

**Risk Management Report** continued

**FINANCIAL RISKS**

**CREDIT RISK**

**INTRODUCTION**

Credit risk is the risk of financial loss arising from the default or credit quality deterioration of a customer or counterparty to which ANTS has directly provided credit, or for which the ANTS has assumed a financial obligation.

This section sets out further detail on:

- > Credit risk classification,
- > Measurement across the credit cycle,
- > Approach to forbearance, and
- > Credit risk exposure at an ANTS group level.

**Credit risk classification**

ANTS’s exposures to credit risk arise in the following businesses:

<b>CORPORATE BANKING</b>	<b>MARKETS</b>	<b>CORPORATE CENTRE</b>
<ul style="list-style-type: none"> <li>&gt; Exposures arise from treasury, corporate and wholesale banking services. These services are provided to large corporates, UK SMEs and specialist businesses.</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Exposures arise from financial services and treasury products provided to financial institutions and large corporates.</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Exposures arise from asset and liability management of the balance sheet. This area is also responsible for managing credit risk on the non-core and legacy portfolios being run down.</li> </ul>

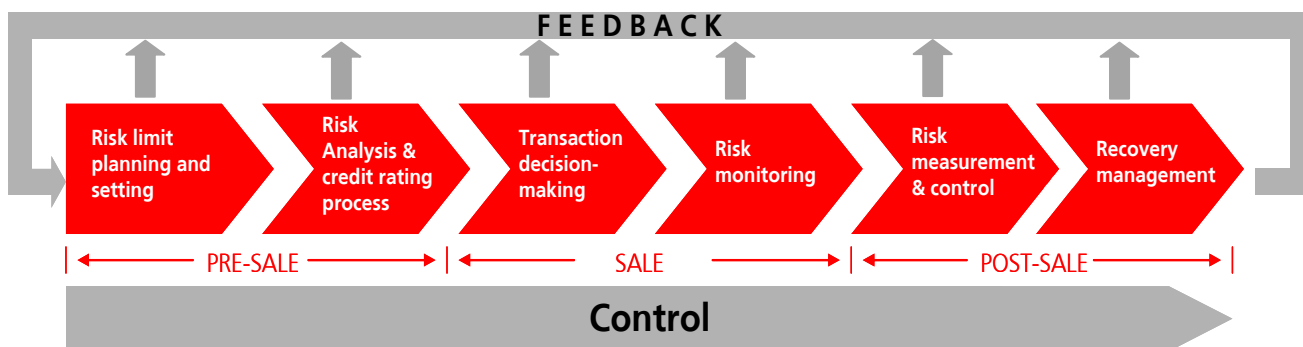
The credit risk arising in each of these businesses is covered in further detail in subsequent sections. Across these business segments, the management of credit risk is tailored according to the type of customer. These are typically classified as either non-standardised or standardised customers as follows:

<b>STANDARDISED CUSTOMERS</b>
<ul style="list-style-type: none"> <li>&gt; Consists primarily of small businesses. Risk management is based on internal risk assessment and automatic decision-making models, supported by teams of analysts specialising in this type of risk.</li> </ul>
<ul style="list-style-type: none"> <li>&gt; As a general rule, the following businesses deal with standardised customers: Corporate Banking and Corporate Centre (for certain non-core portfolios).</li> </ul>

<b>NON-STANDARDISED CUSTOMERS</b>
<ul style="list-style-type: none"> <li>&gt; Consist mostly of medium and large corporate customers and financial institutions where risk management is performed through expert analysis supplemented by decision-making support tools based on internal risk assessment models.</li> </ul>
<ul style="list-style-type: none"> <li>&gt; As a general rule, the following businesses deal with non-standardised customers: Corporate Banking, Markets and Corporate Centre.</li> </ul>

## Measurement across the credit cycle

The credit cycle comprises the following elements. Each element is described in further detail below:



### 1. Risk limit planning and setting

This phase involves setting risk limits which:

- > Are aligned to Santander UK’s business plan and strategic aims,
- > Ensure adherence to Santander UK’s Risk Appetite, and
- > Control the risk associated with any new product proposals.

Risk limit planning and setting is a dynamic process involving the discussion of business proposals and the attitude to risk. This process is defined in the risk limit plan, a comprehensive document for the integrated management of the balance sheet and its inherent risks. The way in which risk limits are set is tailored to each risk classification as follows:

STANDARDISED CUSTOMERS
<ul style="list-style-type: none"> <li>&gt; The risk limits are planned and set on a portfolio basis.</li> </ul>
<ul style="list-style-type: none"> <li>&gt; For each portfolio, a credit management programme is produced. These documents contain the expected results of the portfolio in terms of risk and return, as well as the limits applicable to various activities and the related risk management.</li> </ul>

NON-STANDARDISED CUSTOMERS
<ul style="list-style-type: none"> <li>&gt; A high-level risk limit is approved to support the customer’s overall financing needs.</li> </ul>
<ul style="list-style-type: none"> <li>&gt; This limit covers a variety of products (such as lending, trade finance or derivatives) enabling Santander UK to define a total risk tolerance with the customer based on current and expected financial requirements.</li> </ul>
<ul style="list-style-type: none"> <li>&gt; For global corporate groups, a system of pre-agreed limits (pre-classification) is used, based on an economic capital measurement and monitoring system. For large corporate customers, a simplified pre-classification model is applied.</li> </ul>

### 2. Risk analysis and credit rating process

Risk analysis is performed to establish the customer’s ability to meet its obligations. The analysis includes a review of customer credit quality, associated operational risk, and risk adjusted returns.

To aid this analysis, Santander UK uses a number of proprietary internal measurement tools including statistical models and rating systems. These are used for internal credit risk assessments, informing lending decisions, and for calculating regulatory and economic capital requirements. These are tailored to each risk classification as follows:

STANDARDISED CUSTOMERS
<ul style="list-style-type: none"> <li>&gt; For standardised customers, Santander UK typically employs statistical models that automatically assign a score to the proposed transaction or customer. Such scorecards typically work in conjunction with other policy rules.</li> </ul>

NON-STANDARDISED CUSTOMERS
<ul style="list-style-type: none"> <li>&gt; For many non-standardised counterparties with a global footprint, Santander UK employs rating tools, co-ordinated on a global basis by the Banco Santander group. Portfolios of this nature include sovereigns, large corporate and certain financial institutions. Ratings for non-standardised customers and financial institutions employ specific proprietary rating systems.</li> </ul>

## Risk Management Report continued

STANDARDISED CUSTOMERS	NON-STANDARDISED CUSTOMERS
<ul style="list-style-type: none"> <li>&gt; Most decisions are made via an automated route. There are cases however where additional qualification and manual intervention is necessary. Risk assessment is not constrained to decisions at origination, as often scorecards exist across the customer lifecycle.</li> </ul>	<ul style="list-style-type: none"> <li>&gt; The tools utilised have both quantitative and qualitative components. The qualitative stage involves the analysis of the relative financial performance of the customer, together with macro-economic data. This is supplemented in the qualitative stage with an analyst's expert judgement.</li> </ul>
<ul style="list-style-type: none"> <li>&gt; Scorecards and policies are monitored frequently, with both quantitative and qualitative triggers embedded.</li> </ul>	<ul style="list-style-type: none"> <li>&gt; The ratings are reviewed at least annually or more frequently in cases where monitoring indicates this is appropriate.</li> </ul>
	<ul style="list-style-type: none"> <li>&gt; The rating tools are also reviewed in order to progressively fine-tune the ratings they provide</li> </ul>

### Credit risk parameters

The Santander UK group (including the ANTS group) uses a number of internal measures and measurement tools for the purposes of making internal credit risk assessments and lending decisions and for calculating regulatory capital in accordance with Basel II requirements but these are not used in the calculation of impairment loss allowances for accounting purposes under IFRS. For the remainder of the Risk Management Report, impairments, impairment losses and impairment loss allowances refer to calculations in accordance with IFRS unless specified as relating to Basel II. For details of the accounting policies for impairment calculated in accordance with IFRS refer to pages 127 to 129.

The Basel II assessment of customers or transactions using rating or scoring systems constitutes a judgement of their credit quality, which is quantified through the probability of default ('PD'). In addition to PD, the quantification of credit risk requires the estimation of other parameters, such as exposure at default ('EAD') and the percentage of EAD that will not be recovered (loss given default or 'LGD'). PD, EAD and LGD are all calculated in accordance with the requirements of Basel II and include direct and indirect costs. In estimating the risk involved in transactions, other factors such as any off-balance sheet exposure and collateral valuations are also taken into account. The combination of these risk parameters (i.e. PD, LGD and EAD) enables calculation of the expected loss ('EL'). The risk parameters are used to calculate the Basel II regulatory capital.

For portfolios with limited internal default experience (e.g. banks) parameter estimates are based on alternative sources, such as market prices or studies conducted by external agencies. These portfolios are known as "low default portfolios". For all other portfolios, parameter estimates are based on internal risk models.

- > PD is calculated by observing the cases of new defaults in relation to the final rating assigned to customers or to the scoring assigned to the related transactions.
- > EAD is calculated by comparing the use of committed facilities at the time of default and their use under normal (i.e. performing) circumstances, so as to estimate the eventual extent of use of the facilities in the event of default.
- > LGD is calculated by observing the recoveries of defaulted loans, taking into account not only the income and expenses associated with the recovery process, but also the timing and the indirect costs arising from the recovery process.

The parameters estimated for global portfolios (e.g. banks) are the same throughout the Banco Santander group. Therefore, a financial institution will have the same PD for a specific rating, regardless of the Banco Santander group entity in which the exposure is booked. By contrast, local portfolios (e.g. residential mortgages) have specific score and rating systems. PDs are assessed specifically for each borrower within the portfolio.

### 3. Transaction decision-making

Having analysed the transactions and rated the customer, a decision is then made about whether or not to approve the transaction. This decision-making process takes account of:

- > The credit quality of the customer, the underlying risk of the transaction and the extent of any risk mitigation (e.g. collateral),
- > Associated risk policy, limits and appetite, and
- > Achievement of the correct balance between risk and associated return.

All decisions to approve credit transactions are made under authority delegated by the Santander UK Board. The approach to the decision-making process differs according to risk classification as follows:

STANDARDISED CUSTOMERS	NON-STANDARDISED CUSTOMERS
<ul style="list-style-type: none"> <li>&gt; In the standardised risk environment, automated decision models are used to facilitate the management of large volumes of credit transactions.</li> </ul>	<ul style="list-style-type: none"> <li>&gt; Credit approval decisions are made under a system of delegated authorities to individuals. Larger transactions above pre-defined limits are referred to governance committees. These include the Credit &amp; Investment Approvals Committee and, for higher value transactions, the Executive Risk Committee.</li> </ul>

Risk Management Report continued**STANDARDISED CUSTOMERS**

- > In certain cases this is supplemented by the use of manual underwriting to ensure adherence to risk policy and that the appropriate decision is made for both the customer and Santander UK.

**NON-STANDARDISED CUSTOMERS**

- > This decision-making process is followed both for transactions under pre-classified limits and those which receive specific approval.

**4. Risk monitoring**

The Risk Division has a specific monitoring function to enable early detection of issues. Monitoring is conducted at a portfolio, segment, customer and transactional level. Mitigating actions are proposed if deterioration is detected. Credit concentrations are also monitored. Concentration limits as defined by the Risk Appetite are reviewed and approved as necessary.

A specialised approach to monitoring is adopted for each risk classification:

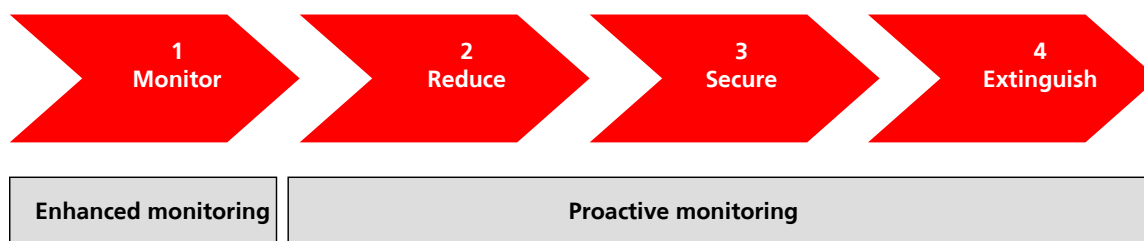
**STANDARDISED CUSTOMERS**

- > For exposures to standardised customers, key indicators are monitored in order to detect any variance in the performance of portfolio compared to the forecasts contained in the credit management programmes.
- > The scorecards, rating systems (including those necessary for Basel II), and associated policy are also monitored to check for stability and performance.

**NON-STANDARDISED CUSTOMERS**

- > For Corporate and some other specific lines of business, a 'watchlist' system is employed of companies under special watch. For brevity, this is referred to by the internal Spanish acronym 'FEVE'.

The four stages in the 'FEVE' system are:



A customer can be classified as FEVE as a result of the monitoring process itself, a decision made by the manager responsible for that customer or the triggering of the automatic warning system. There are a range of indicators that may trigger a case being added to FEVE, including downturn in trade, covenant breaches, major contract loss, and resignation of key management. Such cases are assessed to determine the potential financial implications of these trigger events. Inclusion in the FEVE system does not automatically mean there has been a default, but will result in the following action:

- > A specific and time-bound action plan will be put in place for this customer, together with the assignment of specific individuals for management.
- > Customers are reviewed monthly and the assigned rating is reviewed at least every six months,

**5. Risk measurement and control**

Changes in Santander UK's credit risk position are measured and controlled on an ongoing and systematic basis against budgets, limits and benchmarks. The potential future impact of these changes, both of an external nature and those arising from strategic decisions, is assessed in order to establish the required mitigating action needed.

Several metrics are used to measure and control credit risk during this phase. The two key metrics are:

KEY METRICS	
>	<b>Expected loss ('EL')</b> EL is defined as the product of the three parameters: PD, EAD and LGD. It is an indication of the likely future costs of credit risk.
>	<b>Net movement in non-performing loans ('NPLs')</b> Defined as net movement in NPLs stock over a period (closing balance less opening balance) plus write-offs, minus assets recovered during the same period. This metric and its components play a decisive role as tracking variables used to detect early changes in the behaviour of portfolios.

## Risk Management Report continued

The risk control function assesses risks from various complementary perspectives, including geographical location, business area, management model and product and process, thus facilitating the detection of specific areas of action requiring remediation. Stress testing techniques are also employed to establish vulnerabilities to economic deterioration.

### 6. Recovery management

The macroeconomic environment directly affects the number of customers who default on an obligation. Recovery management is therefore critical to the success of our business, and is deployed through special recovery units.

Recovery management is a strategic, integrated business activity. The Banco Santander group has a global model which is applied and implemented by Santander UK. The objectives of the recovery process are as follows:

CREDIT RISK OBJECTIVES	
> Customer Relationship	To maintain and strengthen the relationship with customers, paying attention to customer payment behaviour. Specifically to ensure that the individual circumstances and reasons for arrears are carefully considered when agreeing solutions with customers to ensure that arrangements are affordable and sustainable.
> Payment Collection	To collect payments in arrears so that accounts return to performing status. If this is not possible within a reasonable time period, the aim is to fully or partially recover debts, regardless of their status for accounting or management purposes.

Effective collections and recoveries activity is dependent on:

ACTION	DESCRIPTION
> Supporting the customer	Effective collections management is focused on assisting customers in finding affordable and sustainable repayment solutions based on their individual circumstances.
> Predicting customer behaviours and treating customers fairly	By monitoring and modelling customer profiles, and designing and implementing appropriate customer communication and repayment strategies, to enable effective support of customers in financial difficulty.
> Negotiation	Ongoing dialogue and negotiation with the customer to return the account to normal status in the shortest affordable and sustainable period.
> Monitoring customer repayment promises	It is essential that repayment agreements are monitored and evaluated to ensure they are reducing the customer's indebtedness in line with agreed terms.

### Approach to forbearance

To support customers that encounter actual or apparent financial difficulties, Santander UK may enter into forbearance arrangements. Forbearance arrangements include the granting of temporary or permanent concessions to customers to amend contractual payment amounts or timings. These are made where a customer's financial position indicates the possibility that satisfactory repayment may not be made within the original terms and conditions of the contract but where analysis suggests that repayment is possible within the revised terms of the loan.

A range of forbearance strategies are employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid foreclosure or repossession.

Santander UK's policies and practices are based on criteria which, in the judgement of management, indicate that repayment is likely to continue and that after the initial period of financial difficulties the customer can revert to the previous terms, with appropriate support where necessary. These agreements may be initiated by the customer, Santander UK or by a third party.

Further detail on the approaches and extent of forbearance in each business segment is set out in the subsequent sections.

## Risk Management Report continued

## Credit risk exposure at an ANTS group level

The following table presents the ANTS group's estimated maximum exposure to credit risk at 31 December 2012 and 2011 without taking account of any collateral held or other credit enhancements:

	2012 £m	2011 £m
Balances with central banks	<b>388</b>	7,013
Trading assets	<b>7,789</b>	12,497
Securities purchased under resale agreements	<b>14,941</b>	11,464
Derivative financial instruments	<b>33,276</b>	33,224
Financial assets designated at fair value	<b>3,531</b>	4,429
Available for sale securities	<b>5,113</b>	-
Loans and receivables securities	<b>162</b>	278
Loans and advances to customers	<b>44,750</b>	38,826
Loans and advances to banks	<b>106,753</b>	111,152
Other	<b>24</b>	60
<b>Total exposure<sup>(1)</sup></b>	<b>216,727</b>	218,943

(1) In addition the ANTS group is exposed to credit risk in respect of guarantees granted, loan commitments and stock borrowing and lending agreements. The estimated maximum exposure to credit risk is described in Note 35 to the Consolidated Financial Statements

**Risk Management Report** continued**CREDIT RISK – CORPORATE BANKING****INTRODUCTION**

Corporate Banking offers a wide range of products and financial services to UK companies. Corporate Banking products and services include loans, bank accounts, deposits, and treasury services. The Large Corporates business offers specialist treasury services in fixed income and foreign exchange, lending, transactional banking services, capital markets and money markets to large multinational corporate customers. Lending includes syndicated loans and structured finance. Transactional banking includes trade finance and cash management. Money market activities include securities lending/borrowing and repos. Credit risk arises by Corporate Banking making loans, investing in other financial instruments or entering into financing transactions or derivatives.

This section sets out further detail on credit risk in Corporate Banking as follows:

>	Management's approach;
>	Committed facilities;
>	Credit risk mitigation;
>	Monitoring and recovery management;
>	Arrears;
>	Forbearance;
>	Other forms of debt management; and
>	Non-performing loans and advances, and restructured/refinanced loans.

<b>MANAGEMENT'S APPROACH TO CREDIT RISK IN CORPORATE BANKING</b>	
>	Corporate Banking aims to achieve controlled corporate growth. It supports lending to the Mid-Corporate, SME and Real Estate sectors, as well as the large corporate market. Based on robust credit policies and risk appetite models, Corporate Banking focuses on the control of credit risks within its portfolio.
>	All transactions are considered using credit limits approved by the appropriate credit authority. The top Risk Committee in Santander UK in this respect is the Executive Risk Committee and it delegates authority to the Credit & Investment Approvals Committee (See 'Key responsibilities' on page 32). All transactions over £70m (and certain others) are approved by the Executive Risk Committee. Santander UK has a delegated authority framework which defines transaction submission levels for escalation to global committees. However, final sign-off is derived from the Executive Risk Committee whilst the portfolio is controlled by the respective credit risk portfolio team.
>	A set of risk appetite limits covering different types of risk (e.g. credit risk arising in Corporate Banking) are used to measure and control economic capital value. Santander UK's credit risk appetite is measured and controlled by a maximum level of unexpected loss that Santander UK is willing to sustain over a one-year period. In addition, specific limits are set by the Santander UK Board in relation to single counterparty risk.
>	Analysis of credit exposures and credit risk trends are analysed on a monthly basis, with key issues escalated to the senior risk committees as required. Larger exposures are reported monthly to the Santander UK Board Risk Committee.

## Risk Management Report continued

In Corporate Banking, credit risk arises on assets and off-balance sheet transactions. Consequently, the credit risk exposure below arises from on balance sheet assets, and off-balance sheet transactions such as committed and un-drawn credit facilities or guarantees.

## CORPORATE BANKING - COMMITTED FACILITIES

COMMITTED FACILITIES BY CREDIT RATING OF THE ISSUER OR COUNTERPARTY<sup>(1)(2)</sup>

2012	Sovereign £m	Large Corporate £m	Mid Corporate and SME £m	Real Estate £m	Social Housing £m	Total £m
AAA	1,131	25	-	36	-	1,192
AA	960	361	197	164	39	1,721
A	66	2,893	1,004	1,320	261	5,544
BBB	1	4,440	3,169	2,658	-	10,268
BB	-	353	758	642	-	1,753
B	-	-	25	202	115	342
CCC	-	-	10	46	-	56
D	-	-	25	281	-	306
<b>Total</b>	<b>2,158</b>	<b>8,072</b>	<b>5,188</b>	<b>5,349</b>	<b>415</b>	<b>21,182</b>

2011	Sovereign £m	Large Corporate £m	Mid Corporate and SME £m	Real Estate £m	Social Housing £m	Total £m
AAA	6,965	63	42	-	-	7,070
AA	819	511	147	218	-	1,695
A	25	2,967	1,061	1,395	-	5,448
BBB	-	4,580	2,961	2,555	-	10,096
BB	-	-	252	773	-	1,025
B	-	-	9	159	-	168
CCC	-	-	11	-	-	11
D	-	-	36	216	-	252
<b>Total</b>	<b>7,809</b>	<b>8,121</b>	<b>4,519</b>	<b>5,316</b>	<b>-</b>	<b>25,765</b>

(1) The committed facilities exposure includes OTC derivatives.

(2) All exposures are internally rated. External ratings are taken into consideration in the rating process, where available.

## COMMITTED FACILITIES BY GEOGRAPHICAL AREA

2012	Sovereign £m	Large Corporate £m	Mid Corporate and SME £m	Real Estate £m	Social Housing £m	Total £m
UK	-	6,885	4,583	5,349	415	17,232
Peripheral eurozone	-	263	73	-	-	336
Rest of Europe	1,132	551	102	-	-	1,785
US	-	265	90	-	-	355
Other, including non-OECD	1,026	108	340	-	-	1,474
<b>Total</b>	<b>2,158</b>	<b>8,072</b>	<b>5,188</b>	<b>5,349</b>	<b>415</b>	<b>21,182</b>

2011	Sovereign £m	Large Corporate £m	Mid Corporate and SME £m	Real Estate £m	Social Housing £m	Total £m
UK	5,477	5,634	4,190	5,316	-	20,617
Peripheral eurozone	-	300	61	-	-	361
Rest of Europe	1,591	1,226	255	-	-	3,072
US	-	525	-	-	-	525
Other, including non-OECD	741	436	13	-	-	1,190
<b>Total</b>	<b>7,809</b>	<b>8,121</b>	<b>4,519</b>	<b>5,316</b>	<b>-</b>	<b>25,765</b>

(1) The geographic location is classified by country of domicile of the counterparty.

The increases in Mid Corporate and SME, and Real Estate exposures in 2012 arose from the continued development of a UK corporate banking franchise. The decrease in sovereign exposures principally reflected changes in holdings of UK and other Organisation of Economic Co-operation and Development ('OECD') government securities as part of Santander UK's liquidity management activity.



**Risk Management Report** continued**Commercial Real Estate loans**

For the non-standardised commercial real estate portfolio of £5.3bn at 31 December 2012 the average loan to value ratio, weighted by exposure, was 52% (2011: 57%) with only 5% of cases having loan exposures in excess of the value of collateral.

Real estate non-performing loans and weighted average LTVs at 31 December 2012 and 2011 may be further analysed between loans originated pre-2009 and thereafter as follows:

2012	Original vintage		Total
	Pre-2009	2009 onwards	
<b>Total loans</b>	<b>£1,299 m</b>	<b>£4,050m</b>	<b>£5,349m</b>
<b>NPLs ratio</b>	<b>19.0%</b>	<b>-</b>	<b>4.6%</b>
<b>Weighted average LTV</b>	<b>64%</b>	<b>49%</b>	<b>52%</b>

2011	Original vintage		Total
	Pre-2009	2009 onwards	
Total loans	£1,929m	£3,387m	£5,316m
NPLs ratio	18.4%	-	6.7%
Weighted average LTV	70%	50%	57%

The pre-2009 vintage loans were written on terms prevailing in the market at that time which, compared to more recent times, included higher original LTVs, lower interest coverage and exposure to development or letting risk. Following the significant downturn in the commercial real estate market in 2008 and 2009 some of these customers suffered financial stresses resulting in their inability to meet the contractual payment terms or to comply with covenants or to achieve refinancing/repayment at maturity. As a result, the pre-2009 sub-portfolio has experienced higher NPLs rates in recent years.

In light of the market deterioration, the Santander UK group's lending criteria were significantly tightened from 2009 onwards, with lower LTVs and the avoidance of transactions with any material letting or development risks. In addition, while the market remains challenging, prices have not declined significantly further since the Santander UK group's lending criteria were tightened. As a result, the sub-portfolio representing loans originating from 2009 onwards has performed significantly better than the pre-2009 sub-portfolio.

## CORPORATE BANKING - CREDIT RISK MITIGATION

At 31 December 2012, ANTS held collateral against impaired loans amounting to 58% (2011: 58%) of the carrying amount of impaired loan balances.

PORTFOLIO	DESCRIPTION
> <b>Sovereigns</b>	Assets held with Sovereign counterparties are mainly with issuers or counterparties with a AAA or AA rating. It is normal market practice that there is no collateral associated with these assets.
> <b>Large Corporates</b>	Primarily unsecured but credit agreements are underpinned by both financial and non-financial covenants. Typically for this type of business the initial, and ongoing, lending decision is based upon factors relating to the financial strength of the client, its position within its industry, its management strengths and other factors as evaluated by the specialised analyst assigned to each customer.
> <b>Structured Finance</b>	A small number of acquisition or project finance transactions where collateral is held in the form of a charge over the assets being acquired. This type of assignment of all assets is combined with other covenants to provide security to the lenders.
> <b>Mid-Corporate and SME</b>	<p>Typically incorporates guarantee structures underpinned by both financial and non-financial covenants and debenture security. Guarantees are not classified as collateral and value is not attributed to them unless supported by tangible security. Lending decisions are assessed against trading cash flows and in the event of a default ANTS does not typically take possession of the assets of the business, although an Administrator may be appointed in more severe cases.</p> <p>The portfolio includes commercial mortgage lending where collateral is taken in the form of a charge over the property being mortgaged. A professional valuation of the real estate security is undertaken at the point of lending but no contractual right of revaluation exists. Revaluations are undertaken in the event that cases become distressed. Collateral is rarely taken into possession. ANTS seeks to ensure the disposal of the collateral, either consensually or via an insolvency process, as early as practical in order to minimise the loss to ANTS.</p>
> <b>Real Estate</b>	<p>Collateral is in the form of commercial real estate assets. Lending to commercial real estate is undertaken against an approved policy setting minimum criteria including such aspects as the quality (e.g. condition and age) and location of the property, the quality of the tenant, the terms and length of the lease, and the experience and creditworthiness of the sponsors. Properties are viewed by ANTS prior to lending and annually thereafter. An independent professional valuation is obtained prior to lending, providing both a value and an assessment of the property, the tenant and future demand for the property (e.g. market rent compared to the current rent). Loan agreements typically permit bi-annual valuations thereafter or more frequently if it is likely that the covenants may be breached.</p> <p>When a commercial real estate loan is transferred to FEVE (described in the section "Risk monitoring" in "Measurement across the credit cycle" on page 43) or Restructuring &amp; Recoveries, ANTS typically undertakes a revaluation of the collateral as part of the process for determining the strategy to be pursued (e.g. whether to restructure/refinance the loan or to realise the collateral). An assessment is made of the need to establish an impairment loss allowance based on the valuation in relation to the loan amount outstanding while also taking into consideration any loan restructuring/refinancing solution to be adopted (e.g. whether provision of additional security or guarantees is available, the prospects of additional equity and the ability to enhance value through asset management initiatives etc.).</p> <p>Collateral is rarely taken into possession. Where collateral has been taken into possession, ANTS would seek to dispose of the collateral as early as practical in order to minimise the loss to ANTS.</p>
> <b>Social Housing</b>	<p>The portfolio is secured on residential real estate owned and let by UK Housing Associations. This collateral is revalued at least every five years and the valuation is based on standard housing methodologies, which generally involve the properties' continued use as social housing. If the valuation were based upon normal residential use the value would be considerably higher. To date, Santander UK has suffered no defaults or losses on this type of lending and has not had to take possession of any collateral.</p> <p>The value of the collateral is in all cases in excess of the loan balance. Typically, the loan balance represents between 25% and 50% of the implied market value of collateral using Santander UK's LGD methodology.</p>

## Risk Management Report continued

## CORPORATE BANKING - MONITORING AND RECOVERY MANAGEMENT

Cases exhibiting potentially higher risk characteristics are subject to risk monitoring under the FEVE system (described in the section "Risk monitoring" in "Measurement across the credit cycle" on page 43). There are a range of indicators that may trigger a case being added to FEVE, including downturn in trade, covenant breaches, major contract loss, and resignation of key management. Such cases are assessed to determine the potential financial implications of these trigger events and in consultation with the borrower, a range of options available is considered which may include temporary forbearance.

In addition, cases that require specialist risk management expertise, including all NPLs, are transferred to a dedicated restructuring team and are categorised as 'Workouts'.

Cases subject to risk monitoring under the FEVE system or in Workouts by portfolio and assessment of risk at 31 December 2012 and 2011 were:

2012	Portfolio £m	Enhanced Monitoring £m	Enhanced Monitoring %	Pro- active £m	Pro- active %	Workout £m	Workout %	NPLs <sup>(1)</sup> £m	NPLs %	Impairment loss allowances	
										Observed £m	IBNO £m
Large Corporates (including Sovereign)	10,230	142	1.4	-	-	-	-	-	-	-	-
Mid Corporate and SME	5,188	123	2.4	56	1.1	23	0.4	23	0.4	11	4
Real Estate	5,349	199	3.7	239	4.5	374	7.0	247	4.6	90	7
Social Housing	415	-	-	-	-	-	-	-	-	-	-
<b>Total</b>	<b>21,182</b>	<b>464</b>	<b>2.2</b>	<b>295</b>	<b>1.4</b>	<b>397</b>	<b>1.9</b>	<b>270</b>	<b>1.3</b>	<b>101</b>	<b>11</b>

2011	Portfolio £m	Enhanced Monitoring £m	Enhanced Monitoring %	Pro- active £m	Pro- active %	Workout £m	Workout %	NPLs <sup>(1)</sup> £m	NPLs %	Impairment loss allowances	
										Observed £m	IBNO £m
Large Corporates (including Sovereign)	15,930	87	0.5	-	-	-	-	-	-	-	-
Mid Corporate and SME	4,519	67	1.5	33	0.7	30	0.7	21	0.5	2	8
Real Estate	5,316	98	1.8	590	11.1	424	8.0	356	6.7	95	25
Social Housing	-	-	-	-	-	-	-	-	-	-	-
<b>Total</b>	<b>25,765</b>	<b>252</b>	<b>1.0</b>	<b>623</b>	<b>2.4</b>	<b>454</b>	<b>1.8</b>	<b>377</b>	<b>1.5</b>	<b>97</b>	<b>33</b>

(1) Includes committed facilities and swaps.

In 2012, the level of cases in NPLs or with the workouts team fell as older real estate cases continued to work through the recovery process. There was an increase in watchlist cases, especially those in monitoring during the year driven by challenging economic conditions in both the real estate and the Mid Corporate and SME portfolios.

## CORPORATE BANKING - ARREARS

	2012 £m	2011 £m	2010 £m
Corporate Banking loans and advances to customers in arrears	173	266	287
Corporate Banking loans and advances to customers <sup>(1)</sup>	6,356	6,370	5,270
Corporate Banking loans and advances to customers in arrears as a % of Corporate Banking loans and advances to customers	2.72%	4.17%	5.45%

(1) Includes social housing loans.

## 2012 compared to 2011

Loans and advances to customers in arrears decreased to £173m (2011: £266m) as a result of the successful implementation of restructuring/refinancing strategies, especially within the Commercial Real Estate portfolio. Consequently, loans and advances to customers in arrears as a percentage of loans and advances to customers decreased to 2.72% (2011: 4.17%).

## 2011 compared to 2010

Loans and advances to customers in arrears decreased slightly to £266m (2010: £287m) as the strategies for managing these cases began to deliver sustained results, especially for real estate exposures written pre-2009. Loans and advances to customers in arrears as a percentage of loans and advances to customers decreased to 4.17% (2010: 5.45%) as a result of the growth in the book exceeding the growth in arrears.

## Risk Management Report continued

## Arrears management

The Restructuring & Recoveries department are responsible for debt management initiatives on the Corporate Banking loan portfolio.

- > Debt management strategies, which include negotiating restructuring/refinancing or repayment arrangements and concessions, often commence prior to actual payment default. Different collection strategies are applied to different segments of the portfolio in accordance with the perceived levels of risk and the individual circumstances of each case.
- > Restructuring & Recoveries activities aim to ensure customers who have failed or are likely to fail to make their contractual payments when due or have exceeded their agreed credit limits are encouraged to pay back the required amounts, and in the event they are unable to do so to pursue recovery of the debt in order to maximise the net recovered balance.

The overall aim is to minimise losses whilst not adversely affecting brand, customer loyalty, fee income, or compliance with relevant legal and regulatory standards.

Problem debt management activity is performed within ANTS:

- > Initially by the relationship manager and, for non standardised cases, the credit partner, and for standardised cases, the Business Support Unit; then
- > Subsequently by Restructuring & Recoveries where the circumstances of the case become more critical or specialist expertise is required.

ANTS seeks to detect weakening financial performance early through close monitoring of regular financial and trading information, periodic testing to ensure compliance with both financial and non-financial covenants and regular dialogue with corporate clients.

The FEVE process is used proactively on cases which need enhanced management activity ranging from increased frequency and intensity of monitoring through to more specific activities to reduce ANTS's exposure, enhance ANTS's security or in some cases seek to exit the position altogether.

Once categorised as FEVE, a strategy is agreed with Credit Risk and this is monitored through monthly FEVE meetings for each portfolio. Where circumstances dictate a more dedicated debt management expertise is required or where the case has been categorised as non-performing (be that through payment arrears or through management judgement that a payment default is likely), the case is transferred to Restructuring & Recoveries.

## FORBEARANCE – LOANS RESTRUCTURED/REFINANCED

The factors considered when concluding whether a borrower is experiencing financial difficulties can include the results of covenant testing, reviews of trading and management information provided under the loan terms or directly from the customer as part of the ANTS's ongoing relationship dialogue.

Restructurings/refinancings allow a customer, by negotiation, to vary the terms of their contractual obligations for an agreed period (such as interest-only period or term extensions). ANTS also aims to ensure that after the initial period of financial difficulties the customer can revert to the previous terms, with appropriate support where necessary. These agreements may be initiated by the customer, ANTS or by a third party.

Restructurings/refinancings are only granted due to financial difficulties and are reported as restructures/refinancings.

ACTION	DESCRIPTION
<b>Restructuring/ refinancing</b>	Solutions in a restructuring/refinancing may include:
	<ul style="list-style-type: none"> <li>&gt; <b>Term extensions</b> The term of the credit facility may be extended to reduce the regular periodic repayments, and where as a minimum, the interest can be serviced and there is a realistic prospect of full or improved recoveries in the foreseeable future. Customers may be offered a term extension where they are up-to-date but showing evidence of financial difficulties, or where the maturity of the loan is about to fall due and near term refinancing is not possible on current market terms.</li> </ul>
	<ul style="list-style-type: none"> <li>&gt; <b>Interest-only concessions</b> Regular periodic repayment may be reduced to interest payment only for a limited period with capital repayment deferred where other options are not appropriate and the issues are viewed as temporary. Customers may be offered an interest only concession where they are up-to-date but showing evidence of financial difficulties, or are already in the Restructuring &amp; Recoveries process. Periodic reviews of the customer's financial situation are undertaken to assess when the customer can afford to return to the repayment method.</li> </ul>
	<ul style="list-style-type: none"> <li>&gt; <b>Capitalisations</b> The customer's arrears may be capitalised and added to the loan balance. Capitalisation is always combined with term extensions and interest-only concessions.</li> </ul>

## Risk Management Report continued

ANTS may offer a term extension or interest only concession provided that the forecasts indicate that the borrower will be able to meet the revised payment arrangements. This applies particularly in the rare circumstances where a second restructuring/refinancing is required as the borrower needs a further term extension but is otherwise meeting revised terms.

The effectiveness of our restructuring/refinancing approach is kept under review. The programmes offered to customers may be adjusted to reflect market conditions, although the range of options is limited to term extensions and interest only concessions, together with other forms of debt management as described in "Other forms of debt management".

Where a restructuring/refinancing in NPL has been agreed, the case is initially retained in the 'non-performing' loan category, until evidence of consistent compliance with the new terms is demonstrated (typically a minimum of three months) before being reclassified out of NPL.

For other restructured/refinanced loans, once a case has demonstrated continued compliance with the new terms and the risk profile is deemed to have improved, it may be reclassified as fully performing. Under ANTS's restructuring/refinancing methodology, a case will remain as a restructured/refinanced asset even when full repayments are recommenced until full repayment is achieved.

The majority of corporate loan restructuring/refinancing to date have been by way of term extensions and payment re-profiling (e.g. interest only concessions), with only a limited number of debt-for-equity swaps. Loan loss allowances are assessed on a case-by-case basis taking into account amongst other factors, the value of collateral held as confirmed by third party professional valuations as well as the cash flow available to service debt over the period of the restructuring/refinancing. These loan loss allowances are assessed regularly and are independently reviewed. In the case of a debt-for-equity conversion, the converted debt is written off against the existing loan loss allowance upon completion of the restructuring/refinancing. The value of the equity acquired is initially held at nil value and reassessed periodically in light of subsequent performance of the restructured company.

### Restructuring/refinancing commenced during the year

No arrangements have been entered into with respect to sovereign or large corporate counterparties. The accounts that entered restructuring/refinancing during the years ended 31 December 2012 and 2011 were:

2012	Mid Corporate and SMEs	Real Estate	Total
	£m	£m	£m
Restructured/refinanced in NPLs	1	-	1
Other restructured/refinanced	-	99	99
	1	99	100

2011	Mid Corporate and SMEs	Real Estate	Total
	£m	£m	£m
Restructured/refinanced in NPLs	23	58	81
Other restructured/refinanced	-	21	21
	23	79	102

### Restructuring/refinancing cumulative number and value of accounts

At 31 December 2012, 86% of the restructuring/refinancing related to the Commercial Real Estate portfolio (2011: 80%).

#### a) Performance status when entering restructuring/refinancing

The status of the cumulative number of accounts in restructuring/refinancing at 31 December 2012 and 2011 when they originally entered restructuring/refinancing, analysed by type of restructuring/refinancing applied, was:

2012	Restructured/ refinanced in NPLs		Other restructured/refinanced		Total		Impairment allowance	
	No.	£m	No.	£m	No.	£m	£m	
Performing	-	-	13	335	13	335	37	
In arrears	3	24	-	-	3	24	11	
Total	3	24	13	335	16	359	48	

2011	Restructured/ refinanced in NPLs		Other restructured/refinanced		Total		Impairment allowance	
	No.	£m	No.	£m	No.	£m	£m	
Performing	-	-	10	307	10	307	15	
In arrears	6	122	-	-	6	122	4	
Total	6	122	10	307	16	429	19	

## Risk Management Report continued

**Debt-for-equity swaps**

In addition to the restructuring/refinancing above, ANTS has entered into a small number of debt-for-equity swaps where, on occasion, ANTS may agree to exchange a proportion of the amount owed by the borrower for equity in that borrower. In circumstances where a borrower's balance sheet is materially over-leveraged but the underlying business is viewed as capable of being turned around, ANTS may agree to reduce the debt by exchanging a portion of it for equity in the company. This will typically only be done alongside new cash equity being raised, the implementation of a detailed business plan to effect a turnaround in the prospects of the business, and satisfaction with management's ability to deliver the strategy.

These debt-for-equity swaps amounted to £34m at 31 December 2012 (2011: £34m) and in view of their small size are not included in these analyses.

**b) Performance status at the year-end**

The current status of accounts in restructuring/refinancing analysed by type of restructuring/refinancing applied, at 31 December 2012 and 2011 was:

2012	Restructured/ refinanced in NPLs		Other restructured/refinanced		Total	Impairment allowance	
	No.	£m	No.	£m		No.	£m
Performing	1	1	11	270	12	271	2
In arrears	2	23	2	65	4	88	46
<b>Total</b>	<b>3</b>	<b>24</b>	<b>13</b>	<b>335</b>	<b>16</b>	<b>359</b>	<b>48</b>

2011	Restructured/ refinanced in NPLs		Other restructured/refinanced		Total	Impairment allowance	
	No.	£m	No.	£m		No.	£m
Performing	4	97	8	238	12	335	-
In arrears	2	25	2	69	4	94	19
<b>Total</b>	<b>6</b>	<b>122</b>	<b>10</b>	<b>307</b>	<b>16</b>	<b>429</b>	<b>19</b>

Accounts that are in restructuring/refinancing continue to be closely monitored as described above, to ensure that the restructuring/refinancing arrangements are sustainable. At 31 December 2012, 75% (2011: 78%) of the accounts in restructuring/refinancing were performing in accordance with the revised terms agreed under ANTS's restructuring/refinancing arrangements. The decrease reflects the impact of the current challenging market conditions which resulted in it taking longer for cases to return to performing status after restructuring/refinancing.

In rare circumstances, these market conditions may, and may continue to, lead to a second term extension, for example in the case of commercial real estate where it remains difficult to sell or refinance the property. These loans are individually assessed for observed impairment loss allowances. The greater probability of ultimate loss in these circumstances is reflected in the calculation of impairment loss allowances.

A customer's ability to adhere to any revised terms agreed is an indicator of the sustainability of ANTS's restructuring/refinancing arrangements.

**2012 compared to 2011**

The level of restructured/refinanced in NPL decreased particularly in the Mid Corporate and SME portfolio as the volume of loans originated near the peak of the cycle (i.e. pre-2009) has reduced both in absolute and relative terms. The level of other restructured/refinanced rose particularly within commercial real estate as restructuring/refinancing strategies were being executed earlier in the credit cycle.

**2011 compared to 2010**

The level of restructured/refinanced in NPL increased which reflected the increasingly challenging economic environment with more limited options to achieve consensual outcomes giving rise to more cases requiring forbearance, especially in the care home sector. The level of other restructured/refinanced however fell slightly over the year as a result of a number of cases being successfully repaid and higher incidence of NPLs cases due to the economic conditions resulting in restructured/refinanced in NPL rather than other restructured/refinanced.

**Risk Management Report** continued**OTHER FORMS OF DEBT MANAGEMENT**

In addition to restructurings/refinancings, ANTS uses other forms of debt management which can include:

ACTION	DESCRIPTION
> Payment arrangements (including debt-for-equity swaps)	Discretion exists to vary the repayment schedule to allow customers to bring the account up to date. The objective is to bring the account up to date as soon as possible. This can involve the partial forgiveness of debt and/or debt-for-equity swaps. At 31 December 2012 there were no outstanding loans where debt forgiveness had been applied.
> Obtaining additional security or guarantees	Where a borrower has unencumbered assets, these may be charged as new or additional security in return for ANTS restructuring/refinancing existing facilities. Alternatively, ANTS may take a guarantee from other companies within the borrower's group and/or major shareholders provided it can be established the proposed guarantor has the resources to support such a commitment.
> Resetting of covenants and trapping surplus cash flow	Financial covenants may be reset at levels which more accurately reflect the current and forecast trading position of the borrower. This may also be accompanied by a requirement for all surplus cash after operating costs to be trapped and used in reduction of ANTS's lending.
> Seeking additional equity	Where a business is over-leveraged, fresh equity capital will be sought from existing or new investors to adjust the capital structure in conjunction with ANTS agreeing to restructure/refinance the residual debt.

**EXIT THE POSITION CONSENSUALLY**

Where it is not possible to agree a restructuring/refinancing, ANTS may seek to exit the position consensually by:

- > Agreeing with the borrower an orderly sale of assets outside insolvency to pay down ANTS's debt;
- > Arranging for the refinance of the debt with another lender; or
- > Sale of the debt where a secondary market exists (either individual loans or on occasion as a portfolio sale).

**LITIGATION AND RECOVERY**

Where it is not possible to agree a restructuring/refinancing or to exit the position consensually, ANTS will pursue recovery by:

- > Pursuing its rights through an insolvency process;
- > Optimising the sale proceeds of any collateral held; and
- > Seeking compensation from third parties, as appropriate.

Where ANTS has to pursue recovery through the appointment of an Administrator (or a Receiver under the Law of Property Act in the case of real estate security), ANTS's shortfall is assessed against the Administrator's estimate of the outcome and an appropriate loan loss allowance is raised. In cases where a sale of the debt is deemed to offer the optimum recovery outcome, the shortfall, if the debt is sold below its par value, is written off upon sale.

## Risk Management Report continued

**CORPORATE BANKING - NON-PERFORMING LOANS AND ADVANCES<sup>(1)</sup>**

An analysis of Corporate Banking NPLs is presented below.

	2012	2011	2010	2009	2008
	£m	£m	£m	£m	£m
Corporate Banking NPLs that are impaired - UK	264	260	287	122	54
Corporate Banking NPLs that are not impaired - UK	-	101	84	76	-
Corporate Banking NPLs <sup>(2)</sup>	264	361	371	198	54
Corporate Banking loans and advances to customers	6,356	6,370	5,270	4,565	5,632
Corporate Banking impairment loan loss allowances	112	130	108	77	26
	%	%	%	%	%
NPLs ratio	4.16	5.67	7.05	4.34	0.96
Coverage ratio	42	36	29	39	48

(1) Loans and advances are classified as non-performing typically when the counterparty fails to make payments when contractually due for three months or where it is deemed unlikely that the counterparty will be able to maintain payments.

(2) All non-performing loans continue accruing interest.

(3) Accrued interest is excluded for purposes of these analyses.

**2012 compared to 2011**

During 2012, the NPLs ratio decreased to 4.16% (2011: 5.67%). This resulted from successful exits and restructures/refinances particularly in respect of the real estate cases originated at the peak of the market. The absolute level of NPLs also reduced which together with the growth in the portfolio being slower than in 2011 lowered the percentage.

**2011 compared to 2010**

During 2011, the NPLs ratio decreased to 5.67% (2010: 7.05%). This reflected the growth of the book exceeding the growth in stressed cases with several larger real estate loans moving out of non-performing status either via a full exit by way of a sale of the underlying collateral or the debt or a successful restructuring/refinancing and return to performing status. The level of new NPLs increased as the options available for managing them, particularly the ability to raise equity capital, to sell assets or to conclude refinancing, remained limited. The real estate market continued to be challenging with reduced sales activity, especially for development finance and land-bank transactions and for older transactions underwritten near the market peak.

**2010 compared to 2009**

During 2010, the NPLs ratio increased to 7.05% (2009: 4.34%) due to deterioration arising from market conditions. This particularly affected customers in the real estate sector. Both NPLs and impairment loss allowances increased. While the level of new NPLs was broadly in line with expectations, the options available for managing them were reduced compared to 2009. The real estate market became more challenging as the year progressed, with reduced sales activity, especially for development finance and land-bank transactions and for older transactions underwritten in 2008 and earlier years. The year-end position was also influenced by a small number of large value transactions which defaulted late in the year but were expected to be restructured/refinanced during 2011.

In 2012, interest income recognised on impaired loans amounted to £5m (2011: £5m, 2010: £4m).

**CORPORATE BANKING – RESTRUCTURED/REFINANCED LOANS**

As previously described, loans may be restructured/refinanced. At 31 December 2012, the carrying amount of financial assets that would otherwise be past due or impaired whose terms have been restructured/refinanced was £nil (2011: £130m).

**CORPORATE BANKING – RATIO OF WRITE-OFFS TO AVERAGE LOANS**

At 31 December 2012 the ratio of net write-offs during the year to average loans outstanding during the year was:

	2012	2011	2010	2009	2008
	%	%	%	%	%
Ratio of write-offs to average loans during the period	0.44	0.60	1.12	-	-



## Risk Management Report continued

### CREDIT RISK – MARKETS

#### INTRODUCTION

Markets offers risk management and other services to financial institutions, as well as other Santander UK divisions. Its main product areas are fixed income and foreign exchange, equity, capital markets and institutional sales. Credit risk arises by Markets making loans, investing in other financial instruments, or entering into financing transactions or derivatives.

This section sets out further detail on credit risk in Markets as follows:

>	Management's approach;
>	Commitments;
>	Credit risk mitigation;
>	Monitoring and recovery management; and
>	Restructured/refinanced loans.

MANAGEMENT'S APPROACH TO CREDIT RISK IN MARKETS	
>	Credit risk on derivative instruments (OTC derivatives, repos and stock borrowing/lending) is taken under specific limits approved for each counterparty. This credit risk is controlled by the Wholesale Credit Risk department, and managed and reported on a counterparty basis, regardless of whether the exposure is incurred by Markets or by ANTS through its Corporate Centre activities.
>	Credit risk on derivative instruments is calculated using the potential future mark-to-market exposure ('PFE') of the instruments at a 97.5% statistical confidence level and adding this value to the current mark-to-market value. The resulting PFE or credit risk is then included against the credit limits approved for individual counterparties along with other non-derivative exposures.
>	In addition, there is a policy around the collateralisation of derivative instruments. If collateral is deemed necessary to reduce credit risk, any unsecured risk threshold, and the nature of any collateral to be accepted, is determined by the Wholesale Credit Risk department's credit evaluation of the counterparty.
>	All exposures are accommodated under credit limits approved by the appropriate credit authority. The relevant senior approving authorities are the Executive Risk Committee and the Credit & Investment Approvals Committee. Exposures which exceed a pre-defined limit are also referred to Banco Santander S.A., although the ultimate approval remains within Santander UK. Exposures and credit risk trends are analysed regularly, with key issues escalated to the Executive Risk Committee or to the Board Risk Committee, as required. Key developments in large exposures are also reported to these committees.

## Risk Management Report continued

## MARKETS - COMMITMENTS

DERIVATIVE COMMITMENTS BY CREDIT RATING OF THE ISSUER OR COUNTERPARTY <sup>(1)</sup>

2012	£m
AAA	38
AA	185
A	4,097
BBB and below	357
<b>Total</b>	<b>4,677</b>

2011	£m
AAA	97
AA	1,574
A	3,447
BBB and below	260
<b>Total</b>	<b>5,378</b>

(1) External ratings are applied to all exposures where available.

## DERIVATIVE COMMITMENTS BY GEOGRAPHICAL AREA

2012	£m
UK	1,635
Peripheral eurozone	364
Rest of Europe	1,409
US	974
Rest of the world	295
<b>Total</b>	<b>4,677</b>

2011	£m
UK	1,296
Peripheral eurozone	597
Rest of Europe	1,597
US	1,480
Rest of the world	408
<b>Total</b>	<b>5,378</b>

## Risk Management Report continued

### MARKETS - CREDIT RISK MITIGATION

Markets continued to focus its activities on derivative products, supported by increased collateralisation and use of central counterparties.

PORTFOLIO	DESCRIPTION
<p>&gt; <b>Derivatives</b></p>	<p><b>Netting arrangements</b> ANTS restricts its credit risk by entering into transactions under industry standard agreements which facilitate netting of transactions in the jurisdictions where netting agreements are recognised and have legal force. The netting arrangements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis.</p> <p>However, there is scope for the credit risk associated with favourable contracts to be reduced by netting arrangements embodied in the agreements to the extent that if an event of default occurs, all amounts with the counterparty under the specific agreement can be terminated and settled on a net basis. In line with industry practice, ANTS executes the standard documentation according to the type of contract being entered into. For example, derivatives will be contracted under the International Swaps and Derivatives Association ('ISDA') Master Agreements, repurchase and reverse repurchase transactions will be governed by Global Master Repurchase Agreement ('GMRA'), stock borrowing/lending transactions and other securities financing transactions are covered by Global Master Securities Lending Agreement ('GMSLA').</p> <p><b>Collateralisation</b> ANTS also mitigates its credit risk to counterparties with which it primarily transacts financial instruments through collateralisation, using industry standard collateral agreements (i.e. the Credit Support Annex ('CSA')) in conjunction with the ISDA Master Agreement. Under these agreements, net exposures with counterparties are collateralised with cash, securities or equities. Exposures and collateral are generally re-valued daily and collateral is adjusted accordingly to reflect deficits/surpluses. Collateral taken must comply with Santander UK's collateral parameters policy. This policy is designed to control the quality and concentration risk of collateral taken such that collateral held can be liquidated when a counterparty defaults. Cash collateral in respect of derivatives held at 31 December 2012 was £0.6bn (2011: £1.2bn), not all derivative arrangements being subject to collateral agreements. Collateral obtained during the period in respect of purchase and resale agreements (including securities financing) is equal to at least 100% of the amount of the exposure.</p> <p><b>Use of Central Counterparties ('CCPs')</b> ANTS continues to use CCPs as an additional means to mitigate counterparty credit risk in derivative transactions. At 31 December 2012, CCPs were used in connection with 6.3% (2011: 0.3%) of ANTS's OTC derivatives.</p>

### MARKETS – MONITORING AND RECOVERY MANAGEMENT

Cases exhibiting potentially higher risk characteristics are subject to risk monitoring under the FEVE system (described in "Risk monitoring" in "Measurement across the credit cycle" on page 43). At 31 December 2012, there were no impaired or non-performing loans or exposures (2011: none) and the assets in the FEVE Active category amounted to only £33m (2011: £40m).

### MARKETS – RESTRUCTURED/REFINANCED LOANS

At 31 December 2012 and 2011, there were no financial assets that would otherwise be past due or impaired whose terms have been restructured/refinanced.

## CREDIT RISK - CORPORATE CENTRE

### INTRODUCTION

Corporate Centre consists of FMIR and the non-core portfolios of social housing loans and structured credit assets. FMIR is responsible for managing capital and funding, balance sheet composition, structural market risk and strategic liquidity risk for the rest of the Santander UK group. The non-core portfolios are being run-down and/or managed for value. Credit risk arises by Corporate Centre making loans (including to other businesses within Santander UK) and investing in debt securities. Credit risk also arises by Corporate Centre investing in other financial instruments (including assets held for liquidity purposes) or entering into financing transactions or derivative contracts.

This section sets out further detail on credit risk in Corporate Centre as follows:

>	Management's approach;
>	Exposures;
>	Credit risk mitigation;
>	Monitoring and recovery management;
>	Arrears;
>	Forbearance; and
>	Non-performing loans and advances.

### MANAGEMENT'S APPROACH TO CREDIT RISK IN CORPORATE CENTRE

>	Credit risk in Corporate Centre is actively controlled by the Wholesale Credit Risk Department and the Corporate and Commercial Credit Risk Department. This is done in accordance with the relevant policies, limits, asset quality plans and aspects of Santander UK Board-approved risk appetite. All exposures, including intra-group items, are captured in the risk management systems and fall within limits approved by the appropriate credit authority. For Corporate Centre exposures, the relevant senior approving authorities are the Executive Risk Committee and the Credit & Investment Approvals Committee. All transactions over £70m (and certain others) are approved by the Executive Risk Committee. Exposures which exceed a pre-defined limit are also referred to Banco Santander, S.A., although the ultimate approval remains within Santander UK.
>	The non-core portfolios consist of social housing loans and structured credit assets. These portfolios are being run-down and/or managed for value. These assets are managed in a manner consistent with the Corporate Banking assets as described in the section "Credit Risk - Corporate Banking".

**Risk Management Report** continued

The table below shows the exposures in Corporate Centre after taking into account the credit mitigation procedures described in Markets on page 58. In addition, on lending to customers, credit risk arises on assets and off-balance sheet transactions. Consequently, the credit risk exposure below arises from on balance sheet assets, and off-balance sheet transactions such as committed and undrawn credit facilities or guarantees.

**CORPORATE CENTRE - EXPOSURES****CORPORATE CENTRE EXPOSURE BY CREDIT RATING OF THE ISSUER OR COUNTERPARTY<sup>(1)</sup>**

	Sovereign £m	Structured Products £m	Derivatives £m	Social Housing £m	Total £m
<b>2012</b>					
AAA	3,368	132	-	-	3,500
AA	283	4	-	2,305	2,592
A	-	29	1,215	5,899	7,143
BBB and below	-	71	-	1,408	1,479
<b>Total</b>	<b>3,651</b>	<b>236</b>	<b>1,215</b>	<b>9,612</b>	<b>14,714</b>
	Sovereign £m	Structured Products £m	Derivatives £m	Social Housing £m	Total £m
<b>2011</b>					
AAA	7,266	255	-	-	7,521
AA	-	27	587	2,651	3,265
A	-	20	716	5,990	6,726
BBB and below	-	59	-	1,300	1,359
<b>Total</b>	<b>7,266</b>	<b>361</b>	<b>1,303</b>	<b>9,941</b>	<b>18,871</b>

(1) External ratings are applied to all exposures where available.

**CORPORATE CENTRE EXPOSURE BY GEOGRAPHICAL AREA<sup>(1)</sup>**

	Sovereign £m	Structured Products £m	Derivatives £m	Social Housing £m	Total £m
<b>2012</b>					
UK	1,978	16	88	9,612	11,694
Peripheral eurozone	-	85	-	-	85
Rest of Europe	627	135	675	-	1,437
US	763	-	452	-	1,215
Rest of world	283	-	-	-	283
<b>Total</b>	<b>3,651</b>	<b>236</b>	<b>1,215</b>	<b>9,612</b>	<b>14,714</b>
	Sovereign £m	Structured Products £m	Derivatives £m	Social Housing £m	Total £m
<b>2011</b>					
UK	218	19	-	9,941	10,178
Peripheral eurozone	-	133	457	-	590
Rest of Europe	-	144	654	-	798
US	7,048	-	192	-	7,240
Rest of world	-	66	-	-	66
<b>Total</b>	<b>7,266</b>	<b>361</b>	<b>1,303</b>	<b>9,941</b>	<b>18,871</b>

(1) The geographic location is classified by country of domicile of the counterparty.

The exposure to Sovereigns in the UK and US principally reflect the holdings of liquid assets.

## CORPORATE CENTRE - CREDIT RISK MITIGATION

The specialist businesses in Corporate Centre service customers in various business sectors including Real Estate and Social Housing. Corporate Centre is also responsible for the non-core portfolios of social housing loans and structured credit assets.

PORTFOLIO	DESCRIPTION
> <b>Sovereigns</b>	Assets held with sovereign counterparties are mainly with issuers or counterparties with a AAA or AA rating. It is normal market practice that there is no collateral associated with these assets.
> <b>Structured products</b>	<p>Assets held within the Treasury asset portfolio include asset-backed securities ('ABS') (including mortgage-backed securities ('MBS')), Collateralised Loan Obligations ('CLOs') and certain credit derivatives. The instruments held are unsecured but benefit from senior positions in the creditor cascade and, in the case of structured products, their rating reflects the over collateralisation inherent in the structure and the assets that underpin the cashflows and repayment schedules.</p> <p>The Treasury Asset Portfolio is monitored for potential impairment through a detailed expected cashflow analysis taking into account the structure and underlying assets of each individual security. Once specific events give rise to a reasonable expectation that future anticipated cash flows may not be received, the asset originating these doubtful cash flows will be deemed to be impaired. Objective evidence of loss events includes significant financial difficulties of the issuer and default or delinquency in interest and principal payments (breach of contractual terms).</p>
> <b>Derivatives</b>	Credit risk in derivatives is mitigated by netting agreements, collateralisation and the use of Central Counterparties. For more details, see "Markets -Credit Risk Mitigation" on page 58.
> <b>Social housing</b>	<p>The portfolio is secured on residential real estate owned and let by UK Housing Associations. This collateral is revalued at least every five years and the valuation is based on standard housing methodologies, which generally involve the properties' continued use as social housing. If the valuation were based upon normal residential use the value would be considerably higher. To date, ANTS has suffered no defaults or losses on this type of lending and has not had to take possession of any collateral.</p> <p>The value of the collateral is in all cases in excess of the loan balance. Typically, the loan balance represents between 25% and 50% of the implied market value of collateral using Santander UK's LGD methodology.</p>

**Risk Management Report** continued**CORPORATE CENTRE – MONITORING AND RECOVERY MANAGEMENT**

Cases exhibiting potentially higher risk characteristics are subject to risk monitoring under the FEVE system (described in the section "Risk monitoring" in "Credit Risk Cycle" on page 43).

Cases subject to risk monitoring under the FEVE system or in Workouts by portfolio and assessment of risk at 31 December 2012 and 2011 were:

	Portfolio £m	Enhanced Monitoring £m	Enhanced Monitoring %	Pro- active £m	Pro- active %	Workout £m	Workout %	NPLs <sup>(1)</sup> £m	NPLs %	Impairment loss allowances	
										Observed £m	IBNO £m
<b>2012</b>											
Sovereign	3,651	-	-	-	-	-	-	-	-	-	-
Structured products	236	-	-	-	-	-	-	-	-	-	-
Derivatives	1,215	-	-	-	-	-	-	-	-	-	-
Social housing	9,612	632	6.6	-	-	-	-	-	-	-	-
<b>Total</b>	<b>14,714</b>	<b>632</b>	<b>4.3</b>	-	-	-	-	-	-	-	-
	Portfolio £m	Enhanced Monitoring £m	Enhanced Monitoring %	Pro- active £m	Pro- active %	Workout £m	Workout %	NPLs <sup>(1)</sup> £m	NPLs %	Impairment loss allowances	
<b>2011</b>											
Sovereign	7,266	-	-	-	-	-	-	-	-	-	-
Structured products	361	15	4.2	-	-	-	-	-	-	-	-
Derivatives	1,303	-	-	-	-	-	-	-	-	-	-
Social housing	9,941	212	2.1	-	-	-	-	-	-	-	-
<b>Total</b>	<b>18,871</b>	<b>227</b>	<b>1.2</b>	-	-	-	-	-	-	-	-

(1) Includes committed facilities and swaps.

The value of cases in enhanced monitoring increased, although this was influenced by a few large value cases in the social housing book where the concerns were more around service standards and governance rather than financial matters and these are expected to return to the performing book in due course.

**CORPORATE CENTRE - ARREARS**

At 31 December 2012, 2011 and 2010, there were no loans and advances to customers in arrears in Corporate Centre.

**FORBEARANCE – LOANS RESTRUCTURED/REFINANCED**

Restructurings/refinancings allow a customer, by negotiation, to vary the terms of their contractual obligations for an agreed period (such as interest-only period or term extensions). ANTS also aims to ensure that after the initial period of financial difficulties the customer can revert to the previous terms, with appropriate support where necessary. These agreements may be initiated by the customer, ANTS or by a third party.

No restructuring/refinancing arrangements have been entered into with respect to sovereign, structured products, derivatives or social housing.

**CORPORATE CENTRE - NON-PERFORMING LOANS AND ADVANCES**

At 31 December 2012 and 2011, there were no non-performing loans in Corporate Centre.

## MARKET RISK

### INTRODUCTION

Market risk is the risk of a variation to the capital, economic value or reported income resulting from changes in the variables of financial instruments including interest rate, inflation, equity, credit spread, property and foreign currency. Traded market risk is the risk of losses in on- and off-balance sheet positions arising from movements in market prices. Non-traded market risk includes exposures arising as a result of the structure of portfolios of assets and liabilities, or where the liquidity of the market is such that the exposure could not be closed out over a short-time horizon.

This section sets out further detail on:

- > Traded market risk,
- > Non-traded market risk (which is classified as a structural risk and presented in the Structural Risks section).

### MANAGEMENT'S APPROACH TO MARKET RISK

- |   |   |
|---|---|
| > | ANTS actively manages and controls traded market risk within clearly defined parameters by limiting the impact of adverse market movements whilst seeking to enhance earnings. The organisational structure ensures a segregation of responsibilities between the functions responsible for market risk origination, risk management and control, and risk oversight. |
| > | A comprehensive set of Santander UK-wide policies, procedures and processes have been developed and implemented to identify, monitor and manage market risk.  |
| > | All material risk exposures must be measured and subject to monitoring against limits and triggers for management action and/or escalation. Market risk limits are approved under Board-delegated authority, and within the market risk appetite.   |

## TRADED MARKET RISK

### INTRODUCTION

Traded market risk arises in connection with financial services for customers and the buying, selling and positioning mainly in fixed income, equities, foreign exchange and property markets. This trading activity may lead to a potential decline in net income due to variations in market factors including interest rates, inflation rates, equity, exchange rates, credit spreads and bond prices, property and other instruments. The most significant risk exposures in traded market risk are sensitivities to moves in interest rates, interest rate basis and the equities market.

The key areas where traded market risk is generated, controlled and managed are:

- > Corporate Banking, and
- > Markets.

Market risks arising from structured products, including exposure to changes in the levels of equity markets, are managed within Markets.



## Risk Management Report continued

### Risk measures

<b>Value at Risk ('VaR')</b>	
>	One of the main tools to measure and control market risks is a statistical risk measure, VaR. VaR estimates the potential loss arising from unfavourable market moves and is calculated using a historical simulation method with two-years of daily price history, equally weighted time period. In accordance with the standard used throughout the Banco Santander group, the VaR calculation uses a one day time horizon and a 99% confidence level. This means that conditional on today's positions, ANTS would expect to incur losses exceeding the predicted VaR estimate one in every 100 trading days, or about two to three times a year.
>	VaR is calculated daily and includes all major risk exposures including interest rates and equities, and is subjected to governance, controls, regular reviews and internal assessments.
>	Among the benefits of VaR is that it incorporates the majority of the material market risk factors and provides a comprehensive and consistent risk measure across the various factors and trading books.
>	Limitations of VaR arise from the use of historical changes and the assumption that these historical changes are an indicator of the future distribution of potential market moves. VaR does not capture intra-day risk taking as it is based on positions as at close of business. Further, it does not indicate the potential loss beyond the 99th percentile. This risk is addressed by monitoring stress testing measures across the different business areas.
>	The main risk exposures are monitored against limits at different levels: aggregated ANTS; business, asset class and individual desk levels. All limit breaches are reported and escalated in accordance with the Risk Framework.
>	Daily back-testing is performed of VaR against its market risk related revenue. This back-testing does address the limitation with the intra-day trading activity revenues.
>	Stressed VaR is an additional VaR measure calculated on a daily basis. The calculation methodology is approved by the FSA and uses a specific 250 day time window instead of the most recent two-year history.

<b>Stress scenarios</b>	
>	Stress scenarios and reverse stress scenarios are important tools for Santander UK to increase transparency, and measure and control risk of losses in stressed markets.
>	Bespoke scenarios are considered to replicate past events but also to create plausible events of abnormal market conditions from changes in financial prices including interest rates, equity, exchange rates and credit spreads. Various degrees of severity are considered which, together with VaR, make it possible to obtain a more complete spectrum of the risk profile. Scenario shocks assuming different holding periods are used to illustrate stress exposures to various degrees of market liquidity.
>	Limits are used to manage ANTS's exposure and restrict the impact of stressed market conditions. Stress testing is also employed in cross-business risk management. The results of the stress calculations, trends and explanations based on current market risk positions are communicated to Santander UK's senior management on a regular basis.

<b>Additional risk measures</b>	
>	Non-statistical risk measures as well as stress testing include sensitivities to variables used to value positions including credit spread sensitivities, interest rate basis point values and market values.
>	All quantitative models are subject to an extensive review and approval process and any uncertainty factors are addressed with fair value adjustments.

## Risk Management Report continued

## TRADED MARKET RISK – CORPORATE BANKING

For trading activities, market risk is incorporated under the VaR risk measure as well as complimentary sensitivity and stress testing metrics. The following table shows the VaR-based consolidated exposures for the major risk classes at 31 December 2012, 2011 and 2010, together with the highest, lowest and average exposures for the year. Exposures within each risk class reflect a range of exposures associated with movements in that financial market. The main exposure is due to interest rate risks, e.g. the impact of absolute rate movements, and movements between interest rate bases.

The amounts below represent the potential change in market values of trading instruments. Since trading instruments are recorded at market value, these amounts also represent the potential effect on income.

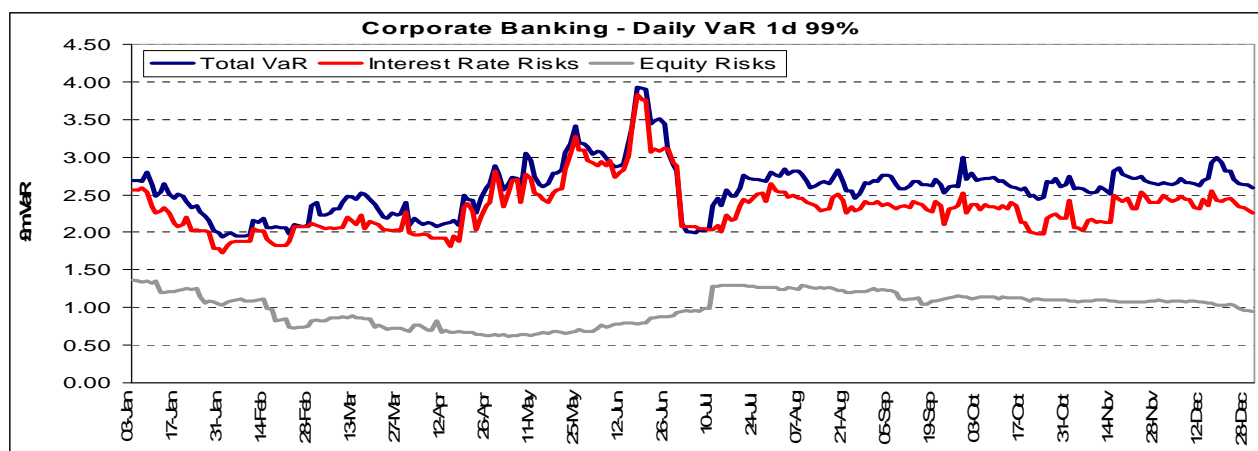
Trading instruments	Actual exposure at 31 December		
	2012 £m	2011 £m	2010 £m
Interest rate risks	2.3	1.9	2.1
Equity risks	1.0	0.5	0.7
Spread risks	-	0.2	1.1
Correlation offsets <sup>(1)</sup>	(0.6)	(0.7)	(0.3)
Total correlated one-day VaR	2.6	2.0	3.1

Trading instruments	Exposure for the year ended 31 December								
	Average exposure			Highest exposure			Lowest exposure		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Interest rate risks	2.3	1.9	2.1	3.8	2.6	4.4	1.7	1.4	0.9
Equity risks	1.0	0.5	0.7	1.4	0.7	0.7	0.6	0.2	0.7
Spread risks	0.2	0.6	1.1	0.8	0.9	1.6	-	0.2	0.6
Correlation offsets <sup>(1)</sup>	(0.9)	(0.6)	(0.9)	-	-	-	-	-	-
Total correlated one-day VaR	2.6	2.4	3.0	3.9	3.6	5.0	1.9	1.6	2.2

(1) The highest and lowest exposure figures reported for each risk type did not necessarily occur on the same day as the highest and lowest total correlated one-day Value-at-Risk. A corresponding correlation offset effect cannot be calculated and is therefore omitted from the above tables.

## Corporate Banking daily VaR (unaudited)



Movements in Total VaR and Interest Rates Risks during 2012 were driven by changing interest rate views taken by the desks.

## Risk Management Report continued

## TRADED MARKET RISK – MARKETS

Market risk-taking is performed only within the constraints of the Market Risk Framework. The majority of the exposure is due to interest rate and equity exposure. Interest rate exposure is generated through trading activities. The main equity exposures are generated by the creation and risk management of structured products by Markets for the personal financial services market. Spread exposure arises indirectly from trading activities within Markets.

The following table shows the VaR-based consolidated exposures for the major risk classes at 31 December 2012, 2011 and 2010, together with the highest, lowest and average exposures for the year. Exposures within each risk class reflect a range of exposures associated with movements in that financial market.

The amounts below represent the potential change in market values of trading instruments. Since trading instruments are recorded at market value, these amounts also represent the potential effect on income.

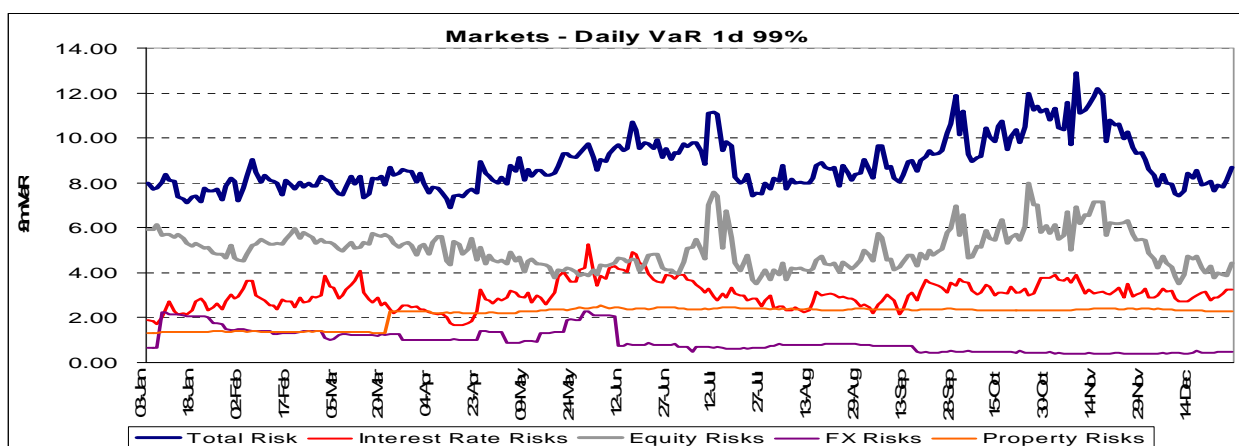
Trading instruments	Actual Exposure at 31 December		
	2012 £m	2011 £m	2010 £m
Interest rate risks	3.3	1.6	2.0
Equity risks	4.4	5.3	1.1
Property risks	2.3	2.1	2.9
Spread risks	0.2	-	-
Other risks <sup>(1)</sup>	0.5	1.9	0.2
Correlation offsets <sup>(2)</sup>	(1.9)	(2.4)	(0.8)
Total correlated one-day VaR	8.7	8.5	5.5

Trading instruments	Exposure for the year ended 31 December									
	2012 £m	Average exposure			Highest exposure			Lowest exposure		
		2011 £m	2010 £m	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m	
Interest rate risks	3.0	2.3	2.4	5.2	3.8	5.2	1.7	1.2	1.2	
Equity risks	5.0	2.6	1.2	8.0	6.9	1.8	3.5	0.6	0.7	
Property risks	2.1	2.2	5.5	2.5	2.9	9.1	1.3	1.9	2.9	
Spread risks	0.1	-	-	0.4	-	-	-	-	-	
Other risks <sup>(1)</sup>	0.9	0.4	0.3	2.3	1.9	0.8	0.4	0.2	0.2	
Correlation offsets <sup>(2)</sup>	(2.4)	(1.1)	(0.9)	-	-	-	-	-	-	
Total correlated one-day VaR	8.8	6.4	8.5	12.9	10.0	14.6	6.9	3.9	4.8	

(1) Other risks include foreign exchange risk.

(2) The highest and lowest exposure figures reported for each risk type did not necessarily occur on the same day as the highest and lowest total correlated one-day Value-at-Risk. A corresponding correlation offset effect cannot be calculated and is therefore omitted from the above tables.

## Markets daily VaR (unaudited)



Movements in Total Risk and Equity Risks during 2012 were driven by changing trading volumes within the Equity Derivatives desk.

## STRUCTURAL RISK

### INTRODUCTION

Structural risk includes exposures arising as a result of the structure of portfolios of assets and liabilities, or where the liquidity of the market is such that the exposure could not be closed out over a short-time horizon. The risk exposure is generated by features inherent in either a product or portfolio and normally presented over the life of the product or portfolio. Such exposures are a result of the decision to undertake specific business activities, can take a number of different forms, and are generally managed over a longer-time horizon.

Through the internal transfer pricing mechanism, material structural risks arising from divisions are transferred from the originating business to FMIR in Corporate Centre where they are monitored, controlled and managed holistically in conjunction with exposures arising from the funding, liquidity or capital management activities of FMIR.

There are three key areas of structural risk within ANTS which are discussed in the sections that follow. These are:

- > Non-traded market risk;
- > Liquidity and funding risk; and
- > Capital risk.

### NON-TRADED MARKET RISK

Non-traded market risk mainly arises through the provision of banking products and services to personal and corporate/business customers, as well as structural exposures arising in Santander UK's balance sheet.

The most significant non-traded market risk on a gross basis is interest rate risk, which includes both yield curve and basis risks. Yield curve risk arises from the timing mismatch in the re-pricing of fixed and variable rate assets, liabilities and off-balance sheet instruments, as well as the investment of non-interest-bearing liabilities in interest-bearing assets. Basis risk arises, to the extent that the underlying market rates impacting pricing within variable rate assets and liabilities are not precisely matched. This exposes the balance sheet to changes in the relationship between market rates, for example between LIBOR and Bank of England Base Rate.

Santander UK is also exposed to behavioural risks arising from features in retail products that give customers the right to alter the expected cash flows of a financial contract. For example prepayment risk where customers may prepay loans before their contractual maturity. Santander UK is also exposed to product launch risk, where the customers may not take the expected volume of new mortgages or other products.

There are two areas where non-traded market risk is permitted, controlled and managed:

- > Corporate Banking; and
- > Corporate Centre.

All non-traded market risks arising from the Santander UK group's Retail Banking and Corporate Banking divisions are substantially transferred from the originating business to FMIR in Corporate Centre.

### Risk measures

For non-traded market risk, Santander UK predominantly measures its market risk exposures with both Net Interest Margin ('NIM') and Economic Value of Equity ('EVE') analysis supplemented by the risk measures described in the Market Risk section.

NIM and EVE measures are commonly used throughout the financial services industry as measures for managing market risk across non-traded portfolios. The calculations for NIM and EVE sensitivities involve many assumptions, including expected customer behaviour (e.g. early repayment of loans) and how interest rates may evolve. The behavioural assumptions form a key part of the overall control framework and are updated and reviewed on an ongoing basis.

## Risk Management Report continued

Net Interest Margin ('NIM') Sensitivity	
>	NIM sensitivity is an income-based measure and is used to forecast the changes to the interest income and interest expense of Santander UK in different scenarios to provide a combined impact on margin over a specified time horizon, the most common being over an annual (i.e. 12 month) period.
>	Typically scenarios compare the impact of an immediate parallel shift to interest rates (both up and down) from a specific expected path of interest rates, usually determined by the market's expectation of interest rates. This method is adopted to provide an illustration or index as to the level of interest rate risk.
>	NIM sensitivity analysis is also used to demonstrate the impact on income of contractual product features such as re-pricing and maturity dates and non-contractual features such as early product redemption.
Economic Value of Equity ('EVE') Sensitivity	
>	EVE sensitivities forecast the difference between scenarios, in a manner similar to NIM sensitivities but over the entire life of instruments currently within the balance sheet. Typically, scenarios compare the impact of an immediate parallel shift to interest rates (both up and down) from the market expected interest rates to give an illustration or index as to the level of interest rate risk.
>	EVE sensitivity analysis is also used to demonstrate the whole life, or value impact of contractual product features such as re-pricing and maturity dates and non-contractual features such as early product redemption.

## NON-TRADED MARKET RISK – CORPORATE BANKING

Non-traded market risks originated in Corporate Banking are transferred from the originating business to FMIR in Corporate Centre. Funds received with respect to deposits taken are lent on to Corporate Centre on matching terms as regards interest rate re-pricing and maturity; in a similar manner loans are funded through matching borrowings. Any permitted retained market risk exposure is minimal, and is monitored against limits approved through the Market Risk Framework.

## NON-TRADED MARKET RISK – CORPORATE CENTRE

As a consequence of the transfer process described above, all material non-trading market risk exposures are substantially transferred to and reside within Corporate Centre. Non-traded market risk is managed in line with the Risk Framework. The exposures at 31 December 2012 and 2011 are outlined below.

## Analysis of non-traded market risk exposures

NIM and EVE measures are two of the key measures used by Santander UK that illustrate its exposure to yield curve risk. The following table reflects how the base case valuations would be affected by a 100 basis point parallel shift applied instantaneously to the yield curve. For comparison purposes these measures are shown at 31 December 2012, 2011 and 2010:

	2012 £m	2011 £m	2010 £m
Net Interest Margin sensitivity to +100 basis points shift in yield curve	343	225	309
Economic Value of Equity sensitivity to +100 basis points shift in yield curve	405	387	410

The change in the sensitivities between 2011 and 2012 was largely attributable to the run off of the hedging strategy implemented during 2011 to lessen the impact of margin compression. Due to the protracted period of historically low interest rates, Santander UK remains exposed to a degree of margin compression. It is attributable to the combination of the historically low level of central bank base rates and to reduced earnings from the assets funded by Santander UK's non-dated liabilities.

## LIQUIDITY AND FUNDING RISK

ANTS is the treasury support function for the Santander UK group. In this regard, ANTS's role is to provide access to financial markets and central bank facilities in order to meet the Santander UK group's liquidity, funding, capital and balance sheet management requirements.

Liquidity and funding risk is managed on a Santander UK group basis and it is not therefore appropriate to consider these risks separately at an ANTS group level. In addition, under the FSA's regulatory liquidity regime, Santander UK and ANTS together with Cater Allen Limited, a fellow subsidiary of Santander UK plc, form the Santander UK Defined Liquidity Group ('DLG'). Under these arrangements, each member of the DLG is liable to support each other in terms of transferring or receiving surplus liquidity in times of stress. In considering the liquidity resources available to the ANTS group, both its own liquid assets and also those of rest of the Santander UK group have been separately presented below.

### INTRODUCTION

Santander UK views the essential elements of liquidity and funding risk management as managing potential cash outflows, maintaining prudent levels of highly liquid assets and ensuring that access to funding is available from a diverse range of sources. The Santander UK Board targets a funding strategy that avoids excessive reliance on wholesale funding and attracts enduring commercial deposits by understanding the behavioural aspects of customer deposits under different scenarios, appropriately reflecting product features and types of customers. The funding strategy aims to provide effective diversification in the sources and tenor of funding as well as establishing the capacity to raise additional unplanned funding from those sources quickly. An excessive concentration in either liquid assets or contractual liabilities also contributes to potential liquidity risk, and so limits on these have been defined under the Liquidity Risk Framework.

Santander UK primarily generates funding and liquidity through UK retail and corporate deposits, as well as in the financial markets through its own debt programmes and facilities to support its business activities and liquidity requirements. It does this in reliance on the strength of its balance sheet and profitability and its own network of investors. It does not rely on a guarantee from Banco Santander, S.A. or any other member of the Banco Santander group (other than certain of Santander UK plc's own subsidiaries, such as ANTS) to generate this funding or liquidity. Santander UK does not raise funds to finance other members of the Banco Santander group or guarantee the debts of other members of the Banco Santander group (other than certain of Santander UK plc's own subsidiaries, such as ANTS). Whilst Santander UK manages its funding and maintains adequate liquidity on a stand-alone basis, Santander UK co-ordinates issuance plans with the Banco Santander group where appropriate.

In addition to Santander UK's liquidity risk being consolidated and centrally controlled, liquidity risk is also measured, monitored and controlled within the specific business area or the subsidiary where it arises. Liquidity and funding risks are identified and encompassed within Santander UK's Risk Framework and subject to Santander UK's three-tier risk governance framework. The Santander UK Board delegates day-to-day responsibility for liquidity risk to the Chief Executive Officer. The Chief Executive Officer has in turn delegated the responsibilities for liquidity and funding risk management to the Chief Financial Officer, (who in turn delegates to the Finance Director), and for risk oversight to the Chief Risk Officer.

Adherence to Santander UK's liquidity and funding risk appetite is monitored on a daily, weekly and monthly basis through different committees and levels of management including the Strategic Risk and Financial Management Committee and the Risk Management Committee, and the Santander UK Board Risk Committee. The Strategic Risk and Financial Management Committee is responsible for overseeing the management of Santander UK's balance sheet in accordance with the Santander UK Board-approved funding plan and for ensuring that the adequacy of liquidity and appropriateness of funding are consistent with risk appetite. This includes consideration of relevant macro-economic factors and conditions in the financial markets.

### DEFINITIONS

#### LIQUIDITY RISK

> Liquidity risk is the risk that Santander UK, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure them only at excessive cost. Liquidity risks arise throughout Santander UK. Santander UK's primary business activity is commercial banking and, as such, it engages in maturity transformation, whereby callable and short-term commercial deposits (including retail and corporate) are invested in longer-term customer loans.

#### FUNDING RISK

> Funding risk is the risk that Santander UK does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient or a funding programme such as debt issuance subsequently fails. For example, a securitisation arrangement may fail to operate as anticipated or the values of the assets transferred to a funding vehicle do not emerge as expected creating additional risks for Santander UK and its depositors. Risks arising from the encumbrance of assets are also included within this definition.

## Risk Management Report continued

## LIQUIDITY RISK

Santander UK's key ongoing liquidity risks are:

KEY LIQUIDITY RISK	DEFINITION
> Retail funding risk	Risk of loss of retail deposits.
> Corporate funding risk	Risk of loss of corporate deposits.
> Wholesale secured and unsecured funding risk	Risk of wholesale unsecured and secured deposits failing to roll over.
> Derivatives and contingent liquidity risks	Risk of ratings downgrades that could trigger events leading to increased outflows of financial resources, for example, to cover additional margin or collateral requirements.

## LIQUIDITY RISK APPETITE

The Santander UK Board's risk objective is to be a risk resilient institution at all times, and to be perceived as such by stakeholders, preserving the short and long-term viability of Santander UK. While recognising that a bank engaging in maturity transformation cannot hold sufficient liquidity to cover all possible stress scenarios, the Santander UK Board requires Santander UK to hold sufficient liquidity to cover stress situations as set out in the stress testing section below. The requirements arising from the FSA's regulatory liquidity regime are reflected in the Santander UK Board's Liquidity Risk Appetite.

- > The liquidity risk appetite has been recommended by the Chief Executive Officer and approved by the Santander UK Board, under advice from the Santander UK Board Risk Committee. The liquidity risk appetite, within the context of the overall Santander UK Risk Appetite, is reviewed and approved by the Santander UK Board at least annually or more frequently if necessary (e.g. in the case of significant methodological or business change). This is designed to ensure that the liquidity risk appetite will continue to be consistent with Santander UK's current and planned business activities.
- > The Chief Executive Officer, under advice from the Santander UK Board Risk Committee, approves more detailed allocation of liquidity risk limits. The Chief Risk Officer, supported by the Risk Division (including the Deputy Chief Risk Officer, Chief Risk Management Officer, and the Director of Liquidity and Banking Market Risk), is responsible for monitoring the ongoing compliance with the liquidity risk appetite.

MANAGEMENT'S APPROACH TO LIQUIDITY RISK	
>	Liquidity risk is managed under a comprehensive and prudent liquidity risk management framework.
>	The primary objective of the framework is to ensure that Santander UK is liquidity risk resilient by holding sufficient financial resources to withstand a series of stresses as well as complying with internal Liquidity Risk Appetite ('LRA') and regulatory requirements.
>	Liquidity management is the responsibility of the Chief Financial Officer, who delegates day-to-day responsibility to the Finance Director.
>	Liquidity risk control and oversight are provided by the Chief Risk Officer, supported by the Chief Risk Management Officer and the Risk Division.

## LIQUIDITY RISK MANAGEMENT

The key element of Santander UK's liquidity risk management is focused on holding sufficient liquidity to withstand a series of stress tests. Within the framework of prudent funding and liquidity management, Santander UK manages its activities to minimise liquidity risk, differentiating between short-term and strategic activities.

Short-term, tactical liquidity management	
> Liquid assets	A portfolio of liquid assets is held to cover unexpected demands on cash in extreme but plausible stress scenarios. In Santander UK's case, the most significant stress events include large and unexpected deposit withdrawals by retail customers and a loss of unsecured wholesale funding.
> Funding profile	Metrics to help control the level of outflow within different maturity buckets.
> Intra-day collateral management	To ensure that adequate collateral is available to support payments in each payment or settlement system in which Santander UK participates, as they fall due.
Strategic funding management	
> Structural balance sheet shape	To manage the extent of maturity transformation (investment of shorter term funding in longer term assets), the funding of non-marketable assets with wholesale funding and the extent to which non-marketable assets can be used to generate liquidity.
> Wholesale funding strategy	To avoid over-reliance on any individual counterparty, currency, market or product, or group of counterparties, currencies, markets or products that may become highly correlated in a stress scenario; and to avoid excessive concentrations in the maturity of wholesale funding.
> Wholesale funding capacity	To maintain and promote counterparty relationships, monitor line availability and ensure funding capacity is maintained through ongoing use of lines and markets.

Collateral calls on derivatives positions can pose a significant liquidity risk. Collateral calls may arise at times of market stress and when asset liquidity may be tightening. The timing of the cash flows on a derivative hedging an asset may be different to the timing of the cash flows of the asset being hedged, even if they are similar in all other respects. Collateral calls may be triggered by a credit downgrading. Santander UK manages these risks by including collateral calls in stress tests on liquidity, and by maintaining a portfolio of assets held for managing liquidity risk.

Risk limits and triggers are set for the key tactical and strategic liquidity risk drivers. These are monitored by the Risk Division and reported monthly to ALCO, SRFM, Risk Management Committee and the Santander UK Board.

### Operational management of liquidity risk

Santander UK maintains, as part of its overall liquidity and funding risk management framework, strong operational and management governance that seeks to make the Santander UK strategy as resilient as possible to potential liquidity stresses by structuring the balance sheet in a prudent and sensible way. The Santander UK Board's Liquidity Risk Appetite defines the balance sheet principles that operational management is tasked to deliver:

- > Implementation of a funding structure that is consistent with the composition of Santander UK's assets.
- > Well balanced growth of assets and liabilities.
- > Implementation of a funding strategy that:
  - > Avoids excessive reliance on short-term wholesale funding and attracts sustainable commercial deposits, and
  - > Provides effective diversification in the sources, products and tenor of funding.
- > Maintenance of an appropriate mix of 'sticky' and 'non-sticky' commercial deposit balances.
- > Use of short-term funding to manage short-term fluctuations in funding and the funding of short-term wholesale assets.
- > Use of Term funding to provide diversification of stable funding as well as an aid to help manage the liquidity structure of the balance sheet.

The Chief Financial Officer has delegated responsibility for day-to-day management of liquidity risk to the Finance Director who in turn delegates to the Director, ALM; the Director, Funding; and the Head of Short Term Funding. These management processes are reviewed and challenged by the independent Risk function and overseen by the Asset and Liabilities Committee ('ALCO'), Strategic Risk and Financial Management Committee ('SRFM') and Risk Management Committee.



## Risk Management Report continued

The Director, ALM is responsible for strategic liquidity management including:

- > The externalisation of liquidity risks from the business into the Term Funding and Short Term Funding desks where it is operationally managed,
- > The internal liquidity transfer pricing that ensures the costs of liquidity are accurately reflected at business line and product level,
- > The production of the three year funding plan in line with strategic goals and taking account of the economic and market environment; this process incorporates the implementation where necessary of liquidity or funding risk actions arising from the tracking and delivery of the plan,
- > Forward liquidity gap analysis to ensure that future potential funding or liquidity risks are managed pro-actively,
- > The formulation and proposal of the Santander UK Liquidity Risk Appetite to executive management and the Santander UK Board,
- > The design and maintenance of the Santander UK Liquidity Recovery Framework that incorporates contingent actions that can be implemented to offset the potential impacts of a liquidity stress event; and
- > Detailed balance sheet analysis with contributions from the business areas supports the projection of daily stressed liquidity outflows for the purposes of the stress testing of risks. These stress outflow assumptions are subject to ongoing assessment and revision in line with market and economic developments.

The Director, Funding covers all aspects of short and term funding in both secured and unsecured markets, delivering Santander UK's strategic funding requirements in line with its detailed funding plan and risk appetite principles. The Director, Funding ensures that Santander UK has active involvement in a range of wholesale funding markets ensuring that sources of funding can be maximised and so a conservative level of diversification of the balance sheet across product and appropriate maturity profile maintained.

The Head of Short Term Funding is in charge of operational liquidity. This encompasses collateral management, the efficient maintenance of a portfolio of liquid assets to counter potential liquidity stress; the maintenance of Bank of England and US Federal Reserve accounts; and efficient operational intra-day liquidity management.

## STRESS TESTING

In addition to regulatory requirements, Santander UK runs stress tests on a frequent basis to ensure it is holding sufficient financial resources. These stress tests consist of:

ACTIVITY	DESCRIPTION
> Santander UK Liquidity Risk Appetite stress	A comprehensive stress test considering all risk drivers applicable to Santander UK during an idiosyncratic shock experienced during a protracted market-wide stress.
> Funding plan review	A thorough review and identification of vulnerabilities in Santander UK's strategic funding plan aimed at assessing the sensitivity of Santander UK's structural funding position to the different growth assumptions applied to each funding source and the impact of undershooting the targets set.
> Overseas operations stress	Stress tests examining the impact of liquidity stresses originating from Santander UK's overseas entities or operations, in particular the effects on the rest of Santander UK.
> Acute and protracted retail stress	Stress tests designed to examine the impact of short-term acute as well as longer-term protracted idiosyncratic retail stress, where there are retail deposit outflows of varying severity over different time periods.
> Wholesale stress	A stress test that considers the wholesale and corporate risk drivers as they related to Santander UK during an idiosyncratic stress that results in a protracted leakage of deposits.
> Santander UK credit ratings downgrade	Santander UK assesses the impact on it of a downgrade of its credit ratings, including the effects on its collateral requirements and liquidity position, on both a standalone basis and as part of its suite of other stress tests that it runs.
> Eurozone stress	Given the continuing uncertainty in the eurozone, Santander UK also stress tests a more extreme scenario where eurozone contagion or collapse results in significant retail, corporate and wholesale deposit outflows, combined with a reduction in the management actions available.

## Risk Management Report continued

These stress tests are supplemented with sensitivity analysis for instantaneous liquidity shocks by each major liquidity risk driver to understand the impact on internal liquidity risk appetite and regulatory liquidity metrics.

## LIQUID ASSETS

Santander UK holds, at all times, a portfolio of unencumbered liquid assets to mitigate liquidity risk. The size and composition of this portfolio is determined both by internal stress tests as well as the FSA's liquidity regime.

The following tables set forth liquid assets held by the ANTS group and additional liquid assets held by the rest of the Santander UK group (to which the ANTS group has access through the cross guarantee and defined liquidity group arrangements described earlier) by the geographic location of the issuer or counterparty at 31 December 2012 and 2011:

	Held by the ANTS group		Held elsewhere in Santander UK	
	31 December 2012 £bn	31 December 2011 £bn	31 December 2012 £bn	31 December 2011 £bn
<b>Core liquid assets (FSA eligible):</b>				
Cash at central banks:				
- UK	-	-	28	18
- US	-	7	-	-
	-	7	28	18
Government bonds:				
- UK	4	2	-	-
- US	3	-	-	-
- Japan	1	-	-	-
- Germany	1	-	-	-
- Other countries, each less than £1bn <sup>(1)</sup>	-	1	-	-
	9	3	-	-
<b>Total core liquid assets (FSA eligible)</b>	<b>9</b>	<b>10</b>	<b>28</b>	<b>18</b>
High quality <sup>(2)</sup> corporate bonds and asset-backed securities:				
- UK	1	1	-	-
- US	-	-	1	1
	1	1	1	1
Other liquid assets:				
- UK – Whole loans and own debt securities <sup>(3) (4)</sup>	-	-	36	24
- UK – Other debt securities, bonds, and equities included in major indices	1	1	-	-
- US – Debt securities and bonds	-	1	-	-
	1	2	36	24
<b>Total liquid assets</b>	<b>11</b>	<b>13</b>	<b>65</b>	<b>43</b>

(1) Consists of US, Switzerland, France and Denmark.

(2) A- rated or higher.

(3) Whole loans are loans acceptable on an unsecuritised basis to the Bank of England as collateral for its various funding arrangements.

(4) Includes own debt securities (i.e. retained issuances) held by Santander UK of £1bn at 31 December 2012 (2011: £24bn).

Core liquid assets are convertible into cash on demand. High quality bonds are convertible into cash through normal market channels. Whole loans and own debt securities are convertible into cash via discount at central banks, a process that, while it varies by asset class, typically takes four weeks. A significant proportion of these whole loans and own debt securities have been pre-positioned for discount at central banks and are therefore almost immediately convertible into cash.

The UK FSA's liquidity regulatory regime requires the actual liquidity of assets classified as core liquid assets to be demonstrated through evidence of the actual ability to convert the assets into cash, rather than by restricting the permissible maximum contractual maturity of such assets. Santander UK periodically tests the liquidity of the core liquid assets portfolio, in accordance with the FSA requirement to realise a proportion of these assets through repo or outright sale to the market. In accordance with the FSA's regulations, Santander UK ensures that the cumulative effect of its periodic realisation over any twelve month period is that a significant proportion of the assets in its core liquid assets portfolio is realised.

Santander UK also maintains a written policy setting out its approach to the periodic realisation of its assets, and ensures that it periodically tests its operational ability to raise funds, through the use of central bank liquidity facilities to which Santander UK has access, by using a proportion of those of its assets not in its liquid asset portfolio.

In deciding on the precise composition of its liquid asset portfolio, Santander UK ensures that it tailors the contents of the portfolio to the needs of its business and the liquidity risk that it potentially faces. In particular, Santander UK ensures that it holds assets in its liquid asset portfolio which can be realised with the speed necessary to meet its liabilities as they fall due.

Core liquid assets consist of assets that meet the definition of liquid assets for purposes of the FSA's liquidity regime, as set out in the FSA's Prudential Sourcebook for Banks, Building Societies and Investment Firms, known as BIPRU. Such assets comprise cash at central banks and government bonds, but only the central government or central bank of a highly-rated European Economic Area state, Canada, Australia, Japan, Switzerland or the United States of America, subject to minimum credit ratings.

## Risk Management Report continued

### Liquidity developments in 2012

2012 represented another very challenging year for UK banks in terms of funding and liquidity risk management. Continued concerns about the eurozone kept risk premiums on the sovereign debt of many European countries in the first half of 2012 at the highest levels since the euro's creation. This market disruption was felt by Santander UK both in terms of market-wide elevated wholesale, unsecured medium-term and secured medium-term funding rates and, as with other UK banks, in terms of credit rating downgrades. However, the second half of 2012 saw a gradual but significant reduction in funding rates, an easing of recent market liquidity constraints and a general improvement in market confidence.

Throughout 2012, Santander UK continued to strengthen its liquidity position despite the impact of the eurozone crisis. During 2012, Santander UK:

- > Reduced reliance on specific short term and wholesale funds and increased the level of medium funding in the funding mix.
- > Developed and expanded Santander UK's liquidity management capabilities through a revision of its risk management framework, imposition of a revised liquidity risk appetite with associated limits and controls, and the imposition of new policy covering such risks as balance sheet encumbrance.
- > Developed and tested an extensive rapid response framework of which Recovery and Resolution Plans form a part. The rapid response framework is designed to ensure that executive management and the Board are able to react to any unforeseen liquidity stresses and that there are effective mechanisms of communication and response to such a stress. As part of this process a series of specific management actions that could be leveraged in the event of a stress event are maintained in an ongoing basis.
- > Maintained a conservative portfolio of liquid assets that can be utilised to counter the potential impact of a liquidity stress on Santander UK balance sheet.
- > Increased total liquid assets to £76bn (2011: £56bn). The increase of core liquid assets was driven primarily by a reduction in the customer funding gap (customer liabilities less customer assets) as a result of deleveraging and increased debt issuance. Whole loans and own debt securities increased with the availability of "whole loans" pre-positioned at central banks pursuant to the Bank of England's decision to accept loans on an unsecured basis (i.e. whole loans) as collateral for its various funding arrangements such as the Funding for Lending Scheme, the Extended Collateral Term Repo Facility and the Discount Window Facility. It was more efficient for Santander UK to use whole loans rather than securitisations as Santander UK is required to include the effect of a downgrade on its securitisation structures for the purposes of calculating liquidity requirements, which is not the case with whole loans.

## FUNDING RISK

Santander UK's primary sources of funding include:

- > Customer deposits;
- > Secured and unsecured money-market funding (including unsecured cash, repo, certificates of deposit and commercial paper issuance);
- > Senior debt issuance (including discrete bond issues and medium term notes);
- > Asset-backed funding (including securitisation and covered bond issuance); and
- > Subordinated debt and capital issuance (although the primary purpose is not funding).

Retail Banking and Corporate Banking funding primarily comprises deposits by customers.

<b>MANAGEMENT'S APPROACH TO FUNDING RISK</b>	
>	Funding risk is managed by the Finance Director, who is responsible for the production of strategic and tactical funding plans as part of Santander UK's planning process.
>	Funding plans are approved by the Board and the SRFM Committee and are controlled on a day-to-day basis by the Finance Director and within the framework of the Liquidity Risk Manual.
>	The plans are stressed to ensure adverse conditions can be accommodated via a range of management levers.
>	Funding management is the responsibility of the Chief Financial Officer who delegates day-to-day responsibility to the Finance Director, who in turn delegates to the Director, ALM and the Director, Funding.

## FUNDING STRATEGY

Santander UK's funding strategy continues to be based upon the maintenance of a conservatively structured balance sheet avoiding over-reliance on wholesale and short term funds whilst ensuring that sources of funding are not overly concentrated. Santander UK also maintains checks and controls to ensure that sources of secured funding are leveraged whilst managing and limiting the level of asset encumbrance that results from this.

The quality of retail, commercial and wholesale deposits continues to be enhanced with Santander UK focused on increasing the average maturity of deposits whilst de-emphasising transient balances. Across all customer segments, Santander UK looks to deepen customer relationships and so lengthen the contractual and behavioural profile of the liability base. In the retail bank this is complemented by the successful introduction of such market leading products as the 1|2|3 Current Account.

Throughout 2012, in response to the uncertainty surrounding the eurozone and associated market challenges, Santander UK held a high level of liquid assets to mitigate the short term impacts of any potential stress event. Santander UK seeks to hold adequate liquid resources at all times, to manage these efficiently and, as far as possible, not to impede the ability of the business to extend credit to the customer base.

## FUNDING RISK MANAGEMENT

### Operational management of funding risk

Santander UK maintains, as part of its overall liquidity and funding risk management framework, strong operational and management governance that seeks to make Santander UK's strategy as resilient as possible to potential funding stresses by structuring the balance sheet in a prudent and sensible way. The framework applies to all aspects of both funding and liquidity risk to ensure that the two are managed in a consistent and complimentary way - in line with the Board's Liquidity Risk Appetite. As with liquidity risk, operational management is tasked to deliver Santander UK's strategy in line with the following principles that define the desired conservative balance sheet structure:

- > Implementation of a funding structure that is consistent with the composition of assets.
- > Well balanced growth of assets and liabilities.
- > Implementation of a funding strategy that:
  - > Avoids excessive reliance on short-term wholesale funding and attracts sustainable commercial deposits, and
  - > Provides effective diversification in the sources, products and tenor of funding.
- > Maintenance of an appropriate mix of 'sticky' and 'non-sticky' retail deposit balances.
- > Use of short-term funding to manage short-term fluctuations in funding and the funding of short-term wholesale assets, and
- > Use of long-term funding to provide diversification of stable funding as well as an aid to help manage the liquidity structure of the balance sheet.

Within Santander UK, the same operational management structure that manages funding risks is responsible for liquidity risk management because of the very close affinity of the two areas. The Chief Financial Officer has delegated responsibility for day-to-day management of Funding Risk to the Finance Director who in turn delegates to the Director, ALM, and the Director, Funding. These management processes are reviewed and challenged by the independent risk function and overseen by the ALCO, SRFM and Risk Management Committee.

The Director, Funding and the Head of Short Term Funding together cover all aspects of short and term funding in both secured and unsecured markets, delivering Santander UK's strategic funding requirements in line with its detailed funding plan and risk appetite principles. The Director, Funding ensures that Santander UK has active involvement in a range of wholesale funding markets ensuring that sources of funding can be maximised and so a conservative level of diversification of the balance sheet across product and average maturity maintained.

## Risk Management Report continued

The Director, ALM is responsible for strategic liquidity management and funding risk analysis and carries out this responsibility through:

- > The externalisation of funding risk from the business into the Term Funding and Short Term Funding desks where it is operationally managed.
- > the internal funding transfer pricing that ensures the costs of funding are accurately reflected at business line and product level;
- > The production of the three year funding plan in line with strategic goals and taking account of the economic and market environment; this process incorporates the implementation where necessary of liquidity or funding risk actions arising from the tracking and delivery of the plan;
- > Forward liquidity gap analysis to ensure that future potential funding or liquidity risks are managed pro-actively;
- > The formulation and proposal of the Liquidity Risk Appetite to executive management and the Board;
- > The design and maintenance of the Liquidity Recovery Framework that incorporates contingent actions to raise funds quickly and that can be implemented to offset the potential funding impacts of a liquidity stress event; and
- > Detailed balance sheet analysis with contributions from the business areas supports the projection of daily stressed liquidity outflows for the purposes of the stress testing of risks. These stress outflow assumptions are subject to ongoing assessment and revision in line with market and economic developments and provide control in terms of the minimum level of liquid assets that Santander UK desires to maintain at all times.

The Head of Short Term Funding is in charge of operational liquidity. This encompasses collateral management, the maintenance of a portfolio of liquid assets to counter potential liquidity stress; the maintenance of Bank of England and US Federal Reserve accounts; and the efficient operation of intra-day liquidity management.

### Financial adaptability

Santander UK also considers its ability to take effective action to alter the amounts and timing of cash flows so that it can respond to unexpected needs or opportunities. In determining its financial adaptability, Santander UK has considered its ability to:

ACTION	DESCRIPTION
<ul style="list-style-type: none"> <li>&gt; Obtain new sources of finance</li> </ul>	<p>Santander UK minimises refinancing risk by sourcing funds from a variety of markets as appropriate and subject to consideration of the appropriate leverage ratio and funding mix for Santander UK, and in particular customer deposit levels and medium-term funding. Santander UK actively manages its relationships with existing providers of funding and considers new sources of funds as and when they arise.</p> <p>Day-to-day sources of finance consist primarily of retail deposits. To the extent that wholesale funding is required, a variety of sources are usually available from a range of markets, including:</p> <ul style="list-style-type: none"> <li>&gt; money markets: both unsecured (including interbank and customer deposits, and issuances of certificates of deposit and commercial paper) and secured (including repos in open market operations);</li> <li>&gt; debt capital markets (including discrete bond issues and medium term notes);</li> <li>&gt; mortgage-backed funding (including securitisation and covered bond issuance); and</li> <li>&gt; capital instruments (although primarily issued to maintain capital ratios).</li> </ul> <p>In addition to day-to-day funding sources, Santander UK has access to contingent sources from central banks, including the Bank of England, the US Federal Reserve and the Swiss National Bank. Santander UK ensures that it has access to these contingent facilities as part of its prudent liquidity risk management. Santander UK minimises reliance on any one market by maintaining a diverse funding base, and avoiding concentrations by maturity, currency and institutional type.</p>
<ul style="list-style-type: none"> <li>&gt; Obtain financial support from other Banco Santander group companies</li> </ul>	<p>For capital, funding and liquidity purposes, Santander UK operates on a stand-alone basis. However, in case of stress conditions, it would consult with its ultimate parent company, Banco Santander, S.A. about financial support.</p>
<ul style="list-style-type: none"> <li>&gt; Continue business by making limited reductions in operations or using alternative resources</li> </ul>	<p>Santander UK maintains, within its Recovery and Resolution Plan, contingency funding plans to cover potential extreme scenarios. This includes the maintenance of specific management actions that can be executed in the event of a stress to rapidly raise funds. These actions are updated on a monthly basis.</p>

## Risk Management Report continued

## WHOLESALE FUNDING

The tables below show ANTS's primary wholesale funding sources excluding short-term repurchase agreements, together with a reconciliation of wholesale funding to the balance sheet at 31 December 2012 and 2011.

2012	Funding analysis £bn	Repos £bn	Other <sup>(1)</sup> £bn	Balance sheet £bn
<b>Deposits by banks</b>	<b>4.8</b>	<b>1.1</b>	<b>108.6</b>	<b>114.5</b>
<b>Deposits by customers<sup>(2)</sup></b>	<b>0.4</b>	-	-	<b>0.4</b>
<b>Debt securities in issue:</b>				
- covered bonds	19.2	-	-	19.2
- other debt securities	13.1	-	1.4	14.5
	<b>37.5</b>	<b>1.1</b>	<b>110.0</b>	<b>148.6</b>
<b>Financial liabilities at fair value</b>	<b>4.0</b>	-	-	<b>4.0</b>
<b>Trading liabilities</b>	<b>0.9</b>	<b>11.7</b>	<b>8.5</b>	<b>21.1</b>
<b>Total wholesale funding</b>	<b>42.4</b>	<b>12.8</b>	<b>118.5</b>	<b>173.7</b>
<b>2011</b>	Funding analysis £bn	Repos £bn	Other <sup>(1)</sup> £bn	Balance sheet £bn
Deposits by banks	5.0	2.5	106.5	114.0
Deposits by customers <sup>(2)</sup>	0.4	-	-	0.4
Debt securities in issue:				
- covered bonds	15.3	-	-	15.3
- other debt securities	10.2	-	1.5	11.7
	<b>30.9</b>	<b>2.5</b>	<b>108.0</b>	<b>141.4</b>
Financial liabilities at fair value	6.8	-	-	6.8
Trading liabilities	4.1	15.6	6.0	25.7
<b>Total wholesale funding</b>	<b>41.8</b>	<b>18.1</b>	<b>114.0</b>	<b>173.9</b>

(1) Principally consists of intercompany funding.

(2) Included in the balance sheet total of £44,750m (2011: £38,826m).

## Risk Management Report continued

### CAPITAL RISK

#### DEFINITION

Capital risk is defined as the risk that the ANTS does not have an adequate amount, or quality of, capital to:

- > Adhere to the Santander UK Board's Risk Appetite and support its internal business objectives;
- > Support market expectations and its credit rating; and
- > Meet regulatory requirements in the UK and other jurisdictions (such as the United States) where regulated activities are undertaken.

Whilst the Company and its parent Santander UK plc are part of the wider Banco Santander group, both the Company and Santander UK plc are incorporated in the UK, regulated by the FSA and do not benefit from guarantees from Banco Santander, S.A. and, as such, Santander UK plc operates as an autonomous subsidiary. As such, responsibility for the management, control and assurance of capital risk lies with the Santander UK Board, and the ANTS Board with respect to its own capital.

The Company, Santander UK plc, and Cater Allen Limited are party to a defined liquidity group liquidity facility agreement (the "DLG Facility Agreement"). The DLG Facility Agreement supports a defined liquidity group for the purposes of section 12 of BIPRU. Section 12.8 of BIPRU permits a member of a defined liquidity group to rely on the liquid resources of other members of the defined liquidity group to comply with the liquidity adequacy requirements under section 12 of BIPRU. Under the DLG Facility Agreement, each party agrees to lend, subject to certain conditions and limitations, its excess liquidity to each other party.

The Santander UK Capital Management Framework, reviewed by the Santander UK Board annually, describes the high level arrangements for the management, control and assurance of Santander UK capital risk. Santander UK adopts a centralised capital management approach that is driven by its strategy and delivers the Santander UK Board approved Santander UK Risk Appetite. This approach takes into account the regulatory and commercial environment in which Santander UK operates the management strategy for each of its material risks and the impact of appropriate adverse scenarios and stresses on its capital position.

The key elements of Santander UK's capital management are:

<b>MANAGEMENT'S APPROACH TO CAPITAL RISK</b>	
>	<b>Strategic capital risk management</b> where, in the form of an annual capital plan (contained within the Internal Capital Adequacy Assessment Process), the regulatory and internal capital requirements and capital resources are forecasted based on the medium term business plan. Alongside this capital plan, Santander UK stresses the capital requirements and resources using a suite of macroeconomic scenarios.
>	<b>Short term, tactical capital risk management</b> , where frequent monitoring and reporting against the capital plan is performed to detect where any deterioration or change in the planned business performance may impact the capital levels. Additionally, monthly monitoring of the economic assumptions used to create and stress the capital plan against economic reality is undertaken to detect potential deterioration in the capital levels.
>	Decisions on the allocation of capital resources are conducted as part of Santander UK's strategic planning process based on the relative returns on capital using both economic and regulatory capital measures.
>	Santander UK also defines management actions in the event that an extremely severe period of stress threatens its viability and solvency.

ANTS manages its capital on a Basel II basis and in anticipation of the finalisation and adoption of Basel III. Capital demand is quantified for credit, traded market, non-traded market, and operational risk in accordance with FSA requirements. Santander UK produces and shares with the FSA its Internal Capital Adequacy Assessment Process document, which informs the supervisory and evaluation process by the FSA Pillar 2 of Basel II and can result in additional capital requirements.

## Risk Management Report continued

## CREDIT RISK – AREAS OF FOCUS AND OTHER ITEMS

Certain areas and/or specific views of credit risk deserve specialist attention, complementary to global risk management. These are described in the following section and consist of:

1. Country risk exposure;
2. Significant concentrations of credit risk;
3. Financial instruments of special interest;
4. Loans and advances; and
5. Impairment loss allowances on loans and advances.

## 1. COUNTRY RISK EXPOSURE

The ANTS group manages its country risk exposure under its global limits framework. Within this framework, the ANTS group sets its individual risk appetite for each country, taking into account any factors that may influence the risk profile of each country, including political events, the macro-economic situation and the nature of the risk incurred. Exposures are actively managed if it is considered appropriate. Accordingly, and over recent years, the ANTS group has intensified its monitoring of exposures to sovereigns and counterparties in eurozone countries, and has proceeded to selectively divest assets directly or indirectly affected by events in those countries. **Santander UK group and other Banco Santander group-related risk is considered separately.**

The country risk tables below show the ANTS group's exposures to central and local governments, government guaranteed counterparties, banks, other financial institutions, retail customers and corporate customers at 31 December 2012 and 2011. Total exposures consist of the total of balance sheet values and off-balance sheet values. Balance sheet values are calculated in accordance with IFRS (i.e. after the effect of netting agreements recognised in accordance with the requirements of IFRS, principally with respect to derivatives) except for credit provisions which have been added back. Off balance sheet values consist of undrawn facilities and letters of credit. The country of exposure has been assigned based on the counterparty's country of incorporation except where the ANTS group is aware that a guarantee is in place, in which case the country of incorporation of the guarantor has been used. The exposures are presented by type of counterparty other than where the specific exposures have been guaranteed by a sovereign counterparty in which case they are presented within the "Government guaranteed" category.

Separate disclosure is presented individually for each country where the exposure exceeds £50m, and aggregated for exposures of less than £50m. Given the ongoing interest in eurozone economies, disclosures relating to those economies are presented first and highlighted separately. **The tables exclude credit risk exposures to other Santander UK group companies and other Banco Santander group companies, which are presented separately on pages 89 to 91.**

31 December 2012	Central and local governments £bn	Government guaranteed £bn	Banks <sup>(2)</sup> £bn	Other financial institutions £bn	Retail £bn	Corporate £bn	Total <sup>(1)</sup> £bn
<b>Eurozone:</b>							
<b>Peripheral eurozone countries:</b>							
Portugal	-	-	-	-	-	0.1	0.1
Ireland	-	-	-	-	-	0.1	0.1
Italy	-	-	0.1	-	-	-	0.1
Spain (excluding Santander)	-	-	-	-	-	0.1	0.1
<b>Other eurozone countries:</b>							
Germany	1.3	-	3.5	-	-	0.2	5.0
France	-	-	2.1	-	-	0.1	2.2
Netherlands	-	-	0.2	0.1	-	0.5	0.8
Luxembourg	-	-	-	0.1	-	0.5	0.6
Belgium	-	-	0.4	-	-	-	0.4
All other eurozone, each < £50m <sup>(3)</sup>	-	-	-	-	-	-	-
	<b>1.3</b>	<b>-</b>	<b>6.3</b>	<b>0.2</b>	<b>-</b>	<b>1.6</b>	<b>9.4</b>
<b>All other countries:</b>							
UK	5.7	0.4	12.4	11.7	-	17.5	47.7
US	0.8	-	15.1	-	-	0.1	16.0
Switzerland	0.5	-	1.6	0.5	-	0.2	2.8
Denmark	-	-	2.3	-	-	-	2.3
Japan	1.2	-	0.2	-	-	0.2	1.6
Canada	-	-	0.3	-	-	-	0.3
Australia	-	-	0.1	-	-	0.1	0.2
Norway	-	-	0.1	-	-	0.1	0.2
Lichtenstein	-	-	-	-	-	0.1	0.1
All others, each < £50m	-	-	0.1	-	-	0.4	0.5
	<b>8.2</b>	<b>0.4</b>	<b>32.2</b>	<b>12.2</b>	<b>-</b>	<b>18.7</b>	<b>71.7</b>

(1) Credit exposures exclude the macro hedge of interest rate risk, intangible assets, property, plant and equipment, current and deferred tax assets, and other assets. Loans and advances to customers are included gross of loan loss allowances.

(2) Excludes balances with central banks.

(3) Includes Greece of £3m and Cyprus of £nil.



## Risk Management Report continued

31 December 2011	Central and local governments £bn	Government guaranteed £bn	Banks <sup>(2)</sup> £bn	Other financial institutions £bn	Retail £bn	Corporate £bn	Total <sup>(1)</sup> £bn
<b>Eurozone:</b>							
<b>Peripheral eurozone countries:</b>							
Ireland	-	-	0.1	-	-	0.1	0.2
Italy	-	-	0.1	-	-	-	0.1
Portugal	-	-	-	-	-	0.1	0.1
Spain (excluding Santander)	-	-	-	-	-	0.1	0.1
<b>Other eurozone countries:</b>							
Germany	-	0.1	3.1	-	-	0.2	3.4
France	-	0.1	1.4	1.0	-	0.2	2.7
Netherlands	-	-	0.1	0.1	-	0.6	0.8
Luxembourg	-	-	-	0.4	-	0.3	0.7
Belgium	-	-	0.1	-	-	-	0.1
All other eurozone, each < £50m <sup>(3)</sup>	-	-	-	-	-	-	-
	-	0.2	4.9	1.5	-	1.6	8.2
<b>All other countries:</b>							
UK	1.1	5.2	12.9	5.6	-	23.7	48.5
US	7.1	-	9.8	1.1	-	-	18.0
Switzerland	1.2	-	2.1	0.4	-	0.3	4.0
Japan	0.6	-	-	0.4	-	-	1.0
Australia	-	0.1	0.1	-	-	0.1	0.3
Denmark	-	0.3	0.3	-	-	-	0.6
Canada	-	-	0.4	-	-	-	0.4
Lichtenstein	-	-	-	-	-	0.2	0.2
China	-	-	-	-	-	0.1	0.1
Jersey	-	-	-	-	-	0.1	0.1
Norway	-	-	0.1	-	-	-	0.1
All others, each < £50m	-	-	0.1	-	-	0.1	0.2
	10.0	5.6	25.8	7.5	-	24.6	73.5

(1) Credit exposures exclude the macro hedge of interest rate risk, intangible assets, property, plant and equipment, current and deferred tax assets, and other assets. Loans and advances to customers are included gross of loan loss allowances.

(2) Excludes balances with central banks.

(3) Includes Greece of £3m and Cyprus of £nil.

### 31 December 2012 compared to 31 December 2011

Key changes in sovereign and other country risk exposures during the year ended 31 December 2012 were as follows:

- > A decrease of £2bn in exposure to the US to £16bn. This was primarily due to reduced deposits at the US Federal Reserve as deposits were placed at the Bank of England instead. This was partially offset by increased securities purchased under resale activity.
- > A decrease of £1.2bn in exposure to Switzerland to £2.8bn. This was primarily due to reduced holdings of government securities as alternative securities were held.
- > An increase of £1.7bn in exposure to Denmark to £2.3bn. This was primarily due to increased securities purchased under resale activity.
- > An increase of £1.6bn in exposure to Germany to £5.0bn. This was primarily due to new holdings of government securities as part of the Santander UK group's liquidity position.
- > An increase of £0.6bn in exposure to Japan to £1.6bn. This was primarily due to new holdings of government securities as part of the Santander UK group's liquidity position.
- > Movements in remaining country risk exposures were minimal and exposures to these countries remained at low levels.

## Risk Management Report continued

## Further analysis of sovereign debt and other country risk exposures, including peripheral eurozone exposures

Presented below separately for sovereign debt and other country risk exposures is additional analysis of exposures into those that are accounted for on-balance sheet (further analysed into those measured at amortised cost and those measured at fair value) and those that are off-balance sheet.

The assets held at amortised cost are principally classified as loans to banks, loans to customers and loans and receivables securities. The ANTS group has no held-to-maturity securities.

The assets held at fair value are classified as either trading assets or have been designated as held at fair value through profit or loss, with the exception of UK, US, German, Swiss and Japanese Government debt held for liquidity purposes, which are classified as available-for-sale securities.

The ANTS group has made no reclassifications to/from the assets which are held at fair value from/to any other category.

## Sovereign debt

31 December 2012	Assets held at Amortised Cost			Assets held at Fair Value			Total on Balance Sheet Asset £bn	Commitments and undrawn facilities £bn	Total <sup>(1)</sup> £bn
	Central and local governments £bn	Government guaranteed £bn	Total at amortised cost £bn	Central and local governments <sup>(1)</sup> £bn	Government guaranteed £bn	Total at fair value £bn			
<b>Eurozone countries:</b>									
Germany	-	-	-	1.3	-	1.3	1.3	-	1.3
	-	-	-	1.3	-	1.3	1.3	-	1.3
<b>All other countries:</b>									
UK	0.1	-	0.1	5.6	0.4	6.0	6.1	-	6.1
Japan	-	-	-	1.2	-	1.2	1.2	-	1.2
US	0.4	-	0.4	0.4	-	0.4	0.8	-	0.8
Switzerland	-	-	-	0.5	-	0.5	0.5	-	0.5
	0.5	-	0.5	7.7	0.4	8.1	8.6	-	8.6

(1) There are no sovereign debt commitments and undrawn facilities.

31 December 2011	Assets held at Amortised Cost			Assets held at Fair Value			Total on Balance Sheet Asset £bn	Commitments and undrawn facilities £bn	Total <sup>(1)</sup> £bn
	Central and local governments <sup>(2)</sup> £bn	Government guaranteed £bn	Total at amortised cost £bn	Central and local governments <sup>(1)</sup> £bn	Government guaranteed £bn	Total at fair value £bn			
<b>Eurozone countries:</b>									
France	-	-	-	-	0.1	0.1	0.1	-	0.1
Germany	-	-	-	-	0.1	0.1	0.1	-	0.1
	-	-	-	-	0.2	0.2	0.2	-	0.2
<b>All other countries:</b>									
US	7.0	-	7.0	0.1	-	0.1	7.1	-	7.1
UK	-	-	-	1.1	5.2	6.3	6.3	-	6.3
Switzerland	-	-	-	1.2	-	1.2	1.2	-	1.2
Japan	-	-	-	0.6	-	0.6	0.6	-	0.6
Denmark	-	-	-	-	0.3	0.3	0.3	-	0.3
Australia	-	-	-	-	0.1	0.1	0.1	-	0.1
	7.0	-	7.0	3.0	5.6	8.6	15.6	-	15.6

(1) There are no sovereign debt commitments and undrawn facilities.

(2) Excludes the exposure on margin given with respect to the Bank of England's Special Liquidity Scheme.

The ANTS group has no direct sovereign exposures to any other countries. The ANTS group has not recognised any impairment losses against sovereign debt which is held at amortised cost, as this sovereign debt was all issued by the UK Government, US Government and governments of other OECD countries with strong credit ratings. The ANTS group has no exposures to credit default swaps (either written or purchased) which are directly referenced to sovereign debt or other instruments that are directly referenced to sovereign debt.

## Risk Management Report continued

Other country risk exposures<sup>(1)</sup>31 December  
2012

	Assets held at Amortised Cost					Assets held at Fair Value <sup>(2)</sup>					Total on Balance Sheet Asset £bn	Commitments and undrawn facilities £bn <sup>(3)</sup>	Total £bn
	Banks £bn	Other financial institutions £bn	Retail £bn	Corporate £bn	Total £bn	Banks £bn	Other financial institutions £bn	Retail £bn	Corporate £bn	Total £bn			
<b>Eurozone:</b>													
<b>Peripheral eurozone countries:</b>													
Spain	-	-	-	0.1	0.1	-	-	-	-	-	0.1	-	0.1
Ireland	-	-	-	-	-	-	-	-	-	-	-	0.1	0.1
Italy	-	-	-	-	-	0.1	-	-	-	0.1	0.1	-	0.1
Portugal	-	-	-	0.1	0.1	-	-	-	-	-	0.1	-	0.1
<b>Other eurozone countries:</b>													
Germany	-	-	-	0.2	0.2	3.5	-	-	-	3.5	3.7	-	3.7
France	-	-	-	-	-	2.1	-	-	0.1	2.2	2.2	-	2.2
Netherlands	-	0.1	-	-	0.1	0.2	-	-	-	0.2	0.3	0.5	0.8
Luxembourg	-	0.1	-	0.4	0.5	-	-	-	-	-	0.5	0.1	0.6
Belgium	-	-	-	-	-	0.4	-	-	-	0.4	0.4	-	0.4
Other<£50m	-	-	-	-	-	-	-	-	-	-	-	-	-
	-	0.2	-	0.8	1.0	6.3	-	-	0.1	6.4	7.4	0.7	8.1
<b>All other countries:</b>													
UK	-	4.7	-	6.4	11.1	12.1	7.0	-	3.0	22.1	33.2	8.4	41.6
US	1.3	-	-	-	1.3	13.8	-	-	0.1	13.9	15.2	-	15.2
Switzerland	-	-	-	0.1	0.1	1.6	0.5	-	-	2.1	2.2	0.1	2.3
Denmark	-	-	-	-	-	2.3	-	-	-	2.3	2.3	-	2.3
Japan	-	-	-	-	-	0.2	-	-	0.2	0.4	0.4	-	0.4
Australia	-	-	-	-	-	0.1	-	-	-	0.1	0.1	0.1	0.2
Canada	-	-	-	-	-	0.3	-	-	-	0.3	0.3	-	0.3
Lichtenstein	-	-	-	0.1	0.1	-	-	-	-	-	0.1	-	0.1
Norway	-	-	-	-	-	0.1	-	-	-	0.1	0.1	0.1	0.2
Other<£50m	-	-	-	0.3	0.3	-	-	-	-	-	0.3	0.2	0.5
	1.3	4.7	-	6.9	12.9	30.5	7.5	-	3.3	41.3	54.2	8.9	63.1

(1) Excluding other Banco Santander group companies.

(2) The assets held at fair value were classified as either trading assets or designated as held at fair value through profit or loss. The ANTS group did not hold any significant available-for-sale securities, with the exception of government debt held for liquidity purposes, as described on the previous page.

(3) Includes £8.5bn classified as Corporate and £0.4bn classified as Banks.

31 December 2011

	Assets held at Amortised Cost					Assets held at Fair Value <sup>(2)</sup>					Total on Balance Sheet Asset £bn	Commitments and undrawn facilities £bn <sup>(3)</sup>	Total £bn
	Banks £bn	Other financial institutions £bn	Retail £bn	Corporate £bn	Total £bn	Banks £bn	Other financial institutions £bn	Retail £bn	Corporate £bn	Total £bn			
<b>Eurozone:</b>													
<b>Peripheral eurozone countries:</b>													
Spain	-	-	-	0.1	0.1	-	-	-	-	-	0.1	-	0.1
Ireland	-	-	-	-	-	0.1	-	-	-	0.1	0.1	0.1	0.2
Italy	-	-	-	-	-	0.1	-	-	-	0.1	0.1	-	0.1
Portugal	-	-	-	0.1	0.1	-	-	-	-	-	0.1	-	0.1
<b>Other eurozone countries:</b>													
Germany	-	-	-	0.1	0.1	3.1	-	-	0.1	3.2	3.3	-	3.3
France	-	-	-	-	-	1.4	1.0	-	-	2.4	2.4	0.2	2.6
Luxembourg	-	0.4	-	0.3	0.7	-	-	-	-	-	0.7	-	0.7
Netherlands	-	0.1	-	-	0.1	0.1	-	-	-	0.1	0.2	0.6	0.8
Belgium	-	-	-	-	-	0.1	-	-	-	0.1	0.1	-	0.1
Other < £50m	-	-	-	-	-	-	-	-	-	-	-	-	-
	-	0.5	-	0.6	1.1	4.9	1.0	-	0.1	6.0	7.1	0.9	8.0
<b>All other countries:</b>													
UK	1.1	-	-	9.9	11	11.8	5.6	-	5.5	22.9	33.9	8.3	42.2
US	-	-	-	-	-	9.8	1.1	-	-	10.9	10.9	-	10.9
Switzerland	-	-	-	0.1	0.1	2.1	0.4	-	-	2.5	2.6	0.2	2.8
Australia	-	-	-	-	-	0.1	-	-	-	0.1	0.1	0.1	0.2
Canada	-	-	-	-	-	0.4	-	-	-	0.4	0.4	-	0.4
Denmark	-	-	-	-	-	0.3	-	-	-	0.3	0.3	-	0.3
Japan	-	-	-	-	-	-	0.4	-	-	0.4	0.4	-	0.4
Lichtenstein	-	-	-	0.2	0.2	-	-	-	-	-	0.2	-	0.2
China	-	-	-	0.1	0.1	-	-	-	-	-	0.1	-	0.1
Jersey	-	-	-	-	-	-	-	-	-	-	-	0.1	0.1
Norway	-	-	-	-	-	0.1	-	-	-	0.1	0.1	-	0.1
Other < £50m	-	-	-	-	-	0.1	-	-	-	0.1	0.1	0.1	0.2
	1.1	-	-	10.3	11.4	24.7	7.5	-	5.5	37.7	49.1	8.8	57.9

(1) Excluding other Banco Santander group companies.

(2) The assets held at fair value were classified as either trading assets or designated as held at fair value through profit or loss. The ANTS group did not hold any significant available-for-sale securities.

(3) Consists of £8.8bn classified as Corporate.

Commitments and undrawn facilities principally consist of formal standby facilities and credit lines in the ANTS group's Corporate Banking operations. A summary of the key terms and a maturity analysis of formal standby facilities, credit lines and other commitments are set out in Note 35 to the Consolidated Financial Statements.

**Risk Management Report** continued

Maturity analyses of loans and advances to banks and customers, which represent almost all of the ANTS group's assets held at amortised cost (excluding cash and balances at central banks) by country are set out on pages 17 and 18.

**Peripheral eurozone countries**

The tables below further analyse the ANTS group's direct exposure to peripheral eurozone countries at 31 December 2012 by type of financial instrument.

**The tables below exclude balances with other Santander UK group companies and other Banco Santander group companies, which are presented separately on pages 89 to 91.**

**(i) Portugal**

31 December 2012	Banks £bn	Other financial institutions £bn	Corporate £bn	Retail £bn	Total £bn
Loans and advances to customers	-	-	0.1	-	0.1

31 December 2011	Banks £bn	Other financial institutions £bn	Corporate £bn	Retail £bn	Total £bn
Loans and advances to customers	-	-	0.1	-	0.1

**(ii) Ireland**

31 December 2012	Banks £bn	Other financial institutions £bn	Corporate £bn	Retail £bn	Total £bn
Commitment and undrawn facilities	-	-	0.1	-	0.1

31 December 2011	Banks £bn	Other financial institutions £bn	Corporate £bn	Retail £bn	Total £bn
Trading Assets	0.1	-	-	-	0.1
Commitment and undrawn facilities	-	-	0.1	-	0.1
	0.1	-	0.1	-	0.2

**(iii) Italy**

31 December 2012	Banks £bn	Other financial institutions £bn	Corporate £bn	Retail £bn	Total £bn
<b>Derivatives</b>					
- Derivative assets	0.1	-	-	-	0.1
- Derivative liabilities	(0.1)	-	-	-	(0.1)
<b>Net derivatives position</b>	-	-	-	-	-

31 December 2011	Banks £bn	Other financial institutions £bn	Corporate £bn	Retail £bn	Total £bn
Derivatives					
- Derivative assets	0.1	-	-	-	0.1
Net derivatives position	0.1	-	-	-	0.1

**(iv) Spain**

31 December 2012	Banks £bn	Other financial institutions £bn	Corporate £bn	Retail £bn	Total £bn
Loans and advances to customers	-	-	0.1	-	0.1

31 December 2011	Banks £bn	Other financial institutions £bn	Corporate £bn	Retail £bn	Total £bn
Loans and advances to customers	-	-	0.1	-	0.1

## Risk Management Report continued

**Indirect exposures to peripheral eurozone countries**

Indirect exposures to peripheral eurozone countries are considered to exist where our direct counterparties outside the peripheral eurozone countries themselves have a direct exposure to one or more peripheral eurozone countries.

Indirect exposures are identified as part of our ongoing credit analysis and monitoring of our counterparty base by the review of available financial information to determine the countries where the material parts of a counterparty's assets, operations or profits arise.

Our indirect exposures to peripheral eurozone countries consist of:

- > A small number of corporate loans to large multinational companies based in the UK that derive a proportion of their profits from one or more peripheral eurozone countries.
- > Trading transactions and hedging transactions with financial institutions based in the UK and Europe that derive a proportion of their profits from or have a proportion of their assets in one or more peripheral eurozone countries.
- > A small number of loans to other corporate entities which have either a proportion of their operations within, or profits from, one or more peripheral eurozone countries.

Direct and indirect risk exposures via large multinational companies and financial institutions are monitored on a regular basis by the Wholesale Credit Risk Department as part of the overall risk management process. Indirect exposures via other corporates are monitored on a regular basis by the Corporate Credit Risk Department.

The large corporates portfolio is mainly comprised of multinational UK companies which are considered to be geographically well diversified in terms of their assets, operations and profits. This enables them to mitigate any country risk concentration that they may have in peripheral eurozone countries. In addition, the risk is further mitigated by the fact that credit agreements are underpinned by both financial and non-financial covenants.

The risk arising from indirect exposures from our transactions with financial institutions is mitigated by the short-term tenor of the transactions, and by the fact that many such transactions contain margin calls and/or collateral requirements, and are subject to standard ISDA Master Agreements permitting offsetting.

The risk arising from indirect exposures from our transactions with other corporates is mitigated by standard financial and non-financial guarantees and the fact that the companies are geographically well diversified in terms of their assets, operations and profits.

**Balances with other Santander UK group companies**

The ANTS group enters into transactions with other Santander UK group companies in the ordinary course of business. ANTS provides treasury, corporate and wholesale banking services to the wider Santander UK group, of which ANTS is a significant part. ANTS is also the treasury support function for the Santander UK group. In this regard, ANTS's role is to provide access to financial markets and central bank facilities in order to meet the Santander UK group's liquidity, funding, capital and balance sheet management requirements. As such, ANTS is one of the main debt issuance vehicles in the Santander UK group.

At 31 December 2012 and 31 December 2011, the ANTS group had gross balances (without taking account of netting, collateral or any other credit risk mitigants) with other Santander UK group companies as follows:

<b>31 December 2012</b>	<b>Banks £bn</b>	<b>Other financial institutions £bn</b>	<b>Corporate £bn</b>	<b>Total £bn</b>
<b>Assets:</b>				
- UK	105.4	32.6	-	138.0
- Other < £50m	-	-	-	-
	<b>105.4</b>	<b>32.6</b>	<b>-</b>	<b>138.0</b>
<b>Liabilities:</b>				
- UK	(106.6)	(2.9)	-	(109.5)
- Jersey	(3.9)	-	-	(3.9)
- Isle of Man	(2.9)	-	-	(2.9)
- Other < £50m	(0.1)	-	-	(0.1)
	<b>(113.5)</b>	<b>(2.9)</b>	<b>-</b>	<b>(116.4)</b>
<b>31 December 2011</b>				
<b>Assets:</b>				
- UK	110.0	27.9	-	137.9
- Other < £50m	-	-	-	-
	110.0	27.9	-	137.9
<b>Liabilities:</b>				
- UK	(102.2)	(2.8)	-	(105.0)
- Jersey	(5.3)	-	-	(5.3)
- Isle of Man	(3.6)	-	-	(3.6)
	<b>(111.1)</b>	<b>(2.8)</b>	<b>-</b>	<b>(113.9)</b>

## Risk Management Report continued

The above balances with other Santander UK group companies at 31 December 2012 principally arose from ANTS's role as treasury support function for the Santander UK group. ANTS provides access to financial markets and central bank facilities in order to meet the Santander UK group's liquidity, funding, capital and balance sheet management requirements.

The above activities are conducted in a manner that appropriately manages the credit risk arising against such other Santander UK group companies within limits acceptable to the FSA. The tables below further analyse the balances with other Santander UK group companies at 31 December 2012 and 2011 by type of financial instrument and country of the counterparty, including the additional mitigating impact of collateral arrangements (which are not included in the summary tables above, as they are accounted for off-balance sheet) and the resulting net credit exposures:

### (i) UK

31 December 2012	Banks £bn	Other financial institutions £bn	Corporate £bn	Total £bn
<b>Loans and advances</b>	<b>104.8</b>	<b>32.6</b>	-	<b>137.4</b>
<b>Repurchase agreements</b>				
- Asset balance - reverse repo	0.6	-	-	0.6
- Net repo asset	<b>0.6</b>	-	-	<b>0.6</b>
- Liability balance - repo	(1.0)	-	-	(1.0)
- Net repo	<b>(1.0)</b>	-	-	<b>(1.0)</b>
<b>Net repurchase agreement position</b>	<b>(0.4)</b>	-	-	<b>(0.4)</b>
<b>Derivatives</b>				
- Derivative liabilities	(4.2)	(1.2)	-	(5.4)
<b>Net derivatives position</b>	<b>(4.2)</b>	<b>(1.2)</b>	-	<b>(5.4)</b>
<b>Total assets, after the impact of collateral</b>	<b>100.2</b>	<b>31.4</b>	-	<b>131.6</b>
<b>Deposits by customers</b>	-	<b>(1.7)</b>	-	<b>(1.7)</b>
<b>Deposits by banks</b>	<b>(101.4)</b>	-	-	<b>(101.4)</b>
<b>Total liabilities</b>	<b>(101.4)</b>	<b>(1.7)</b>	-	<b>(103.1)</b>
<b>Net balance</b>	<b>(1.2)</b>	<b>29.7</b>	-	<b>28.5</b>
<b>31 December 2011</b>	Banks £bn	Other financial institutions £bn	Corporate £bn	Total £bn
Loans and advances	106.8	27.8	-	134.6
Repurchase agreements				
- Asset balance - reverse repo	3.2	-	-	3.2
Net repo asset	3.2	-	-	3.2
Net repurchase agreement position	3.2	-	-	3.2
Derivatives				
- Derivative liabilities	(5.4)	(0.9)	-	(6.3)
Net derivatives position	(5.4)	(0.9)	-	(6.3)
Floating rate notes	-	0.1	-	0.1
Total assets, after the impact of collateral	104.6	27.0	-	131.6
Deposits by customers	-	(1.9)	-	(1.9)
Deposits by banks	(96.8)	-	-	(96.8)
Total liabilities	(96.8)	(1.9)	-	(98.7)
Net balance	7.8	25.1	-	32.9

### (ii) Jersey

31 December 2012	Banks £bn	Other financial institutions £bn	Corporate £bn	Total £bn
<b>Deposits by banks</b>	<b>(3.9)</b>	-	-	<b>(3.9)</b>
<b>31 December 2011</b>	Banks £bn	Other financial institutions £bn	Corporate £bn	Total £bn
Deposits by banks	(5.3)	-	-	(5.3)

### (iii) Isle of Man

31 December 2012	Banks £bn	Other financial institutions £bn	Corporate £bn	Total £bn
<b>Deposits by banks</b>	<b>(2.9)</b>	-	-	<b>(2.9)</b>
<b>31 December 2011</b>	Banks £bn	Other financial institutions £bn	Corporate £bn	Total £bn
Deposits by banks	(3.6)	-	-	(3.6)

## Risk Management Report continued

## Balances with other Banco Santander group companies outside the Santander UK group

The ANTS group enters into transactions with other Banco Santander group companies outside the Santander UK group in the ordinary course of business. Such transactions are undertaken in areas of business where the ANTS group has a particular advantage or expertise and where Banco Santander group companies can offer commercial opportunities, substantially on the same terms as for comparable transactions with third party counterparties. These transactions also arise in support of the activities of, or with, larger multinational corporate clients and financial institutions which may have relationships with a number of entities in the Banco Santander group. In early 2012, ANTS raised funding directly from certain members of the Banco Santander group through repo transactions and debt issuance to take advantage of the commercial opportunities available at the time, and in accordance with the subsidiary model set out on page 3. All such activities are conducted in a manner that manages the credit risk arising against such other Santander companies and within limits acceptable to the FSA. The repo balances have now been repaid, and the remaining debt issuances will mature or be repaid in 2013.

At 31 December 2012 and 2011, the ANTS group had gross balances (without taking account of netting, collateral or any other credit risk mitigants) with other Banco Santander group companies as follows:

<b>31 December 2012</b>	<b>Banks £bn</b>	<b>Other financial institutions £bn</b>	<b>Corporate £bn</b>	<b>Total £bn</b>
<b>Assets:</b>				
- Spain	2.5	-	-	2.5
- Chile	0.1	-	-	0.1
- Other < £50m	-	0.1	-	0.1
	<b>2.6</b>	<b>0.1</b>	-	<b>2.7</b>
<b>Liabilities:</b>				
- Spain	(4.3)	(0.1)	-	(4.4)
- Italy	-	(0.6)	-	(0.6)
- Ireland	-	(0.2)	-	(0.2)
- Chile	(0.1)	-	-	(0.1)
- Other < £50m	-	-	-	-
	<b>(4.4)</b>	<b>(0.9)</b>	-	<b>(5.3)</b>
<b>31 December 2011</b>				
<b>Assets:</b>				
- Spain	5.0	0.1	-	5.1
- Other < £50m	-	-	-	-
	5.0	0.1	-	5.1
<b>Liabilities:</b>				
- Spain	(5.3)	(0.1)	-	(5.4)
- UK	-	(0.2)	-	(0.2)
- Belgium	-	(0.6)	-	(0.6)
- Ireland	-	(0.2)	-	(0.2)
- Other < £50m	-	-	-	-
	<b>(5.3)</b>	<b>(1.1)</b>	-	<b>(6.4)</b>

The above activities are conducted in a manner that appropriately manages the credit risk arising against such other Banco Santander group companies within limits acceptable to the FSA.

## Redenomination risk

ANTS considers the total dissolution of the eurozone to be extremely unlikely and therefore believes widespread redenomination of its euro-denominated assets and liabilities to be highly improbable. However, for contingency planning purposes it has analysed the redenomination risk that might arise from an exit of a member state from the euro or a total dissolution of the euro and how that exit or dissolution would be implemented. It is not possible to predict what the total financial impact on ANTS might be of a eurozone member state exit or the dissolution of the euro. The determination of which assets and liabilities would be legally redenominated is potentially complex and depends on a number of factors, including the precise exit scenario, as the consequences on external contracts of a disorderly exit or one sanctioned under EU law may be different. ANTS has already identified and is monitoring these risks and has taken steps to mitigate them and/or reduce ANTS's overall exposure to losses that might arise in the event of a redenomination, which include reducing ANTS's exposures and funding mismatches.

As part of its objective of maintaining a diversified funding base, ANTS raises funding in a number of currencies, including euro, and converts these back into sterling, to fund its commercial assets which are largely sterling denominated. ANTS's net position denominated in euro, reflecting assets and liabilities and associated swaps (which primarily comprise cross-currency derivatives entered into to swap funding raised in euro back into sterling for reasons set out above) arising in connection with contracts denominated in euro, amounted to £0.1bn at 31 December 2012. This comprised debt securities (covered bonds) of £22.7bn issued by ANTS as part of its medium term funding activities, net loans and advances of £18.5bn to other Santander UK group companies (principally representing the on lending of these net funds to other Santander UK group companies), net repos of £1.3bn, other deposits of £0.7bn, other loans and securities of £2.2bn, and related cross-currency swaps of £4.1bn which swap the resultant euro exposures back into sterling in order to ensure that assets and liabilities are currency matched in sterling. Disclosures of ANTS's exposure to individual eurozone countries and total exposures to counterparties in those countries, which amounts include any euro-denominated contracts with those counterparties, are set out on pages 84 to 91.

## Risk Management Report continued

## 2. SIGNIFICANT CONCENTRATIONS OF CREDIT RISK

The management of risk concentration is a key part of risk management. The ANTS group tracks the degree of concentration of its credit risk portfolios using various criteria, including geographic areas and countries, economic sectors, products and groups of customers.

During 2012, the ANTS group's most significant exposures to credit risk derived from:

- > secured lending and derivatives exposures to companies in Corporate Banking;
- > derivatives exposure to financial institutions in Markets; and
- > the non-core portfolios of social housing loans and structured credit assets in Corporate Centre.

In Corporate Banking, the business consists of a relatively small number of high value balances where a problem with one customer may cause a relatively large impact. Details of the committed facilities exposure to these portfolios are set out in the "Corporate Banking – committed facilities", "Markets - commitments" and "Corporate Centre - exposures" sections of the Risk Management Report.

Details of credit risk mitigation techniques employed by the ANTS group, including the holding of collateral, are set out in the "Corporate Banking - Credit Risk mitigation", "Markets - Credit Risk mitigation" and "Corporate Centre - Credit Risk mitigation" sections of the Risk Management Report.

Although the operations of Corporate Banking, Markets and Corporate Centre are based mainly in the UK, they have built up exposures to various entities around the world and are therefore exposed to concentrations of risk related to geographic area. These are further analysed below:

Country	2012								2011
	Corporate Banking	Markets		Corporate Centre	Corporate Banking	Markets		Corporate Centre	
		Non derivatives	Derivatives			Non derivatives	Derivatives		
%	%	%	%	%	%	%	%	%	
UK	79	16	35	79	85	68	23	55	
Peripheral eurozone	2	10	8	1	-	6	11	3	
Rest of Europe	10	25	30	10	10	12	30	4	
US	2	-	21	8	2	14	28	38	
Other, including non-OECD	7	49	6	2	3	-	8	-	
	100	100	100	100	100	100	100	100	

Geographical exposures are governed by country limits set by Banco Santander, S.A. centrally and determined according to the classification of the country (whether it is a developed OECD country or not), the rating of the country, its gross domestic product and the type of business activities and products the Banco Santander, S.A. group wishes to engage in within that country. The ANTS group is constrained in its country risk exposure, within the Banco Santander, S.A. group limits, and by its capital base. Detailed disclosures of the ANTS group's geographical exposures are set out in the preceding section "Country risk exposures".



## Risk Management Report continued

### 3. FINANCIAL INSTRUMENTS OF SPECIAL INTEREST

This section summarises the types of financial instruments which have been of special interest as a result of the economic environment of the last few years. The table below shows the type of financial instrument and where they are classified on the ANTS group's Consolidated Balance Sheet. It also provides cross references to the Notes to the Consolidated Financial Statements containing additional analysis of the significant assets.

The ANTS group's financial instruments which are considered to have been most affected by the current credit environment include floating rate notes ('FRNs'), asset-backed securities ('ABS') (including mortgage-backed securities ('MBS') and the ANTS group's exposures to monoline insurers), loans to banks, certain credit derivatives in the Treasury asset portfolio, and off-balance sheet entities. The ANTS group has no investments in Collateralised Debt Obligations ('CDOs') or Collateralised Loan Obligations ('CLOs') and has no holdings in Structured Investment Vehicles.

For completeness, all the ANTS group's loans to banks have been included in the following analysis, even though almost all of the ANTS group's loans and advances to banks are transactions with other Santander UK group companies in the ordinary course of business, and there are no particular concerns about these transactions. ANTS provides treasury, corporate and wholesale banking services to the wider Santander UK group, of which ANTS is a significant part. ANTS is also the treasury support function for the Santander UK group. In this regard, ANTS's role is to provide access to financial markets and central bank facilities in order to meet the Santander UK group's liquidity, funding, capital and balance sheet management requirements.

The ANTS group aims to actively manage these exposures.

#### Classification in the Consolidated Balance Sheet

The classification of these assets in the ANTS group's Consolidated Balance Sheet, and cross references to the Notes to the Consolidated Financial Statements containing additional analysis of the significant assets, is as follows:

2012	Note	Type of Financial Instrument					Total £m
		FRNs £m	ABS £m	Loans £m	OECD Govt debts £m	Others £m	
<b>Balance sheet line item</b>							
Trading assets – debt securities	14	564	-	-	3,917	13	4,494
Derivatives – equity & credit contracts	15	-	-	-	-	17	17
Financial assets designated at fair value – debt securities	16	-	328	-	-	-	328
Loans and advances to banks	17	-	-	106,986	-	-	106,986
Available for sale – debt securities	22	-	-	-	5,113	-	5,113
Loans and receivables securities	20	-	162	-	-	-	162
		564	490	106,986	9,030	30	117,100

2011	Note	Type of Financial Instrument					Total £m
		FRNs £m	ABS £m	Loans £m	OECD Govt debts £m	Others £m	
<b>Balance sheet line item</b>							
Trading assets – debt securities	14	5,768	-	-	2,943	-	8,711
Derivatives – equity & credit contracts	15	-	-	-	-	16	16
Financial assets designated at fair value – debt securities	16	-	379	-	-	-	379
Loans and advances to banks	17	-	-	113,222	-	-	113,222
Loans and receivables securities	20	-	278	-	-	-	278
		5,768	657	113,222	2,943	16	122,606

#### Exposure to off-balance sheet entities sponsored by the ANTS group

Certain Special Purpose Entities ('SPE's) are formed by the ANTS group to accomplish specific and well-defined objectives, such as securitising financial assets. The ANTS group consolidates these SPEs when the substance of the relationship indicates control, as described in Note 1 of the Consolidated Financial Statements. Details of SPEs sponsored by the ANTS group (including SPEs not consolidated by the ANTS group) are set out in Note 19 to the Consolidated Financial Statements.

The only SPEs sponsored but not consolidated by the ANTS group are SPEs which issue shares that back retail structured products. The ANTS group's arrangements with these entities comprise the provision of equity derivatives and a secondary market-making service to those retail customers who wish to exit early from these products. Further information on these entities is set out in Note 19 to the Consolidated Financial Statements.

## Risk Management Report continued

## 4. LOANS AND ADVANCES

The following tables categorise the ANTS group's loans and advances into three categories as:

- > neither past due nor impaired;
- > past due but not individually impaired; or
- > individually impaired.

For certain homogeneous portfolios of loans and advances, impairment is assessed on a collective basis and each loan is not individually assessed for impairment. Loans in this category are classified as neither past due nor impaired, or past due but not individually impaired, depending upon their arrears status. The impairment loss allowances include allowances against financial assets that have been individually assessed for impairment and those that are subject to collective assessment for impairment.

2012						Group
	Neither past due nor impaired	Past due but not individually impaired	Individually impaired	Total	Impairment loss allowances	Total carrying value
Statutory balance sheet line items	£m	£m	£m	£m	£m	£m
<b>Trading assets</b>						
- Loans and advances to banks	9,988	-	-	9,988	-	9,988
- Loans and advances to customers	7,552	-	-	7,552	-	7,552
<b>Financial assets designated at fair value through profit and loss</b>						
- Loans and advances to customers	3,203	-	-	3,203	-	3,203
<b>Loans and advances to banks</b>						
- Placements with other banks	1,290	-	-	1,290	-	1,290
- Amounts due from parent	237	-	-	237	-	237
<b>Loans and advances to customers</b>						
- Corporate loans	6,892	-	742	7,634	(112)	7,522
- Other secured advances	4,855	-	-	4,855	-	4,855
- Amounts due from subsidiaries	32,368	-	-	32,368	-	32,368
- Amounts due from Banco Santander group undertakings	5	-	-	5	-	5
<b>Loans and receivables securities</b>	162	-	-	162	-	162
<b>Total loans and advances</b>	<b>66,552</b>	<b>-</b>	<b>742</b>	<b>67,294</b>	<b>(112)</b>	<b>67,182</b>

2012						Company
	Neither past due nor impaired	Past due but not individually impaired	Individually impaired	Total	Impairment loss allowances	Total carrying value
Statutory balance sheet line items	£m	£m	£m	£m	£m	£m
<b>Trading assets</b>						
- Loans and advances to banks	9,988	-	-	9,988	-	9,988
- Loans and advances to customers	7,551	-	-	7,551	-	7,551
<b>Financial assets designated at fair value through profit and loss</b>						
- Loans and advances to customers	3,203	-	-	3,203	-	3,203
<b>Loans and advances to banks</b>						
- Placements with other banks	1,285	-	-	1,285	-	1,285
- Amounts due from parent	237	-	-	237	-	237
<b>Loans and advances to customers</b>						
- Corporate loans	6,892	-	742	7,634	(112)	7,522
- Other secured advances	4,849	-	-	4,849	-	4,849
- Amounts due from subsidiaries	32,482	-	-	32,482	-	32,482
- Amounts due from Banco Santander group undertakings	5	-	-	5	-	5
<b>Loans and receivables securities</b>	162	-	-	162	-	162
<b>Total loans and advances</b>	<b>66,654</b>	<b>-</b>	<b>742</b>	<b>67,396</b>	<b>(112)</b>	<b>67,284</b>

## Risk Management Report continued

2011						Group	
	Neither past due nor impaired	Past due but not individually impaired	Individually impaired	Total	Impairment loss allowances	Total carrying value	
Statutory balance sheet line items	£m	£m	£m	£m	£m	£m	
<b>Trading assets</b>							
- Loans and advances to banks	6,144	-	-	6,144	-	6,144	
- Loans and advances to customers	6,687	-	-	6,687	-	6,687	
<b>Financial assets designated at fair value through profit and loss</b>							
- Loans and advances to customers	4,050	-	-	4,050	-	4,050	
<b>Loans and advances to banks</b>							
- Placements with other banks	1,136	-	-	1,136	-	1,136	
- Amounts due from parent	2,082	-	-	2,082	-	2,082	
<b>Loans and advances to customers</b>							
- Corporate loans	7,273	95	260	7,628	(130)	7,498	
- Other secured advances	3,492	-	-	3,492	-	3,492	
- Amounts due from subsidiaries	27,831	-	-	27,831	-	27,831	
- Amounts due from Banco Santander group undertakings	5	-	-	5	-	5	
<b>Loans and receivables securities</b>	278	-	-	278	-	278	
<b>Total loans and advances</b>	<b>58,978</b>	<b>95</b>	<b>260</b>	<b>59,333</b>	<b>(130)</b>	<b>59,203</b>	

2011						Company	
	Neither past due nor impaired	Past due but not individually impaired	Individually impaired	Total	Impairment loss allowances	Total carrying value	
Statutory balance sheet line items	£m	£m	£m	£m	£m	£m	
<b>Trading assets</b>							
- Loans and advances to banks	6,144	-	-	6,144	-	6,144	
- Loans and advances to customers	6,686	-	-	6,686	-	6,686	
<b>Financial assets designated at fair value through profit and loss</b>							
- Loans and advances to customers	4,050	-	-	4,050	-	4,050	
<b>Loans and advances to banks</b>							
- Placements with other banks	1,130	-	-	1,130	-	1,130	
- Amounts due from parent	2,081	-	-	2,081	-	2,081	
<b>Loans and advances to customers</b>							
- Corporate loans	7,273	95	260	7,628	(130)	7,498	
- Other secured advances	3,485	-	-	3,485	-	3,485	
- Amounts due from subsidiaries	27,938	-	-	27,938	-	27,938	
- Amounts due from Banco Santander group undertakings	5	-	-	5	-	5	
<b>Loans and receivables securities</b>	278	-	-	278	-	278	
<b>Total loans and advances</b>	<b>59,070</b>	<b>95</b>	<b>260</b>	<b>59,425</b>	<b>(130)</b>	<b>59,295</b>	

## Credit quality of loans and advances that are neither past due nor individually impaired

The credit quality of loans and advances that are neither past due nor individually impaired is as follows:

2012				Group	
	Good £m	Satisfactory £m	Higher Risk £m	Total £m	Total £m
<b>Trading assets</b>					
- Loans and advances to banks	9,781	190	17		9,988
- Loans and advances to customers	7,552	-	-		7,552
<b>Financial assets designated at fair value through profit and loss</b>					
- Loans and advances to customers	3,203	-	-		3,203
<b>Loans and advances to banks</b>					
- Placements with other banks	1,290	-	-		1,290
- Amounts due from parent	237	-	-		237
<b>Loans and advances to customers</b>					
- Corporate loans	6,185	701	6		6,892
- Other secured advances	4,855	-	-		4,855
- Amounts due from subsidiaries	32,368	-	-		32,368
- Amounts due from Banco Santander group undertakings	5	-	-		5
<b>Loans and receivables securities</b>	162	-	-		162
<b>Total loans and advances</b>	<b>65,638</b>	<b>891</b>	<b>23</b>		<b>66,552</b>

## Risk Management Report continued

	Company			
<b>2012</b>	Good £m	Satisfactory £m	Higher Risk £m	Total £m
<b>Trading assets</b>				
- Loans and advances to banks	9,988	-	-	9,988
- Loans and advances to customers	7,551	-	-	7,551
<b>Financial assets designated at fair value through profit and loss</b>				
- Loans and advances to customers	3,203	-	-	3,203
<b>Loans and advances to banks</b>				
- Placements with other banks	1,285	-	-	1,285
- Amounts due from parent	237	-	-	237
<b>Loans and advances to customers</b>				
- Corporate loans	6,185	701	6	6,892
- Other secured advances	4,849	-	-	4,849
- Amounts due from subsidiaries	32,482	-	-	32,482
- Amounts due from Banco Santander group undertakings	5	-	-	5
<b>Loans and receivables securities</b>	162	-	-	162
<b>Total loans and advances</b>	<b>65,947</b>	<b>701</b>	<b>6</b>	<b>66,654</b>

	Group			
<b>2011</b>	Good £m	Satisfactory £m	Higher Risk £m	Total £m
<b>Trading assets</b>				
- Loans and advances to banks	5,647	486	11	6,144
- Loans and advances to customers	6,678	9	-	6,687
<b>Financial assets designated at fair value through profit and loss</b>				
- Loans and advances to customers	4,050	-	-	4,050
<b>Loans and advances to banks</b>				
- Placements with other banks	1,136	-	-	1,136
- Amounts due from parent	2,082	-	-	2,082
<b>Loans and advances to customers</b>				
- Corporate loans	6,429	802	42	7,273
- Other secured advances	3,492	-	-	3,492
- Amounts due from subsidiaries	27,831	-	-	27,831
- Amounts due from Banco Santander group undertakings	5	-	-	5
<b>Loans and receivables securities</b>	278	-	-	278
<b>Total loans and advances</b>	<b>57,628</b>	<b>1,297</b>	<b>53</b>	<b>58,978</b>

	Company			
<b>2011</b>	Good £m	Satisfactory £m	Higher Risk £m	Total £m
<b>Trading assets</b>				
- Loans and advances to banks	5,647	486	11	6,144
- Loans and advances to customers	6,677	9	-	6,686
<b>Financial assets designated at fair value through profit and loss</b>				
- Loans and advances to customers	4,050	-	-	4,050
<b>Loans and advances to banks</b>				
- Placements with other banks	1,130	-	-	1,130
- Amounts due from parent	2,081	-	-	2,081
<b>Loans and advances to customers</b>				
- Corporate loans	6,429	802	42	7,273
- Other secured advances	3,485	-	-	3,485
- Amounts due from subsidiaries	27,938	-	-	27,938
- Amounts due from Banco Santander group undertakings	5	-	-	5
<b>Loans and receivables securities</b>	278	-	-	278
<b>Total loans and advances</b>	<b>57,720</b>	<b>1,297</b>	<b>53</b>	<b>59,070</b>

Internal measures of credit quality have been used in the table analysing credit quality above, as follows:

Financial statements description	Probability of default
Good	0.0 - 0.5%
Satisfactory	0.5 - 12.5%
Higher Risk	12.5%+

## Risk Management Report continued

Summarised descriptions of credit quality used in the financial statements relating to corporate lending are as follows:

RATING	DESCRIPTION
<b>Good</b>	There is a very high likelihood that the asset will not default and will be recovered in full. The exposure has a negligible or low probability of default. Such exposure also exhibits a strong capacity to meet financial commitments and only exceptionally shows any period of delinquency.
<b>Satisfactory</b>	There is a high likelihood that the asset will be recovered and is therefore of no cause for concern to Santander UK. The asset has low to moderate probability of default, strong recovery rates and may typically show only short periods of delinquency. Moderate to high application scores, credit bureau scores or behavioural scores characterise this credit quality.
<b>Higher Risk</b>	All rated accounts that are not viewed as Good or Satisfactory are rated as Higher Risk. The assets are characterised by some concern over the obligor's ability to make payments when due. There may also be doubts over the value of collateral or security provided. However, the borrower or counterparty is continuing to make payments when due i.e. the assets have not yet converted to actual delinquency and is expected to settle all outstanding amounts of principal and interest.

### Maturity analysis of loans and advances that are past due but not individually impaired

A maturity analysis of loans and advances that are past due but not individually impaired is set out below.

In the corporate loan portfolio, a loan or advance is considered past due when it is 90 days or more in arrears, and also when ANTS has reason to believe that full repayment of the loan is in doubt.

2011						Group
	Past due up to 1 month £m	Past due 1-2 months £m	Past due 2-3 months £m	Past due 3-6 months £m	Past due 6 months and over £m	Total £m
<b>Loans and advances to customers</b>						
- Corporate loans	-	-	-	95	-	95
<b>Total loans and advances</b>	-	-	-	95	-	95

2011						Company
	Past due up to 1 month £m	Past due 1-2 months £m	Past due 2-3 months £m	Past due 3-6 months £m	Past due 6 months and over £m	Total £m
<b>Loans and advances to customers</b>						
- Corporate loans	-	-	-	95	-	95
<b>Total loans and advances</b>	-	-	-	95	-	95

Risk Management Report continued

## 5. IMPAIRMENT LOSS ALLOWANCES ON LOANS AND ADVANCES TO CUSTOMERS

### IMPAIRMENT LOSS ALLOWANCES ON LOANS AND ADVANCES TO CUSTOMERS

The only impairment loss allowances arise in Corporate Banking. An analysis of the Corporate Banking impairment loss allowances on loans and advances to customers is presented below.

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
<b>Observed impairment loss allowances</b>					
Corporate loans - UK	109	97	79	63	13
<b>Total observed impairment loss allowances</b>	<b>109</b>	<b>97</b>	<b>79</b>	<b>63</b>	<b>13</b>
<b>Incurred but not yet observed impairment loss allowances</b>					
Corporate loans - UK	3	33	29	14	13
<b>Total incurred but not yet observed impairment loss allowances</b>	<b>3</b>	<b>33</b>	<b>29</b>	<b>14</b>	<b>13</b>
<b>Total impairment loss allowances</b>	<b>112</b>	<b>130</b>	<b>108</b>	<b>77</b>	<b>26</b>

### Movements in impairment loss allowances on loans and advances

An analysis of movements in the Corporate Banking impairment loss allowances on loans and advances is presented below.

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
<b>Impairment loss allowances at 1 January</b>	<b>130</b>	<b>108</b>	<b>77</b>	<b>26</b>	<b>-</b>
<b>Amounts written off:</b>					
Corporate loans - UK	(27)	(32)	(49)	-	-
<b>Total amounts written off</b>	<b>(27)</b>	<b>(32)</b>	<b>(49)</b>	<b>-</b>	<b>-</b>
<b>Observed impairment losses charged against profit:</b>					
Corporate loans - UK	40	50	65	50	13
<b>Total observed impairment losses charged against profit</b>	<b>40</b>	<b>50</b>	<b>65</b>	<b>50</b>	<b>13</b>
<b>Incurred but not yet observed impairment losses charged against/ (released into) profit</b>	<b>(31)</b>	<b>4</b>	<b>15</b>	<b>1</b>	<b>13</b>
<b>Total impairment losses charged against profit</b>	<b>9</b>	<b>54</b>	<b>80</b>	<b>51</b>	<b>26</b>
<b>Impairment loss allowances at 31 December</b>	<b>112</b>	<b>130</b>	<b>108</b>	<b>77</b>	<b>26</b>

### Recoveries

An analysis of Corporate Banking recoveries is presented below.

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Corporate loans - UK	-	-	11	21	-
<b>Total amount recovered</b>	<b>-</b>	<b>-</b>	<b>11</b>	<b>21</b>	<b>-</b>

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# Independent Auditor's Report to the Members of Abbey National Treasury Services plc

We have audited the financial statements of Abbey National Treasury Services plc (the "Company" and together with its subsidiaries the "Group") for the year ended 31 December 2012 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Company Balance Sheets, the Consolidated and Company Statements of Changes in Equity, the Consolidated and Company Cash Flow Statements, the related Notes 1 to 45 to the financial statements and the information on pages 40 to 78 and 84 to 98 of the Risk Management Report, except for those items marked as unaudited. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

## Respective responsibilities of directors and auditor

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

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## Opinion on financial statements

In our opinion:

- > the financial statements give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2012 and of the Group's profit for the year then ended;
- > the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- > the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- > the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

## Separate opinion in relation to IFRSs as issued by the IASB

As explained in Note 1 to the Group financial statements, the Group in addition to complying with its legal obligation to apply IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB). In our opinion the Group financial statements comply with IFRSs as issued by the IASB.

## Opinion on other matter prescribed by the Companies Act 2006

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

## Matters on which we are required to report by exception

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

- > adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- > the parent company financial statements are not in agreement with the accounting records and returns; or
- > certain disclosures of directors' remuneration specified by law are not made; or
- > we have not received all the information and explanations we require for our audit.



Tom Millar (Senior statutory auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
London, UK  
18 March 2013



## Notes to the Financial Statements

## CONSOLIDATED INCOME STATEMENT

For the years ended 31 December 2012, 2011 and 2010

	Notes	2012 £m	2011 <sup>(1)</sup> £m	2010 £m
Interest and similar income		<b>3,870</b>	3,667	3,045
Interest expense and similar charges		<b>(3,731)</b>	(3,156)	(2,642)
<b>Net interest income</b>	3	<b>139</b>	511	403
Net fee and commission income	4	<b>119</b>	113	28
Net trading and other income	5	<b>304</b>	(46)	462
<b>Total operating income</b>		<b>562</b>	578	893
Administration expenses	6	<b>(198)</b>	(229)	(209)
Depreciation and amortisation	7	<b>(3)</b>	(7)	(6)
<b>Total operating expenses excluding provisions and charges</b>		<b>(201)</b>	(236)	(215)
Impairment losses on loans and advances	8	<b>(9)</b>	(54)	(69)
Provisions for other liabilities and charges	8	<b>(20)</b>	(20)	-
<b>Total operating provisions and charges</b>		<b>(29)</b>	(74)	(69)
<b>Profit before tax</b>		<b>332</b>	268	609
Taxation charge	11	<b>(68)</b>	(104)	(149)
<b>Profit for the year</b>		<b>264</b>	164	460
<b>Attributable to:</b>				
Equity holders of the parent		<b>264</b>	164	460

(1) As restated, see Note 45

All profits during the year were generated from continuing operations.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the years ended 31 December 2012, 2011 and 2010

	Notes	2012 £m	2011 <sup>(1)</sup> £m	2010 £m
<b>Profit for the year</b>		<b>264</b>	164	460
<b>Other comprehensive income:</b>				
Gains on available-for-sale securities	22	<b>5</b>	-	-
Tax on above items	11	<b>(1)</b>	-	-
<b>Net gain recognised directly in other comprehensive income</b>		<b>4</b>	-	-
Gains on available-for-sale securities transferred to profit or loss on sale		-	-	-
Tax on items transferred to profit or loss	11	-	-	-
<b>Net transfers to profit</b>		-	-	-
<b>Total other comprehensive income for the year before tax</b>		<b>5</b>	-	-
<b>Tax relating to components of other comprehensive income</b>	11	<b>(1)</b>	-	-
<b>Total comprehensive income for the year</b>		<b>268</b>	164	460
<b>Attributable to:</b>				
Equity holders of the parent		<b>268</b>	164	460

(1) As restated, see Note 45

The accompanying Notes on pages 118 to 189 and the audited sections of the Risk Management Report on pages 28 to 98 form an integral part of these Consolidated Financial Statements.

## Primary Financial Statements continued

## CONSOLIDATED BALANCE SHEET

At 31 December 2012 and 2011

	Notes	2012 £m	2011 <sup>(1)</sup> £m
<b>Assets</b>			
Cash and balances at central banks	13	388	7,013
Trading assets	14	22,498	21,891
Derivative financial instruments	15	33,276	33,224
Financial assets designated at fair value	16	3,531	4,429
Loans and advances to banks	17	106,986	113,222
Loans and advances to customers	18	44,750	38,826
Loans and receivables securities	20	162	278
Available-for-sale securities	22	5,113	-
Macro hedge of interest rate risk		1,171	1,141
Intangible assets	24	7	3
Property, plant and equipment	25	6	5
Deferred tax assets	26	20	17
Other assets	27	4	43
<b>Total assets</b>		<b>217,912</b>	<b>220,092</b>
<b>Liabilities</b>			
Deposits by banks	28	114,535	114,019
Deposits by customers	29	6,249	7,114
Derivative financial instruments	15	34,088	35,417
Trading liabilities	30	21,109	25,745
Financial liabilities designated at fair value	31	4,002	6,836
Debt securities in issue	32	33,770	26,943
Other liabilities	33	169	142
Provisions	34	20	20
Current tax liabilities		175	329
<b>Total liabilities</b>		<b>214,117</b>	<b>216,565</b>
<b>Equity</b>			
Share capital	36	2,549	2,549
Retained earnings		1,226	962
Other reserves		20	16
<b>Total shareholders' equity</b>		<b>3,795</b>	<b>3,527</b>
<b>Total liabilities and equity</b>		<b>217,912</b>	<b>220,092</b>

(1) As restated, see Note 45

The accompanying Notes on pages 118 to 189 and the audited sections of the Risk Management Report on pages 28 to 98 form an integral part of these Consolidated Financial Statements.

The Financial Statements on pages 112 to 189 were approved and authorised for issue by the Board on 18 March 2013 and signed on its behalf by:



David Green  
Director

Company Registered Number 2338548

## Primary Financial Statements continued

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the years ended 31 December 2012, 2011 and 2010

Notes	Share Capital £m	Other reserves		Retained earnings <sup>(1)</sup> £m	Total <sup>(1)</sup> £m
		Available for sale reserve £m	Foreign currency translation reserve £m		
<b>1 January 2012</b>	<b>2,549</b>	<b>-</b>	<b>16</b>	<b>962</b>	<b>3,527</b>
Total comprehensive income:					
- Profit for the year	-	-	-	264	264
- Other comprehensive income for the year	-	5	-	-	5
- Tax on other comprehensive income	-	(1)	-	-	(1)
	-	4	-	264	268
Dividends and other distributions	-	-	-	-	-
<b>31 December 2012</b>	<b>2,549</b>	<b>4</b>	<b>16</b>	<b>1,226</b>	<b>3,795</b>
1 January 2011	2,549	-	16	798	3,363
Total comprehensive income:					
- Profit for the year	-	-	-	164	164
	-	-	-	164	164
Dividends and other distributions	-	-	-	-	-
31 December 2011	2,549	-	16	962	3,527
1 January 2010	2,549	-	16	938	3,503
Total comprehensive income:					
- Profit for the year	-	-	-	460	460
	-	-	-	460	460
Dividends and other distributions	-	-	-	(600)	(600)
31 December 2010	2,549	-	16	798	3,363

(1) As restated, see Note 45

## CONSOLIDATED CASH FLOW STATEMENT

For the years ended 31 December 2012, 2011 and 2010

Notes	2012 £m	2011 <sup>(1)</sup> £m	2010 £m
<b>Net cash flow (used in)/from operating activities</b>			
Profit for the year	264	164	460
Adjustments for:			
Non cash items included in profit	101	4	125
Change in operating assets	7,518	26,669	38,039
Change in operating liabilities	(4,600)	(30,962)	(36,856)
Corporation taxes paid	(42)	(13)	(28)
Effect of exchange rate differences	(853)	(417)	399
<b>Net cash flow from/(used in) operating activities</b>	<b>38</b>	<b>(4,555)</b>	<b>2,139</b>
<b>Net cash flow (used in)/from investing activities</b>			
Purchase of property, plant and equipment and intangible assets	24, 25	(10)	(9)
Proceeds from sale of property, plant and equipment and intangible assets		2	42
Purchase of securities		(5,990)	-
Proceeds from sale and redemption of securities		864	-
<b>Net cash flow (used in)/from investing activities</b>		<b>(5,134)</b>	<b>33</b>
<b>Net cash flow from/(used in) financing activities</b>			
Issue of long-term debt		31,314	38,603
Repayments of long-term debt		(28,388)	(40,607)
Dividends paid		-	-
		-	(600)
<b>Net cash flow from/(used in) financing activities</b>		<b>2,926</b>	<b>(2,004)</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>180</b>	<b>(6,526)</b>
Cash and cash equivalents at beginning of the year		79,858	86,729
Effect of exchange rate changes on cash and cash equivalents		(624)	(345)
<b>Cash and cash equivalents at the end of the year</b>	<b>38</b>	<b>79,414</b>	<b>79,858</b>

(1) As restated, see Note 45

The accompanying Notes on pages 118 to 189 and the audited sections of the Risk Management Report on pages 28 to 98 form an integral part of these Consolidated Financial Statements.

## Primary Financial Statements continued

## COMPANY BALANCE SHEET

At 31 December 2012 and 2011

	Notes	2012 <sup>(2)</sup> £m	2011 <sup>(1,2)</sup> £m
<b>Assets</b>			
Cash and balances at central banks	13	388	7,013
Trading assets	14	22,155	21,564
Derivative financial instruments	15	33,312	33,242
Financial assets designated at fair value	16	3,531	4,429
Loans and advances to banks	17	106,972	113,211
Loans and advances to customers	18	44,858	38,926
Loans and receivable securities	20	162	278
Available-for-sale securities	22	5,113	-
Macro hedge of interest rate risk		1,171	1,141
Investment in subsidiary undertakings	23	2,184	2,187
Intangible assets	24	7	3
Property, plant and equipment	25	6	5
Deferred tax assets	26	20	17
Other assets	27	4	43
<b>Total assets</b>		<b>219,883</b>	<b>222,059</b>
<b>Liabilities</b>			
Deposits by banks	28	114,535	114,018
Deposits by customers	29	10,599	12,276
Derivative financial instruments	15	34,088	35,417
Trading liabilities	30	21,109	25,745
Financial liabilities designated at fair value	31	4,002	6,780
Debt securities in issue	32	31,481	23,869
Other liabilities	33	166	137
Provisions	34	20	20
Current tax liabilities		175	320
<b>Total liabilities</b>		<b>216,175</b>	<b>218,582</b>
<b>Equity</b>			
Share capital	36	2,549	2,549
Retained earnings		1,140	914
Other reserves		19	14
<b>Total shareholders equity</b>		<b>3,708</b>	<b>3,477</b>
<b>Total liabilities and equity</b>		<b>219,883</b>	<b>222,059</b>

(1) As restated, see Note 45

(2) The Company financial statements and all related footnotes have not been audited under the standards of the Public Company Accounting Oversight Board.

The accompanying Notes on pages 118 to 189 and the audited sections of the Risk Management Report on pages 28 to 98 form an integral part of these Consolidated Financial Statements.

The Financial Statements on pages 112 to 189 were approved and authorised for issue by the Board on 18 March 2013 and signed on its behalf by:



David Green  
Director

Company Registered Number 2338548

## Primary Financial Statements continued

## COMPANY STATEMENT OF CHANGES IN EQUITY

For the years ended 31 December 2012, 2011 and 2010

Notes	Share Capital £m	Other reserves		Retained earnings <sup>(1)</sup> £m	Total <sup>(1, 2)</sup> £m
		Available for sale reserve £m	Foreign currency translation reserve £m		
<b>1 January 2012</b>	<b>2,549</b>	<b>-</b>	<b>14</b>	<b>914</b>	<b>3,477</b>
Total comprehensive income:					
- Profit for the year	-	-	-	226	226
- Other comprehensive income for the year before tax	-	5	1	-	6
- Tax on other comprehensive income	-	(1)	-	-	(1)
	-	4	1	226	231
Dividends and other distributions	-	-	-	-	-
<b>31 December 2012</b>	<b>2,549</b>	<b>4</b>	<b>15</b>	<b>1,140</b>	<b>3,708</b>
1 January 2011	2,549	-	14	692	3,255
Total comprehensive income:					
- Profit for the year	-	-	-	222	222
	-	-	-	222	222
Dividends and other distributions	-	-	-	-	-
31 December 2011	2,549	-	14	914	3,477
1 January 2010	2,549	-	15	622	3,186
Total comprehensive income/(expense):					
- Profit for the year	-	-	-	670	670
- Other comprehensive income for the year before tax	-	-	(1)	-	(1)
- Tax on other comprehensive income	-	-	-	-	-
	-	-	(1)	670	669
Dividends and other distributions	-	-	-	(600)	(600)
31 December 2010	2,549	-	14	692	3,255

(1) As restated, see Note 45

(2) The Company financial statements and all related footnotes have not been audited under the standards of the Public Company Accounting Oversight Board.

The accompanying Notes on pages 118 to 189 and the audited sections of the Risk Management Report on pages 28 to 98 form an integral part of these Consolidated Financial Statements.

## Primary Financial Statements continued

## COMPANY CASH FLOW STATEMENT

For the years ended 31 December 2012, 2011 and 2010

	Notes	2012 <sup>(2)</sup> £m	2011 <sup>(1, 2)</sup> £m	2010 <sup>(2)</sup> £m
<b>Net cash flow from/(used in) operating activities</b>				
Profit for the year		226	222	670
Adjustments for:				
Non cash items included in profit		115	137	157
Change in operating assets		7,741	26,374	33,019
Change in operating liabilities		(4,762)	(31,385)	(2,824)
Corporation taxes paid		(12)	(13)	(17)
Effects of exchange rate differences		(598)	(685)	154
<b>Net cash flow from/(used in) operating activities</b>	38	<b>2,710</b>	<b>(5,350)</b>	<b>31,159</b>
<b>Net cash flow (used in)/from investing activities</b>				
Purchase of property, plant and equipment and intangible assets	24, 25	(9)	(9)	-
Proceeds from sale of property, plant and equipment and intangible assets		2	42	(40)
Investment in associate		3	-	-
Purchase of securities		(5,990)	-	-
Proceeds from sale and redemption of securities		863	-	-
<b>Net cash flow (used in)/from investing activities</b>		<b>(5,131)</b>	<b>33</b>	<b>(40)</b>
<b>Net cash flow from/(used in) financing activities</b>				
Issue of long term debt		31,314	38,607	11,419
Repayments of long term debt		(28,364)	(40,307)	(4,840)
Dividends paid		-	-	(600)
<b>Net cash flow from/(used in) financing activities</b>		<b>2,950</b>	<b>(1,700)</b>	<b>5,979</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>529</b>	<b>(7,017)</b>	<b>37,098</b>
Cash and cash equivalents at beginning of the year		79,747	86,712	49,327
Effect of exchange rate changes on cash and cash equivalents		(876)	52	287
<b>Cash and cash equivalents at the end of the year</b>	38	<b>79,400</b>	<b>79,747</b>	<b>86,712</b>

(1) As restated, see Note 45

(2) The Company financial statements and all related footnotes have not been audited under the standards of the Public Company Accounting Oversight Board.

The accompanying Notes on pages 118 to 189 and the audited sections of the Risk Management Report on pages 28 to 98 form an integral part of these Consolidated Financial Statements.

## Notes to the Financial Statements

### 1. ACCOUNTING POLICIES

These financial statements are prepared for Abbey National Treasury Services plc (the 'Company') and its subsidiaries (together, the 'ANTS group') under the Companies Act 2006. The principal activity of the ANTS group is to provide treasury, corporate and wholesale banking services. The ANTS group provides these services to UK clients and also to the wider Santander UK group, of which the ANTS group is a significant part. The ANTS group is also the treasury support function for the Santander UK group. In this regard, the ANTS group's role is to provide access to financial markets and central bank facilities in order to meet the Santander UK group's liquidity, funding, capital and balance sheet management requirements. As such, ANTS is one of the main debt issuance vehicles in the Santander UK group.

Abbey National Treasury Services plc is a public limited company, incorporated in England and Wales, having a registered office in England and is the holding company of the ANTS group as well as undertaking business transactions.

#### BASIS OF PREPARATION

These consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year. 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 of accounting as set out below.

#### Compliance with International Financial Reporting Standards

The ANTS group consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ('IASB'), including interpretations issued by the IFRS Interpretations Committee ('IFRIC') of the IASB (together 'IFRS'). The ANTS group has also complied with its legal obligation to comply with International Financial Reporting Standards as adopted by the European Union as there are no applicable differences between the two frameworks for the periods presented.

The Company financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union, as applied in accordance with the provision of the Companies Act 2006.

Disclosures required by IFRS 7 'Financial Instruments: Disclosures' relating to the nature and extent of risks arising from financial instruments can be found in the Risk Management Report on pages 28 to 98 which form an integral part of these financial statements.

#### Recent accounting developments

In 2012, the ANTS group adopted the following amendments to standards which became effective for financial years beginning on 1 January 2012.

- a) IFRS 7 'Financial Instruments: Disclosures' – In October 2010, the IASB issued amendments to IFRS 7 that increase the disclosure requirements for transactions involving transfers of financial assets. The amendments are intended to provide greater transparency around risk exposures when a financial asset is transferred but the transferor retains some level of continuing exposure in the asset. The amendments also require disclosures where transfers of financial assets are not evenly distributed throughout the period. The amendments to IFRS 7 are effective for annual periods beginning on or after 1 July 2011, with earlier application permitted. Disclosures are not required for comparative periods before the date of initial application of the amendments. The disclosures required by the amendment to IFRS 7 may be found on pages 151.
- b) There are a number of other changes to IFRS that were effective from 1 January 2012. Those changes did not have a significant impact on the ANTS group's financial statements.

#### Future accounting developments

The ANTS group has not yet adopted the following significant new or revised standards and interpretations, and amendments thereto, which have been issued but which are not yet effective for the ANTS group:

- a) IAS 1 'Presentation of Financial Statements' – In June 2011, the IASB issued amendments to IAS 1 that retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements. However, the amendments to IAS 1 require additional disclosures to be made in the other comprehensive income section such that items of other comprehensive income are grouped into two categories: (i) items that will not be reclassified subsequently to profit or loss; and (ii) items that will be reclassified subsequently to profit or loss when specific conditions are met. Income tax on items of other comprehensive income is required to be allocated on the same basis. The amendments to IAS 1 are effective for annual periods beginning on or after 1 July 2012.

The ANTS group anticipates that IAS 1 (2011) will be adopted in the ANTS group's financial statements for the annual period beginning on 1 January 2013 and that the application of the new Standard will modify the presentation of items of other comprehensive income accordingly. Retrospective application is required. The ANTS group does not anticipate that these amendments to IAS 1 will have a significant impact on the ANTS group's disclosures.

## Notes to the Financial Statements continued

- b) IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements', IFRS 12 'Disclosure of Interests in Other Entities', IAS 27 'Separate Financial Statements' and IAS 28 'Investments in Associates and Joint Ventures' – In May 2011, the IASB issued new and amended guidance on consolidated financial statements and joint arrangements. IFRS 10, IFRS 11 and IFRS 12 were new standards issued while IAS 27 and IAS 28 were amended. Each of the standards issued is effective for annual periods beginning on or after 1 January 2013 with earlier application permitted as long as each of the other standards is also applied earlier.
- > Under IFRS 10 'Consolidated Financial Statements', control is the single basis for consolidation, irrespective of the nature of the investee; this standard therefore eliminates the risks-and-rewards approach. IFRS 10 identifies the three elements of control as power over the investee, exposure, or rights, to variable returns from involvement with the investee and the ability to use power over the investee to affect the amount of the investor's returns. An investor must possess all three elements to conclude that it controls an investee. The assessment of control is based on all facts and circumstances, and the conclusion is reassessed if there are changes to at least one of the three elements. Retrospective application is required subject to certain transitional provisions.
  - > IFRS 11 applies to all entities that are parties to a joint arrangement. A joint arrangement is an arrangement of which two or more parties have joint control. IFRS 11 establishes two types of joint arrangements, joint operations and joint ventures, which are distinguished by the rights and obligations of the parties to the arrangement. In a joint operation, the parties to the joint arrangement (referred to as 'joint operators') have rights to the assets and obligations for the liabilities of the arrangement. By contrast, in a joint venture, the parties to the arrangement (referred to as 'joint venturers') have rights to the net assets of the arrangement. IFRS 11 requires that a joint operator recognise its share of the assets, liabilities, revenues, and expenses in accordance with applicable IFRSs; however, a joint venturer would account for its interest by using the equity method of accounting under IAS 28 (2011). Transitional provisions vary depending on how an interest is accounted for under IAS 31 and what its nature is under IFRS 11.
  - > IFRS 12 integrates the disclosure requirements on interests in other entities, currently included in several standards to make it easier to understand and apply the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard also contains additional requirements on a number of topics. Under IFRS 12, an entity should disclose information about significant judgements and assumptions (and any changes to those assumptions) made in determining whether it has control, joint control, or significant influence over another entity and the type of joint arrangement. IFRS 12 also requires additional disclosures to provide information to enable users to assess the nature of, and risks associated with the Company's interests in other entities and the effect of those interests on the Company's financial position, performance and cash flow. Disclosures shall be aggregated or disaggregated so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics. The standard applies prospectively from the beginning of the annual period in which it is adopted.
- In June 2012, the IASB issued amendments to IFRS 10, IFRS 11 and IFRS 12 that clarify the transitional guidance in IFRS 10 Consolidated Financial Statements, IFRS 11 Joints Arrangements and IFRS 12 Disclosure of Interest in Other Entities. The amendments provide additional transition relief in IFRS 10, IFRS 11 and IFRS 12 by limiting the requirement to provide adjusted comparative information to only the preceding comparative period, and are in response to constituent requests for clarification on certain aspects of the transition guidance.
- The ANTS group anticipates that IFRS 10, IFRS 11 and IFRS 12 will be adopted in the ANTS group's financial statements for the annual period beginning on 1 January 2013. The ANTS group is still completing its analysis but does not anticipate that the application of the new standards will have a significant impact on its profit or loss or financial position but expects to enhance its disclosures around holdings of structured entities as a result of IFRS 12.
- > IAS 27 was amended for the issuance of IFRS 10 but retains the current guidance on separate financial statements.
  - > IAS 28 was amended for conforming changes on the basis of the issuance of IFRS 10 and IFRS 11. The ANTS group anticipates that IAS 27 (2011) and IAS 28 (2011) will be adopted in the Company's financial statements for the annual period beginning on 1 January 2013. The ANTS group is still completing its analysis but does not anticipate that these amendments to IAS 27 and IAS 28 will have a significant impact on its disclosures and on amounts reported in respect of the ANTS group's profit or loss, financial position or disclosures.
- c) IFRS 13 'Fair Value Measurement' - In May 2011, the IASB issued IFRS 13, which establishes a single source of guidance for fair value measurement. IFRS 13 defines fair value, establishes a framework for measuring fair value, and requires disclosures about fair value measurements. IFRS 13 applies to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except in specified circumstances. In general, the disclosure requirements in IFRS 13 are more extensive than those required in the current accounting standards. IFRS 13 is effective for annual periods beginning on or after 1 January 2013, with early adoption permitted, and applies prospectively from the beginning of the annual period in which it is adopted.
- The ANTS group anticipates that IFRS 13 will be adopted in the ANTS group's financial statements for the annual period beginning on 1 January 2013. The ANTS group is still completing its analysis but does not anticipate that the application of the new standards will have a significant impact on its profit or loss, financial position or disclosures.



## Notes to the Financial Statements continued

- d) IFRS 9 'Financial Instruments' – In November 2009, the IASB issued IFRS 9 'Financial Instruments' ('IFRS 9') which introduced new requirements for the classification and measurement of financial assets. In October 2010, the IASB issued an amendment to IFRS 9 incorporating requirements for financial liabilities. Together, these changes represent the first phase in the IASB's planned replacement of IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39') with a less complex and improved standard for financial instruments.

Following the IASB's decision in December 2011 to defer the effective date, the standard is effective for annual periods beginning on or after 1 January 2015 with early adoption permitted. IFRS 9 is required to be applied retrospectively but prior periods need not be restated.

The second and third phases in the IASB's project to replace IAS 39 will address impairment of financial assets measured at amortised cost and hedge accounting.

The IASB re-opened the requirements for classification and measurement in IFRS 9 in 2012 to address practice and other issues, with an exposure draft of revised proposals issued in November 2012.

The ANTS group anticipates that IFRS 9 will be adopted in the ANTS group's financial statements for the annual period beginning on 1 January 2015 and that the application of the new Standard may have a significant impact on amounts reported in respect of the ANTS group's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of that effect until a detailed review has been completed.

- e) IAS 19 'Employee Benefits' – In June 2011, the IASB issued amendments to IAS 19 that change the accounting for defined benefit plans and termination benefits. The most significant change relates to the accounting for changes in defined benefit obligations and plan assets. The amendments require the recognition of changes in defined benefit obligations and in fair value of plan assets when they occur, and hence eliminate the 'corridor approach' permitted under the previous version of IAS 19 and accelerate the recognition of past service costs. The amendments require all actuarial gains and losses to be recognised immediately through other comprehensive income in order for the net pension asset or liability recognised in the consolidated statement of financial position to reflect the full value of the plan deficit or surplus. The amendments to IAS 19 are effective for annual periods beginning on or after 1 January 2013 and require retrospective application with certain exceptions.

The ANTS group anticipates that IAS 19 (2011) will be adopted in the ANTS group's financial statements for the annual period beginning on 1 January 2013. The ANTS group does not anticipate that these amendments to IAS 19 will have a significant impact on its profit or loss or financial position as the ANTS group does not account for any of its employee benefits as defined benefit plans.

- f) In December 2011, the IASB issued amendments to IFRS 7 'Disclosures – Offsetting Financial Assets and Financial Liabilities' which requires the disclosures about the effect or potential effects of offsetting financial assets and financial liabilities and related arrangements on an entity's financial position. The amendments are effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. The amendments are required to be applied retrospectively.

- g) In December 2011, the IASB issued amendments to IAS 32 'Offsetting Financial Assets and Financial Liabilities' which clarified the requirements for offsetting financial instruments and addressed inconsistencies in current practice when applying the offsetting criteria in IAS 32 'Financial Instruments: Presentation'. The amendments are effective for annual periods beginning on or after 1 January 2014 with early adoption permitted and are required to be applied retrospectively.

The ANTS group is currently assessing the impact of these clarifications but it is not practicable to quantify the effect as at the date of the publication of these financial statements.

- h) There are a number of other standards which have been issued or amended that are expected to be effective in future periods. However, it is not practicable to provide a reasonable estimate of their effects on the ANTS group's financial statements until a detailed review has been completed.

### b) Comparative information

As required by US public company reporting requirements, these Consolidated Financial Statements include two years of comparative information for the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows and related Notes.

## GOING CONCERN

The ANTS group's objectives, policies and processes for managing its capital are described in Note 44. Details of the ANTS group's financial risk management objectives, its financial instruments and hedging activities; and its exposures to credit risk, interest rate risk, liquidity risk, operational risk and other risks are set out in the Risk Management Report on pages 28 to 98.

The ANTS group is reliant on Santander UK plc and other companies in the Santander UK group of companies ('Santander UK') for a significant proportion of its funding. The Santander UK Board has confirmed that Santander UK plc is a going concern, and that it will provide funding to the ANTS group for the foreseeable future. In giving this commitment to provide funding to the ANTS group, the Santander UK Board has considered the uncertainties that affect the ANTS group when preparing the forecasts and budgets of the combined business of Santander UK.

## Notes to the Financial Statements continued

The Company has given a full and unconditional guarantee in respect of the unsubordinated liabilities of Santander UK plc incurred prior to 30 June 2015 under a deed poll guarantee entered into by the Company on 10 May 2012. Santander UK plc has given a reciprocal guarantee in respect of the unsubordinated liabilities of the Company incurred prior to 30 June 2015.

The Company, Santander UK plc, and Cater Allen Limited, which are the three FSA-regulated entities within the Santander UK group, are party to a capital support deed dated 14 December 2012 (the "Capital Support Deed") with certain other non-regulated subsidiaries of Santander UK plc. The parties to the Capital Support Deed constitute a core UK group for the purposes of section 10 of the Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU") of the FSA Handbook. Under section 10.8 of BIPRU, exposures of each of the three regulated entities to other members of the core UK group are exempt from large exposure limits that would otherwise apply. The purpose of the Capital Support Deed is to facilitate the prompt transfer of available capital resources from, or repayment of liabilities by, the non-regulated parties to any of the regulated parties in the event that one of the regulated parties has breached or is at risk of breaching its capital resources requirements or risk concentrations requirements.

In addition, the Company, Santander UK plc, and Cater Allen Limited are party to a defined liquidity group liquidity facility agreement dated 28 May 2010 (the "DLG Facility Agreement"). The DLG Facility Agreement supports a defined liquidity group for the purposes of section 12 of BIPRU. Section 12.8 of BIPRU permits a member of a defined liquidity group to rely on the liquid resources of other members of the defined liquidity group to comply with the liquidity adequacy requirements under section 12 of BIPRU. Under the DLG Facility Agreement, each party agrees to lend, subject to certain conditions and limitations, its excess liquidity to each other party.

After making enquiries, the Directors have a reasonable expectation that the Company and the ANTS group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis of accounting in preparing the financial statements.

## CONSOLIDATION

Subsidiaries, which are those companies and other entities (including Special Purpose Entities ('SPEs')) over which the ANTS 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 currently exercisable or currently convertible are considered when assessing whether the ANTS 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 ANTS group and are no longer consolidated from the date that control ceases. The acquisition 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. Acquisition related costs are expensed as incurred. The excess of the cost of acquisition, as well as the fair value of any interest previously held, over the fair value of the ANTS group's share of the identifiable net assets of the acquired subsidiary, associate or business at the date of acquisition is recorded as goodwill. Inter-company transactions, balances and unrealised gains on transactions between ANTS 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 investment 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.

In the context of SPE's, the following circumstances may indicate a relationship in which, in substance, the ANTS group controls and consequently consolidates an SPE:

- > the activities of the SPE are being conducted on behalf of the ANTS group according to the ANTS group's specific business needs so that it obtains benefits from the SPE's operation;
- > the ANTS group has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an 'autopilot' mechanism, the ANTS group has delegated those decision-making powers;
- > the ANTS group has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks arising from the activities of the SPE; or
- > the ANTS group retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

Assessments of control are made based on the initial arrangements in place, but these are reconsidered if there are subsequent changes to the substance of the arrangements, such as the nature of the ANTS group's involvement, the contractual arrangements or the governing rules of the SPE.

Transactions between entities under common control are outside the scope of IFRS 3 – Business Combinations, and there is no other guidance for such situations under IFRS. The ANTS group elects to account for transactions between entities under common control for cash consideration in a manner consistent with the approach under IFRS 3, unless the transaction represents a reorganisation of entities within the ANTS group, in which case the transaction is accounted for at its historical cost.

## Notes to the Financial Statements continued

### FOREIGN CURRENCY TRANSLATION

Items included in the Financial Statements of each entity (including foreign branch operations) in the ANTS 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 ANTS group's reporting currency at average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December. Exchange differences arising from the translation of the net investment in foreign entities are taken to shareholders' equity. When a foreign entity is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

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

The amount of exchange rate differences recognised in profit or loss on items not at fair value through profit and loss was £649m income (2011: £526m income). This was partially offset by charges on items held at fair value.

### REVENUE RECOGNITION

#### (a) Interest income and expense

Interest income on financial assets that are classified as loans and receivables 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 ANTS 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, interest expense on liabilities classified as amortised cost and interest income and expense on hedging derivatives are recognised in interest and similar income and interest expense and similar charges in the income statement.

In accordance with IFRS, the ANTS group recognises interest income on assets after they have been written down as a result of an impairment loss. Interest continues to be accrued on all loans, and the element of interest that is not anticipated to be recovered is provided for.

#### (b) Fee and commission income

Fees and commissions that are not an integral part of the effective interest rate are recognised when the service is provided. Fee and commission income which forms an integral part of the effective interest rate of a financial instrument (for example, certain loan commitment fees) is recognised as an adjustment to the effective interest rate and recorded in 'Interest income' (See (a) above).

#### (c) Dividend income

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

#### (d) Net trading and other income

Net trading and other income comprises all gains and losses from changes in the fair value of financial assets and liabilities held at fair value through profit or loss (including financial assets and financial liabilities held for trading and designated as fair value through profit or loss), together with related interest income, expense and dividends. It also includes income from operating lease assets, and profits/(losses) on the sales of property, plant and equipment and intangible assets and subsidiary undertakings. Changes in the fair value of financial assets and liabilities held for trading, including trading derivatives, are recognised in the income statement as net trading and other income together with dividends and interest income and expense. Changes in the fair value of assets and liabilities designated as fair value through profit or loss are recognised in net trading and other income together with dividends, accrued interest income and expense and changes in fair value of derivatives managed in conjunction with these assets and liabilities. Changes in fair value of derivatives in a hedging relationship are recognised in net trading and other income along with the fair value of the hedged item if designated in a fair value hedge or macro hedging relationship.

## Notes to the Financial Statements continued

**BORROWING COSTS**

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

**PENSIONS AND OTHER POST RETIREMENT BENEFITS**

The ANTS group participates in various Santander UK group defined benefit and defined contribution pension schemes in operation. Details of the schemes are disclosed in the Annual Report and Accounts of Santander UK plc. There is no contractual agreement or stated policy for charging the net defined benefit cost of the Santander UK defined benefit schemes. Therefore in accordance with IAS 19 the defined benefit asset or liability has been recognised in the financial statements of the sponsoring employer of the scheme and the ANTS group accounts for its contributions as a defined contribution scheme. The contribution to be paid by the ANTS group is calculated as the contributions made by Santander UK plc to the schemes in respect of the ANTS group's employees.

**INTANGIBLE ASSETS**

Software development costs are capitalised when they are direct costs 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. These costs include payroll, the costs of materials and services, and directly attributable overheads. Internally developed software meeting these criteria and externally purchased software are classified in intangible assets on the balance sheet and amortised on a straight-line basis over their useful life of 3 years, unless the software is an integral part of the related computer hardware, in which case it is treated as property, plant and equipment as described below. Capitalisation of costs cease when the software is capable of operating as intended. Costs associated with maintaining software programmes are expensed as incurred.

**PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment include owner-occupied properties (including leasehold 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.

Internally developed software meeting the criteria set out in "intangible assets" 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. 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	5 to 8 years
Computer software	3 years

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

**FINANCIAL ASSETS**

The ANTS group classifies its financial assets as: financial assets at fair value through profit or loss, loans and receivables and held-to-maturity 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 ANTS 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.

## Notes to the Financial Statements continued

### (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 (except where in a hedging relationship) 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 ANTS 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 ANTS 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 ANTS 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 and Loans and receivables securities.

### (c) Available-for-sale financial assets

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

Income on investments in equity shares, debt instruments 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 ANTS group has transferred substantially all the risks and rewards of ownership.

### (d) Held to maturity investments

Held to maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity. Held to maturity investments are initially recognised at fair value including direct and incremental transaction costs. They are subsequently valued at amortised cost, using the effective interest method. They are derecognised when the rights to receive cash flows have expired or the ANTS group has transferred substantially all of the risks and rewards of ownership. Were the ANTS 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 ANTS group does not hold any held to maturity financial assets.

## VALUATION OF FINANCIAL INSTRUMENTS

Financial instruments that are classified at fair value through profit or loss ('FVTPL') including those held for trading purposes 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 knowledgeable willing parties other than in a forced or liquidation sale.

Changes in the valuation of such financial instruments, including derivatives, are included in the line item 'Net trading and other income' in the income statement or in 'Other comprehensive income' in the statement of comprehensive income as applicable.

### (a) Initial measurement

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price unless the valuation 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.

## Notes to the Financial Statements continued

**(b) Subsequent measurement**

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

The ANTS 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 ANTS group has the ability to access at the measurement date. Level 1 positions include debt securities, equity securities, exchange traded derivatives and short positions in securities.
- Level 2: Quoted prices in markets that are not active, quoted prices for similar assets or liabilities, recent market transactions, inputs other than quoted market prices for the asset or liability that are observable either directly or indirectly for substantially the full term, and inputs to valuation techniques that are derived principally from or corroborated by observable market data through correlation or other statistical means for substantially the full term of the asset or liability. Level 2 positions include loans and advances to banks, loans and advances to customers, equity securities, exchange rate derivatives, interest rate derivatives, equity and credit derivatives, debt securities, deposits by banks, deposits by customers and debt securities in issue.
- Level 3: Inputs to the pricing or valuation techniques that are significant to the overall fair value measurement of the asset or liability are unobservable. Level 3 positions include equity securities, exchange rate derivatives, equity and credit derivatives, loans and advances to customers, debt securities, and debt securities in issue.

The ANTS 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 ANTS group assesses active markets for debt instruments based on both the average daily trading volume and the number of days with trading activity. The ANTS 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. 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 ANTS group performs regular analyses on the assets and liabilities. Underlying assets and liabilities are regularly reviewed to determine whether a position should be regarded as illiquid; the most important practical consideration being the observability of trading. Where the bid-offer spread is observable, this is tested against actual trades. Changes in the observability of significant valuation inputs during the reporting period may result in a reclassification of certain assets and liabilities within the fair value hierarchy.

**Financial instruments valued using observable market prices**

If a quoted market price in an active market is available for an instrument, the fair value is calculated as the current bid price multiplied by the number of units of the instrument held.

**Financial instruments valued using a valuation technique**

In the absence of a quoted market price in an active market, management uses internal models to make its best estimate of the price that the market would set for that financial instrument. In order to make these estimations, various techniques are employed, including extrapolation from observable market data and observation of similar financial instruments with similar characteristics. Wherever possible, valuation parameters for each product are based on prices directly observable in active markets or that can be derived from directly observable market prices. Valuation parameters for each type of financial instrument are discussed in Note 43.

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

The timing of recognition of deferred day one profit and loss is determined individually. It is deferred until either the instrument's fair value can be determined using market observable inputs or is realised through settlement. The financial instrument is subsequently measured at fair value adjusted for the deferred day one profit and loss. Subsequent changes in fair value are recognised immediately in the consolidated income statement without immediate reversal of deferred day one profits and losses.

## Notes to the Financial Statements continued

### **“REGULAR WAY” PURCHASES OF FINANCIAL ASSETS AND ISSUES OF FINANCIAL LIABILITIES**

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

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

Issues of equity or financial liabilities measured at amortised cost are recognised on settlement date; all other regular way issues are recognised on trade date. The liabilities are derecognised when extinguished.

### **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.

The ANTS group is party to a number of arrangements, including master netting arrangements under industry standard agreements which facilitate netting of transactions in jurisdictions where netting agreements are recognised and have legal force. The netting arrangements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis.

### **SALE AND REPURCHASE AGREEMENTS (INCLUDING STOCK BORROWING AND LENDING)**

Securities sold subject to a commitment to repurchase them at a predetermined price ('repos') under which substantially all the risks and rewards of ownership are retained by the ANTS group remain on the balance sheet as trading assets and a liability is recorded in trading liabilities in respect of the consideration received. Securities purchased under commitments to resell ('reverse repos') are not recognised on the balance sheet and the consideration paid is recorded in trading assets. The difference between the sale and repurchase price is treated as trading income in the income statement.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. Securities lent or borrowed are not reflected on the balance sheet. Collateral in the form of cash received or advanced is recorded as a deposit or a loan. Collateral in the form of securities is not recognised.

### **DERIVATIVE FINANCIAL INSTRUMENTS**

Derivative financial instruments ('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. Transactions are undertaken in 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 held for trading or for risk management purposes. Derivatives are classified as held for trading unless they are designated as being in a hedge relationship. The ANTS group chooses to designate certain derivatives as in a hedging relationship if they meet specific criteria, as further described within 'hedge accounting' below.

Derivatives are recognised initially (on the date on which a derivative contract is entered into), and are subsequently remeasured, at their fair value. Fair values of exchange-traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow and option pricing models.

Derivatives may be embedded in other financial instruments, such as the conversion option in a convertible bond. Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated at fair value. 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 either there has been a change in the terms of the contract which significantly modifies the cash flows (in which case the contract is reassessed at the time of modification) or the contract has been reclassified (in which case the contract is reassessed at the time of reclassification).

All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative, except where netting is permitted.

The method of recognising fair value gains and losses depends on whether derivatives are held for trading or are designated as hedging instruments and, if the latter, the nature of the risks being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement, and included within net trading and other income.

## Notes to the Financial Statements continued

**HEDGE ACCOUNTING**

In certain circumstances, derivatives may be designated as hedges and classified as: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges'); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedges'); or (iii) a hedge of a net investment in a foreign operation ('net investment hedges'). The ANTS group enters into derivatives as fair value hedges, but not as cash flow hedges or net investment hedges. 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 (i.e., at the inception of the hedge), the ANTS group formally documents the relationship between the hedging instrument(s) and hedged item(s), its risk management objective and strategy for undertaking the hedge. The documentation includes the identification of each hedging instrument and respective hedged item, the nature of the risk being hedged (including the benchmark interest rate being hedged in a hedge of interest rate risk) and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value attributable to the hedged risk is to be assessed. Accordingly, the ANTS 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 attributable to the hedged risk during the period that the hedge is designated. A hedge is normally regarded as highly effective if, at inception and throughout its life, the ANTS 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.

The main derivatives held for risk management purposes are interest rate and cross-currency swaps, which are used to hedge fixed-rate lending and structured savings products and medium-term note issuances, capital issuances and other capital markets funding. The ANTS 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 profit and loss within net trading and other income.

Gains and losses on components of a hedging derivative that are not part of the hedging relationship and are therefore excluded from the hedge effectiveness assessment are also included in net trading and other income.

**IMPAIRMENT OF FINANCIAL ASSETS**

At each balance sheet date the ANTS 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 loans and receivables, available-for-sale or loans and receivables securities have become impaired. Evidence of impairment varies across different portfolios and may include indications that the borrower or group of borrowers have defaulted, are experiencing significant financial difficulty, or the debt has been restructured potentially reducing the burden to the borrower. Impairment losses are recorded as charges in the income statement and the carrying amount of the financial asset or group of financial assets is reduced by establishing an impairment loss allowance. Impairment loss allowances are maintained at the level that management deems sufficient to absorb probable incurred losses in the ANTS group's loans. Losses expected from future events are not recognised.

Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. An impairment loss allowance for incurred 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 or interest will not be repaid or recovered through enforcement of any applicable security. An allowance for incurred inherent losses is established for loans for which no evidence of loss has been specifically identified on an individual basis because the loans are not yet past due (i.e. incurred but not observed ('IBNO')) but are known from past experience to have deteriorated since the initial decision to lend was made. An example of this situation is where a borrower has not yet missed a payment but is experiencing financial difficulties at the reporting date, e.g. due to loss of employment or divorce. In these circumstances, an inherent loss had been incurred at the reporting date.

Impairment loss allowances for loans and advances, less amounts released and recoveries of amounts written off are charged to the line item 'Impairment losses on loans and advances' in the income statement. The impairment loss allowances are deducted from the 'Loans and advances to banks', 'Loans and advances to customers' and 'Loans and receivables securities' line items on the balance sheet.



## Notes to the Financial Statements continued

### (i) Corporate assets

Corporate assets are assessed either individually or collectively for impairment. An impairment loss is incurred if there is objective evidence that a loss event has occurred since initial recognition of the assets that has an impact on the estimated future cash flows of the assets.

### Potential indicators of loss events

Potential indicators of loss events which may be evidence of financial difficulty for a corporate borrower may include the borrower notifying the ANTS group of current or likely financial distress; corporate results not meeting forecasts, missed repayments, requests for additional funding; breaches of covenants and changes in business plans.

### Individual assessment

Impairment reviews are conducted monthly for individually significant assets:

- > where an asset has a payment default which has been outstanding for 90 days or more;
- > where non-payment defaults have occurred and/or where it has become evident that a restructuring exercise will be undertaken; or
- > where it has become evident that the value of any security is no longer considered adequate.

In such situations the asset is transferred to the Corporate Banking Restructuring & Recoveries team. As part of their impairment reviews, an assessment is undertaken of the expected future cash flows (including a revaluation of collateral held) in relation to the relevant asset, appropriately discounted. The result is compared to the current net book value of the asset. Any shortfall evidenced as a result of such a review will be assessed against the opportunities to enhance future cash flows and the need for an observed impairment loss allowance established.

### Collective assessment

A collective impairment loss allowance is established for all loans that have experienced a loss event. For individually significant loans this is undertaken as detailed above. Loans which are not individually significant but are not performing are grouped together according to their credit risk characteristics and the allowance for observed losses is determined on a collective basis by applying an estimated loss given default. Loans for which evidence of potential loss has been specifically identified and that are on the Santander UK group's watchlist are grouped together according to their credit risk characteristics for the purpose of calculating an estimated allowance for observed losses. This is assessed on a collective basis using an estimate of the propensity for these loans to enter non performing loan status and the potential loss per case.

#### *Incurring but not observed impairment loss allowances*

Loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated allowance for incurred inherent losses. Such losses will only be individually identified in the future. As soon information becomes available which identifies incurred losses on individual loans within the group, those loans are removed from the group and assessed for observed losses.

The allowance for incurred losses is determined on a portfolio basis using the following factors:

- > historical loss experience in portfolios of similar credit risk characteristics (for example, similar sector or product);
- > the estimated period between an impairment event occurring and establishment of the loss event (known as the emergence period, as discussed below); and
- > management's judgement as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

#### *The emergence period*

This is the period in which losses that had been incurred but have not been separately identified become evident. The emergence period of 6 months is estimated having regard to historic experience and loan characteristics across the portfolio. The factors considered in determining the length of the emergence period include the frequency of the management information received or any change in account utilisation behaviour.

### Reversals of impairment

If in a subsequent period, the amount of an impairment loss reduces and the reduction can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the impairment loss allowance account accordingly. The write-back is recognised in the income statement.

### Write-off

For secured loans, a write-off is made when all collection procedures have been exhausted and the security has been sold. For unsecured loans, a write-off is made when all avenues for collecting the debt have been exhausted. There may be occasions where a write-off occurs for other reasons, for example, following a consensual restructure of the debt or where the debt is sold for strategic reasons into the secondary market at a value lower than the face value of the debt. Write-offs are charged against previously established impairment loss allowances. There are no thresholds based on past due status beyond which all secured or unsecured loans are written-off.

## Notes to the Financial Statements continued

**Recoveries**

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

**Impairment losses on restructured/renegotiated corporate assets (forbearance)**

To support corporate customers that encounter actual or apparent financial difficulties, the ANTS group may grant a concession, whether temporary or permanent, to accept less than contractual amounts where financial distress would otherwise prevent satisfactory repayment within the original terms and conditions of the contract. These arrangements are known as forbearance.

There are different risk characteristics associated with loans that are subject to forbearance as compared to loans that are not. A range of forbearance arrangements may be entered into by the ANTS group, reflecting the different risk characteristics of such loans. The ANTS group's forbearance programmes are described in the credit risk section in the Risk Management Report.

For corporate borrowers, the main types of forbearance offered are payment arrangements, refinancing (principally, either a term extension or an interest only concession) and in limited circumstances other forms of restructuring policies (principally a debt for equity swap), subject to customer negotiation and vetting.

If such accounts were classified in the "non-performing" loan category prior to the restructuring, they continue to be classified as non-performing until evidence of compliance with the new terms is demonstrated (typically over a period of at least three months) before being reclassified as "substandard". If the account was not categorised as non-performing at the time the revised arrangements were agreed, the case is considered to be a renegotiation and is reclassified to "substandard" upon completion of the restructuring agreement.

Once a substandard asset has demonstrated continued compliance with the new terms and the risk profile is deemed to have improved it may be reclassified as a "performing asset". When such accounts are reclassified as performing assets, they continue to be assessed for impairment collectively for inherent losses under the ANTS group's normal collective assessment methodology. Until then, impairment loss allowances for such restructured loans are assessed individually, taking into account the value of collateral held as confirmed by third party professional valuations and the available cashflow to service debt over the period of the restructuring. These impairment loss allowances are assessed and reviewed regularly. In the case of a debt for equity conversion, the converted debt is written off against the existing impairment loss allowance upon completion of the restructuring. The value of the equity acquired is reassessed periodically in light of subsequent performance of the restructured company.

Where an account is in forbearance, its additional risk characteristics are reflected by way of a management's best estimate as the only practical means of factoring recent conditions into impairment calculations until the ANTS group's models can be recalibrated. As more comprehensive data on the performance of loans in forbearance is gathered, the ANTS group's models will be recalibrated.

**(ii) Loans and receivables securities**

Loans and receivables securities are assessed individually for impairment. An impairment loss is incurred if there is objective evidence that a loss event has occurred since initial recognition of the assets that has an impact on the estimated future cash flows of the loans and receivables securities. Potential indicators of loss events include significant financial distress of the issuer and default or delinquency in interest and principal payments (breach of contractual terms).

Loans and receivables securities are monitored for potential impairment through a detailed expected cashflow analysis taking into account the structure and underlying assets of each individual security. Once specific events give rise to a reasonable expectation that future anticipated cash flows may not be received, the asset originating these doubtful cash flows will be deemed to be impaired.

**IMPAIRMENT OF NON-FINANCIAL ASSETS**

At each balance sheet date, or more frequently when events or changes in circumstances dictate, property plant and equipment (including operating lease assets) and intangible assets 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.

The fair value is calculated by reference to the amount at which the asset could be disposed of in a binding sale agreement in an arm's length transaction evidenced by an active market or recent transactions for similar assets, less costs to sell. Value in use is calculated by discounting the expected future cash flows obtainable as a result of the asset's continued use, including those resulting from its ultimate disposal, at a market based discount rate on a pre tax basis.

The carrying values of property, plant and equipment 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. A previously recognised impairment loss relating to property, plant and equipment may be reversed in part or in full when a change in circumstances leads to a change in the estimates used to determine the property, plant and equipments recoverable amount. The carrying amount of the property, plant and equipment will only be increased up to the amount that would have been had the original impairment not been recognised. For conducting impairment reviews, cash generating units are the lowest level at which management monitors the return on investment on assets.

## Notes to the Financial Statements continued

### LEASES

#### a) The ANTS 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.

#### b) The ANTS group as lessee

The ANTS 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 the tax expected to be payable or recoverable on income tax losses available to carry forward and on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Consolidated Financial Statements and is accounted for using the balance sheet liability method.

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 liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill. Deferred tax assets and liabilities are not recognised if the temporary difference arises from the initial recognition of other assets (other than in a business combination) and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on rates enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity or directly in equity. Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the ANTS group is able to control reversal of the temporary difference and it is probable that it will not reverse in the foreseeable future.

The ANTS group 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.

## Notes to the Financial Statements continued

**FINANCIAL LIABILITIES**

Financial liabilities are initially recognised when the ANTS group becomes contractually bound to the transfer of economic benefits in the future. Financial liabilities are derecognised when extinguished.

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

Financial liabilities are classified as fair value through profit or loss if they are either held for trading or otherwise designated at fair value through profit or loss on initial recognition. A financial liability is classified as held for trading if it is a derivative or is incurred principally for the purpose of repurchasing 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 transactions costs are taken directly to the income statement. Gains and losses arising from changes in fair value are included directly in the income statement.

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

**(b) Other financial liabilities**

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

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

**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. The principal products are capital guaranteed/protected products which 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. 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.

Until 2009, equity index-linked deposits were managed within the equity derivatives trading book as an integral part of the equity derivatives portfolio, and classified as deposits by customers within trading liabilities. For products sold until 2009, the embedded derivatives are not separated from the host instrument and are not separately accounted for as a derivative financial 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 those equity index-linked deposits.

Following a change in management's trading strategy in 2009, products sold subsequently are not accounted for as fair value through profit and loss nor classified as trading liabilities. These products are accounted for as deposits by customers at amortised cost. The embedded derivatives are separated from the host instrument and are separately accounted for as a derivative financial instrument. The embedded derivatives are economically hedged internally with the equity derivatives trading desk. These internal transactions are managed as part of the overall positions of the equity derivatives trading desk. This activity is managed and recorded on a fair value trading basis, with exposures managed on a value-at-risk basis, as described in "Traded market risk" in the Risk Management Report.

There is no difference between the products sold until 2009 which are accounted for fair value through profit and loss and classified as trading liabilities, and the subsequent products sold that are accounted for as deposits by customers and related embedded derivatives.

**BORROWINGS**

Borrowings (which include deposits by banks, deposits by customers and debt securities in issue) are recognised initially at fair value, being their issue 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.

## Notes to the Financial Statements continued

### 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.

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

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 loan commitments, other than those classified as held for trading, within impairment loss allowances if it is probable that the facility will be drawn and the resulting loan will be recognised at a value less than the cash advanced.

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

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the terms of a debt instrument. The ANTS 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 an impairment loss allowance as described in the accounting policies above.

### SHARE CAPITAL

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

### DIVIDENDS

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

**Notes to the Financial Statements** continued**CRITICAL ACCOUNTING POLICIES AND AREAS OF SIGNIFICANT MANAGEMENT JUDGEMENT**

The preparation of the ANTS 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 accounting estimates and judgements are considered important to the portrayal of the ANTS group's financial results and financial condition because: (i) they are highly susceptible to change from period to period as assumptions are made to calculate the estimates, and (ii) any significant difference between the ANTS group's estimated amounts and actual amounts could have a material impact on the ANTS group's future financial results and financial condition.

In calculating each estimate, a range of outcomes was calculated based principally on management's conclusions regarding the input assumptions relative to historic experience. The actual estimates were based on what management concluded to be the most probable assumptions within the range of reasonably possible assumptions:

**Valuation of financial instruments**

The ANTS group trades in a wide variety of financial instruments in the major financial markets. When estimating the value of its financial instruments, including derivatives where quoted market prices are not available, management 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, a larger or smaller change in the valuation of financial instruments including derivatives where quoted market prices are not available would have resulted that could have had a material impact on the ANTS group's reported profit before tax.

Detailed disclosures on financial instruments, including sensitivities, can be found in Note 43. Further information about sensitivities to market risk (including Value-at-Risk ('VaR')) arising from financial instrument trading activities can be found in the Risk Management Report on page 63.

## Notes to the Financial Statements continued

### 2. SEGMENTS

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

- > Corporate Banking;
- > Markets; and
- > Corporate Centre.

In the first half of 2012, certain non-core portfolios were transferred to Corporate Centre where this was felt to be more appropriate for the management of these assets and liabilities. The non-core portfolios transferred into Corporate Centre included the Social Housing assets previously managed within Corporate Banking. With respect to these, even though there are no credit concerns, the terms of these loans are unfavourable in the current funding environment and offer little prospect for renegotiation. The ANTS group's intention is to hold these assets to maturity and as such the balances will gradually decrease over time. In addition, the management of hedging and other variances has been transferred to Corporate Centre. The prior period's segmental analysis has been adjusted to reflect the fact that reportable segments have changed.

The ANTS 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 ANTS group has three segments:

- > **Corporate Banking** offers a wide range of products and financial services to UK companies. Corporate Banking products and services include loans, bank accounts, deposits, and treasury services.  
The Large Corporates business offers specialist treasury services in fixed income and foreign exchange, lending, transactional banking services, capital markets and money markets to large multinational corporate customers. Lending includes syndicated loans and structured finance. Transactional banking includes trade finance and cash management. Money market activities include securities lending/borrowing and repos.
- > **Markets** offers risk management and other services to financial institutions, as well as other Santander UK divisions. Its main product areas are fixed income and foreign exchange, equity, capital markets and institutional sales.
- > **Corporate Centre** consists of Financial Management & Investor Relations ('FMIR', formerly known as Asset and Liability Management) and the non-core portfolios of social housing loans and structured credit assets. FMIR is responsible for managing capital and funding, balance sheet composition, structural market risk and strategic liquidity risk for the rest of the Santander UK group. The non-core portfolios are being run-down and/or managed for value.

The Company's board of directors (the 'Board') is the chief operating decision maker for the ANTS group. The segment information below is presented on the basis used by the Board to evaluate performance and allocate resources. The Board reviews discrete financial information for each segment of the business, including measures of operating results, assets and liabilities. The segment information reviewed by the Board is prepared on a statutory basis of accounting rather than on an adjusted internal management basis as in prior periods.

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 operating income. Interest charged for these funds is based on the ANTS group's cost of wholesale funding.

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

## Notes to the Financial Statements continued

## a) Segmental information

	Corporate Banking £m	Markets £m	Corporate Centre £m	Total £m
<b>2012</b>				
Net interest income/(expense)	93	(6)	52	139
Non-interest income/(expense)	271	184	(32)	423
<b>Total operating income</b>	<b>364</b>	<b>178</b>	<b>20</b>	<b>562</b>
Administration expenses	(84)	(98)	(16)	(198)
Depreciation and amortisation	(1)	(2)	-	(3)
<b>Total operating expenses excluding provisions and charges</b>	<b>(85)</b>	<b>(100)</b>	<b>(16)</b>	<b>(201)</b>
Impairment losses on loans and advances	(9)	-	-	(9)
Provisions for other liabilities and charges	(2)	(2)	(16)	(20)
<b>Total operating provisions and charges</b>	<b>(11)</b>	<b>(2)</b>	<b>(16)</b>	<b>(29)</b>
<b>Profit before tax</b>	<b>268</b>	<b>76</b>	<b>(12)</b>	<b>332</b>
Average number of staff <sup>(1)</sup>	305	275	122	702
<b>Total assets</b>	<b>22,509</b>	<b>28,173</b>	<b>167,230</b>	<b>217,912</b>
	Corporate Banking £m	Markets £m	Corporate Centre £m	Total £m
<b>2011</b>				
Net interest income/(expense)	75	(3)	439	511
Non-interest income/(expense)	275	162	(370)	67
<b>Total operating income</b>	<b>350</b>	<b>159</b>	<b>69</b>	<b>578</b>
Administration expenses	(95)	(109)	(25)	(229)
Depreciation and amortisation	(3)	(2)	(2)	(7)
<b>Total operating expenses excluding provisions and charges</b>	<b>(98)</b>	<b>(111)</b>	<b>(27)</b>	<b>(236)</b>
Impairment losses on loans and advances	(54)	-	-	(54)
Provisions for other liabilities and charges	(3)	(3)	(14)	(20)
<b>Total operating provisions and charges</b>	<b>(57)</b>	<b>(3)</b>	<b>(14)</b>	<b>(74)</b>
<b>Profit before tax</b>	<b>195</b>	<b>45</b>	<b>28</b>	<b>268</b>
Average number of staff <sup>(1)</sup>	399	263	99	761
<b>Total assets</b>	<b>25,768</b>	<b>28,652</b>	<b>165,672</b>	<b>220,092</b>
	Corporate Banking £m	Markets £m	Corporate Centre £m	Total £m
<b>2010</b>				
Net interest income	68	-	335	403
Non-interest income	220	221	49	490
<b>Total operating income</b>	<b>288</b>	<b>221</b>	<b>384</b>	<b>893</b>
Administration expenses	(89)	(74)	(46)	(209)
Depreciation and amortisation	(1)	(2)	(3)	(6)
<b>Total operating expenses excluding provisions and charges</b>	<b>(90)</b>	<b>(76)</b>	<b>(49)</b>	<b>(215)</b>
Impairment losses on loans and advances	(69)	-	-	(69)
<b>Total operating provisions and charges</b>	<b>(69)</b>	<b>-</b>	<b>-</b>	<b>(69)</b>
<b>Profit before tax</b>	<b>129</b>	<b>145</b>	<b>335</b>	<b>609</b>
Average number of staff <sup>(1)</sup>	343	187	91	621
<b>Total assets</b>	<b>28,678</b>	<b>22,070</b>	<b>202,512</b>	<b>253,260</b>

(1) Full-time equivalents

## b) By geographical region

	Group		
	2012 £m	2011 £m	2010 £m
<b>Total operating income/(expenses)</b>			
United Kingdom	566	570	900
Other	(4)	8	(7)
	<b>562</b>	<b>578</b>	<b>893</b>
<b>Total assets other than financial instruments and current and deferred tax assets</b>			
United Kingdom	13	8	48
Other	-	-	-
	<b>13</b>	<b>8</b>	<b>48</b>



## Notes to the Financial Statements continued

## Revenue by products and services

Details of revenue by product and service are disclosed in Notes 3 to 5.

## 3. NET INTEREST INCOME

	2012	2011	Group 2010
	£m	£m	£m
<b>Interest and similar income:</b>			
On loans and advances to Santander UK group undertakings	3,415	3,326	2,796
On loans and advances to Banco Santander, S.A.	4	12	15
On loans and advances to other Banco Santander group undertakings	1	2	24
Other interest earning financial assets	450	327	210
<b>Total interest and similar income</b>	<b>3,870</b>	<b>3,667</b>	<b>3,045</b>
<b>Interest expense and similar charges:</b>			
On deposits by Santander UK group undertakings	(2,326)	(2,474)	(2,254)
On deposits by Banco Santander, S.A.	(30)	(15)	(2)
On deposits by other Banco Santander group undertakings	(4)	(7)	(7)
Other interest bearing financial liabilities	(1,371)	(660)	(379)
<b>Total interest expense and similar charges</b>	<b>(3,731)</b>	<b>(3,156)</b>	<b>(2,642)</b>
<b>Net interest income</b>	<b>139</b>	<b>511</b>	<b>403</b>

## 4. NET FEE AND COMMISSION INCOME

	2012	2011	Group 2010
	£m	£m	£m
<b>Fee and commission income:</b>			
Corporate Products	119	115	28
<b>Fee and commission expense:</b>			
Other fees paid	-	(2)	-
<b>Net fee and commission income</b>	<b>119</b>	<b>113</b>	<b>28</b>

## 5. NET TRADING AND OTHER INCOME

	2012	2011 <sup>(1)</sup>	Group 2010
	£m	£m	£m
Net trading and funding of other items by the trading book	344	254	378
Income on assets designated at fair value through profit or loss	545	223	246
Expense on liabilities designated at fair value through profit or loss	(180)	(105)	(111)
Losses on derivatives managed with assets/liabilities held at fair value through profit or loss	(439)	(458)	(150)
Profit on sale of available for sale assets	7	-	-
Hedge ineffectiveness and other	27	40	99
	<b>304</b>	<b>(46)</b>	<b>462</b>

(1) As restated, see Note 45

"Net trading and funding of other items by the trading book" includes fair value gains/(losses) of £(149)m (2011: £(125)m, 2010: £(250)m) on embedded derivatives bifurcated from certain equity index-linked deposits, as described in the Accounting Policies. The embedded derivatives are economically hedged internally with the equity derivatives trading desk. These internal transactions are managed as part of the overall positions of the equity derivatives trading desk, the results of which are also included in this line item, and amounted to £150m (2011: £127m, 2010: £263m). As a result, the net fair value movements recognised on the equity index-linked deposits and the related economic hedges were £1m (2011: £2m, 2010: £13m).

## Notes to the Financial Statements continued

## 6. ADMINISTRATION EXPENSES

	2012	2011	Group 2010
	£m	£m	£m
<b>Staff costs:</b>			
Wages and salaries	111	119	91
Social security costs	15	14	11
<b>Pensions costs:</b>			
- defined contribution plans	6	5	41
Other personnel costs	7	9	4
	<b>139</b>	147	147
Property and equipment expenses	7	5	5
Information technology expenses	44	43	37
Other administrative expenses	8	34	20
	<b>198</b>	229	209

## 7. DEPRECIATION AND AMORTISATION

	2012	2011	Group 2010
	£m	£m	£m
Depreciation of property, plant and equipment	3	3	3
Amortisation of intangible assets	-	4	3
	<b>3</b>	7	6

## 8. IMPAIRMENT LOSSES AND PROVISIONS

	2012	2011	Group 2010
	£m	£m	£m
Impairment losses on loans and advances:			
- loans and advances to customers (Note 18)	9	54	80
Recoveries of loans and advances	-	-	(11)
	<b>9</b>	54	69
Provisions for other liabilities and charges			
- New and increased allowances (Note 34)	20	20	-
Total impairment losses and provisions charged to the income statement	<b>29</b>	74	69

## 9. AUDIT AND OTHER SERVICES

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

	2012	2011	Group 2010
	£m	£m	£m
Fees payable to the Company's auditor for the audit of the ANTS group's annual accounts	0.6	0.7	0.4
Fees payable to the Company's auditor and its associates for the audit of the Company's subsidiaries pursuant to legislation	0.1	0.1	0.2
Total audit fees	<b>0.7</b>	0.8	0.6
Other assurance fees – Debt issuance	0.7	0.6	0.4
Total fees	<b>1.4</b>	1.4	1.0

**Notes to the Financial Statements** continued

Other assurance relates to services performed in connection with debt issuances work which accords with the definition 'Audit related fees' per SEC guidance. No information technology, internal audit, valuation and actuarial, litigation, recruitment and remuneration or corporate finance services were provided by the external auditor during these years. A framework for ensuring auditor's independence has been adopted which defines unacceptable non-audit assignments, pre-approval of acceptable non-audit assignments and procedures for approval of acceptable non-audit assignments by the Santander UK Board Audit Committee. Services provided by the ANTS group's external auditor are subject to approval by the Santander UK Board Audit Committee.

**10. DIRECTORS' REMUNERATION AND INTERESTS**

The aggregate remuneration received by the Directors of the ANTS group was:

	2012	2011	Group 2010
	£	£	£
Salaries and fees	<b>640,914</b>	638,567	509,931
Performance-related payments	<b>858,387</b>	865,293	832,374
Total remuneration excluding pension contributions	<b>1,499,301</b>	1,503,860	1,342,305
Pension contributions	<b>79,889</b>	75,298	44,523
	<b>1,579,190</b>	1,579,158	1,386,828

The aggregate emoluments above exclude emoluments received by Directors in respect of their primary duties as Directors or officers of Banco Santander, S.A. and Santander UK plc. Salaries and performance-related payments comprise payments to three (2011: three, 2010: three) Directors serving during the year.

The Company ensures that it is compliant with the mandatory deferral requirements of the FSA's Remuneration Code for staff who meet the relevant criteria ("Code Staff") and the amount of bonus to be deferred is based on the total variable pay received. The FSA Remuneration Code prescribes that at least 40% of variable pay must be made over a period of at least three years and, for staff earning more than £500,000 in variable remuneration, at least 60% of a bonus must be deferred over the same period.

All UK bonus awards in 2012 are subject to deferral principles that have been set at Banco Santander, S.A. group level. Such principles, as applied to the Company, are subject to ratification by the Santander UK Board Remuneration Oversight Committee and can be overridden by UK national requirements to meet any criteria set by the FSA or other regulator/law. However, the general deferral principles are as follows:

- > a proportion of an individual's bonus (on a sliding scale) will become subject to deferral if the bonus exceeds certain levels depending on the nature of the role;
- > any deferred amount will be issued in shares over a three year period (in three equal deferral tranches); and
- > deferrals are subject to continued employment with the Banco Santander, S.A. group in the UK and on the condition that none of the prescribed circumstances of forfeiture occur.

**Remuneration of highest paid Director**

The remuneration, excluding pension contributions, of the highest paid Director was £1,045,170 (2011: £1,023,956, 2010: £990,993) of which £625,000 (2011: £625,000, 2010: £650,001) was performance-related. In 2012, 2011 and 2010, no amounts were paid with respect to a defined contribution scheme on behalf of the highest paid director.

At 31 December 2012, 2011 and 2010, there was no accrued pension benefit for the highest paid Director and there was no lump sum accrued by the highest paid director. One Director will be receiving benefits under a defined benefit scheme (2011: two, 2010: two) and no Director (2011: nil, 2010: nil) will be receiving benefits under a defined contribution scheme.

**Long-Term Incentive Plan**

In 2012 and 2011, no Directors were granted conditional awards of shares in Banco Santander, S.A. under the Santander Long-Term Incentive Plan ("LTIP") (2010: three directors). Under the Santander LTIPs granted in previous years, certain Executive Directors, Key Management Personnel (as defined in Note 41) and other nominated individuals were granted conditional awards of shares in Banco Santander, S.A.. Further details can be found in Note 41.

## Notes to the Financial Statements continued

## 11. TAXATION CHARGE

	2012 £m	2011 <sup>(1)</sup> £m	Group 2010 £m
<b>Current tax:</b>			
UK corporation tax on profit for the year	42	63	175
Adjustments in respect of prior years	30	32	(21)
<b>Total current tax</b>	<b>72</b>	95	154
<b>Deferred tax</b> (Note 26)			
Origination and reversal of temporary differences	4	9	(7)
Change in rate of UK corporation tax	1	1	1
Adjustments in respect of prior years	(9)	(1)	1
<b>Total deferred tax</b>	<b>(4)</b>	9	(5)
<b>Tax on profit for the year</b>	<b>68</b>	104	149

(1) As restated, see Note 45

UK corporation tax is calculated at 24.5% (2011: 26.5%, 2010: 28%) of the estimated assessable profits for the year. The standard rate of UK corporation tax was reduced from 26% to 24% with effect from 1 April 2012. Taxation for other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

The Finance Act 2012, which provides for a reduction in the main rate of UK corporation tax to 23% effective from 1 April 2013 was enacted on 17 July 2012. As this change in rate was substantively enacted prior to 31 December 2012, it has been reflected in the deferred tax balance at 31 December 2012. The UK Government has also indicated that it intends to enact a further reduction in the main tax rate down to 21% by 1 April 2014. These changes in the rate had not been substantively enacted at the balance sheet date and, therefore, are not included in these financial statements. The estimated financial effect of these changes is insignificant.

The effective tax rate for 2012 based on profit before tax was 20.5% (2011: 38.9%, 2010: 24.1%). The tax on the ANTS group's profit before tax differs from the theoretical amount that would arise using the basic corporation tax rate of the Company as follows:

	2012 £m	2011 <sup>(1)</sup> £m	Group 2010 £m
<b>Profit before tax</b>	<b>332</b>	268	609
Tax calculated at a tax rate of 24.5% (2011: 26.5%, 2010: 28%)	81	71	171
Non-taxable dividend income	(3)	(3)	(4)
Non-deductible UK Bank Levy	5	5	-
Other non-equalised items (including index-linked gilts)	(29)	(1)	(1)
Utilisation of capital losses for which credit not previously recognised	(8)	-	-
Effect of change in tax rate on deferred tax provision	1	1	1
Adjustment in respect of prior periods	21	31	(18)
<b>Tax expense</b>	<b>68</b>	104	149

(1) As restated, see Note 45

In addition to the corporation tax expense charged to profit or loss, tax of £1m (2011: £nil, 2010: £nil) has been charged in other comprehensive income in the year, as follows:

	Before tax amount £m	Total tax £m	Group After tax amount £m
Movements in available-for-sale securities:			
- Gains due to changes in fair value	5	(1)	4
Other comprehensive income	5	(1)	4

Further information about deferred tax is presented in Note 26.

## 12. PROFIT ON ORDINARY ACTIVITIES AFTER TAX

The profit after tax of the Company attributable to the shareholders was £226m (2011: £222m, 2010: £670m). As permitted by Section 408 of the UK Companies Act 2006, the Company's individual income statement has not been presented.

## Notes to the Financial Statements continued

## 13. CASH AND BALANCES AT CENTRAL BANKS

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Balances with central banks	388	7,013	388	7,013

For regulatory purposes, certain minimum cash balances are required to be maintained with the Bank of England. At 31 December 2012, these amounted to £23m (2011: £18m) for the ANTS group and £23m (2011: £18m) for the Company. Balances with central banks above represent amounts held with the US Federal Reserve and the Bank of England as part of the Santander UK group's liquidity management activities. This is described further in the Risk Management Report.

## 14. TRADING ASSETS

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Loans and advances to banks – securities purchased under resale agreements	7,245	3,056	7,245	3,056
Loans and advances to banks - other <sup>(1)</sup>	2,743	3,088	2,743	3,088
Loans and advances to customers – securities purchased under resale agreements	7,463	6,338	7,463	6,338
Loans and advances to customers – other <sup>(2)</sup>	89	349	88	348
Debt securities	4,494	8,711	4,494	8,711
Equity securities	464	349	122	23
	<b>22,498</b>	<b>21,891</b>	<b>22,155</b>	<b>21,564</b>

(1) Comprises short-term loans of £2m (2011: £84m) and cash collateral of £2,741m (2011: £3,004m).

(2) Comprises short-term loans

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

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Issued by public bodies:				
- Government securities	3,917	2,943	3,917	2,943
Issued by other issuers:				
- Bank and building society certificates of deposit: Other	13	-	13	-
- Fixed and floating rate notes <sup>(1)</sup> : Government guaranteed	426	5,754	426	5,754
- Fixed and floating rate notes <sup>(1)</sup> : Other	138	14	138	14
	<b>4,494</b>	<b>8,711</b>	<b>4,494</b>	<b>8,711</b>

(1) The FRNs are 75% AAA rated, 18% A and above rated, and 7% BBB and below rated (2011: all AAA rated).

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

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Debt securities:				
- Listed in the UK	2,145	5,904	2,145	5,904
- Listed elsewhere	687	1,165	687	1,165
- Unlisted	1,662	1,642	1,662	1,642
	<b>4,494</b>	<b>8,711</b>	<b>4,494</b>	<b>8,711</b>
Equity securities:				
- Listed in the UK	372	335	34	11
- Listed elsewhere	92	14	88	12
	<b>464</b>	<b>349</b>	<b>122</b>	<b>23</b>

Included in the above balances are amounts owed to the ANTS group by Banco Santander, S.A. and by fellow subsidiaries of Banco Santander, S.A. outside the ANTS group of £206m (2011: £270m) and £nil (2011: £14m) respectively.

## Notes to the Financial Statements continued

## 15. DERIVATIVE FINANCIAL INSTRUMENTS

Derivatives are financial instruments whose value is derived from the price of one or more underlying items such as equities, equity indices, interest rates, foreign exchange rates, property indices, commodities and credit spreads. Derivatives enable users to manage exposure to credit or market risks. The ANTS group sells derivatives to its customers and uses derivatives to manage its own exposure to credit and market risks.

### Use of derivatives

The ANTS group transacts derivatives for four primary purposes:

- > to create risk management solutions for customers,
- > to manage the portfolio risks arising from customer business,
- > to manage and hedge the ANTS group's own risks, and
- > to generate profits through sales activities.

Under IAS 39, all derivatives are classified as "held for trading" (except for derivatives which are designated as effective hedging instruments in accordance with the detailed requirements of IAS 39) even if this is not the purpose of the transaction. The held for trading classification therefore includes two types of derivatives:

- > those used in sales activities, and
- > those used for risk management purposes but, for various reasons, either the ANTS group does not elect to claim hedge accounting for or they do not meet the qualifying criteria for hedge accounting. These consist of:
  - > non-qualifying hedging derivatives (known as "economic hedges"), whose terms match other on-balance sheet instruments but do not meet the technical criteria for hedge accounting, or which use natural offsets within other on-balance sheet instruments containing the same risk features as part of an integrated approach to risk management, and hence do not require the application of hedge accounting to achieve a reduction in income statement volatility,
  - > derivatives managed in conjunction with financial instruments designated at fair value (known as the "fair value option"). The fair value option is described more fully in the Accounting Policy "Financial assets" and Notes 16 and 31. The ANTS group's business model is primarily structured to maximise use of the fair value option, rather than electing to apply hedge accounting, in order to reduce the administrative burden on the ANTS group associated with complying with the detailed hedge accounting requirements of IAS 39,
  - > derivatives that do not meet the qualifying criteria for hedge accounting, including ineffective hedging derivatives and any components of hedging derivatives that are excluded from assessing hedge effectiveness, and
  - > derivative contracts that represent the closing-out of existing positions through the use of matching deals.

The following table summarises the activities undertaken, the related risks associated with such activities and the types of hedging derivatives used in managing such risks. These risks may also be managed using on-balance sheet instruments as part of an integrated approach to risk management.

Activity	Risk	Type of derivative
Management of the return on variable rate assets financed by shareholders' funds and net non-interest-bearing liabilities.	Reduced profitability due to falls in interest rates.	Receive fixed interest rate swaps.
Management of the basis between administered rate assets and liabilities and wholesale market rates.	Reduced profitability due to adverse changes in the basis spread.	Basis swaps.
Management of repricing profile of wholesale funding.	Reduced profitability due to adverse movement in wholesale interest rates when large volumes of wholesale funding are repriced.	Forward rate agreements.
Fixed rate lending and investments.	Sensitivity to increases in interest rates.	Pay fixed interest rate swaps.
Fixed rate retail and wholesale funding.	Sensitivity to falls in interest rates.	Receive fixed interest rate swaps.
Equity-linked retail funding.	Sensitivity to increases in equity market indices.	Receive equity swaps.
Management of other net interest income on retail activities.	Sensitivity of income to changes in interest rates.	Interest rate swaps.
Issuance of products with embedded equity options.	Sensitivity to changes in underlying index and index volatility causing option exercise.	Interest rate swaps combined with equity options.
Lending and investments.	Sensitivity to weakening credit quality.	Purchase credit default swaps and total return swaps.
Borrowing funds in foreign currencies.	Sensitivity to changes in foreign exchange rates.	Cross currency swaps.
Lending and issuance of products with embedded interest rate options.	Sensitivity to changes in underlying rate and rate volatility causing option exercise.	Interest rate swaps plus caps/floors.
Investment in, and issuance of, bonds with put/call features.	Sensitivity to changes in rates causing option exercise.	Interest rate swaps combined with swaptions <sup>(1)</sup> and other matched options.

(1) A swaption is an option on a swap that gives the holder the right but not the obligation to buy or sell a swap.

## Notes to the Financial Statements continued

The ANTS group's derivative activities do not give rise to significant open positions in portfolios of derivatives. Any residual position is managed to ensure that it remains within acceptable risk levels, with matching deals being utilised to achieve this where necessary. When entering into derivative transactions, the ANTS group employs the same credit risk management procedures to assess and approve potential credit exposures that are used for traditional lending.

The hedging classification consists of derivatives that the ANTS group has chosen to designate as in a hedging relationship because they meet the specific criteria in IAS 39.

All derivatives are required to be held at fair value through profit or loss, and shown in the balance sheet as separate totals of assets and liabilities. A description of how the fair values of derivatives are derived is set out in Note 43. This is described in more detail in the accounting policies "Derivative financial instruments" and "Hedge accounting" on pages 126 and 127. Derivative assets and liabilities on different transactions are only set off if the transactions are with the same counterparty, a legal right of set-off or netting exists and the cash flows are intended to be settled on a net basis.

### Trading derivatives

Most of the ANTS group's derivative transactions relate to sales activities and derivative contracts that represent the closing-out of existing positions through the use of matching deals. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Limited positions may be traded actively or be held over a period of time to benefit from expected changes in exchange rates, interest rates, equity prices or other market parameters. Trading includes market-making, positioning and arbitrage activities. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume; positioning means managing market risk positions in the expectation of benefiting from favourable movements in prices, rates or indices; arbitrage involves identifying and profiting from price differentials between markets and products.

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 options and equity index options.

Corporate Banking deals with commercial customers who wish to enter into derivative contracts. Any market risk arising from such transactions is hedged by Markets. Markets is responsible for implementing ANTS group derivative hedging with the external market together with its own trading activities. 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 ANTS group's balance sheet.

As mentioned above, other derivatives classified as held for trading include non-qualifying hedging derivatives (economic hedges), ineffective hedging derivatives and any components of hedging derivatives that are excluded from assessing hedge effectiveness, derivatives managed in conjunction with financial instruments designated at fair value and derivative contracts that represent the closing-out of existing positions through the use of matching deals.

### Hedging derivatives

The ANTS group uses derivatives (principally interest rate swaps and cross-currency swaps) for hedging purposes in the management of its own asset and liability portfolios, including fixed-rate lending, fixed-rate asset purchases, medium-term note issues, capital issues, and structural positions. This enables the ANTS group to optimise the overall cost to it of accessing debt capital markets, and to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

The accounting for these derivatives is described in the accounting policy "Hedge accounting" on page 127. Such risks may also be managed using natural offsets within other on-balance sheet instruments as part of an integrated approach to risk management.

Derivative products which are combinations of more basic derivatives (such as swaps with embedded option features), or which have leverage features, may be used in circumstances where the underlying position being hedged contains the same risk features. In such cases, the derivative used will be structured to match the risks of the underlying asset or liability. Exposure to market risk on such contracts is therefore hedged.

The fair values of derivative instruments classified as held for trading and hedging purposes are set out in the following tables. The tables show the contract or underlying principal amounts, and positive and negative fair values of derivatives analysed by contract. The contract/notional amounts of derivatives indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent actual exposures. 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.

As described above, derivatives classified as held for trading in the table below consist of those used in sales and trading activities, and those used for risk management purposes but which, for various reasons, either for which the ANTS group does not elect to claim hedge accounting or which do not meet the qualifying criteria for hedge accounting. Derivatives classified as held for hedging in the table below consist of those that have been designated as in a hedging relationship in accordance with IAS 39.

## Notes to the Financial Statements continued

	Group		
	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
<b>2012 Derivatives held for trading</b>			
Exchange rate contracts:			
- Cross-currency swaps	120,339	2,768	3,613
- Forward exchange swaps, options and forwards	19,093	928	620
	<b>139,432</b>	<b>3,696</b>	<b>4,233</b>
Interest rate contracts:			
- Interest rate swaps	572,558	24,044	22,559
- Caps, floors and swaptions <sup>(1)</sup>	61,904	3,582	3,612
- Futures	19,273	54	31
- Forward rate agreements	123,132	9	13
	<b>776,867</b>	<b>27,689</b>	<b>26,215</b>
Equity and credit contracts:			
- Equity index swaps and similar products	44,083	1,292	1,945
- Equity index options	29,652	152	86
- Credit default swaps and similar products	381	37	7
	<b>74,116</b>	<b>1,481</b>	<b>2,038</b>
Commodity contracts:			
- swaps	227	7	7
	<b>227</b>	<b>7</b>	<b>7</b>
<b>Total derivative assets and liabilities held for trading</b>	<b>990,642</b>	<b>32,873</b>	<b>32,493</b>

	Group		
	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
<b>2012 Derivatives held for fair value hedging</b>			
Exchange rate contracts:			
- Cross-currency swaps	4,270	-	319
Interest rate contracts:			
- Interest rate swaps	67,111	403	1,276
<b>Total derivative assets and liabilities held for fair value hedging</b>	<b>71,381</b>	<b>403</b>	<b>1,595</b>
<b>Total recognised derivative assets and liabilities</b>	<b>1,062,023</b>	<b>33,276</b>	<b>34,088</b>

	Group		
	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
<b>2011 Derivatives held for trading</b>			
Exchange rate contracts:			
- Cross-currency swaps	104,519	1,507	2,839
- Forward exchange swaps, options and forwards	19,497	149	248
	<b>124,016</b>	<b>1,656</b>	<b>3,087</b>
Interest rate contracts:			
- Interest rate swaps	566,365	25,949	24,700
- Caps, floors and swaptions <sup>(1)</sup>	63,100	3,484	3,522
- Futures	32,503	54	41
- Forward rate agreements	78,090	21	31
	<b>740,058</b>	<b>29,508</b>	<b>28,294</b>
Equity and credit contracts:			
- Equity index swaps and similar products	32,330	1,491	2,755
- Equity index options	43,708	152	12
- Credit default swaps and similar products	550	45	21
	<b>76,588</b>	<b>1,688</b>	<b>2,788</b>
Commodity contracts:			
- swaps	542	12	11
	<b>542</b>	<b>12</b>	<b>11</b>
<b>Total derivative assets and liabilities held for trading</b>	<b>941,204</b>	<b>32,864</b>	<b>34,180</b>

	Group		
	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
<b>2011 Derivatives held for fair value hedging</b>			
Exchange rate contracts:			
- Cross-currency swaps	437	32	-
Interest rate contracts:			
- Interest rate swaps	35,848	328	1,237
<b>Total derivative assets and liabilities held for fair value hedging</b>	<b>36,285</b>	<b>360</b>	<b>1,237</b>
<b>Total recognised derivative assets and liabilities</b>	<b>977,489</b>	<b>33,224</b>	<b>35,417</b>

(1) A swaption is an option on a swap that gives the holder the right but not the obligation to buy or sell a swap.



## Notes to the Financial Statements continued

	Company		
	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
<b>2012 Derivatives held for trading</b>			
Exchange rate contracts:			
- Cross-currency swaps	120,339	2,769	3,613
- Forward exchange swaps, options and forwards	19,093	927	620
	<b>139,432</b>	<b>3,696</b>	<b>4,233</b>
Interest rate contracts:			
- Interest rate swaps	572,558	24,059	22,559
- Caps, floors and swaptions <sup>(1)</sup>	61,904	3,582	3,612
- Futures	19,273	54	31
- Forward rate agreements	123,132	9	13
	<b>776,867</b>	<b>27,704</b>	<b>26,215</b>
Equity and credit contracts:			
- Equity index swaps and similar products	44,383	1,313	1,945
- Equity index options	29,652	152	86
- Credit default swaps and similar products	381	37	7
	<b>74,416</b>	<b>1,502</b>	<b>2,038</b>
Commodity contracts:			
- swaps	227	7	7
	<b>227</b>	<b>7</b>	<b>7</b>
<b>Total derivative assets and liabilities held for trading</b>	<b>990,942</b>	<b>32,909</b>	<b>32,493</b>

	Company		
	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
<b>2012 Derivatives held for fair value hedging</b>			
Exchange rate contracts:			
- Cross-currency swaps	4,270	-	320
Interest rate contracts:			
- Interest rate swaps	67,111	403	1,275
<b>Total derivative assets and liabilities held for fair value hedging</b>	<b>71,381</b>	<b>403</b>	<b>1,595</b>
<b>Total recognised derivative assets and liabilities</b>	<b>1,062,323</b>	<b>33,312</b>	<b>34,088</b>

	Company		
	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
<b>2011 Derivatives held for trading</b>			
Exchange rate contracts:			
- Cross-currency swaps	104,519	1,506	2,839
- Forward exchange swaps, options and forwards	19,497	149	248
	<b>124,016</b>	<b>1,655</b>	<b>3,087</b>
Interest rate contracts:			
- Interest rate swaps	566,365	25,951	24,700
- Caps, floors and swaptions <sup>(1)</sup>	63,100	3,484	3,522
- Futures	32,503	54	41
- Forward rate agreements	78,090	21	31
	<b>740,058</b>	<b>29,510</b>	<b>28,294</b>
Equity and credit contracts:			
- Equity index swaps and similar products	32,629	1,504	2,755
- Equity index options	43,708	156	12
- Credit default swaps and similar products	612	45	21
	<b>76,949</b>	<b>1,705</b>	<b>2,788</b>
Commodity contracts:			
- swaps	542	12	11
	<b>542</b>	<b>12</b>	<b>11</b>
<b>Total derivative assets and liabilities held for trading</b>	<b>941,565</b>	<b>32,882</b>	<b>34,180</b>

	Company		
	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
<b>2011 Derivatives held for fair value hedging</b>			
Exchange rate contracts:			
- Cross-currency swaps	437	32	-
Interest rate contracts:			
- Interest rate swaps	35,848	328	1,237
<b>Total derivative assets and liabilities held for fair value hedging</b>	<b>36,285</b>	<b>360</b>	<b>1,237</b>
<b>Total recognised derivative assets and liabilities</b>	<b>977,850</b>	<b>33,242</b>	<b>35,417</b>

(1) A swaption is an option on a swap that gives the holder the right but not the obligation to buy or sell a swap.

## Notes to the Financial Statements continued

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

	Group		
	2012 £m	2011 £m	2010 £m
Net gains/(losses):			
- on hedging instruments	(100)	(36)	(169)
- on hedged items attributable to hedged risks	169	31	171
	69	(5)	2

The ANTS group hedges its exposures to various risks, including interest rate risk and foreign currency risk, in connection with 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.

In addition, in the ordinary course of business, the ANTS group entered into long-term interest rate contracts as economic hedges with five investment vehicles whose underlying assets comprise debt securities, bank loans and energy and infrastructure financings. Although the vehicles themselves are not externally rated, the counterparty exposure ranks super-senior to the most senior notes issued by the vehicles and these notes are rated AAA or AA. The total mark-to-market exposure at 31 December 2012 was £50m (2011: £67m).

Included in the above balances are amounts owed to the ANTS group by Banco Santander, S.A. and by fellow subsidiaries of Banco Santander, S.A. outside the ANTS group of £2,025m (2011: £2,640m), £1,899m (2011: £904m) and £2,983m (2011: £3,598m) respectively and amounts owed by the ANTS group to Banco Santander, S.A. and to fellow subsidiaries of Banco Santander, S.A. outside the ANTS group of £1,914m (2011: £2,144m), £4,094m (2011: £5,277m) and £1,473m (2011: £1,125m). The net exposures after collateral to the Banco Santander, S.A. and fellow subsidiaries of Banco Santander, S.A. outside the ANTS group at 31 December 2012 amounted to £137m (2011: £146m) and £3,697m (2011: £2,422m) respectively.

## 16. FINANCIAL ASSETS DESIGNATED AT FAIR VALUE

	Group		Company	
	2012 £m	2011 <sup>(1)</sup> £m	2012 £m	2011 <sup>(1)</sup> £m
Loans and advances to customers	3,203	4,050	3,203	4,050
Debt securities	328	379	328	379
	3,531	4,429	3,531	4,429

(1) As restated, see Note 45

Financial assets are designated at fair value through profit or loss where this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis, or where the assets are managed and their performance evaluated on a fair value 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 of £3,142m (2011: £3,992m) and other loans of £61m (2011: £58m).
  - > Loans secured on residential property to housing associations of £3,142m (2011: £3,992m) which, at the date of their origination, were managed, and their performance evaluated, on a fair value basis in accordance with a documented investment strategy, and information about them was provided on that basis to management. Since 2009, the ANTS group's policy has been not to designate similar new loans at fair value through profit or loss.
  - > Other loans of £61m (2011: £58m), representing a portfolio of roll-up mortgages, are managed, and their performance evaluated, on a fair value basis in accordance with a documented investment strategy, and information about them is provided on that basis to management.
- > **Debt securities**, representing holdings of asset-backed securities of £328m (2011: £379m):
  - > Mortgage-backed securities of £250m (2011: £279m) and other asset backed debt securities of £31m (2011: £49m) are managed and their performance evaluated on a fair value basis in accordance with a documented strategy, and information about them is provided on that basis to management.
  - > Other asset-backed securities of £47m (2011: £51m) which, at the date of their acquisition, were managed, and their performance evaluated, on a fair value basis in accordance with a documented investment strategy, and information about them was provided on that basis to management. Almost all of these securities are now managed on an accrual basis, but are not eligible for reclassification under IAS 39. These securities were issued by Banco Santander entities in Spain.

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 £3,203m (2011: £4,050m) for the ANTS group and £3,203m (2011: £4,050m) for the Company. The maximum exposure was mitigated by the ANTS group having a charge over residential properties in respect of lending to housing associations amounting to £3,343m (2011: £4,556m) for the ANTS group and £3,343m (2011: £4,556m) for the Company.

## Notes to the Financial Statements continued

The net movement during the year attributable to changes in credit risk for loans and advances designated at fair value was £182m (2011: net loss of £307m, 2010: net loss £26m) for the ANTS group. The cumulative net loss attributable to changes in credit risk for loans and advances designated at fair value at 31 December 2012 was £356m (2011: net loss of £538m, 2010: net loss of £231m).

Included in the above balances are amounts owed to the ANTS group by Banco Santander, S.A. and by fellow subsidiaries of Banco Santander, S.A. outside the ANTS group of £nil (2011: £nil) and £47m (2011: £49m) respectively.

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

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Mortgage-backed securities	250	279	250	279
Other asset-backed securities	78	100	78	100
<b>Total</b>	<b>328</b>	<b>379</b>	<b>328</b>	<b>379</b>

Debt securities can be analysed by listing status as follows:

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Listed UK	237	256	237	256
Listed elsewhere	80	107	80	107
Unlisted <sup>(1)</sup>	11	16	11	16
<b>Total</b>	<b>328</b>	<b>379</b>	<b>328</b>	<b>379</b>

(1) Comprises Social Housing.

Asset-backed securities can be analysed by the geographical location of the issuer or counterparty as follows:

Country	31 December 2012				31 December 2011				Income statement	
	Nominal value £m	Book value £m	Fair value £m	Fair value as % of nominal	Nominal value £m	Book value £m	Fair value £m	Fair value as % of nominal	2012 £m	2011 £m
<b>UK</b>										
MBS	171	238	238	139	187	263	263	141	8	26
<b>Total UK</b>	<b>171</b>	<b>238</b>	<b>238</b>	<b>139</b>	<b>187</b>	<b>263</b>	<b>263</b>	<b>141</b>	<b>8</b>	<b>26</b>
<b>US</b>										
MBS	8	11	11	138	8	9	9	113	4	(4)
<b>Total US</b>	<b>8</b>	<b>11</b>	<b>11</b>	<b>138</b>	<b>8</b>	<b>9</b>	<b>9</b>	<b>113</b>	<b>4</b>	<b>(4)</b>
<b>Rest of Europe</b>										
ABS	98	78	78	80	105	100	100	95	(13)	11
MBS	1	1	1	100	10	7	7	70	-	1
<b>Total Rest of Europe</b>	<b>99</b>	<b>79</b>	<b>79</b>	<b>80</b>	<b>115</b>	<b>107</b>	<b>107</b>	<b>93</b>	<b>(13)</b>	<b>12</b>
<b>Total</b>	<b>278</b>	<b>328</b>	<b>328</b>	<b>118</b>	<b>310</b>	<b>379</b>	<b>379</b>	<b>122</b>	<b>(1)</b>	<b>34</b>

Asset-backed securities can be analysed by the credit rating of the issuer or counterparty as follows:

Credit rating <sup>(1)</sup>	31 December 2012				31 December 2011				Income statement	
	Nominal value £m	Book value £m	Fair value £m	Fair value as % of nominal	Nominal value £m	Book value £m	Fair value £m	Fair value as % of nominal	2012 £m	2011 £m
<b>AAA</b>										
ABS	-	-	-	-	28	16	16	57	-	-
MBS	159	222	222	140	175	247	247	141	10	18
<b>Total AAA</b>	<b>159</b>	<b>222</b>	<b>222</b>	<b>140</b>	<b>203</b>	<b>263</b>	<b>263</b>	<b>130</b>	<b>10</b>	<b>18</b>
<b>AA+</b>										
ABS	-	-	-	-	46	30	30	65	-	1
<b>Total AA+</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>46</b>	<b>30</b>	<b>30</b>	<b>65</b>	<b>-</b>	<b>1</b>
<b>AA</b>										
ABS	54	49	49	91	28	52	52	186	(15)	10
MBS	20	27	27	135	21	27	27	129	2	5
<b>Total AA</b>	<b>74</b>	<b>76</b>	<b>76</b>	<b>103</b>	<b>49</b>	<b>79</b>	<b>79</b>	<b>161</b>	<b>(13)</b>	<b>15</b>
<b>A</b>										
ABS	42	28	28	67	3	2	2	67	2	-
MBS	1	1	1	100	-	-	-	-	-	-
<b>Total A</b>	<b>43</b>	<b>29</b>	<b>29</b>	<b>67</b>	<b>3</b>	<b>2</b>	<b>2</b>	<b>67</b>	<b>2</b>	<b>-</b>
<b>BBB</b>										
ABS	2	1	1	50	-	-	-	-	-	-
<b>Total BBB</b>	<b>2</b>	<b>1</b>	<b>1</b>	<b>50</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Below BBB</b>										
MBS	-	-	-	-	9	5	5	56	-	-
<b>Total</b>	<b>278</b>	<b>328</b>	<b>328</b>	<b>118</b>	<b>310</b>	<b>379</b>	<b>379</b>	<b>122</b>	<b>(1)</b>	<b>34</b>

(1) All exposures are internally rated. External ratings are taken into consideration in the rating process, where available.

## Notes to the Financial Statements continued

## 17. LOANS AND ADVANCES TO BANKS

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Amounts due from Santander UK group undertakings - securities purchased under resale agreements	566	3,193	564	3,193
Amounts due from Banco Santander	104,893	106,811	104,886	106,807
- other	233	2,071	233	2,070
- securities purchased under resale agreements				
- other	4	11	4	11
Other loans and advances	1,290	1,136	1,285	1,130
	<b>106,986</b>	<b>113,222</b>	<b>106,972</b>	<b>113,211</b>

Almost all of the ANTS group's loans and advances to banks are transactions with other Santander UK group companies in the ordinary course of business. ANTS provides treasury, corporate and wholesale banking services to the wider Santander UK group. The ANTS group is also the treasury support function for the Santander UK group.

During the year, no impairment losses were incurred (2011: £nil). Loans and advances to banks are repayable as follows:

Repayable:	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
On demand	28,177	18,507	28,163	18,500
In not more than 3 months	39,887	40,763	39,887	40,762
In more than 3 months but not more than 1 year	12,704	9,911	12,704	9,911
In more than 1 year but not more than 5 years	24,040	35,214	24,040	35,214
In more than 5 years	2,178	8,827	2,178	8,824
	<b>106,986</b>	<b>113,222</b>	<b>106,972</b>	<b>113,211</b>

Loans and advances to banks can be analysed by the geographical location of the issuer or counterparty as follows:

Country	Group	
	2012 £m	2011 £m
UK	105,466	110,531
Spain	237	2,082
France	13	-
Rest of Europe	-	89
US	1,237	245
Rest of world	33	275
Total	<b>106,986</b>	<b>113,222</b>

Loans and advances to banks can be analysed by the credit rating of the issuer or counterparty as follows:

Credit rating <sup>(1)</sup>	Group	
	2012 £m	2011 £m
AAA	5	238
AA-	203	112,087
A+	30	-
A	105,614	-
A-	897	897
BB+	237	-
Total	<b>106,986</b>	<b>113,222</b>

(1) All exposures are internally rated. External ratings are taken into consideration in the rating process, where available.

## Notes to the Financial Statements continued

## 18. LOANS AND ADVANCES TO CUSTOMERS

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Amounts due from Santander UK group undertakings	32,368	27,831	32,482	27,938
Amounts due from Banco Santander group undertakings	5	5	5	5
Other loans and advances	12,489	11,120	12,483	11,113
<b>Loans and advances to customers</b>	<b>44,862</b>	<b>38,956</b>	<b>44,970</b>	<b>39,056</b>
Less: impairment loss allowances	(112)	(130)	(112)	(130)
<b>Loans and advances to customers, net of impairment loss allowances</b>	<b>44,750</b>	<b>38,826</b>	<b>44,858</b>	<b>38,926</b>

Repayable:	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
On demand	71	1,026	122	1,078
In no more than 3 months	7,377	6,692	7,434	6,736
In more than 3 months but not more than a year	2,751	2,110	2,750	2,112
In more than 1 year but not more than 5 years	16,973	15,970	16,968	15,965
In more than 5 years	17,690	13,158	17,696	13,165
<b>Loans and advances to customers</b>	<b>44,862</b>	<b>38,956</b>	<b>44,970</b>	<b>39,056</b>
Less: impairment loss allowance	(112)	(130)	(112)	(130)
<b>Loans and advances to customers, net of impairment loss allowances</b>	<b>44,750</b>	<b>38,826</b>	<b>44,858</b>	<b>38,926</b>

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

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Fixed rate	25,803	19,349	25,918	19,454
Variable rate	19,059	19,607	19,052	19,602
Less: impairment loss allowances	(112)	(130)	(112)	(130)
	<b>44,750</b>	<b>38,826</b>	<b>44,858</b>	<b>38,926</b>

Movement in impairment loss allowances:

	Group		Company 2010 £m
	2012 £m	2011 £m	
At 1 January:			
- Observed	97	79	63
- Incurred but not yet observed	33	29	14
At 1 January	130	108	77
Charge/(release) to the income statement:			
- Observed	40	50	65
- Individual	32	50	65
- Collective	8	-	-
- Incurred but not yet observed	(31)	4	15
Charge/(release) to the income statement	9	54	80
Write offs:			
- Observed	(27)	(32)	(49)
- Incurred but not yet observed	-	-	-
Write offs	(27)	(32)	(49)
At 31 December:			
- Observed	110	97	79
- Incurred but not yet observed	2	33	29
At 31 December	112	130	108
			Company 2010 £m
At 1 January	130	108	77
Charge to the income statement	9	54	86
Write offs	(27)	(32)	(55)
At 31 December	112	130	108

**Notes to the Financial Statements** continued**19. SPECIAL PURPOSE ENTITIES**

Special Purpose Entities ('SPEs') are formed by the ANTS group to accomplish specific and well-defined objectives. The ANTS group consolidates these SPEs when the substance of the relationship indicates control, as described in Note 1.

**Consolidated special purpose entities**

The only SPE sponsored and consolidated by the ANTS group is Guaranteed Investment Products 1 PCC Limited, a Guernsey-incorporated, closed-ended, protected cell company. The objective of each cell is to achieve capital growth. In order to achieve the investment objective, Guaranteed Investment Products 1 PCC Limited, on behalf of the respective cell, has entered into transactions with the ANTS group. Santander Guarantee Company, a Santander UK group company, also guarantees the shareholders of cells a fixed return on their investment and/or the investment amount. Guaranteed Investment Products 1 PCC Limited has no third party assets.

**Off balance sheet special purpose entities**

The only SPEs sponsored but not consolidated by the ANTS group are SPEs which issue shares that back retail structured products. At 31 December 2012, the total value of products issued by these SPEs was £25m (2011: £36m). The ANTS group's arrangements with these entities comprise the provision of equity derivatives and a secondary market-making service to those retail customers who wish to exit early from these products.

The maximum exposure to the SPEs sponsored but not consolidated by the ANTS group consists of trading assets (repurchases held by the ANTS group) of £10m (2011: £17m).

## Notes to the Financial Statements continued

## 20. LOANS AND RECEIVABLE SECURITIES

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Loans and receivable securities	162	278	162	278

These asset-backed securities were acquired as part of an alignment of portfolios across the Banco Santander group in 2010 and are being run down. Detailed analysis of these securities is set out below.

Included in the above balances are amounts owed to the ANTS group by Banco Santander, S.A. and by fellow subsidiaries of Banco Santander, S.A. outside the ANTS group of £nil (2011: £nil) and £nil (2011: £87m) respectively.

Asset-backed securities can be analysed by the geographic location of the issuer or counterparty as follows:

Country	31 December 2012				31 December 2011				Income statement	
	Nominal value £m	Book value £m	Fair value £m	Fair value as % of nominal %	Nominal value £m	Book value £m	Fair value £m	Fair value as % of nominal %	2012 £m	2011 £m
<b>UK</b>										
MBS	5	5	5	100	91	91	91	100	-	1
	5	5	5	100	91	91	91	100	-	1
<b>US</b>										
ABS	27	21	21	78	29	22	22	76	1	1
	27	21	21	78	29	22	22	76	1	1
<b>Rest of Europe</b>										
ABS	2	2	2	100	3	3	3	100	-	-
MBS	131	125	125	95	151	143	143	95	4	4
	133	127	127	95	154	146	146	95	4	4
<b>Rest of world</b>										
ABS	10	9	9	90	21	19	19	90	1	4
	10	9	9	90	21	19	19	90	1	4
<b>Total</b>	<b>175</b>	<b>162</b>	<b>162</b>	<b>93</b>	<b>295</b>	<b>278</b>	<b>278</b>	<b>94</b>	<b>6</b>	<b>10</b>

Asset-backed securities can be analysed by the credit rating of the issuer or counterparty as follows:

Credit rating <sup>(1)</sup>	31 December 2012				31 December 2011				Income statement	
	Nominal value £m	Book value £m	Fair value £m	Fair value as % of nominal %	Nominal value £m	Book value £m	Fair value £m	Fair value as % of nominal %	2012 £m	2011 £m
<b>AAA</b>										
ABS	4	4	4	100	19	16	16	84	-	2
MBS	120	115	115	96	147	143	143	97	3	3
	124	119	119	96	166	159	159	96	3	5
<b>AA+</b>										
ABS	2	2	2	100	-	-	-	-	-	-
MBS	-	-	-	-	84	80	80	95	-	2
	2	2	2	100	84	80	80	95	-	2
<b>AA</b>										
MBS	16	15	15	94	5	5	5	100	1	-
	16	15	15	94	5	5	5	100	1	-
<b>A</b>										
ABS	15	13	13	87	19	16	16	84	1	2
MBS	-	-	-	-	6	6	6	100	-	-
	15	13	13	87	25	22	22	88	1	2
<b>Below BBB</b>										
ABS	18	13	13	72	15	12	12	80	1	1
	18	13	13	72	15	12	12	80	1	1
<b>Total</b>	<b>175</b>	<b>162</b>	<b>162</b>	<b>93</b>	<b>295</b>	<b>278</b>	<b>278</b>	<b>94</b>	<b>6</b>	<b>10</b>

(1) All exposures are internally rated. External ratings are taken into consideration in the rating process, where available.

Asset-backed securities above include the following:

- > **ALT-A US asset-backed securities** – the ANTS group holds no ALT-A US asset-backed securities.
- > **Monoline insurer exposures** - the ANTS group has a £30m (2011: £44m) exposure to corporate bonds and securitisations which are wrapped by monoline insurers. The principal risk exposures are recorded against the securitisations, with the monoline wraps being viewed as contingent exposures.

## Notes to the Financial Statements continued

**21. TRANSFERS OF FINANCIAL ASSETS NOT QUALIFYING FOR DERECOGNITION**

The ANTS group enters into transactions in the normal course of business by which it transfers recognised financial assets directly to third parties or to SPEs. These transfers may give rise to the full or partial derecognition of the financial assets concerned.

- > Full derecognition occurs when the ANTS group transfers its contractual right to receive cash flows from the financial assets, or retains the right but assumes an obligation to pass on the cash flows from the asset, and transfers substantially all the risks and rewards of ownership. The risks include credit, interest rate, currency, prepayment and other price risks.
- > Partial derecognition occurs when the ANTS group sells or otherwise transfers financial assets in such a way that some but not substantially all of the risks and rewards of ownership are transferred but control is retained. These financial assets are recognised on the balance sheet to the extent of the ANTS group's continuing involvement.

Financial assets that do not qualify for derecognition consist of (i) securities held by counterparties as collateral under repurchase agreements, (ii) securities lent under securities lending agreements, and (iii) loans that have been securitised under arrangements by which the ANTS group retains a continuing involvement in such transferred assets.

As the substance of these transactions is secured borrowings, the asset collateral continues to be recognised in full and the related liability reflecting the ANTS group's obligation to repurchase the transferred assets for a fixed price at a future date is recognised in deposits from banks or customers, as appropriate. As a result of these transactions, the ANTS group is unable to use, sell or pledge the transferred assets for the duration of the transaction. The ANTS group remains exposed to interest rate risk and credit risk on these pledged instruments. The counterparty's recourse is not limited to the transferred assets.

The following table analyses the carrying amount of financial assets that did not qualify for derecognition and their associated financial liabilities:

Nature of transaction	2012	2012	2011	Group
	£m	£m	£m	2011
	Carrying amount of transferred assets	Carrying amount of associated liabilities	Carrying amount of transferred assets	Carrying amount of associated liabilities
Sale and repurchase agreements	1,293	1,372	3,678	3,905
Securities lending agreements	2,422	2,603	2,913	2,964
	3,715	3,975	6,591	6,869

**22. AVAILABLE-FOR-SALE SECURITIES**

	2012	Group	2012	Company
	£m	2011	£m	2011
	£m	£m	£m	£m
Debt securities	5,113	-	5,113	-
	5,113	-	5,113	-

Debt securities can be analysed by listing status as follows:

	2012	Group	2012	Company
	£m	2011	£m	2011
	£m	£m	£m	£m
Debt securities:				
- Listed in the UK	3,844	-	3,844	-
- Listed elsewhere	623	-	623	-
- Unlisted	646	-	646	-
	5,113	-	5,113	-

Debt securities at 31 December 2012 by contractual maturity and the related yield:

2012	On demand	In not more than 3 months	In more than 3 months but not more than 1 year	In more than 1 year but not more than 5 years	In more than five years	Total
	£m	£m	£m	£m	£m	£m
Issued by public bodies:						
- UK Government	-	-	995	2,849	-	3,844
- Other OECD	-	-	905	-	364	1,269
	-	-	1,900	2,849	364	5,113
Weighted average yield for year %	-	-	0.80%	1.08%	0.24%	2.12%



## Notes to the Financial Statements continued

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

	Group £m	Company £m
<b>At 1 January 2012</b>	-	-
Additions	5,990	5,990
Redemptions and maturities	(869)	(869)
Exchange adjustments	(13)	(13)
Movement in fair value	5	5
<b>At 31 December 2012</b>	<b>5,113</b>	<b>5,113</b>

## 23. INVESTMENT IN SUBSIDIARY UNDERTAKINGS

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

	Cost £m	Impairment £m	Company Net book value £m
<b>At 1 January 2012</b>	<b>2,213</b>	<b>(26)</b>	<b>2,187</b>
Reversal of impairment	-	5	5
Capital reduction of subsidiary	(8)	-	(8)
<b>At 31 December 2012</b>	<b>2,205</b>	<b>(21)</b>	<b>2,184</b>

	Cost £m	Impairment £m	Company Net book value £m
<b>At 1 January and 31 December 2011</b>	<b>2,213</b>	<b>(26)</b>	<b>2,187</b>

In 2012, the reversal of impairment and capital reduction of subsidiary represented changes in the capital invested in certain subsidiaries as a result of an internal reorganisation within the ANTS group.

The principal subsidiaries of the Company that comprise related undertakings under the UK Companies Act 2006 (and so exclude certain securitisation companies) at 31 December 2012 are shown below, all of which are directly held, except where noted, and are unlisted. The Directors consider that to give full particulars of all subsidiary undertakings would lead to a statement of excessive length. In accordance with Section 410(2) of the UK Companies Act 2006, the following information relates to those subsidiary undertakings whose results or financial position, in the opinion of the Directors, principally affect the results of the ANTS group. Full particulars of all subsidiary undertakings will be annexed to the Company's next annual return in accordance with Section 410(3)(b) of the UK Companies Act 2006.

	Nature of business	% Interest held	Country of Incorporation or registration
Abbey National Treasury Services Overseas Holdings *	Investment	100	England & Wales
Abbey National North America LLC *	Commercial paper issue	100	United States
Abbey National Treasury Services Investments Limited	Investment	100	England & Wales
Abbey National (Holdings) Limited	Holding Company	100	England & Wales
Abbey National American Investments Limited	Investment	100	England & Wales
Abbey National Treasury Investments	Investment	100	England & Wales

\* Held indirectly or partly indirectly through subsidiary companies.

All the above companies are included in the Consolidated Financial Statements. All companies operate principally in their country of incorporation or registration. The Company also has branch offices in the US and the Cayman Islands.

## Notes to the Financial Statements continued

## 24. INTANGIBLE ASSETS

	Group 2012 £m	Company 2012 £m
<b>Cost</b>		
At 1 January 2012	26	10
Additions	6	6
Disposals	(8)	(8)
At 31 December 2012	24	8
<b>Accumulated amortisation / impairment</b>		
At 1 January 2012	23	7
Disposals	(6)	(6)
31 December 2012	17	1
<b>Net book value</b>	7	7

	Group 2011 £m	Company 2011 £m
<b>Cost</b>		
At 1 January 2011	45	29
Additions	7	7
Disposals	(26)	(26)
At 31 December 2011	26	10
<b>Accumulated amortisation / impairment</b>		
At 1 January 2011	19	3
Charge for the year	4	4
31 December 2011	23	7
<b>Net book value</b>	3	3

The intangible assets of the ANTS group and the Company consist of computer software.

## 25. PROPERTY, PLANT AND EQUIPMENT

	Property £m	Office fixtures and equipment £m	Computer software £m	Group Total £m
<b>Cost</b>				
At 1 January 2012	1	20	61	82
Additions	-	4	-	4
At 31 December 2012	1	24	61	86
<b>Accumulated depreciation</b>				
At 1 January 2012	1	16	60	77
Charge for the year	-	3	-	3
At 31 December 2012	1	19	60	80
<b>Net book value</b>				
At 31 December 2012	-	5	1	6

	Property £m	Office fixtures and equipment £m	Computer software £m	Group Total £m
<b>Cost</b>				
At 1 January 2011	1	29	66	96
Additions	-	2	-	2
Disposals	-	(11)	(5)	(16)
At 31 December 2011	1	20	61	82
<b>Accumulated depreciation</b>				
At 1 January 2011	1	13	60	74
Charge for the year	-	3	-	3
At 31 December 2011	1	16	60	77
<b>Net book value</b>				
At 31 December 2011	-	4	1	5

## Notes to the Financial Statements continued

				Company
	Property	Office fixtures and equipment	Computer software	Total
	£m	£m	£m	£m
<b>Cost</b>				
At 1 January 2012	-	18	60	78
Additions	-	3	-	3
Disposals	-	-	-	-
At 31 December 2012	-	21	60	81
<b>Accumulated depreciation</b>				
At 1 January 2012	-	14	59	73
Charge for the year	-	2	-	2
At 31 December 2012	-	16	59	75
<b>Net book value</b>				
At 31 December 2012	-	5	1	6

				Company
	Property	Office fixtures and equipment	Computer software	Total
	£m	£m	£m	£m
<b>Cost</b>				
At 1 January 2011	-	27	65	92
Additions	-	2	-	2
Disposals	-	(11)	(5)	(16)
At 31 December 2011	-	18	60	78
<b>Accumulated depreciation</b>				
At 1 January 2011	-	11	59	70
Charge for the year	-	3	-	3
At 31 December 2011	-	14	59	73
<b>Net book value</b>				
At 31 December 2011	-	4	1	5

At 31 December 2012, capital expenditure contracted, but not provided for was £nil (2011: £1m) in respect of property, plant and equipment. There were no disposals in 2012 (2011: £16m disposals of were made to Santander UK at book value).

## 26. 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 movement on the deferred tax account is as follows:

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
At 1 January	17	25	17	25
Income statement credit /(charge)	4	(9)	3	(8)
Charged to other comprehensive income: - available-for-sale financial assets	(1)	-	-	-
Intra group transfer	-	1	-	-
At 31 December	20	17	20	17

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

	Group		Company	
	2012	2011	2012	2011
	£m	£m	£m	£m
<b>Deferred income tax liabilities</b>				
Other temporary differences	-	-	-	-
<b>Deferred income tax assets</b>				
Accelerated book depreciation	1	2	1	2
IAS 32 and 39 transition adjustments	5	7	5	7
Other temporary differences	14	8	14	8
	20	17	20	17

## Notes to the Financial Statements continued

The deferred tax assets scheduled above have been recognised in both the Company and the ANTS group on the basis that sufficient future taxable profits are forecast within the foreseeable future, in excess of the profits arising from the reversal of existing taxable temporary differences, to allow for the utilisation of the assets as they reverse.

The deferred tax (credit)/charge in the income statement comprises the following temporary differences:

	2012 £m	2011 £m	Group 2010 £m
Accelerated tax depreciation	1	-	-
IAS 32 and 39 transitional adjustments	2	4	2
Other temporary differences	(7)	5	(7)
	<b>(4)</b>	9	(5)

At 31 December 2012, the ANTS group had UK capital losses carried forward of £23m (2011: £59m). These losses are available for offset against future UK chargeable gains and under current UK tax legislation do not time expire. No deferred tax asset has been recognised in respect of these capital losses on the basis that future capital gains required to utilise the losses are not probable.

## 27. OTHER ASSETS

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Trade and other receivables	4	43	4	43

## 28. DEPOSITS BY BANKS

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Amounts due to Santander UK undertakings	109,306	105,713	109,306	105,713
Amounts due to fellow Banco Santander subsidiaries (not with Banco Santander, S.A.)	-	603	-	603
Securities sold under agreements to repurchase	4,799	4,955	4,799	4,955
Amounts due to Banco Santander, S.A. - securities sold under agreements to repurchase	140	2,517	140	2,517
Time and demand deposits	290	231	290	230
Total deposits by banks	<b>114,535</b>	114,019	<b>114,535</b>	114,018

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Repayable:				
On demand	6,360	4,784	6,360	4,783
In not more than 3 months	25,055	30,705	25,055	30,705
In more than 3 months but not more than 1 year	24,621	25,136	24,621	25,136
In more than 1 year but not more than 5 years	39,178	38,388	39,178	38,388
In more than 5 years	19,321	15,006	19,321	15,006
	<b>114,535</b>	114,019	<b>114,535</b>	114,018

## Notes to the Financial Statements continued

## 29. DEPOSITS BY CUSTOMERS

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Current and demand accounts				
- interest bearing	-	10	-	10
- non interest bearing	-	1	-	1
Amounts due to Santander UK subsidiaries	<b>1,697</b>	1,847	<b>6,047</b>	6,973
Amounts due to Banco Santander group subsidiaries	<b>165</b>	345	<b>165</b>	381
Securities sold under agreements to repurchase	<b>406</b>	418	<b>406</b>	418
Wholesale funds and deposits <sup>(1)</sup>	<b>3,981</b>	4,493	<b>3,981</b>	4,493
	<b>6,249</b>	7,114	<b>10,599</b>	12,276
Repayable:				
On demand	<b>145</b>	101	<b>254</b>	247
In no more than 3 months	<b>551</b>	884	<b>2,643</b>	3,309
In more than 3 months but no more than 1 year	<b>1,016</b>	781	<b>1,314</b>	1,486
In more than 1 year but no more than 5 years	<b>3,484</b>	5,248	<b>5,335</b>	7,134
In more than 5 years	<b>1,053</b>	100	<b>1,053</b>	100
	<b>6,249</b>	7,114	<b>10,599</b>	12,276

(1) Consists of equity index-linked deposits of £3,981m (2011: £4,493m). The capital amount guaranteed/protected and the amount of return guaranteed in respect of the equity index-linked deposits were £3,981m and £224m, respectively (2011: £4,493m and £254m, respectively).

Wholesale deposits by customers are interest bearing.

## 30. TRADING LIABILITIES

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Deposits by banks - securities sold under repurchase agreements	<b>6,833</b>	10,105	<b>6,833</b>	10,105
- other <sup>(1)</sup>	<b>2,909</b>	4,403	<b>2,909</b>	4,403
Deposits by customers - securities sold under repurchase agreements	<b>4,847</b>	5,519	<b>4,847</b>	5,519
- other <sup>(2)</sup>	<b>2,401</b>	4,963	<b>2,401</b>	4,963
Short positions in securities and unsettled trades	<b>4,119</b>	755	<b>4,119</b>	755
	<b>21,109</b>	25,745	<b>21,109</b>	25,745

(1) Comprises cash collateral £2,269m (2011: £2,401m) and short-term deposits £640m (2011: £2,002m).

(2) Comprises short-term deposits £1,702m (2011: £3,662m) and equity linked deposits £699m (2011: £1,301m). The capital amount guaranteed/protected and the amount of return guaranteed in respect of the equity index-linked deposits were £559m and £109m, respectively (2011: £1,005m and £207m, respectively).

Included in the above balances are amounts owed by the ANTS group to Banco Santander, S.A. of £180m (2011: £620m) and to fellow subsidiaries of Banco Santander, S.A. outside the ANTS group of £45m (2011: £51m).

## 31. FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Debt securities in issue:				
- US\$10bn Euro Commercial Paper Programme	<b>1,403</b>	429	<b>1,403</b>	429
- US\$20bn Euro Medium Term Note Programme	<b>655</b>	4,594	<b>655</b>	4,594
- Euro 10bn Structured Notes	<b>1,740</b>	1,744	<b>1,740</b>	1,744
- Other bonds	-	61	-	5
Warrants	<b>204</b>	8	<b>204</b>	8
	<b>4,002</b>	6,836	<b>4,002</b>	6,780

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 or where a contract contains one or more embedded derivatives that would otherwise require separate recognition. The 'fair value option' has been used where debt securities in issue and warrants would otherwise be measured at amortised cost and any embedded derivatives or associated derivatives used to economically hedge the risk are held at fair value.

**Notes to the Financial Statements** continued

Where the ANTS group records its own debt securities in issue at fair value, the fair value is based on quoted prices in an active market for the specific instrument concerned, if available. When quoted market prices are unavailable, the own debt security in issue is valued using valuation techniques, the inputs for which are either based upon quoted prices in an inactive market for the instrument, or are estimated by comparison with quoted prices in an active market for similar instruments. In both cases, the fair value includes the effect of applying the credit spread which is appropriate to the ANTS group's liabilities.

The change in fair value of issued debt securities attributable to the ANTS group's own credit spread is computed as follows: for each security at each reporting date, an externally verifiable price is obtained or a price is derived using credit spreads for similar securities for the same issuer or credit default swaps. Each security is then valued using discounted cash flows, incorporating a LIBOR-based discount curve. The difference in the valuations is attributable to the ANTS group's own credit spread. This methodology is applied consistently across all securities where it is believed that counterparties would consider the ANTS group's creditworthiness when pricing trades.

Gains and losses arising from changes in the credit spread of liabilities issued by the ANTS group reverse over the contractual life of the debt, provided that the debt is not repaid at a premium or a discount.

The net loss during the year attributable to changes in the ANTS group's own credit risk on the above debt securities in issue was £86m (2011: net gain of £64m, 2010: net gain of £2m) for the ANTS group and £86m (2011: net gain of £64m, net gain of £2m) for the Company. The cumulative net gain attributable to changes in the ANTS group's own credit risk on the above debt securities in issue at 31 December 2012 was £7m (2011: £93m, 2010: £29m) for the ANTS group and £7m (2011: £93m, 2010: £29m) for the Company.

The amount that would be required to be contractually paid at maturity of the debt securities in issue above is £531m (2011: £366m) higher than the carrying value.

**US\$10bn Euro Commercial Paper Programme**

The Company may from time to time issue commercial paper under the US\$10bn Euro Commercial Paper Programme that may be denominated in any currency as agreed between the Company and the relevant dealer. The commercial paper ranks at least pari passu with all other unsecured and unsubordinated obligations of the Company. The payments of all amounts due in respect of the commercial paper have been unconditionally and irrevocably guaranteed by Santander UK plc.

The commercial paper is issued in bearer form, subject to a minimum maturity of 1 day and a maximum maturity of 364 days. The commercial paper may be issued on a discounted basis or may bear fixed or floating rate interest or a coupon calculated by reference to an index or formula. The maximum aggregate nominal amount of all commercial paper outstanding from time to time under the Programme will not exceed US\$10bn (or its equivalent in other currencies). This was increased from US\$4bn in January 2011. The commercial paper is not listed on any stock exchange.

**US\$20bn Euro Medium Term Note Programme**

The Company may from time to time issue notes denominated in any currency as agreed between the issuer and the relevant dealer under the US\$20bn Euro Medium Term Note Programme. The payment of all amounts payable in respect of the notes is unconditionally and irrevocably guaranteed by Santander UK plc. The programme provides for issuance of fixed rate notes, floating rate notes, variable interest notes and zero coupon/discount notes.

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

**Euro 10bn Note, Certificate and Warrant Programme**

The Company may from time to time issue structured notes and redeemable certificates (together the 'N&C Securities') and warrants (together with the N&C Securities, the 'Securities') denominated in any currency as agreed between the Company and the relevant dealers under the euro 10bn note, certificate and warrant programme (the 'Omnibus Programme'). The securities are direct, senior and unsecured obligations of the Company that rank pari passu without preference among themselves and, subject as to any applicable statutory provisions or judicial order, at least equally with all other present and future senior and unsecured obligations of the Company. The payment of all amounts due in respect of the Securities has been unconditionally and irrevocably guaranteed by Santander UK plc.

The Omnibus Programme provides for the issuance of commodity linked N&C Securities, credit-linked N&C Securities, currency-linked Securities, equity-linked Securities, equity index-linked Securities, fixed rate notes, floating rate N&C Securities, floating rate N&C Securities, fund-linked Securities, inflation-linked Securities, property-linked Securities, zero-coupon/discount N&C Securities and any other structured Securities as agreed between the Company and the relevant dealers. Securities issued under the Omnibus Programme are governed by English law.

The maximum aggregate outstanding nominal amount of all N&C Securities and the aggregate issue prices of outstanding warrants from time to time issued under the Omnibus Programme will not exceed euro 10bn (or its equivalent in other currencies).

**Warrants programme**

The Company established a warrants programme (the 'Warrants Programme') in 2009 for the issuance of structured warrants denominated in any currency as agreed between the Company and the relevant dealers under the Warrants Programme. Warrants are direct, unsecured and unconditional obligations of the Company that rank pari passu without preference among themselves and, subject as to any applicable statutory provisions or judicial order, rank at least equally with all other present and future unsecured and unsubordinated obligations of the Company.

**Notes to the Financial Statements** continued

As at the date of this report, the Company has discontinued the issue of new warrants under the Warrants Programme as new issuances are being made under the Omnibus Programme. The payments of all amounts due in respect of the previously issued warrants have been unconditionally and irrevocably guaranteed by Santander UK plc.

**32. DEBT SECURITIES IN ISSUE**

	Group		Company	
	2012	2011 <sup>(1)</sup>	2012	2011
	£m	£m	£m	£m
Euro 35bn Global Covered Bond Programme	<b>20,576</b>	16,945	<b>20,576</b>	16,945
US\$20bn Euro Medium Term Note Programme (see Note 31)	<b>6,396</b>	4,258	<b>6,396</b>	4,253
US\$20bn Commercial Paper Programme	<b>2,289</b>	3,069	-	-
Certificates of deposit in issue	<b>4,509</b>	2,671	<b>4,509</b>	2,671
	<b>33,770</b>	26,943	<b>31,481</b>	23,869

(1) As restated, see Note 45

Included in the above balances are amounts owed by the ANTS group to Banco Santander, S.A. and to fellow subsidiaries of Banco Santander, S.A. outside the ANTS group of £2,040m (2011: £84m) and £698m (2011: £134m) respectively.

**Euro 35bn Global Covered Bond Programme**

The Company issues covered bonds under the euro 35bn Global Covered Bond Programme that may be denominated in any currency as agreed between the Company and the relevant dealers. The programme provides that covered bonds may be listed or admitted to trading, on the official list of the UK Listing Authority and on the London Stock Exchange or any other stock exchanges or regulated or unregulated markets. The Company may also issue unlisted covered bonds and/or covered bonds not admitted to trading on any regulated or unregulated market.

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

Covered bonds may be issued in bearer or registered form. The maximum aggregate nominal amount of all covered bonds from time to time outstanding under the programme will not exceed euro 35bn (or its equivalent in other currencies), subject to any modifications in accordance with the programme. On 11 November 2008, the Company was admitted to the register of issuers and the programme and the covered bonds issued previously under the programme were admitted to the register of regulated covered bonds, pursuant to Regulation 14 of the Regulated Covered Bonds Regulations 2008 (SI 2008/346).

**US\$20bn Commercial Paper Programme**

Abbey National North America LLC may from time to time issue unsecured notes denominated in United States dollars as agreed between Abbey National North America LLC and the relevant dealers under the US\$20bn US commercial paper programme. The Notes will rank at least pari passu with all other unsecured and unsubordinated indebtedness of Abbey National North America LLC and Santander UK plc. The payments of all amounts due in respect of the Notes have been unconditionally and irrevocably guaranteed by Santander UK plc. The Notes are not redeemable prior to maturity or subject to voluntary prepayment. The maximum aggregate nominal amount of all Notes from time to time outstanding under the Programme will not exceed US\$20bn (or its equivalent in other currencies).

**US SEC registered debt shelf**

The Company issues notes in the US from time to time pursuant to a shelf registration statement on Form F-3 filed with the US Securities and Exchange Commission. The notes may be issued in any currency agreed between the Company and the relevant underwriters in any particular issuance under the registration statement.

## Notes to the Financial Statements continued

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

	Interest Rate	Maturity	Group		Company	
			2012 £m	2011 £m	2012 £m	2011 £m
Euro	0.00% - 3.99%	Up to 2012	-	741	-	736
		2012 - 2013	<b>3,497</b>	2,212	<b>3,497</b>	2,212
		2014 - 2019	<b>8,089</b>	7,827	<b>8,089</b>	7,827
	4.00% - 4.99%	2020 - 2029	<b>2,622</b>	211	<b>2,622</b>	211
		2030 - 2039	<b>90</b>	-	<b>90</b>	-
		2014 - 2019	<b>1,775</b>	945	<b>1,775</b>	945
US dollar	0.00% - 3.99%	2020 - 2029	<b>1,830</b>	1,661	<b>1,830</b>	1,661
		2030 - 2039	<b>172</b>	101	<b>172</b>	101
		Up to 2012	-	3,628	-	559
Pounds sterling	0.00% - 3.99%	2012 - 2013	<b>3,456</b>	592	<b>1,167</b>	592
		2014 - 2019	<b>1,900</b>	1,347	<b>1,900</b>	1,347
		2014 - 2019	<b>654</b>	676	<b>654</b>	676
Other currencies	0.00% - 3.99%	2020 - 2029	-	1,850	-	1,850
		2012 - 2013	<b>3,312</b>	516	<b>3,312</b>	516
		2014 - 2019	<b>1,679</b>	675	<b>1,679</b>	675
	4.00% - 5.99%	2020 - 2029	<b>75</b>	-	<b>75</b>	-
		2014 - 2019	<b>1,023</b>	1,013	<b>1,023</b>	1,013
		2020 - 2029	<b>2,984</b>	2,330	<b>2,984</b>	2,330
Other currencies	0.00% - 5.99%	2012 - 2013	<b>244</b>	251	<b>244</b>	251
		2014 - 2019	<b>190</b>	194	<b>190</b>	194
		2020 - 2029	<b>178</b>	173	<b>178</b>	173
			<b>33,770</b>	26,943	<b>31,481</b>	23,869

### 33. OTHER LIABILITIES

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Trade and other payables	<b>35</b>	39	<b>32</b>	34
Accrued expense	<b>134</b>	103	<b>134</b>	103
	<b>169</b>	142	<b>166</b>	137

Included in the above balances are amounts owed by the ANTS group to Banco Santander, S.A. and to fellow subsidiaries of Banco Santander, S.A. outside the ANTS group of £nil (2011: £nil) and £2m (2011: £1m) respectively.



## Notes to the Financial Statements continued

## 34. PROVISIONS

	Group £m	Company £m
At 1 January 2012	20	20
Additional provisions	20	20
Used during the year	(20)	(20)
At 31 December 2012	20	20
To be settled:		
Within 12 months	20	20
In more than 12 months	-	-
	20	20
	Group £m	Company £m
At 1 January 2011	-	-
Additional provisions	20	20
Used during the year	-	-
At 31 December 2011	20	20
To be settled:		
Within 12 months	20	20
In more than 12 months	-	-
	20	20

The charge disclosed in the income statement in respect of provisions for other liabilities and charges of £20m (2011: £20m), comprises the additional provisions of £20m (2011: £20m), relating to the UK Bank Levy.

**UK Bank Levy**

The Finance Act 2011 introduced an annual bank levy in the UK which is collected through the existing quarterly Corporation Tax collection mechanism. The first chargeable period for the ANTS group was the year ended 31 December 2011.

The UK Bank Levy is based on the total aggregated chargeable equity and liabilities as reported in the balance sheet of a Relevant Group at the end of a chargeable period. The Relevant Group for this purpose is a Foreign Banking Group whose ultimate parent is Banco Santander, S.A.. The Bank Levy is calculated principally on the aggregation of the consolidated balance sheet of the UK sub-group parented by Santander UK plc, of which this Company is a part. In determining the chargeable equity and liabilities the following amounts are excluded: adjusted Tier 1 capital; certain "protected deposits" (for example those protected under the Financial Services Compensation Scheme); liabilities that arise from certain insurance business within banking groups; liabilities in respect of currency notes in circulation; Financial Services Compensation Scheme liabilities; liabilities representing segregated client money; and deferred tax liabilities, current tax liabilities, liabilities in respect of the UK Bank Levy, revaluation of property liabilities, liabilities representing the revaluation of business premises and defined benefit retirement liabilities.

It is also permitted in specified circumstances to reduce certain liabilities: by netting them against certain assets; offsetting assets on the relevant balance sheets that would qualify as high quality liquid assets (in accordance with the FSA definition); and repo liabilities secured against sovereign and supranational debt.

The UK Bank Levy will be set at a rate of 0.130% from 2013. During 2012 a rate of 0.088% was applied and three different rates applied during 2011 which averaged to 0.075%. Certain liabilities are subject to only a half rate, namely any deposits not otherwise excluded, (except for those from financial institutions and financial traders) and liabilities with a maturity greater than one year at the balance sheet date. The UK Bank Levy is not charged on the first £20bn of chargeable liabilities of the Relevant Group.

The cost of the UK Bank Levy to the ANTS group for 2012 was £20m (2011: £20m). In accordance with IFRS's, the UK Bank Levy is not accrued over each year but is recognised on 31 December of each year.

## Notes to the Financial Statements continued

## 35. CONTINGENT LIABILITIES AND COMMITMENTS

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Guarantees given on behalf of the Company's UK parent, fellow subsidiaries and subsidiaries	153,047	150,742	155,336	153,811
Guarantees given to third parties	505	457	505	457
Formal standby facilities, credit lines and other commitments:				
– Original term to maturity of one year or less	1,186	678	1,186	678
– Original term to maturity of more than one year	8,167	8,601	8,167	8,601
	162,905	160,478	165,194	163,547

**Guarantees given on behalf of the Company's parent**

The Company has given a full and unconditional guarantee in respect of the unsubordinated liabilities of Santander UK plc incurred prior to 30 June 2015 under a deed poll guarantee entered into by the Company on 10 May 2012. A copy of this guarantee is included on pages 208 to 210.

**Capital Support Deed**

The Company, Santander UK plc, and Cater Allen Limited, which are the three FSA-regulated entities within the Santander UK group, are party to a capital support deed dated 14 December 2012 (the "Capital Support Deed") with certain other non-regulated subsidiaries of Santander UK plc. The parties to the Capital Support Deed constitute a core UK group for the purposes of section 10 of the Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU") of the FSA Handbook. Under section 10.8 of BIPRU, exposures of each of the three regulated entities to other members of the core UK group are exempt from large exposure limits that would otherwise apply. The purpose of the Capital Support Deed is to facilitate the prompt transfer of available capital resources from, or repayment of liabilities by, the non-regulated parties to any of the regulated parties in the event that one of the regulated parties has breached or is at risk of breaching its capital resources requirements or risk concentrations requirements.

**Defined Liquidity Group liquidity facility**

The Company, Santander UK plc, and Cater Allen Limited are party to a defined liquidity group liquidity facility agreement dated 28 May 2010 (the "DLG Facility Agreement"). The DLG Facility Agreement supports a defined liquidity group for the purposes of section 12 of BIPRU. Section 12.8 of BIPRU permits a member of a defined liquidity group to rely on the liquid resources of other members of the defined liquidity group to comply with the liquidity adequacy requirements under section 12 of BIPRU. Under the DLG Facility Agreement, each party agrees to lend, subject to certain conditions and limitations, its excess liquidity to each other party.

**Guarantees given to fellow subsidiaries and subsidiaries**

Via the guarantee given to the Company's parent described above, the Company has also indirectly guaranteed the obligations of Cater Allen Limited, Abbey National International Limited and Alliance & Leicester International Limited that have been or will be incurred before 30 June 2015.

**Guarantees given to third parties**

Guarantees given to third parties consist primarily of letters of credit, bonds and guarantees granted by Corporate Banking as part of normal product facilities which are offered to customers.

**Formal standby facilities, credit lines and other commitments**

Standby facilities, credit lines and other commitments are granted by Corporate Banking. Corporate facilities comprise standby facilities which are subject to the ongoing compliance with covenants and the provision of agreed security, failure to comply with these terms can result in the withdrawal of the unutilised facility headroom.

**Overseas tax claim**

A claim was filed against the Company by tax authorities abroad in relation to the refund of certain tax credits and other associated amounts. A favourable judgement at first instance was handed down in September 2006, although the judgement was appealed against by the tax authorities in January 2007 and the court found in favour of the latter in June 2010. The Company appealed against this decision at a higher court and in December 2011 the tax authorities confirmed their intention to file the related pleadings. Although the matter remained in dispute, in January 2012, following a demand from the tax authorities, the Company paid £67m, for which it already held a provision. The higher court hearing took place in April 2012 and the judgement found in favour of the tax authorities upholding their appeal. There is no recourse for further appeal.

## Notes to the Financial Statements continued

## Regulatory

The ANTS group engages in discussion, and co-operates, with the FSA in its supervision of the ANTS group, including reviews exercised under statutory powers, regarding its interaction with past and present customers, both as part of the FSA's general thematic work and in relation to specific products and services. A provision established with respect to interest rate derivatives is held by Santander UK plc.

## Other

As part of the sale of subsidiaries, and as is normal in such circumstances, the ANTS 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 totalled £9,309m at 31 December 2012 (2011: £10,850m) and are offset by a contractual right to receive stock under other contractual agreements.

## Other off-balance sheet commitments

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

## Operating lease commitments

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Rental commitments under non-cancellable operating leases:				
- No later than 1 year	5	5	5	5
- Later than 1 year but no later than 5 years	21	17	21	17
- Later than 5 years	20	19	20	19
	<b>46</b>	<b>41</b>	<b>46</b>	<b>41</b>

ANTS group rental expense comprises:

	Group	
	2012 £m	2011 £m
In respect of minimum rentals	7	5
Less: sub-lease rentals	-	-
	<b>7</b>	<b>5</b>

In 2012 and 2011, there was no contingent rent expense included in the above ANTS group rental expense.

## 36. SHARE CAPITAL

	Ordinary shares of £1 each £m	Tracker shares of £1 each £m	B Tracker shares of £1 each £m	Total £m
<b>Issued and fully paid share capital:</b>				
At 1 January and 31 December 2012 and 2011 <sup>(1)</sup>	<b>2,549</b>	-	-	<b>2,549</b>

(1) The number of ordinary shares in issuance is 2,549,000,000.

In 2008, the Company issued 1,000 Tracker Shares of £1 each at par to its parent company for £1,000. The Tracker Shares entitled the holders to dividends related to certain cashflows that were received by the Company in the period up to 7 April 2010. The Tracker Shares are not redeemable and do not confer any rights to participate in the assets of the Company on winding up (beyond the amount subscribed). The Tracker Shares carry no voting rights.

In 2010, the Company issued 1,000 B Tracker Shares of £1 each at par to its parent company for £1,000. The B Tracker Shares entitled the holders to dividends related to certain cashflows expected to be received by the Company in the period up to 31 December 2011. The B Tracker Shares are not redeemable and do not confer any rights to participate in the assets of the company on a winding up (beyond the amount subscribed). The B Tracker Shares carry no voting rights.

## Notes to the Financial Statements continued

## 37. DIVIDENDS

No dividends were declared on the Company's ordinary shares in the years ended 31 December 2012, 2011 and 2010.

In addition, the terms of the Tracker Shares and the B Tracker Shares are such that the issue of those shares (or in the case of the B Tracker Shares entry by the Company into contractual arrangements relating to the future issue of these shares) caused a derecognition of certain cashflows expected to be received by the Company. The amounts derecognised equate to the fair value of the cashflows involved and are shown in the Statement of Changes to Equity as amounts representative of contractual obligations for the year in which the derecognition occurs. Subsequent declaration and payment of dividends in respect of these cashflows is not further reflected in the Company's financial statements.

## 38. CONSOLIDATED CASH FLOW STATEMENT

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

	Group			Company		
	2012 £m	2011 <sup>(1)</sup> £m	2010 £m	2012 £m	2011 <sup>(1)</sup> £m	2010 £m
<b>Profit for the year</b>	<b>264</b>	164	460	<b>226</b>	222	670
<b>Non-cash items included in net profit</b>						
Depreciation and amortisation	3	7	6	3	7	6
(Increase)/decrease in prepayments and accrued income	(116)	86	(191)	(119)	85	(205)
Increase/(decrease) in accruals and deferred income	57	(56)	197	57	(23)	252
Impairment losses	9	54	80	9	54	80
Amortization of premiums/(discounts) on debt securities	18	-	-	18	-	-
Provisions for liabilities and charges	20	20	-	20	20	-
Corporation tax charge	68	104	149	88	116	138
Other non-cash items	42	(211)	(116)	39	(122)	(114)
<b>Net cash flow (used in)/from trading activities</b>	<b>365</b>	168	585	<b>341</b>	359	827
<b>Changes in operating assets and liabilities</b>						
Net increase in cash and balances held at central banks	(5)	(5)	-	(5)	(5)	-
Net (increase)/ decrease in trading assets	(2,787)	11,008	(1,453)	(2,682)	10,773	(4,711)
Net decrease/(increase) in financial assets designated at fair value	898	2,037	5,560	898	2,037	5,560
Net (increase)/decrease in derivative assets	(52)	(9,987)	(36)	(70)	(9,965)	(148)
Net decrease/(increase) in loans and advances to banks and customers	9,427	23,254	34,002	9,562	23,504	32,320
Net decrease/(increase) in other assets	37	362	(34)	38	30	(2)
Net (decrease)/increase in deposits by banks and customers	(250)	(22,660)	(32,097)	(1,060)	(24,375)	(33,265)
Net (decrease)/increase in derivative liabilities	(1,329)	10,374	588	(1,329)	10,374	713
Net (decrease)/increase in trading liabilities	(4,629)	(17,068)	(3,310)	(4,629)	(17,068)	29,500
Net (decrease)/increase in financial liabilities designated at fair value	(22)	(185)	(669)	9	(184)	(673)
Net increase/(decrease) in debt issued	1,806	(1,291)	(1,413)	2,462	-	761
Net (decrease)/increase in other liabilities	(176)	(132)	45	(215)	(132)	140
Effects of exchange rate differences	(853)	(417)	399	(598)	(685)	154
<b>Net cash flow from/(used in) operating activities before tax</b>	<b>2,430</b>	(4,542)	2,167	<b>2,722</b>	(5,337)	31,176
Corporation tax paid	(42)	(13)	(28)	(12)	(13)	(17)
<b>Net cash flow from/(used in) operating activities</b>	<b>2,388</b>	(4,555)	2,139	<b>2,710</b>	(5,350)	31,159

(1) As restated, see Note 45

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

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Cash and balances at central banks	388	7,013	388	7,013
Less: regulatory minimum cash balances (See Note 13)	(23)	(18)	(23)	(18)
	365	6,995	365	6,995
Debt securities - Trading	1,196	4,093	1,196	4,093
Loans and advances to banks - Trading	6,425	3,140	6,425	3,140
Loans and advances to customers - Trading	3,363	6,360	3,363	6,360
<b>Net trading other cash equivalents</b>	<b>10,984</b>	13,593	<b>10,984</b>	13,593
Loans and advances to banks - Non trading	68,065	59,270	68,051	59,159
<b>Net non-trading other cash equivalents</b>	<b>68,065</b>	59,270	<b>68,051</b>	59,159
<b>Cash and cash equivalents at year end</b>	<b>79,414</b>	79,858	<b>79,400</b>	79,747

## Notes to the Financial Statements continued

**39. ASSETS CHARGED AS SECURITY FOR LIABILITIES AND COLLATERAL ACCEPTED AS SECURITY FOR ASSETS**

The following transactions are conducted under terms that are usual and customary to collateralised transactions, including, where relevant, standard securities lending and repurchase agreements.

**a) Financial assets pledged to secure liabilities**

The financial assets below are analysed between those assets accounted for on the balance sheet and off-balance sheet in accordance with IFRS.

	2012	Group 2011
	£m	£m
<b>On balance sheet:</b>		
Treasury bills and other eligible securities	2,924	6,141
Cash	2,741	3,004
Debt securities	483	129
Equity securities	309	321
	<b>6,457</b>	9,595
<b>Off balance sheet:</b>		
Treasury bills and other eligible securities	17,666	14,046
Debt securities	6,784	17,217
Equity securities	105	196
	<b>24,555</b>	31,459

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

**Sale and repurchase agreements**

The Company and certain of its subsidiaries 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 Company and subsidiaries provide collateral equal to 100%-131% of the borrowed amount. The carrying amount of assets that were so provided at 31 December 2012 was £18,269m (2011: £26,232m).

**Stock borrowing and lending agreements**

Asset balances under stock borrowing and lending agreements represent stock lent by the ANTS group. These balances amounted to £10,002m at 31 December 2012 (2011: £12,180m) and are offset by contractual commitments to return stock borrowed or cash received.

**Derivatives business**

In addition to the arrangements described above, collateral is also provided in the normal course of derivative business to counterparties. At 31 December 2012, £2,741m (2011: £2,642m) of such collateral in the form of cash had been provided by the ANTS group and is included in the table above.

**b) Collateral held as security for assets:**

	2012	Group 2011
	£m	£m
<b>On balance sheet:</b>		
Trading liabilities	2,269	3,004
	<b>2,269</b>	3,004
<b>Off balance sheet:</b>		
Trading liabilities	23,865	19,552
Deposits by banks	233	2,054
	<b>24,098</b>	21,606

**Purchase and resale agreements**

The Company and certain of its subsidiaries 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 Company and subsidiaries receive collateral equal to 100%-105% of the loan amount. The level of collateral held is monitored daily and if required, further calls are made to ensure the market values of collateral remains at least equal to the loan balance. The Company and subsidiaries are permitted to sell or repledge the collateral held in the absence of default. At 31 December 2012, the fair value of such collateral received was £14,789m (2011: £11,776m), almost all of which was sold or repledged. The Company and its subsidiaries have an obligation to return collateral that they have sold or pledged.

## Notes to the Financial Statements continued

**Stock borrowing and lending agreements**

Obligations under stock borrowing and lending agreements represent contractual commitments to return stock borrowed. These obligations totalling £9,309m at 31 December 2012 (2011: £9,830m) and are offset by a contractual right to receive stock lent by the ANTS group.

**Derivatives business**

In addition to the arrangements described above, collateral is also received in the normal course of derivative business from counterparties. At 31 December 2012, £2,269m (2011: £2,642m) of such collateral in the form of cash had been received by the ANTS group and is included in the table above.

**Lending activities**

In addition to the above collateral held as security for assets, the ANTS group may obtain a charge over a customer's property in connection with its lending activities. Details of these arrangements are set out in the "Credit Risk" section of the Risk Management Report.

**40. PENSIONS AND OTHER POST-RETIREMENT BENEFITS**

The ANTS group participates in various Santander UK defined benefit and defined contribution pension schemes in operation. There is no contractual agreement of stated policy for charging the net defined benefit cost of the Santander UK defined benefit schemes. Therefore, in accordance with IAS 19, the defined benefit asset or liability has been recognised in the financial statements of the sponsoring employer of the scheme and the ANTS group accounts for its contributions as a defined contribution scheme. The contribution to be paid by the ANTS group is calculated as the contributions made by Santander UK plc to the schemes in respect of the ANTS group's employees. An amount of £6m (2011: £5m) was recognised as an expense for these contributions and is included in staff costs within administration expenses in the income statement.

**41. RELATED PARTY DISCLOSURES****Transactions with Directors, Key Management Personnel and their connected persons**

Other than as disclosed below, there were no other related party transactions during the year, or existing at the balance sheet date with the Company or parent company's Key Management Personnel. Key Management Personnel are defined as the Directors of the Company.

**Remuneration of Key Management Personnel**

The remuneration of the Directors 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 Note 10.

Key management compensation	2012 £	2011 £	2010 £
Short-term employee benefits	<b>1,499,301</b>	1,503,860	1,342,305
Post employment benefits	<b>79,889</b>	75,298	44,523
Share-based payments	<b>32,927</b>	68,075	116,711
Total key management compensation	<b>1,612,117</b>	1,647,233	1,503,539

Of the Directors that served during the year, three were remunerated in relation to their services as directors of this Company and the amounts included above are based on an estimated time allocation basis.

**Long-Term Incentive Plan**

In 2012, no Executive Directors (2011: none, 2010: three) were granted conditional awards of shares in Banco Santander, S.A. under the Santander Long-Term Incentive Plan (2010: total fair value of £59,414 based on a share price of euro 5.57). Under the Santander Long-Term Incentive Plans granted on 1 July 2010, 1 July 2009, 21 June 2008 and 31 December 2007, certain Executive Directors, Key Management Personnel and other nominated individuals were granted conditional awards of shares in Banco Santander, S.A..

## Notes to the Financial Statements continued

The number of shares participants will receive depends on the performance of Banco Santander, S.A. during this period. The vesting of awards under the Santander Long-Term Incentive Plan depends on Santander's Total Shareholder Return performance against a competitor benchmark group. Awards made prior to 2009 also depend on Santander's Earnings Per Share performance against a competitor benchmark group. 90.79% of the 40% of the 2007 conditional award of shares vested in July 2009 and 90.79% of the remaining 60% of the 2007 conditional award vested in July 2010. Subject to performance conditions being met, 100% of the 2008 conditional award vested in July 2011, 100% of the 2009 conditional award vested in July 2012 and 100% of the 2010 conditional award will vest in July 2013. In 2012, Long-Term Incentive Plan shares awarded in 2009 vested for three Director(s) (2011: two).

## Parent undertaking and controlling party

The Company's immediate parent is Santander UK plc. The ultimate parent and controlling party is Banco Santander, S.A., a company incorporated in Spain. The smallest and largest groups into which the Company's results are included are the group accounts of Santander UK plc and Banco Santander, S.A. respectively. A copy of the accounts of Santander UK plc may be obtained from Secretariat, Santander UK plc, 2 Triton Square, Regent's Place, London NW1 3AN. A copy of the accounts of Banco Santander, S.A. may be obtained from Santander Shareholder Relations, 2 Triton Square, Regent's Place, London NW1 3AN or on the Santander UK corporate website ([www.aboutsantander.co.uk](http://www.aboutsantander.co.uk)).

## Transactions with related parties

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

	Interest, fees and other income received			Interest, fees and other expense paid			Amounts owed by related parties		Amounts owed to related parties	
	2012	2011	2010	2012	2011	2010	2012	2011	2012	2011
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Ultimate parent company	(53)	(163)	(322)	151	12	12	2,470	4,991	(4,274)	(5,364)
Immediate parent	(2,687)	(3,169)	(3,280)	2,010	2,118	1,998	107,324	110,848	(101,231)	(94,801)
Fellow subsidiaries	(1,210)	(833)	(499)	458	448	349	35,653	31,644	(16,247)	(20,296)
	<b>(3,950)</b>	<b>(4,165)</b>	<b>(4,101)</b>	<b>2,619</b>	<b>2,578</b>	<b>2,359</b>	<b>145,447</b>	<b>147,483</b>	<b>(121,752)</b>	<b>(120,461)</b>

	Interest, fees and other income received			Interest, fees and other expense paid			Amounts owed by related parties		Amounts owed to related parties	
	2012	2011	2010	2012	2011	2010	2012	2011	2012	2011
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Ultimate parent company	(53)	(107)	(313)	151	12	11	2,470	4,991	(4,274)	(5,360)
Immediate parent	(2,687)	(3,156)	(3,188)	2,010	2,118	1,998	107,319	110,848	(101,231)	(94,800)
Subsidiaries	(4)	(88)	(323)	22	30	29	151	126	(4,351)	(5,163)
Fellow subsidiaries	(1,210)	(832)	(496)	458	448	346	35,649	31,638	(16,247)	(20,296)
	<b>(3,954)</b>	<b>(4,183)</b>	<b>(4,320)</b>	<b>2,641</b>	<b>2,608</b>	<b>2,384</b>	<b>145,589</b>	<b>147,603</b>	<b>(126,103)</b>	<b>(125,619)</b>

Further information on balances due from/(to) other Santander group companies is set out in the section "Balances with other Santander UK group companies" and "Balances with other Banco Santander group companies" in the Risk Management Report on pages 89 to 91. 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 and within limits acceptable to the UK Financial Services Authority. Such transactions do not involve more than the normal risk of collectability or present any unfavourable features.

## 42. EVENTS AFTER THE BALANCE SHEET DATE

None.

## Notes to the Financial Statements continued

## 43. FINANCIAL INSTRUMENTS

## a) Measurement basis of financial assets and liabilities

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. Note 1 describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following tables analyse the ANTS group's financial instruments into those measured at fair value and those measured at amortised cost in the balance sheet:

31 December 2012	Held at fair value				Held at amortised cost		Group	
	Trading	Derivatives designated as hedges	Designated at fair value through P&L	Available-for-sale	Financial assets at amortised cost	Financial liabilities at amortised cost	Non-financial assets / liabilities	Total
	£m	£m	£m	£m	£m	£m	£m	£m
<b>Assets</b>								
Cash and balances at central banks	-	-	-	-	388	-	-	388
Trading assets	22,498	-	-	-	-	-	-	22,498
Derivative financial instruments	32,873	403	-	-	-	-	-	33,276
Financial assets designated at FV	-	-	3,531	-	-	-	-	3,531
Loans and advances to banks	-	-	-	-	106,986	-	-	106,986
Loans and advances to customers	-	-	-	-	44,750	-	-	44,750
Available-for-sale securities	-	-	-	5,113	-	-	-	5,113
Loans and receivables securities	-	-	-	-	162	-	-	162
Macro hedge of interest rate risk	-	-	-	-	1,171	-	-	1,171
Intangible assets	-	-	-	-	-	-	7	7
Property, plant and equipment	-	-	-	-	-	-	6	6
Deferred tax assets	-	-	-	-	-	-	20	20
Other assets	-	-	-	-	-	-	4	4
	<b>55,371</b>	<b>403</b>	<b>3,531</b>	<b>5,113</b>	<b>153,457</b>	-	<b>37</b>	<b>217,912</b>
<b>Liabilities</b>								
Deposits by banks	-	-	-	-	-	114,535	-	114,535
Deposits by customers	-	-	-	-	-	6,249	-	6,249
Derivative financial liabilities	32,493	1,595	-	-	-	-	-	34,088
Trading liabilities	21,109	-	-	-	-	-	-	21,109
Financial liabilities at FVTPL	-	-	4,002	-	-	-	-	4,002
Debt securities in issue	-	-	-	-	-	33,770	-	33,770
Other liabilities	-	-	-	-	-	-	169	169
Provisions	-	-	-	-	-	-	20	20
Current tax liabilities	-	-	-	-	-	-	175	175
	<b>53,602</b>	<b>1,595</b>	<b>4,002</b>	-	-	<b>154,554</b>	<b>364</b>	<b>214,117</b>

31 December 2012	Held at fair value				Held at amortised cost		Company	
	Trading	Derivatives designated as hedges	Designated at fair value through P&L	Available-for-sale	Financial assets at amortised cost	Financial liabilities at amortised cost	Non-financial assets / liabilities	Total
	£m	£m	£m	£m	£m	£m	£m	£m
<b>Assets</b>								
Cash and balances at central banks	-	-	-	-	388	-	-	388
Trading assets	22,155	-	-	-	-	-	-	22,155
Derivative financial instruments	32,909	403	-	-	-	-	-	33,312
Financial assets designated at FV	-	-	3,531	-	-	-	-	3,531
Loans and advances to banks	-	-	-	-	106,972	-	-	106,972
Loans and advances to customers	-	-	-	-	44,858	-	-	44,858
Available-for-sale securities	-	-	-	5,113	-	-	-	5,113
Loans and receivables securities	-	-	-	-	162	-	-	162
Macro hedge of interest rate risk	-	-	-	-	1,171	-	-	1,171
Intangible assets	-	-	-	-	-	-	7	7
Investment in subsidiary undertakings	-	-	-	-	-	-	2,184	2,184
Property, plant and equipment	-	-	-	-	-	-	6	6
Deferred tax assets	-	-	-	-	-	-	20	20
Other assets	-	-	-	-	-	-	4	4
	<b>55,064</b>	<b>403</b>	<b>3,531</b>	<b>5,113</b>	<b>153,551</b>	-	<b>2,221</b>	<b>219,883</b>
<b>Liabilities</b>								
Deposits by banks	-	-	-	-	-	114,535	-	114,535
Deposits by customers	-	-	-	-	-	10,599	-	10,599
Derivative financial liabilities	32,493	1,595	-	-	-	-	-	34,088
Trading liabilities	21,109	-	-	-	-	-	-	21,109
Financial liabilities at FVTPL	-	-	4,002	-	-	-	-	4,002
Debt securities in issue	-	-	-	-	-	31,481	-	31,481
Other liabilities	-	-	-	-	-	-	166	166
Provisions	-	-	-	-	-	-	20	20
Current tax liabilities	-	-	-	-	-	-	175	175
	<b>53,602</b>	<b>1,595</b>	<b>4,002</b>	-	-	<b>156,615</b>	<b>361</b>	<b>216,175</b>



## Notes to the Financial Statements continued

31 December 2011	Held at fair value			Held at amortised cost		Group	
	Trading	Derivatives designated as hedges	Designated at fair value through P&L	Financial assets at amortised cost	Financial liabilities at amortised cost	Non- financial assets / liabilities	Total
	£m	£m	£m	£m	£m	£m	£m
<b>Assets</b>							
Cash and balances at central banks	-	-	-	7,013	-	-	7,013
Trading assets	21,891	-	-	-	-	-	21,891
Derivative financial instruments	32,864	360	-	-	-	-	33,224
Financial assets designated at FV	-	-	4,429	-	-	-	4,429
Loans and advances to banks	-	-	-	113,222	-	-	113,222
Loans and advances to customers	-	-	-	38,826	-	-	38,826
Loans and receivables securities	-	-	-	278	-	-	278
Macro hedge of interest rate risk	-	-	-	1,141	-	-	1,141
Intangible assets	-	-	-	-	-	3	3
Property, plant and equipment	-	-	-	-	-	5	5
Deferred tax assets	-	-	-	-	-	17	17
Other assets	-	-	-	-	-	43	43
	54,755	360	4,429	160,480	-	68	220,092
<b>Liabilities</b>							
Deposits by banks	-	-	-	-	114,019	-	114,019
Deposits by customers	-	-	-	-	7,114	-	7,114
Derivative financial liabilities	34,180	1,237	-	-	-	-	35,417
Trading liabilities	25,745	-	-	-	-	-	25,745
Financial liabilities at FVTPL	-	-	6,836	-	-	-	6,836
Debt securities in issue	-	-	-	-	26,943	-	26,943
Other liabilities	-	-	-	-	-	142	142
Provisions	-	-	-	-	-	20	20
Current tax liabilities	-	-	-	-	-	329	329
	59,925	1,237	6,836	-	148,076	491	216,565

31 December 2011	Held at fair value			Held at amortised cost		Company	
	Trading	Derivatives designated as hedges	Designated at fair value through P&L	Financial assets at amortised cost	Financial liabilities at amortised cost	Non- financial assets / liabilities	Total
	£m	£m	£m	£m	£m	£m	£m
<b>Assets</b>							
Cash and balances at central banks	-	-	-	7,013	-	-	7,013
Trading assets	21,564	-	-	-	-	-	21,564
Derivative financial instruments	32,882	360	-	-	-	-	33,242
Financial assets designated at FV	-	-	4,429	-	-	-	4,429
Loans and advances to banks	-	-	-	113,211	-	-	113,211
Loans and advances to customers	-	-	-	38,926	-	-	38,926
Loans and receivables securities	-	-	-	278	-	-	278
Macro hedge of interest rate risk	-	-	-	1,141	-	-	1,141
Investment in subsidiary undertakings	-	-	-	-	-	2,187	2,187
Intangible assets	-	-	-	-	-	3	3
Property, plant and equipment	-	-	-	-	-	5	5
Deferred tax assets	-	-	-	-	-	17	17
Other assets	-	-	-	-	-	43	43
	54,446	360	4,429	160,569	-	2,255	222,059
<b>Liabilities</b>							
Deposits by banks	-	-	-	-	114,018	-	114,018
Deposits by customers	-	-	-	-	12,276	-	12,276
Derivative financial liabilities	34,180	1,237	-	-	-	-	35,417
Trading liabilities	25,745	-	-	-	-	-	25,745
Financial liabilities at FVTPL	-	-	6,780	-	-	-	6,780
Debt securities in issue	-	-	-	-	23,869	-	23,869
Other liabilities	-	-	-	-	-	137	137
Provisions	-	-	-	-	-	20	20
Current tax liabilities	-	-	-	-	-	320	320
	59,925	1,237	6,780	-	150,163	477	218,582

## Notes to the Financial Statements continued

## b) Fair values of financial instruments carried at amortised cost

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

31 December 2012	Group		
	Carrying value £m	Fair value £m	Surplus/(deficit) £m
<b>Assets</b>			
Cash and balances at central banks	388	388	-
Loans and advances to banks	106,986	107,145	159
Loans and advances to customers	44,750	47,533	2,783
Loans and receivable securities	162	154	(8)
<b>Liabilities</b>			
Deposits by banks	114,535	118,208	(3,673)
Deposits by customers	6,249	6,264	(15)
Debt securities in issue	33,770	35,071	(1,301)

31 December 2012	Company		
	Carrying value £m	Fair value £m	Surplus/(deficit) £m
<b>Assets</b>			
Cash and balances at central banks	388	388	-
Loans and advances to banks	106,972	107,131	159
Loans and advances to customers	44,858	47,641	2,783
Loans and receivable securities	162	154	(8)
<b>Liabilities</b>			
Deposits by banks	114,535	118,208	(3,673)
Deposits by customers	10,599	10,615	(16)
Debt securities in issue	31,481	32,783	(1,302)

31 December 2011	Group		
	Carrying value £m	Fair value £m	Surplus/(deficit) £m
<b>Assets</b>			
Cash and balances at central banks	7,013	7,013	-
Loans and advances to banks	113,222	114,915	1,693
Loans and advances to customers	38,826	41,133	2,307
Loans and receivable securities	278	280	2
<b>Liabilities</b>			
Deposits by banks	114,019	115,060	(1,041)
Deposits by customers	7,114	7,213	(99)
Debt securities in issue	26,943	27,788	(845)

31 December 2011	Company		
	Carrying value £m	Fair value £m	Surplus/(deficit) £m
<b>Assets</b>			
Cash and balances at central banks	7,013	7,013	-
Loans and advances to banks	113,211	114,905	1,694
Loans and advances to customers	38,926	41,233	2,307
Loans and receivable securities	278	281	3
<b>Liabilities</b>			
Deposits by banks	114,018	115,058	(1,040)
Deposits by customers	12,276	12,362	(86)
Debt securities in issue	23,869	24,714	(845)

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

**Valuation methodology**

The fair value of financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. If a quoted market price is available for an instrument, the fair value is calculated based on the market price. Where quoted market prices are not available, fair value is determined using pricing models which use a mathematical methodology based on accepted financial theories, depending on the product type and its components. Further information on fair value measurement can be found in Note 1 and the valuation techniques section below.

## Notes to the Financial Statements continued

### 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

This consists of demand deposits with the Bank of England and the US Federal Reserve, together with cash in tills and ATMs. The carrying amount of cash and balances at central banks is deemed a reasonable approximation of the fair value.

#### Loans and advances to banks

These comprise secured loans, short term placements with banks including collateral, and unsettled financial transactions. The secured loans have been valued on the basis of spreads on credit default swaps for the term of the loans. The carrying amount of the other items is deemed a reasonable approximation of their fair value, as the transactions are very short-term in duration.

#### Loans and advances to customers

The approach to estimating the fair value of the principal products and portfolios of loans and advances to customers was as follows:

##### *i) Corporate lending*

Following the transfer of the non-core portfolios to Corporate Centre, the remaining corporate assets are written at current interest rates and margins and are considered appropriately provided for. A shortfall in Large Corporates relates to certain infrastructure assets which have not been transferred to Corporate Centre.

With respect to the non-core portfolios, an exercise has been undertaken to estimate their market value, based on an orderly disposal process over a period of three years. This portfolio is well provided for, and this is reflected in a relatively small mark-to-market deficit.

##### *ii) Social housing*

Part of this portfolio is held for historic reasons at fair value and the methodology used to value the fair value part of the portfolio has been used to calculate the market value of the amortised cost part of the portfolio.

#### Loans and receivables securities

These debt securities consist primarily of asset-backed securities which are complex products and are valued with the assistance of an independent, specialist valuation firm. These fair values are determined using industry-standard valuation techniques, including discounted cash-flow models. The inputs to these models used in these valuation techniques include quotes from market makers, prices of similar assets, adjustments for differences in credit spreads, and additional quantitative and qualitative research. Disposals of these securities since 2008 have demonstrated that actual sales prices achieved have been close to fair values estimated under this method.

### Liabilities

#### Deposits by banks

The fair value of deposits by banks, including repos, has been estimated using "valuation technique A" as described in the valuation technique section below.

#### 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 ANTS group's customers, the Directors believe there is significant value to the ANTS group in this source of funds. Certain of the deposit liabilities are at a fixed rate until maturity. The deficit of fair value over carrying value of these liabilities has been estimated by reference to the market rates available at the balance sheet date for similar deposit liabilities of similar maturities. The fair value of such deposits liabilities has been estimated using "valuation technique A" as described in the valuation technique section below.

#### Debt securities in issue

Where reliable prices are available, the fair value of debt securities in issue has been calculated using quoted market prices. Other market values have been determined using "valuation technique A" as described in the valuation technique section below.

## Notes to the Financial Statements continued

## c) Fair value valuation bases of financial instruments carried at fair value

The following tables summarise the fair values at 31 December 2012 and 2011 of the financial asset and liability classes accounted for at fair value, analysed by the valuation methodology used by the ANTS group to determine their fair value. The tables also disclose the percentages that the recorded fair values of financial assets and liabilities represent of the total assets and liabilities, respectively, that are recorded at fair value in the balance sheet:

## 31 December 2012

Balance sheet category		Internal models based on						Total	Valuation technique	
		Quoted prices in active markets (Level 1)		Market observable data (Level 2)		Significant unobservable data (Level 3)				
		£m	%	£m	%	£m	%			£m
<b>Assets</b>										
Trading assets	Loans and advances to banks	-	-	9,988	16	-	-	9,988	16	A
	Loans and advances to customers	-	-	7,552	12	-	-	7,552	12	A
	Debt securities	4,494	7	-	-	-	-	4,494	7	-
	Equity securities	464	1	-	-	-	-	464	1	-
Derivative assets	Exchange rate contracts	-	-	3,660	6	36	-	3,696	6	A
	Interest rate contracts	54	-	28,038	43	-	-	28,092	43	A & C
	Equity and credit contracts	152	-	957	1	372	1	1,481	2	B
	Commodity contracts	-	-	7	-	-	-	7	-	A
Financial assets at FVTPL	Loans and advances to customers	-	-	3,142	5	61	-	3,203	5	A
	Debt securities	-	-	279	-	49	-	328	-	A
AFS Financial assets	Debt securities	5,113	8	-	-	-	-	5,113	8	-
Total assets at fair value		10,277	16	53,623	83	518	1	64,418	100	
<b>Liabilities</b>										
Trading liabilities	Deposits by banks	-	-	9,742	16	-	-	9,742	16	A
	Deposits by customers	-	-	7,248	12	-	-	7,248	12	A
	Short positions	4,119	7	-	-	-	-	4,119	7	-
Derivative liabilities	Exchange rate contracts	-	-	4,552	8	-	-	4,552	8	A
	Interest rate contracts	31	-	27,460	47	-	-	27,491	47	A & C
	Equity and credit contracts	86	-	1,880	3	72	-	2,038	3	B
	Commodity contracts	-	-	7	-	-	-	7	-	A
Financial liabilities at FVTPL	Debt securities in issue	-	-	3,916	7	86	-	4,002	7	A
Total liabilities at fair value		4,236	7	54,805	93	158	-	59,199	100	

## 31 December 2011

Balance sheet category		Internal models based on						Total	Valuation technique	
		Quoted prices in active markets (Level 1)		Market observable data (Level 2)		Significant unobservable data (Level 3)				
		£m	%	£m	%	£m	%			£m
<b>Assets</b>										
Trading assets	Loans and advances to banks	-	-	6,144	10	-	-	6,144	10	A
	Loans and advances to customers	-	-	6,687	11	-	-	6,687	11	A
	Debt securities	8,711	14	-	-	-	-	8,711	14	-
	Equity securities	349	1	-	-	-	-	349	1	-
Derivative assets	Exchange rate contracts	-	-	1,618	3	70	-	1,688	3	A
	Interest rate contracts	54	-	29,782	50	-	-	29,836	50	A & C
	Equity and credit contracts	152	-	1,176	2	360	1	1,688	3	B
	Commodity contracts	-	-	12	-	-	-	12	-	A
Financial assets at FVTPL	Loans and advances to customers	-	-	3,992	7	58	-	4,050	7	A
	Debt securities	-	-	328	1	51	-	379	1	A
Total assets at fair value		9,266	15	49,739	84	539	1	59,544	100	
<b>Liabilities</b>										
Trading liabilities	Deposits by banks	-	-	14,508	21	-	-	14,508	21	A
	Deposits by customers	-	-	10,482	15	-	-	10,482	15	A
	Short positions	755	1	-	-	-	-	755	1	-
Derivative liabilities	Exchange rate contracts	-	-	3,087	5	-	-	3,087	5	A
	Interest rate contracts	41	-	29,490	44	-	-	29,531	44	A & C
	Equity and credit contracts	12	-	2,687	4	89	-	2,788	4	B
	Commodity contracts	-	-	11	-	-	-	11	-	A
Financial liabilities at FVTPL	Debt securities in issue	-	-	6,695	10	141	-	6,836	10	A
Total liabilities at fair value		808	1	66,960	99	230	-	67,998	100	

## Notes to the Financial Statements continued

31 December 2012		Company								
		Balance sheet category	Quoted prices in active markets (Level 1)	Internal models based on				Total	Valuation technique	
				Market observable data (Level 2)		Significant unobservable data (Level 3)				
				£m	%	£m	%			£m
<b>Assets</b>										
Trading assets	Loans and advances to banks	-	-	9,988	16	-	-	9,988	16	A
	Loans and advances to customers	-	-	7,551	12	-	-	7,551	12	A
	Debt securities	4,494	7	-	-	-	-	4,494	7	-
	Equity securities	122	-	-	-	-	-	122	-	-
Derivative assets	Exchange rate contracts	-	-	3,660	6	36	-	3,696	6	A
	Interest rate contracts	54	-	28,053	43	-	-	28,107	43	A & C
	Equity and credit contracts	152	-	978	2	372	1	1,502	3	B
	Commodity contracts	-	-	7	-	-	-	7	-	A
Financial assets at FVTPL	Loans and advances to customers	-	-	3,142	5	61	-	3,203	5	A
	Debt securities	-	-	279	-	49	-	328	-	A
Available-for-sale financial assets	Debt securities	5,113	8	-	-	-	-	5,113	8	-
Total assets at fair value		9,935	15	53,658	84	518	1	64,111	100	
<b>Liabilities</b>										
Trading liabilities	Deposits by banks	-	-	9,742	16	-	-	9,742	16	A
	Deposits by customers	-	-	7,248	12	-	-	7,248	12	A
	Short positions	4,119	7	-	-	-	-	4,119	7	-
Derivative liabilities	Exchange rate contracts	-	-	4,552	8	-	-	4,552	8	A
	Interest rate contracts	31	-	27,460	46	-	-	27,491	46	A & C
	Equity and credit contracts	86	-	1,880	4	72	-	2,038	4	B
	Commodity contracts	-	-	7	-	-	-	7	-	A
Financial liabilities at FVTPL	Debt securities in issue	-	-	3,916	7	86	-	4,002	7	A
Total liabilities at fair value		4,236	7	54,805	93	158	-	59,199	100	

31 December 2011		Company								
		Balance sheet category	Quoted prices in active markets (Level 1)	Internal models based on				Total	Valuation technique	
				Market observable data (Level 2)		Significant unobservable data (Level 3)				
				£m	%	£m	%			£m
<b>Assets</b>										
Trading assets	Loans and advances to banks	-	-	6,144	10	-	-	6,144	10	A
	Loans and advances to customers	-	-	6,686	11	-	-	6,686	11	A
	Debt securities	8,711	15	-	-	-	-	8,711	15	-
	Equity securities	23	-	-	-	-	-	23	-	-
Derivative assets	Exchange rate contracts	-	-	1,617	3	70	-	1,687	3	A
	Interest rate contracts	54	-	29,784	50	-	-	29,838	50	A & C
	Equity and credit contracts	156	-	1,189	2	360	1	1,705	3	B
	Commodity contracts	-	-	12	-	-	-	12	-	A
Financial assets at FVTPL	Loans and advances to customers	-	-	3,992	7	58	-	4,050	7	A
	Debt securities	-	-	328	1	51	-	379	1	A
Available-for-sale financial assets	Equity securities	-	-	-	-	-	-	-	-	-
Total assets at fair value		8,944	15	49,752	84	539	1	59,235	100	
<b>Liabilities</b>										
Trading liabilities	Deposits by banks	-	-	14,508	21	-	-	14,508	21	A
	Deposits by customers	-	-	10,482	15	-	-	10,482	15	A
	Short positions	755	1	-	-	-	-	755	1	-
Derivative liabilities	Exchange rate contracts	-	-	3,087	5	-	-	3,087	5	A
	Interest rate contracts	41	-	29,490	44	-	-	29,531	44	A & C
	Equity and credit contracts	12	-	2,687	4	89	-	2,788	4	B
	Commodity contracts	-	-	11	-	-	-	11	-	A
Financial liabilities at FVTPL	Debt securities in issue	-	-	6,639	10	141	-	6,780	10	A
Total liabilities at fair value		808	1	66,904	99	230	-	67,942	100	

## Notes to the Financial Statements continued

The following tables present the fair values at 31 December 2012 and 2011 of the above financial assets and liabilities by product, analysed by the valuation methodology used by the ANTS group to determine their fair value. The tables also disclose the percentages that the recorded fair values of products represent of the total assets and liabilities, respectively, that are recorded at fair value in the balance sheet:

		Group							
Product		Internal models based on							
		Quoted prices in active markets		Market observable data		Significant unobservable data		Total	
		£m	%	£m	%	£m	%	£m	%
<b>31 December 2012</b>									
<b>Assets</b>									
Government and government-guaranteed debt securities	3,917	6	-	-	-	-	3,917	6	
Asset-backed securities	-	-	279	-	49	-	328	-	
Certificates of deposits	13	-	-	-	-	-	13	-	
Floating rate notes	564	1	-	-	-	-	564	1	
Other debt securities	5,113	8	-	-	-	-	5,113	8	
UK Social housing association loans	-	-	3,142	5	-	-	3,142	5	
Other loans	-	-	-	-	61	-	61	-	
Term deposits and money market instruments	-	-	17,540	28	-	-	17,540	28	
Exchange rate derivatives	-	-	3,660	6	36	-	3,696	6	
Interest rate derivatives	54	-	28,038	43	-	-	28,092	43	
Equity & credit derivatives	152	-	957	1	372	1	1,481	2	
Commodity derivatives	-	-	7	-	-	-	7	-	
Ordinary shares and similar securities	464	1	-	-	-	-	464	1	
	<b>10,277</b>	<b>16</b>	<b>53,623</b>	<b>83</b>	<b>518</b>	<b>1</b>	<b>64,418</b>	<b>100</b>	
<b>Liabilities</b>									
Exchange rate derivatives	-	-	4,552	8	-	-	4,552	8	
Interest rate derivatives	31	-	27,460	47	-	-	27,491	47	
Equity & credit derivatives	86	-	1,880	3	72	-	2,038	3	
Commodity derivatives	-	-	7	-	-	-	7	-	
Deposits	-	-	16,990	28	-	-	16,990	28	
Debt securities in issue	4,119	7	3,916	7	86	-	8,121	14	
	<b>4,236</b>	<b>7</b>	<b>54,805</b>	<b>93</b>	<b>158</b>	<b>-</b>	<b>59,199</b>	<b>100</b>	
		Group							
		Internal models based on							
Product		Quoted prices in active markets		Market observable data		Significant unobservable data		Total	
		£m	%	£m	%	£m	%	£m	%
<b>31 December 2011</b>									
<b>Assets</b>									
Government and government-guaranteed debt securities	2,943	6	-	-	-	-	2,943	6	
Asset-backed securities	-	-	328	1	51	-	379	1	
Floating rate notes	5,768	9	-	-	-	-	5,768	9	
UK Social housing association loans	-	-	3,992	7	-	-	3,992	7	
Other loans	-	-	-	-	58	-	58	-	
Term deposits and money market instruments	-	-	12,831	21	-	-	12,831	21	
Exchange rate derivatives	-	-	1,618	3	70	-	1,688	3	
Interest rate derivatives	54	-	29,782	50	-	-	29,836	50	
Equity & credit derivatives	152	-	1,176	2	360	1	1,688	3	
Commodity derivatives	-	-	12	-	-	-	12	-	
Ordinary shares and similar securities	349	-	-	-	-	-	349	-	
	<b>9,266</b>	<b>15</b>	<b>49,739</b>	<b>84</b>	<b>539</b>	<b>1</b>	<b>59,544</b>	<b>100</b>	
<b>Liabilities</b>									
Exchange rate derivatives	-	-	3,087	5	-	-	3,087	5	
Interest rate derivatives	41	-	29,490	44	-	-	29,531	44	
Equity & credit derivatives	12	-	2,687	4	89	-	2,788	4	
Commodity derivatives	-	-	11	-	-	-	11	-	
Deposits	-	-	24,990	36	-	-	24,990	36	
Debt securities in issue	755	1	6,695	10	141	-	7,591	11	
	<b>808</b>	<b>1</b>	<b>66,960</b>	<b>99</b>	<b>230</b>	<b>-</b>	<b>67,998</b>	<b>100</b>	

## Notes to the Financial Statements continued

Company

31 December 2012

Product	Quoted prices in active markets		Internal models based on				Total	
			Market observable data		Significant unobservable data			
	£m	%	£m	%	£m	%	£m	%
<b>Assets</b>								
Government and government-guaranteed debt securities	3,917	6	-	-	-	-	3,917	6
Asset-backed securities	-	-	279	-	49	-	328	-
Certificates of deposits	13	-	-	-	-	-	13	-
Floating rate notes	564	1	-	-	-	-	564	1
Other debt securities	5,113	8	-	-	-	-	5,113	8
UK Social housing association loans	-	-	3,142	5	-	-	3,142	5
Other loans	-	-	-	-	61	-	61	-
Term deposits and money market instruments	-	-	17,539	28	-	-	17,539	28
Exchange rate derivatives	-	-	3,660	6	36	-	3,696	6
Interest rate derivatives	54	-	28,053	43	-	-	28,107	43
Equity & credit derivatives	152	-	978	2	372	1	1,502	3
Commodity derivatives	-	-	7	-	-	-	7	-
Ordinary shares and similar securities	122	-	-	-	-	-	122	-
	<b>9,935</b>	<b>15</b>	<b>53,658</b>	<b>84</b>	<b>518</b>	<b>1</b>	<b>64,111</b>	<b>100</b>
<b>Liabilities</b>								
Exchange rate derivatives	-	-	4,552	8	-	-	4,552	8
Interest rate derivatives	31	-	27,460	46	-	-	27,491	46
Equity & credit derivatives	86	-	1,880	4	72	-	2,038	4
Commodity derivatives	-	-	7	-	-	-	7	-
Deposits	-	-	16,990	28	-	-	16,990	28
Debt securities in issue	4,119	7	3,916	7	86	-	8,121	14
	<b>4,236</b>	<b>7</b>	<b>54,805</b>	<b>93</b>	<b>158</b>	<b>-</b>	<b>59,199</b>	<b>100</b>

Company

31 December 2011

Product	Quoted prices in active markets		Internal models based on				Total	
			Market observable data		Significant unobservable data			
	£m	%	£m	%	£m	%	£m	%
<b>Assets</b>								
Government and government-guaranteed debt securities	2,943	6	-	-	-	-	2,943	6
Asset-backed securities	-	-	328	1	51	-	379	1
Floating rate notes	5,768	9	-	-	-	-	5,768	9
UK Social housing association loans	-	-	3,992	7	-	-	3,992	7
Other loans	-	-	-	-	58	-	58	-
Term deposits and money market instruments	-	-	12,830	21	-	-	12,830	21
Exchange rate derivatives	-	-	1,617	3	70	-	1,687	3
Interest rate derivatives	54	-	29,784	50	-	-	29,838	50
Equity & credit derivatives	156	-	1,189	2	360	1	1,705	3
Commodity derivatives	-	-	12	-	-	-	12	-
Ordinary shares and similar securities	23	-	-	-	-	-	23	-
	<b>8,944</b>	<b>15</b>	<b>49,752</b>	<b>84</b>	<b>539</b>	<b>1</b>	<b>59,235</b>	<b>100</b>
<b>Liabilities</b>								
Exchange rate derivatives	-	-	3,087	5	-	-	3,087	5
Interest rate derivatives	41	-	29,490	44	-	-	29,531	44
Equity & credit derivatives	12	-	2,687	4	89	-	2,788	4
Commodity derivatives	-	-	11	-	-	-	11	-
Deposits	-	-	24,990	36	-	-	24,990	36
Debt securities in issue	755	1	6,639	10	141	-	7,535	11
	<b>808</b>	<b>1</b>	<b>66,904</b>	<b>99</b>	<b>230</b>	<b>-</b>	<b>67,942</b>	<b>100</b>

During 2012, 2011 and 2010, there were no transfers between Level 1, Level 2 and Level 3 financial instruments.

#### d) Valuation techniques

The main valuation techniques employed in the ANTS group's internal models to measure the fair value of the financial instruments disclosed above at 31 December 2012 and 2011 are set out below. In substantially all cases, the principal inputs into these models are derived from observable market data. The ANTS group did not make any material changes to the valuation techniques and internal models it used during the years ended 31 December 2012 and 2011.

- A** In the valuation of financial instruments requiring static hedging (for example interest rate, currency derivatives and commodity swaps) 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 or forward commodity prices as appropriate. 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. The forward commodity prices are generally observable market data.

## Notes to the Financial Statements continued

- B** In the valuation of equity financial instruments requiring dynamic hedging (principally equity securities, options and other structured instruments), proprietary local volatility and stochastic volatility models are used. These types of models are widely accepted in the financial services industry. Observable market inputs used in these models include the bid-offer spread, foreign currency exchange rates, volatility and correlation between indices. In limited circumstances, other inputs may be used in these models that are based on data other than observable market data, such as the Halifax's UK House Price Index ('HPI') volatility, HPI forward growth, HPI spot rate and mortality.
- C** In the valuation of financial instruments exposed to interest rate risk that require either static or dynamic hedging (such as interest rate futures, caps and floors, and options), the present value method (futures), Black's model (caps/floors) and the Hull/White and Markov functional models (Bermudan options) are used. These types of models are widely accepted in the financial services industry. The significant inputs used in these models are observable market data, including appropriate interest rate curves, volatilities, correlations and exchange rates. In limited circumstances, other inputs may be used in these models that are based on data other than observable market data, such as HPI volatility, HPI forward growth, HPI spot rate and mortality.

The fair values of the financial instruments arising from the ANTS 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. 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 ANTS 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.

### e) Fair value adjustments

The internal models incorporate assumptions that the ANTS group believes would be made by a market participant to establish fair value. Fair value adjustments are adopted when the ANTS group considers that there are additional factors that would be considered by a market participant in the determination of fair value of the instrument that are not incorporated in the valuation model. The magnitude of fair value adjustments depends upon many entity-specific factors, including modelling sophistication, the nature of products traded, and the size and type of risk exposures. For this reason, fair value adjustments may not be comparable across the banking industry.

The ANTS group classifies fair value adjustments as either 'risk-related' or 'model-related'. The fair value adjustments form part of the portfolio fair value and are included in the balance sheet values of the product types to which they have been applied. The majority of these adjustments relate to Markets. The magnitude and types of fair value adjustment adopted by Markets are listed in the following table:

	2012	2011
	£m	£m
<b>Risk-related:</b>		
- Bid-offer and trade specific adjustments	26	71
- Uncertainty	22	47
- Credit risk adjustment	107	70
	<b>155</b>	188
<b>Model-related:</b>		
- Model limitation	17	23
<b>Day One profits</b>	-	-
	<b>172</b>	211



## Notes to the Financial Statements continued

### Risk-related adjustments

'Risk-related' adjustments are driven, in part, by the magnitude of the ANTS group's market or credit risk exposure, and by external market factors, such as the size of market spreads.

#### (i) Bid-offer and trade specific adjustments

IAS 39 requires that portfolios are marked at bid or offer, as appropriate. Bid prices represent the price at which a long position could be sold and offer prices represent the price at which a short position could be bought back. Valuation models will typically generate mid market values. The bid-offer adjustment reflects the cost that would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the actual position.

The majority of the bid-offer adjustment relates to OTC derivative portfolios. For each portfolio, the major risk types are identified. These may include, inter alia, delta (the sensitivity to changes in the price of an underlying), vega (the sensitivity to changes in volatilities) and basis risk (the sensitivity to changes in the spread between two rates). For each risk type, the net portfolio risks are first classified into buckets, and then a bid-offer spread is applied to each risk bucket based upon the market bid-offer spread for the relevant hedging instrument.

The granularity of the risk bucketing is determined by reference to several factors, including the actual risk management practice undertaken by the ANTS group, the granularity of risk bucketing within the risk reporting process, and the extent of correlation between risk buckets. Within a risk type, the bid-offer adjustment for each risk bucket may be aggregated without offset or limited netting may be applied to reflect correlation between buckets. There is no netting applied between risk types or between portfolios that are not managed together for risk management purposes. There is no netting across legal entities.

As bid-offer spreads vary by maturity and risk type to reflect different spreads in the market, for positions where there is no observable quote, a trade specific adjustment is further made. This is to reflect widened spreads in comparison to proxies due to reduced liquidity or observability. Trade specific adjustments can also be made to incorporate liquidity triggers whereby wider spreads are applied to risks above pre-defined thresholds or on exotic products to ensure overall reserves match market close-out costs. These market close-out costs inherently incorporate risk decay and cross-effects which are unlikely to be adequately reflected in the static hedge based on vanilla instruments.

#### (ii) Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective, with less market evidence available from which to determine general market practice. In these circumstances, there exists a range of possible values that the financial instrument or market parameter may assume and an adjustment may be necessary to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt rather more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model. Uncertainty adjustments are derived by considering the potential range of derivative portfolio valuation given the available market data. The objective of an uncertainty adjustment is to arrive at a fair value that is not overly prudent but rather reflects a level of prudence believed to be consistent with market pricing practice.

Uncertainty adjustments are applied to various types of exotic OTC derivative. For example, the mean reversion speed of interest rates may be an important component of an exotic derivative value and an uncertainty adjustment may be taken to reflect the range of possible values that market participants may assume for this parameter.

#### (iii) Credit risk adjustment

The ANTS group adopts a credit risk adjustment (also frequently known as a 'credit valuation adjustment') against OTC derivative transactions to reflect within fair value the possibility that the counterparty may default, and the ANTS group may not receive the full market value of the transactions. The ANTS group calculates a separate credit risk adjustment for each Santander UK legal entity, and within each entity for each counterparty to which the entity has exposure. The ANTS group attempts to mitigate credit risk to third parties by entering into netting and collateral arrangements. The net counterparty exposure (i.e. counterparty positions netted by offsetting transactions and both cash and securities collateral) is then assessed for counterparty creditworthiness.

The ANTS group calculates the credit risk adjustment by applying the probability of default of the counterparty to the expected positive exposure to the counterparty, and multiplying the result by the loss expected in the event of default (i.e. the loss given default or 'LGD'). The timing of the expected losses is reflected by using a discount factor. The calculation is performed over the life of the potential exposure i.e. the credit risk adjustment is measured as a lifetime expected loss.

The expected positive exposure is calculated at a trade level. The main drivers of the expected positive exposure are the size of the risk position with the counterparty along with the prevailing market environment. Probabilities of default are calculated using credit default swap prices where available. Where these are not available, probabilities of default are based upon analysis of historic default rates. The credit rating used for a particular counterparty is that determined by the Group's internal credit process. The LGD is calculated at the facility level and takes into account the counterparty characteristics. Credit ratings and LGD are updated by the credit team as new relevant information becomes available and at periodic reviews performed at least annually.

**Notes to the Financial Statements** continued

The ANTS 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 ANTS group believes market participants would take that into account when transacting the respective instrument. The approach to measuring the impact of the ANTS group's credit risk on an instrument is done in the same manner as for third party credit risk. The impact of the ANTS 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. The ANTS group has not realised any profit or loss on revaluing fair values of derivatives to reflect its own creditworthiness. If the ANTS group had reflected such adjustments it would not have had a material impact on the valuations. Consequently, the ANTS group does not derive the adjustment on a bilateral basis and has a zero adjustment against derivative liabilities, often referred to as a 'debit valuation adjustment'.

For certain types of exotic derivatives where the products are not currently supported by the standard methodology, the ANTS group adopts an alternative methodology. Alternative methodologies used by the ANTS group fall into two categories. One method maps transactions against the results for similar products which are accommodated by the standard methodology. Where such a mapping approach is not appropriate, a bespoke methodology is used, generally following the same principles as the standard methodology, reflecting the key characteristics of the instruments but in a manner that is computationally less intensive. The calculation is applied at a trade level, with more limited recognition of credit mitigants such as netting or collateral agreements than used in the standard methodology described previously.

The methodologies do not, in general, account for 'wrong-way risk'. Wrong-way risk arises where the underlying value of the derivative prior to any credit risk adjustment is related to the probability of default of the counterparty. A more detailed description of wrong-way risk is set out below.

The ANTS group includes all third-party counterparties in the credit risk adjustment calculation and the ANTS group does not net credit risk adjustments across ANTS group entities.

**Wrong-way risk**

Wrong-way risk arises when there is a strong correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction. Wrong-way risk can be seen in the following examples:

- > When the counterparty is resident and/or incorporated in an emerging market and seeks to sell a non-domestic currency in exchange for its home currency;
- > When the trade involves the purchase of an equity put option from a counterparty whose shares are the subject of the option;
- > The purchase of credit protection from a counterparty who is closely associated with the reference entity of the credit default swap or total return swap; and
- > The purchase of credit protection on an asset type which is highly concentrated in the exposure of the counterparty selling the credit protection.

Exposure to 'wrong-way risk' is limited via internal governance processes and deal pricing. The ANTS group considers that an appropriate adjustment to reflect wrong-way risk is currently nil (2011: £nil).

**Model-related adjustments**

These adjustments are primarily related to internal factors, such as the ability of the ANTS group's models to incorporate all material market characteristics. A description of each adjustment type is given below:

**(i) Model limitation**

Models used for portfolio valuation purposes, particularly for exotic derivative products, may be based upon a simplifying set of assumptions that do not capture all material market characteristics or may be less reliable under certain market conditions. Additionally, markets evolve, and models that were adequate in the past may require development to capture all material market characteristics in current market conditions. In these circumstances, model limitation adjustments are adopted outside the core valuation model. The adjustment methodologies vary according to the nature of the model. The Quantitative Risk Group ('QRG'), an independent quantitative support function reporting into the Risk Department, highlights the requirement for model limitation adjustments and develops the methodologies employed. Over time, as model development progresses, model limitations are addressed within the core revaluation models and a model limitation adjustment is no longer needed.

**Day One profits adjustments**

Day One profit adjustments are adopted where the fair value estimated by a valuation model is based on one or more significant unobservable inputs, in accordance with IAS 39. Day One profits adjustments are amounts that have yet to be recognised in the income statement, which represent the difference between a 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. Day One profits adjustments are calculated and reported on a portfolio basis. At 31 December 2012 and 2011, the Day One profits adjustments were less than £1m.

**Notes to the Financial Statements** continued**f) Control framework**

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker. To this end, ultimate responsibility for the determination of fair values lies jointly with the Risk Department and the Finance Department. For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the ANTS group will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable.

The factors that are considered in this regard include:

- > The extent to which prices may be expected to represent genuine traded or tradeable prices;
- > The degree of similarity between financial instruments;
- > The degree of consistency between different sources;
- > The process followed by the pricing provider to derive the data;
- > The elapsed time between the date to which the market data relates and the balance sheet date; and
- > The manner in which the data was sourced.

The source of pricing data is considered as part of the process that determines the classification of the level of a financial instrument. 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.

**Internal valuation model review**

Models provide a logical framework for the capture and processing of necessary valuation inputs. For fair values determined using a valuation model, the control framework may include, as applicable, independent development or validation of:

- > The logic within valuation models;
- > The inputs to those models;
- > Any adjustments required outside the valuation models; and
- > Where possible, model outputs.

All internal valuation models are validated independently by QRG. A validation report is produced for each model-derived valuation 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 results of the independent valuation process are presented to the Models Committee UK for formal approval. Various Risk functions are represented including QRG and Trading Market Risk in addition to senior management. The members of the Models Committee UK consider the appropriateness of the model and whether model risk fair value adjustments are required. Any changes to the fair value adjustments methodology must also be approved by the Models Committee UK.

**g) Internal models based on observable market data (Level 2)****1. Trading Assets****Loans and advances to banks and loans and advances to customers - securities purchased under resale agreements**

These instruments consist of reverse repos with both professional non-bank customers and bank counterparties as part of the ANTS group's trading activities. The fair value of reverse repos is estimated by using the 'present value' method. Future cash flows are evaluated taking into consideration any derivative features of the reverse repos and are then discounted using the appropriate market rates for the applicable maturity and currency. Under these agreements, the ANTS group receives collateral with a market value equal to, or in excess of, the principal amount loaned. The level of collateral held is monitored daily and if required, further calls are made to ensure the market values of collateral remains at least equal to the loan balance. As a result, there would be no adjustment, or an immaterial adjustment, to reflect the credit quality of the counterparty related to these agreements. As the inputs used in the valuation are based on observable market data, these reverse repos are classified within level 2 of the valuation hierarchy.

**Loans and advances to banks and loans and advances to customers - other**

These instruments consist of term deposits placed which are short-term in nature and are both utilised and managed as part of the funding requirements of the trading book. The fair value of loans and advances to banks and loans and advances to customers is estimated using the 'present value' method. 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. As the inputs used in the valuation are based on observable market data, these loans are classified within level 2 of the valuation hierarchy.

**Notes to the Financial Statements** continued**2. Derivative assets and liabilities**

These instruments consist of exchange rate contracts, interest rate contracts, equity and credit contracts and equity derivatives. The models used in estimating the fair value of these derivatives do not contain a high level of subjectivity as the methodologies used in the models do not require significant judgement, and the inputs used in the models are observable market data such as plain vanilla interest rate swaps and option contracts. As the inputs used in the valuation are based on observable market data, these derivatives are classified within level 2 of the valuation hierarchy.

Certain derivatives which represent cross currency swaps, reversionary property interests, credit default swaps and options and forwards contain significant unobservable inputs or are traded less actively or traded in less-developed markets, and so are classified within level 3 of the valuation hierarchy. The valuation of such instruments is further discussed in the 'internal models based on information other than market data' section below.

**3. Financial assets at fair value through profit or loss ('FVTPL')****Loans and advances to customers**

These instruments consist of loans secured on residential property to housing associations. The fair value of these social housing loans is estimated using the 'present value' model based on a credit curve derived from current market spreads observable in the social housing loan data. Observable market data include current market spreads for new accepted mandates and bids for comparable loans and are used to support or challenge the benchmark level.

This provides a range of reasonably possible estimates of fair value. As the inputs used in the valuation are based on market observable data, these loans are classified within level 2 of the valuation hierarchy.

Certain loans and advances to customers which represent a portfolio of roll-up mortgages contain significant unobservable inputs and so are classified within level 3 of the valuation hierarchy. The valuation of such instruments is further discussed below.

**Debt securities**

These instruments consist of holdings of asset-backed securities. A significant portion of these securities are priced using the 'present value' models, based on observable market data e.g. LIBOR, credit spreads. Where there are quoted prices for these instruments, the model value is checked against the quoted prices for reference purposes, but is not used as the fair value as the market for these instruments are lacking in liquidity and depth. As the inputs used in the valuation are based on observable market data, these debt securities are classified within level 2 of the valuation hierarchy.

Certain debt securities which represent reversionary property securities and securities issued by Banco Santander entities contain significant unobservable inputs, and so are classified within level 3 of the valuation hierarchy. The valuation of such instruments is further discussed below.

**4. Trading liabilities****Deposits by banks and deposits by customers - securities sold under repurchase agreements**

These instruments consist of repos with both professional non-bank customers and bank counterparties as part of the ANTS group's trading activities. The fair value of repos is estimated using the same technique as those reverse repos in trading assets discussed above. Under these agreements, the ANTS group is required to provide and maintain collateral with a market value equal to, or in excess of, the principal amount borrowed. As a result, there would be no adjustment, or an immaterial adjustment, to reflect the credit quality of the ANTS group related to these agreements. As the inputs used in the valuation are based on observable market data, these repos are classified within level 2 of the valuation hierarchy.

**Deposits by banks and deposits by customers - other**

These instruments consist of certain term and time deposits which tend to be short-term in nature and are both utilised and managed as part of the funding requirements of the trading book. These instruments are valued using the same techniques as those instruments in trading assets - loans and advances to banks and loans and advances to customers discussed above. As the inputs used in the valuation are based on observable market data, these deposits are classified within level 2 of the valuation hierarchy.

**5. Financial liabilities at FVTPL****Debt securities in issue**

These instruments include commercial paper, medium term notes and other bonds and are valued using the same techniques as those instruments in financial assets at FVTPL - debt securities discussed above. As the inputs used in the valuation are based on observable market data, these debt securities are classified within level 2 of the valuation hierarchy.

Certain debt securities in issue which represent the more exotic senior debt issuances, consisting of power reverse dual currency ('PRDC') notes contain significant unobservable inputs and so are classified within level 3 of the valuation hierarchy. The valuation of such instruments is further discussed below.

## Notes to the Financial Statements continued

## h) Internal models based on information other than market data (Level 3)

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

Balance sheet line item	Category	Financial instrument product type	Balance sheet value		Amount recognised in income/(expense)		
			2012	2011	2012	2011	2010
			£m	£m	£m	£m	£m
<b>1. Derivative assets</b>	Exchange rate contracts	Cross-currency swaps	<b>36</b>	70	<b>(5)</b>	6	42
<b>2. Derivative assets</b>	Equity and credit contracts	Reversionary property interests	<b>76</b>	78	<b>2</b>	15	(6)
<b>3. Derivative assets</b>	Equity and credit contracts	Credit default swaps	<b>17</b>	16	<b>1</b>	1	-
<b>4. Derivative assets</b>	Equity contracts	Options and forwards	<b>279</b>	266	<b>6</b>	5	(20)
<b>5. FVTPL</b>	Loans and advances to customers	Roll-up mortgage portfolio	<b>61</b>	58	<b>3</b>	8	5
<b>6. FVTPL</b>	Debt securities	Mortgage-backed securities	<b>49</b>	51	<b>4</b>	(8)	53
<b>7. Derivative liabilities</b>	Equity contracts	Options and forwards	<b>(72)</b>	(89)	<b>3</b>	8	99
<b>8. FVTPL</b>	Debt securities in issue	Non-vanilla debt securities	<b>(86)</b>	(141)	<b>7</b>	(6)	(42)
<b>Total net assets</b>			<b>360</b>	309	-	-	-
<b>Total income</b>			-	-	<b>21</b>	29	131

## Valuation technique

## 1. Derivative assets - Exchange rate contracts

These cross currency swaps are used to hedge the foreign currency risks arising from the power reverse dual currency ('PRDC') notes issued by the ANTS group, as described in Instrument 8 below. These derivatives are valued using a standard valuation model valuing each leg of the swap, with expected future cash flows less notional amount exchanged at maturity date discounted using an appropriate floating rate. The floating rate is adjusted by the relevant cross currency basis spread. Interest rates, foreign exchange rates, cross currency basis spread and long-dated foreign exchange ('FX') volatility are used as inputs to determine fair value. Interest rates, foreign exchange rates are observable on the market. Cross currency spreads may be market observable or unobservable depending on the liquidity of the cross currency pair. As the Japanese Yen-US dollar cross currency pair related to the PRDC notes is liquid, the cross currency spreads (including long-dated cross currency spread) for these swaps are market observable.

The significant unobservable inputs for the valuation of these financial instruments are the long-dated FX volatility and the correlation between the underlying assets. The correlation between the underlying assets is assumed to be zero, as there are no actively traded options from which correlations between the underlying assets could be implied. Furthermore, the zero correlation assumption implies that the sources of the long-dated FX volatility are independent.

*Long-dated FX volatility*

Long-dated FX volatility is extrapolated from shorter-dated FX volatilities which are directly observable on the market. Short dated FX volatility is observable from the trading of FX options. As there is no active market for FX options with maturities greater than five years (long-dated FX options), long-dated FX volatility is not market observable. Furthermore, as historical prices are not relevant in determining the cost of hedging long-dated FX risk, long-dated FX volatility cannot be inferred from historical volatility. The ANTS group extrapolates the long-dated FX volatility from the shorter-dated FX volatilities using Black's model.

FX volatility is modelled as the composition of the domestic interest rate, foreign interest rates and FX spot volatilities using standard Hull-White formulae. The Hull-White approach is used for estimating the future distribution of domestic and foreign zero-coupon rates, constructed from the relevant yield curves. Using short dated FX options, the FX spot volatility is calculated which is then extrapolated to derive the long-dated FX volatility.

## 2. Derivative assets - Equity and credit contracts

These reversionary property derivatives are valued using a probability weighted set of HPI forward prices, which are assumed to be a reasonable representation of the increase in value of the ANTS group's reversionary interest portfolio underlying the derivatives. The probability used reflects the likelihood of the home owner vacating the property and is calculated from mortality rates and acceleration rates which are a function of age and gender, obtained from the relevant mortality tables. Indexing is felt to be appropriate due to the size and geographical dispersion of the ANTS group's reversionary interest portfolio. These are determined using HPI Spot Rates adjusted to reflect estimated forward growth. Launched in 1984, the Halifax's UK HPI is the UK's longest running monthly house price data series covering the whole country. The indices calculated are standardised and represent the price of a typically transacted house. Both national and regional HPI are published. The national HPI is published monthly. The regional HPI reflects the national HPI disaggregated into 12 UK regions and is published quarterly. Both indices are published on two bases, including and excluding seasonal adjustments in the housing market. The ANTS group uses the non-seasonally adjusted ('NSA') national and regional HPI in its valuation model to avoid any subjective judgement in the adjustment process which is made by Halifax.

The inputs used to determine the value of the reversionary property derivatives are HPI spot, HPI forward growth and mortality rates. The principal pricing parameter is HPI forward growth.

## Notes to the Financial Statements continued

*HPI Spot Rate*

The HPI spot rate used in the model is a weighted average of NSA regional HPI spot rates i.e. adjusted for difference in the actual regional composition of the property underlying the ANTS group's reversionary interest portfolio and the composition of the published regional indices. The regional HPI spot rate (which is observable market data) is only published on specific quarterly dates. In between these dates, its value is estimated by applying the growth rate over the relevant time period inferred from the national HPI spot rates (which are observable market data and published monthly) to the most recently calculated weighted average regional HPI spot rate based on published regional indices.

An adjustment is also made to reflect the specific property risk i.e. possible deviation between the actual growth in the house prices underlying the ANTS group's reversionary interest portfolio and their assumed index-linked growth, which is based on the regional HPI. This adjustment is based on the average historical deviation of price changes of the ANTS group's actual property portfolio from that of the published indices over the time period since the last valuation date.

*HPI Forward Growth Rate*

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

*Mortality Rate*

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

**3. Derivative assets - Equity and credit contracts**

These derivative assets are credit default swaps held against certain bonds. The credit default swaps are valued using the credit spreads of the referenced bonds. These referenced bonds are valued with the assistance of valuations prepared by an independent, specialist valuation firm as a deep and liquid market does not exist.

In valuing the credit default swaps, the main inputs used to determine the underlying cost of credit are quoted risk premiums and the correlation between the quoted credit derivatives of various issuers. The assumptions relating to the correlation between the values of quoted and unquoted assets are based on historical correlations between the impact of adverse changes in market variables and the corresponding valuation of the associated unquoted assets. The measurement of the assets will vary depending on whether a more or less conservative scenario is selected. The other main input is the probability of default of the referenced bonds. The significant unobservable input for the valuation of these financial instruments is the probability of default.

*Probability of default*

The probability of default is assessed by considering the credit quality of the underlying referenced bonds. However, as no deep and liquid market exists for these assets the assessment of the probability of default is not directly observable and instead an estimate is calculated using the Standard Gaussian Copula model.

**4. Derivative assets – Equity contracts**

There are three types of derivatives within this category:

**European options** - These derivatives are valued using a modified Black-Scholes model where the HPI is log-normally distributed with the forward rates determined from the HPI forward growth.

**Asian options** - Asian (or average value) options are valued using a modified Black-Scholes model, with an amended strike price and volatility assumption to account for the average exercise period, through a closed form adjustment that reflects the strike price relative to the distribution of stock prices at each relevant date. This is also known as the Curran model.

**Forward contracts** - Forward contracts are valued using a standard forward pricing model.

The inputs used to determine the value of the above instruments are HPI spot rate, HPI forward growth rate and HPI volatility. The principal pricing parameter is HPI forward growth rate.

*HPI Spot Rate*

The HPI spot rate used is the NSA national HPI spot rate which is published monthly and directly observable in the market. This HPI rate used is different from the weighted average regional HPI spot rate used in the valuation of Instrument 2 above, as the underlying of these derivatives is the UK national HPI spot rate.

*HPI Forward Growth Rate*

The HPI forward growth rate used is unobservable and is the same as used in the valuation of Instrument 2 above.

*HPI Volatility*

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

## Notes to the Financial Statements continued

**5. FVTPL – Loans and advances to customers**

These loans and advances to customers represent roll-up mortgages, which are an equity release scheme under which a property owner takes out a loan secured against their home. The owner does not make any interest payments during their lifetime and the fixed interest payments are rolled up into the mortgage. The loan or mortgage (capital and rolled-up interest) is repaid upon the owner's vacation of the property and the value of the loan is only repaid from the value of the property. This is known as a 'no negative pledge'. The ANTS group suffers a loss if the sale proceeds from the property are insufficient to repay the loan, as it is unable to pursue the homeowner's estate or beneficiaries for the shortfall.

The value of the mortgage 'rolls up' or accretes until the owner vacates the property. In order to value the roll-up mortgages, the ANTS group uses a probability-weighted set of European option prices (puts) determined using the Black-Scholes model, in which the 'no negative pledges' are valued as short put options. The probability weighting applied is calculated from mortality rates and acceleration rates as a function of age and gender, taken from mortality tables.

The inputs used to determine the value of these instruments are HPI spot, HPI forward growth, HPI volatility, mortality rates and repayment rates. The principal pricing parameter is HPI forward growth. The HPI forward growth rate used is unobservable and is the same as used in the valuation of Instrument 2 above. The other parameters do not have a significant effect on the value of the instruments.

**6. FVTPL – Debt securities**

These securities consist of residential mortgage-backed securities issued by Banco Santander entities. Each instrument is valued with reference to the price from a consensus pricing service. This is then corroborated against the price from another consensus pricing service due to the lack of depth in the number of available market quotes. An average price is used where there is a more than insignificant difference between the two sources.

The significant unobservable input is the adjustment to the credit spread embedded in the pricing consensus quotes.

**7. Derivative liabilities - Equity contracts**

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

**8. FVTPL - Debt securities in issue**

These debt securities in issue are power reverse dual currency notes. These notes are financial structured products where an investor is seeking a better return and a borrower/issuer a lower rate by taking advantage of the interest rate differential between two countries. The note pays a foreign interest rate in the investor's domestic currency. The power component of the name denotes higher initial coupons and the fact that coupons rise as the domestic/foreign exchange rate depreciates. The power feature comes with a higher risk for the investor. Cash flows may have a digital cap feature where the rate gets locked once it reaches a certain threshold. Other add-on features are barriers such as knockouts and cancellation provisions for the issuer. These debt securities in issue are valued using a three-factor Gaussian Model. The three factors used in the valuation are domestic interest rates, foreign interest rates and foreign exchange rates. The correlations between the factors are assumed to be zero within the valuation.

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

The significant unobservable inputs for the valuation of these financial instruments are the long dated FX volatility and the correlation between the underlying assets and are the same as Instrument 1.

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

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

	Assets			Liabilities		
	Derivatives £m	Fair value through P&L £m	Total £m	Derivatives £m	Fair value through P&L £m	Total £m
<b>At 1 January 2012</b>	<b>430</b>	<b>109</b>	<b>539</b>	<b>(89)</b>	<b>(141)</b>	<b>(230)</b>
Total gains/(losses) recognised in profit/(loss):						
- Fair value movements	4	7	11	3	7	10
- Foreign exchange and other movements	(12)	(1)	(13)	-	16	16
Issues	10	-	10	-	-	-
Sales	-	-	-	-	-	-
Settlements	(24)	(5)	(29)	14	32	46
<b>At 31 December 2012</b>	<b>408</b>	<b>110</b>	<b>518</b>	<b>(72)</b>	<b>(86)</b>	<b>(158)</b>
Total gains/(losses) recognised in profit/(loss) relating to assets and liabilities held at the end of the year	(8)	6	(2)	3	23	26

## Notes to the Financial Statements continued

	Assets			Liabilities		
	Derivatives £m	Fair value through P&L £m	Total £m	Derivatives £m	Fair value through P&L £m	Total £m
<b>At 1 January 2011</b>	408	118	526	(102)	(137)	(239)
Total gains/(losses) recognised in profit/(loss):						
- Fair value movements	27	-	27	8	(6)	2
- Foreign exchange and other movements	4	(2)	2	-	(7)	(7)
Purchases	27	-	27	(6)	-	(6)
Settlements	(1)	-	(1)	-	-	-
Transfers out	(35)	(7)	(42)	11	9	20
<b>At 31 December 2011</b>	430	109	539	(89)	(141)	(230)
Total gains/(losses) recognised in profit/(loss) relating to assets and liabilities held at the end of the year	31	(2)	29	8	(13)	(5)

**Financial instrument assets and liabilities at 31 December 2012**

Financial instrument assets valued using internal models based on information other than market data were 1% (2011: 1%) of total assets measured at fair value and 0.2% (2011: 0.2%) of total assets at 31 December 2012.

Derivative assets decreased in 2012 principally due to settlements and foreign exchange movements offset by purchases. Assets designated at fair value through profit or loss increased marginally in 2012 principally due to fair value movements offset by sales and settlements.

Financial instrument liabilities valued using internal models based on information other than market data were 0.3% (2011: 0.3%) of total liabilities measured at fair value and 0.1% (2011: 0.1%) of total liabilities at 31 December 2012.

Derivative liabilities decreased in 2012 primarily due to settlements. Liabilities designated at fair value through profit or loss decreased in 2012 principally due to fair value and foreign exchange movements and settlements.

**Gains and losses for the year ended 31 December 2012**

Losses of £8m in respect of derivatives assets principally reflected changes in credit spreads and the HPI Index and unfavourable movements in foreign exchange rates. Gains of £6m in respect of assets designated at fair value through profit or loss primarily reflects the mark to market volatility on a reduced portfolio of mortgage backed securities.

Gains of £3m in respect of derivatives liabilities principally reflected changes in credit spreads and the HPI Index. Gains of £23m in respect of liabilities designated at fair value through profit or loss principally reflected changes in foreign exchange. They are fully matched with derivatives.

**Gains and losses for the year ended 31 December 2011**

Gains of £31m in respect of derivatives assets principally reflected changes in credit spreads and the HPI Index. Losses of £2m in respect of assets designated at fair value through profit or loss principally reflected favourable changes in foreign exchange rates during the year.

Gains of £8m in respect of derivatives liabilities principally reflected changes in credit spreads and the HPI Index. Losses of £13m in respect of liabilities designated at fair value through profit or loss principally reflected changes in foreign exchange and interest rates. They are fully matched with derivatives.



## Notes to the Financial Statements continued

**Effect of changes in significant unobservable assumptions to reasonably possible alternatives (Level 3)**

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

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

**At 31 December 2012**

Balance sheet note line item and product	Fair value £m	Assumptions	Shift	Reflected in income statement	
				Favourable changes £m	Unfavourable changes £m
<b>2. Derivative assets</b> – Equity and credit contracts:	<b>76</b>	HPI Forward growth rate	<b>1%</b>	<b>11</b>	<b>(11)</b>
– Reversionary property derivatives		HPI Spot rate	<b>10%</b>	<b>8</b>	<b>(8)</b>
		Mortality rate	<b>2 yrs</b>	<b>1</b>	<b>(1)</b>
<b>3. Derivative assets</b> – Equity and credit contracts:	<b>17</b>	Probability of default	<b>20%</b>	<b>3</b>	<b>(3)</b>
– Credit default swaps					
<b>4. Derivative assets</b> – Equity and credit contracts:	<b>279</b>	HPI Forward growth rate	<b>1%</b>	<b>7</b>	<b>(7)</b>
– Options and forwards		HPI Spot rate	<b>10%</b>	<b>12</b>	<b>(11)</b>
		HPI Volatility	<b>1%</b>	<b>1</b>	<b>(1)</b>
<b>5. FVTPL</b> – Loans and advances to customers:	<b>61</b>	HPI Forward growth rate	<b>1%</b>	<b>2</b>	<b>(2)</b>
– Roll-up mortgage portfolio					
<b>6. FVTPL</b> – Debt securities:	<b>49</b>	Credit spread	<b>10%</b>	<b>5</b>	<b>(5)</b>
– Mortgage-backed securities					
<b>7. Derivative liabilities</b> - Equity and credit contracts:	<b>(72)</b>	HPI Forward growth rate	<b>1%</b>	<b>3</b>	<b>(3)</b>
– Options and forwards		HPI Spot rate	<b>10%</b>	<b>6</b>	<b>(9)</b>
		HPI Volatility	<b>1%</b>	<b>1</b>	<b>(1)</b>

**At 31 December 2011**

Balance sheet note line item and product	Fair value £m	Assumptions	Shift	Reflected in income statement	
				Favourable changes £m	Unfavourable changes £m
<b>2. Derivative assets</b> – Equity and credit contracts:	<b>78</b>	HPI Forward growth rate	<b>1%</b>	<b>11</b>	<b>(11)</b>
– Reversionary property derivatives		HPI Spot rate	<b>10%</b>	<b>8</b>	<b>(8)</b>
		Mortality rate	<b>2 yrs</b>	<b>-</b>	<b>-</b>
<b>3. Derivative assets</b> – Equity and credit contracts:	<b>16</b>	Probability of default	<b>20%</b>	<b>3</b>	<b>(3)</b>
– Credit default swaps					
<b>4. Derivative assets</b> – Equity and credit contracts:	<b>266</b>	HPI Forward growth rate	<b>1%</b>	<b>7</b>	<b>(7)</b>
– Options and forwards		HPI Spot rate	<b>10%</b>	<b>4</b>	<b>(3)</b>
		HPI Volatility	<b>1%</b>	<b>1</b>	<b>(1)</b>
<b>5. FVTPL</b> – Loans and advances to customers:	<b>58</b>	HPI Forward growth rate	<b>1%</b>	<b>2</b>	<b>(2)</b>
– Roll-up mortgage portfolio					
<b>6. FVTPL</b> – Debt securities:	<b>51</b>	Credit spread	<b>10%</b>	<b>5</b>	<b>(5)</b>
– Mortgage-backed securities					
<b>7. Derivative liabilities</b> - Equity and credit contracts:	<b>(89)</b>	HPI Forward growth rate	<b>1%</b>	<b>4</b>	<b>(4)</b>
– Options and forwards		HPI Spot rate	<b>10%</b>	<b>13</b>	<b>(17)</b>
		HPI Volatility	<b>1%</b>	<b>2</b>	<b>(2)</b>

No sensitivities are presented for the FVTPL - debt securities in issue (instrument 8) per page 182 and related exchange rate derivatives (instrument 1) per page 180 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.

## Notes to the Financial Statements continued

## i) Maturities of financial assets, liabilities and off-balance sheet commitments

The table below analyses the maturities of the undiscounted cash flows relating to financial assets, liabilities and off-balance sheet commitments of the ANTS group based on the remaining period to the contractual maturity date at the balance sheet date.

There are no significant financial liabilities related to financial guarantee contracts. This table is not intended to show the liquidity of the ANTS group.

At 31 December 2012

	On demand £m	Within 1 month £m	1-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
Group								
<b>Assets by balance sheet category</b>								
Cash and balances at central banks	365	-	-	23	-	-	-	388
Trading assets	1	13,013	4,800	3,391	30	485	867	22,587
Derivative financial instruments	104	590	562	1,487	3,673	4,035	24,488	34,939
Financial assets designated at fair value	-	-	-	-	-	124	3,694	3,818
Loans and advances to banks	28,177	2,040	37,883	12,747	12,373	12,057	2,238	107,515
Loans and advances to customers	71	2,858	4,556	2,815	8,135	10,797	20,973	50,205
Available-for-sale securities	-	-	-	1,902	-	2,936	395	5,233
Loans and receivables securities	-	-	-	-	-	-	175	175
Macro hedge of interest rate risk	-	20	18	12	151	192	778	1,171
<b>Total financial assets</b>	<b>28,718</b>	<b>18,521</b>	<b>47,819</b>	<b>22,377</b>	<b>24,362</b>	<b>30,626</b>	<b>53,608</b>	<b>226,031</b>
Other assets	37	-	-	-	-	-	-	37
<b>Total assets</b>	<b>28,755</b>	<b>18,521</b>	<b>47,819</b>	<b>22,377</b>	<b>24,362</b>	<b>30,626</b>	<b>53,608</b>	<b>226,068</b>
<b>Liabilities by balance sheet category</b>								
Deposits by banks	6,360	12,846	12,468	25,244	32,424	8,963	20,425	118,730
Deposits by customers	145	164	406	1,066	3,272	388	1,125	6,566
Derivative financial instruments	337	256	274	1,274	5,144	4,113	26,997	38,395
Trading liabilities	4,377	5,574	4,668	1,993	982	560	3,233	21,387
Financial liabilities designated at fair value	-	735	341	628	954	616	836	4,110
Debt securities in issue	-	5,183	2,367	4,228	10,050	6,369	10,619	38,816
<b>Total financial liabilities</b>	<b>11,219</b>	<b>24,758</b>	<b>20,524</b>	<b>34,433</b>	<b>52,826</b>	<b>21,009</b>	<b>63,235</b>	<b>228,004</b>
Other liabilities	-	152	-	-	-	-	-	152
Equity	-	-	-	-	-	-	3,808	3,808
<b>Total liabilities and Shareholders equity</b>	<b>11,219</b>	<b>24,910</b>	<b>20,524</b>	<b>34,433</b>	<b>52,826</b>	<b>21,009</b>	<b>67,043</b>	<b>231,964</b>
Off-balance sheet commitments given	25	139	64	958	2,438	3,789	1,940	9,353

## Notes to the Financial Statements continued

## At 31 December 2011

	Group							Total
	On demand	Within 1 month	1-3 months	3-12 months	1-3 years	3-5 years	Over 5 years	£m
	£m	£m	£m	£m	£m	£m	£m	£m
<b>Assets by balance sheet category</b>								
Cash and balances at central banks	6,995	-	-	18	-	-	-	7,013
Trading assets	-	11,654	5,183	3,851	215	13	1,138	22,054
Derivative financial instruments	2,169	172	409	1,604	4,135	3,887	22,380	34,756
Financial assets designated at fair value	-	-	-	-	-	-	5,030	5,030
Loans and advances to banks	18,507	19,159	21,628	9,941	19,911	15,785	9,036	113,967
Loans and advances to customers	1,026	4,396	2,324	2,159	7,408	10,437	15,619	43,369
Available-for-sale securities	-	-	-	-	-	-	-	-
Loans and receivables securities	-	-	-	-	2	-	313	315
Macro hedge of interest rate risk	-	1	10	104	247	122	657	1,141
<b>Total financial assets</b>	<b>28,697</b>	<b>35,382</b>	<b>29,554</b>	<b>17,677</b>	<b>31,918</b>	<b>30,244</b>	<b>54,173</b>	<b>227,645</b>
Other assets	68	-	-	-	-	-	-	68
<b>Total assets</b>	<b>28,765</b>	<b>35,382</b>	<b>29,554</b>	<b>17,677</b>	<b>31,918</b>	<b>30,244</b>	<b>54,173</b>	<b>227,713</b>
<b>Liabilities by balance sheet category</b>								
Deposits by banks	4,784	10,623	20,353	25,768	9,992	31,255	15,928	118,703
Deposits by customers	101	280	623	832	3,120	2,345	107	7,408
Derivative financial instruments	-	-	6	24	442	55	803	1,330
Trading liabilities	7,781	9,697	4,786	1,415	1,121	433	656	25,889
Financial liabilities designated at fair value	-	1,445	187	1,634	2,406	668	1,015	7,355
Debt securities in issue	-	2,542	1,991	2,575	8,428	7,189	7,846	30,571
<b>Total financial liabilities</b>	<b>12,666</b>	<b>24,587</b>	<b>27,946</b>	<b>32,248</b>	<b>25,509</b>	<b>41,945</b>	<b>26,355</b>	<b>191,256</b>
Other liabilities	-	142	-	-	-	-	-	142
Equity	-	-	-	-	-	-	3,500	3,500
<b>Total liabilities and Shareholders equity</b>	<b>12,666</b>	<b>24,729</b>	<b>27,946</b>	<b>32,248</b>	<b>25,509</b>	<b>41,945</b>	<b>29,855</b>	<b>194,898</b>
Off-balance sheet commitments given	10	-	2	666	1,731	4,548	2,322	9,279

## At 31 December 2012

	Company							Total
	On demand	Within 1 month	1-3 months	3-12 months	1-3 years	3-5 years	Over 5 years	£m
	£m	£m	£m	£m	£m	£m	£m	£m
<b>Assets by balance sheet category</b>								
Cash and balances at central banks	365	-	-	23	-	-	-	388
Trading assets	1	13,012	4,800	3,391	31	485	497	22,217
Derivative financial instruments	105	590	562	1,487	3,710	4,035	24,489	34,978
Financial assets designated at fair value	-	-	-	-	-	124	3,694	3,818
Loans and advances to banks	28,163	2,038	37,884	12,747	12,373	12,057	2,238	107,500
Loans and advances to customers	122	2,877	4,594	2,814	8,130	10,797	20,981	50,315
Available-for-sale securities	-	-	-	1,902	-	2,936	395	5,233
Loans and receivables securities	-	-	-	-	-	-	175	175
Macro hedge of interest rate risk	-	20	18	12	151	192	778	1,171
<b>Total financial assets</b>	<b>28,756</b>	<b>18,537</b>	<b>47,858</b>	<b>22,376</b>	<b>24,395</b>	<b>30,626</b>	<b>53,247</b>	<b>225,795</b>
Other assets	2,221	-	-	-	-	-	-	2,221
<b>Total assets</b>	<b>30,977</b>	<b>18,537</b>	<b>47,858</b>	<b>22,376</b>	<b>24,395</b>	<b>30,626</b>	<b>53,247</b>	<b>228,016</b>
<b>Liabilities by balance sheet category</b>								
Deposits by banks	6,360	12,846	12,468	25,244	32,424	8,963	20,425	118,730
Deposits by customers	254	1,732	937	1,383	3,322	2,311	1,125	11,064
Derivative financial instruments	337	256	274	1,274	5,144	4,113	26,997	38,395
Trading liabilities	4,377	5,574	4,668	1,993	982	560	3,233	21,387
Financial liabilities designated at fair value	-	735	341	628	954	616	836	4,110
Debt securities in issue	-	3,646	1,865	3,926	10,050	6,369	10,619	36,475
<b>Total financial liabilities</b>	<b>11,328</b>	<b>24,789</b>	<b>20,553</b>	<b>34,448</b>	<b>52,876</b>	<b>22,932</b>	<b>63,235</b>	<b>230,161</b>
Other liabilities	-	149	-	-	-	-	-	149
Equity	-	-	-	-	-	-	3,721	3,721
<b>Total liabilities and Shareholders equity</b>	<b>11,328</b>	<b>24,938</b>	<b>20,553</b>	<b>34,448</b>	<b>52,876</b>	<b>22,932</b>	<b>66,956</b>	<b>234,031</b>
Off-balance sheet commitments given	25	139	64	958	2,438	3,789	1,940	9,353

## Notes to the Financial Statements continued

At 31 December 2011

								Company
	On demand £m	Within 1 month £m	1-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
<b>Assets by balance sheet category</b>								
Cash and balances at central banks	6,995	-	-	18	-	-	-	7,013
Trading assets	-	11,654	5,183	3,851	215	13	767	21,683
Derivative financial instruments	2,169	172	409	1,604	4,153	3,887	22,380	34,774
Financial assets designated at fair value	-	-	-	-	-	-	5,030	5,030
Loans and advances to banks	18,500	19,159	21,628	9,944	19,911	15,785	9,034	113,961
Loans and advances to customers	1,078	4,420	2,345	2,161	7,402	10,437	15,628	43,471
Available-for-sale securities	-	-	-	-	-	-	-	-
Loans and receivables securities	-	-	-	-	2	-	313	315
Macro hedge of interest rate risk	-	1	10	104	247	122	657	1,141
<b>Total financial assets</b>	<b>28,742</b>	<b>35,406</b>	<b>29,575</b>	<b>17,682</b>	<b>31,930</b>	<b>30,244</b>	<b>53,809</b>	<b>227,388</b>
Other assets	2,255	-	-	-	-	-	-	2,255
<b>Total assets</b>	<b>30,997</b>	<b>35,406</b>	<b>29,575</b>	<b>17,682</b>	<b>31,930</b>	<b>30,244</b>	<b>53,809</b>	<b>229,643</b>
<b>Liabilities by balance sheet category</b>								
Deposits by banks	4,783	10,623	20,353	25,768	9,992	31,255	15,928	118,702
Deposits by customers	247	2,029	1,368	1,726	3,730	4,966	1,384	15,450
Derivative financial instruments	-	-	6	24	442	55	803	1,330
Trading liabilities	7,781	9,697	4,786	1,415	1,121	433	656	25,889
Financial liabilities designated at fair value	-	1,444	187	1,574	2,406	668	1,015	7,294
Debt securities in issue	-	894	1,258	1,879	8,423	7,189	7,846	27,489
<b>Total financial liabilities</b>	<b>12,811</b>	<b>24,687</b>	<b>27,958</b>	<b>32,386</b>	<b>26,114</b>	<b>44,566</b>	<b>27,632</b>	<b>196,154</b>
Other liabilities	-	137	-	-	-	-	-	137
Equity	-	-	-	-	-	-	3,450	3,450
<b>Total liabilities and Shareholders equity</b>	<b>12,811</b>	<b>24,824</b>	<b>27,958</b>	<b>32,386</b>	<b>26,114</b>	<b>44,566</b>	<b>31,082</b>	<b>199,741</b>
Off-balance sheet commitments given	10	-	2	666	1,731	4,548	2,322	9,279

As the above table is based on contractual maturities, no account is taken of a customer's ability to repay early where it exists. The repayment terms of debt securities may be accelerated in line with the covenants described in Note 32 to the Consolidated Financial Statements. In addition, no account is taken of the possible early repayment of the ANTS group's mortgage-backed non-recourse finance which is redeemed by the Santander UK group as funds become available from redemptions of the residential mortgages. The Santander UK group has no control over the timing and amount of redemptions of residential mortgages.

## 44. CAPITAL MANAGEMENT AND RESOURCES

### Capital management and capital allocation

Within the Santander UK group, capital is managed on a Santander UK group basis. The Santander UK Board is responsible for capital management strategy and policy and ensuring that capital resources are appropriately monitored and controlled within regulatory and internal limits within the Santander UK group. Authority for capital management flows to the Chief Executive Officer and from her to specific individuals who are members of Santander UK's Strategic Risk and Financial Management Committee ('SRFM') and Asset and Liability Management Committee ('ALCO').

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

Santander UK manages its capital requirements, debt funding and liquidity on the basis of policies and plans reviewed regularly at SRFM and ALCO and as part of the ICAAP process while debt funding and liquidity are also reviewed as part of the Internal Liquidity Adequacy Assessment ('ILAA') process. To support its capital and senior debt issuance programmes, the Company is rated on a stand alone basis.

On an ongoing basis and in accordance with the latest ICAAP review, Santander UK 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.

The 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 various other capital management techniques are used to shape the most cost-effective structure to fulfil Santander UK's capital needs.

## Notes to the Financial Statements continued

## Capital adequacy

From 1 January 2008, the ANTS group has managed its capital on a Basel II basis. Throughout 2012 and 2011, the ANTS group held capital over and above its regulatory requirements.

The Company, Santander UK plc, and Cater Allen Limited, which are the three FSA-regulated entities within the Santander UK group, are party to a capital support deed dated 14 December 2012 (the "Capital Support Deed") with certain other non-regulated subsidiaries of Santander UK plc. The parties to the Capital Support Deed constitute a core UK group for the purposes of section 10 of the Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU") of the FSA Handbook. Under section 10.8 of BIPRU, exposures of each of the three regulated entities to other members of the core UK group are exempt from large exposure limits that would otherwise apply. The purpose of the Capital Support Deed is to facilitate the prompt transfer of available capital resources from, or repayment of liabilities by, the non-regulated parties to any of the regulated parties in the event that one of the regulated parties has breached or is at risk of breaching its capital resources requirements or risk concentrations requirements.

## Group Capital

	<b>31 December 2012</b>	31 December 2011 <sup>(1)</sup>
	<b>£m</b>	£m
Tier 1 capital	<b>3,785</b>	3,457
Deductions from Tier 1 capital	<b>(29)</b>	(44)
<b>Total Tier 1 capital</b>	<b>3,756</b>	3,413
<b>Tier 2 Capital</b>	<b>2</b>	-
<b>Total capital resources</b>	<b>3,758</b>	3,413

(1) As restated, see Note 45

Tier 2 capital consists of collectively assessed impairment allowances on standardised portfolios. Tier 1 capital consists of shareholders' equity and audited profits for the years ended 31 December 2012 and 2011 after adjustment to comply with UK Financial Services Authority rules.

Tier 1 deductions relate to intangible assets and expected losses. The expected loss deduction represents the difference between expected loss calculated in accordance with the ANTS group's Basel II IRB models, and the impairment losses calculated in accordance with IFRS. The ANTS group's accounting policy for impairment loss allowances is set out in Note 1. Regulatory expected losses are higher than the impairment losses 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. In addition, the ANTS group has elected to deduct certain securitisation positions from capital rather than treat these exposures as a risk weighted asset.

The increase in Tier 1 capital is due to the inclusion of audited profits for the year ended 31 December 2012.

## Notes to the Financial Statements continued

## 45. RESTATEMENTS

The financial statements have been revised to correct misstatements in the measurement of the Company's loans secured on residential property to UK housing associations that are designated at fair value of £281m and the measurement of the fair value hedge adjustment for debt securities of £37m. The misstatements resulted in restatements of previously reported amounts in respect of "Net Trading and Other Income", "Financial assets designated at fair value", "Debt securities in issue" and "Retained earnings", and their related tax effects, as follows:

**Net Trading and Other Income**

	2011 (Restated) £m	2011 (Original) £m
Net trading and other (expense)/income	(46)	198

**Taxation Charge**

	2011 (Restated) £m	2011 (Original) £m
Tax on profit for the year	104	168

**Financial assets designated at fair value**

	2011 (Restated) £m	2011 (Original) £m
Loans and advances to customers	4,050	4,331
Debt securities	379	379
	4,429	4,710

**Debt securities in issue**

	2011 (Restated) £m	2011 (Original) £m
Debt securities in issue	26,943	26,980

**Current tax liabilities**

	2011 (Restated) £m	2011 (Original) £m
Current tax liabilities	329	393

**Retained earnings**

	2011 (Restated) £m	2011 (Original) £m
Retained earnings	962	1,142