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Report of Independent Registered Public Accounting Firm

We have audited the group and parent company financial statements (the "financial statements") of Abbey National plc for the year ended 31 December 2008 which comprise the Consolidated Income Statement, the Consolidated and Company Balance Sheets, the Consolidated and Company Statements of Recognised Income and Expense, the Consolidated and Company Cash Flow Statements, the Accounting Policies and the related notes 1 to 48. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes specific information presented in the Business and Financial Review that is cross referred from the Principal Activities and Business Review section of the Directors' Report.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 December 2008 and of its profit for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2008;
- the financial statements have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial statements, Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

Separate opinion in relation to IFRSs

As explained in the Accounting Policies section of the group financial statements, the group in addition to complying with its legal obligation to comply with IFRSs as adopted by the European Union, has also complied with the IFRSs as issued by the International Accounting Standards Board.

In our opinion, the group financial statements give a true and fair view, in accordance with IFRSs, of the state of the group's affairs as at 31 December 2008 and of its profit for the year then ended.



Deloitte LLP

Chartered Accountants and Registered Auditors
London, United Kingdom
19 March 2009

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Financial Statements

Consolidated Income Statement

For the years ended 31 December 2008, 2007 and 2006

	Notes	2008 £m	2007 £m	2006 £m
Interest and similar income	2	7,915	7,043	5,644
Interest expense and similar charges	2	(6,143)	(5,544)	(4,416)
Net interest income		1,772	1,499	1,228
Fee and commission income	3	768	785	789
Fee and commission expense	3	(97)	(90)	(90)
Net fee and commission income		671	695	699
Dividend income		-	1	1
Net trading and other income	4	561	587	542
Total operating income		3,004	2,782	2,470
Administration expenses	5	(1,343)	(1,369)	(1,420)
Depreciation and amortisation	6	(202)	(205)	(215)
Total operating expenses excluding provisions and charges		(1,545)	(1,574)	(1,635)
Impairment losses on loans and advances	8	(348)	(344)	(344)
Provisions for other liabilities and charges		(17)	-	(63)
Total operating provisions and charges		(365)	(344)	(407)
Profit on continuing operations before tax		1,094	864	428
Tax on profit on continuing operations	9	(275)	(179)	(115)
Profit for the year from continuing operations		819	685	313
Loss for the year from discontinued operations	11	-	-	(245)
Profit for the year		819	685	68
Attributable to:				
Equity holders of the parent		811	685	68
Minority interest		8	-	-

The Notes on pages 95 to 137 are an integral part of these Consolidated Financial Statements.

Consolidated Balance Sheet

As at 31 December 2008 and 2007

	Notes	2008 £m	2007 £m
Assets			
Cash and balances at central banks	12	2,464	1,038
Trading assets	13	25,486	56,427
Derivative financial instruments	14	32,281	9,951
Financial assets designated at fair value	15	11,314	11,783
Loans and advances to banks	16	24,301	3,441
Loans and advances to customers	17	129,023	112,147
Available for sale securities	19	1,005	40
Macro hedge of interest rate risk		1,475	217
Investment in associated undertakings	21	735	29
Intangible assets	22	502	90
Property, plant and equipment	23	581	528
Operating lease assets	24	-	2,164
Current tax assets		195	197
Deferred tax assets	25	539	665
Other assets	26	1,841	906
Total assets		231,742	199,623
Liabilities			
Deposits by banks	27	3,337	7,923
Deposits by customers	28	99,246	69,650
Derivative financial instruments	14	26,309	9,931
Trading liabilities	29	40,738	54,916
Financial liabilities designated at fair value	30	4,945	7,538
Debt securities in issue	31	41,178	35,712
Other borrowed funds	32	2,076	1,419
Subordinated liabilities	33	5,826	4,732
Other liabilities	34	1,770	2,337
Provisions	35	107	131
Current tax liabilities		517	369
Deferred tax liabilities	25	86	544
Retirement benefit obligations	36	796	979
Total liabilities		226,931	196,181
Equity			
Share capital	38	1,148	148
Share premium account	38	1,857	1,857
Retained earnings	39	1,700	1,339
		4,705	3,344
Minority interest	39	106	98
Total shareholders equity		4,811	3,442
Total liabilities and equity		231,742	199,623

The Notes on pages 95 to 137 are an integral part of these Consolidated Financial Statements.

The Financial Statements on pages 72 to 137 were approved and authorised for issue by the Board on 19 March 2009 and signed on its behalf by:



Nathan Bostock
Chief Financial Officer

Consolidated Statement of Recognised Income and Expense

For the years ended 31 December 2008, 2007 and 2006

	Notes	2008 £m	2007 £m	2006 £m
Actuarial (losses)/gains on defined benefit pension plans	36	(44)	(113)	219
Gains on available for sale securities	19	8	19	1
Gains on available for sale securities transferred to profit or loss on sale		-	(1)	-
Exchange differences on translation of foreign operations		28	(1)	(9)
Tax on items taken directly to equity		8	9	(66)
Net gain/(loss) recognised directly in equity		-	(87)	145
Profit for the year		819	685	68
Total recognised income and expense for the year		819	598	213
Attributable to:				
Equity holders of the parent		811	598	213
Minority interest		8	-	-

Consolidated Cash Flow Statement

For the years ended 31 December 2008, 2007 and 2006

	Notes	2008 £m	2007 ⁽¹⁾ £m	2006 ⁽¹⁾ £m
Net cash flow (used in)/from operating activities				
Profit for the year		819	685	68
Adjustments for:				
Non cash items included in net profit		1,297	1,307	1,125
Change in operating assets		(40,978)	(12,411)	(9,636)
Change in operating liabilities		8,135	696	10,130
Income taxes received/(paid)		43	(5)	(60)
Effects of exchange rate differences		8,569	396	(1,196)
Net cash flow (used in)/from operating activities	40	(22,115)	(9,332)	431
Net cash flows from/(used in) investing activities				
Acquisition of businesses, net of cash acquired	40	18,001	-	-
Dividends received from associates		2	-	3
Investment in associates		(708)	(8)	(1)
Disposal of subsidiaries, net of cash disposed	40	1,605	5	(365)
Disposal of non-controlling interest in subsidiaries		-	203	-
Purchase of tangible and intangible fixed assets		(278)	(407)	(230)
Proceeds from sale of tangible and intangible fixed assets		15	8	5
Purchase of non-trading securities		(1,222)	-	(9)
Proceeds from sale of non-trading securities		290	3	-
Net cash flow from/(used in) investing activities		17,705	(196)	(597)
Net cash flow (used in)/from financing activities				
Issue of ordinary share capital		1,000	-	-
Issue of loan capital		-	13,363	10,778
Repayment of loan capital		(7,787)	(8,587)	(8,813)
Dividends paid		(595)	-	(207)
Net cash flow (used in)/from financing activities		(7,382)	4,776	1,758
Net (decrease)/increase in cash and cash equivalents		(11,792)	(4,752)	1,592
Cash and cash equivalents at beginning of the year		34,056	39,082	40,359
Effects of exchange rate changes on cash and cash equivalents		3,042	(274)	(2,869)
Cash and cash equivalents at the end of the year	40	25,306	34,056	39,082

(1) Amended for the change in accounting policy for cash equivalents described in the Accounting Policies on page 85.

The Notes on pages 95 to 137 are an integral part of these Consolidated Financial Statements.

Company Balance Sheet

As at 31 December 2008 and 2007

	Notes	2008 £m	2007 £m
Assets			
Cash and balances at central banks	12	2,456	1,032
Derivative financial instruments	14	2,735	689
Financial assets designated at fair value	15	47,525	7,500
Loans and advances to banks	16	116,486	40,685
Loans and advances to customers	17	123,319	110,976
Available for sale securities	19	25	28
Investment in associated undertakings	21	741	33
Investment in subsidiary undertakings	20	5,222	5,053
Intangible assets	22	406	-
Property, plant and equipment	23	569	501
Current tax asset		194	190
Deferred tax assets	25	458	620
Other assets	26	990	686
Total assets		301,126	167,993
Liabilities			
Deposits by banks	27	124,846	59,798
Deposits by customers	28	155,466	95,687
Derivative financial instruments	14	5,393	1,051
Trading liabilities	29	739	-
Debt securities in issue	31	-	-
Other borrowed funds	32	905	834
Subordinated liabilities	33	7,030	5,352
Macro hedge of interest rate risk		-	3
Other liabilities	34	1,283	1,452
Provisions	35	99	100
Current tax liabilities		128	137
Deferred tax liabilities	25	6	6
Retirement benefit obligations	36	797	982
Total liabilities		296,692	165,402
Equity			
Share capital	38	1,148	148
Share premium account	38	1,857	1,857
Retained earnings	39	1,429	586
Total shareholders equity		4,434	2,591
Total liabilities and equity		301,126	167,993

The Notes on pages 95 to 137 are an integral part of these Consolidated Financial Statements.

The Financial Statements on pages 72 to 137 were approved and authorised for issue by the Board on 19 March 2009 and signed on its behalf by:



Nathan Bostock
Chief Financial Officer

Company Statement of Recognised Income and Expense

For the years ended 31 December 2008, 2007 and 2006

	Notes	2008 £m	2007 £m	2006 £m
Actuarial (losses)/gains on defined benefit pension plans	36	(43)	(116)	180
(Losses)/gains on available for sale securities	19	(4)	18	-
Gains on available for sale securities transferred to profit or loss on sale		-	(1)	-
Tax on items taken directly to equity		12	10	(54)
Net (loss)/gain recognised directly in equity		(35)	(89)	126
Profit/(loss) for the year		1,328	351	(128)
Attributable to:		1,293	262	(2)
Equity holders of the parent		1,293	262	(2)

Company Cash Flow Statement

For the years ended 31 December 2008, 2007 and 2006

	Notes	2008 £m	2007 ⁽¹⁾ £m	2006 ⁽¹⁾ £m
Net cash flow from/(used in) operating activities				
Profit/(loss) for the year		1,328	351	(128)
Adjustments for:				
Non cash items included in net profit		2,038	446	251
Change in operating assets		(80,636)	(8,761)	(19,662)
Change in operating liabilities		128,109	13,865	13,733
Income taxes received/(paid)		80	48	56
Effects of exchange rate differences		897	-	(108)
Net cash flow from/(used in) operating activities	40	51,816	5,949	(5,858)
Cash flows (used in)/from investing activities				
Increase in investment in subsidiaries		(598)	(418)	(54)
Investment in associates		(708)	(8)	(1)
Disposal of subsidiaries, net of cash disposed		111	415	3,751
Disposal of non-controlling interest in subsidiary		-	203	-
Pre-acquisition dividends		-	-	197
Purchase of tangible and intangible fixed assets		(174)	(181)	(179)
Proceeds from sale of tangible and intangible fixed assets		11	-	3
Purchase of non-trading securities		(9)	-	(9)
Proceeds from sale and redemption of non-dealing securities		8	3	269
Net cash flow (used in)/from investing activities		(1,359)	14	3,977
Cash flows from/(used in) financing activities				
Issue of ordinary share capital		1,000	-	-
Issue of loan capital		-	65	-
Repayment of loan capital		(253)	(641)	(1,032)
Dividends paid		(595)	-	(207)
Net cash flows from/(used in) financing activities		152	(576)	(1,239)
Net increase/(decrease) in cash and cash equivalents		50,609	5,387	(3,120)
Cash and cash equivalents at beginning of the year		10,594	5,207	8,327
Effects of exchange rate changes on cash and cash equivalents		-	-	-
Cash and cash equivalents at the end of the year	40	61,203	10,594	5,207

(1) Amended for the change in accounting policy for cash equivalents described in the Accounting Policies on page 85.

The Notes on pages 95 to 137 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 Group's reporting date. Abbey National plc (the 'Company') and its subsidiaries (together the 'Group') has 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 36 to 56 which form part of these Consolidated Financial Statements.

Recent developments

In 2008, the Group adopted the following new or revised IFRS:

- a) IFRIC 14 'IAS 19 – The Asset Ceiling' – On 5 July 2007 IFRIC issued IFRIC 14 which clarifies the effect of minimum funding requirements on the recognition of a defined benefit asset. The adoption of IFRIC 14 did not have a material impact on the Group's profit or loss or financial position.
- b) IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 7 'Financial Instruments: Disclosures' - On 13 October 2008, the IASB issued amendments to IAS 39 and IFRS 7 regarding the reclassification of financial instruments. The changes to IAS 39 permit an entity to reclassify, in limited circumstances, certain non-derivative financial assets out of the 'fair value through profit and loss' and 'available-for-sale' categories into 'loans and receivables', 'available-for-sale' and 'held to maturity'. In addition, the amendments to IFRS 7 require expanded disclosures about these assets. The amendments became effective on 1 July 2008. The adoption of the amendments to IAS 39 and IFRS 7 had no impact on the Group's profit or loss or financial position, because the Group did not reclassify any of its financial instruments in 2008.

In addition, the Group applied IFRIC 11 'IFRS 2 - Group and Treasury Share Transactions'. On 30 November 2006 IFRIC issued IFRIC 11 which requires that treasury share transactions are treated as equity-settled, and share-based payments involving equity instruments of the parent should be treated as equity-settled where the obligation is from the parent to the employee and cash-settled when the obligation is from the subsidiary to the employee. This is consistent with the Group's previous practice and therefore the application of IFRIC 11 did not have a material impact on the Group's profit or loss or financial position.

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) 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 Group does not expect the adoption of the amendment to IAS 23 to have a material impact on the Group's profit or loss or financial position. The amendment to IAS 23 is effective for periods beginning on or after 1 January 2009.
- 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. It also changes the titles of primary financial statements as they will be referred to in IFRS but does not require that these be renamed in an entity's financial statements. The Group does not expect the adoption of the amendment to IAS 1 to have an impact on the financial statements. The amendment to IAS 1 is effective for periods beginning on or after 1 January 2009.
- c) 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.

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 60 and 61.

Accounting Policies continued

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.

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.

The amount of exchange rate differences recognised in profit or loss on items not at fair value through profit and loss was £5,850m charge (2007: £505m charge, 2006: £1,383m income). 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 and similar expense in the income statement.

Accounting Policies continued**(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 are recognised as earned when the service is provided.

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 financial liabilities held for trading, 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.

(e) Financial assets and liabilities held at fair value through profit or loss

Financial assets and liabilities held for trading, and financial assets and financial liabilities designated as fair value through profit or loss are recorded at fair value. Changes in fair value of trading assets and liabilities 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 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.

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.

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 recognised income and expense. 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.

Accounting Policies continued

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 Abbey National plc by Banco Santander, S.A., share options were satisfied by issue of new Abbey National plc shares. 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 by an independent expert 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, 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.

Accounting Policies continued

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 10 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, 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. 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 and Loans and advances to customers.

(c) Available-for-sale

Available-for-sale investments are non-derivative financial investments 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.

Accounting Policies continued

(d) Held to maturity

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.

Regular way purchases of financial assets

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.

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.

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.

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%.

Accounting Policies continued

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

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, to reflect the effects of current conditions not affecting the period of historical experience, based on observable data. 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 reserves 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. However, for assessing the level of non-performing asset repayment default depends 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.

Accounting Policies continued

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 is experiencing financial difficulties at the reporting date, e.g. due to loss of employment, although the borrower has not yet missed a payment. In these circumstances, an impairment 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 2008, 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, 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. A write-off is made when all collection procedures have been completed and is 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.

(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 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. 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.

Accounting Policies continued

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 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 substantially 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.

In 2008, the Group voluntarily changed its accounting policy for cash equivalents to exclude liabilities from its determination of cash equivalents. The Group believes that this new policy is preferable because it provides for consistency with industry practice. The Group considers this a change in accounting policy to be applied retrospectively as required by IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'. As a result, the Group and the Company cash flow statements for 2007 and 2006 on pages 74 and 76 have been amended to reclassify £(1,481)m and £(13,517)m respectively for the Group and £10,526m and £(3,013)m respectively for the Company between Net cash flow from/(used in) operating activities ('Net (decrease)/increase in operating liabilities') and Cash and cash equivalents ('Net trading other cash equivalents' and 'Net non trading other cash equivalents' in the Group and the Company, respectively). There was no impact on the income statements or balance sheets of any period or as at any date presented.

Financial liabilities

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

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.

Accounting Policies continued

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

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 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.

Accounting Policies continued

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 2008 include a net provision charge (i.e. after recoveries) for loans and advances in connection with retail lending for an amount equal to £348m. This provision charge was broadly unchanged from the previous year, reflecting improved credit quality and a continued reduction in the size of the unsecured personal lending book, offset by a further general deterioration in economic conditions affecting the mortgage portfolio provision. In calculating the retail lending provisions, principally within the Retail Banking segment, 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 principally in the Retail Banking segment that could have had a material impact on the Group's reported profit on continuing operations before tax in 2008. 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 principally in the Retail Banking segment could have decreased in 2008 from an actual provision charge of £348m (2007: £344m, 2006: £344m) by up to £78m (2007: £163m, 2006: £52m), with a potential corresponding increase in the Group's profit before tax on continuing operations in 2008 of up to 7% (2007: 19%, 2006: 12%), or increased by up to £66m (2007: £52m, 2006: £6m), with a potential corresponding decrease in the Group's profit before tax on continuing operations in 2008 of up to 6% (2007: 6%, 2006: 1%).

The actual provision charge of £348m (2007: £344m, 2006: £344m) in 2008 was based on what management estimated to be the most probable economic outlook within the range of reasonably possible assumptions.

(b) 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 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**Fair value hierarchy**

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.

Accounting Policies continued

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 measurements include equity securities, debt 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, 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 measurements include loans and advances to banks, loans and advances to customers, debt securities, equity securities, exchange rate derivatives, interest rate derivatives, equity and credit derivatives, 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 measurements include equity securities, exchange rate derivative, equity and credit derivatives, loans and advances to customers, debt securities, and debt securities in issue.

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. If trades are not observed, the bid/offer spread is disregarded as a sign of liquidity and the position is regarded as illiquid.

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 below.

The Group did not make any material changes to the valuation techniques and internal models it used during the years ended 31 December 2008 and 2007.

Accounting Policies continued

The following table summarises the fair values at 31 December 2008 and 2007 of the asset and liability classes accounted for at fair value, by the valuation methodology used by the Group to determine their fair value. The table also discloses 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 2008

Balance sheet category		Quoted prices in active markets		Internal models based on				Total		Valuation technique
				market observable data		other than market observable data				
		£m	%	£m	%	£m	%	£m	%	
Assets										
Trading assets	Loans and advances to banks	-	-	4,947	7	-	-	4,947	7	A
	Loans and advances to customers	-	-	532	1	-	-	532	1	A
	Debt securities	16,801	25	-	-	-	-	16,801	25	-
	Equity securities	671	1	-	-	37	-	708	1	B
Derivative assets	Exchange rate contracts	-	-	8,598	13	5	-	8,603	13	A
	Interest rate contracts	232	-	20,672	31	-	-	20,904	31	A & C
	Equity & credit contracts	843	1	1,782	3	149	-	2,774	4	B
Financial assets at FVTPL	Loans and advances to customers	-	-	6,405	9	282	1	6,687	10	A
	Debt securities	-	-	280	1	4,347	6	4,627	7	A
Available-for-sale financial Assets	Debt securities	970	1	-	-	-	-	970	1	-
	Equity securities	10	-	25	-	-	-	35	-	B
Total assets at fair value		19,527	28	43,241	65	4,820	7	67,588	100	
Liabilities										
Trading liabilities	Deposits by banks	-	-	34,341	48	-	-	34,341	48	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	-	-	1,324	2	-	-	1,324	2	A
	Interest rate contracts	-	-	20,576	29	-	-	20,576	29	A & C
	Equity & credit contracts	803	1	3,437	5	169	-	4,409	6	B
Financial liabilities at FVTPL	Debt securities in issue	-	-	4,698	6	247	1	4,945	7	A
Total liabilities at fair value		1,554	2	70,022	97	416	1	71,992	100	

At 31 December 2007

Balance sheet category		Quoted prices in active markets		Internal models based on				Total		Valuation technique
				market observable data		other than market observable data				
		£m	%	£m	%	£m	%	£m	%	
Assets										
Trading assets	Loans and advances to banks	-	-	8,847	12	-	-	8,847	12	A
	Loans and advances to customers	-	-	17,255	22	-	-	17,255	22	A
	Debt securities	19,118	24	9,713	13	-	-	28,831	37	A
	Equity securities	1,494	2	-	-	-	-	1,494	2	-
Derivative assets	Exchange rate contracts	-	-	1,072	1	-	-	1,072	1	A
	Interest rate contracts	88	-	6,368	8	-	-	6,456	8	A & C
	Equity & credit contracts	523	1	1,782	2	118	-	2,423	3	B
Financial assets at FVTPL	Loans and advances to customers	-	-	5,575	7	126	-	5,701	7	A
	Debt securities	-	-	1,693	2	4,389	6	6,082	8	A
Available-for-sale financial Assets	Debt securities	-	-	8	-	-	-	8	-	A
	Equity securities	12	-	20	-	-	-	32	-	B
Total assets at fair value		21,235	27	52,333	67	4,633	6	78,201	100	
Liabilities										
Trading liabilities	Deposits by banks	-	-	19,632	27	-	-	19,632	27	A
	Deposits by customers	-	-	20,498	28	-	-	20,498	28	A
	Short positions	2,252	3	-	-	-	-	2,252	3	-
	Debt securities in issue	-	-	12,534	17	-	-	12,534	17	A
Derivative liabilities	Exchange rate contracts	-	-	1,083	1	-	-	1,083	1	A
	Interest rate contracts	-	-	6,626	9	-	-	6,626	9	A & C
	Equity & credit contracts	216	1	1,858	3	148	-	2,222	4	B
Financial liabilities at FVTPL	Debt securities in issue	-	-	7,262	10	276	1	7,538	11	A
Total liabilities at fair value		2,468	4	69,493	95	424	1	72,385	100	

Accounting Policies continued

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 2008 and 2007 are set out below. In substantially all cases, the principal inputs into these models are derived from observable market data.

- 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 instrument 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 Markov functional model (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 both the credit risk of its counterparties, as well as its own creditworthiness. 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 Group generally calculates the credit risk adjustment for derivatives on observable credit data.

Credit risk is measured using dynamic models that calculate the probability and potential future exposure given default. The main inputs used in these models are generally data relating to individual issuers in the portfolio and correlations thereto. The main inputs used in determining the underlying cost of credit for credit risk derivatives are quoted credit spreads and the correlation between individual issuers' quoted credit derivatives.

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 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.

Accounting Policies continued

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 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:

Instrument	Valuation technique	Balance sheet value		Amount recognised in income	
		31 December 2008 £m	31 December 2007 £m	31 December 2008 £m	31 December 2007 £m
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.	37	-	16	-
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.	5	-	5	4
3. Derivative assets - Equity and credit contracts	These property derivatives are valued using a valuation model with Halifax's UK House Price Index ('HPI') volatility, HPI forward growth, HPI spot rate, and mortality as inputs to derive valuations.	77	98	3	17
4. Derivative assets - Equity and credit contracts	These property derivatives are valued using a valuation model with HPI spot rate, HPI forward growth, and HPI volatility as inputs to derive valuations.	72	20	91	11
5. FVTPL - Loans and advances to customers	These loans are valued using a valuation model with HPI spot rate, HPI forward growth, HPI volatility, and mortality as inputs to derive valuations.	282	126	121	12
6. FVTPL - Debt securities	These debt securities are valued using a valuation model with HPI spot rate, HPI forward growth, HPI volatility, and mortality as inputs to derive valuations.	265	268	1	33
7. FVTPL - Debt securities	These prime mortgage backed securities (almost all of which are AAA rated, and issued by Santander entities) are valued using a valuation model with reference to the most relevant generic curve from a consensus pricing service, and an assumption with respect to the specific credit spread for that instrument as inputs to derive valuations.	4,082	4,121	(328)	(72)
8. Derivative liabilities - Equity and credit contracts	These derivatives are valued using a valuation model with HPI spot rate, HPI forward growth, and HPI volatility as inputs to derive valuations.	(169)	(148)	(94)	(14)
9. FVTPL - Debt securities in issue	These debt securities in issue are valued using a valuation model with interest rates, foreign exchange rates and long-dated foreign exchange volatility as inputs to derive valuations.	(247)	(276)	(5)	(4)
Total assets		4,820	4,633	-	-
Total liabilities		(416)	(424)	-	-
Total income/(expense)		-	-	(190)	(13)

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.

Accounting Policies 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 £187m in 2008 principally due to exchange rate movements on euro-denominated investments. During 2008, there were no acquisitions or 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 1% (2007: 1%) of total liabilities measured at fair value and 0.2% (2007: 0.2%) of total liabilities at 31 December 2008. During 2008, there were no redemptions or transfers of financial instrument liabilities valued using internal models based on information other than market data.

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.

Sensitivity analysis

The impacts of changes in the valuation inputs that are assumptions rather than observable, such as interest rates, foreign exchange rates, and the HPI spot rate, are shown below:

2008		Impact on profit or loss before tax for the period for instrument number:						
Input	Assumed change	1	3	4	5	6	7	8
		£m	£m	£m	£m	£m	£m	£m
Discount to asset value	10%	7	n/a	n/a	n/a	n/a	n/a	n/a
HPI forward growth	1%	n/a	16	-	39	13	n/a	(11)
HPI volatility	1%	n/a	1	-	(6)	-	n/a	(1)
Mortality	1 year	n/a	-	n/a	(6)	-	n/a	n/a
Credit spread	100 basis points	n/a	n/a	n/a	n/a	n/a	90	n/a

2007		Impact on profit or loss before tax for the year for instrument number:						
Input	Assumed change	1	3	4	5	6	7	8
		£m	£m	£m	£m	£m	£m	£m
HPI forward growth	1%	n/a	12	-	15	14	n/a	(12)
HPI volatility	1%	n/a	-	-	(2)	-	n/a	-
Mortality	1 year	n/a	(1)	n/a	(2)	-	n/a	n/a
Credit spread	100 basis points	n/a	n/a	n/a	n/a	n/a	110	n/a

No sensitivities are presented for the FVTPL - debt securities in issue (instrument 9) and related exchange rate derivatives (instrument 2) 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.

Accounting Policies continued

Day One profits

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, was as follows. This is calculated and reported on a portfolio basis:

	2008 £m	2007 £m	2006 £m
At 1 January	45	18	32
Additions	12	27	-
Releases	(2)	-	(14)
At 31 December	55	45	18

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.

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 on continuing operations before tax in 2008. Due to the individual nature of these contracts, the Group does not believe generally it is appropriate to apply a global adjustment to management's estimates, as it would not give a meaningful sensitivity with respect to financial instrument fair values based on data other than market prices. Sensitivities have been given with respect to key management estimates where they can be separately identified. 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 48.

(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 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 Contingent liabilities and commitments.

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 2008 include a provision release for misselling in the Retail Banking segment for an amount equal to £40m (2007: £nil, 2006: charge of £61m). The balance sheet provision decreased from £95m in 2007 to £41m in 2008, reflecting settlement of claims principally relating to endowments, as well as a reduction in the provision requirement mainly in respect of insurance products. 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 2008.

Accounting Policies continued

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 (excluding bank charges) in the Retail Banking segment could have decreased in 2008 by up to £8m (2007: £29m, 2006: £7m), with a potential corresponding increase in the Group's profit on continuing operations before tax in 2008 of up to 1% (2007: 3%, 2006: 2%), or increased by up to £9m (2007: £19m, 2006: £40m), with a potential corresponding decrease in the Group's profit on continuing operations before tax in 2008 of up to 1% (2007: 2%, 2006: 9%). The actual charge in 2008 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. With respect to the reimbursement of bank charges, the legal and regulatory position continues to evolve and remains unclear, as described in Note 37 Contingent liabilities and commitments. As a result, management remain unable to quantify reliably a meaningful sensitivity or range of 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 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 2008 include current year service cost of £55m and a pension scheme deficit of £796m. The current year service cost of £55m (2007: £67m, 2006: £92m) and pension scheme deficit of £796m (2007: £979m, 2006: £1,034m) were reduced, reflecting reductions in scheme membership, salary reviews and changes in discount rates. 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 on continuing operations before tax in 2008. 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 2008 from an actual pension charge of £55m (2007: £67m, 2006: £92m) by up to £8m (2007: £13m, 2006: £8m), with a potential corresponding increase in the Group's profit on continuing operations before tax in 2008 of up to 1% (2007: 2%, 2006: 2%), or increased by up to £8m (2007: £7m, 2006: £11m), with a potential corresponding decrease in the Group's profit on continuing operations before tax in 2008 of up to 1% (2007: 1%, 2006: 3%). The actual current year service pension charge of £55m (2007: £67m, 2006: £92m) in 2008 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. In addition, 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 value of the deficit at the year end could have decreased in 2008 from an actual of £796m (2007: £979m, 2006: £1,034m) by up to £502m (2007: £642m, 2006: £717m), or increased by up to £215m (2007: £507m, 2006: £297m).

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
- > Global Banking & Markets
- > Corporate Banking
- > Private Banking
- > Group Infrastructure
- > Sold Life Businesses

In 2008, the Wealth Management business was renamed Private Banking. In addition, the results of the intermediary protection business that was terminated in 2007 have been reclassified from Retail Banking to Group Infrastructure. The segmental analysis of the Group's results for 2007 and 2006 has been amended to reflect this change. In this report, the Retail Banking, Global Banking & Markets, Corporate Banking, Private Banking and Group Infrastructure segments are referred to as the Personal Financial Services 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 six segments. Retail Banking offers a range of personal banking, savings and mortgage products and services. Global Banking & Markets provides financial markets sales, trading and risk management services, as well as manufacturing retail structured products. Corporate Banking offers banking services principally to small and mid-sized UK companies. It also contains operations in run down. Private Banking offers self-invested pension plans, WRAP products and specialist banking services. Group Infrastructure consists of Asset and Liability Management activities, Group Capital and Funding. The Sold Life Businesses offered a range of investment products such as pensions, investment bonds, with-profits bonds, structured products, unit trusts, and endowment life insurance policies, as well as a range of protection products such as term life insurance, critical illness cover and disability cover.

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 77 to 94) 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:

- > **Reorganisation and other costs** - Comprise implementation costs in relation to the strategic change cost reduction projects, 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 Porterbrook operating lease businesses that were sold in 2008 had been managed as financing businesses and, therefore, management needed to see the margin earned on the businesses. Residual value risk was separately managed. As a result the depreciation was 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 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 excluded. In 2006, the profit on the sale of the Asset Management businesses was similarly excluded.
- > **Hedging and certain other mark-to-market 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.
- > **Capital and other charges** - Principally comprise internal nominal charges for capital invested in the Group's businesses. Management implemented this charge to assess if capital is invested effectively.

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.

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.

Notes to the Financial Statements continued

a) Segmental information

2008	Retail Banking £m	Global Banking & Markets £m	Corporate Banking £m	Private Banking ⁽¹⁾ £m	Group Infrastructure £m	Sold Life Businesses £m	Total £m	Adjustments £m	Group Total £m
Net interest income	1,827	-	(13)	85	(127)	-	1,772	-	1,772
Non-interest income	622	326	133	35	59	-	1,175	57	1,232
Total trading income	2,449	326	120	120	(68)	-	2,947	57	3,004
Administration expenses	(930)	(104)	(45)	(58)	(140)	-	(1,277)	(66)	(1,343)
Depreciation & amortisation	(58)	(3)	-	(1)	(1)	-	(63)	(139)	(202)
Total trading expenses	(988)	(107)	(45)	(59)	(141)	-	(1,340)	(205)	(1,545)
Impairment losses on loans and advances	(309)	-	6	(3)	-	-	(306)	(42)	(348)
Provisions for other Liabilities and charges	-	-	-	-	-	-	-	(17)	(17)
Trading profit/(loss) before tax	1,152	219	81	58	(209)	-	1,301	(207)	1,094
Adjust for:									
Reorganisation & other costs	(121)	-	-	-	(42)	-	(163)	-	-
Profit on part sale of PFS subs	-	-	40	-	-	-	40	-	40
Hedging and certain other mark-to-market variances	-	-	-	-	(84)	-	(84)	-	-
Capital and other charges	(103)	-	(14)	16	101	-	-	-	-
Profit/(loss) from continuing operations before tax	928	219	107	74	(234)	-	1,094	-	-
Average number of staff	13,475	300	226	638	190	-	14,829	-	14,829
Total assets	125,808	52,590	10,277	179	42,888	-	231,742	-	231,742

(1) Formerly known as Wealth Management

Adjustments comprise:	Non interest income £m	Admin expenses £m	Depreciation and amortisation £m	Impairment losses on loans and advances £m	Provisions for other liabilities and charges £m	Profit on continuing ops before tax £m
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 certain other mark-to-market variances	(84)	-	-	-	-	(84)
	57	(66)	(139)	(42)	(17)	(207)

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.

2007	Retail Banking £m	Global Banking & Markets £m	Corporate Banking £m	Private Banking £m	Group Infrastructure £m	Sold Life Businesses £m	Total £m	Adjustments £m	Group Total £m
Net interest income	1,623	-	(31)	70	(163)	-	1,499	-	1,499
Non-interest income	635	260	132	34	55	-	1,116	167	1,283
Total trading income	2,258	260	101	104	(108)	-	2,615	167	2,782
Administration expenses	(937)	(105)	(30)	(59)	(105)	-	(1,236)	(133)	(1,369)
Depreciation & amortisation	(59)	(2)	-	(2)	-	-	(63)	(142)	(205)
Total trading expenses	(996)	(107)	(30)	(61)	(105)	-	(1,299)	(275)	(1,574)
Impairment losses on loans and advances	(239)	-	29	(2)	-	-	(212)	(132)	(344)
Trading profit/(loss) before tax	1,023	153	100	41	(213)	-	1,104	(240)	864
Adjust for:									
Reorganisation & other costs	(139)	(6)	-	(1)	(132)	-	(278)	-	-
Profit on part sale of PFS subs	-	-	5	-	105	-	110	-	110
Hedging and certain other mark-to-market variances	-	-	-	-	(72)	-	(72)	-	-
Capital and other charges	(89)	-	(11)	19	81	-	-	-	-
Profit/(loss) from continuing operations before tax	795	147	94	59	(231)	-	864	-	-
Average number of staff	13,269	389	166	858	221	-	14,903	-	14,903
Total assets	114,306	54,029	9,357	211	21,720	-	199,623	-	199,623

Notes to the Financial Statements continued

	Net interest income £m	Non interest income £m	Admin expenses £m	Depreciation and amortisation £m	Impairment losses on loans and advances £m	Provisions for other liabilities and charges £m	Profit on continuing ops before tax £m
Adjustments comprise:							
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 certain other mark-to-market variances	-	(72)	-	-	-	-	(72)
	-	167	(133)	(142)	(132)	-	(240)

2006	Retail Banking £m	Global Banking & Markets £m	Corporate Banking £m	Private Banking £m	Group Infrastructure £m	Sold Life Businesses £m	Total £m	Adjustments £m	Group Total £m
Net interest income	1,466	-	(46)	62	(146)	-	1,336	(108)	1,228
Non-interest income	645	240	125	32	74	-	1,116	126	1,242
Total trading income	2,111	240	79	94	(72)	-	2,452	18	2,470
Administration expenses	(943)	(92)	(41)	(55)	(149)	-	(1,280)	(140)	(1,420)
Depreciation & amortisation	(62)	(1)	-	(3)	(3)	-	(69)	(146)	(215)
Total trading expenses	(1,005)	(93)	(41)	(58)	(152)	-	(1,349)	(286)	(1,635)
Impairment losses on loans and advances	(273)	-	27	-	(5)	-	(251)	(93)	(344)
Provisions for other liabilities and charges	-	-	-	(2)	-	-	(2)	(61)	(63)
Trading profit/(loss) before tax	833	147	65	34	(229)	-	850	(422)	428
Adjust for:									
Reorganisation & other costs	(133)	(9)	-	(5)	(151)	-	(298)	-	-
Profit on part sale of PFS subs	-	-	-	-	41	-	41	-	-
Hedging and certain other mark-to-market variances	(8)	-	-	-	(37)	-	(45)	-	-
Capital and other charges	(44)	-	(4)	15	(87)	-	(120)	-	-
Profit/(loss) from continuing operations before tax	648	138	61	44	(463)	-	428		
Average number of staff	15,077	420	178	1,309	356	1,917	19,257	-	19,257
Total assets	105,214	76,164	7,495	249	2,683	-	191,805	-	191,805

	Net interest income £m	Non interest income £m	Admin expenses £m	Depreciation and amortisation £m	Impairment losses on loans and advances £m	Provisions for other liabilities and charges £m	Profit on continuing ops before tax £m
Adjustments comprise:							
Reorganisation and other costs	-	-	(128)	(16)	(93)	(61)	(298)
Depreciation on operating lease assets	-	130	-	(130)	-	-	-
Profit on part sale of PFS subsidiaries	-	41	-	-	-	-	41
Hedging and certain other mark-to-market variances	-	(45)	-	-	-	-	(45)
Capital and other charges	(108)	-	(12)	-	-	-	(120)
	(108)	126	(140)	(146)	(93)	(61)	(422)

b) Geographical information

	2008 £m	2007 £m	2006 £m
Total operating income			
United Kingdom	2,974	2,678	2,370
Other	30	104	100
	3,004	2,782	2,470
Total assets other than financial instruments and deferred tax assets			
United Kingdom	1,817	2,809	
Other	2	2	
	1,819	2,811	

Notes to the Financial Statements continued

2. Net interest income

	2008	2007	Group 2006
	£m	£m	£m
Interest and similar income:			
Loans and advances to banks	448	227	141
Loans and advances to customers	7,394	6,747	5,458
Other interest earning financial assets	73	69	45
Total interest and similar income	7,915	7,043	5,644
Interest expense and similar charges:			
Deposits by banks	218	200	101
Deposits by customers	3,155	2,905	2,514
Debt securities in issue and other borrowed funds	2,218	1,955	1,329
Other interest bearing financial liabilities	552	484	472
Total interest expense and similar charges	6,143	5,544	4,416
Net interest income	1,772	1,499	1,228

3. Net fee and commission income

	2008	2007	Group 2006
	£m	£m	£m
Fee and commission income:			
Insurance products	155	201	200
Retail products	461	450	473
Fund management	152	134	116
Total fee and commission income	768	785	789
Fee and commission expense:			
Other fees paid	97	90	90
Total fee and commission expense	97	90	90
Net fee and commission income	671	695	699

4. Net trading and other income

	2008	2007	Group 2006
	£m	£m	£m
Net trading and funding of other items by the trading book	54	260	408
Income from operating lease assets	223	245	243
Income on assets designated at fair value through profit or loss	916	368	188
Expense on liabilities designated at fair value through profit or loss	(435)	(382)	(261)
Losses on derivatives managed with assets/liabilities held at fair value through profit or loss	(396)	(19)	(27)
Profit on sale of a non-controlling interest in subsidiary undertakings	-	105	-
Profit on sale of subsidiary undertakings	40	7	41
(Loss)/profit on sale of fixed assets	(17)	5	1
Hedge ineffectiveness and other	176	(2)	(51)
	561	587	542

5. Administration expenses

	2008	2007	Group 2006
	£m	£m	£m
Staff costs:			
Wages and salaries	545	529	550
Social security costs	45	42	43
Pensions costs: - defined contribution plans	8	7	4
- defined benefit plans	47	62	81
Other personnel costs	50	77	88
	695	717	766
Property, plant and equipment expenses	182	191	204
Information technology expenses	201	195	175
Other administration expenses	265	266	275
	1,343	1,369	1,420

Notes to the Financial Statements continued

6. Depreciation and amortisation

	2008	2007	Group 2006
	£m	£m	£m
Depreciation of property, plant and equipment excluding operating lease assets	78	76	85
Depreciation of operating lease assets	117	129	130
Amortisation of intangible fixed assets	7	-	-
	202	205	215

7. Audit and other services

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

	2008	2007	Group 2006
	£m	£m	£m
Audit fees:			
Fees payable to the Company's auditors for the audit of the Group's annual accounts	1.6	1.2	1.7
Fees payable to the Company's auditors and its associates for the audit of the Company's subsidiaries pursuant to legislation	1.6	1.6	1.6
Total audit fees	3.2	2.8	3.3
Non-audit fees:			
- Other services pursuant to legislation	0.7	1.4	1.5
- Tax services	0.4	-	0.1
- Other services	0.8	0.7	0.8
Total non-audit fees	1.9	2.1	2.4

In 2006, fees payable to the Company's auditors for the audit of the Group's annual accounts of £1.7m included £0.6m related to the audit of entities that were disposed of during the year.

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, £0.6m (2007: £1.0m, 2006: £0.3m) accords with the definition of 'Audit fees' per US Securities and Exchange Commission guidance. The remaining £0.1m (2007: £0.4m, 2006: £1.2m) accords with the definition of 'Audit related fees' per that guidance.

Tax services relate to advisory and compliance services on the Group's tax affairs.

Other services relates to advice on accounting matters. Of this category, £0.2m (2007: £0.7m, 2006: £0.8m) accords with the definition of 'Audit fees' per US Securities and Exchange Commission guidance. The remaining £0.6m (2007: £nil, 2006: £nil) accords with the definition of 'Audit related fees' per that guidance.

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 other 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 Committee.

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

	2008	2007	Group 2006
	£m	£m	£m
Impairment losses on loans and advances to customers	394	388	385
Recoveries of loans and advances to customers	(46)	(44)	(41)
	348	344	344

9. Taxation expense

	2008	2007	Group 2006
	£m	£m	£m
Current tax:			
UK corporation tax on profit of the year	218	122	41
Adjustments and reclassifications in respect of prior periods	(65)	(31)	120
Total current tax	153	91	161
Deferred tax:			
Current year	95	68	82
Adjustments and reclassifications in respect of prior periods	27	20	(128)
Total deferred tax	122	88	(46)
Tax on profit for the year	275	179	115

Notes to the Financial Statements continued

Domestic income tax is calculated at 28.5% (2007: 30%, 2006: 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		
	2008 £m	2007 £m	2006 £m
Profit before tax	1,094	864	428
Tax calculated at a tax rate of 28.5% (2007: 30%, 2006: 30%)	310	259	128
Non taxable gain on sale of subsidiary undertakings	(11)	(33)	(12)
Non deductible preference dividends paid	8	9	17
Effect of non-allowable provisions and other non-equalised items	19	(10)	1
Non-taxable dividend income	(5)	(3)	(5)
Effect of non-UK profits and losses	(8)	(11)	(4)
Utilisation of capital losses for which credit not previously recognised	-	(11)	(2)
Effect of change in tax rate on deferred tax provision	-	(10)	-
Adjustment to prior year provisions	(38)	(11)	(8)
Income tax expense	275	179	115

In addition to the income tax expense charged to profit or loss, a deferred tax asset of £8m (2007: asset of £9m, 2006: liability of £66m) 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 £1,328m (2007: profit £351m, 2006: loss £128m). As permitted by Section 230 of the UK Companies Act 1985, the Company's income statement has not been presented in these Consolidated Financial Statements.

11. Discontinued operations

In 2006, the Company sold its entire life insurance business to Resolution plc for cash consideration of approximately £3.6bn. The principal life companies sold were Scottish Mutual Assurance plc, Scottish Provident Limited and Abbey National Life plc, as well as the two offshore life companies, Scottish Mutual International plc and Scottish Provident International Life Assurance Limited. The life insurance businesses, which constituted the Sold Life Businesses segment, qualify as discontinued operations. The results, and loss on sale, of the discontinued operations were as follows:

	Group		
	2008 £m	2007 £m	2006 £m
Total income net of insurance claims	-	-	236
Total operating expenses	-	-	(73)
Impairment losses on intangible assets	-	-	(69)
Profit of discontinued operations before tax	-	-	94
Taxation expense	-	-	(75)
Profit of discontinued operations	-	-	19
Loss on sale of discontinued operations before and after tax	-	-	(264)
Loss for the year from discontinued operations	-	-	(245)

12. Cash and balances with central banks

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Cash in hand	347	365	347	365
Balances with central banks	2,117	673	2,109	667
	2,464	1,038	2,456	1,032

For regulatory purposes, certain minimum cash balances are required to be maintained with the Bank of England. At 31 December 2008, these amounted to £123m (2007: £136m).

Notes to the Financial Statements continued

13. Trading assets

	2008	Group 2007
	£m	£m
Balances with central banks	2,498	-
Loans and advances to banks	4,947	8,847
Loans and advances to customers	532	17,255
Debt securities	16,801	28,831
Equity securities	708	1,494
	25,486	56,427

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

	2008	Group 2007
	£m	£m
Issued by public bodies:		
- Government securities	3,139	3,722
Issued by other issuers:		
- Bank and building society certificates of deposit	8,032	9,679
Other debt securities	5,630	15,430
	16,801	28,831

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

	2008	Group 2007
	£m	£m
Debt securities:		
- Listed in the UK	9,576	8,054
- Listed elsewhere	7,225	11,064
- Unlisted	-	9,713
	16,801	28,831
Equity securities:		
- Listed in the UK	317	965
- Listed elsewhere	391	529
	708	1,494

The Company has no trading assets (2007: nil).

14. Derivative financial instruments

All derivatives are required to be held at fair value through profit or loss and 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.

The table in the Risk Management Report on page 51 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.

Notes to the Financial Statements continued

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 fair value hedging below.

2008 Derivatives held for trading	Group		
	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Exchange rate contracts:			
- Cross-currency swaps	27,681	6,501	533
- Foreign exchange swaps and forwards	17,102	1,421	793
	44,783	7,922	1,326
Interest rate contracts:			
- Interest rate swaps	451,467	16,505	16,376
- Caps, floors and swaptions	44,093	1,775	1,841
- Futures (exchange traded)	55,534	232	-
- Forward rate agreements	250,324	604	599
	801,418	19,116	18,816
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	1,829	110	167
	29,638	2,550	4,629
Total derivative assets and liabilities held for trading	875,839	29,588	24,771

2008 Derivatives held for fair value hedging	Group		
	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Exchange rate contracts:			
- Cross-currency swaps	2,425	1,056	-
Interest rate contracts:			
- Interest rate swaps	46,890	1,637	1,538
Total derivative assets and liabilities held for fair value hedging	49,315	2,693	1,538
Total recognised derivative assets and liabilities	925,154	32,281	26,309

2008 Derivatives held for trading	Company		
	Contract/ notional amount £m	Fair value assets £m	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	Company		
	Contract/ notional amount £m	Fair value assets £m	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

2007 Derivatives held for trading	Group		
	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Exchange rate contracts:			
- Cross-currency swaps	28,386	816	823
- Foreign exchange swaps and forwards	21,524	256	260
	49,910	1,072	1,083
Interest rate contracts:			
- Interest rate swaps	436,212	5,211	5,724
- Caps, floors and swaptions	42,318	649	621
- Futures (exchange traded)	29,383	88	-
- Forward rate agreements	148,742	76	78
	656,655	6,024	6,423
Equity and credit contracts:			
- Equity index and similar products	15,204	847	1,820
- Equity index options (exchange traded)	6,009	556	216
- Credit default swaps and similar products	35,588	1,020	186
	56,801	2,423	2,222
Total derivative assets and liabilities held for trading	763,366	9,519	9,728

2007 Derivatives held for fair value hedging	Group		
	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Exchange rate contracts:			
- Cross-currency swaps	2,425	-	-
Interest rate contracts:			
- Interest rate swaps	39,629	432	203
Total derivative assets and liabilities held for fair value hedging	42,054	432	203
Total recognised derivative assets and liabilities	805,420	9,951	9,931

2007 Derivatives held for trading	Company		
	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Exchange rate contracts:			
- Cross-currency swaps	7,654	25	194
Interest rate contracts:			
- Interest rate swaps	48,531	181	343
- Caps, floors and swaptions	424	-	4
	48,955	181	347
Equity and credit contracts:			
- Equity index and similar products	564	120	208
Total derivative assets and liabilities held for trading	57,173	326	749

2007 Derivatives held for fair value hedging	Company		
	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Exchange rate contracts:			
- Cross-currency swaps	998	222	-
Interest rate contracts:			
- Interest rate swaps	4,207	141	302
Total derivative assets and liabilities held for fair value hedging	5,205	363	302
Total recognised derivative assets and liabilities	62,378	689	1,051

Net gains or losses arising from fair value hedges

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Net gains/(losses):				
On hedging instruments				
On the hedged items attributable to hedged risk	39	(413)	885	26
Hedge ineffectiveness	53	449	(906)	(28)
	92	36	(21)	(2)

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.

Notes to the Financial Statements continued

15. Financial assets designated at fair value

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Loans and advances to banks	-	-	162	-
Loans and advances to customers	6,687	5,701	44	54
Debt securities	4,627	6,082	47,319	7,446
	11,314	11,783	47,525	7,500

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

- > Loans and advances to customers, representing 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 in issue representing holdings of asset-backed securities. At the date of their acquisition, they 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. These securities are now managed on an accruals basis, but are not eligible for reclassification under IAS 39.

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 £6,258m (2007: £5,587m) for the Group and £206m (2007: £54m) 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 £474m (2007: £83m) was due to changes in credit spreads.

Debt securities can be analysed by listing status as follows:

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Listed in the UK	-	304	26,978	-
Listed elsewhere	4,082	5,510	20,341	7,446
Unlisted	545	268	-	-
	4,627	6,082	47,319	7,446

16. Loans and advances to banks

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Placements with other banks	5,484	1,801	970	1,171
Amounts due from parent	9,353	1,640	1,004	1,018
Amounts due from associated undertakings	9,464	-	334	-
Amounts due from subsidiaries	-	-	114,178	38,496
	24,301	3,441	116,486	40,685

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Repayable:				
On demand	2,814	1,271	7,826	5,771
In not more than 3 months	9,343	940	50,760	3,791
In more than 3 months but not more than 1 year	10,663	204	6,135	3,822
In more than 1 year but not more than 5 years	61	-	18,263	20,930
In more than 5 years	1,420	1,026	33,502	6,371
	24,301	3,441	116,486	40,685

17. Loans and advances to customers

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Advances secured on residential properties	115,488	105,169	115,474	105,156
Corporate loans	6,776	1,302	24	17
Other secured advances	4,152	2,962	4,133	2,889
Other unsecured advances	3,249	3,265	3,082	3,258
Amounts due from subsidiaries	-	-	1,328	310
Loans and advances to customers	129,665	112,698	124,041	111,630
Less: loan loss allowances	(642)	(551)	(722)	(654)
Loans and advances to customers, net of loan loss allowances	129,023	112,147	123,319	110,976

Notes to the Financial Statements continued

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Repayable:				
On demand	528	331	523	291
In no more than 3 months	5,881	1,657	1,418	610
In more than 3 months but not more than 1 year	2,712	1,983	2,532	2,121
In more than 1 year but not more than 5 years	15,118	12,725	13,248	12,681
In more than 5 years	105,426	96,002	106,320	95,927
Loans and advances to customers	129,665	112,698	124,041	111,630
Less: loan loss allowances	(642)	(551)	(722)	(654)
Loans and advances to customers, net of loan loss allowances	129,023	112,147	123,319	110,976

The loans and advances to customers in the above table have the following interest rate structures:

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Fixed rate	65,678	56,031	66,682	55,942
Variable rate	63,987	56,667	57,359	55,688
Less: loan loss allowances	(642)	(551)	(722)	(654)
	129,023	112,147	123,319	110,976

Movement in loan loss allowances:

	Group					Total £m
	Loans secured on residential property £m	Corporate Loans £m	Finance leases £m	Other secured advances £m	Other unsecured advances £m	
As at 1 January 2008	176	-	-	40	335	551
Charge/(release) to the income statement:						
- Individually assessed	132	13	-	14	239	398
- Collectively assessed	21	13	-	3	(41)	(4)
Write offs	153	26	-	17	198	394
At 31 December 2008	297	26	-	48	271	642
As at 1 January 2007	105	-	1	76	354	536
Charge/(release) to the income statement:						
- Individually assessed	38	-	-	(17)	346	367
- Collectively assessed	42	-	-	5	(26)	21
Write offs	80	-	-	(12)	320	388
At 31 December 2007	176	-	(1)	(24)	(339)	(373)
As at 1 January 2006	56	-	3	123	212	394
Charge/(release) to the income statement:						
- Individually assessed	35	-	-	(25)	289	299
- Collectively assessed	25	-	-	3	59	87
Write offs	60	-	-	(22)	348	386
At 31 December 2006	105	-	1	76	354	536

	Company					Total £m
	Loans secured on residential property £m	Amounts due from subsidiaries £m	Finance leases £m	Other secured advances £m	Other unsecured advances £m	
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
As at 1 January 2006	48	186	3	6	210	453
Charge/(release) to the income statement	60	(25)	-	1	374	410
Write offs	(3)	-	(2)	(3)	(232)	(240)
At 31 December 2006	105	161	1	4	352	623

During 2006, with respect to unsecured loan books no longer open to new business, the maturity of the books enabled management to refine the estimates of the likelihood of the assets leading to loss and the loss thereby incurred.

Notes to the Financial Statements continued

18. 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 ('Securitisation Companies'), and have been funded primarily through the issue of mortgage-backed securities ('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.

Abbey National plc 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 Abbey National plc.

The purpose of the special purpose entities is to obtain diverse, low cost funding through the issue of asset-backed securities. 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 Abbey and Holmes Funding Limited. Holmes Funding Limited acquires beneficial interests in the portfolios of mortgages with funds borrowed from the Securitisation Companies, Holmes Financing No.s 1, 8, 9, and 10 plc and Holmes Master Issuer plc.

Abbey National plc and its subsidiaries are under no obligation to support any losses that may be incurred by the 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 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.

Abbey National plc receives payments from the Securitisation Companies in respect of fees for administering the loans, and payment of deferred consideration for the sale of the loans. Abbey National plc has no right or obligation to repurchase the benefit of any securitised loan, except if certain representations and warranties given by Abbey National plc 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 Abbey National plc. It is intended that any future issues will continue to be made from Holmes Master Issuer plc. In April 2008 the remaining mortgage backed securities in issue in Holmes Financing (No. 6) plc and Holmes Financing (No. 7) plc were redeemed. The remaining share of the beneficial interest in residential mortgage loans held by Holmes Trustees Limited belongs to Abbey National plc, and amounts to £8.8bn at 31 December 2008. Mortgage backed notes totalling £7.1bn equivalent were redeemed during the year.

Outstanding balances of assets securitised and non-recourse finance at 31 December 2008 were as follows:

Securitisation company	Closing date of securitisation	Gross assets securitised £m	Non-recourse finance £m
Holmes Financing (No. 1) plc	26 July 2000	275	275
Holmes Financing (No. 8) plc	1 April 2004	-	1,278
Holmes Financing (No. 9) plc	8 December 2005	1,507	1,507
Holmes Financing (No. 10) plc	8 August 2006	2,354	2,364
Holmes Master Issuer plc – 2006/1	28 November 2006	2,618	2,618
Holmes Master Issuer plc – 2007/1	28 March 2007	4,210	4,210
Holmes Master Issuer plc – 2007/2	20 June 2007	4,319	4,319
Holmes Master Issuer plc – 2007/3	21 December 2007	7,259	7,259*
Holmes Master Issuer plc – 2008/1	10 April 2008	8,240	8,240*
Holmes Master Issuer plc – 2008/2	19 December 2008	13,360	13,360*
Beneficial interest in mortgages held by Holmes Trustees Limited		8,759	-
		52,901	45,430

*Held by Abbey National plc

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 Securitisation Companies have placed cash deposits totalling £1.3bn, which have been accumulated to finance the redemption of a number of Securities issued by the Securitisation Companies. The Securitisation Companies' contractual interest in advances secured on residential property is therefore reduced by this amount. Abbey National plc does not own directly, or indirectly, any of the share capital of any of the Securitisation Companies.

A summarised aggregated income statement for the years ended 31 December 2008, 2007, and 2006 and a summarised aggregated balance sheet at 31 December 2008 and 2007 for the above companies are set out below:

Notes to the Financial Statements continued

Income statement for the year ended 31 December

	2008 £m	Securitisation companies	
		2007 £m	2006 £m
Net interest income	85	35	21
Other operating income/(expenses)	169	35	67
Administration expenses	(1)	(1)	-
Impairment losses on loans and advances	(52)	(8)	(4)
Taxation expense/(income)	34	(17)	(25)
Profit/(loss) for the year	235	44	59

Balance sheet as at 31 December

	2008 £m	Securitisation companies	
		2007 £m	2007 £m
Derivative financial instruments	8,925	866	
Loans and advances to banks	2,937	2,375	
Loans and advances to customers	44,183	29,569	
Other assets	-	11	
Total assets	56,045	32,821	
Deposits by banks	1,346	743	
Derivative financial instruments	-	588	
Debt securities in issue	54,377	31,357	
Other liabilities	1	47	
Total liabilities	55,724	32,735	
Retained earnings	321	86	
Total liabilities and equity	56,045	32,821	

Issues under the covered bond programme are not included in the tables above. For more information, see Note 31.

19. Available-for-sale securities

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Debt securities	970	8	-	8
Equity securities	35	32	25	20
	1,005	40	25	28

Maturities of debt securities:

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Due in less than 1 year	970	8	-	8
Due in more than 1 year but less than 5 years	-	-	-	-
Due in more than one year but not more than 5 years	-	-	-	-
	970	8	-	8

Debt securities comprise UK Government Treasury Bills and issues by other Organisation of Economic Co-operation and Development Governments. Equity securities do not bear interest. Equity securities can be analysed by listing status as follows:

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Listed in the UK	10	12	-	-
Unlisted	25	20	25	20
	35	32	25	20

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

	Group		Company	
	£m		£m	
At 1 January 2008			40	28
Additions			1,222	9
Disposals (sale and redemption)			(286)	(8)
Amortisation of discount			21	-
Movement in fair value			8	(4)
At 31 December 2008			1,005	25
			Group £m	Company £m
At 1 January 2007			23	12
Disposals (sale and redemption)			(2)	(2)
Movement in fair value			19	18
At 31 December 2007			40	28

Notes to the Financial Statements continued

20. Investment in subsidiary undertakings

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

	Cost £m	Impairment £m	Company Net book value £m
At 1 January 2008	5,213	(160)	5,053
Additions	208	-	208
Disposals within the Group	(94)	-	(94)
Write-back of impairments	-	55	55
At 31 December 2008	5,327	(105)	5,222

	Cost £m	Impairment £m	Net book value £m
At 1 January 2007	5,148	(222)	4,926
Additions	418	-	418
Disposals	(353)	29	(324)
Write-back of impairments	-	33	33
At 31 December 2007	5,213	(160)	5,053

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, Abbey National plc 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, Abbey National plc 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 2008 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 231(5) of the UK Companies Act 1985, 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 231(6)(b) of the UK Companies Act 1985.

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
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.

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. Abbey National plc has branches in the Isle of Man and Northern Ireland. Abbey National International Limited has a branch in the Isle of Man. Cater Allen Limited has a branch in Northern Ireland.

21. Investment in associated undertakings

The movement in interests in associated undertakings was as follows:

	Group £m	Company £m
At 1 January 2008	29	33
Additional investments	708	708
Share of results	(2)	-
At 31 December 2008	735	741

	Group £m	Company £m
At 1 January 2007	22	25
Additional investment	8	8
Share of results	(1)	-
At 31 December 2007	29	33

Notes to the Financial Statements continued

On 17 December 2008, the Company injected £950m of capital into Alliance & Leicester plc through a subscription of: (i) 234,113,712 Alliance & Leicester plc ordinary shares for cash at £2.99 per ordinary share; (ii) US\$220m undated subordinated notes issued by Alliance & Leicester plc; and (iii) Euro 115m undated subordinated notes issued by Alliance & Leicester plc. As a result of the above subscription of ordinary shares, the Company held 35.6 per cent of the issued share capital of Alliance & Leicester plc at 31 December 2008.

The principal associated undertakings at 31 December 2008 and 2007 were:

2008

Name and nature of business	Country of incorporation	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
Alliance & Leicester plc, financial services	England and Wales	75,248	(73,420)	824*	(1,288)*	35.6

* Income and loss represent results prior to acquisition by the Company.

2007

Name and nature of business	Country of incorporation	Assets £m	Liabilities £m	Income £m	Profit/(loss) £m	% interest held
PSA Finance plc, personal finance	England and Wales	8	(1)	4	3	50.0
Santander Consumer (UK) plc, consumer finance	England and Wales	592	(542)	57	(7)	49.9

All associated undertakings have a year-end of 31 December and are unlisted, except for Alliance & Leicester plc, which has listed preference shares and debt.

22. Intangible assets

a) Goodwill

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Cost				
At 1 January				
Acquisitions	112	112	-	-
At 31 December	341	-	341	-
Accumulated impairment				
At 1 January and 31 December	22	22	-	-
Net book value	431	90	341	-

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 £341m was recognised. The initial accounting for this transaction is incomplete given its recent closing date.

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 2008 there was no impairment of goodwill (2007: £nil, 2006: £46m). In 2006, the impairment was recognised upon classification of the life insurance businesses as held for sale on announcement of the sale in June 2006. 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.

Business Division	Cash Generating Unit	Goodwill		Basis of valuation	Key assumptions	Discount rate	Growth rate
		2008 £m	2007 £m				
Retail Banking	Cater Allen Private Bank	90	90	Value in use: cash flow	3 year plan	3.59%	2.25%
Retail Banking	Bradford & Bingley branches and savings	341	-	Value in use: cash flow	3 year plan	5.71%	2.50%

Notes to the Financial Statements continued

b) Other intangibles

	Group 2008 £m	Company 2008 £m
Cost		
At 1 January 2008	-	-
Acquisition of business	4	4
Additions	81	68
Disposals	(7)	-
At 31 December 2008	78	72
Accumulated amortisation / impairment		
At 1 January 2008	-	-
Charge for the year	7	7
At 31 December 2008	7	7
Net book value	71	65

Other intangible assets of the Group and the Company consist of computer software. The amounts in 2007 were not significant.

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

	Owner-occupied properties £m	Office fixtures and equipment £m	Computer software £m	Group Total £m
Cost:				
At 1 January 2008	74	479	359	912
Acquired through business combinations	34	10	-	44
Additions	11	59	39	109
Disposals	(2)	(28)	(13)	(43)
At 31 December 2008	117	520	385	1,022
Accumulated depreciation:				
At 1 January 2008	18	283	83	384
Depreciation charge for the year	7	49	22	78
Disposals	(1)	(20)	-	(21)
At 31 December 2008	24	312	105	441
Net book value	93	208	280	581

	Owner-occupied properties £m	Office fixtures and equipment £m	Computer software £m	Group Total £m
Cost:				
At 1 January 2007	55	432	261	748
Additions	23	66	103	192
Disposals	(4)	(19)	(5)	(28)
At 31 December 2007	74	479	359	912
Accumulated depreciation:				
At 1 January 2007	14	245	74	333
Depreciation charge for the year	6	56	14	76
Disposals	(2)	(18)	(5)	(25)
At 31 December 2007	18	283	83	384
Net book value	56	196	276	528

	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
Depreciation charge	7	45	22	74
Disposals	-	(17)	-	(17)
At 31 December 2008	22	299	35	356
Net book value	90	199	280	569

Notes to the Financial Statements continued

				Company
	Owner-occupied properties £m	Office fixtures and equipment £m	Computer software £m	Total £m
Cost:				
At 1 January 2007				
Additions	47	406	186	639
Disposals	23	60	98	181
At 31 December 2007	(2)	(13)	(5)	(20)
	68	453	279	800
Accumulated depreciation:				
At 1 January 2007				
Depreciation charge	10	230	5	245
Disposals	6	53	13	72
At 31 December 2007	(1)	(12)	(5)	(18)
Net book value	15	271	13	299
	53	182	266	501

At 31 December 2008 capital expenditure contracted, but not provided for was £3m (2007: £nil, 2006: £7m) in respect of property, plant and equipment. Of the carrying value at 31 December 2008, £107m (2007: £163m) related to assets under construction.

24. Operating lease assets

	Group	
	2008 £m	2007 £m
Cost		
At 1 January		
Additions	3,474	3,275
Disposals of subsidiary undertaking	88	215
At 31 December	(3,562)	(16)
	-	3,474
Depreciation and impairment		
At 1 January		
Charge for the year	1,310	1,193
Impairment charge	117	129
Disposals of subsidiary undertaking	-	4
At 31 December	(1,427)	(16)
Net book value	-	1,310
	-	2,164

The operating lease assets of the Group consisted of trains and related assets and were sold in 2008 as described in Note 40. The Company had no operating lease assets.

25. Deferred tax

Deferred income 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 effective rate for 2008 was 28% (2007: 28.1%, 2006: 30%).

The movement on the deferred tax account was as follows:

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
At 1 January				
Income statement charge	121	240	614	747
Credited/ (charged) to equity	(122)	(88)	(174)	(103)
Disposals of subsidiary undertaking	8	9	12	10
At 31 December	446	(40)	-	(40)
	453	121	452	614

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

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Deferred tax liabilities				
Accelerated tax depreciation	-	(463)	-	-
Other temporary differences	(86)	(81)	(6)	(6)
	(86)	(544)	(6)	(6)

Notes to the Financial Statements continued

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Deferred tax assets				
Pensions and other post retirement benefits	224	275	224	275
Accelerated book depreciation	69	45	66	41
IAS 32 & IAS 39 transitional adjustments	95	135	76	91
Other temporary differences	105	64	46	67
Tax losses carried forward	46	146	46	146
	539	665	458	620

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

	Group			Company	
	2008 £m	2007 £m	2006 £m	2008 £m	2006 £m
Pensions and other post retirement benefits	291	300	309	289	309

The deferred tax assets scheduled above have been recognised in both the Company and the Group on the evidence that sufficient future taxable profits are forecast within the foreseeable future 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 Abbey National plc 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		2006 £m
	2008 £m	2007 £m	
Accelerated tax depreciation	24	1	36
Pensions and other post-retirement benefits	(63)	(4)	(27)
IAS 32 & IAS 39 transition adjustments	(20)	(23)	(16)
Tax losses carried forward	(100)	(48)	105
Other temporary differences	37	(14)	(52)
	(122)	(88)	46

At the balance sheet date the aggregate amount of the temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised is £113m (2007: £84m). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

26. Other assets

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Trade and other receivables	1,668	746	834	541
Prepayments	48	48	47	45
Accrued income	16	12	-	-
General insurance assets	109	100	109	100
	1,841	906	990	686

27. Deposits by banks

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Items in the course of transmission	922	786	895	769
Sale and repurchase agreements	-	-	3,620	-
Amounts due to subsidiaries	-	-	120,285	59,005
Other deposits	2,415	7,137	46	24
	3,337	7,923	124,846	59,798

Notes to the Financial Statements continued

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Repayable:				
On demand	1,096	416	2,907	2,060
In not more than 3 months	1,987	7,256	17,600	13,838
In more than 3 months but not more than 1 year	144	251	18,575	7,845
In more than 1 year but not more than 5 years	110	-	53,245	31,045
In more than 5 years	-	-	32,519	5,010
	3,337	7,923	124,846	59,798

28. Deposits by customers

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Retail deposits	95,505	67,208	85,150	59,187
Amounts due to subsidiaries	-	-	67,801	34,623
Wholesale deposits by customers	3,741	2,442	2,515	1,877
	99,246	69,650	155,466	95,687
Repayable:				
In no more than 3 months	81,649	64,204	82,060	59,588
In more than 3 months but no more than 1 year	13,892	3,579	13,506	3,322
In more than 1 year but not more than 5 years	3,070	1,728	8,804	5,687
In more than 5 years	635	139	51,096	27,090
	99,246	69,650	155,466	95,687

In 2008, issuances of commercial paper and certificates of deposit were used to fund commercial banking operations. As a result, such issuances have been classified as deposits by customers. In previous years, similar debt issuances were used to fund the Group's trading operations and therefore were classified as trading liabilities.

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

29. Trading liabilities

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Deposits by banks	34,341	19,632	-	-
Deposits by customers	4,622	20,498	-	-
Short positions in securities	751	2,252	739	-
Debt securities in issue	1,024	12,534	-	-
	40,738	54,916	739	-

In 2007, issuances of commercial paper and certificates of deposit were used to fund the Group's trading operations and were classified as trading liabilities. In 2008, such issuances were used to fund commercial banking operations and therefore have been classified as deposits by customers.

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. The total fair value of equity index-linked deposits was £2,205m at 31 December 2008 (2007: £2,455m). There are two principal product types.

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.

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 from 1 July 2008 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.

Notes to the Financial Statements continued

30. Financial liabilities designated at fair value

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Debt securities in issue	4,945	7,538	-	-

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 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 £88m (2007: nil) result from changes in the Group's own credit risk. The amount that would be required to be contractually paid at maturity of the debt securities in issue above is £39m (2007: £257m) higher than the carrying value.

31. Debt securities in issue

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Bonds and medium term notes	36,940	29,613	-	-
Other debt securities in issue	4,238	6,099	-	-
	41,178	35,712	-	-

A breakdown, by issue currency, of the above is as follows:

	Interest rate	Maturity	Group		Company	
			2008 £m	2007 £m	2008 £m	2007 £m
Euro	0.00% - 3.99%	Up to 2010	2,921	-	-	-
		2011 - 2019	1,959	1,406	-	-
	4.00% - 4.99%	Up to 2010	82	1,476	-	-
		2020 - 2029	1,469	1,063	-	-
	5.00% - 7.99%	2020 - 2029	2,887	3,887	-	-
		2030 - 2040	2,590	2,679	-	-
US dollar	0.00% - 3.99%	Up to 2010	8,430	1,496	-	-
		2011 - 2019	595	5,351	-	-
	4.00% - 6.87%	Up to 2010	-	1,102	-	-
		2020 - 2029	4,340	4,509	-	-
	7.00% - 8.99%	2030 - 2040	4,916	3,831	-	-
		Up to 2010	221	-	-	-
		2011 to 2040	-	35	-	-
Pounds sterling	0.00% - 4.99%	Up to 2010	882	-	-	-
		2011 - 2019	984	-	-	-
	5.00% - 5.99%	Up to 2010	2,428	378	-	-
		2011 - 2019	771	776	-	-
	6.00% - 6.87%	2020 - 2029	881	1,439	-	-
		2030 - 2040	856	1,469	-	-
	7.00% - 8.99%	2011 - 2040	3,545	4,408	-	-
		2011 - 2040	73	113	-	-
Other currencies	0.00% - 3.99%	2020 - 2029	337	-	-	-
		2011 - 2019	11	-	-	-
			2020 - 2029	-	294	-
			41,178	35,712	-	-

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. There were no new issuances in 2007.

Notes to the Financial Statements continued

32. Other borrowed funds

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
£300m Step Up Callable Perpetual Reserve Capital Instruments	356	308	356	308
£175m Fixed/Floating Rate Tier One Preferred Income Capital Securities	205	182	205	182
\$1,000m Non-Cumulative Trust Preferred Securities	1,171	585	-	-
£325m Sterling Preference Shares	344	344	344	344
	2,076	1,419	905	834

£300m Step-up Callable Perpetual Reserve Capital Instruments

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 each coupon payment date thereafter, subject to the prior approval of the 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.

£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 each coupon payment date thereafter, subject to the prior approval of the 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.

The Reserve Capital Instruments and 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. Upon the occurrence of certain tax or regulatory events, the Reserve Capital Instruments may be exchanged, their terms varied, or redeemed.

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. 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 and 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 Abbey National plc loan capital. Upon the winding up of the Company, holders of Reserve Capital Instruments and 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.

\$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. Abbey National Capital Trust I has registered trust preferred securities, and Abbey National Capital LP I has registered partnership preferred securities, for issuance in the US. 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 the issued trust preferred securities. All of the trust preferred securities and the partnership preferred securities have been fully and unconditionally guaranteed on a subordinated basis by the Company. Abbey National Capital Trust I has issued to the public US \$1bn of 8.963% Non-Cumulative Trust Preferred Securities. There are no 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 at the rate of 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.

On a return of capital or on a distribution of assets on a 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.

The trust preferred securities, the partnership preferred securities and the subordinated guarantees taken together will not entitle the holders to receive more than they would have been entitled to receive had they been the holders of directly issued non-cumulative, non-voting preference shares of the Company.

Notes to the Financial Statements continued

£325m Sterling Preference Shares

Size of shareholding	Shareholders	Preference shares of £1 each
1-100	4	284
101-1,000	50	37,173
1,001+	1,887	324,962,543
	1,941	325,000,000

Holders of the 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. 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	
	2008 £m	2007 £m	2008 £m	2007 £m
Dated subordinated liabilities:				
5.00% Subordinated bond 2009 (€511.3m)	515	393	515	393
4.625% Subordinated notes 2011 (€500m)	515	378	515	378
10.125% Subordinated guaranteed bond 2023	231	212	-	-
11.50% Subordinated guaranteed bond 2017	238	220	-	-
11.59% Subordinated loan stock 2017	-	-	221	203
10.18% Subordinated loan stock 2023	-	-	217	198
7.57% Subordinated notes 2029 (US\$1,000m)	1,142	588	1,142	588
6.50% Subordinated notes 2030	194	164	194	164
8.9% Subordinated notes 2030 (US\$1,000m)	-	-	1,170	586
5.25% Subordinated notes 2015	215	206	215	206
Subordinated floating rate EURIBOR notes 2015	485	370	485	370
Subordinated floating rate EURIBOR notes 2016	-	-	65	65
	3,535	2,531	4,739	3,151
Undated subordinated liabilities:				
10.0625% Exchangeable subordinated capital securities	204	204	204	204
6.70% Perpetual subordinated reset capital securities (US\$500m)	-	252	-	252
5.56% Subordinated guaranteed notes (YEN 15,000m)	143	84	143	84
5.50% Subordinated guaranteed notes (YEN 5,000m)	47	28	47	28
Fixed/Floating rate subordinated notes (YEN 5,000m)	45	26	45	26
7.50% 10 Year step-up perpetual subordinated notes	354	342	354	342
7.50% 15 Year step-up perpetual subordinated notes	514	465	514	465
7.38% 20 Year step-up perpetual subordinated notes	223	198	223	198
7.13% 30 Year step-up perpetual subordinated notes	348	293	348	293
7.13% Fixed to floating rate perpetual subordinated notes	413	309	413	309
	2,291	2,201	2,291	2,201
Total subordinated liabilities	5,826	4,732	7,030	5,352

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.

Notes to the Financial Statements continued

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.

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 2008, the 6.70% perpetual subordinated reset capital securities were redeemed in full.

Subordinated liabilities including convertible debt securities in issue are repayable:

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £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	515	771	515	771
In more than 5 years	2,504	1,760	3,709	2,380
Undated	2,291	2,201	2,291	2,201
	5,825	4,732	7,030	5,352

34. Other liabilities

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Trade and other payables	1,762	2,271	1,283	1,452
Deferred income	8	66	-	-
	1,770	2,337	1,283	1,452

35. Provisions

	Group		
	Misselling £m	Other £m	Total £m
At 1 January 2008	95	36	131
Disposal of subsidiary undertakings	-	(2)	(2)
Additional provisions	-	58	58
Provisions released	(40)	(1)	(41)
Used during the year	(14)	(25)	(39)
At 31 December 2008	41	66	107
To be settled:			
Within 12 months	36	63	99
In more than 12 months	5	3	8
	41	66	107
	Company		
	Misselling £m	Other £m	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

Notes to the Financial Statements continued

	Misselling £m	Other £m	Total £m
To be settled:			
Within 12 months	37	57	94
In more than 12 months	5	-	5
	42	57	99

	Group		
	Misselling £m	Other £m	Total £m
At 1 January 2007	153	27	180
Additional provisions	-	1	1
Provisions released	-	(1)	(1)
Used during the year	(58)	(7)	(65)
Reclassifications	-	16	16
At 31 December 2007	95	36	131

	Misselling £m	Other £m	Total £m
To be settled:			
Within 12 months	55	26	81
In more than 12 months	40	10	50
	95	36	131

	Company		
	Misselling £m	Other £m	Total £m
At 1 January 2007	151	6	157
Used during the year	(56)	(1)	(57)
At 31 December 2007	95	5	100

	Misselling £m	Other £m	Total £m
To be settled:			
Within 12 months	55	1	56
In more than 12 months	40	4	44
	95	5	100

The charge disclosed in the income statement in respect of provisions for other liabilities and charges of £17m (2007: nil), comprises the additional provisions of £58m (2007: £1m), less the provisions released of £41m (2007: £1m) 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 93.

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

36. Retirement benefit obligations

Defined Contribution Pension schemes

The Group operates a number of defined contribution pension schemes, of which the Stakeholder scheme introduced in 2001 is the principal scheme. The scheme assets are held separately from those of the Company by an independently administered scheme.

An expense of £8m (2007: £7m, 2006: £4m) 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 2008, 2007 and 2006.

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, National & Provincial Building Society Pension Fund, the Scottish Mutual Assurance Staff Pension Scheme and the Scottish Provident Institution Staff Pension Fund are the principal pension schemes within the Group, covering 41% (2007: 45%, 2006: 47%) 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.

On 31 August 2006, the Company became the legally sponsoring employer of the Scottish Mutual Assurance Staff Pension Scheme and the Scottish Provident Institution Staff Pension Fund. Employees of these schemes who transferred to Resolution plc upon the sale of the life insurance businesses became deferred members of these schemes.

Notes to the Financial Statements continued

Formal actuarial valuations of the assets and liabilities of the schemes are carried out on a triennial basis 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 Amalgamated Pension Fund, Associated Bodies Pension Fund, Group Pension Scheme and the National & Provincial Building Society Pension Fund and as at 31 December 2006 for the Scottish Mutual Assurance Staff Pension Scheme and the Scottish Provident Institution Staff Pension Fund.

In July 2008, as part of the Group's periodic review of its pension schemes, updated funding arrangements were agreed with the pension scheme Trustees of four schemes.

The total amount charged to the income statement, including amounts classified in discontinued operations and redundancy costs, is determined as follows:

	Group			Company		
	2008 £m	2007 £m	2006 £m	2008 £m	2007 £m	2006 £m
Current service cost	55	67	92	42	57	76
Past service cost	16	14	16	16	14	15
Gain on settlements or curtailments	(2)	(10)	(69)	(2)	(10)	(69)
Expected return on pension scheme assets	(237)	(194)	(180)	(236)	(192)	(168)
Interest cost	264	220	211	262	220	197
	96	97	70	82	89	51

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

	Group				2004
	2008 £m	2007 £m	2006 £m	2005 £m	£m
Present value of defined benefit obligation	(3,955)	(4,581)	(4,264)	(4,354)	(3,686)
Fair value of plan assets	3,159	3,602	3,230	2,974	2,489
Unfunded benefit obligation	(796)	(979)	(1,034)	(1,380)	(1,197)

	Company				2004
	2008 £m	2007 £m	2006 £m	2005 £m	£m
Present value of defined benefit obligation	(3,944)	(4,559)	(4,241)	(3,822)	(3,229)
Fair value of plan assets	3,147	3,577	3,208	2,582	2,169
Unfunded benefit obligation	(797)	(982)	(1,033)	(1,240)	(1,060)

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

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Balance at 1 January	(4,581)	(4,264)	(4,559)	(4,241)
Current service cost	(55)	(67)	(42)	(65)
Interest cost	(264)	(220)	(262)	(220)
Employee contributions	(7)	(8)	(7)	(8)
Past service cost	(16)	(14)	(16)	(14)
Actuarial (loss)/gain	818	(138)	793	(140)
Actual benefit payments	148	120	147	119
Settlement/curtailment	2	10	2	10
Balance at 31 December	(3,955)	(4,581)	(3,944)	(4,559)

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

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Balance at 1 January	3,602	3,230	3,577	3,208
Expected return on scheme assets	237	194	236	192
Actuarial gain/(loss) on scheme assets	(862)	33	(836)	32
Company contributions paid (regular)	307	243	294	242
Company contributions paid (special)	16	14	16	14
Employee contributions	7	8	7	8
Actual benefit payments	(148)	(120)	(147)	(119)
Balance at 31 December	3,159	3,602	3,147	3,577

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 using the Bloomberg AA Banks Index.

Notes to the Financial Statements continued

The amounts recognised in the statement of recognised income and expense for each of the five years indicated were as follows:

	Group				
	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Experience gain on scheme liabilities	-	-	-	-	13
Actuarial (gain)/loss on scheme liabilities	(818)	146	(228)	436	164
Actuarial (gain)/loss on scheme assets	862	(33)	9	(282)	(107)
	44	113	(219)	154	70

	Company				
	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Experience gain on scheme liabilities	-	-	-	7	10
Actuarial (gain)/loss on scheme liabilities	(793)	148	(180)	387	133
Actuarial (gain)/loss on scheme assets	836	(32)	-	(242)	(94)
	43	116	(180)	152	49

The actual return on scheme assets was £(625)m (2007: £227m, 2006: £171m). Cumulative net actuarial losses of £162m (2007: £118m, 2006: £5m) have been recognised in the Consolidated Statement of Recognised Income and Expenses.

The Group's pension schemes did not directly hold any equity securities of the Company or any of its related parties at 31 December 2008, 2007 and 2006. In addition, the Group does not hold insurance policies over the schemes, and has not entered into any significant transactions with the schemes.

The principal actuarial assumptions used for the Group and the Company were as follows:

	Nominal per annum		
	2008 %	2007 %	2006 %
To determine benefit obligations:			
- Discount rate for scheme liabilities	6.4	5.8	5.2
- General salary increase	3.5	4.0	4.0
- General price inflation	3.0	3.5	3.0
- Expected rate of pension increase	3.0	3.5	3.0
- Expected rate of return on plan assets at the start of the year	6.7	6.1	6.0
To determine net periodic benefit cost:			
- Discount rate	5.8	5.2	4.85
- Expected rate of pension increase	3.5	3.0	2.8
- Expected rate of return on plan assets	6.7	6.1	6.0

The mortality assumption used in preparation of the valuation was the Continuous Mortality Investigation Table PXA 92MCC 2008. The Group determined its expense measurements above based upon long-term assumptions taking into account target asset allocations of equities and bonds 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 trustees of the schemes are required under the Pensions Act 2004 to prepare a statement of investment principles. The principal duty of the trustees is to act in the best interest of the members of the schemes and they have developed the following investment objectives for their defined benefit sections:

- > 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.

The statement of investment principles has set the target allocation of plan assets at 48% Equities, 30% Bonds and 22% Gilts for 2008, 2007 and 2006, which was changed from 2005 when a 50% Equity, 30% Bonds and 20% Gilts policy was in place.

The expected rates of return by asset class used to calculate the expected return for 2008 are Equities 8.3% (2007: 7.7%, 2006: 7.8%), Bonds 5.8% (2007: 5.1%, 2006: 4.8%) and Gilts 4.4% (2007: 4.3%, 2006: 4.0%). The overall long-term rate of return on the assets employed has been determined after considering projected movements in asset indices.

The categories of assets in the scheme as a percentage of total scheme assets for Group and Company are as follows:

	2008 %	2007 %
UK equities	20	24
Overseas equities	19	20
Corporate bonds	29	30
Government Fixed Interest	16	12
Government Index Linked	13	10
Others	3	4
	100	100

Notes to the Financial Statements continued

The Group currently expects to contribute £241m to its defined benefit pension schemes in 2009. The benefits expected to be paid in each of the next five years, and in the aggregate for the five years thereafter are:

Year ending 31 December:	£m
2009	153
2010	165
2011	178
2012	191
2013	206
Five years ended 2018	1,290

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. Payments agreed with the trustees following the sale of the life insurance businesses in 2006 were made by the end of 2007.

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

37. Contingent liabilities and commitments

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

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Guarantees given to subsidiaries	-	-	105,022	101,785
Guarantees given to third parties	369	3,589	-	-
Formal standby facilities, credit lines and other commitments with original term to maturity of:				
- One year or less	1,883	1,928	1,883	1,925
- More than one year	6,672	5,392	3,688	3,150
	8,924	10,909	110,593	106,860

	Group		Company	
	2008 £m	2007 £m	2008 £m	2006 £m
Other contingent liabilities	8	8	8	8

Unauthorised overdraft fees

The Group, in line with other UK banks and building societies, levies charges on current account customers, for example when a customer goes overdrawn (if they did not have an arranged overdraft facility) when a customer exceeds their agreed overdraft limit, or when the bank refuses to pay an item if the customer does not have sufficient funds in their account. UK banks and building societies believe these fees are fair and clearly set out in account terms and conditions.

In common with other banks in the United Kingdom, the Group has received claims and complaints from a large number of customers relating to the legal status and enforceability of current and historic contractual terms in personal current account agreements relating to unarranged overdraft and unpaid item charges ('Relevant Charges') and seeking repayment of Relevant Charges that had been applied to their accounts in the past. The claims and complaints are based primarily on the common law penalty doctrine and the Unfair Terms in Consumer Contract Regulations 1999 (the 'Regulations'). Because of the High Court test case referred to below, most existing and new claims in the County Courts are currently stayed and there is also a UK Financial Services Authority ('FSA') waiver of the complaints handling process and a standstill of Financial Ombudsman Service decisions.

On 27 July 2007, following discussions between the Office of Fair Trading ('OFT'), the Financial Ombudsman Service, the FSA and major UK banks (including Abbey National plc), the OFT issued proceedings in a test case against the banks which was intended to determine certain preliminary issues concerning the legal status and enforceability of contractual terms relating to Relevant Charges.

The preliminary trial concluded on 8 February 2008 and the judgement was handed down on 24 April 2008. The High Court held that the contractual terms relating to unarranged overdraft charges currently used by the Group (i) are not unenforceable as penalties, but (ii) are not exempt from assessment for fairness under the Regulations. At a subsequent court hearing on 22 and 23 May 2008, the judge granted Abbey National plc and other test case banks permission to appeal his decision that unarranged overdraft charges are assessable for fairness under the Regulations. The appeal hearing concluded in November 2008 and on 26 February 2009 the Court of Appeal upheld the judge's decision and rejected the appeal.

Notes to the Financial Statements continued

The test case banks are now likely to take the appeal to the House of Lords. In October 2008 the High Court also delivered its judgement to the effect that terms and conditions previously used by the test case banks are not capable of being penalties but are assessable for fairness under the Regulations. Depending on the outcome of an appeal to the House of Lords, further hearings may be required in order for the Court to determine the fairness of the charges.

The issues relating to the legal status and enforceability of the Relevant Charges are complex. The Company maintains that its Relevant Charges are fair and enforceable and believes that it has a number of substantive and credible defences. The Group cannot, however, at this stage predict with any certainty if, or for how long, the stays, waiver and standstill referred to above will remain in place. Nor can it at this stage predict with any certainty the timing or substance of the final outcome of the customer claims and complaints, any appeals and any further stages of the test case. It is unable reliably to estimate the liability, if any, which may arise as a result of or in connection with these matters or its effect on the Group's consolidated net assets, operating results or cash flows in any particular period.

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 September 2011.

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 accrued for its share of management expenses levies for the 2008/9 and 2009/10 levy years in the amount of £63m.

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 in September 2011, 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. As a consequence, the amount of the principal which the FSCS will levy to deposit-taking institutions is not yet known and is unlikely to be determined until 2011. 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 £80m at the balance sheet exchange rate (2007: £61m). At 31 December 2008, additional interest in relation to the demand could amount to £34m at the balance sheet exchange rate (2007: £24m). 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 £17,139m at 31 December 2008 (2007: £33,774m) 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.

Notes to the Financial Statements continued

Operating lease commitments

	Group £m	Company £m
Rental commitments under operating leases expiring:		
- No later than 1 year	104	98
- Later than 1 year but no later than 5 years	396	369
- Later than 5 years	597	549
	1,097	1,016

At 31 December 2008, 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:

Year ended 31 December:	Group £m	Company £m
2009	104	98
2010	105	99
2011	106	100
2012	100	93
2013	85	78
Total thereafter	597	549

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:

	2008 £m	2007 £m	Group 2006 £m
In respect of minimum rentals	95	96	105
Less: sub-lease rentals	-	-	-
	95	96	105

Associates

The Group's share of associates' contingent liabilities amounted to £775m as at 31 December 2008. Alliance and Leicester plc, a significant associate of the Company at 31 December 2008, is also affected by the test case referred to above in relation to unauthorised overdraft fees. It too is unable reliably to estimate the liability, if any, which may arise as a result of or in connection with those matters, or their effect on its consolidated net assets, operating results or cash flows in any particular period.

Appropriate provisions are maintained to cover the above matters.

38. Share capital

	Ordinary shares of 10 pence each £m	Preference shares of £1 each £m	Preference shares of \$50.01 each £m	Preference shares of Euro0.01 each £m	Total £m
Share capital					
Authorised share capital					
At 1 January 2008	175	1,000	6	6	1,187
Increase	2,300	-	-	-	2,300
At 31 December 2008	2,475	1,000	6	6	3,487
At 1 January and 31 December 2007	175	1,000	6	6	1,187
Issued and fully paid share capital					
At 1 January 2008	148	325	-	-	473
Shares issued	1,000	-	-	-	1,000
At 31 December 2008	1,148	325	-	-	1,473
At 1 January and 31 December 2007	148	325	-	-	473
Share premium account					
At 1 January 2008	1,857	-	-	-	1,857
Shares issued	-	-	-	-	-
At 31 December 2008	1,857	-	-	-	1,857
At 1 January and 31 December 2007	1,857	-	-	-	1,857

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

Notes to the Financial Statements continued

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 authorised share capital of the Company was increased by £1bn consisting of ten billion ordinary shares of 10 pence each and these shares were issued at par, to Banco Santander, S.A. on the same date.

On 16 December 2008, the authorised share capital was further increased by £1.3bn consisting of 13 billion ordinary shares of 10 pence each.

39. Retained earnings and minority interest

Movements in retained earnings were as follows:

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
At 1 January	1,339	1,111	586	694
Profit for the year	811	685	1,328	351
Post-tax actuarial movement on defined benefit pension schemes	(33)	(98)	(31)	(100)
Gains/(losses) on available for sale securities	5	13	(4)	12
Gains on available for sale securities transferred to profit or loss on sale	-	(1)	-	(1)
Exchange differences on translation of foreign operations	28	(1)	-	-
Equity dividends proposed	(450)	(370)	(450)	(370)
At 31 December	1,700	1,339	1,429	586

The balance of the available-for-sale reserve included in retained earnings at 31 December 2008 was £28m (2007:£20m).

Movements in minority interest were as follows:

	Group	
	2008 £m	2007 £m
At 1 January	98	-
Share of profit	8	98
At 31 December	106	98

Analysis of dividends paid is as follows:

	Group			Company	
	2008 Pence per Share	2007 Pence per Share	2006 Pence per Share	2007 Pence per Share	2006 Pence per Share
Ordinary shares (equity):					
2006 interim	-	-	13.93	-	13.93
2007 interim	13.46	-	-	-	-
2007 interim	11.44	-	-	-	-
July 2008 interim	15.14	-	-	-	-
	40.04	-	13.93	-	13.93

40. Cash flow statement

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

	Group			Company		
	2008 £m	2007 ⁽¹⁾ £m	2006 ⁽¹⁾ £m	2008 £m	2007 ⁽¹⁾ £m	2006 ⁽¹⁾ £m
Profit/(loss) for the year	819	685	68	1,328	351	(128)
Non-cash items included in net profit						
(Increase)/decrease in prepayments and accrued income	(126)	(105)	(91)	(902)	(353)	(91)
Increase/(decrease) in accruals and deferred income	346	531	176	1,260	411	(64)
Depreciation and amortisation	202	205	217	81	72	79
(Profit)/loss on sale of subsidiary and associated undertakings	(40)	-	223	-	-	-
Amortisation of premiums/(discounts) on debt securities	(21)	-	-	-	-	-
Change in value of in-force Life Assurance Business	-	-	96	-	-	-
Provisions for liabilities and charges	17	-	63	16	-	159
Provision for impairment	394	388	413	302	346	375
Other non-cash items	525	288	28	1,281	(30)	(207)
	2,116	1,992	1,193	3,366	797	123

Notes to the Financial Statements continued

	Group			Company		
	2008 £m	2007 ⁽¹⁾ £m	2006 ⁽¹⁾ £m	2008 £m	2007 ⁽¹⁾ £m	2006 ⁽¹⁾ £m
Changes in operating assets and liabilities						
Net decrease/(increase) in trading assets	8,965	(695)	(938)	-	-	-
Net (increase)/decrease in derivative assets	(22,330)	(1,615)	2,512	(2,046)	(43)	581
Net decrease/(increase) in financial assets designated at fair value	469	(3,107)	(933)	(39,863)	(7,434)	724
Net (increase)/decrease in loans and advances to banks and customers	(27,893)	(8,908)	(9,914)	(38,835)	(1,641)	(20,801)
Net (increase)/decrease in other assets	(189)	1,914	(360)	108	357	(166)
Net (increase)/decrease in deferred acquisition costs	-	-	(3)	-	-	-
Net increase/(decrease) in deposits by banks and deposits by customers	4,182	4,104	2,344	123,614	13,813	13,809
Net increase/(decrease) in derivative liabilities	16,378	(287)	(1,046)	4,342	370	58
Net (decrease)/increase in trading liabilities	(14,054)	(2,850)	4,834	739	-	-
Net (decrease)/increase in financial liabilities designated at fair value	(2,591)	(619)	679	-	-	-
Net decrease in insurance contract liabilities	-	-	(1,832)	-	-	-
Net decrease in investment contract liabilities	-	-	(53)	-	-	-
Net increase/(decrease) in debt issued	5,027	368	5,879	-	(3)	-
Net (decrease)/increase in other liabilities	(807)	(20)	(675)	(586)	(315)	(134)
Effects of exchange rate differences	8,569	396	(1,196)	897	-	(108)
Net cash flow (used in)/from operating activities before tax	(22,158)	(9,327)	491	51,736	5,901	(5,914)
Income tax received/(paid)	43	(5)	(60)	80	48	56
Net cash flow (used in)/from operating activities	(22,115)	(9,332)	431	51,816	5,949	(5,858)

(1) Amended for the change in accounting policy for cash equivalents described in the Accounting Policies on page 85.

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

	Group			Company		
	2008 £m	2007 ⁽¹⁾ £m	2006 ⁽¹⁾ £m	2008 £m	2007 ⁽¹⁾ £m	2006 ⁽¹⁾ £m
Cash and balances with central banks	2,464	1,038	888	2,456	1,032	888
Debt securities	5,208	5,819	8,026	-	-	-
Net trading other cash equivalents	5,479	24,989	29,644	-	-	-
Net non trading other cash equivalents	12,155	2,210	524	58,747	9,562	4,319
Cash and cash equivalents	25,306	34,056	39,082	61,203	10,594	5,207

(1) Amended for the change in accounting policy for cash equivalents described in the Accounting Policies on page 85.

c) Sale of subsidiaries and businesses

	Group		
	2008 £m	2007 £m	2006 £m
Net assets disposed of:			
Derivative financial instruments	-	-	1,007
Financial assets designated at fair value	-	-	24,130
Loans and advances to banks	-	-	1,329
Loans and advances to customers	-	-	19
Value of in force business	-	-	1,625
Operating lease assets	2,134	-	-
Current tax accounts	8	-	4
Deferred tax asset	-	-	1
Other assets	60	-	1,903
Deposits by banks	(8)	-	(609)
Deposits by customers	-	-	(3)
Financial liabilities designated at fair value	-	-	(544)
Debt securities in issue	-	-	(67)
Subordinated liabilities	-	-	(334)
Insurance and reinsurance liabilities	-	-	(19,647)
Other liabilities	(163)	-	(1,151)
Investment contract liabilities	-	-	(3,253)
Other provisions	(2)	-	-
Current tax liabilities	(19)	-	(34)
Deferred tax liabilities	(446)	-	(406)
Retirement benefit obligations	1	-	(2)
	1,565	-	3,968
Profit/ (loss) on disposal	40	-	(223)
	1,605	-	3,745
Satisfied by:			
Cash and cash equivalents	1,605	-	3,745
Less: Cash and cash equivalents in subsidiary sold	-	-	(4,110)
Net cash inflow of sale	1,605	-	(365)

Notes to the Financial Statements continued

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.

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

	Group 2008 £m
Net assets acquired:	
Cash and balances at central banks	18,613
Loans and advances to banks	1,624
Available for sale securities	3
Other intangible assets	4
Property, plant and equipment	44
Other assets	428
Customer accounts	(20,434)
Other liabilities	(7)
Current tax liabilities	(4)
Net identified assets and liabilities	271
Goodwill	341
Consideration	612
Satisfied by:	
Cash and cash equivalents	612
Less: Cash and cash equivalents in businesses acquired	(18,613)
Net cash (inflow) acquired	(18,001)

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.

e) Discontinued operations

The life insurance businesses that were sold in 2006, which constitute the Sold Life Businesses segment, qualify as discontinued operations. The net cash flows attributable to the operating, investing and financing activities of discontinued operations in 2006 were £554m, nil, and nil respectively.

41. Collateral pledged and received

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

The Company enters 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 2008 £44,142m (2007: £29,494m) of residential mortgage loans were so assigned.

In 2005, the Company also established a covered bond programme, whereby securities are issued to investors and are secured by a pool of ring-fenced residential mortgages. At 31 December 2008 £20,879m (2007: £3,170m) of residential mortgage loans had been so secured.

Collateral is also provided by Abbey National Treasury Services plc in the normal course of its derivative business to counterparties. At 31 December 2008 £1,646m (2007: £683m) 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 provided as collateral. At 31 December 2008 £844m (2007: £2,035m) of assets had been provided 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%-105% of the borrowed amount. The carrying amount of assets that were so provided at 31 December 2008 was £30,134m (2007: £37,455m).

Notes to the Financial Statements continued

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 companies 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 companies are permitted to sell or repledge the collateral held. At 31 December 2008, the fair value of such collateral was £26,987m (2007: £48,015m) of which £26,987m (2007: £48,015m) was sold or repledged. The companies have an obligation to return the collateral that it has sold or pledged with a fair value of £26,987m (2007: £48,015m).

As part of revised arrangements relating to the funding of the Group's defined benefit pension schemes, £968m of securities classified as available-for-sale have been pledged during the year to cover the group's obligations.

42. Share-based compensation

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.

In response to employee feedback, and in support of the Human Resources strategy, the Group introduced its first Sharesave Scheme under Banco Santander, S.A. ownership. The HM Revenue and Customs approved Sharesave Scheme was launched in September 2008. 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 2008.

The total carrying amount at the end of the period for liabilities arising from share-based payment transactions was £3m (2007: £68m, 2006: £54m). Cash received from the exercise of share options and the actual tax benefits realised from tax deductions were £14m (2007: £6m, 2006: £18m) and £4m (2007: £2m, 2006: £6m), respectively.

The fair value of each option for 2008, 2007 and 2006 has been estimated at the date of acquisition or grant using a partial differential equation model with the following assumptions:

	2008	2007	2006
Risk free interest rate	2.9%-6.5%	5.0%-5.8%	4.5%-5.0%
Dividend growth, based solely upon average growth since 1989	10%	10%	10%
Volatility of underlying shares based upon historical volatility over five years	20.2%-29.6%	19.80%-26.90%	17.70%-19.85%
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	3 years
- Long term incentive plans	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.

Notes to the Financial Statements continued

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		Employee Share Option scheme	
	Number of options '000s	Weighted average exercise price £	Number of options '000s	Weighted average exercise price £	Number of options '000s	Weighted average exercise price £
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	-	-	-	-
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	-	-	-	-
2006						
Options outstanding at the start of the year	270	4.08	13,799	3.38	54	5.90
Options exercised during the year	(92)	4.01	(5,095)	3.36	(33)	5.90
Options forfeited during the year	-	-	(897)	3.42	-	-
Options expired during the year	-	-	(169)	6.05	(21)	5.90
Options outstanding at the end of the year	178	4.11	7,638	3.32	-	-
Options exercisable at the end of the year	178	4.11	-	-	-	-

The intrinsic value of the options exercised and the fair value of the shares vested during the year were £31m (2007: £3m, 2006: £25m) and £6m (2007: £3m, 2006: £37m), respectively.

Executive Share Option scheme

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

Range of exercise prices	Options outstanding			Options exercisable	
	Number '000s	Weighted average remaining contractual life years	Weighted average exercise price £	Number '000s	Weighted average exercise price £
Between £3 and £4	-	-	-	-	-
Between £4 and £5	12	5	4.54	12	4.54

The following table summarises information about the options outstanding at 31 December 2007.

Range of exercise prices	Options outstanding			Options exercisable	
	Number '000s	Weighted average remaining contractual life years	Weighted average exercise price £	Number '000s	Weighted average exercise price £
Between £3 and £4	70	5	3.73	70	3.73
Between £4 and £5	74	6	4.54	74	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.

In response to employee feedback, and in support of the Human Resources strategy, the Group introduced its first Sharesave Scheme under Banco Santander, S.A. ownership. The HM Revenue and Customs approved Sharesave Scheme was launched in September 2008. 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 2008.

Employee Share Option scheme

All outstanding options under the Employee Share Option scheme expired on 8 August 2006. Accordingly, none were outstanding at 31 December 2008, 2007 and 2006. Movements in the share options for 2006 are contained in the summary table above.

Notes to the Financial Statements continued

Medium Term Incentive Plan

See Note 44 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 granted during the year	-
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 £19m vested during the year (2007: nil, 2006: nil).

Long Term Incentive Plan

See Note 44 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.

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

2007	Number of awards granted 000s
Conditional awards outstanding at the beginning of the year	-
Conditional awards granted during the year	3,092
Conditional awards forfeited during the year	-
Conditional awards outstanding at the end of the year	3,092

The weighted average grant-date fair value of conditional awards granted during the year was £4.24 (2007: £4.23). At 31 December 2008, the weighted average remaining contractual life was two years.

43. Directors' emoluments and interests

Ex gratia pensions paid to former Directors of the Company in 2008, which have been provided for previously, amounted to £22,341 (2007: £21,524, 2006: £26,998). 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
2008	2	647
2007	1	806

* 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.

Notes to the Financial Statements continued

44. 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.

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	1	806
Loans outstanding at 1 January	4	(159)
Net movements in the year	5	647
Loans outstanding at 31 December		
Deposit, bank and instant access accounts and investments	12	5,565
Deposits, bank instant access accounts and investments at 1 January	4	(1,102)
Net movements in the year	16	4,463
Deposit, bank and instant access accounts and investments at 31 December		
Life assurance policies	2	1,600
Life assurance policies at 1 January	(1)	(574)
Net movements in the year	1	1,026
Life assurance policies at 31 December		

2007	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	2	1,281
Loans outstanding at 1 January	(1)	(475)
Net movements in the year	1	806
Loans outstanding at 31 December		
Deposit, bank and instant access accounts and investments	14	2,588
Deposits, bank instant access accounts and investments at 1 January	(2)	2,977
Net movements in the year	12	5,565
Deposit, bank and instant access accounts and investments at 31 December		
Life assurance policies	6	1,515
Life assurance policies at 1 January	(4)	85
Net movements in the year	2	1,600
Life assurance policies at 31 December		

(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 2008, two Directors undertook sharedealing transactions through the Group's execution only stockbroker subsidiary (2007: one Director) with an aggregate net value of £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 63.

	2008 £	2007 £	2006 £
Key management compensation	13,016,060	11,602,405	15,076,922
Short-term employee benefits	306,902	77,814	89,753
Post employment benefits	-	-	-
Other long term benefits	-	-	548,692
Termination benefits	1,572,973	1,101,786	904,217
Share-based payments	14,895,935	12,782,005	16,619,584

Notes to the Financial Statements continued

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 2008, two Executive Directors (2007: three) and six other Key Management Personnel (2007: seven) were granted conditional awards of shares in Banco Santander, S.A. under the Santander Long Term Incentive Plan for a total fair value of £1,325,592 (2007: £2,884,471) based on the closing share price on 20 June 2008 of Euro 11.96 (2007: Euro 14.79). 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 21 June 2008 and 31 December 2007, certain Executive Directors, Key Management Personnel (as defined above) and other nominated individuals were granted conditional awards of shares in Banco Santander, S.A. The amount of shares participants will receive throughout a three year period (2007: a three year period) depends on 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 and Earnings Per Share performance against a competitor benchmark group. Provided the performance conditions are met, 100% of the 2008 conditional award of shares will vest in 2011. 40% of the 2007 conditional award of shares will vest in July 2009 with the remaining 60% vesting in July 2010.

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, Abbey National House, 2 Triton Square, Regent's Place, London, NW1 3AN.

Transactions with related parties

During the year, the Group entered into the following transactions with related parties:

	Interest, fees and other income received			Interest, fees and other expenses paid			Amounts owed by related parties		Amounts owed to related parties	
	2008 £m	2007 £m	2006 £m	2008 £m	2007 £m	2006 £m	2008 £m	2007 £m	2008 £m	2007 £m
Parent company	(537)	(293)	(23)	509	327	80	11,021	2,238	(2,337)	(7,388)
Fellow subsidiaries	(383)	(171)	(28)	377	24	84	6,065	3,031	(1,795)	(351)
Associates	(23)	(19)	-	2	5	2	10,125	3	(150)	(8)
	(943)	(483)	(51)	888	356	166	27,211	5,272	(4,282)	(7,747)

During the year, the Company entered into the following transactions with related parties:

	Interest, fees and other income received			Interest, fees and other expenses paid			Amounts owed by related parties		Amounts owed to related parties	
	2008 £m	2007 £m	2006 £m	2008 £m	2007 £m	2006 £m	2008 £m	2007 £m	2008 £m	2007 £m
Parent company	(55)	(91)	(21)	-	-	7	1,004	1,018	(230)	(373)
Subsidiaries	(6,654)	(2,072)	(1,611)	8,312	4,532	3,592	165,557	39,464	(198,369)	(95,553)
Fellow subsidiaries	(261)	(106)	(3)	253	17	61	352	13	(320)	(228)
Associates	(2)	-	-	-	-	-	334	-	(2)	-
	(6,972)	(2,269)	(1,635)	8,565	4,549	3,660	167,247	40,495	(198,921)	(96,154)

In addition, transactions with pension schemes operated by the Group are described in Note 36.

In December 2008, following the acquisition by Banco Santander, S.A. of Alliance & Leicester plc, Abbey National plc injected £950m of capital into Alliance & Leicester plc through a subscription of: (i) 234,113,712 new Alliance & Leicester plc ordinary shares for cash at £2.99 per ordinary share; (ii) US\$220m undated subordinated notes issued by Alliance & Leicester plc; and (iii); euro 115m undated subordinated notes issued by Alliance & Leicester plc. Previously, in October 2008, Abbey subscribed for US\$100m undated floating rate subordinated notes issued by Alliance & Leicester plc. As a result of the subscription of ordinary shares, Abbey National plc held 35.6% of the issued ordinary share capital of Alliance & Leicester plc at 31 December 2008.

On 17 December 2007, Abbey National plc 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 Abbey National plc, 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, Abbey National plc 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.

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On 31 December 2006, Abbey National plc sold its asset management businesses to Santander Asset Management UK Holdings Limited, an indirect subsidiary of Banco Santander, S.A., for a total cash consideration of £134m. The asset management companies sold were Abbey National Asset Managers Limited (now called Santander Asset Management UK Limited), Abbey National PEP & ISA Managers Limited, Abbey National Unit Trust Managers Limited (now called Santander Unit Trust Managers UK Limited) and Inscape Investments Limited (now called Santander Portfolio Management UK Limited).

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.

45. Events after the reporting period

On 9 January 2009, in order to optimise the capital, liquidity funding and overall financial efficiency of the enlarged group, Banco Santander, S.A. transferred all of its shares in Alliance & Leicester plc (a major UK financial services group that offers a broad range of financial services and products to personal and commercial customers) to Abbey National plc in exchange for Abbey National plc ordinary shares. The result of this was to increase Abbey National plc's holding of 35.6% of Alliance & Leicester plc's equity voting interests to 100%. Accordingly, Abbey National plc is now the immediate parent company of Alliance & Leicester plc.

A summary of the net assets at 31 December 2008 is as follows:

	Book value £m
Loans and advances to banks	1,239
Loans and advances to customers	51,402
Loans and receivables	14,250
Available for sale securities	1,658
Other assets	6,699
Deposits by banks	(11,516)
Deposits by customers	(39,765)
Debt securities in issue	(17,477)
Other liabilities	(4,662)
	1,828

The contingent liabilities assumed included guarantees, liquidity facilities and irrevocable letters of credit, and exposures under the Financial Services Compensation Scheme. In addition, Alliance & Leicester plc will be bound by the outcome of the test case on unauthorised overdraft fees described in Note 37.

The transfer of Alliance & Leicester plc to Abbey National plc from Banco Santander, S.A. in exchange for Abbey National plc ordinary shares represents a combination of entities under common control outside the scope of IFRS 3 'Business Combinations'. The initial accounting for this transaction is incomplete given its recent closing date. It has not yet been possible to establish the fair value of the shares issued which form the total consideration transferred, as these shares are not traded in an active market. It has also not yet been possible to establish the fair value of each major class of assets acquired and liabilities assumed, including contingent liabilities, and the amount of goodwill, if any, to be recognised.

The Company has given a full and unconditional guarantee in respect of the unsubordinated liabilities of Alliance & Leicester plc incurred prior to 31 July 2012 under a deed poll guarantee entered into by the Company on 19 March 2009. Alliance & Leicester plc has given a reciprocal guarantee in respect of the unsubordinated liabilities of the Company incurred prior to 31 July 2012 on the same date. It has not yet been practicable to estimate the financial effect of the deed poll guarantee given by the Group due to its recent completion.

46. Financial instruments

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The Accounting Policies Note describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. Each class of financial asset and liability on the balance sheet has a single measurement basis, which is described in the Accounting Policies Note. The following tables analyse the fair value of financial instruments not measured at fair value in the balance sheet:

2008	Group		
	Carrying value £m	Fair value £m	Surplus/(deficit) £m
Assets			
Cash and balances at central banks	2,464	2,464	-
Loans and advances to banks	24,301	24,426	125
Loans and advances to customers	129,023	133,856	4,833
Liabilities			
Deposits by banks	3,337	3,337	-
Deposits by customers	99,246	99,758	(512)
Debt securities in issue	41,178	41,069	109
Other borrowed funds	2,076	926	1,150
Subordinated liabilities	5,826	4,201	1,625

Notes to the Financial Statements continued

2008	Company		
	Carrying value £m	Fair value £m	Surplus/(deficit) £m
Assets			
Cash and balances at central banks	2,456	2,456	-
Loans and advances to banks	116,486	116,777	291
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

2007	Group		
	Carrying value £m	Fair value £m	Surplus/(deficit) £m
Assets			
Cash and balances at central banks	1,038	1,038	-
Loans and advances to banks	3,441	3,441	-
Loans and advances to customers	112,147	112,824	677
Liabilities			
Deposits by banks	7,923	7,923	-
Deposits by customers	69,650	69,754	(104)
Debt securities in issue	35,712	35,399	313
Other borrowed funds	1,419	1,620	(201)
Subordinated liabilities	4,732	4,698	34

2007	Company		
	Carrying value £m	Fair value £m	Surplus/(deficit) £m
Assets			
Cash and balances at central banks	1,032	1,032	-
Loans and advances to banks	40,685	40,685	-
Loans and advances to customers	110,976	111,653	677
Liabilities			
Deposits by banks	59,798	60,019	(221)
Deposits by customers	95,686	95,791	(105)
Other borrowed funds	834	1,022	(188)
Subordinated liabilities	5,352	5,361	(9)

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.

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. Pricing models take into account the contract terms of the securities as well as market-based valuation parameters, such as interest rates, volatility, exchange rates and the credit rating of the counterparty. Valuation adjustments are an integral component of the fair value estimation process and are taken on individual positions where either the absolute size of the trade or other specific features of the trade or the particular market (such as counterparty credit risk, concentration or market liquidity) require more than the simple application of pricing models. Further information on fair value measurement can be found in 'Critical Accounting Policies' within the Accounting Policies on page 87.

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/Loans and advances to banks

The carrying amount of cash and balances at central banks is deemed a reasonable approximation of the fair value. The fair value of loans and advances to banks has been estimated using in-house pricing models.

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.

Notes to the Financial Statements continued**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.

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.

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 in-house pricing models.

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 estimated using in-house pricing models.

Net gains and losses on financial instruments

	2008	2007	Group 2006
	£m	£m	£m
Financial assets and liabilities at fair value through profit or loss on initial recognition	481	(14)	(73)
Financial assets and liabilities held for trading	(53)	85	430
Loans and receivables	7,754	6,974	5,599
Available for sale	33	18	1
Financial liabilities held at amortised cost	(6,093)	(5,292)	(4,388)
	2,122	1,771	1,569

47. Capital management and resources**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 programs, the Group is rated on a standalone 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 2008, 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

	Basel II 31 December 2008 £m	Basel I 31 December 2007 £m
Core Tier 1 capital	4,694	3,808
Deductions from Core Tier 1 capital	(792)	(90)
Total Core Tier 1 capital after deductions	3,902	3,718
Other Tier 1 capital	1,485	1,253
Total Tier 1 capital after deductions	5,387	4,971
Tier 2 capital	4,766	4,260
Deductions from tier 2 capital	(284)	-
Total Tier 2 capital after deductions	4,482	4,260
Deductions from Tier 1 and Tier 2	(988)	(1,434)
Total Capital Resources	8,881	7,797

Tier 1 includes audited profits for the years ended 31 December 2008 and 31 December 2007 respectively after adjustment to comply with FSA rules. The change to Basel II reduced the capital resources by £0.5bn. This is attributed to the introduction of expected losses into the capital resources calculation. This reduction is partly offset by a change in the treatment of securitised residential mortgages under Basel II.

The expected losses deduction represents the difference between expected loss calculated in accordance with the Group's Retail IRB and AIRB 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 83. 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.

At 31 December 2007, in accordance with Basel 1, the Group deducted the capital requirement on securitised residential mortgages from capital resources. From 1 January 2008, in accordance with Basel II, there is no equivalent deduction from capital resources as residential lending risk weighted assets includes securitised mortgage assets.

The Group and Santander recognise the additional security inherent in Tier 1 capital in the current commercial and regulatory environment. As a result, on 12 October 2008, Banco Santander, S.A. agreed to inject capital of £1bn into Abbey National plc and Alliance & Leicester plc fulfilling its agreed commitment to the UK Government's banking support scheme announced on 8 October 2008. Consequently, on 12 October 2008, Abbey National plc 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. This increase was partly offset by an increase in the pension contributions due to be paid in the next five years and dividends paid. At 31 December 2008 Tier 1 includes the Tier 1 capital of Alliance & Leicester plc on a proportional consolidation basis at that date.

Tier 1 deductions for goodwill have increased following the purchase of Bradford and Bingley plc's savings business and branch network, and software capitalised during the year. Other Tier 1 deductions relate to expected losses described above.

Increases in Tier 2 relate to exchange rate fluctuations and the inclusion of the Tier 2 capital of Alliance & Leicester plc on a proportional consolidation basis. Deductions from Tier 2 represent expected losses described above.

At 31 December 2008, deductions from Tier 1 and Tier 2 represent lending which is capital in nature. The decrease during the year primarily relates to the securitised residential mortgages which, as described above, are no longer deductions from capital resources under Basel II.

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.

48. Consolidating financial information

Abbey National Treasury Services plc is a wholly owned subsidiary of Abbey National plc 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 Group is planning on registering a new shelf registration statement. Abbey National plc has fully and unconditionally guaranteed the obligations of Abbey National Treasury Services plc that have been, or will be incurred before 31 July 2012: this guarantee includes all securities issued by Abbey National Treasury Services plc pursuant to the Registration Statement.

Abbey National Treasury Services 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) Abbey National Treasury Services plc, on a stand-alone basis ('ANTS plc'); (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 Abbey National Treasury Services 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 Abbey National Treasury Services plc in the information below by £(517)m and £127m, respectively (2007: £334m and £218m, 2006: £196m and £177m). The net assets of the Company and Abbey National Treasury Services plc in the information below would also be increased by £271m and £497m, respectively (2007: £753m and £359m).

Notes to the Financial Statements continued

Income statements

	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
For the year ended 31 December 2008					
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) on continuing operations before tax	1,454	213	698	(1,271)	1,094
Tax on profit/(loss) on continuing operations	(126)	(10)	(204)	65	(275)
Profit/(loss) for the year from continuing operations	1,328	203	494	(1,206)	819
Profit/(loss) for the year from discontinued operations	-	-	-	-	-
Profit/(loss) for the year	1,328	203	494	(1,206)	819

	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
For the year ended 31 December 2007					
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) on continuing operations before tax	420	136	586	(278)	864
Tax on profit/(loss) on continuing operations	(69)	(29)	(89)	8	(179)
Profit/(loss) for the year from continuing operations	351	107	497	(270)	685
Profit/(loss) for the year from discontinued operations	-	-	-	-	-
Profit/(loss) for the year	351	107	497	(270)	685

	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
For the year ended 31 December 2006					
Net interest income	983	109	136	-	1,228
Fee, commission, net trading, and other income	574	122	805	(259)	1,242
Total operating income	1,557	231	941	(259)	2,470
Administration expenses	(1,181)	(109)	(130)	-	(1,420)
Depreciation and amortisation	(79)	(3)	(133)	-	(215)
Impairment and provisions	(534)	-	165	(38)	(407)
Profit/(loss) on continuing operations before tax	(237)	119	843	(297)	428
Tax on profit/(loss) on continuing operations	109	(55)	(169)	-	(115)
Profit/(loss) for the year from continuing operations	(128)	64	674	(297)	313
Profit/(loss) for the year from discontinued operations	-	-	(245)	-	(245)
Profit/(loss) for the year	(128)	64	429	(297)	68

Balance sheets

	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
At 31 December 2008					
Cash and balances at central banks	2,456	8	-	-	2,464
Trading assets	-	26,389	19,675	(20,578)	25,486
Derivative financial instruments	2,735	32,160	11,213	(13,827)	32,281
Financial assets designated at fair value	47,525	11,005	276	(47,492)	11,314
Loans and advances to banks	116,486	128,035	103,284	(323,504)	24,301
Loans and advances to customers	123,319	25,027	47,820	(67,143)	129,023
Available for sale securities	25	-	980	-	1,005
Macro hedge of interest rate risk	-	1,475	-	-	1,475
Investment in associated undertakings	741	-	-	(6)	735
Investment in subsidiary undertakings	5,222	2,335	2,050	(9,607)	-
Intangible assets	406	6	90	-	502
Property, plant and equipment	569	9	3	-	581
Current tax assets	194	-	1	-	195
Deferred tax assets	458	75	9	(3)	539
Other assets	990	778	73	-	1,841
Total assets	301,126	227,302	185,474	(482,160)	231,742
Deposits by banks	124,846	123,366	21,212	(266,087)	3,337
Deposits by customers	155,466	9,743	57,420	(123,383)	99,246
Derivative financial instruments	5,393	33,511	1,393	(13,988)	26,309
Trading liabilities	739	22,996	36,672	(19,669)	40,738
Financial liabilities designated at fair value	-	4,898	47	-	4,945
Debt securities in issue	-	29,692	58,612	(47,126)	41,178
Other borrowed funds	905	-	1,028	143	2,076
Subordinated liabilities	7,030	-	1,122	(2,326)	5,826
Other liabilities	1,283	83	402	2	1,770
Other provisions	99	-	8	-	107
Current tax liabilities	128	236	153	-	517
Deferred tax liabilities	6	-	143	(63)	86
Retirement benefit obligations	797	-	(1)	-	796
Total liabilities	296,692	224,525	178,211	(472,497)	226,931
Total shareholders equity	4,434	2,777	7,262	(9,662)	4,811
Total liabilities and equity	301,126	227,302	185,473	(482,159)	231,742

Notes to the Financial Statements continued

	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
At 31 December 2007					
Cash and balances at central banks	1,032	7	(1)	-	1,038
Trading assets	-	32,760	34,622	(10,955)	56,427
Derivative financial instruments	689	10,358	1,618	(2,714)	9,951
Financial assets designated at fair value	7,500	11,446	283	(7,446)	11,783
Loans and advances to banks	40,685	57,021	60,124	(154,389)	3,441
Loans and advances to customers	110,976	6,181	35,143	(40,153)	112,147
Available for sale securities	28	45	1,929	(1,962)	40
Macro hedge of interest rate risk	-	220	-	(3)	217
Investment in associated undertakings	33	-	-	(4)	29
Investment in subsidiary undertakings	5,053	2,336	2,925	(10,314)	-
Intangible assets	-	-	90	-	90
Property, plant and equipment	501	13	14	-	528
Operating lease assets	-	-	2,164	-	2,164
Current tax assets	190	-	7	-	197
Deferred tax assets	620	18	27	-	665
Other assets	686	57	165	(2)	906
Total assets	167,993	120,462	139,110	(227,942)	199,623
Deposits by banks	59,798	49,847	17,990	(119,712)	7,923
Deposits by customers	95,687	9,714	43,768	(79,519)	69,650
Derivative financial instruments	1,051	10,457	1,137	(2,714)	9,931
Trading liabilities	-	33,926	27,219	(6,229)	54,916
Financial liabilities designated at fair value	-	7,530	8	-	7,538
Debt securities in issue	-	5,840	37,502	(7,630)	35,712
Other borrowed funds	834	-	737	(152)	1,419
Subordinated liabilities	5,352	-	1,091	(1,711)	4,732
Macro hedge of interest rate risk	3	-	-	(3)	-
Other liabilities	1,452	254	632	(1)	2,337
Other provisions	100	-	31	-	131
Current tax liabilities	137	176	56	-	369
Deferred tax liabilities	6	-	532	6	544
Retirement benefit obligations	982	-	(3)	-	979
Total liabilities	165,402	117,744	130,700	(217,665)	196,181
Total shareholders equity	2,591	2,718	8,410	(10,277)	3,442
Total liabilities and equity	167,993	120,462	139,110	(227,942)	199,623

Cash flow statements

	The Company £m	ANTS plc £m	Other £m	Adjustments £m	Consolidated £m
For the year ended 31 December 2008					
Net cash flow from / (used in) operating activities	51,816	6,658	(80,589)	-	(22,115)
Net cash flow from / (used in) investing activities	(1,359)	38	19,026	-	17,705
Net cash flow from / (used in) financing activities	152	(161)	(7,373)	-	(7,382)
Net increase/ (decrease) in cash and cash equivalents	50,609	6,535	(68,936)	-	(11,792)
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	(73,917)	-	25,306
For the year ended 31 December 2007					
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 from / (used in) 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
For the year ended 31 December 2006					
Net cash flow from / (used in) operating activities	(5,858)	1,922	4,367	-	431
Net cash flow from / (used in) investing activities	3,977	294	(4,868)	-	(597)
Net cash flow from / (used in) financing activities	(1,239)	(247)	3,244	-	1,758
Net (decrease) in cash and cash equivalents	(3,120)	1,969	2,743	-	1,592
Cash and cash equivalents at beginning of the year	8,327	29,406	2,626	-	40,359
Effects of exchange rate changes on cash and cash equivalents	-	(355)	(2,514)	-	(2,869)
Cash and cash equivalents at end of the year	5,207	31,020	2,855	-	39,082