & credit contracts	258	-	1,060	2	157	-	1,475	2	B
Financial assets at FVTPL	Loans and advances to customers	-	-	6,116	9	263	-	6,379	9	A
	Debt securities	-	-	4,498	7	1,481	2	5,979	9	A
Available-for-sale financial assets	Debt securities	747	1	-	-	-	-	747	1	-
	Equity securities	20	-	30	-	-	-	50	-	B
Total assets at fair value		18,432	26	48,895	72	1,945	2	69,272	100	
Liabilities										
Trading liabilities	Deposits by banks	-	-	40,824	59	-	-	40,824	59	A
	Deposits by customers	-	-	4,115	6	-	-	4,115	6	A
	Short positions	1,071	2	-	-	-	-	1,071	2	-
	Debt securities in issue	-	-	142	-	-	-	142	-	A
Derivative liabilities	Exchange rate contracts	-	-	521	1	-	-	521	1	A
	Interest rate contracts	-	-	16,208	23	-	-	16,208	23	A & C
	Equity & credit contracts	29	-	1,945	3	260	-	2,234	3	B
Financial liabilities at FVTPL	Deposits by banks	-	-	45	-	-	-	45	-	A
	Deposits by customers	-	-	12	-	-	-	12	-	A
	Debt securities in issue	-	-	4,257	6	109	-	4,366	6	A
Total liabilities at fair value		1,100	2	68,069	98	369	-	69,538	100	

Notes to the Financial Statements continued

At 31 December 2008[1]

Balance sheet category		Quoted prices in active markets		Internal models based on Market observable data		Internal models based on Significant unobservable data		Total		Valuation technique
		£m	%	£m	%	£m	%	£m	%	
Assets										
Trading assets	Loans and advances to banks	-	-	4,947	7	-	-	4,947	7	A
	Loans and advances to customers	-	-	1,310	2	-	-	1,310	2	A
	Debt securities	16,801	23	-	-	-	-	16,801	23	-
	Equity securities	671	1	-	-	37	-	708	1	B
Derivative assets	Exchange rate contracts	-	-	10,788	15	5	-	10,793	15	A
	Interest rate contracts	232	-	21,549	29	-	-	21,781	29	A & C
	Equity & credit contracts	843	1	1,559	2	149	-	2,551	3	B
Financial assets at FVTPL	Loans and advances to customers	-	-	6,405	9	282	-	6,687	9	A
	Debt securities	-	-	343	-	4,347	7	4,690	7	A
Available-for-sale financial assets	Debt securities	2,618	4	-	-	-	-	2,618	4	-
	Equity securities	10	-	35	-	-	-	45	-	B
Total assets at fair value		21,175	29	46,936	64	4,820	7	72,931	100	
Liabilities										
Trading liabilities	Deposits by banks	-	-	34,341	47	-	-	34,341	47	A
	Deposits by customers	-	-	4,622	6	-	-	4,622	6	A
	Short positions	751	1	-	-	-	-	751	1	-
	Debt securities in issue	-	-	1,024	1	-	-	1,024	1	A
Derivative liabilities	Exchange rate contracts	-	-	1,680	2	-	-	1,680	2	A
	Interest rate contracts	-	-	21,489	30	-	-	21,489	30	A & C
	Equity & credit contracts	803	1	3,669	5	169	-	4,641	6	B
Financial liabilities at FVTPL	Deposits by banks	-	-	153	-	-	-	153	-	A
	Deposits by customers	-	-	252	-	-	-	252	-	A
	Debt securities in issue	-	-	5,021	7	247	-	5,268	7	A
Total liabilities at fair value		1,554	2	72,251	98	416	-	74,221	100	

(1) Amended for the transfer of Alliance & Leicester plc to the Company as described in Note 47.

The following tables presents the fair values at 31 December 2009 and 2008 of the above financial assets and liabilities by product, analysed by the valuation methodology used by the Group to determine their fair value. The tables also disclose the percentages that the recorded fair values of products represent of the total assets and liabilities, respectively, that are recorded at fair value in the balance sheet:

At 31 December 2009

Product	Quoted prices in active markets		Internal models based on Market observable data		Internal models based on Significant unobservable data		Total	
	£m	%	£m	%	£m	%	£m	%
Assets								
Government and government-guaranteed debt securities	3,061	5	-	-	-	-	3,061	5
Asset-backed securities	-	-	4,498	7	1,481	2	5,979	9
Floating rate notes	11,128	16	-	-	-	-	11,128	16
Other debt securities	2,490	4	-	-	263	-	2,753	4
UK Social housing association loans	-	-	6,116	9	-	-	6,116	9
Term deposits and money market instruments	-	-	15,881	23	-	-	15,881	23
Exchange rate derivatives	-	-	4,088	6	37	-	4,125	6
Interest rate derivatives	4	-	17,223	25	-	-	17,227	25
Equity & credit derivatives	258	-	1,060	1	157	-	1,475	1
Ordinary shares and similar securities	1,491	2	30	-	7	-	1,528	2
	18,432	27	48,896	71	1,945	2	69,273	100
Liabilities								
Exchange rate derivatives	-	-	521	1	-	-	521	1
Interest rate derivatives	-	-	16,208	23	-	-	16,208	23
Equity & credit derivatives	29	-	1,945	3	260	-	2,234	3
Ordinary shares and similar securities	-	-	-	-	-	-	-	-
Deposits and debt securities in issue	1,071	2	49,395	71	-	-	50,466	73
Debt securities in issue	-	-	-	-	109	-	109	-
	1,100	2	68,069	98	369	-	69,538	100

At 31 December 2008[(1)]

Product	Quoted prices in active markets		Internal models based on Market observable data		Internal models based on Significant unobservable data		Total	
	£m	%	£m	%	£m	%	£m	%
Assets								
Government and government-guaranteed debt securities	9,804	14	-	-	-	-	9,804	14
Asset-backed securities	-	-	343	-	4,347	6	4,690	6
Floating rate notes	5,101	7	-	-	-	-	5,101	7
Other debt securities	4,514	7	-	-	282	-	4,796	7
UK Social housing association loans	-	-	6,405	8	-	-	6,405	8
Term deposits and money market instruments	-	-	6,257	9	-	-	6,257	9
Exchange rate derivatives	-	-	10,788	15	5	-	10,793	15
Interest rate derivatives	232	-	21,549	30	-	-	21,781	30
Equity & credit derivatives	843	1	1,559	2	149	-	2,551	3
Ordinary shares and similar securities	681	1	35	-	37	-	753	1
	21,175	30	46,936	64	4,820	6	72,931	100
Liabilities								
Exchange rate derivatives	-	-	1,680	3	-	-	1,680	3
Interest rate derivatives	-	-	21,489	29	-	-	21,489	29
Equity & credit derivatives	803	1	3,669	5	169	-	4,641	6
Ordinary shares and similar securities	751	1	-	-	-	-	751	1
Deposits and debt securities in issue	-	-	45,413	61	247	-	45,660	61
Debt securities in issue	-	-	-	-	-	-	-	-
	1,554	2	72,251	98	416	-	74,221	100

(1) Amended for the transfer of Alliance & Leicester plc to the Company as described in Note 47

Valuation techniques

The main valuation techniques employed in the Group's internal models to measure the fair value of the financial instruments disclosed above at 31 December 2009 and 2008 are set out below. In substantially all cases, the principal inputs into these models are derived from observable market data. The Group did not make any material changes to the valuation techniques and internal models it used during the years ended 31 December 2009, 2008 and 2007, except for the technique applied in 2009 to the holdings of Portuguese mortgage-backed securities classified as FVTPL – Debt securities, described on page 182 for Instrument 7.

A In the valuation of financial instruments requiring static hedging (for example interest rate and currency derivatives) and in the valuation of loans and advances and deposits, the 'present value' method is used. Expected future cash flows are discounted using the interest rate curves of the applicable currencies. The interest rate curves are generally observable market data and reference yield curves derived from quoted interest rates in appropriate time bandings, which match the timings of the cashflows and maturities of the instruments.

B In the valuation of equity financial instruments requiring dynamic hedging (principally equity securities, options and other structured instruments), proprietary stochastic volatility models are used. These types of models are widely accepted in the financial services industry. Observable market inputs are used in these models to generate variables such as the bid-offer spread, foreign currency exchange rates, credit risk, volatility, correlation between indices and market liquidity as appropriate. In limited circumstances, other inputs may be used in these models that are based on data other than observable market data, such as the Halifax's UK House Price Index ('HPI') volatility, HPI forward growth, HPI spot rate, and mortality.

C In the valuation of financial instruments exposed to interest rate risk that require either static or dynamic hedging (such as interest rate futures, caps and floors, and options), the present value method (futures), Black's model (caps/floors) and the Hull/White and Markov functional models (Bermudan options) are used. These types of models are widely accepted in the financial services industry. The significant inputs used in these models are observable market data, including appropriate interest rate curves, volatilities, correlations and exchange rates. In limited circumstances, other inputs may be used in these models that are based on data other than observable market data, such as the Halifax's UK House Price Index ('HPI') volatility, HPI forward growth, HPI spot rate, mortality, and the specific credit spread for that instrument.

In determining fair value, the Group also considers the credit risk of its counterparties, as well as its own creditworthiness, on all over-the-counter (OTC) derivatives in the trading book. The Group attempts to mitigate credit risk to third parties by entering into netting and collateral arrangements. Net counterparty exposure (counterparty positions netted by offsetting transactions and both cash and securities collateral) is then valued for counterparty creditworthiness and this resultant value is incorporated into the fair value of the respective instruments.

The credit risk adjustment is measured as a lifetime expected loss for each counterparty based on the probability of default the loss given default and the expected exposure of the OTC derivative position with the counterparty.

The probability of default is calculated at the counterparty level through the use of internal rating models. The loss given default ("LGD") is calculated at the facility level and takes into account the counterparty characteristics as well as the instrument traded. Credit ratings and LGD are updated by the credit team as new relevant information becomes available and at periodic reviews performed at least annually.

The expected exposure is calculated on a portfolio level and is based on the underlying risks of the portfolio. The main drivers of the expected exposure are the size of the risk position with the counterparty along with the prevailing market environment. The total credit risk adjustment on the Group's counterparties was £7m (2008: £6m).

Notes to the Financial Statements continued

Residential property derivative contracts, where the underlying is a specific property, are referenced to regional property indices for valuation. The indexing of the contracts is appropriate due to the number and wide geographical dispersion of the portfolio. In these circumstances, an adjustment to fair value is made to take account of specific risk against the index. Illiquid commercial property assets are written down with reference to actual and anticipated declines in the commercial property index to reflect a realistic estimate of realisable value.

Broker quotes and external consensus market data are used for validating the fair values of some items in the trading portfolio, or designated at fair value through profit or loss. All derivatives pricing models are validated independently by the Quantitative Risk Group ('QRG'). A validation report is produced for each model-derived payment that assesses the mathematical assumptions behind the model and the implementation of the model and its integration within the trading system. Where there is observable market data the models calibrate to market. Where pricing data is unobservable then the input parameters are regularly reviewed by QRG. The source of pricing data is considered as part of the process that determines the classification of the level of a financial instrument.

The Group also considers its own creditworthiness when determining the fair value of an instrument, including over-the-counter ('OTC') derivative instruments and financial liabilities held at fair value through profit or loss if the Group believes market participants would take that into account when transacting the respective instrument. The approach to measuring the impact of the Group's credit risk on an instrument is done in the same manner as for third party credit risk. The impact of the Group's credit risk is considered when calculating the fair value of an instrument, even when credit risk is not readily observable such as in OTC derivatives contracts. The Group has not realised any profit or loss on revaluing fair values of derivatives to reflect its own creditworthiness. If the Group had reflected such adjustments it would not have had a material impact on the valuations.
The fair values of the financial instruments arising from the Group's internal models take into account, among other things, contract terms and observable market data, which include such factors as bid-offer spread, interest rates, credit risk, exchange rates, the quoted market price of raw materials and equity securities, volatility and prepayments. The main assumptions taken into account when internal models use information other than market data can be found in the table below. In all cases, when it is not possible to derive a valuation for a particular feature of an instrument, management uses judgement to determine the fair value of the particular feature. In exercising this judgement, a variety of tools are used including proxy observable data, historical data and extrapolation techniques. Extrapolation techniques take into account behavioural characteristics of equity markets that have been observed over time, and for which there is a strong case to support an expectation of a continuing trend in the future. Estimates are calibrated to observable market prices when they become available.

The estimates thus obtained could vary if other valuation methods or assumptions were used. The Group believes its valuation methods are appropriate and consistent with other market participants. Nevertheless, the use of different valuation methods or assumptions, including imprecision in estimating unobservable market inputs, to determine the fair value of certain financial instruments could result in different estimates of fair value at the reporting date and the amount of gain or loss recorded for a particular instrument. Most of the valuation models are not significantly subjective, because they can be tested and, if necessary, recalibrated by the internal calculation of and subsequent comparison to market prices of actively traded securities, where available.

Internal models based on observable market data

During 2008 and 2009, there were no transfers between Level 1 and Level 2 financial instruments.

Internal models based on information other than market data

The table below provides an analysis of financial instruments valued using internal models based on information other than market data together with the subsequent valuation technique used for each type of instrument. Each instrument is initially valued at transaction price:

			Balance sheet value		Amount recognised in income/(expense)		
Balance sheet line item	Category	Financial instrument product type	2009 £m	2008[1] £m	2009 £m	2008 £m	2007 £m
1. Trading assets	Equity securities	Property unit trusts	**7**	37	**(1)**	16	-
2. Derivative assets	Exchange rate contracts	Cross-currency swaps	**37**	5	**14**	5	4
3. Derivative assets	Equity and credit contracts	Reversionary property interests	**73**	77	**(4)**	3	17
4. Derivative assets	Equity contracts	Options and forwards	**84**	72	**(5)**	91	11
5. FVTPL	Loans and advances to customers	Roll-up mortgage portfolio	**262**	282	**(36)**	58	12
6. FVTPL	Debt securities	Reversionary property securities	**263**	265	**(4)**	1	33
7. FVTPL	Debt securities	Portuguese mortgage-backed securities	**-**	2,474	**-**	(144)	(62)
		Other asset-backed securities	**1,169**	1,608	**62**	(184)	(10)
8. FVTPL	Debt securities	Collateralised synthetic obligations (CSOs)	**50**	-	**-**	-	-
9. Derivative liabilities	Equity contracts	Options and forwards	**(260)**	(169)	**(82)**	(94)	(14)
10. FVTPL	Debt securities in issue	Non-vanilla debt securities	**(109)**	(247)	**(23)**	(5)	(4)
Total net assets			**1,576**	4,404	**-**	-	-
Total income/(expense)			**-**	-	**(79)**	(253)	(13)

(1) Amended for the transfer of Alliance & Leicester plc to the Company as described in Note 47.

Notes to the Financial Statements continued

Valuation technique

1. Trading assets - Equity securities
These unit trusts are valued using Net Asset Values, which are regular third party asset valuations, with an adjustment for the estimated discount to asset value inherent in current similar market prices, reflecting the specific asset characteristics and degree of leverage in each unit trust.

2. Derivative assets - Exchange rate contracts
These derivatives are valued using a valuation model with interest rates, foreign exchange rates and long-dated foreign exchange volatility as inputs to derive valuations. Long-dated foreign exchange volatility is extrapolated from the shorter-dated foreign exchange volatilities which are directly observable in the market.

3. Derivative assets - Equity and credit contracts
These reversionary property derivatives are valued using a probability weighted set of the Halifax's UK House Price Index ('HPI') forward prices. These are determined using HPI Spot Rates adjusted to reflect estimated forward growth. Launched in 1984, the Halifax House Price Index is based on the lending of the UK's largest mortgage lender and provides the longest unbroken monthly data series of any UK housing index. The indices calculated are standardised and represent the price of a typically transacted house. Regional and national HPI indices are published, which are similar except that the former reflects the national HPI indices disaggregated into 12 UK regions and is published quarterly. The national indices are published monthly.
The inputs used to determine the value of the reversionary property derivatives are HPI spot, HPI forward growth and mortality rates. The principal pricing parameter is HPI forward growth.

HPI Spot Rate
The regional HPI spot rate (which is observable market data) is only published on specific quarterly dates. In between these dates, its value is estimated by applying the changes in the national HPI spot rate (which is also observable market data and published monthly) to the most recently available regional HPI spot rate. An adjustment is made to reflect the specific property risk i.e. the difference in the actual regional composition of the property underlying the Group's reversionary interest portfolio and the composition of the published regional indices. This adjustment is based on the average historical deviation of price changes of the Group's actual property portfolio from that of the published indices.

HPI Forward Growth Rate
Long-dated HPI forward growth rate is not directly observable in the market but is estimated from broker quotes and traded forward contracts. A specific spread is applied to the long-dated forward growth rate to reflect the uncertainty surrounding long-dated data. This spread is calculated by analysing the historical volatility of the HPI, whilst incorporating mean reversion. An adjustment is made to reflect the specific property risk as for the HPI spot rate above.

Mortality Rate
Mortality rates are obtained from the PNMA00 and PNFA00 Continuous Mortality Investigation Tables published by the UK Institute and Faculty of Actuaries. These mortality rates are adjusted by acceleration rates to reflect the mortality profile of the holders of Group's reversionary property products underlying the derivatives.

4. Derivative assets - Equity contracts
There are three types of derivatives within this category:
European derivatives (vanilla call and put options)
These derivatives are valued using a modified Black-Scholes model where the HPI index is log-normally distributed with the forward rates determined from the HPI forward growth.
Asian options
Asian (or average value) options are valued using a modified Black-Scholes model, with an amended strike price and volatility assumption to account for the average exercise period, through a closed form adjustment that reflects the strike price relative to the distribution of stock prices at each relevant date. This is also known as the Curran model.
Forward contracts
Forward contracts are valued using a standard forward pricing model.

The inputs used to determine the value of the above instruments are HPI spot rate, HPI forward growth rate and HPI volatility. The principal pricing parameter is HPI forward growth rate. Discussion of the HPI spot and HPI forward growth rates for these financial instruments is the same as for Instrument 3 above.

HPI Volatility
Long-dated HPI volatility is not directly observable in the market but is estimated from the most recent traded values. An adjustment is applied to the long-dated HPI volatility rate to reflect the uncertainty surrounding long-dated data. This adjustment is based on the empirical standard deviation of historical volatility over a range of time horizons.

Notes to the Financial Statements continued

5. FVTPL – Loans and advances to customers

Roll-up mortgages are an equity release scheme, where the property owner takes out a loan secured against their home. The loan is repaid upon the owner's vacation of the property. The value of the loan is only repaid from the value of the property. This is known as a "no negative pledge". The Group suffers a loss if the sale proceeds from the property are insufficient to repay loan. These roll-up mortgages are valued using a probability-weighted set of European option prices (puts) determined using the Black-Scholes model, where the put represents the values of the no negative pledges.

The inputs used to determine the value of these instruments are HPI spot, HPI forward growth, HPI volatility, mortality rates and repayment rates. The principal pricing parameter is HPI forward growth. Discussion of the HPI spot rate, HPI forward growth rate, and mortality rates for this financial instrument is the same as for Instrument 3 above. Discussion of the HPI volatility rate is the same as for Instrument 4 above.

Repayment rates

The costs to the Group arising from early repayment by customers (inherent specifically to this financial instrument) are estimated from prices of swaptions which reflect the costs associated with unwinding the swap hedges held by the Group against these roll-up mortgages in the event of early repayment. Early repayment most typically occurs following a fall in market interest rates. Prepayment rates were taken from the academic paper 'Pricing and Risk Capital in the Equity Release Market', presented to the Institute and Faculty of Actuaries in 2007.

6. FVTPL – Debt securities

Reversionary property securities are an equity release scheme, where the property owner receives an upfront lump sum in return for paying a fixed percentage of the sales proceeds of the property when the owner vacates the property. These reversionary property securities are valued using a probability-weighted set of HPI forward prices.

The inputs used to determine the value of these instruments are HPI spot, HPI forward growth and mortality rates. The principal pricing parameter is HPI forward growth. The valuation methodology for these securities is similar to Instrument 3 above.

7. FVTPL – Debt securities

There are three types of debt securities within this category:

Portuguese mortgage-backed securities

In December 2009, Euro 190m of the Group's holdings of these securities were purchased by the issuer. As a result, the Group's remaining positions in these securities have been transferred to Level 2. Prior to 2009, these securities were valued using a valuation model with reference to the most relevant generic curve (in this case, Portuguese residential mortgage-backed securities) from a consensus pricing service and an assumption with respect to the specific credit spread for that instrument as inputs to derive valuations.

Other asset-backed securities

These other asset-backed securities consist of residential mortgage backed securities, securities backed by small business and automotive loans and other collateralised debt obligations almost all of which are AAA rated, and issued by Santander entities. Each instrument was valued with reference to the price from a consensus pricing service. This is then corroborated against the price from another consensus pricing service due to the lack of depth in the number of available market quotes. An average price is used where there is a more than an insignificant difference between the two sources.

8. FVTPL – Debt securities

These debt securities are valued using valuations prepared by an independent, specialist valuation firm.

9. Derivative liabilities - Equity and credit contracts

These derivatives are the same as Instrument 4 with the exception that they have a negative fair value.

10. FVTPL - Debt securities in issue

These debt securities in issue are valued using a three-factor Gaussian Model. The three factors used in the valuation are domestic interest rates, foreign interest rates and foreign exchange rates. The correlations between the factors are assumed to be zero within the valuation.

The Hull-White approach is used for estimating the future distribution of domestic and foreign zero-coupon rates, constructed from the relevant yield curves. A Geometric Brownian Motion model is used for estimating the future distribution of spot foreign exchange rates. The foreign exchange and interest rate volatilities are the most crucial pricing parameters; the model calibrates to the relevant swaption volatility surface.

Unrecognised gains as a result of the use of valuation models using unobservable inputs ("Day One profits")

The table below shows the amount that has yet to be recognised in the income statement that relates to the difference between the transaction price (i.e. the fair value at initial recognition) and the amount that would have arisen had valuation models using unobservable inputs been used on initial recognition, less amounts subsequently recognised. This is calculated and reported on a portfolio basis:

	2009 £m	2008 £m	2007 £m
At 1 January	**55**	45	18
New transactions	**42**	12	27
Amounts recognised in profit or loss during the year	**(5)**	(2)	-
At 31 December	**92**	55	45

Internal valuation review

In all instances, risk control teams review positions to assess a realistic realisable value for the position and develop a methodology for any adjustment to fair value which marks the position to that value using information relevant to that asset. Consideration is given to the quality of the information available that provides the current mark-to-model valuation and estimates of how different these valuations could be on an actual trade, taking into consideration how active the market is. For spot assets that cannot be sold due to illiquidity, forward estimates are discounted to provide an estimate of a realisable value over time. All adjustments for illiquid positions are regularly reviewed to reflect changing market conditions.

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

The following table provides a reconciliation of the movement between opening and closing balances of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

	Assets				Liabilities		
	Trading Assets £m	Derivatives £m	Fair value through profit or loss £m	Total £m	Derivatives £m	Fair value through profit or loss £m	Total £m
At 1 January 2009	**37**	**154**	**4,629**	**4,820**	**(169)**	**(247)**	**(416)**
Total gains/(losses) recognised in profit/(loss):							
- Fair value movements	**(1)**	**5**	**22**	**26**	**(82)**	**(23)**	**(105)**
- Foreign exchange and other movements	**(3)**	**43**	**(106)**	**(66)**	**(18)**	**5**	**(13)**
Purchases/issues	**-**	**-**	**30**	**30**	**-**	**-**	**-**
Sales	**(26)**	**-**	**(121)**	**(147)**	**-**	**-**	**-**
Settlements	**-**	**(8)**	**(499)**	**(507)**	**9**	**156**	**165**
Transfers in	**-**	**-**	**50**	**50**	**-**	**-**	**-**
Transfers out	**-**	**-**	**(2,261)**	**(2,261)**	**-**	**-**	**-**
At 31 December 2009	**7**	**194**	**1,744**	**1,945**	**(260)**	**(109)**	**(369)**
Total gains/(losses) recognised in profit/(loss) relating to those assets and liabilities held at the end of the year	**(4)**	**48**	**(84)**	**(40)**	**(100)**	**(18)**	**(118)**

	Assets				Liabilities		
	Trading Assets £m	Derivatives £m	Fair value through profit or loss £m	Total £m	Derivatives £m	Fair value through profit or loss £m	Total £m
At 1 January 2008	-	118	4,515	4,633	(148)	(276)	(424)
Total gains/(losses) recognised in profit/(loss):							
- Fair value movements	16	99	(269)	(154)	(94)	(5)	(99)
- Foreign exchange and other movements	-	(88)	286	198	73	17	90
Purchases	21	49	139	209	-	-	-
Settlements	-	(24)	(42)	(66)	-	17	17
At 31 December 2008	37	154	4,629	4,820	(169)	(247)	(416)
Total gains/(losses) recognised in profit/(loss) relating to those assets and liabilities held at the end of the year	16	11	17	44	(21)	12	(9)

Financial instrument assets and liabilities at 31 December 2009

Financial instrument assets valued using internal models based on information other than market data were 2% (2008: 7%) of total assets measured at fair value and 0.7% (2008: 2%) of total assets at 31 December 2009.

Trading assets valued using internal models based on information other than market data decreased in 2009 principally due to assets being sold.

Derivatives valued using internal models based on information other than market data increased in 2009 principally due to gains reflecting changes in foreign exchange rates.

Assets designated at fair value through profit or loss valued using internal models based on information other than market data decreased in 2009 principally due to settlements and transfers to Level 2. During December 2009, euro 190m of the Group's holdings of AAA-rated prime mortgage-backed securities were sold to the issuer. As a result, the Group's remaining positions in these securities of £2,261m were transferred to Level 2. During 2009, there were acquisitions of £30m of financial instrument assets valued using internal models based on information other than market data.

Financial instrument liabilities valued using internal models based on information other than market data were 0.5% (2008: 0.6%) of total liabilities measured at fair value and 0.1% (2008: 0.1%) of total liabilities at 31 December 2009.

Derivative liabilities valued using internal models based on information other than market data increased in 2009 principally due to losses reflecting changes in credit spreads, the HPI index and foreign exchange rates.

Liabilities designated at fair value through profit or loss valued using internal models based on information other than market data decreased in 2009 principally due to maturities of debt securities in issue.

Notes to the Financial Statements continued

Financial instrument assets and liabilities at 31 December 2008

Financial instrument assets valued using internal models based on information other than market data were 7% (2007: 6%) of total assets measured at fair value and 2% (2007: 2%) of total assets at 31 December 2008.

Financial instrument assets valued using internal models based on information other than market data increased in 2008 principally due to exchange rate movements on euro-denominated investments. During 2008, there were no sales of financial instrument assets valued using internal models based on information other than market data.

Financial instrument liabilities valued using internal models based on information other than market data were 0.6% (2007: 1%) of total liabilities measured at fair value and 0.1% (2007: 0.2%) of total liabilities at 31 December 2008.

Liabilities designated at fair value through profit or loss valued using internal models based on information other than market data decreased in 2008 principally due to maturities of debt securities in issue and changes in foreign exchange rates.

Gains and losses for the year ended 31 December 2009

Losses of £4m in respect of trading assets valued using internal models based on information other than market data principally reflected the lack of market liquidity during the year.

Gains of £48m in respect of derivatives assets valued using internal models based on information other than market data principally reflected movements in foreign exchange rates.

Losses of £84m in respect of assets designated at fair value through profit or loss valued using internal models based on information other than market data principally reflected changes in foreign exchange rates partly offset by an increase in the value of the prime securities due to tightening of credit spreads of asset-backed and mortgage-backed securities.

Losses of £100m in respect of derivatives liabilities valued using internal models based on information other than market data principally reflected changes in credit spreads, the HPI index and foreign exchange rates.

Losses of £18m in respect of liabilities designated at fair value through profit or loss valued using internal models based on information other than market data principally reflected changes in foreign exchange and interest rates. They are fully matched with derivatives.

Gains and losses on assets and liabilities classified as held for trading are presented in the income statement under "Net trading and other income". Fair value changes on long-term debt designated at fair value and related derivatives are presented in the income statement under 'Changes in fair value of long-term debt issued and related derivatives'. The income statement line item 'Net income/(expense) from other financial instruments designated at fair value' captures fair value movements on all other financial instruments designated at fair value and related derivatives.

Gains and losses for the year ended 31 December 2008

The value of the prime securities classified as FVTPL - Debt securities (Instrument 7) decreased due to an increase in credit spreads reflecting a general lack of demand for asset-backed and mortgage-backed securities, exacerbated by the collapse of wholesale funding activity which led to a significant decline in wider asset demand. The Group believes that the fair values of these instruments have diverged materially from the amounts it currently anticipates realising on maturity, because the mortgages underlying these securities continue to perform adequately.

The values of the HPI-related loans and advances to customers, debt securities and associated derivatives declined due to a further lack of market liquidity.

The terms of the instruments presented as FVTPL - debt securities in issue (instrument 9) and related exchange rate derivatives (instrument 2) are fully matched. The movement in these financial instruments reflects changes in foreign exchange rates and interest rates.

The Group risk manages the unit trusts using derivative positions valued using quoted prices in active markets, or internal models based on observable market data. The effects of these risk management activities are not reflected in the gains and losses included in the table above.

Gains and losses for the year ended 31 December 2007

The value of the prime securities classified as FVTPL - Debt securities (Instrument 7) decreased due to an increase in credit spreads reflecting reduced demand for asset-backed and mortgage-backed securities.

The values of the HPI-related loans and advances to customers, debt securities and associated derivatives increased/(decreased) due to a lack of market liquidity.

The terms of the instruments presented as FVTPL - debt securities in issue (instrument 9) and related exchange rate derivatives (instrument 2) are fully matched. The movement in these financial instruments reflects changes in foreign exchange rates and interest rates.

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

As discussed above, the fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data and, as such require the application of a degree of judgement. Changing one or more of the inputs to the valuation models to reasonably possible alternative assumptions would change the fair values significantly. The following table shows the sensitivity of these fair values to reasonably possible alternative assumptions.

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable input as described in the table below. The potential effects do not take into effect any offsetting or hedged positions.

At 31 December 2009

Balance sheet note line item and product	Fair value £m	Assumptions	Shift	Reflected in income statement: Favourable changes £m	Unfavourable changes £m
1. Trading assets – Equity securities: – Property unit trusts	**7**	Estimated discount to asset value	**10%**	1	(1)
3. Derivative assets – Equity and credit contracts: – Reversionary property derivatives	**73**	HPI Forward growth rate	**1%**	11	(11)
		HPI Spot rate	**10%**	8	(8)
		Mortality rate	**2 yrs**	1	(1)
4. Derivative assets – Equity and credit contracts: – Options and forwards	**84**	HPI Forward growth rate	**1%**	3	(3)
		HPI Spot rate	**10%**	3	(2)
		HPI Volatility	**1%**	1	(1)
5. FVTPL – Loans and advances to customers: – Roll-up mortgage portfolio	**263**	HPI Forward growth rate	**1%**	28	(28)
		HPI Spot rate	**10%**	9	(11)
		HPI Volatility	**1%**	5	(5)
		Mortality rate	**2 yrs**	7	(6)
6. FVTPL – Debt securities: – Reversionary property securities	**263**	HPI Forward growth rate	**1%**	24	(24)
		HPI Spot rate	**10%**	27	(27)
		Mortality rate	**2 yrs**	5	(5)
7. FVTPL – Debt securities: – Other asset-backed securities	**1,169**	Credit spread	**75 bps**	15	(15)
9. Derivative liabilities - Equity and credit contracts: – Options and forwards	**(260)**	HPI Forward growth rate	**1%**	14	(14)
		HPI Spot rate	**10%**	32	(37)
		HPI Volatility	**1%**	2	(2)

No sensitivities are presented for the FVTPL - debt securities in issue (instrument 10) per page 182 and related exchange rate derivatives (instrument 2) per page 181, as the terms of these instruments are fully matched. As a result, any changes in the valuation of the debt securities in issue would be exactly offset by an equal and opposite change in the valuation of the exchange rate derivatives. In addition, no sensitivities are presented for the FVTPL – debt securities (instrument 8) as they have been valued by an independent, specialist valuation firm.

50. Capital management and resources

This note reflects the transactions and amounts reported on a basis consistent with the Group's regulatory filings, and therefore has not been amended to reflect the application of group reconstruction relief to account for the transfer of Alliance & Leicester plc to the Company as reflected elsewhere in the financial statements.

Capital management and capital allocation

The Board is responsible for capital management strategy and policy and ensuring that capital resources are appropriately monitored and controlled within regulatory and internal limits. Authority for capital management flows to the Chief Executive and from him to specific individuals who are members of the Group's Asset and Liability Management Committee ('ALCO').

ALCO adopts a centralised capital management approach that is driven by the Group's corporate purpose and strategy. This approach takes into account the regulatory and commercial environment in which the Group operates, the Group's risk appetite, the management strategy for each of the Group's material risks (including whether or not capital provides an appropriate risk mitigant) and the impact of appropriate adverse scenarios and stresses on the Group's capital requirements. This approach is reviewed annually as part of the Group's Internal Capital Adequacy Assessment Process ('ICAAP').

The Group manages its capital requirements, debt funding and liquidity on the basis of policies and plans reviewed regularly at ALCO and as part of the ICAAP process. To support its capital and senior debt issuance programmes, the Group is rated on a stand alone basis.

On an ongoing basis, and in accordance with the latest ICAAP review, the Group forecasts its regulatory and internal capital requirements based on the approved capital volumes allocated to business units as part of the corporate planning process and the need to have access to a capital buffer. Capital allocation decisions are made as part of planning based on the relative returns on capital using both economic and regulatory capital measures. Capital allocations are reviewed in response to changes in risk appetite and risk management strategy, changes to the commercial environment, changes in key economic indicators or when additional capital requests are received.

This combination of regulatory and economic capital ratios and limits, internal buffers and restrictions, together with the relevant costs of differing capital instruments and a consideration of the various other capital management techniques are used to shape the most cost-effective structure to fulfil the Group's capital needs.

Capital adequacy

From 1 January 2008, the Group has managed its capital on a Basel II basis. Throughout 2009, the Group held capital over and above its regulatory requirements, and managed internal capital allocations and targets in accordance with its capital and risk management policies.

Notes to the Financial Statements continued

Group Capital	31 December 2009 £m	31 December 2008 £m
Core Tier 1 capital	**6,520**	4,694
Deductions from Core Tier 1 capital	**(1,941)**	(792)
Total Core Tier 1 capital after deductions	**4,579**	3,902
Other Tier 1 capital	**1,859**	1,485
Total Tier 1 capital after deductions	**6,438**	5,387
Tier 2 capital	**5,832**	4,766
Deductions from Tier 2 capital	**(400)**	(284)
Total Tier 2 capital after deductions	**5,432**	4,482
Deductions from Tier 1 and Tier 2	**-**	(988)
Total Capital Resources	**11,870**	8,881

Tier 1 includes audited profits for the years ended 31 December 2009 and 31 December 2008 respectively after adjustment to comply with UK Financial Services Authority rules.

The Group and Banco Santander, S.A. recognise the additional security inherent in Tier 1 capital in the current commercial and regulatory environment. Consequently, on 12 October 2008, the Company issued ten billion ordinary shares of 10 pence each and these shares were issued at par to Banco Santander, S.A. on the same date.

These ordinary shares qualified as Tier 1 capital for the Group. This capital was, in turn, transferred to Alliance & Leicester plc in late December 2008 as planned. At 31 December 2008 Tier 1 includes the Tier 1 capital of Alliance & Leicester plc on a proportional consolidation basis.

On 9 January 2009, in order to optimise the capital, liquidity funding and overall financial efficiency of the enlarged Santander group, Banco Santander, S.A. transferred all of its Alliance & Leicester plc shares to the Company in exchange for 12,631,375,230 newly issued ordinary shares of the Company of £0.10 each.

Tier 1 deductions primarily relate to goodwill and expected losses. In addition, the Group has elected to deduct certain securitisation positions from capital rather than treat these exposures as a risk weighted asset.

The expected loss deduction represents the difference between expected loss calculated in accordance with the Group's IRB models, and the impairment provisions calculated in accordance with IFRS. Details of the Group's accounting policy for credit provisions are set out in the Accounting Policies Note on page 116. Expected losses are higher than the impairment provision as the expected loss amount includes all losses that are anticipated to arise over the twelve months following the balance sheet date, not just those incurred at the balance sheet date.

The increase in Tier 1 deductions primarily relate to additional goodwill following the transfer of Alliance & Leicester on 9 January 2009, and software capitalised during the year.

Increases in Tier 2 relate to interest rate and exchange rate fluctuations and the inclusion of the Tier 2 capital of Alliance & Leicester plc. Deductions from Tier 2 represent expected losses and securitisation positions described above.

At 31 December 2008, deductions from Tier 1 and Tier 2 represent lending which is capital in nature. This was repaid during 2009.

The overall changes in the fair value of assets and liabilities during 2008 did not have a significant impact on the capital position reported by the Group.

51. Consolidating financial information

Abbey National Treasury Services plc ('ANTS plc') is a wholly owned subsidiary of the Company and was able to offer and sell certain securities in the US from time to time pursuant to a registration statement on Form F-3 filed with the SEC (the 'Registration Statement'). The Registration Statement expired in December 2008. The possibility of filing a new registration statement is being kept under review. The Company has fully and unconditionally guaranteed the obligations of ANTS plc that have been, or will be incurred before 31 July 2012: this guarantee includes all securities issued by ANTS plc pursuant to the Registration Statement.

ANTS plc utilises an exception provided in Rule 3-10 of Regulation S-X, and therefore does not file its financial statements with the SEC. In accordance with the requirements to qualify for the exception, presented below is condensed consolidating financial information for (i) the Company on a stand-alone basis as guarantor; (ii) ANTS plc on a stand-alone basis; (iii) other subsidiaries of the Company on a combined basis ('Other'); (iv) consolidation adjustments ('Adjustments'); and (v) total consolidated amounts ('Consolidated').

Under IAS 27, the Company and ANTS plc account for investments in their subsidiaries at cost subject to impairment. Rule 3-10 of Regulation S-X requires a company to account for its investments in subsidiaries using the equity method, which would increase/(decrease) the results for the year of the Company and ANTS plc in the information below by £443m and £(178)m, respectively (2008: £517m and £127m, 2007: £334m and £218m).

The net assets of the Company and ANTS plc in the information below would also be increased by £584m and £316m, respectively (2008: £1,552m and £497m).

Notes to the Financial Statements continued

Income statements

For the year ended 31 December 2009	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
Net interest income	1,985	41	1,396	(10)	3,412
Fee, commission, net trading, and other income	963	721	138	(538)	1,284
Total operating income	**2,948**	**762**	**1,534**	**(548)**	**4,696**
Administration expenses	(1,136)	(144)	(547)	(21)	(1,848)
Depreciation and amortisation	(132)	(3)	(129)	4	(260)
Impairment and provisions	(645)	(30)	(650)	427	(898)
Profit/(loss) before tax	**1,035**	**585**	**208**	**(138)**	**1,690**
Taxation (charge)/credit	(288)	(29)	63	(191)	(445)
Profit/(loss) for the year	**747**	**556**	**271**	**(329)**	**1,245**

For the year ended 31 December 2008	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
Net interest income	1,185	198	391	(2)	1,772
Fee, commission, net trading, and other income	1,807	180	490	(1,245)	1,232
Total operating income	2,992	378	881	(1,247)	3,004
Administration expenses	(1,114)	(136)	(92)	(1)	(1,343)
Depreciation and amortisation	(81)	(3)	(118)	-	(202)
Impairment and provisions	(343)	(26)	27	(23)	(365)
Profit/(loss) before tax	1,454	213	698	(1,271)	1,094
Taxation charge	(126)	(10)	(204)	65	(275)
Profit/(loss) for the year	1,328	203	494	(1,206)	819

For the year ended 31 December 2007	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
Net interest income	1,101	241	162	(5)	1,499
Fee, commission, net trading, and other income	900	22	623	(262)	1,283
Total operating income	2,001	263	785	(267)	2,782
Administration expenses	(1,163)	(129)	(92)	15	(1,369)
Depreciation and amortisation	(72)	(2)	(131)	-	(205)
Impairment and provisions	(346)	4	24	(26)	(344)
Profit/(loss) before tax	420	136	586	(278)	864
Taxation charge	(69)	(29)	(89)	8	(179)
Profit/(loss) for the year	351	107	497	(270)	685

Balance sheets

At 31 December 2009	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
Cash and balances at central banks	3,266	448	449	-	4,163
Trading assets	-	24,976	30,321	(22,007)	33,290
Derivative financial instruments	2,539	23,129	8,422	(11,263)	22,827
Financial assets designated at fair value	37,145	12,000	313	(37,100)	12,358
Loans and advances to banks	109,658	166,020	156,075	(422,602)	9,151
Loans and advances to customers	131,749	20,266	105,421	(70,632)	186,804
Available-for-sale securities	30	-	767	-	797
Loans and receivables securities	2	896	12,244	(3,244)	9,898
Macro hedge of interest rate risk	-	682	504	(59)	1,127
Investment in associated undertakings	76	-	-	(1)	75
Investment in subsidiary undertakings	7,038	2,185	2,291	(11,514)	-
Intangible assets	552	8	132	754	1,446
Property, plant and equipment	561	6	270	101	938
Operating lease assets	-	-	313	(1)	312
Current tax assets	-	3	82	-	85
Deferred tax assets	428	21	401	96	946
Other assets	651	67	548	(192)	1,074
Total assets	**293,695**	**250,707**	**318,553**	**(577,664)**	**285,291**
Deposits by banks	116,414	166,169	81,097	(357,869)	5,811
Deposits by customers	159,187	17,601	110,834	(143,729)	143,893
Derivative financial instruments	3,352	24,330	2,711	(11,430)	18,963
Trading liabilities	-	13,315	47,159	(14,322)	46,152
Financial liabilities designated at fair value	-	4,282	141	-	4,423
Debt securities in issue	1	21,631	63,888	(37,762)	47,758
Other borrowed funds	539	-	958	(145)	1,352
Subordinated liabilities	5,580	-	1,975	(1,958)	5,597
Other liabilities	1,611	135	762	(185)	2,323
Other provisions	74	-	17	-	91
Current tax liabilities	92	57	151	-	300
Deferred tax liabilities	-	-	272	64	336
Retirement benefit obligations	922	-	148	-	1,070
Total liabilities	**287,772**	**247,520**	**310,113**	**(567,336)**	**278,069**
Total shareholders' equity	5,923	3,187	8,440	(10,328)	7,222
Total liabilities and equity	**293,695**	**250,707**	**318,553**	**(577,664)**	**285,291**

Notes to the Financial Statements continued

At 31 December 2008	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
Cash and balances at central banks	2,456	8	1,553	-	4,017
Trading assets	-	27,146	19,675	(20,557)	26,264
Derivative financial instruments	2,735	32,160	14,089	(13,859)	35,125
Financial assets designated at fair value	47,525	11,005	339	(47,492)	11,377
Loans and advances to banks	116,486	128,035	104,448	(332,968)	16,001
Loans and advances to customers	123,319	24,501	98,973	(66,617)	180,176
Available-for-sale securities	25	-	2,638	-	2,663
Loans and advances securities	-	526	14,250	(669)	14,107
Macro hedge of interest rate risk	-	1,475	713	-	2,188
Investment in associated undertakings	741	-	-	(706)	35
Investment in subsidiary undertakings	5,147	2,335	2,050	(9,532)	-
Intangible assets	484	6	375	482	1,347
Property, plant and equipment	569	9	226	50	854
Operating lease assets	-	-	348	-	348
Current tax assets	194	-	18	-	212
Deferred tax assets	458	75	744	(3)	1,274
Other assets	987	21	332	(18)	1,322
Total assets	301,126	227,302	260,771	(491,889)	297,310
Deposits by banks	124,846	123,366	32,728	(266,452)	14,488
Deposits by customers	155,466	9,743	97,185	(132,149)	130,245
Derivative financial instruments	5,393	33,511	2,926	(14,020)	27,810
Trading liabilities	739	22,996	36,672	(19,669)	40,738
Financial liabilities designated at fair value	-	4,898	775	-	5,673
Debt securities in issue	-	29,692	76,089	(47,270)	58,511
Other borrowed funds	905	-	1,028	143	2,076
Subordinated liabilities	7,030	-	2,558	(2,801)	6,787
Other liabilities	1,283	83	1,034	(58)	2,342
Other provisions	99	-	108	-	207
Current tax liabilities	128	236	154	-	518
Deferred tax liabilities	6	-	408	(9)	405
Retirement benefit obligations	797	-	16	-	813
Total liabilities	296,692	224,525	251,681	(482,285)	290,613
Total shareholders' equity	4,434	2,777	9,090	(9,604)	6,697
Total liabilities and equity	301,126	227,302	260,771	(491,889)	297,310

Cash flow statements

For the year ended 31 December 2009	**The Company £m**	**ANTS plc £m**	**Other £m**	**Adjustments £m**	**Consolidated £m**
Net cash flow from / (used in) operating activities	**(4,770)**	**12,150**	**(4,532)**	**81**	**2,929**
Net cash flow from / (used in) investing activities	**(232)**	**126**	**1,539**	**-**	**1,433**
Net cash flow from / (used in) financing activities	**(803)**	**-**	**(3,737)**	**(81)**	**(4,621)**
Net (decrease) in cash and cash equivalents	**(5,805)**	**12,276**	**(6,730)**	**-**	**(259)**
Cash and cash equivalents at beginning of the year	**61,203**	**38,020**	**(71,548)**	**-**	**27,675**
Effects of exchange rate changes on cash and cash equivalents	**-**	**(969)**	**(83)**	**-**	**(1,052)**
Cash and cash equivalents at end of the year	**55,398**	**49,327**	**(78,361)**	**-**	**26,364**

For the year ended 31 December 2008	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
Net cash flow from / (used in) operating activities	51,816	6,658	(79,918)	-	(21,444)
Net cash flow (used in) / from investing activities	(1,359)	38	20,723	-	19,402
Net cash flow from / (used in) financing activities	152	(161)	(7,372)	-	(7,381)
Net increase/ (decrease) in cash and cash equivalents	50,609	6,535	(66,567)	-	(9,423)
Cash and cash equivalents at beginning of the year	10,594	29,137	(5,675)	-	34,056
Effects of exchange rate changes on cash and cash equivalents	-	2,348	694	-	3,042
Cash and cash equivalents at end of the year	61,203	38,020	(71,548)	-	27,675

For the year ended 31 December 2007	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
Net cash flow from / (used in) operating activities	5,949	(1,874)	(13,407)	-	(9,332)
Net cash flow from / (used in) investing activities	14	(9)	(201)	-	(196)
Net cash flow (used in) / from financing activities	(576)	-	5,352	-	4,776
Net increase/ (decrease) in cash and cash equivalents	5,387	(1,883)	(8,256)	-	(4,752)
Cash and cash equivalents at beginning of the year	5,207	31,020	2,855	-	39,082
Effects of exchange rate changes on cash and cash equivalents	-	-	(274)	-	(274)
Cash and cash equivalents at end of the year	10,594	29,137	(5,675)	-	34,056