

LISTING PARTICULARS



Abbey National plc

(incorporated with limited liability under
the Companies Act 1985, registered number 2294747)

**Placing of 125,000,000 8⁵/₈ per cent.
Non-Cumulative Sterling Preference Shares of £1 each
Issue Price 101.55 pence per New Sterling Preference Share**

Application has been made to the London Stock Exchange Limited (the "London Stock Exchange") for the New Sterling Preference Shares (as defined below) to be admitted to the Official List. Copies of these Listing Particulars, which comprise listing particulars which have been approved by the London Stock Exchange, have been delivered to the Registrar of Companies in England and Wales as required by Section 149 of the Financial Services Act 1986.

The New Sterling Preference Shares will have a nominal value of £1 each and will be issued fully paid for cash. Subject as herein provided, dividends on the New Sterling Preference shares will be paid in equal half yearly instalments on April 6 and October 6 save that the first dividend instalment on the New Sterling Preference Shares will be payable on October 6, 1997 and will be in respect of the period from (and including) June 9, 1997 to (but excluding) October 6, 1997.

The New Sterling Preference Shares will rank *pari passu* inter se and with all other shares expressed to rank *pari passu* therewith and in priority as regards participation in profits or assets to the Ordinary Shares of 10p each (the "Ordinary Shares") and any other shares of Abbey National.

A summary of the provisions of the Articles of Association of Abbey National applicable to, and of the rights attaching to, the 125,000,000 8⁵/₈ per cent. Non-Cumulative Sterling Preference Shares of £1 each (the "New Sterling Preference Shares") is set out under "Description of the New Sterling Preference Shares" herein.

Goldman Sachs International
ABN AMRO Hoare Govett Barclays de Zoete Wedd Limited
Dresdner Kleinwort Benson Merrill Lynch International

The date of these Listing Particulars is June 6, 1997.

accept responsibility for the information contained in these Listing Particulars. To the best of the knowledge and belief of the directors (having taken all reasonable care to ensure that such is the case) the information contained in these Listing Particulars is in accordance with the facts and does not omit anything likely to affect the import of such information.

In these Listing Particulars, references to "Abbey National plc", "Abbey National" and the "Company" are references to Abbey National plc, and references to the "Group" are to Abbey National and its subsidiaries.

The New Sterling Preference Shares have not been and will not be registered under the U.S. Securities Act of 1933 as amended (the "Securities Act"). The New Sterling Preference Shares are subject to U.S. tax law requirements. Subject to certain exceptions, the New Sterling Preference Shares may not be offered, sold or delivered within the United States or to U.S. persons. Neither the delivery of these Listing Particulars nor any sale made hereunder shall, under any circumstances, create any implication or constitute a representation that there has been no change in the affairs of Abbey National or the Group since the date hereof. These Listing Particulars do not constitute an offer of, or an invitation by or on behalf of Abbey National or the Managers (as defined under "Placing of the New Sterling Preference Shares" below) to subscribe for or purchase, any of the New Sterling Preference Shares.

No person is authorised in connection with the offering of the New Sterling Preference Shares to give any information or to make any representation not contained in this document and any information or representation not contained herein must not be relied upon as having been authorised by Abbey National or any of the Managers. The distribution of these Listing Particulars in certain jurisdictions may be restricted by law. Neither Abbey National nor any of the Managers represents that these Listing Particulars may be lawfully distributed in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assumes any responsibility for facilitating any such distribution or offering. In particular, save for obtaining the approval of these Listing Particulars as listing particulars by the London Stock Exchange and delivery of copies of these Listing Particulars to the Registrar of Companies in England and Wales, no action has been taken by Abbey National or the Managers which would permit distribution of these Listing Particulars in any jurisdiction where action for that purpose is required. Accordingly, neither these Listing Particulars nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws.

In connection with the placing of the New Sterling Preference Shares Goldman Sachs International may over-allot or effect transactions on the London Stock Exchange which stabilise or maintain the market price of the New Sterling Preference Shares at a level which might not otherwise prevail on that exchange. Such stabilising, if commenced, may be discontinued at any time.

In these Listing Particulars, unless otherwise specified or the context otherwise requires, all references to "Dollars", "U.S. dollars" and "US\$" are to the currency of, and the references to "United States" and "U.S." are to, the United States of America and references to "pounds", "Sterling" and "£" are to the currency of the United Kingdom of Great Britain and Northern Ireland (the "United Kingdom").

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DESCRIPTION OF THE NEW STERLING PREFERENCE SHARES

At the Annual General Meeting held on April 17, 1996, Abbey National's shareholders gave the Board of Directors of Abbey National (the "Directors") authority to allot during the period ending on April 27, 1999 *inter alia* up to £1,000,000,000 aggregate nominal value of preference shares denominated in Sterling. The terms of, and the rights attaching to, the New Sterling Preference Shares (together with all other shares expressed to rank *pari passu* therewith, the "Preference Shares") are contained in Abbey National's Articles of Association (the "Articles") and in a resolution of a duly constituted Committee of the Board of Directors of Abbey National passed on June 2, 1997 (together, the "Terms of Issue").

The summary set forth below is a summary of the relevant provisions of Abbey National's Memorandum of Association and Articles and the resolutions adopted by the Board of Directors of Abbey National or an authorised committee thereof establishing the rights, preferences, privileges, limitations and restrictions relating to the New Sterling Preference Shares, such Memorandum of Association and Articles and resolutions being available for inspection during normal business hours at Abbey House, Baker Street, London, MW1 6XL.

Denomination and Form

The New Sterling Preference Shares will have a nominal value of £1 each and will be issued fully paid for cash. The New Sterling Preference Shares will rank *pari passu* *inter se* and with all other shares expressed to rank *pari passu* therewith and in priority to the Ordinary Shares of 10p each ("Ordinary Shares") and any other shares of Abbey National.

The New Sterling Preference Shares will be in Certificated registered form. Certificates shall be delivered to the persons entitled thereto as soon as practicable after admission of the New Sterling Preference Shares to the Official List of the London Stock Exchange and, in any case, no later than three business days thereafter.

Transfers of the New Sterling Preference Shares must be in writing, in the usual common form, or in such other form as the Directors may approve. The Directors may refuse to register a transfer of shares if:—

- (i) the transfer is in respect of more than one class of shares; or
- (ii) the transfer is not lodged, duly stamped, at the registered office of Abbey National or at such other place as the Directors may appoint, accompanied by the certificate of the shares to be transferred and such other evidence (if any) as the Directors may require to show the right of the intending transferor to make the transfer; or
- (iii) the transfer is to more than four joint holders.

The Directors may also decline to register any transfer of a share which is not fully paid up.

Title to New Sterling Preference Shares will pass by transfer and registration on the register for the New Sterling Preference Shares. Any such registration of transfer will be effected without charge to the person requesting such registration, but subject to payment by such person of any taxes, stamp duties or other governmental charges payable in connection therewith.

Dividends

- (a) Each New Sterling Preference Share shall entitle the holder thereof to receive a non-cumulative preferential dividend at the rate of $8\frac{5}{8}$ per cent. per annum of the nominal amount of such share calculated on the basis set out in sub-paragraph (b) below which will be payable in Sterling in equal half yearly instalments in arrear on April 6 and October 6 in each year (each a "Dividend Payment Date") and shall accrue from (and including) the preceding April 6 or October 6 respectively provided that the first dividend instalment shall be payable on October 6, 1997 and shall be in respect of the period from (and including) June 9, 1997 to (but excluding) October 6, 1997.

Such dividend shall only be payable to the extent that payment of the same can be made out of profits available for distribution under the provisions of the Companies Act 1985, as amended (the "Companies Act") as at each

Dividend Payment Date. The New Sterling Preference Shares shall rank as regards participation in profits *pari passu* inter se and with all other shares to the extent that they are expressed to rank *pari passu* therewith and in priority to the Ordinary Shares and any other class of shares.

(b) (i) Subject to the Companies Act, the dividend payable on each New Sterling Preference Share on any Dividend Payment Date shall be fixed at such rate per annum as will ensure that the sum of (1) the dividend payable on such date and (2) the Associated Tax Credit (as defined below) in respect of any such dividend represents an annual rate equal to 8½ per cent. per annum of the nominal amount of such share provided that if, as a result of any actual change in, or amendment to, the laws of the United Kingdom or any political sub-division thereof or any authority having power to levy or impose in the United Kingdom any taxes, duties, assessments or governmental charges of whatsoever nature ("tax") or any change in the application of official or generally accepted interpretation of such laws, which change or amendment becomes effective after June 6, 1997, Abbey National is obliged to pay any amount representing tax by reference to any dividend payable on the New Sterling Preference Shares (the "Dividend") and the aggregate of the Dividend and any such amount representing tax exceeds the amount calculated by applying an annual rate of 8½ per cent. per annum to the nominal amount of the New Sterling Preference Shares, the amount of the Dividend shall be reduced so that the amount of the Dividend together with the amount representing tax shall be no more than an annual rate of 8½ per cent. per annum of the nominal amount of the New Sterling Preference Shares.

(ii) For these purposes, Abbey National shall not be regarded as being obliged to pay an amount representing tax to the extent that it (or any of its subsidiaries (as defined for the purposes of the Companies Act)) is entitled as a matter of law to any credit (which term shall include any allowance, reduction, or other relief) for such amount against its own liability to tax (even if it (or any of its subsidiaries (as defined for the purposes of the Companies Act)) did not make the necessary claim to get the credit, or have profits, make gains, or bear tax in relation to which to use the credit).

(iii) For these purposes, the term "Associated Tax Credit" means any United Kingdom taxation in accordance with, and at the rate specified by, United Kingdom law in effect at the relevant time (a) which is, or is treated as having been, borne by a recipient of dividends on the New Sterling Preference Shares by deduction at source or otherwise or (b) for which a credit (which term shall include an absence of or relief from liability and, if appropriate, a repayment of United Kingdom taxation) in respect of United Kingdom taxation is available to the recipient of such dividends, in each case on the assumption that such recipient is an individual resident in the United Kingdom for United Kingdom taxation purposes.

(iv) For the avoidance of doubt, if Abbey National were to elect for any dividend paid on the New Sterling Preference Shares to be treated as a "foreign income dividend" or if any dividend paid on the New Sterling Preference Shares were otherwise treated for tax purposes as a "foreign income dividend" with the result that such dividend does not carry an Associated Tax Credit, Abbey National shall be required to increase the rate of the cash dividend paid on the New Sterling Preference Shares on the basis described above so that the sum of the dividend payable on the New Sterling Preference Shares on the relevant Dividend Payment Date, together with the Associated Tax Credit (if any) in respect of such cash dividend, expressed as an annual rate, shall equal 8½ per cent. of the nominal amount of such New Sterling Preference Shares subject to the proviso to the first sub-paragraph of this paragraph (b).

Any reference in this paragraph (b) to the United Kingdom shall mean the United Kingdom, any political sub-division thereof and any authority having power to levy or impose taxation therein.

(c) If, in the opinion of the Directors, the profits of Abbey National available for distribution are sufficient to enable payment in full of dividends on the New Sterling Preference Shares on any Dividend Payment Date and also the payment in full of all other dividends stated to be payable on the same date on any other shares (including any arrears or deficiency of dividend on such other shares that are in cumulative form) ranking *pari passu* as to dividends with the New Sterling Preference Shares, then such dividends on the New Sterling Preference Shares and such other shares shall be declared and paid in full.

- (d) If, in the opinion of the Directors, the profits of Abbey National available for distribution are insufficient to cover the payment in full of dividends on the New Sterling Preference Shares on any Dividend Payment Date and also the payment in full of all other dividends stated to be payable on such date on any other shares (including any arrears or deficiency of dividend on any such other shares that are in cumulative form) expressed to rank *pari passu* with the New Sterling Preference Shares as regards participation in profits then dividends shall be declared by the Directors *pro rata* on such New Sterling Preference Shares and on such other shares to the extent of the profits (if any) available for distribution so that the amount of dividend declared per share on each such New Sterling Preference Share and on each such other share shall bear to each other the same ratio as the dividends accrued per share on each such New Sterling Preference Share and on each such other share (including any arrears or deficiency of dividend on any such other shares that are in cumulative form) bear to each other. If it shall subsequently appear that any such dividend which has been paid should not, in accordance with the provisions of this and the preceding sub-paragraph, have been so paid, then, provided the Directors shall have acted in good faith, they shall not incur any liability for any loss which any shareholder may suffer in consequence of such payment having been made.
- (e) If, in the opinion of the Directors, the payment of any dividend on any New Sterling Preference Shares would breach or cause a breach of the Bank of England's capital adequacy requirements from time to time applicable to Abbey National, then none of such dividend shall be declared or paid unless the Bank of England shall otherwise agree.
- (f) Subject to any right to be allotted additional New Sterling Preference Shares in accordance with sub-paragraph (g) below, New Sterling Preference Shares shall carry no further right as regards participation in the profits of Abbey National and if on any occasion a dividend (or any part thereof) is not paid for the reason specified in sub-paragraph (d) or (e) above, the holders of the New Sterling Preference Shares shall have no claim in respect of such non-payment.
- (g) (i) The provisions of this sub-paragraph shall apply where any dividend or any part thereof otherwise payable on a particular Dividend Payment Date on any New Sterling Preference Shares (a "Relevant Payment") is, for a reason specified in sub-paragraphs (d) or (e) above, not payable and the amounts (if any) standing to the credit of Abbey National's profit and loss account together with the amount of the reserves of Abbey National available for the purpose (including any share premium account and capital redemption reserve) are sufficient to be applied and capable of being applied in paying up in full at par additional New Sterling Preference Shares on the basis provided in (ii) below.
- (ii) On the Dividend Payment Date of the Relevant Payment had such payment been payable in cash, the Directors shall, subject to the Companies Act, in lieu of such cash payment and in discharge of any entitlement thereto allot and issue credited as fully paid to each holder of New Sterling Preference Shares such additional nominal amount of New Sterling Preference Shares as is, ignoring fractions, equal to the amount which would have been payable to him had such payment been made in cash, plus any Associated Tax Credit (as defined in paragraph (b)(iii) above had such cash payment been made) but subject to the proviso set out in paragraph (b)(i) as applied to the allotment of the New Sterling Preference Shares rather than to the dividend which they represent but not subject to that proviso in relation to the calculation of the cash amount.
- (h) For the purposes of paying up the New Sterling Preference Shares to be allotted pursuant to sub-paragraph (g) above, the Directors shall capitalise, out of such of the accounts or reserves of Abbey National available for the purpose as they shall determine (including any share premium account and capital redemption reserve), a sum equal to the aggregate nominal amount of the additional New Sterling Preference Shares then to be allotted and shall apply such sum in paying up in full the additional New Sterling Preference Shares referred to in sub-paragraph (g) above.
- (i) The additional New Sterling Preference Shares so allotted pursuant to sub-paragraph (g) shall be denominated in Sterling and shall confer the same rights and be subject to the same limitations as, and shall rank *pari passu* and *pro rata* in all respects with, the New Sterling Preference Shares save only as regards participation in the Relevant Payment.
- (j) If any additional New Sterling Preference Shares falling to be allotted under sub-paragraph (g) above cannot be allotted by reason of any insufficiency in Abbey National's authorised share capital or in the amount of relevant securities which the Directors are authorised to allot in accordance with Section 80 of the Companies Act, at the

next annual general meeting of Abbey National, the Directors shall propose a resolution or resolutions to effect an appropriate increase in the authorised share capital of Abbey National and to grant to the Directors the appropriate authority to allot the additional New Sterling Preference Shares.

- (k) If any Dividend Payment Date is not a day on which banks in London are open for business and on which foreign exchange dealings may be conducted in London (a "Sterling Business Day"), then payment of the dividend otherwise payable on such Dividend Payment Date will be made on the next succeeding Sterling Business Day (and without any interest or other payment in respect of such delay) unless such day shall fall within the next calendar month in which case such payment will be made on the preceding Sterling Business Day.
- (m) Dividends payable on New Sterling Preference Shares in respect of any period shorter or longer than a full dividend period will be calculated on the basis of a 365 day year and the actual number of days elapsed in such period.
- (n) If any dividend stated to be payable on any New Sterling Preference Share is not declared and paid in full (or a sum is not set aside to provide for such payment in full) or additional New Sterling Preference Shares have not been allotted in respect thereof in accordance with sub-paragraph (g) above, then until such time as:—
 - (i) all dividends on preference shares of Abbey National in cumulative form (including any arrears or deficiency of dividend in respect thereof) have been paid in full or a sum has been set aside for payment in full; and
 - (ii) all dividends on New Sterling Preference Shares have been paid in full or a sum has been set aside for payment in full or, where relevant, additional New Sterling Preference Shares have been allotted in respect thereof in accordance with sub-paragraph (g) above, in respect of the then most recently ended half-yearly dividend period in relation to the New Sterling Preference Shares,

Abbey National may not (without the written consent of three-fourths in nominal value of, or the sanction of an extraordinary resolution passed at a separate general meeting of the holders of New Sterling Preference Shares) thereafter redeem, reduce, purchase or otherwise acquire for any consideration any other share capital of Abbey National ranking as regards participation in the assets of Abbey National *pari passu* with or after the New Sterling Preference Shares and, save as provided in sub-paragraph (o) below, no dividends may be paid or declared on any other share capital of Abbey National ranking as regards participation in profits after the New Sterling Preference Shares.

- (o) Notwithstanding any of the foregoing or any provision in the Articles, the Directors may, subject to the Statutes, pay a special dividend (net of any Associated Tax Credit) on any class of share capital of an amount not exceeding £0.01 per share if, in the opinion of the Directors, it is necessary to do so to preserve the status of Abbey National's shares as wider range investments under the Trustee Investments Act 1961 as amended or re-enacted from time to time.

Capital

- (a) On a return of capital or on a distribution of assets on a winding up (but not on a redemption or purchase by Abbey National of shares of any class) the New Sterling Preference Shares shall rank *pari passu* inter se and with any other shares that are expressed to rank *pari passu* therewith as regards participation in assets, and otherwise in priority to any other share capital of Abbey National. On such a return of capital or winding up, each New Sterling Preference Share shall, out of the surplus assets of Abbey National available for distribution amongst the members after payment of Abbey National's liabilities, carry the right to receive an amount equal to the amount paid up or credited as paid up on such New Sterling Preference Share together with any premium paid on issue, and also together with:—
 - (i) the full amount of any dividend thereon, whether or not declared or earned, which would otherwise be due for payment and is not otherwise paid on a Dividend Payment Date falling on or after the date of commencement of the winding up or other return of capital but which is payable in respect of a period ending on or before such date; and
 - (ii) in respect of any period in respect of which a dividend thereon would otherwise be payable and is not otherwise paid that begins before, but ends after, the date of the commencement of the winding up or other

return of capital, the proportion, whether or not declared or earned, of the dividend that would otherwise have been payable thereon in respect of such period that is attributable to the part of the period that ends on such date.

- (b) If, upon any such return of capital or winding up, the amounts available for payment are insufficient to cover the amounts payable in full on the New Sterling Preference Shares and on any other shares expressed to rank *pari passu* therewith as regards participation in assets, then the holders of the New Sterling Preference Shares and such other shares will share rateably in the distribution of surplus assets (if any) in proportion to the full respective preferential amounts to which they are entitled.
- (c) No New Sterling Preference Share shall confer any right to participate on a return of capital or a distribution of assets of Abbey National other than that set out in (a) and (b) above.

Redemption

The New Sterling Preference Shares shall not be redeemable.

Voting

The holders of New Sterling Preference Shares shall only be entitled to receive notice of or to attend, speak and/or vote at General Meetings of Abbey National in the following circumstances:

- (i) if the dividend on the New Sterling Preference Shares has not been paid in full (or the entitlement thereto discharged by the allotment of additional New Sterling Preference Shares in accordance with these terms and conditions) for the three consecutive dividend periods immediately prior to the notice convening the relevant General Meeting; or
- (ii) if a resolution is to be proposed at the General Meeting varying, altering or abrogating any of the rights, privileges, limitations or restrictions attaching to the New Sterling Preference Shares and then only on the relevant resolution; or
- (iii) if a resolution is to be proposed at the General Meeting to wind up Abbey National and then only on the relevant resolution;

but not otherwise. Whenever holders of the New Sterling Preference Shares are entitled to vote at a General Meeting, on a show of hands every such holder who is present in person shall have one vote and, on a poll, every such holder who is present in person or by proxy shall have one vote for each New Sterling Preference Share held.

Purchases

Subject to the provisions of the Companies Act, the Articles and, if applicable, the rights conferred on any class of shares of Abbey National, Abbey National may at any time purchase any New Sterling Preference Shares in issue in the market, by tender or by private treaty upon such terms and conditions as the Directors may think fit. No repurchase of any New Sterling Preference Shares will be made without the prior consent of the Bank of England.

Variations of Rights and Further Issues

- (a) Save with the written consent of the holders of three-quarters in nominal value of the New Sterling Preference Shares then in issue, or with the sanction of an Extraordinary Resolution passed at a separate General Meeting of the holders of the New Sterling Preference Shares then in issue, the Directors shall not authorise or create, or increase the amount of, any shares of any class, or any securities convertible into shares of any class, ranking as regards rights to participate in the profits or assets of Abbey National (other than on a redemption or purchase by Abbey National of any such share) in priority to the New Sterling Preference Shares.
- (b) Subject to sub-paragraph (a) above, the rights attaching to the New Sterling Preference Shares shall not be deemed to be varied by the creation or issue of any other preference shares or other shares, or any securities convertible into shares of any class, ranking, as regards participation in profits or assets, *pari passu* with or after the New Sterling

Preference Shares, whether carrying identical rights in all respects with the New Sterling Preference Shares or carrying rights differing therefrom in any respect including as to dividend, premium on a return of capital, redemption, conversion, denomination and currency of issue.

Notices

Any notice required to be given by Abbey National to the holders of the New Sterling Preference Shares shall be sufficiently given if posted to such holders in accordance with the Articles.

Registrar and Paying Agent

The registrar's department of Abbey National, presently located at Carbrook House, 5 Carbrook Hall Road, Sheffield S9 2EG, will act as registrar and paying agent for the New Sterling Preference Shares.

The following is a summary of certain rights attaching to the Ordinary Shares and of certain provisions of Abbey National's Articles of Association. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the Articles, copies of which are available for inspection (see "General Information — Documents available for inspection") below. The rights attaching to the New Sterling Preference Shares are summarised in the section headed "Description of the New Sterling Preference Shares" above; the rights attaching to the Preference Shares other than the New Sterling Preference Shares are described in "Preference Shares and Exchangeable Capital Securities of Abbey National plc" below.

Income

Dividends may only be declared and paid out of the distributable profits of Abbey National.

Subject to the rights of the holders of shares having special rights as to dividends, Abbey National may by ordinary resolution from time to time declare dividends on the Ordinary Shares in amounts not exceeding the amounts recommended by the board. The board may pay interim dividends on the Ordinary Shares according to the financial position of Abbey National. Dividends on the Ordinary Shares may be declared or paid in any currency. No dividends may be paid or declared on the Ordinary Shares until such time as all dividends on any class of share capital ranking prior to the Ordinary Shares have been paid in full.

Except in so far as the rights attaching to, or the terms of issue of, any share otherwise provide, all dividends shall be declared and paid according to the amounts paid up on the shares in respect of which the dividend is paid and all dividends shall be apportioned and paid pro rata according to the amounts paid up on the shares during any portion or portions of the period in respect of which the dividend is paid.

Any dividend unclaimed after a period of twelve years from the date when it becomes due for payment will be forfeited and revert to Abbey National.

Abbey National may by ordinary resolution direct, upon the recommendation of the board, that a dividend shall be satisfied wholly or partly by the distribution of assets.

The board may, if authorised by an ordinary resolution of Abbey National, offer any holders of Ordinary Shares the right to elect to receive Ordinary Shares, credited as fully paid, instead of cash in respect of the whole (or some part, to be determined by the board) of any dividend specified in such resolution.

Capital

In the event of a return of capital on a winding up, or otherwise, after payment of all liabilities and subject to the rights of the holders of any shares with preferential rights on a return of capital, the remaining assets of Abbey National will be divided among the holders of the Ordinary Shares according to the number held thereof.

Alteration of share capital

Abbey National may from time to time by ordinary resolution:

- (a) increase its share capital by such sum divided into shares of such amount as the resolution shall direct; or
- (b) consolidate and divide all or any of its share capital into shares of larger amount than its existing shares; or
- (c) (subject to the provisions of the Companies Acts) sub-divide its shares, or any of them, into shares of smaller amount and the resolution may determine that, as between the resulting shares, one or more of such shares may be given preference over the others; or
- (d) cancel any shares which, at the date of the passing of the resolution, have not been taken or agreed to be taken by any person and diminish the amount of its share capital by the amount of the shares so cancelled.

Subject to the provisions of the Companies Acts and to the rights conferred on any class of shares, Abbey National may from time to time by special resolution reduce its share capital, any capital redemption reserve and any share premium account.

Voting Rights

Subject to any special terms as to voting upon which any shares may be issued or may for the time being be held or any suspension or any abrogation of voting rights, upon a show of hands every holder of Ordinary Shares who is present in person at a general meeting shall have one vote, and on a poll every holder of Ordinary Shares who is present in person or by proxy shall have one vote for every Ordinary Share of which he is the holder. Voting at a general meeting is by show of hands unless a poll is demanded.

Pre-emption Rights

Holders of Ordinary Shares have no pre-emptive rights under the Articles of Association. However, the ability of the directors to (a) allot any shares or rights to subscribe for, or to convert any security into, any shares of Abbey National under any circumstances or (b) issue for cash Ordinary Shares or rights to subscribe for, or to convert any security into, Ordinary Shares otherwise than by way of rights to existing holders of Ordinary Shares is restricted by law and (except in certain cases) requires appropriate authorisation to be given by shareholders in general meeting.

Variation of Rights

Subject to the provisions of the Companies Acts, all or any of the rights for the time being attached to any class of shares for the time being issued may from time to time be varied with the consent in writing of the holders of not less than three-fourths in nominal value of the issued shares of that class or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of those shares.

Transfer of Shares

Any member may transfer all or any of his Ordinary Shares by an instrument of transfer in any usual form or in any other form which the board may approve. The instrument of transfer shall be executed by or on behalf of the transferor and (in the case of a partly paid share) the transferee, and the transferor shall be deemed to remain the holder of the share until the name of the transferee is entered in the register in respect of it.

The board may, in its absolute discretion and without giving any reason for so doing, decline to register any transfer of any share which is not a fully paid share. The board may also decline to register a transfer unless the instrument of transfer:

- (a) is lodged with Abbey National at its registered office (or at such other place as the board may appoint) accompanied by the certificate for the shares to which it relates and such other evidence as the board may reasonably require to show the right of the transferor to make the transfer;
- (b) is in respect of only one class of shares; and
- (c) if to joint transferees, is in favour of not more than four such transferees.

PREFERENCE SHARES AND EXCHANGEABLE CAPITAL SECURITIES OF ABBEY NATIONAL PLC

On October 23, 1995, Abbey National issued 100,000,000 10³/₈ per cent. Non-Cumulative Sterling Preference Shares of £1 each (the "October 1995 Preference Shares") and £200,000,000 10¹/₁₆ per cent. Exchangeable Capital Securities (the "Capital Securities") which are exchangeable (as described below) into 10³/₈ per cent. Non-Cumulative Sterling Preference Shares of £1 each (the "Additional Sterling Preference Shares").

Abbey National may, having given not less than 30 and not more than 60 days' notice to the holders of the Capital Securities (the "Holders") exchange all or part of the Capital Securities (having a principal amount which is an integral multiple of £25,000,000) for Additional Sterling Preference Shares on the basis that the Holders will receive one Additional Sterling Preference Share for each £1 principal amount of Capital Securities held. In the case of a partial exchange, serial numbers for the Capital Securities will be drawn in a manner approved by the trustee for the Holders. Abbey National is at liberty to make such number of partial exchanges as it may consider appropriate.

On February 13, 1996, Abbey National issued 100,000,000 10³/₈ per cent. Non-Cumulative Sterling Preference Shares of £1 each (the "February 1996 Preference Shares") ranking *pari passu* with and forming a single series with the October 1995 Preference Shares except as to the first dividend date. On November 15, 1996, Abbey National issued 8,000,000 Non-cumulative Dollar-denominated Preference Shares of \$25 each (the "Dollar Preference Shares").

The October 1995 Preference Shares, the February 1996 Preference Shares and the Dollar Preference Shares rank, and the Additional Preference Shares (if allotted) would rank *pari passu* with each other and with the New Sterling Preference Shares. The October 1995 Preference Shares, the Capital Securities and the February 1996 Preference Shares have all been admitted to the Official List. The Dollar Preference Shares have been admitted to listing on the New York Stock Exchange, Inc. All of the Capital Securities remain outstanding.

PROCEEDS OF ISSUE

The net proceeds from the issue of the New Sterling Preference Shares will be used to strengthen the Group's capital base, in line with the group's strategy to maintain a prudent level of capital.

THE ABBEY NATIONAL GROUP

Introduction

The Abbey National Group was the fifth largest banking group in the United Kingdom in terms of assets at December 31, 1996 with total assets of £124 billion (1995: £103.1 billion). During 1996 the Group made pre-tax profits of £1,228 million (1995: £1,026 million) excluding integration costs arising from the transfer of the business of National and Provincial Building Society ("N&P") of £61 million.

Abbey National plc was incorporated in England and Wales on September 12, 1988 with registered number 2294747 and is the successor company to which the Abbey National Building Society transferred its business in July 1989. Abbey National is the parent company of the Group.

The Business of the Group

Abbey National and its subsidiaries comprise a major personal financial services group in the United Kingdom, providing a wide range of financial products and services. The Group operates principally in the following business segments:

U.K. Retail Banking

U.K. Retail Banking is the largest business of the Group and the major areas of activity are:

Mortgage Lending

The Group provides an extensive mortgage service and, at December 31, 1996, had total mortgage assets of £60 billion (1995: £48 billion) net of suspended interest and provisions. During 1996 the Group's market share of the increase in U.K. mortgages outstanding was an estimated 2.4 per cent. (1995: 9.3 per cent.). As at December 31, 1996 the Group's market share of the total U.K. mortgage stock was an estimated 14.7 per cent. compared to 12.3 per cent. as at December 31, 1995, primarily as a result of the acquisition of N&P.

Savings

The Group provides a range of savings accounts to meet the varied requirements of its customers and, at December 31, 1996, savings of customers amounted to £45.9 billion (1995: £37.9 billion). As at December 31, 1996, the Group's market share of the total U.K. liquid savings stock was an estimated 9.3 per cent. compared to 8.2 per cent. at December 31, 1995.

Bank Account

During 1996, 113,000 new bank accounts were opened (1995: 120,000) bringing the total number of accounts opened to 1.56 million.

Consumer Credit

The first full year of First National Bank's inclusion in the results brought a doubling of the pre-tax profit to £98 million (1995: £49 million) and an increase in total loan assets to £2,489 million (1995: £1,629 million). A range of secured and unsecured loans are provided through First National Finance Corporation plc and the Group's distribution channels.

Life Assurance Operations

The Group is active in each of the three principal areas of the U.K. life assurance industry, including life and ill-health protection assurance, pensions and investments and savings. Scottish Mutual Assurance plc offers a broad range of products through independent financial advisers, while Abbey National Life plc offers products through the Group's distribution network. Scottish Mutual Assurance plc's new business premium income arising from policies in the year to December 31, 1996 increased by 81 per cent. to £949 million (1995: £523 million) with a substantial part of new

business being pension-related and life assurance and the remainder being other long-term savings products. Abbey National Life plc's new business premiums from policies sold in 1996 totalled £671 million (1995: £434 million), 55 per cent. higher than in 1995.

Treasury and Offshore

The activities of Treasury & Offshore are conducted primarily through Abbey National Treasury Services plc and subsidiaries in Jersey and Gibraltar. The assets of Treasury & Offshore grew by 14 per cent. during 1996 to £47.8 billion (1995: £41.8 billion). A change to a mix of investment and trading assets provided greater flexibility in capital management.

Other Operations outside the United Kingdom

The Group has operations in France, Spain and Italy, the main activity of which is the provision of residential mortgage loans. In addition, the operation in Spain takes retail deposits.

Financial Results for the twelve months to December 31, 1996

The Group increased its pre-tax profit by 20 per cent. to £1,228 million excluding integration costs arising from the transfer of the business of N&P for £61 million (1995: £1,026 million). The Group's tier 1 capital ratio improved to 8.5 per cent. (1995: 8.4 per cent.) and the risk asset ratio for the period remained at 11.7 per cent.

U.K. Retail Banking increased pre-tax profit by 7 per cent. to £736 million (1995: £687 million) on the back of growth in mortgage assets and retail liabilities. This was a competitive market in 1996 and consequently the net U.K. retail interest spread narrowed from 2.15 per cent. in 1995 to 2.08 per cent. in 1996. There was a provisions charge of £80 million (1995: £44 million) relating mainly to the significant growth in personal banking products. The number of mortgages six months or more in arrears fell by 14 per cent. during the period and the stock of repossessed properties (including those of N&P) was reduced by 11 per cent. when compared to the previous 12 months. Consumer Credit pre-tax profit doubled to £98 million (1995: £49 million) reflecting the first full year of First National Bank's inclusion in the results and an increase in unsecured personal loans.

Life Assurance Operations increased pre-tax profit by 44 per cent. to £151 million (1995: £105 million) reflecting a continued increase in new business levels through non-mortgage related investment, pension and protection products.

Treasury & Offshore increased pre-tax profit to £256 million (1995: £217 million) reflecting the increased emphasis on the management of selected asset portfolios and the first full year of operations of Abbey National Financial Products. Abbey National Treasury Services plc also continued to be a major issuer of debt in the international capital markets and provided capital liquidity for the Group during a year of expansion.

The pre-tax loss in Continental Europe of £19 million (1995: £22 million) was 13.6 per cent. lower than 1995, reflecting an overall improvement in business activity.

MANAGEMENT

Directors of Abbey National

The following are members of the Board of Directors of Abbey National:

<i>Position</i>	<i>Name</i>	<i>Principal external directorships</i>
Chairman	The Lord Tugendhat	Director, Eurotunnel plc Chairman, Blue Circle Industries PLC
Deputy Chairmen	Martin Llowarch, FCA	Chairman, Transport Development Group plc Chairman, Firth Rixson plc Director, Hickson International plc
	The Lord Shuttleworth, FRICS	
Chief Executive	Peter Birch, CBE FCIB	Director, Argos plc Director, Dalgety PLC Director, Land Securities PLC
Deputy Chief Executive	Charles Toner	
Executive Directors	Ian Harley, FCA Tim Ingram, MBA FCIB Gareth Jones, FCA FCT Andrew Pople, MBA Charles Villiers, FCA	
Non-Executive Directors	Mair Barnes	Director, Fosters Trading Company Limited Executive Chairman, Vantios Plc Director, George Wimpey PLC
	Allan Denholm, CBE CA Sir Terence Heiser, GCB	Director, J. Sainsbury plc Director, Wessex Water plc Director, Personal Investment Authority
	Peter Ogden	Director, Anglo & Overseas Trust PLC Chairman, Computacenter Limited Director, Omnia Limited
	The Lord Rockley	Director, Kleinwort Benson Group plc Director, Christie's International plc Director, The Foreign and Colonial Investment Trust PLC Director, Cobham plc Chief Executive, MEPC plc
	James Tuckey, FRICS Keith Woodley, FCA	

The business address of each of the above is Abbey House, Baker Street, London NW1 6XL.

Directors' remuneration.

The following table shows an analysis of directors' remuneration excluding pensions, details of which are provided below:

	Salary/ Fee	Performance related Annual Bonus	Performance related 3 year Bonus	Other bonus payments	Taxable benefits	1996 Total	1995 Total
	£	£	£	£	£	£	£
The Lord Tugendhat (Chairman) . . .	272,727				15,401	288,128	263,762
Executive Directors							
P G Birch (Chief Executive)	381,783	90,000	97,820	25,000	6,300	600,903	447,845
J M Fry (retired April 17, 1996)	56,000		32,667		3,595	92,262	196,810
I Harley	219,533	60,000	57,150		8,698	345,381	255,649
T C W Ingram*	70,067	40,000	20,495		1,389	131,951	
D G Jones	207,297	50,000	54,400	50,000	9,659	371,356	242,285
R F Knighton (resigned December 31, 1996)	214,667	50,000	55,650	75,000	8,436	403,753	262,967
A D Lyons* (resigned April 4, 1997)	104,230	10,000	8,645		2,378	125,253	
A H Pople*	69,655	40,000	28,833		25,054	163,542	
C G Toner	210,030	50,000	55,700		10,321	326,051	260,584
C N Villiers	210,667	50,000	54,650		6,939	322,256	268,315
Non-Executive Directors							
M Barnes	21,000				1,045	22,045	21,278
J A Denholm	26,000					26,000	29,577
Sir Terence Heiser	21,000				78	21,078	20,669
M E Llowarch	34,500				777	35,277	33,811
S Morrison (retired June 27, 1995) . .							8,792
P J Ogden	18,000					18,000	17,792
The Lord Rockley	21,000					21,000	20,583
The Lord Shuttleworth*	13,091				187	13,278	
J L Tuckey	21,000					21,000	20,583
K S Woodley*	7,864					7,864	
Totals	<u>2,200,111</u>	<u>440,000</u>	<u>466,010</u>	<u>150,000</u>	<u>100,257</u>	<u>3,356,378</u>	<u>2,371,302</u>

* Appointed August 5, 1996

Directors' pensions

Executive directors are eligible to join one of Abbey National's pension schemes.

The following table shows an analysis of the accrued pension benefits as at December 31, 1996 for executive directors participating in Abbey National's defined benefits pension schemes:

	Contributions from directors during 1996	Increase in accrued pension during 1996 (1)(5)	Transfer value of the increase in accrued pension during 1996 (2)	Total accrued pension as at December 31, 96 (3)	Total accrued pension as at December 31, 95 (4)
	£	£	£	£	£
Executive Directors					
P G Birch (Chief Executive)	3,800	31,901	473,700	235,899	196,341
J M Fry (retired April 17, 1996)	600	181	2,000	108,448	106,667
I Harley	5,600	10,616	91,000	80,745	67,497
D G Jones	2,100	5,547	53,300	33,184	26,600
R F Knighton (resigned December 31, 1996) (6)	32,200	11,104	584,200	125,821	110,411
A D Lyons* (resigned April 4, 1997)	4,900	4,132	22,800	37,807	33,675
A H Pople*	700	5,160	31,700	23,496	18,336
C G Toner	2,100	11,588	151,800	126,191	110,301
C N Villiers	31,600	11,749	133,200	77,596	63,375
Totals	<u>83,600</u>	<u>91,978</u>	<u>1,543,700</u>	<u>849,187</u>	<u>733,203</u>

* Appointed August 5, 1996

Notes:

- (1) The increase in accrued pension during 1996 represents the increase in the annual pension which each director would be entitled to receive from normal retirement age (less the statutory inflationary increase of 3.9%, where relevant), if he had left service voluntarily at December 31, 1996 or at his actual retirement date if earlier. For directors appointed during the year, the increase relates to the period of service from appointment to December 31, 1996.
- (2) The transfer value of the increase in accrued pension represents the current capital sum which would be required, using demographic and financial assumptions, to produce an equivalent increase in accrued pension and ancillary benefits, excluding the statutory inflationary increase, and after deducting members' contributions (including additional voluntary contributions ("AVCs")).
- (3) The accrued pension as at December 31, 1996 represents the annual pension which each director would be entitled to receive from normal retirement age if he had left service voluntarily at December 31, 1996, or at his actual retirement date if earlier.
- (4) Stated as at the date of appointment if later.
- (5) The figure for the increase in accrued pension during 1996 which appears in the table does not in all cases equal the difference between the total accrued pension as at December 31, 1996, and the total accrued pension as at December 31, 1995. The difference arises where the increase in accrued pension is stated after deducting the statutory inflationary increase which would have been applied to the deferred pension entitlement had the director left at the start of the year. This deduction has been made where directors have been in service for the whole year, and is made in order to present a figure showing that element of the increase which results from an extra full year of service and from changes in remuneration.
- (6) R F Knighton resigned from the Board on December 31, 1996 and has opted to take early retirement from the Group during 1997. This is reflected in the transfer value of the increase in pension during 1996.
- (7) The pension provision for T C W Ingram has been made on a defined contributions basis during 1996. The cost of this provision, including ancillary benefits, amounted to £23,100 during the year. He made no contributions during the year.
- (8) AVCs made have been included in the above table where these payments result in an increase in the value of the director's pension entitlements earned during the year.

The above disclosures for directors' pensions have been made with reference to the consultative document on proposed changes to the Listing Rules issued by the London Stock Exchange in May 1996 following the final report of the Institute and Faculty of Actuaries in April 1996. Further information concerning Abbey National's pension schemes is set out in Note 49 to the Consolidated Financial Statements contained elsewhere in this Document.

On his retirement John Fry was permitted to retain his company car and received a gift. The value of these ex-gratia items, when grossed up for tax purposes, was £52,666. John Fry was a Deputy Chairman and director who had been on the board of Abbey National and its building society predecessor since 1984 and had been an employee for 34 years. As discussed below, Abbey National no longer provides directors with a company car.

A further ex-gratia gift, valued at £4,158 when grossed up for tax purposes, was made to Robert Knighton, who resigned from the Board on December 31, 1996 and will retire from Abbey National on July 31, 1997 after 27 years with Abbey National.

The Chairman's emoluments consist wholly of fees and benefits and expenses in respect of services. He is not entitled to participate in any bonus or profit sharing arrangements nor is he entitled to participate in the Executive Share Option scheme. However, he is entitled to participate in Abbey National's Employee Sharesave scheme which is available to all eligible employees. The Chairman's appointment is non-pensionable and he makes his own private pension arrangements.

Fees are paid to non-executive directors. The basic fee for non-executive directors during 1996 was £18,000 per annum augmented by £3,000 for service on Board committees. On January 1, 1997 the basic fee and the fee for committee service were each increased by £2,000 per annum. The last increase was in June 1995.

Deputy Chairmen and Board Committee Chairmen receive additional fees directly proportionate to those for Board and Committee service.

The remuneration arrangements for executive directors are as follows:

- a. Basic salary is determined by reference to salaries for similar positions in comparable organizations. Those organisations include U.K. banks, building societies, insurance companies and other U.K. companies with an equivalent market capitalization to Abbey National.

- b. The basic system of discretionary performance payments was revised during 1994, and now comprises a bonus scheme based on annual performance which pays out for 1996 in March 1997, and a three year scheme. The maximum potential cash payment, to be shared among the executive directors and other members of the top management team for the annual scheme, is 30 per cent. of the participant's basic salary earned during the year. Such payments are not pensionable.

The actual level of any payment under the annual bonus scheme is determined by the Personnel and Remuneration Committee's view of the Group's performance set against the Chief Executive's objectives included in the annual budget. The Committee pays particular attention to certain quantifiable targets and then modifies that assessment in the light of its view of performance against qualitative objectives, such as customer service and product quality.

The key financial targets for 1996 were achievement of a specified level of Group pre-tax profits; achievement of a specified cost:income ratio and a specified measure of shareholder value (known as the value based management profit after capital charge). In setting the quantifiable financial targets the Committee requires an enhanced budget performance over the results achieved in the preceding year. Payments to individual executive directors reflect both corporate and individual performance and in total represented approximately 24 per cent. of the basic salaries earned by such directors during the year (other than that of John Fry).

- c. As well as an annual bonus scheme there is also a three year performance scheme which was first established in 1994 and covered the three calendar years to 1996. The maximum potential cash payment, to be shared among the executive directors and other members of the top management team, is 30 per cent. of the participant's basic salary. Such payments are not pensionable.

In determining whether or not to make a payment under the three year bonus scheme, and if so its size, the Personnel and Remuneration Committee is guided by a formula which compares, over the relevant three year period, (i) total shareholder return against the FTSE 100 share index, (ii) performance against relevant quoted and unquoted comparable competitors, and (iii) performance against Abbey National's Three Year Plan. The maximum bonus is paid for performance in the top quartile and there is no payment for performance in the bottom quartile with pro rata payments in between.

Each of the executive directors set out above participated in the three year bonus scheme pro rata to his service in that period. In respect of the 1994 -1996 scheme, entitlements represented 25 per cent. of participants' basic salaries at December 31, 1996 or at their date of retirement and are detailed above. Entitlements, if any, will not be determined until March 1998 in respect of the 1995 - 1997 scheme and March 1999 in respect of the 1996 - 1998 scheme, both of which are constructed on similar principles. For periods thereafter, the new Long Term Incentive Plan (see below) will replace the present scheme.

- d. In addition, the Personnel and Remuneration Committee may in exceptional circumstances make an ex-gratia payment to an individual executive director who has rendered a particular and outstanding contribution. Payments under this heading were made to three directors during 1996 and these are shown under the 'Other Bonus Payments' column above.
- e. There is an Executive Share Option scheme, an Employee Sharesave scheme, and an Employee Share Option scheme all of which have been approved by shareholders. Membership of all these schemes was available to executive directors, and their interests are set out below. As from January 1, 1997 executive directors will no longer participate in future grants under the Executive Share Option scheme (see Long Term Incentive Plan below). Grants of executive share options are made on the determination of the Personnel and Remuneration Committee and reflect both corporate and individual performance. The performance criteria for the Executive Share Option scheme were strengthened during the year and, for options issued from 1997, exercise will require a total shareholder return above the median for quoted comparators in addition to the requirement, introduced for 1996, for the average growth in earnings per ordinary share to exceed the average increase in the U.K. Retail Prices Index by 2 per cent. Executive share options are granted on a phased basis rather than in one block. Annual awards are normally equivalent to a maximum of one times annual salary, subject always to the Inland Revenue requirements on the total

limit that may be awarded under such schemes. Replacement options will only be granted after due consideration by the Personnel and Remuneration Committee and providing performance has shown sustained growth in the preceding years.

Executive Options are granted at an exercise price based on the average of the market price as shown by the Daily Official List of the London Stock Exchange for the three business days immediately preceding the date of grant.

- f. Taxable benefits for executive directors include car expenses, medical expenses, relocation expenses and subsidised mortgage loans. During the year Abbey National bought out the entitlement to a fully expensed car, and the provision of private petrol. The Chief Executive received an annual pensionable salary increase of £16,280 in lieu of such entitlements, while for other executive directors (except Alastair Lyons) the pensionable salary increase was £13,600 per annum.

In the case of non-executive directors some travelling expenses are classified as taxable benefits.

Long Term Incentive Plan

During 1996 the Personnel and Remuneration Committee undertook a major review of the current arrangements for remunerating executive directors, with particular attention being paid to the long-term bonus and share option schemes. The Committee concluded that a new Long-Term Incentive Plan for senior executives should be recommended for adoption at the Annual General Meeting which was held in April 1997.

The Long-Term Incentive Plan is designed to enhance the link between the remuneration of executives and the Company's medium term performance and will incorporate challenging performance targets. No payment will be made if performance is below median and maximum payment will be made for upper quartile performance, with pro rata payments in between. In the case of the first performance period (1997 - 1999), the performance targets will be based on the share price and dividend performance (total shareholder return) of Abbey National relative both to specified financial institutions and to the constituents of the FTSE 100 share index.

The existing three year bonus scheme will cease to operate, and no payments will be made under that scheme after March 1999.

Future participation in Abbey National's Executive Share Option scheme will be primarily confined to less senior executives, a group of approximately 150 managers. Those who participate in the Long-Term Incentive Plan will not also participate in future grants under the Executive Share Option scheme. Initially the Plan will be open only to 9 members of the Executive Committee, although it is expected that in time the Plan may include wider senior management participation.

Directors' share interests

The beneficial interests of directors and their immediate families in the ordinary shares of 10 pence each in Abbey National are shown below:

<u>Ordinary shares:</u>	<u>No. of shares</u>		
	<u>At January 1, 1996</u> (or date of appointment if later)	<u>At December 31, 1996</u>	<u>At March 10, 1997</u>
M Barnes	1,000	1,000	1,000
P G Birch	313,458	313,838	328,053
J A Denholm	3,000	3,000	3,000
I Harley	20,501	27,643	27,643
Sir Terance Heiser	1,500	1,500	1,500
T C W Ingram	17,180	18,150	18,156
D G Jones	70,910	68,576	68,576
R F Knighton (resigned December 31, 1996)	14,300	11,350	N/A
M E Llowarch	1,750	1,750	1,750
A D Lyons (resigned April 4, 1997)	691	691	691
P J Ogden	4,000	4,000	4,000
A H Pople	5,886	4,386	4,391
The Lord Rockley	5,000	5,000	5,000
The Lord Shuttleworth	816	816	816
C G Toner	20,143	21,898	21,916
J L Tuckey	12,000	12,000	12,000
The Lord Tugendhat	10,000	10,000	10,000
C N Villiers	26,657	26,323	26,323
K S Woodley	660	660	2,160

In addition T C W Ingram held £232,529 Abbey National Floating Rate Unsecured Loan Notes 2000 issued on August 23, 1995 in consideration for shares held in FNFC plc and J A Denholm had a non-beneficial interest in 9,250 ordinary shares as at December 31, 1996 (1995: nil).

Share options:

	<u>At January 1, 1996</u> (or date of appointment if later)	<u>No. of Options</u>		<u>At December 31, 1996</u>	<u>Exercise price £</u>	<u>Market price at date of exercise £</u>	<u>Date from which exercisable</u>	<u>Expiry date</u>	<u>Notes</u>	
		<u>Granted</u>	<u>Exercised</u>							
P G Birch	8,456			8,456	1.49		07/01/97	12/31/97	Sharesave	
	1,939			1,939	2.32		10/01/98	03/31/99	Sharesave	
	1,882			1,882	2.39		06/01/99	11/30/99	Sharesave	
	2,418			2,418	4.28		10/01/00	03/31/01	Sharesave	
	14,134			14,134	2.99		05/05/95	05/05/02	Executive	
	69,478			69,478	2.99		05/05/95	05/05/02	Executive ⁽¹⁾	
	25,215			25,215	3.69		03/29/96	03/29/03	Executive	
	8,404			8,404	3.69		03/29/96	03/29/03	Executive ⁽²⁾	
	60,897			60,897	4.68		04/11/97	04/10/04	Executive	
	71,500			71,500	4.83		04/10/98	04/09/05	Executive	
	97,765			97,765	5.37		08/29/98	08/28/02	Executive [#]	
			150		150	5.91		09/09/99	09/08/06	Employee
		<u>362,088</u>	<u>150</u>		<u>362,238</u>					

	At January 1, 1996 (or date of appointment if later)	No. of Options		At December 31, 1996	Exercise price £	Market price at date of exercise £	Date from which exercisable	Expiry date	Notes
		Granted	Exercised						
I Harley	1,616		1,616		2.32	5.995	10/01/96	03/31/97	Sharesave
	1,569		1,569		2.39		06/01/97	11/30/97	Sharesave
	2,418		2,418		4.28		10/01/00	03/31/01	Sharesave
	20,476		5,476	15,000	3.69	5.505	03/29/96	03/29/03	Executive
	6,825		6,825	6,825	3.69		03/29/96	03/29/03	Executive ⁽²⁾
	23,237		23,237	23,237	4.68		04/11/97	04/10/04	Executive
	7,745		7,745	7,745	4.68		04/11/97	04/10/04	Executive ⁽³⁾
	40,500		40,500	40,500	4.83		04/10/98	04/09/05	Executive
		38,053		38,053	5.65		03/25/99	03/24/06	Executive
		36,379		36,379	5.91		09/09/99	09/08/06	Executive*
		150		150	5.91		09/09/99	09/08/06	Employee
	<u>104,386</u>	<u>74,582</u>	<u>7,092</u>	<u>171,876</u>					
T C W Ingram	3,701		3,701		4.66		04/01/01	09/30/01	Sharesave
	4,180		4,180		4.097		08/31/96	08/30/03	Executive*
	25,663		25,663		5.65		03/25/99	03/24/06	Executive
		150		150	5.91		09/09/99	09/08/06	Employee
	<u>33,544</u>	<u>150</u>		<u>33,694</u>					
D G Jones	1,616		1,616		2.32	7.635	10/01/96	03/31/97	Sharesave
	1,569		1,569		2.39		06/01/97	11/30/97	Sharesave
	2,418		2,418		4.28		10/01/00	03/31/01	Sharesave
	23,322		23,322		2.99		05/05/95	05/05/02	Executive ⁽¹⁾
	25,575		25,575		3.69		03/29/96	03/29/03	Executive
	8,525		8,525		3.69		03/29/96	03/29/03	Executive ⁽²⁾
	24,038		24,038		4.68		04/11/97	04/10/04	Executive
	8,012		8,012		4.68		04/11/97	04/10/04	Executive ⁽³⁾
	39,500		39,500		4.83		04/10/98	04/09/05	Executive
		36,106		36,106	5.65		03/25/99	03/24/06	Executive
		22,829		22,829	5.91		09/09/99	09/08/06	Executive*
		150		150	5.91		09/09/99	09/08/06	Employee
	<u>134,575</u>	<u>59,085</u>	<u>1,616</u>	<u>192,044</u>					
R F Knighton (resigned 12/31/96)	8,456		8,456		1.49		07/01/97	12/31/97	Sharesave
	22,404		22,404		3.69		03/29/96	03/29/03	Executive
	7,468		7,468		3.69		03/29/96	03/29/03	Executive ⁽²⁾
	22,435		22,435		4.68		04/11/97	04/10/04	Executive
	7,478		7,478		4.68		04/11/97	04/10/04	Executive ⁽³⁾
	39,500		39,500		4.83		04/10/98	04/09/05	Executive
		24,665		24,665	5.65		03/25/99	03/24/06	Executive
		37,665		37,665	5.91		09/09/99	09/08/06	Executive*
		150		150	5.91		09/09/99	09/08/06	Employee
	<u>107,741</u>	<u>62,480</u>		<u>170,221</u>					
A D Lyons (resigned April 4, 1997)		150		150	5.90		09/09/99	09/08/06	Employee
		150		150					

	At January 1, 1996 (or date of appointment if later)	No. of Options		At December 31, 1996	Exercise price £	Market price at date of exercise £	Date from which exercisable	Expiry date	Notes
		Granted	Exercised						
A H Pople	1,939			1,939	2.32		10/01/98	03/31/99	Sharesave
	1,882			1,882	2.39		06/01/99	11/30/99	Sharesave
	2,418			2,418	4.28		10/01/00	03/31/01	Sharesave
	25,000			25,000	4.00		09/01/97	08/31/04	Executive
	30,000			30,000	4.83		04/10/98	04/09/05	Executive
	23,008			23,008	5.65		03/25/99	03/24/06	Executive
		150		150	5.91		09/09/99	09/08/06	Employee
		<u>84,247</u>	<u>150</u>	<u>84,397</u>					
C G Toner	1,616		1,616	2.32	5.995	10/01/96	03/31/97	Sharesave	
	1,569			1,569	2.39	06/01/97	11/30/97	Sharesave	
		2,221		2,221	4.66	04/01/01	09/30/01	Sharesave	
	24,449			24,449	3.69	03/29/96	03/29/03	Executive	
	8,149			8,149	3.69	03/29/96	03/29/03	Executive ⁽²⁾	
	24,038			24,038	4.68	04/11/97	04/10/04	Executive	
	8,012			8,012	4.68	04/11/97	04/10/04	Executive ⁽³⁾	
	39,500			39,500	4.83	04/10/98	04/09/05	Executive	
		30,884		30,884	5.65	03/25/99	03/24/06	Executive	
		35,364		35,364	5.91	09/09/99	09/08/06	Executive [#]	
		150		150	5.91	09/09/99	09/08/06	Employee	
	<u>107,333</u>	<u>68,619</u>	<u>174,336</u>						
The Lord Tugendhat	7,845		7,845	2.39		06/01/97	11/30/97	Sharesave	
	<u>7,845</u>		<u>7,845</u>						
C N Villiers	1,616		1,616	2.32	6.15	10/01/96	03/31/97	Sharesave	
	1,569		1,569	2.39		06/01/97	11/30/97	Sharesave	
	2,418		2,418	4.28		10/01/00	03/31/01	Sharesave	
	37,111		37,111	2.99		05/05/95	05/05/02	Executive ⁽¹⁾	
	31,145		31,145	3.69		03/29/96	03/29/03	Executive	
	10,381		10,381	3.69		03/29/96	03/29/03	Executive ⁽²⁾	
	9,612		9,612	4.68		04/11/97	04/10/04	Executive	
	3,204		3,204	4.68		04/11/97	04/10/04	Executive ⁽³⁾	
	32,086		32,086	4.83		04/10/98	04/09/05	Executive	
		10,055		10,055	5.65	03/25/99	03/24/06	Executive	
		36,988		36,988	5.91	09/09/99	09/08/06	Executive [#]	
	150		150	5.91	09/09/99	09/08/06	Employee		
	<u>129,142</u>	<u>47,193</u>	<u>174,719</u>						

Replacement options

Notes:

- a. The executive share options detailed above become exercisable if the average growth of earnings per ordinary share exceeds the average increase in the Retail Prices Index in any three years prior to exercise. For those executive options granted in 1996, the average growth of earnings per ordinary share must exceed the average increase in the Retail Prices Index by 2%.
- b. Parallel discounted options were granted over the shares noted (1), (2) and (3) exercisable as follows:
 - (1) at £2.54 from 5.5.1997 to 5.5.2002.
 - (2) at £3.14 from 3.29.1998 to 3.29.2003.
 - (3) at £3.98 from 4.11.1999 to 4.10.2004.

Parallel discounted options become exercisable if the average growth in earnings per ordinary share exceeds the average increase in the Retail Prices Index by at least 10% in any five year period prior to the date of exercise. The

option holder may exercise either the standard or discounted option, but not both, thereby reducing both options, subject to the achievement of the appropriate performance criteria. The Board determined in 1994 that it would no longer make grants of discounted options.

- c. The options refer to those granted under Abbey National's Executive Share Option, Employee Share Option and Sharesave schemes, as set out in Note 40 to the Consolidated Financial Statements included elsewhere in this Document.
- d. Options shown under the headings 'Granted' or 'Exercised' refer to options granted or exercised during the year or since appointment if later.
- e. Market price at the date of exercise is the Middle Market Quotation, as derived from the London Stock Exchange Daily Official List. The market price of the shares on December 31, 1996 was 765p (635.5p) and the range during 1996 was 529p to 765p.

Aggregate Pension Amounts and Share Options

The aggregate amount set aside or accrued by the Group for pension, retirement and similar benefits for all directors of Abbey National as a group in the year ended December 31, 1996 was £849,187. The accrued pension represents the annual pension which each director would be entitled to receive from normal retirement age if he had left service voluntarily at December 31, 1996, or at his actual retirement date if earlier.

The aggregate amount set aside or accrued by the Group for pension, retirement and similar benefits for executive officers of Abbey National in the year ended December 31, 1996 was £78,228, based upon the contributions paid by Abbey National.

At March 10, 1997, directors and executive officers of Abbey National as a group held options to purchase 1,589,447 ordinary shares of Abbey National at prices ranging from £1.49 to £4.66 under the Sharesave scheme, from £2.54 to £5.91 under the Executive Share Option scheme and from £5.90 to £5.91 under the Employee Share Option scheme, exercisable in the period from 1995 to 2006.

Terms of Office of Directors

One-third (or the whole number nearest to one-third) of the directors of Abbey National are required to retire by rotation at each Annual General Meeting, together with directors newly appointed since the previous Annual General Meeting in accordance with power given to the Board. The directors retiring by rotation and the newly appointed directors are eligible to stand for re-election.

Interests of Directors and Officers

In 1996, loans made by the Group to 12 directors and executive officers of the Group and connected persons were outstanding with principal amounts of £845,000 (£751,326 of which related to directors of the Company). See Note 50 to the Consolidated Financial Statements included elsewhere in this Document for disclosures of deposits and investments made and insurance policies entered into by directors, executive officers and connected persons with the Group as at December 31, 1996.

In 1996 there were no other transactions, arrangements or agreements with Abbey National or its subsidiaries in which directors or executive officers or persons connected with them had a material interest, other than options to subscribe for ordinary shares under the Abbey National Executive Share Option scheme, the Employee Sharesave scheme and the Employee Share Option scheme. No director had a material interest in any contract of significance other than a service contract with the Group, or any of its subsidiaries, at any time during the year. All executive directors have a service contract whereby Abbey National is required to give them 12 months' notice to sever their employment contract with the exception of Alastair Lyons, whose terms and conditions required him to be given two years' notice of termination of contract. Alastair Lyons resigned on April 4, 1997.

CONTROLLING INTERESTS

As at June 2, 1997, Abbey National did not know, and had not been notified of any interest in the register maintained under Section 211 of the Companies Act, of any person who, directly or indirectly was interested in 3 per cent. or more of the share capital of Abbey National.

The following table sets forth the aggregate shareholdings, as at December 31, 1996, of the directors and executive officers of Abbey National as a group.

<u>Title of Class</u>	<u>Owner</u>	<u>Number Owned</u>	<u>% of Class</u>
Ordinary shares of nominal value 10p each	Directors and executive officers of Abbey National	560,037	0.04

The following table sets forth, as at June 2, 1997, the beneficial interests relating to securities notified by each director of Abbey National pursuant to Sections 324 or 328 of the Companies Act and which are entered in the register required to be kept by Abbey National pursuant to Section 325 of that Act.

<u>Owner</u>	<u>Ordinary shares of nominal value 10p each</u>	<u>Percentage of issued share</u>
Lord Tugendhat	17,845	0.001%
Peter Birch	328,053	0.02%
Ian Harley	29,212	0.002%
Tim Ingram	18,156	0.001%
Gareth Jones	68,576	0.005%
Andrew Popie	4,391	0.0003%
Charles Toner	23,485	0.002%
Charles Villiers	27,892	0.002%
Mair Barnes	1,000	0.00007%
Sir Terry Heiser	1,500	0.0001%
Martin Llowarch	1,750	0.0001%
Peter Ogden	4,000	0.0002%
Lord Rockley	5,000	0.0004%
Lord Shuttleworth	816	0.00006%
James Tuckey	12,000	0.0009%
Keith Woodley	2,160	0.0002%

DESCRIPTION OF PROPERTIES

The property interests of the Group at December 31, 1996 consisted of the following:

	<u>Freehold</u>	<u>Leasehold</u>	<u>Total</u>
U.K. Retail Banking branches	504	583	1,087
Mortgage administration centers	—	37	37
Checking account administration centers	—	9	9
Scottish Mutual offices	1	16	17
Continental Europe	—	42	42
Treasury & Offshore	5	5	10
ANICG branches	—	19	19
HMC	—	4	4
Abbey National Mortgage Finance plc	—	1	1
First National Finance Corporation plc	2	86	88
Head office and other administration sites	17	32	49
Other sites	12	41	53
Total	<u>541</u>	<u>875</u>	<u>1,416</u>

Included in the above table are 235 branches and other sites which were not occupied by the Group as at December 31, 1996.

The main head office sites and computer buildings are freehold properties. The Group's leasehold properties are subject to leases ranging from 1 to 999 years in maturity with the majority being 25 years in duration and subject to rolling five-year rent reviews. The Group currently has a number of retail property interests either in the course of development or disposal as part of the continuing branch development program, which are included above.

CAPITALISATION OF THE GROUP

The following table sets out the authorised and issued share capital of Abbey National and the capitalization of the Group at December 31, 1996 and at April 30, 1997⁽⁷⁾:

	<u>As at December 31, 1996</u> (Audited) (in £ million)	<u>As at April 30, 1997</u> (Unaudited)
Authorised share capital comprising:		
Ordinary shares of 10p each	175	175
Sterling preference shares of £1 each	1,000	1,000
U.S. dollar preference shares of U.S.\$0.01 each	6	6
Issued and fully paid comprising:		
Ordinary shares of 10p each	141	141
Sterling preference shares of £1 each	<u>200</u>	<u>200</u>
GROUP		
Equity Shareholders' Funds		
Issued and fully paid ordinary share capital	141	141
Share premium	1,320	1,320
Reserves	230	230 ⁽¹⁾
Profit and loss account	2,381	2,381 ⁽¹⁾
Non-Equity Shareholders' Funds		
Issued and fully paid preference share capital	200	200
Share premium	121	131
	<u>4,393</u>	<u>4,403</u>
Subordinated Bonds/Notes ⁽²⁾⁽³⁾		
Due within one year	8	—
Due after more than one year and less than five years	80	202
Due after five years	2,093	2,025
Exchangeable capital securities ⁽⁴⁾	200	200
	<u>2,381</u>	<u>2,427</u>
Medium-Term Note Programme ⁽²⁾⁽³⁾		
Due within one year	4,129	5,964
Due after more than one year and less than five years	3,005	3,218
Due after five years	550	759
	<u>7,684</u>	<u>9,941</u>
Other Loan Capital ⁽²⁾⁽³⁾		
Floating/Variable Rate Bonds/Notes		
Due within one year	271	187
Due after more than one year and less than five years	157	137
Due after five years	—	—
	<u>428</u>	<u>324</u>
Fixed Rate Bonds/Notes		
Due within one year	2,111	1,143
Due after more than one year and less than five years	4,438	6,168
Due after five years	4,202	4,616
	<u>10,751</u>	<u>11,927</u>
Total Capitalisation ⁽⁵⁾	<u>25,637</u>	<u>29,022⁽⁶⁾</u>

Notes:

- (1) The profit and loss account movement during 1996 is stated after writing off goodwill of £610 million relating to the transfer of the business of N&P and Wagon Finance Group.
- (2) All the bonds and notes are guaranteed by Abbey National, with the exception of certain unsecured indebtedness of Abbey National which amounted to £1,188 million and £1,223 million at December 31, 1996 and April 30, 1997, respectively, and certain secured indebtedness of Abbey National which amounted to £269 million and £166 million at December 31, 1996 and April 30, 1997, respectively.
- (3) Liabilities in foreign currencies are translated into Sterling at market exchange rates prevailing at December 31, 1996 and April 30, 1997, as appropriate.
- (4) £200 million 10 $\frac{1}{16}$ per cent. Exchangeable Capital Securities, exchangeable into 200 million 10 $\frac{3}{8}$ per cent. non-cumulative sterling preference shares of £1 each of Abbey National on any Exchange Date at the option of Abbey National.
- (5) The total capitalisation of the Group has decreased by £871 million between April 30, 1997 and June 4, 1997 as a result of issues and repayments of loan capital amounting to £259 million and £1,130 million respectively, and will increase by £125 million as a result of this issue.
- (6) Save for the information disclosed above there has been no material change in the authorised or issued share capital of the issuer and of the Guarantor, and no material change in the capitalisation of the Issuer Group or the Group since April 30, 1997.

UNITED KINGDOM TAXATION

The summary below reflects certain aspects of current law and practice in the United Kingdom and may not apply to certain classes of person (such as dealers). Prospective holders who are in doubt as to their tax position or who may be subject to tax in any other jurisdiction should consult their professional advisers.

Dividends on the New Sterling Preference Shares

(a) Cash Dividends

Under current United Kingdom taxation legislation, no withholding tax will be deducted from dividends paid by the Company but the Company is required to account for advance corporation tax ("ACT") when a dividend is paid. The current rate of ACT is $\frac{1}{4}$ of the cash dividend paid. An individual preference shareholder who is resident (for tax purposes) in the United Kingdom is currently entitled, in respect of any cash dividend received, to a tax credit which, at current rates, is equal to $\frac{1}{4}$ of the dividend paid. The individual will be liable to United Kingdom income tax (if at all) on the total of the dividend and the related tax credit at either the lower rate of income tax (currently 20 per cent.) or the higher rate (currently 40 per cent.) depending upon the individual shareholder's circumstances. The tax credit will satisfy in full the individual shareholder's liability to lower rate income tax on the dividend plus the tax credit. To the extent that the shareholder is liable to higher rate income tax, the tax payable on the dividend plus the tax credit will be at a rate equal to the excess of the higher rate over the lower rate (i.e. 20 per cent.). If the aggregate of the tax credit and any other income tax payments or credits exceeds the individual's overall liability to income tax, the tax credit may be refunded, in whole or in part, by the Inland Revenue.

A corporate preference shareholder which is resident (for tax purposes) in the United Kingdom and receives a dividend paid by the Company will be entitled to a tax credit in respect of that dividend. The shareholder will not be liable to United Kingdom corporation tax on any dividend received from the Company and the dividend and associated tax credit will generally represent franked investment income in the hands of such a shareholder. The value of the tax credit will, at current rates, be an amount equal to $\frac{1}{4}$ of the dividend.

Subject to certain exceptions for Commonwealth citizens, citizens of the Republic of Ireland and certain other classes of person, the right of a preference shareholder who is not resident (for tax purposes) in the United Kingdom to a tax credit in respect of a dividend received from the Company and to reclaim from the Inland Revenue any proportion of the tax credit relating to the dividend will depend, in general, upon the provisions of any double taxation agreement or convention which exists between the United Kingdom and the country in which the shareholder is resident. Any shareholder who is not resident in the United Kingdom should consult his own tax adviser concerning his tax liability on dividends received and on the question of the double taxation provisions (if any) applying between his country of residence and the United Kingdom.

If the Company were to elect for any dividend paid to be treated as a "foreign income dividend", or, if any dividend paid were otherwise treated for tax purposes as a "foreign income dividend", such dividend would not carry an associated U.K. tax credit. In calculating any further tax due from an individual shareholder who receives a "foreign income dividend" the shareholder would be treated as receiving income which has borne income tax at the lower rate of 20 per cent. There would be no further tax to pay by a shareholder who is liable to income tax on dividends at the lower rate and there would be no repayment of tax to a shareholder who is not liable to income tax.

A corporate shareholder would not be liable to United Kingdom corporation tax on any "foreign income dividend". If a company which receives "foreign income dividends" during an accounting period also pays "foreign income dividends" during that period, it has to pay ACT in respect of the "foreign income dividends" it pays only to the extent that they exceed the "foreign income dividends" received. If there is a surplus of "foreign income dividends" received over "foreign income dividends" paid, the surplus can be carried forward to the next period in which it can be used. It is not possible for "foreign income dividends" received to frank the liability to pay ACT on an ordinary dividend, nor is it possible for an ordinary dividend to frank the liability to pay ACT on a "foreign income dividend".

(b) Tax treatment of additional New Sterling Preference shares issued in lieu of cash dividends

Where a U.K. resident individual shareholder receives additional New Sterling Preference Shares in lieu of a dividend payment as provided in paragraph (g) under "Description of the New Sterling Preference Shares — Dividends", he will be treated for U.K. income tax purposes as having received income of an amount which after deduction of income tax at the lower rate (currently 20 per cent.) equals the market value of the additional New Sterling Preference Shares received as determined on the first day of dealings in them on the London Stock Exchange. Thus if the market value of the additional New Sterling Preference Shares received by the shareholder at that date is £100, he will be treated as having received gross income of £125 on which income tax of £25 will be treated as having been paid.

U.K. resident individual shareholders who pay tax at the lower rate (currently 20 per cent.) or the basic rate (currently 23 per cent.) only will have no further tax to pay but to the extent that U.K. resident individual shareholders pay tax at the higher rate (currently 40 per cent.), they will be liable to pay additional tax by reference to the excess of the higher rate over the lower rate on the gross amount of income they are treated as having received. The market value of the additional New Sterling Preference Shares received will be added to the base cost of the New Sterling Preference Shares for the purposes of the individual shareholders' tax on capital gains.

No repayable tax credit attaches to the receipt of the additional New Sterling Preference Shares and, accordingly, no amount can be reclaimed from the Inland Revenue by shareholders who are exempt from tax, or whose liability is less than the lower or basic rate, or who are entitled to the benefit of any double tax treaty.

U.K. resident corporate shareholders will not be charged to U.K. tax on any additional New Sterling Preference Shares, but will not have any amount added to their base cost of New Sterling Preference Shares for the purposes of tax on capital gains.

Capital Gains Tax

For the purposes of the following paragraph, reference to "U.K. Holders" is to persons who are resident or ordinarily resident in the United Kingdom for tax purposes or who are not so resident but who at the relevant time carry on a trade, profession or vocation in the United Kingdom through a branch or agency to which the relevant New Sterling Preference Share is attributable.

Disposal of New Sterling Preference Shares

U.K. Holders of New Sterling Preference Shares may, depending upon their individual circumstances, be liable to pay United Kingdom taxation on any gain realised on a disposal of all or any part of their holding of New Sterling Preference Shares.

Stamp Duty and Stamp Duty Reserve Tax ('SDRT')

United Kingdom stamp duty or SDRT will generally be payable in respect of the transfer of, or agreement to transfer, the New Sterling Preference Shares.

PLACING OF THE NEW STERLING PREFERENCE SHARES

Goldman Sachs International, ABN AMRO Bank N.V., Barclays de Zoete Wedd Limited, Kleinwort Benson Limited and Merrill Lynch International (the "Managers") have, pursuant to a Placing Agreement dated June 6, 1997 (the "Placing Agreement"), agreed, jointly and severally, with Abbey National to procure subscribers, failing which, to subscribe themselves, for the New Sterling Preference Shares at the cash price of 101.55p per New Sterling Preference Share. Abbey National has also agreed to reimburse the Managers in connection with certain expenses of the issue. The Managers are entitled to terminate the Placing Agreement in certain circumstances prior to making payment to Abbey National for the New Sterling Preference Shares. The placing of the New Sterling Preference Shares (the "Placing") is conditional on, *inter alia*, the New Sterling Preference Shares being admitted to the Official List by the London Stock Exchange, such admission becoming effective not later than 8:30 a.m. on June 10, 1997 or such other agreed date and on the Placing Agreement becoming unconditional in accordance with its terms.

The Placing Agreement contains certain representations, warranties, undertakings and indemnities given by Abbey National relating, *inter alia*, to the accuracy of the information contained in this document. The Managers may terminate the Placing Agreement in certain exceptional circumstances (including the occurrence of a force majeure event) prior to the admission to listing becoming effective.

Abbey National has agreed to pay to the Managers commissions amounting to one per cent. of the aggregate nominal amount of the New Sterling Preference Shares. Abbey National will also pay to the Managers a sum equal to any stamp or other duties or taxes (if any) payable in connection with the Placing and any value added tax payable in connection with the commission payable in connection with or arising out of the Placing.

The Placing Price for the New Sterling Preference Shares will be payable in cash net of the commissions referred to above on June 9, 1997. It is estimated that the cash proceeds (net of expenses) accruing to Abbey National from the Placing will amount to approximately £125,587,500.

The New Sterling Preference Shares have not been and will not be registered under the U.S. Securities Act of 1933 (the "Securities Act") and may not be offered, sold or delivered within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

Each Manager has agreed that, except as permitted by the Placing Agreement, it will not offer, sell or deliver New Sterling Preference Shares, (i) as part of their distribution at any time, or (ii) otherwise until 40 days after the later of the commencement of the offering and the issue date, within the United States or to, or for the account or benefit of, U.S. persons, and it will have sent to each dealer to which it sells New Sterling Preference Shares during the restricted period a confirmation or other notice setting forth the restrictions on offers and sales of New Sterling Preference Shares, respectively, within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after the commencement of the offering, an offer or sale of the New Sterling Preference Shares within the United States by any dealer (that is not participating in the offer) may violate the registration requirements of the Securities Act.

The Shares have not been marketed or made available in whole or in part to the public. Each Manager has represented and agreed that:

- (i) it has not offered or sold and will not offer or sell any New Sterling Preference Shares to persons in the United Kingdom prior to their admission to listing in accordance with Part IV of the Financial Services Act 1986 (the "Act") except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 or the Act;
- (ii) it has complied and will comply with all applicable provisions of the Act with respect to anything done by it in relation to the New Sterling Preference Shares in, from or otherwise involving the United Kingdom; and

- (iii) it has only issued or passed on and will only issue or pass on in the United Kingdom any document received by it in connection with the placing of the New Sterling Preference Shares, other than any document which consists of or any part of listing particulars, supplementary listing particulars or any other document required or permitted to be published by listing rules under Part IV of the FSA, to a person who is of a kind described in Article 11(3) of the Financial Services Act 1986 (Investment Advertisements) (Exemptions) Order 1996 or is a person to whom such document may otherwise lawfully be issued or passed on.

GENERAL INFORMATION

1. Abbey National was incorporated in England and Wales on September 12, 1988 with registered number 2294747. The registered office of Abbey National is Abbey House, Baker Street, London NW1 6XL. The principal object of Abbey National set out in Clause 4 of its Memorandum of Association is to carry on the business of banking and other financial and monetary transactions. The Memorandum of Association is available for inspection at the address set out in "Documents available for inspection" below. The registered office of Abbey National Treasury Services plc ("ANTS") is Abbey House, Baker Street, London NW1 6XL. ANTS has authorised and issued share capital of £255,000,000. ANTS is a wholly owned subsidiary of Abbey National.
2. It is expected that listing of the New Sterling Preference Shares on the London Stock Exchange will be granted on June 6, 1997, subject only to allotment, and that dealings in the New Sterling Preference Shares will commence on June 10, 1997. Transactions will normally be effected for settlement in Sterling and for delivery on the fifth working day after the date of the transaction.
3. The estimated total expenses of the issue of the New Sterling Preference Shares payable by Abbey National (excluding any value added tax) are £1.35 million (of which £1.25 million represents the commissions due to the Managers under the Subscription and Placing Agreement).
4. Save as disclosed herein, there has been no significant change in the financial or trading position of the Group which has occurred since December 31, 1996, being the date to which the last audited financial statements were made up.
5. Neither Abbey National nor the Group is involved in any litigation or arbitration proceedings which may have, or have had during the previous twelve months, a significant effect upon the financial position of Abbey National or the Group nor, so far as Abbey National is aware, are any such litigation or arbitration proceedings pending or threatened.
6. Abbey National's subsidiary Abbey National Treasury Services plc has received a demand from an overseas tax authority in an amount of approximately £118 million relating to the repayment of certain tax credits received and related charges. Abbey National has been advised that it has strong grounds to challenge the validity of the demand.
7. The consolidated accounts of Abbey National for each of the three years ended December 31, 1996 were audited by Coopers & Lybrand, chartered accountants and registered auditors, in accordance with Auditing Standards and have been reported on without qualification. The address of Coopers & Lybrand is 1 Embankment Place, London WC2N 6NN.
8. The statutory consolidated accounts of Abbey National for each of the three financial years ended December 31, 1996 were delivered to the Registrar of Companies in England and Wales. The auditors of Abbey National have made reports under Section 235 of the Companies Act in respect of the statutory consolidated accounts for each of the three financial years ended December 31, 1996 and each such report was an unqualified report and did not contain a statement under Section 237(2) or (3) of the Companies Act.
9. The London listing sponsor for the New Sterling Preference Shares is Goldman Sachs International.

Documents available for inspection

10. Copies of the following documents will be available for inspection during usual business hours on any weekday (Saturdays and public holidays excepted) at the offices of Slaughter and May, 35 Basinghall Street, London EC2V 5DB for a period of 14 days from the date hereof:
 - (a) the Memorandum and Articles of Abbey National;
 - (b) the audited consolidated Report and Accounts of Abbey National for the two years ended December 31, 1995 and 1996;
 - (c) the Placing Agreement; and
 - (d) the consent referred to in paragraph 7 above.
11. All current directors' service contracts have previously been made available for inspection in accordance with the listing rules of the London Stock Exchange (such contracts having not been subsequently varied).
12. The following contract (not being a contract entered into in the ordinary course of business) has been entered into in the two years preceding the date of this document and is or may be material and has previously been made available for inspection in accordance with the listing rules of the London Stock Exchange:

A framework agreement dated July 9, 1995, made between National & Provincial and Abbey National, relating to the agreement in principle for Abbey National to acquire the business of National & Provincial.

**FINANCIAL INFORMATION
RELATING TO ABBEY NATIONAL**

Set out below is financial information relating to Abbey National for the three years ended December 31, 1996 and details of accounting policies which have been extracted without material adjustment from the audited accounts of Abbey National for the three years ended December 31, 1996.

The financial information relating to Abbey National does not comprise full accounts within the meaning of section 240 of the Act. Full financial statements for Abbey National for the three years ended December 31, 1996, on which the auditors gave unqualified audit reports and which did not contain statements under section 237(2) or (3) of the Act, have been delivered to the Registrar of Companies.

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ABBEY NATIONAL plc
CONSOLIDATED PROFIT AND LOSS ACCOUNTS
FOR THE YEARS ENDED 31 DECEMBER 1996, 1995 and 1994.

	<u>Notes</u>	<u>1996</u> £m	<u>1995</u> £m	<u>1994</u> £m
Interest receivable				
Interest receivable and similar income arising from debt securities	2	2,016	2,335	1,468
Other interest receivable and similar income	3	4,544	4,246	3,861
Interest payable	4	<u>(4,766)</u>	<u>(4,997)</u>	<u>(3,935)</u>
<i>Net interest income</i>		1,794	1,584	1,394
Dividend income	5	3	2	42
Fees and commissions receivable		398	281	201
Fees and commissions payable		(62)	(36)	(32)
Dealing profits		29	6	24
Other operating income	6	<u>187</u>	<u>146</u>	<u>130</u>
<i>Total operating income</i>		2,349	1,983	1,759
Administrative expenses				
Integration costs in continuing businesses	7	(61)	—	—
Other administrative expenses	8	(884)	(783)	(671)
Depreciation and amortisation	27	(93)	(87)	(84)
Provisions				
Provisions for bad and doubtful debts	11	(127)	(72)	(74)
Provisions for contingent liabilities and commitments	38	(4)	(7)	—
Amounts written off fixed asset investments	20	<u>(13)</u>	<u>(8)</u>	<u>2</u>
<i>Profit on ordinary activities before tax</i>		1,167	1,026	932
Tax on profit on ordinary activities	12	<u>(403)</u>	<u>(344)</u>	<u>(322)</u>
<i>Profit on ordinary activities after tax</i>	13	764	682	610
Minority interests — equity		<u>3</u>	<u>1</u>	<u>—</u>
<i>Profit attributable to the shareholders of Abbey National plc</i>		767	683	610
Transfer to non-distributable reserve	41	(67)	(59)	(65)
Dividends including amounts attributable to non-equity interests	14	<u>(373)</u>	<u>(290)</u>	<u>(233)</u>
<i>Profit retained for the financial year</i>		<u>327</u>	<u>334</u>	<u>312</u>
Profit on ordinary activities before tax includes:				
for acquired operations (excluding integrated businesses)	26	8	9	22
for discontinued operations		—	(8)	(9)
<i>Earnings per ordinary share</i>	15	56.5p	51.7p	46.5p
<i>Earnings per ordinary share, excluding integration costs</i>	15	59.8p	51.7p	46.5p

The Group's results as reported are on an historical cost basis. Accordingly, no note of historical cost profits and losses has been presented.

ABBEY NATIONAL plc
CONSOLIDATED BALANCE SHEETS
AS AT 31 DECEMBER 1996 AND 1995.

	Notes	1996	1996	1995	1995	1994	1994
		£m	£m	£m	£m	£m	£m
<i>Assets</i>							
Cash and balances at central banks			228		145		166
Treasury bills and other eligible bills	16		111		246		432
Loans and advances to banks	17		2,825		3,579		2,906
Loans and advances to customers	18		64,227		51,090		48,484
Net investment in finance leases	19		4,310		2,844		2,278
Debt securities	20		39,730		35,243		32,332
Equity shares and other variable yield securities	21		44		54		42
Long term assurance business	22		555		425		352
Interests in associated undertakings	23		8		1		—
Tangible fixed assets	27		715		585		534
Other assets	28		1,509		1,649		1,081
Prepayments and accrued income	29		1,880		1,753		1,620
Assets of long term assurance funds	22		7,869		5,518		4,230
<i>Total assets</i>			<u>124,011</u>		<u>103,132</u>		<u>94,457</u>
<i>Liabilities</i>							
Deposits by banks	30		17,718		19,393		17,826
Customer accounts	31		49,678		40,962		38,056
Debt securities in issue	32		35,193		26,095		23,852
Dividend proposed			245		191		158
Other liabilities	33		2,980		1,879		2,019
Accruals and deferred income	35		2,591		2,396		2,623
Provisions for liabilities and charges	36		970		630		469
Subordinated liabilities including convertible debt	39		2,374		2,127		1,520
Liabilities of long term assurance funds	22		7,869		5,518		4,230
			<u>119,618</u>		<u>99,191</u>		<u>90,753</u>
Minority interests - equity			—		—		—
Called up share capital — ordinary shares	40	141		132		131	
— preference shares		200		100		—	
Share premium account	40	1,441		856		840	
Reserves	41	230		163		104	
Profit and loss account	41	2,381		2,690		2,629	
Shareholders' funds including non-equity interests	42		<u>4,393</u>		<u>3,941</u>		<u>3,704</u>
<i>Total liabilities</i>			<u>124,011</u>		<u>103,132</u>		<u>94,457</u>
Memorandum items							
<i>Contingent liabilities</i>							
Guarantees and assets pledged as collateral security	44		2,570		1,129		836
Other contingent liabilities	45		138		197		59
			<u>2,708</u>		<u>1,326</u>		<u>895</u>
Commitments	46		<u>2,910</u>		<u>1,541</u>		<u>1,546</u>

**STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
FOR THE YEARS ENDED 31 DECEMBER 1996, 1995 and 1994.**

	<u>Notes</u>	<u>1996</u>	<u>1995</u>	<u>1994</u>
		<u>£m</u>	<u>£m</u>	<u>£m</u>
Profit attributable to the shareholders of Abbey National plc		767	683	610
Translation differences on foreign currency net investment		(26)	15	(7)
<i>Total recognised gains relating to the year</i>		<u>741</u>	<u>698</u>	<u>603</u>

**CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEARS ENDED 31 DECEMBER 1996, 1995 and 1994.**

		<u>1996</u>	<u>1995</u>	<u>1994</u>
		<u>£m</u>	<u>£m</u>	<u>£m</u>
Net cash inflow from operating activities	48a	3,239	2,187	6,343
Returns on investments and servicing of finance				
Dividends paid		(321)	(256)	(204)
Net cash outflow from returns on investments and servicing of finance		(321)	(256)	(204)
Taxation				
UK corporation tax paid		(153)	(195)	(93)
Overseas tax paid		(11)	(10)	(5)
Total taxation paid		(164)	(205)	(98)
Investing activities				
Purchases of investment securities		(15,641)	(37,459)	(35,346)
Sales of investment securities		10,444	32,968	26,548
Redemptions and maturities of investment securities		2,237	2,393	2,301
Purchases of tangible fixed assets		(147)	(127)	(114)
Sales of tangible fixed assets		46	13	10
Transfers to life assurance funds		(41)	(10)	—
Acquisitions of subsidiary and associated undertakings/purchase of business	48f	729	(298)	(52)
Sale of subsidiary undertakings		—	1	—
Net cash outflow from investing activities		<u>(2,373)</u>	<u>(2,519)</u>	<u>(6,653)</u>
Net cash inflow (outflow) before financing		381	(793)	(612)
Financing				
Issue of ordinary share capital		12	14	4
Issue of preference share capital		224	101	—
Issue of loan capital		311	715	676
Repayments of loan capital		(21)	(128)	(17)
Net cash inflow from financing	48d	<u>526</u>	<u>702</u>	<u>663</u>
Increase (decrease) in cash and cash equivalents	48c	<u>907</u>	<u>(91)</u>	<u>51</u>

ACCOUNTING POLICIES

Basis of presentation

The consolidated accounts are prepared in accordance with the special provisions of Part VII of the Companies Act 1985 applicable to banking companies and banking groups.

Accounting convention

The Group prepares its accounts under the historical cost convention, and in accordance with applicable UK accounting standards. In preparing the accounts, reasonable and prudent judgments and estimates have been made that affect the reported amounts of certain assets, liabilities, memorandum items, income and expenditure. Actual outcomes may differ from these estimates.

Basis of consolidation

The Group accounts comprise the accounts of the Company and its subsidiary undertakings made up to 31 December, with the exception of a number of leasing, investment, insurance and funding companies, which, because of commercial considerations, have various accounting reference dates. The accounts of these subsidiaries have been consolidated on the basis of interim accounts for the period to 31 December 1996. In addition, Wagon Finance Ltd, which was acquired before 31 December 1996, currently has an accounting reference date other than 31 December. The accounts of this subsidiary have been consolidated on the basis of interim accounts for the period to 31 December 1996.

The assets and liabilities of the long term assurance funds are presented separately from those of other businesses in order to reflect the different nature of the shareholders' interest in them.

Interests in subsidiary and associated undertakings

The Company's interests in subsidiary undertakings and associated undertakings are stated at cost less any provisions for permanent diminution in value. The Group's interests in associated undertakings are stated at the Group's share of the book value of the net tangible assets of the associated undertakings.

Goodwill

Goodwill arising on consolidation as a result of the acquisition of subsidiary and associated undertakings and goodwill arising on the purchase of businesses are taken directly to reserves in the year in which they occur. On disposal of subsidiary and associated undertakings and businesses, the goodwill previously taken to reserves is charged to the profit and loss account balanced by an equal credit to reserves. Where the directors believe that the purchased goodwill in continuing businesses has suffered a permanent diminution in value, a similar charge to the profit and loss account and credit to reserves is made.

Deferred taxation

Deferred taxation is accounted for where it is probable that a liability or asset will arise. Provision is calculated at rates expected to be applicable when the liability or asset crystallises.

Depreciation

Tangible fixed assets are depreciated on a straight line basis over their estimated useful lives. The following annual rates are used:

Premises

Freehold buildings: 1%

Long and short leasehold premises: Over the remainder of the lease, with a maximum of 100 years.

Acquisition premiums are depreciated over the period to the next rent review.

Equipment

Office fixtures, equipment and furniture: 12.5%

Computer equipment: 25% for mainframes and 20% for peripherals

Motor vehicles: 25%

No depreciation is provided on freehold land.

Interest receivable

Interest is suspended where due but not received on loans and advances in arrears where recovery is doubtful. The amounts suspended, less recoveries of amounts suspended in previous years, are excluded from interest receivable on loans and advances.

Fees and commissions receivable

Fees and commissions receivable in respect of services provided are taken to the profit and loss account when the related services are performed. Where fees and commissions are receivable which are in the nature of interest, these are taken to the profit and loss account on a systematic basis over the expected period of the loan, and are included under the heading, Interest receivable. Fees which are receivable in order to cover a proportion of future losses, as explained in more detail under Deferred income, are taken to the profit and loss account as the relevant losses are identified and provided for, and are included under the heading, Other operating income.

Lending-related fees and commissions payable and discounts

Under certain schemes, fees and discounts may be granted to customers as incentives to take out loans. It is usually a condition of such schemes that incentive payments are recoverable by way of early redemption penalty charges in the event of redemption within a specified period ("the penalty period"). Such incentive payments are charged to the profit and loss account over the penalty period where their cost is recoverable from the net interest income earned from the related loans over the penalty period, or from the penalty charge in the event of early redemption. When the related loan is redeemed, sold or becomes impaired any amounts previously unamortised are charged to the profit and loss account. The profit and loss account charge for such fees and discounts is included under the heading, Interest receivable.

Commissions payable to introducers in respect of obtaining certain lending business, where this is the primary form of distribution, are charged to the profit and loss account over the anticipated life of the loans. The profit and loss account charge for such commissions is included under the heading, Fees and commissions payable.

Deferred income

The Company has entered into insurance arrangements with certain insurance subsidiaries, to cover a proportion of future losses on certain UK residential secured loans with high loan to value ratios. In the Group accounts, income from customers in relation to such lending is deferred and is included in the balance sheet under the heading, Accruals and deferred income. The deferred income is released to the profit and loss account as relevant losses are identified and provided for.

Securities

Securities held for investment purposes are stated at cost, adjusted for any amortisation of premium or discount on an appropriate basis over their estimated lives. Provision is made for any permanent diminution in value. Investment securities are intended for use on a continuing basis by the Group.

In accordance with industry practice, securities which are not held for the purpose of investment, certain money market deposits and the associated funding of these assets are stated at market value and profits and losses arising from this revaluation are taken to the profit and loss account. The net return on these assets appears in Dealing profits in the profit and loss account. This net return comprises the revaluation profit and loss referred to above, plus profits and losses on disposal of these assets, plus interest receivable on these assets less interest payable on their associated funding. The cost of securities which are not held for the purpose of investment is not disclosed as it cannot be determined without unreasonable expense. Where securities are transferred from portfolios held for investment purposes to portfolios held for other purposes, the securities are transferred at market value. Gains and losses on these transfers are included in the profit and loss account.

Interests in securities are recognised as assets or, in the case of short positions, liabilities, at the date at which the commitment to purchase or sell is considered to be binding.

Securities sold subject to agreements to repurchase are retained on the balance sheet where the risks and rewards of ownership of the securities remain with the Group. Similarly, securities purchased subject to a commitment to resell are treated as collateralised lending transactions where the Group does not acquire the risks and rewards of ownership. The difference between sale and repurchase prices for such transactions is charged or credited to the profit and loss account over the life of the relevant transactions.

Derivatives

Transactions are undertaken in derivative financial instruments ("derivatives"), which include interest rate swaps, cross currency swaps, futures, options, warrants and similar instruments, for trading and non-trading purposes. Derivatives classified as non-trading are held for the purpose of hedging exposures relating to the Group's assets, liabilities and positions which are held for the purpose of investment.

Gains and losses arising from the hedging of investment transactions are released to the profit and loss account over the life of the asset, liability or position against which the hedge is held. Gains and losses arising from the hedging of assets which are not held for the purpose of investment are taken directly to the profit and loss account. Where a transaction originally entered into as a hedge no longer represents a hedge, its value is restated at fair value and any change in value is taken to the profit and loss account.

Gains and losses on instruments purchased or sold for trading and market making purposes are taken directly to the profit and loss account. Any such transactions outstanding at the balance sheet date are stated at fair value.

Development properties

Completed properties and work in progress are valued at the lower of cost and net realisable value. Cost comprises land purchase, building works thereon and interest.

Equipment leased to customers

Assets leased to customers under agreements which transfer substantially all the risks and rewards associated with ownership, other than legal title, are classified as finance leases. The net investment in finance leases represents total minimum lease payments less gross earnings allocated to future periods. Income from finance leases is credited to the profit and loss account using the actuarial after tax method to give a constant periodic rate of return on the net cash investment.

Provisions for bad and doubtful debts

Specific provisions are made against loans and advances when, as a result of regular appraisals of the assets, it is considered that recovery is doubtful. A general provision is made against loans and advances to cover bad and doubtful debts which have not been separately identified but which are known from experience to be present in any portfolio of loans and advances. The specific and general provisions are deducted from loans and advances. Provisions made during the year, less amounts released and recoveries of amounts written off in previous years, are charged to the profit and loss account.

Securitisations

Certain subsidiary undertakings have issued debt securities, or have entered into funding arrangements with lenders, in order to finance the purchase of certain portfolios of loan assets. These obligations are secured on the loan assets and other assets of the subsidiary undertakings. Where the Group has retained significant benefits and risks relating to the portfolios of loan assets, the loan assets and the related liabilities are presented separately within the relevant headings in the Group balance sheet.

Long term assurance business

The value of the long term assurance business represents the value of the shareholders' interest in the long term assurance funds, which consists of the present value of surplus expected to emerge in the future from business currently in force, together with the Group's interest in the surplus retained within the long term assurance funds.

In determining this value, assumptions relating to future mortality, persistency and levels of expenses are based on experience of the business concerned. Surplus expected to emerge in the future is discounted at a risk-adjusted discount rate after provision has been made for taxation. Changes in the value, which is determined on a post-tax basis, are included in the profit and loss account grossed up at the standard rate of corporation tax. The post-tax increase in the value is treated as non-distributable until it emerges as part of the surplus arising during the year.

The values of the assets and liabilities of the long term assurance funds are based on the amounts included in the accounts of the Life Assurance companies. These are determined in accordance with the terms of the Companies Act

1985 (Insurance Companies Accounts) Regulations 1993, adjusted for the purposes of inclusion in the Group accounts in order to be consistent with the Group's accounting policies and presentation, where a separate asset is established to account for the value of long term assurance business. See note 22.

Foreign currency translation

Income and expenses arising in foreign currencies during the year are translated into sterling at the average rates of exchange ruling over the accounting period unless they are hedged in which case the relevant hedge rate is applied. Dividends are translated at the rate prevailing on the date the dividend is receivable. Assets and liabilities in foreign currencies are translated into sterling at the rates of exchange current at the balance sheet date. Exchange differences arising on foreign currency borrowings used to hedge net assets of overseas Group undertakings are taken directly to reserves to the extent that they offset corresponding exchange differences on the translation of the net assets. Those differences resulting from the restatement of the profits and losses of overseas Group undertakings from average to year-end rates are taken to reserves. Other translation differences are dealt with through the profit and loss account. In the Company accounts, exchange differences arising on the translation of foreign currency borrowings used to hedge investments in Group undertakings are taken directly to reserves to the extent that they offset the corresponding exchange differences arising on the translation of the investments.

Pensions

Where pensions are provided by means of a funded defined benefits scheme, annual contributions are based on actuarial advice. The expected cost of providing pensions is recognised on a systematic basis over the expected average remaining service lives of members of the scheme.

Cash equivalents

For the purposes of the consolidated cash flow statement, cash equivalents are short term highly liquid investments which are readily convertible into known amounts of cash without notice and which were within three months of maturity when acquired.

NOTES TO THE CONSOLIDATED ACCOUNTS

I. Segmental analysis

	U.K. Retail Banking	Consumer Credit	Life Assurance	Treasury & Offshore	Continental Europe	Other Operations	Group Total
	£m	£m	£m	£m	£m	£m	£m
1996							
Net interest income	1,254	213	4	288	26	9	1,794
Other income and charges	341	(4)	154	36	4	24	555
Total operating income	<u>1,595</u>	<u>209</u>	<u>158</u>	<u>324</u>	<u>30</u>	<u>33</u>	<u>2,349</u>
Profit (loss) before taxation and integration costs	736	98	151	256	(19)	6	1,228
Integration costs in continuing businesses	(60)	—	—	(1)	—	—	(61)
Profit (loss) before taxation	<u>676</u>	<u>98</u>	<u>151</u>	<u>255</u>	<u>(19)</u>	<u>6</u>	<u>1,167</u>
Includes for acquired operations (excluding integrated businesses)	—	8	—	—	—	—	8
Includes for discontinued operations	—	—	—	—	—	—	—
Total assets	63,207	2,705	8,527	47,810	1,288	474	124,011
Net assets	1,499	245	440	1,286	967	(44)	4,393
1995							
Net interest income	1,190	97	2	275	20	—	1,584
Other income and charges	258	1	107	2	2	29	399
Total operating income	<u>1,448</u>	<u>98</u>	<u>109</u>	<u>277</u>	<u>22</u>	<u>29</u>	<u>1,983</u>
Profit (loss) before taxation	687	49	105	217	(22)	(10)	1,026
Includes for acquired operations	—	13	(1)	—	—	(3)	9
Includes for operations discontinued in 1995	—	—	—	—	—	(8)	(8)
Total assets	51,583	1,803	6,001	41,780	1,489	476	103,132
Net assets	1,399	223	282	1,135	961	(59)	3,941
1994							
Net interest income	1,156	39	2	161	21	15	1,394
Other income and charges	188	5	92	59	2	19	365
Total operating income	<u>1,344</u>	<u>44</u>	<u>94</u>	<u>220</u>	<u>23</u>	<u>34</u>	<u>1,759</u>
Profit (loss) before taxation	650	31	94	190	(36)	3	932
Includes for acquired operations	22	—	—	—	—	—	22
Includes for operations discontinued in 1995	—	—	—	—	—	(9)	(9)
Total assets	49,363	442	4,630	37,030	1,361	1,631	94,457
Net assets	1,505	67	185	1,063	906	(22)	3,704

The segmental analysis is prepared on a basis which ensures the comparability of results across the Group's business segments by assuming a consistent allocation of Group capital across those segments.

The results reflect the regulatory capital notionally absorbed by each business, based on the Group's Bank of England regulatory requirements. This is achieved by making a notional adjustment to the profit before taxation of each business entity where relevant, by applying an average market-related interest rate to the difference between the capital held in the entity and the capital which would be required if the Group's Bank of England risk asset ratio was applied to that entity.

There have been no changes in the classification of businesses within segments during the year.

No separate geographical analysis is presented because the only significant non-UK businesses are shown in the Continental Europe business segment.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

2. Interest receivable and similar income arising from debt securities

	1996	1995	1994
	£m	£m	£m
Income from listed and registered securities	1,792	2,111	1,262
Income from unlisted securities	224	224	206
	2,016	2,335	1,468

Preference dividends of £88m (1995: £30m, 1994: £6m) are included in income from unlisted securities.

3. Other interest receivable and similar income

	1996	1995	1994
	£m	£m	£m
On secured advances	3,890	3,832	3,513
On unsecured advances	294	169	71
On finance leases	244	180	135
On other assets and investments	116	65	142
	4,544	4,246	3,861

Interest receivable on secured advances has been reduced by £187m (1995: £98m, 1994: £22m) in respect of the charge for lending-related fees and discounts payable, which are charged against interest income over the period of time which the Group has the right to recover the incentives in the event of early redemption. The movements on such incentives are as follows (see also note 29, Prepayments and accrued income):

	Interest rate discounts	Cashbacks	Total
	£m	£m	£m
Group			
At 1 January 1996	76	67	143
Acquisitions of subsidiary undertakings/purchase of business	8	37	45
Expenditure incurred in the year	146	219	365
Transfer to profit and loss account	(129)	(58)	(187)
At 31 December 1996	101	265	366

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

3. Other interest receivable and similar income (Continued)

Interest due but not received on loans and advances in arrears has not been recognised in interest receivable where collectability is in doubt, but has been suspended. The movements on suspended interest are as follows:

	<u>On advances secured on residential properties</u>	<u>On other secured advances</u>	<u>On unsecured advances</u>	<u>Total</u>
	£m	£m	£m	£m
Group				
At 1 January 1996	61	116	6	183
Exchange adjustments	(4)	(12)	—	(16)
Acquisitions of subsidiary undertakings/purchase of business	34	11	1	46
Amounts suspended in the period	19	25	5	49
Irrecoverable amounts written off	<u>(37)</u>	<u>(25)</u>	<u>(3)</u>	<u>(65)</u>
At 31 December 1996	<u>73</u>	<u>115</u>	<u>9</u>	<u>197</u>

The value of loans and advances at 31 December 1996 on which interest is suspended is as follows:

Group				
Loans and advances to customers	685	491	110	1,286
Provisions on these amounts	(137)	(201)	(73)	(411)

4. Interest payable

	<u>1996</u>	<u>1995</u>	<u>1994</u>
	£m	£m	£m
On retail customer accounts	1,873	2,026	1,841
On other deposits and loans	2,893	2,971	2,094
	<u>4,766</u>	<u>4,997</u>	<u>3,935</u>
Including:			
Amounts payable on subordinated liabilities	167	133	80
Finance charges in respect of leased assets	—	1	2

5. Dividend income

	<u>1996</u>	<u>1995</u>	<u>1994</u>
	£m	£m	£m
Income from equity shares and other variable yield securities	3	2	42

6. Other operating income

	<u>1996</u>	<u>1995</u>	<u>1994</u>
	£m	£m	£m
Income from long term assurance business (see note 22)	133	98	91
Profits less losses on disposal of investment securities	—	7	14
Other	54	41	25
	<u>187</u>	<u>146</u>	<u>130</u>

7. Administrative expenses: Integration costs in continuing businesses

	<u>1996</u>	<u>1995</u>	<u>1994</u>
	£m	£m	£m
Reorganisation and restructuring costs	46	—	—
Branch closure costs	15	—	—
	<u>61</u>	<u>—</u>	<u>—</u>

7. Administrative expenses: Integration costs in continuing businesses (Continued)

Integration costs in continuing businesses include costs relating to the integration of the business of the former National and Provincial Building Society (N&P) into existing businesses of the Abbey National Group.

8. Administrative expenses: Other administrative expenses

	<u>1996</u>	<u>1995</u>	<u>1994</u>
	£m	£m	£m
Staff costs:			
Wages and salaries	374	300	274
Social security costs	32	26	24
Other pension costs	41	31	36
	<u>447</u>	<u>357</u>	<u>334</u>
Other administrative expenses	437	426	337
	<u>884</u>	<u>783</u>	<u>671</u>
Other administrative expenses include the following items:			
Hire of equipment	6	6	7
Rent and rates payable	68	57	57

The charges above exclude those incurred by Life Assurance, which are charged to the income from long term assurance business.

Staff costs incurred by Life Assurance are:

	<u>1996</u>	<u>1995</u>	<u>1994</u>
	£m	£m	£m
Staff costs:			
Wages and salaries	31	30	24
Social security costs	2	2	2
Other pension costs	3	3	4
	<u>36</u>	<u>35</u>	<u>30</u>

The auditors' remuneration was £2.0m (1995: £1.8m, 1994: £1.5m) for audit services and £2.9m (1995: £1.8m, 1994: £2.4m) was payable to the Group auditors for other services. Included within the remuneration for audit services is the audit fee for companies within Life Assurance of £0.3m (1995: £0.2m, 1994: £0.2m).

9. Directors' emoluments and interests

The aggregate emoluments of directors were:

	<u>1996</u>	<u>1995</u>	<u>1994</u>
	£	£	£
Total emoluments excluding pension contributions	3,356,378	2,371,302	2,277,951
Pension contributions	384,591	342,476	302,944
Ex-gratia payments to former directors	56,824	38,500	82,500
	<u>3,797,793</u>	<u>2,752,278</u>	<u>2,663,395</u>

The Chairman's emoluments were £288,128 (1995: £263,762, 1994: £242,393). His appointment is non-pensionable and he makes his own private pension arrangements.

The highest paid director is the Chief Executive. His emoluments, excluding pension contributions were £600,903 (1995: £447,845, 1994: £408,280). The pension contribution paid by the Company for the benefit of the Chief Executive was £79,035 (1995: £71,415, 1994: £63,841).

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

9. Directors' emoluments and interests (Continued)

On his retirement, John Fry was permitted to retain his company car and received a gift. The value of these ex-gratia items, when grossed up for tax purposes, was £52,666. John Fry was a Deputy Chairman and director who had been on the Board of Abbey National and its building society predecessor since 1984 and had been an employee for 34 years. As explained under "Management — Directors' remuneration" elsewhere in this Document, the Company no longer provides directors with a company car.

A further ex-gratia gift, valued at £4,158 when grossed up for tax purposes, was made to Robert Knighton, who resigned from the Board on 31 December 1996 and will retire from the Company on 31 July 1997 after 27 years with Abbey National.

Ex-gratia payments to former directors in 1995 comprised a gift of £38,500 to Sara Morrison, who retired as a director in June 1995.

The following table shows the number of directors, including the Chairman and the highest paid director, receiving emoluments before pension contributions within the undermentioned ranges.

£	1996	1995	1994
0 - 5,000	—	—	1
5,001 - 10,000	1	—	—
10,001 - 15,000	1	—	—
15,001 - 20,000	1	1	4
20,001 - 25,000	4	4	1
25,001 - 30,000	1	1	2
30,001 - 35,000	—	1	—
35,001 - 40,000	1	—	—
45,001 - 50,000	—	1	—
55,001 - 60,000	—	—	1
90,001 - 95,000	—	—	1
125,001 - 130,000	1	—	—
130,001 - 135,000	1	—	—
140,001 - 145,000	1	—	—
160,001 - 165,000	1	—	—
195,001 - 200,000	—	1	—
210,001 - 215,000	—	—	2
225,001 - 230,000	—	—	1
230,001 - 235,000	—	—	1
240,001 - 245,000	—	1	2
255,001 - 260,000	—	1	—
260,001 - 265,000	—	3	—
265,001 - 270,000	—	1	—
275,001 - 280,000	—	—	1
285,001 - 290,000	1	—	—
320,001 - 325,000	1	—	—
325,001 - 330,000	1	—	—
345,001 - 350,000	1	—	—
370,001 - 375,000	1	—	—
405,001 - 410,000	1	—	1
445,001 - 450,000	—	1	—
600,001 - 605,000	1	—	—

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

9. Directors' emoluments and interests (Continued)

Ex-gratia pensions paid to former directors of Abbey National plc in 1996, which have been provided for previously, amounted to £166,038 (1995: £161,225; 1994: £157,600). The Board has determined that it will no longer award any new such ex-gratia pensions and accordingly, no charge (nil) to the profit and loss account has been made in respect of them.

Further details of directors' emoluments and interests see "Management — Directors' remuneration" and "Management — Directors' share interests" elsewhere in this Document.

Details of loans, quasi loans and credit transactions entered into or agreed by the Company or its subsidiaries with persons who are or were directors and connected persons and officers of the Company during the year were as follows:

	Number of persons	Aggregate amount outstanding £000
Directors		
Loans	10	751
Quasi loans	5	11
Credit transactions	—	—
Officers		
Loans	48	4,841
Quasi loans	7	11
Credit transactions	—	—

No director had a material interest in any contract of significance, other than a service contract, with the Company or any of its subsidiaries at any time during the year. The directors did not have any interests in shares or debentures of subsidiaries.

Further disclosures relating to these transactions, as required under Financial Reporting Standard (FRS) 8, 'Related party disclosures' are given in note 50.

10. Employees

The average number of staff employed by the Group during the year was as follows:

	1996	1995	1994
Full time			
Male	5,784	5,046	4,678
Female	11,347	10,234	9,948
	17,131	15,280	14,626
Part time			
Male	129	69	52
Female	4,999	4,391	4,102
	5,128	4,460	4,154

Included in the above for Life Assurance are 1,445 (1995: 1,346, 1994: 1,285) full time and 70 (1995: 61, 1994: 50) part time staff.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

11. Provisions for bad and doubtful debts

	On advances secured on residential properties	On other secured advances	On unsecured advances	Total
	£m	£m	£m	£m
Group				
At 1 January 1996				
General	43	9	14	66
Specific	148	194	75	417
Exchange adjustments	(4)	(17)	(1)	(22)
Acquisitions of subsidiary undertakings/purchase of business	53	35	13	101
Transfer from profit and loss account	52	15	60	127
Irrecoverable amounts written off	<u>(80)</u>	<u>(23)</u>	<u>(52)</u>	<u>(155)</u>
At 31 December 1996	<u>212</u>	<u>213</u>	<u>109</u>	<u>534</u>
Being for the Group:				
General	67	11	17	95
Specific	145	202	92	439

12. Tax on profit on ordinary activities

	1996	1995	1994
	£m	£m	£m
UK Corporation tax:			
Current at 33% (33%)	249	286	285
Prior years	(148)	(110)	(66)
Double tax relief	(13)	(10)	(5)
Advance corporation tax written back	(7)	—	—
Deferred tax:			
Current year	150	44	34
Prior years	148	117	69
Tax on franked investment income	11	6	—
Overseas taxation	<u>13</u>	<u>11</u>	<u>5</u>
	<u>403</u>	<u>344</u>	<u>322</u>

There are unrelieved losses carried forward for which no tax relief has been recognised because their utilisation is currently uncertain. The adjustments in respect of prior years arise mainly because certain subsidiary undertakings have accounting reference dates other than 31 December.

13. Profit on ordinary activities after tax

The profit after tax of the Company attributable to the shareholders is £421m (1995:£510m, 1994:£484m). As permitted by section 230 of the Companies Act 1985, the Company's profit and loss account has not been presented in these accounts.

14. Dividends

	1996	1995	1994	1996	1995	1994
	Pence per share	Pence per share	Pence per share	£m	£m	£m
Ordinary shares						
Interim (paid)	8.70	7.25	5.70	115	97	75
Final (proposed)	<u>17.40</u>	<u>14.50</u>	<u>12.05</u>	245	191	158
	<u>26.10</u>	<u>21.75</u>	<u>17.75</u>	<u>360</u>	<u>288</u>	<u>233</u>
Preference shares (non-equity)				<u>13</u>	<u>2</u>	<u>—</u>
				<u>373</u>	<u>290</u>	<u>233</u>

15. Earnings per ordinary share

Earnings per ordinary share have been calculated by dividing the profit attributable to the shareholders of Abbey National plc after preference dividends of £754m (1995:£681m, 1994:£610m) by the average number of ordinary shares in issue of 1,335m (1995:1,317m, 1994:1,312m).

Earnings per ordinary share have also been calculated on the basis of earnings as described above, adjusted to exclude the post-tax effect of integration costs in continuing businesses.

The adjusted earnings per ordinary share has been calculated in addition to the earnings per ordinary share required by FRS3 because, in the opinion of the directors, its inclusion is necessary to enable the shareholders to assess underlying trading performance.

16. Treasury bills and other eligible bills

	Group 1996		Group 1995	
	Book value £m	Market value £m	Book value £m	Market value £m
Investment securities				
Treasury bills and similar securities	<u>9</u>	<u>9</u>	<u>34</u>	<u>33</u>
Other securities				
Treasury bills and similar securities	102	102	212	212
Other eligible bills	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
	<u>102</u>	<u>102</u>	<u>212</u>	<u>212</u>
Total	<u>111</u>	<u>111</u>	<u>246</u>	<u>245</u>

The movement on treasury bills and similar securities held for investment purposes was as follows:

	Group £m
At 1 January 1996	34
Exchange adjustments	(3)
Additions	74
Disposals	<u>(96)</u>
At 31 December 1996	<u>9</u>

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

17. Loans and advances to banks

	Group 1996	Group 1995
	£m	£m
Items in the course of collection	209	193
Other loans and advances	2,616	3,386
	2,825	3,579
Repayable:		
On demand	568	435
In not more than three months	1,847	2,583
In more than three months but not more than one year	169	327
In more than one year but not more than five years	223	172
In more than five years	18	62
	2,825	3,579

The Group enters into reverse sale and repurchase agreements. The total amount of collateralised deposits which are included above is £350m (£345m). The total nominal value of assets acquired as collateral via such agreements amounted to £364m (£326m).

18. Loans and advances to customers

	Group 1996	Group 1995
	£m	£m
Advances secured on residential properties	60,271	48,746
Other secured advances	1,136	724
Unsecured loans	2,623	1,385
Collateralised and guaranteed mortgage loans	197	235
	64,227	51,090
Repayable:		
On demand or at short notice	3,268	2,505
In not more than three months	825	439
In more than three months but not more than one year	1,112	839
In more than one year but not more than five years	4,385	3,277
In more than five years	55,171	44,513
Less: provisions	(534)	(483)
	64,227	51,090

Included in Group loans and advances to customers are loans to associated undertakings of nil (£12m).

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

19. Net investment in finance leases

	Group 1996	Group 1995
	£m	£m
Amounts receivable	9,315	6,152
Less: deferred income	(5,005)	(3,308)
	4,310	2,844
Repayable:		
In not more than three months	29	27
In more than three months but not more than one year	57	55
In more than one year but not more than five years	307	325
In more than five years	3,917	2,437
	4,310	2,844
Cost of assets acquired for the purpose of letting under finance leases in the year	1,541	675
Gross rentals receivable	351	408
Commitments as lessor for the purchase of equipment for use in finance leases	231	339
Amounts outstanding subject to a sub-participation	216	213

20. Debt securities

	Group 1996		Group 1995	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£m
Investment securities				
Issued by public bodies:				
Government securities	7,716	8,190	7,793	8,118
Other public sector securities	4,023	4,082	3,884	3,953
	11,739	12,272	11,677	12,071
Issued by other issuers:				
Bank and building society certificates of deposit	221	221	154	154
Other debt securities	14,853	15,080	19,408	19,716
	15,074	15,301	19,562	19,870
Sub-total	26,813	27,573	31,239	31,941
Other securities				
Issued by public bodies:				
Government securities	1,343	1,343	812	812
Other public sector securities	32	32	430	430
	1,375	1,375	1,242	1,242
Issued by other issuers:				
Bank and building society certificates of deposit	1,615	1,615	1,776	1,776
Other debt securities	9,927	9,927	986	986
	11,542	11,542	2,762	2,762
Sub-total	12,917	12,917	4,004	4,004
Total	39,730	40,490	35,243	35,945

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

20. Debt securities (Continued)

	Group 1996		Group 1995	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£m
Analysed by listing status:				
Investment securities				
Listed in the UK	7,172	7,257	5,695	5,837
Listed or registered elsewhere	15,991	16,598	21,273	21,696
Unlisted	3,650	3,718	4,271	4,408
	<u>26,813</u>	<u>27,573</u>	<u>31,239</u>	<u>31,941</u>
Other securities				
Listed in the UK	334	334	16	16
Listed or registered elsewhere	10,142	10,142	2,033	2,033
Unlisted	2,441	2,441	1,955	1,955
	<u>12,917</u>	<u>12,917</u>	<u>4,004</u>	<u>4,004</u>
Total	<u>39,730</u>	<u>40,490</u>	<u>35,243</u>	<u>35,945</u>
			Group 1996	Group 1995
			£m	£m
Book value				
Analysed by maturity:				
Due within one year			4,273	3,976
Due one year and over			<u>35,457</u>	<u>31,267</u>
			<u>39,730</u>	<u>35,243</u>

The movement on debt securities held for investment purposes was as follows:

	Cost	Provisions	Net book value
	£m	£m	£m
Group			
At 1 January 1996	31,250	(11)	31,239
Exchange adjustments	(2,537)	—	(2,537)
Acquisitions of subsidiary undertakings/purchase of business	693	—	693
Additions	15,634	—	15,634
Disposals	(10,252)	—	(10,252)
Redemptions and maturities	(2,237)	—	(2,237)
Transfers to other securities	(5,632)	—	(5,632)
Transfer from profit and loss account	—	(13)	(13)
Amortisation of premiums	(82)	—	(82)
At 31 December 1996	<u>26,837</u>	<u>(24)</u>	<u>26,813</u>

The total net book value of debt securities held for investment purposes at 31 December 1996 includes unamortised premiums of £30m (£62m) for the Group.

The Group enters into sale and repurchase agreements. The total nominal value of assets so transferred and which are included above is £749m (£1,173m). Collateral associated with these transactions of £737m (£1,161m) for the Group is included in Deposits by banks.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

20. Debt securities (Continued)

Market values are based on market prices of securities where available. Where market prices are not available, the directors' valuation has been used.

Included within investment securities are a number of securities held for hedging purposes. Some of these provide temporary hedging cover where permanent hedges are not immediately available.

There are hedges in place in respect of the majority of securities whereby the rise or fall in their market value will be offset by a substantially equivalent reduction or increase in the value of the hedges.

21. Equity shares and other variable yield securities

	Group 1996		Group 1995	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£m
Listed in the UK	27	50	25	40
Listed elsewhere	1	1	1	1
Unlisted	16	16	28	28
	<u>44</u>	<u>67</u>	<u>54</u>	<u>69</u>

Included within unlisted securities of the Group are variable yield securities held by Abbey National Unit Trust Managers Ltd for purposes other than investment, having a book and market value of £8m (£3m). All other equity shares and variable yield securities are held for investment purposes.

The movement on equity shares and other variable yield securities held for investment purposes was as follows:

	Group Cost & Book value
	£m
At 1 January 1996	51
Exchange adjustments	(1)
Additions	16
Disposals	<u>(30)</u>
At 31 December 1996	<u>36</u>

22. Long term assurance business

The value of the long term assurance business is as follows:

	1996	1995
	£m	£m
Value of shareholders' interest in the long term assurance funds	555	425

The value of the long term assurance business is calculated by discounting the proportion of surplus which is projected to accrue to shareholders in future years from business currently in force, and adding the shareholders' interest in the surplus retained within the long term assurance funds. The basis on which this value is determined is reviewed regularly in the light of the experience of the business and expectations regarding future economic conditions. The principal economic assumptions used have not changed from 1994 and are as follows:

	%
Risk adjusted discount rate (net of tax)	10.0
Return on equities (gross of tax)	9.0
Return on gilts (gross of tax)	7.5
Inflation	<u>4.0</u>

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

22. Long term assurance business (Continued)

The assumed rates of return on investments above are applied to the value of investments adjusted by reference to the assumed long term rate of investment return.

In view of the different lapse rate and mortality levels which have been experienced in recent years compared to those assumed it was decided to change the assumed levels in 1996. The effect of the change in assumptions was determined by calculating the value of the long term assurance business at the beginning of the year on both the old and new assumptions. This resulted in an increase in the value of long term assurance business of £7m before tax and £5m after tax, which was included in income from long term assurance business for the year ended 31 December 1996.

Business in force is defined as all live policies where the first premium has been paid. Recurrent single premium policies are treated as single premium policies, with the exception of Department of Social Security rebate policies, which are treated as regular premium policies. Shareholders are entitled to 10% of the value of bonuses declared in any particular year derived from the Scottish Mutual with profits fund. The level of assumed future bonuses is calculated by projecting the portfolio of with profits business forward and applying reversionary and terminal bonus rates at such a level as to exhaust the level of projected surplus of assets over liabilities. For all other business the entire surplus is attributable to shareholders.

The income from life assurance business which is included as other operating income in the consolidated profit and loss account is calculated as follows:

	1996	1995
	£m	£m
Value of shareholders' interest in the long term assurance funds at 31 December	555	425
Value of shareholders' interest in the long term assurance funds at 1 January	425	352
Increase in value of long term assurance business	130	73
Transfers into long term assurance funds	(41)	(10)
Acquisition of Pegasus Assurance Group Ltd	—	(4)
Acquisitions of subsidiary undertakings/purchase of business	(25)	—
Net increase in value of long term assurance business	64	59
Surplus transferred from long term funds	24	7
Income after tax from long term assurance business	88	66
Income before tax from long term assurance business	133	98

The assets and liabilities of the long term assurance funds are presented separately from those of other businesses in order to reflect the different nature of the shareholders' interest in them. The amounts of these assets, which are valued at market value, and liabilities of the long term assurance funds included in the consolidated balance sheet are based on the Life Assurance balance sheets prepared under the Companies Act 1985 (Insurance Companies Accounts) Regulations 1993.

The assets and liabilities of the long term assurance funds are:

	1996	1995
	£m	£m
Investments	4,406	2,961
Assets held to cover linked liabilities	2,862	2,133
Debtors and prepayments	235	83
Other assets	366	341
Assets of the long term assurance funds	7,869	5,518
Technical provisions	3,485	2,733
Technical provisions for linked liabilities	2,894	2,102
Fund for future appropriations	659	577
Other creditors	831	106
Liabilities of the long term assurance funds	7,869	5,518

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

23. Interests in associated undertakings

The movement in interests in associated undertakings was as follows:

	<u>Group</u> <u>£m</u>
At 1 January 1996	1
Additions	2
Other movements	5
At 31 December 1996	<u>8</u>

Other movements arose on the disposal by First National Finance Corporation plc (FNFC) of its associated undertakings and the purchase by FNFC of the remaining shareholding in First National Robert Leonard Ltd, which has been reclassified as a subsidiary undertaking. The FNFC associated undertakings had accumulated net losses, which resulted in a negative carrying value in the Group accounts.

On the historical cost basis, the Group's interest in associated undertakings would have been included as follows:

	<u>1996</u> <u>£m</u>	<u>1995</u> <u>£m</u>
Cost	22	33
Provisions	—	(12)
Net book value	<u>22</u>	<u>21</u>

Provisions have reduced to nil due to the transactions described above.

The principal associated undertakings at 31 December 1996 are:

	<u>Nature of business</u>	<u>Issued share capital</u>	<u>Group</u> <u>interest</u> <u>(%)</u>	<u>Group's share of</u> <u>results based on</u> <u>accounts for the</u> <u>year ended</u>
Travellers Exchange Corporation plc	Foreign currency services	166,588 £1 ordinary shares 2,500,000 £1 preference shares	33 60	31 December
Commercial Union Underwriting Ltd	Insurance underwriting services	100 £1 ordinary A shares 30,000,000 £1 ordinary B shares	15 21	31 December

The United Kingdom is the principal area of operation of both principal associated undertakings and both are registered in England & Wales.

All associated undertakings are unlisted.

Abbey National plc has the right to increase its interests in Commercial Union Underwriting Ltd up to a maximum of 75% after the fifth anniversary of the commencement of the operation, and to 100% in certain circumstances.

24. Shares in Group undertakings

	<u>1996</u> <u>Cost &</u> <u>Book value</u> <u>£m</u>	<u>1995</u> <u>Cost &</u> <u>Book value</u> <u>£m</u>
Subsidiary undertakings		
Banks	451	451
Others	1,994	1,820
	<u>2,445</u>	<u>2,271</u>

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

24. Shares in Group undertakings (Continued)

The movement in shares in Group undertakings was as follows:

	<u>Company</u>
	<u>£m</u>
At 1 January 1996	2,271
Exchange adjustments	(133)
Acquisitions of subsidiary undertakings/purchase of business	134
Additions	173
Disposals	—
At 31 December 1996	<u>2,445</u>

First National Bank plc acquired Wagon Finance Ltd on 2 July 1996 and Elton Holdings Ltd, subsequently renamed First National Vehicle Contracts, on 12 August 1996. The amounts payable in consideration for the issued share capital of the companies were £5m and £7m respectively and were both payable in the form of cash. In addition, a further £110m was paid in settlement of certain indebtedness of Wagon Finance Ltd. The terms of the acquisition of Elton Holdings Ltd by First National Bank plc are such that additional consideration may become payable to the vendors. The amount of any future consideration payable is dependent upon certain conditions being met and the future performance of First National Vehicle Contracts Ltd. The maximum amount payable, which has been provided against in full, is £5m, which may fall due within two to five years. In addition, acquisition costs of £1m were incurred in the purchase of the companies. Both companies are included in the consolidated accounts as acquisitions.

On 30 April 1996, FNFC acquired the remaining share capital of its associated undertaking, First National Robert Leonard Ltd, which has therefore been reclassified as a subsidiary undertaking.

On 5 August 1996, Abbey National plc purchased the business of N&P for a total consideration of £1,363m, including £12m of transfer costs and other provisions. The consideration for the business, excluding costs and provisions, comprised £882m paid in the form of a cash transfer to eligible customer accounts, and £469m paid in the form of ordinary shares in Abbey National plc. The purchase of the business has been accounted for as an acquisition.

Further disclosures relating to these transactions are given in note 25.

On 25 October 1996 the Abbey National Independent Financial Advisers Group of Companies underwent an internal restructure. The principal holding company is now Abbey National Independent Consulting Group Limited.

On 31 December 1996, FNFC underwent an internal restructure. The principal subsidiary is now First National Bank plc.

During the year ended 31 December 1996, Abbey National subscribed for £173m of share capital in subsidiary undertakings. This includes £122m in FNFC to finance the acquisition of Wagon Finance Ltd and Elton Holdings Ltd.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

24. Shares in Group undertakings (Continued)

The principal subsidiaries of Abbey National plc at 31 December 1996 are listed below, all of which are directly held except where indicated.

	<u>Nature of business</u>	<u>Country of incorporation or registration</u>
Abbey National Independent Consulting Group Ltd	Personal finance	England & Wales
Abbey National Leasing Companies*	Leasing	England & Wales
Abbey National Mortgage Finance plc	Personal finance	England & Wales
Abbey National Treasury Services plc	Treasury operations	England & Wales
First National Bank plc*	Personal finance and commercial lending	England & Wales
Future Insurance Services Limited	General insurance	England & Wales
HMC Group plc	Personal finance	England & Wales
Wagon Finance Ltd*	Personal finance	England & Wales
Abbey National France SA*	Personal finance	France
Abbey National (Gibraltar) Ltd*	Personal finance	Gibraltar
Carfax Insurance Ltd	Insurance	Guernsey
Abbey National Treasury International Ltd*	Personal finance and treasury operations	Jersey
Abbey National Life plc	Insurance	Scotland
Abbey National Unit Trust Managers Ltd*	Unit trust/PEP management	Scotland
N&P Life Assurance Limited	Insurance	Scotland
Scottish Mutual Assurance plc*	Insurance	Scotland
Abbey National Bank SAE	Personal finance	Spain
Abbey National North America Corporation	Funding	United States

* Subsidiary held indirectly through subsidiary companies.

All the above companies are included in the consolidated accounts. The Company holds directly or indirectly 100% of the issued ordinary share capital of its principal subsidiaries except for Future Insurance Services Limited where the Company holds 75% of the issued ordinary share capital. All companies operate principally in their country of incorporation or registration. Abbey National Treasury Services plc also has branch offices in France and Jersey and a representative office in Hong Kong and Abbey National plc has a branch in Italy.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

25. Summary of the effect of business purchase and acquisitions

The following table summarises the effect of the purchase of the business of N&P and its subsidiaries:

	Book value before acquisition	Accounting policy adjustments	Revaluation adjustments	Total fair value adjustments	Fair value at acquisition
	£m	£m	£m	£m	£m
Loans and advances to banks	1,359	—	—	—	1,359
Loans and advances to customers	11,840	(2)	(4)	(6)	11,834
Debt securities	693	—	—	—	693
Tangible fixed assets	134	(26)	(4)	(30)	104
Assets of long term assurance funds	246	—	—	—	246
Other assets	242	(3)	29	26	268
Total assets	<u>14,514</u>	<u>(31)</u>	<u>21</u>	<u>(10)</u>	<u>14,504</u>
Customer accounts	10,216	—	10	10	10,226
Debt securities in issue	1,973	—	6	6	1,979
Accruals and deferred income	810	—	—	—	810
Subordinated liabilities	100	—	1	1	101
Liabilities of long term assurance funds	246	—	—	—	246
Other liabilities	267	(6)	42	36	303
Total liabilities excluding shareholders' funds	<u>13,612</u>	<u>(6)</u>	<u>59</u>	<u>53</u>	<u>13,665</u>
Net assets acquired	<u>902</u>	<u>(25)</u>	<u>(38)</u>	<u>(63)</u>	<u>839</u>
Total fair value of the consideration and costs of acquisition					<u>1,363</u>
Total goodwill on purchase of business of N&P					<u>524</u>

Summary of the results of N&P both for the period 1 January 1996 to 4 August 1996 and for the year ended 31 December 1995.

	Period ended 4 August 1996	Year ended 31 December 1995
	£m	£m
Profit before taxation and exceptional items	127	195
Exceptional items	(29)	(8)
Profit before taxation	98	187
Taxation	(51)	(63)
Retained profit	47	124

Other than those recognised gains and losses included in the summary headings above, N&P had no recognised gains and losses and so no separate Statement of Total Recognised Gains and Losses has been presented.

In accordance with the U.S. Accounting Principles Board Opinion No. 16, the following pro forma condensed results for the years ended 31 December 1996 and 1995 have been prepared on the assumption that the transfer of the business of N&P to Abbey National occurred on 1 January 1996 and 1995 respectively.

	Year ended 31 December	
	1996	1995
	£m	£m
Profit before taxation and integration costs	1,355	1,221
Net income	861	810
Earnings per share, excluding integration costs	61.35p	57.97p

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

25. Summary of the effect of business purchase and acquisitions (Continued)

The following table summarises the effect of all acquisitions of subsidiary undertakings, other than the subsidiary undertakings transferred with the business of N&P, in the year ended 31 December 1996:

	<u>Book value before acquisition</u>	<u>Accounting policy adjustments</u>	<u>Revaluation adjustments</u>	<u>Total fair value adjustments</u>	<u>Fair value at acquisition</u>
	£m	£m	£m	£m	£m
Loans and advances to banks	8	—	—	—	8
Loans and advances to customers	367	—	—	—	367
Tangible fixed assets	13	—	—	—	13
Other assets	18	—	—	—	18
Total assets	<u>406</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>406</u>
Deposits by banks	6	—	—	—	6
Debt securities in issue	199	—	—	—	199
Subordinated liabilities	13	—	—	—	13
Other liabilities	141	1	—	1	142
Total liabilities excluding shareholders' funds .	<u>359</u>	<u>1</u>	<u>—</u>	<u>1</u>	<u>360</u>
Net assets acquired	<u>47</u>	<u>(1)</u>	<u>—</u>	<u>(1)</u>	<u>46</u>
Total fair value of the consideration and costs of acquisition					<u>128</u>
Goodwill on acquisition of subsidiary undertakings					<u>82</u>

The only significant subsidiary undertaking included in the above table is Wagon Finance Limited and its profit after tax for the year ended 30 June 1996 was £8m.

Summary of goodwill taken to Group reserves

	<u>£m</u>
Total goodwill on purchase of business of N&P	524
Total goodwill on acquisition of subsidiary undertakings	82
Other goodwill movements	4
Total goodwill taken to Group reserves	<u>610</u>

26. Post-acquisition results of business acquired

FRS3, "Reporting Financial Performance", requires the disclosure of the results of operations acquired during the year which are included in the results of the Group for the current period. The standard provides that where it is not practicable to determine the post-acquisition results of an acquired operation, then this should be stated and the reason for it should be explained.

The business of N&P has been fully integrated into existing businesses of the Abbey National Group. In particular, product systems have been integrated and Abbey National product ranges are offered to the combined customer base. For this reason, it is not practicable to identify the post-acquisition results of the acquired business separately. A summary of the pre-transfer results of N&P is provided in note 25.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

27. Tangible fixed assets

	Group		
	Premises £m	Equipment £m	Total £m
Cost			
At 1 January 1996	362	700	1,062
Acquisitions of subsidiary undertakings/purchase of business	69	58	127
Additions	19	128	147
Disposals	(10)	(94)	(104)
At 31 December 1996	<u>440</u>	<u>792</u>	<u>1,232</u>
Depreciation			
At 1 January 1996	52	425	477
Acquisitions of subsidiary undertakings/purchase of business	—	10	10
Charge for the year	8	85	93
Disposals	—	(63)	(63)
At 31 December 1996	<u>60</u>	<u>457</u>	<u>517</u>
Net book value			
At 31 December 1996	380	335	715
At 31 December 1995	<u>310</u>	<u>275</u>	<u>585</u>
		<u>Group 1996</u>	<u>Group 1995</u>
		£m	£m
The net book value of premises comprises:			
Freeholds		303	244
Long leaseholds		20	10
Short leaseholds		57	56
Land and buildings occupied for own activities:			
Net book value at 31 December		321	246
The net book value of equipment includes:			
Assets held under finance leases		7	3
Depreciation charge for the year on these assets		4	5
Capital expenditure which has been contracted, but has not been provided in the accounts		38	11

28. Other assets

	Group 1996	Group 1995
	£m	£m
Development properties	26	26
Foreign exchange and interest rate contracts (see note 47)	700	907
Other	783	716
	<u>1,509</u>	<u>1,649</u>

Other assets of the Group include £89m (£60m) in respect of unamortised commissions payable to introducers in respect of obtaining certain lending business where this is the primary form of distribution. Such commissions are charged to the profit and loss account over the expected life of the loans, the charge for the period being £40m (£13m).

The figure for development properties includes completed properties of £19m (£21m) and work in progress of £7m (£5m).

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

28. Other assets (Continued)

The amounts in respect of foreign exchange and interest rate contracts relate to translation differences arising from instruments which are used to hedge currency assets and liabilities, and to the revaluation of certain interest rate contracts where appropriate.

29. Prepayments and accrued income

	Group 1996	Group 1995
	£m	£m
Other accrued interest	1,856	1,695
Prepayments and other accruals	24	58
	1,880	1,753

Other accrued interest includes £366m (£143m) in respect of unamortised lending-related fees and discounts paid which are charged against interest income over the period of time which the Group has the right to recover the incentives in the event of early redemption. See note 3 for further details.

30. Deposits by banks

	Group 1996	Group 1995
	£m	£m
Items in the course of transmission	336	268
Other deposits	17,382	19,125
	17,718	19,393
Repayable:		
On demand	530	437
In not more than three months	13,575	14,742
In more than three months but not more than one year	3,221	3,842
In more than one year but not more than five years	125	119
In more than five years	267	253
	17,718	19,393

31. Customer accounts

	Group 1996	Group 1995
	£m	£m
Retail funds and deposits	45,119	37,564
Other customer accounts	4,559	3,398
	49,678	40,962
Repayable:		
On demand	42,376	33,856
In not more than three months	3,937	6,173
In more than three months but not more than one year	2,460	596
In more than one year but not more than five years	420	320
In more than five years	485	17
	49,678	40,962

Included in Group customer accounts are amounts due to associated undertakings of £1m (nil).

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

32. Debt securities in issue

	Group 1996	Group 1995
	£m	£m
Bonds and medium term notes	18,542	14,652
Other debt securities in issue	16,651	11,443
	35,193	26,095
Bonds and medium term notes are repayable:		
In not more than three months	2,008	1,083
In more than three months but not more than one year	4,218	3,184
In more than one year but not more than two years	3,242	2,974
In more than two years but not more than five years	4,342	3,691
In more than five years	4,732	3,720
	18,542	14,652
Other debt securities in issue are repayable:		
In not more than three months	12,920	8,433
In more than three months but not more than one year	3,637	2,631
In more than one year but not more than two years	38	318
In more than two years but not more than five years	34	33
In more than five years	22	28
	16,651	11,443

Where premiums, discounts and expenses relating to debt securities issued as part of the Group's funding programme are matched by swap fees, the presentation of these premiums, discounts and expenses has been matched with the presentation of swap fees.

33. Other liabilities

	Group 1996	Group 1995
	£m	£m
Creditors and accrued expenses	740	534
Short positions in government debt securities		
Investment securities	355	19
Other securities	—	330
Income tax	169	197
Corporation tax	299	299
Foreign exchange and interest rate contracts (see note 47)	1,408	496
Obligations under finance leases (see note 34)	9	4
	2,980	1,879

The amounts in respect of foreign exchange and interest rate contracts relate to translation differences arising from instruments which are used to hedge currency assets and liabilities, and to the revaluation of certain interest rate contracts where appropriate.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

34. Obligations under finance leases

	Group 1996	Group 1995
	£m	£m
Amounts payable:		
In not more than one year	5	3
In more than one year but not more than five years	4	1
	9	4

35. Accruals and deferred income

	Group 1996	Group 1995
	£m	£m
Other accrued interest	2,362	2,260
Deferred income	229	136
	2,591	2,396

The Company has entered into insurance arrangements with certain insurance subsidiaries, to cover a proportion of future losses on certain UK residential secured loans with high loan to value ratios. In the Group accounts, income from customers in relation to such lending is deferred and is included in the balance sheet under the heading, Accruals and deferred income. The deferred income is released to the profit and loss account as losses are identified and provided for. The balance of such deferred income is £228m (£135m). This includes a balance of £31m added with the purchase of the business of N&P. The amount released during the year was £14m (£4m).

36. Provisions for liabilities and charges

	Group 1996	Group 1995
	£m	£m
Deferred taxation (note 37)	889	560
Other provisions for liabilities and charges (note 38)	81	70
	970	630

37. Deferred taxation

	Group £m
At 1 January 1996	560
Acquisitions of subsidiary undertakings/purchase of business	34
Transfer from profit and loss account	298
Other movements	(3)
At 31 December 1996	889

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

37. Deferred taxation (Continued)

The amounts provided and total potential liability are:

	Amount provided	Total potential liability
	Group	Group
	£m	£m
Tax effect of timing differences due to:		
Excess of capital allowances over depreciation	23	23
Capital allowances on finance lease receivables	758	758
Other	108	108
	889	889

38. Other provisions for liabilities and charges

	Pension and other similar obligations (1)	Provisions for contingent liabilities and commitments	Other provisions (2)	Total
	£m	£m	£m	£m
Group				
At 1 January 1996	47	11	12	70
Acquisitions of subsidiary undertakings/purchase of business	1	6	5	12
Transfer from profit and loss account	40	4	11	55
Pension contributions/provisions utilised	(56)	1	(1)	(56)
At 31 December 1996	32	22	27	81

(1) Included within Other assets is a balance in respect of the pension surplus acquired with the purchase of the business of N&P. This balance, which was £29m as at 5 August 1996, is being amortised over the remaining service lives of employees contributing to the scheme, and £1m was charged to the profit and loss account over the five months to 31 December 1996.

(2) Other provisions include amounts in respect of possible compensation payable as a result of the review of business involving the transfers from occupational to personal pension schemes and the opting-out of and the non-joining of occupational pension schemes. The provisions for the Group excluding Life Assurance are included within Other provisions. Amounts provided in respect of Life Assurance are charged to Income from long term assurance business and carried against the asset Long term assurance business in the balance sheet. In addition, provisions have been made for the administrative costs of carrying out the review, which are included within Provisions for contingent liabilities and commitments as at 31 December 1996.

Amounts provided in respect of pension misselling are as follows:

	Group excluding Life Assurance	Life Assurance	Group
	£m	£m	£m
At 1 January 1996	6	3	9
Acquisitions of subsidiary undertakings/purchase of business	4	7	11
Transfer from profit and loss account	6	—	6
Provisions utilised	—	—	—
At 31 December 1996	16	10	26

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

39. Subordinated liabilities including convertible debt

	Group 1996	Group 1995
	£m	£m
Dated subordinated liabilities:		
Subordinated floating rate note 1997	8	17
9.00% Subordinated guaranteed bond 2002 (LUX 1,000m)	19	22
Subordinated guaranteed note 2002 (US \$75m)	44	48
8.00% Subordinated guaranteed bond 2002 (DFL 200m)	68	80
10.375% Subordinated guaranteed bond 2002	100	101
Subordinated floating rate note 2003 (US \$100m)	58	64
Subordinated floating rate note 2004 (US \$137m)	80	88
Subordinated floating rate note 2004 (CAN \$100m)	43	47
8.75% Subordinated guaranteed bond 2004	151	151
8.2% Subordinated bond 2004 (US \$500m)	292	322
6.69% Subordinated bond 2005 (US \$750m)	436	484
10.75% Subordinated bond 2006*	101	—
Subordinated guaranteed floating rate note 2009 (CHF 130m)	57	73
11.50% Subordinated guaranteed bond 2017	152	153
10.125% Subordinated guaranteed bond 2023	152	152
Undated subordinated liabilities:		
10.0625% Exchangeable subordinated capital securities	198	200
7.35% Subordinated step-up perpetual notes (US \$500m)	289	—
5.56% Subordinated guaranteed bond (YEN 15 billion)	76	94
5.50% Subordinated guaranteed notes (YEN 5 billion)	25	31
4.00% Subordinated perpetual notes (YEN 5 billion)	25	—
	<u>2,374</u>	<u>2,127</u>

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

* This represents the Subordinated bond transferred with the purchase of the business of N&P.

The 10.0625% Exchangeable subordinated capital securities are exchangeable into fully paid 10.375% non-cumulative non-redeemable sterling preference shares of £1 each, at the option of Abbey National. Exchange may take place on any interest payment date providing that between 30 and 60 days notice has been given to the holders. The holders will receive one new sterling preference share for each £1 principal amount of capital securities held. The rights attaching to these preference shares would be the same as those detailed in note 40.

The 7.35% Subordinated step-up perpetual notes are redeemable at par, at the option of Abbey National, on 15 October 2006 and each fifth anniversary thereafter.

The 4.00% Subordinated perpetual notes are redeemable at par, at the option of Abbey National, on 24 December 2016 and each fifth anniversary thereafter.

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

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

40. Called up share capital and share premium account

	Ordinary shares of 10 pence each £m	Preference shares of £1 each £m	Preference shares of US\$0.01 each £m	Total £m
Authorised share capital				
At 31 December 1996	175	1,000	6	1,181
Issued and fully paid share capital				
At 1 January 1996	132	100	—	232
Issued in respect of subsidiary acquisitions/business purchase	8	—	—	8
Issued under employee share option schemes	1	—	—	1
Issue of preference shares	—	100	—	100
At 31 December 1996	141	200	—	341
Share premium account				
At 1 January 1996	855	1	—	856
Shares issued	465	8	116	589
Exchange adjustments	—	—	(4)	(4)
At 31 December 1996	1,320	9	112	1,441
Authorised share capital				
At 31 December 1995	175	500	6	681
Issued and fully paid share capital				
At 1 January 1995	131	—	—	131
Issued under employee share option schemes	1	—	—	1
Issue of preference shares	—	100	—	100
At 31 December 1995	132	100	—	232
Share premium account				
At 1 January 1995	840	—	—	840
Shares issued	15	1	—	16
At 31 December 1995	855	1	—	856
Authorised share capital				
At 31 December 1994	175	500	6	681
Issued and fully paid share capital				
At 1 January 1994	131	—	—	131
Issued under employee share option schemes	—	—	—	—
Issue of preference shares	—	—	—	—
At 31 December 1994	131	—	—	131
Share premium account				
At 1 January 1994	836	—	—	836
Shares issued	4	—	—	4
At 31 December 1994	840	—	—	840

Following approval by shareholders at the Company's 1996 Annual General Meeting, to increase the Company's authorised preference share capital by £500m, the authorised share capital of Abbey National is £1,181m (1995: £681m, 1994: £681m) which includes £175m (1995: £175m, 1994: £175m) ordinary share capital (comprising 1,750 million ordinary shares of 10 pence each) and £1,006m (1995: £506m, 1994: £506m) preference share capital (comprising 1 billion shares of £1 each and 1 billion shares of US \$0.01 each).

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

40. Called up share capital and share premium account (Continued)

Under the Company's Executive, Employee and Sharesave schemes, employees hold options to subscribe for 27,145,971 (1995: 23,860,453, 1994: 26,094,580) ordinary shares at prices ranging from 149.0 to 591.0 pence per share, exercisable up to 2006. During the year 3,239,214 (1995: 7,862,810) ordinary shares were issued on the exercise of options for a consideration of £7,642,308 (1995: £14,045,805).

During 1996, 840,550 ordinary shares (1995: nil, 1994: 493,213) were issued to eligible staff under the share participation scheme. The market value of the shares at the date of issue was £4,782,730.

During the period to 31 December 1996, 82,644,563 ordinary shares were issued as part consideration for the purchase of the business of N&P, at an ex-dividend market value of £461,693,851.

The issue of the above shares resulted in the increase in the ordinary share premium account of £465m.

As of 31 December 1996 there were 2,715,303 shareholders. The following table shows an analysis of their holdings:

Size of shareholding	Ordinary shares of 10 pence each		Preference shares of £1 each		Preference shares of US\$0.01 each	
	Shareholders	Shares	Shareholders	Shares	Shareholders	Shares
1 - 100	1,815,710	176,699,828	—	—	2	200
101 - 1,000	867,010	365,195,563	6	3,521	18	8,200
1,001+	31,936	865,277,604	614	199,996,479	7	7,991,600
	<u>2,714,656</u>	<u>1,407,172,995</u>	<u>620</u>	<u>200,000,000</u>	<u>27</u>	<u>8,000,000</u>

Sterling preference shares

On 13 February 1996, Abbey National plc issued 100 million non-cumulative non-redeemable 10.375% Sterling preference shares of £1 each for a consideration of approximately £108m excluding issue costs of £0.1m for the purpose of strengthening the Group's capital base. The terms of these preference shares are identical to the issue made in October 1995, except that the first dividend has been accrued from 13 February 1996, and are described below.

Holders of the sterling preference shares are entitled to receive a bi-annual non-cumulative preferential dividend payable in sterling out of the distributable profits of the Company at a rate per annum which will ensure that the sum of the dividend payable on such date and the Associated Tax Credit (as defined in the terms of the sterling preference shares) represents an annual rate of 10.375% per annum of the nominal amount of such shares.

On a return of capital or on a distribution of assets on a winding up, the sterling preference shares shall rank pari passu with any other shares that are expressed to rank pari passu therewith as regards participation in assets, and otherwise in priority to any other share capital of the Company. On such a return of capital or winding up, each sterling preference share shall, out of the surplus assets of the Company available for distribution amongst the members after payment of the Company's liabilities, carry the right to receive an amount equal to the amount paid up or credited as paid together with any premium paid on issue and the full amount of any dividend otherwise due for payment.

Other than as set out above, no sterling preference share confers any right to participate on a return of capital or a distribution of assets of the Company.

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

In any such case, the sterling preference shareholders are entitled to receive notice of and attend the general meeting at which such resolution is proposed and will be entitled to speak and vote on such a resolution but not on any other resolution.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

40. Called up share capital and share premium account (Continued)

US dollar preference shares

On 15 November 1996, Abbey National plc issued 8 million non-cumulative US dollar denominated 8.75% preference shares of \$0.01 each for a consideration of \$200m excluding issue costs of £3.8m, for the purpose of strengthening the Group's capital base.

Holders of the dollar preference shares are entitled to receive a quarterly non-cumulative preferential dividend payable in US dollars out of the distributable profits of the company payable at a rate per annum which will ensure that the sum of the dividend payable on such date and the Associated Tax Credit represents an annual rate of 8.75% per annum of the nominal amount of such shares.

The dollar preference shares are redeemable, in whole or in part, at the option of Abbey National at any time and from time to time after five years and one day after the date of original issue. Redemption may only occur if the sterling dollar exchange rate is at or above its level at date of allotment, or in the event of a tax or regulatory change. The redemption amount will be \$25, unless redeemed in year five to ten in which instance a redemption premium will be payable.

On a return of capital or on a distribution of assets on a winding up, the dollar preference shares shall rank pari passu with any other shares that are expressed to rank pari passu therewith as regards participation in assets, and otherwise in priority to any other share capital of the Company. On such a return of capital or winding up, each dollar preference share shall, out of the surplus assets of the company available for distribution amongst the members after payment of the Company's liabilities, carry the right to receive an amount equal to £22.67, payable in US dollars together with any accrued and unpaid dividends at that time.

Other than as set out above, no dollar preference share confers any right to participate on a return of capital or a distribution of assets of the Company.

Holders of the dollar preference shares are not entitled to receive notice of or attend, speak and vote at general meetings of the Company unless the business of the meeting includes the consideration of a resolution to wind up the Company or any resolution varying, altering or abrogating any of the rights, privileges, limitations or restrictions attached to the dollar preference shares or if the dividend on the dollar preference shares has not been paid in full for the six consecutive quarters immediately prior to the relevant general meeting.

In any such case, the dollar preference shareholders are entitled to receive notice of and attend the general meeting at which such resolution is proposed and will be entitled to speak and vote on such a resolution but not on any other resolution.

41. Reserves and profit and loss account

	<u>Group 1996</u>	<u>Group 1995</u>	<u>Group 1994</u>
	£m	£m	£m
Profit and loss account			
At 1 January	2,690	2,629	2,380
Profit retained for the financial year	327	334	312
Goodwill recognised in the profit and loss account in the year	—	1	10
Goodwill taken to profit and loss account reserve during the year	(610)	(289)	(66)
Exchange adjustments	(26)	15	(7)
At 31 December	<u>2,381</u>	<u>2,690</u>	<u>2,629</u>
Non-distributable reserve			
At 1 January	163	104	39
Transfer from profit and loss account	67	59	65
At 31 December	<u>230</u>	<u>163</u>	<u>104</u>

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

44. Memorandum items: Guarantees and assets pledged as collateral security

	Group 1996	Group 1995
	£m	£m
Guarantees given to third parties	1,759	343
Mortgaged assets granted to secure future obligations to third parties who have provided security to the leasing subsidiaries	811	786
	2,570	1,129
Credit risk weighted amounts	435	318

Credit risk weighted amounts are intended to represent a measure of the credit risk associated with the above principal amounts and are calculated in accordance with the Bank of England's guidelines.

The Company has unconditionally and irrevocably guaranteed all the obligations of Abbey National Treasury Services plc, Abbey National North America Corporation, Abbey National Bank SAE, Abbey National Treasury International Ltd, Abbey National (Gibraltar) Ltd, Abbey National France SA, Abbey National Funding (Jersey) Ltd, Abbey National Treasury (IOM) Ltd and Abbey National Second Capital BV. The Company has guaranteed certain liabilities of Abbey National First Capital BV, Abbey National Homes Ltd, Solarlaser Ltd, Abbey National Beta Investments Ltd and Abbey National Life plc.

45. Memorandum items: Other contingent liabilities

	Group 1996	Group 1995
	£m	£m
Other contingent liabilities	138	197

Repayment of certain tax credits

Abbey National Treasury Services plc has received a demand from an overseas tax authority for an amount of £118m (at the balance sheet exchange rate) (1995: £140m) relating to the repayment of certain tax credits received and related charges. The subsidiary has been advised that it has strong grounds to challenge the validity of the demand and accordingly no specific provision has been made.

Pension transfers and opt-outs

The Securities and Investments Board (SIB) has issued detailed guidance for the review of business involving the transfers from occupational to personal pension schemes and the opting-out of and the non-joining of occupational pension schemes. The Group has carried out a review of the potential exposures in respect of such business following SIB guidelines, using the information currently available. In view of the uncertainty regarding this issue, provisions in respect of possible compensation to customers have been made where considered appropriate and are included in note 38, Other provisions for liabilities and charges.

Deferred consideration

In connection with the acquisition of a one third share in Travellers Exchange Corporation plc (Travelex) which took place in 1995, the Group has entered into an arrangement whereby additional consideration may become payable to the vendors. The amount of future consideration payable is dependent on the future performance of both Travelex and the foreign exchange and travellers cheque business of Abbey National plc and is payable in cash. No provision has been made for any additional consideration as at 31 December 1996, as it cannot be accurately quantified. The maximum unprovided amount is £8.5m, falling due between years 1997 and 2001 as follows: within one year, £1m; within two to five years, £7.5m.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

46. Memorandum items: Commitments

The table below shows the contract or principal amount of commitments other than those relating to derivative financial instruments (see note 47). In addition, credit risk weighted amounts are shown, calculated in accordance with the Bank of England's guidelines which are intended to represent a measure of the credit risk associated with such commitments.

	Group 1996	Group 1995
	£m	£m
Forward asset purchases and forward deposits placed	620	332
Formal standby facilities, credit lines and other commitments to lend:		
One year and over	1,526	1,073
Less than one year	764	136
	2,910	1,541
Credit risk weighted amounts	758	674

47. Derivatives

The British Bankers' Association Statement of Recommended Practice (BBA SORP) on Derivatives which was published in February 1996 applies in respect of the 1996 accounts. The recommendations have been adopted in full.

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. Derivatives are used in two distinct ways by Abbey National. The first is as hedging instruments to manage balance sheet foreign exchange rate and interest rate risk, which is classified as non-trading activity. The second is in the trading activity such as market making activity undertaken by Abbey National Financial Products (ANFP), a separately managed trading unit of the Group, and portfolio management within the ANTS trading books.

Non-trading derivatives

The major instruments used in balance sheet risk management are interest rate and cross currency swaps, which are used to hedge Group balance sheet exposures, fixed rate mortgage and consumer credit lending and savings products in relevant operations throughout the Group. Other exposures to fixed interest rates within Treasury & Offshore include those arising from the risks within the ANTS investment portfolio.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

47. Derivatives (Continued)

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

Activity	Risk	Type of Hedge
Management of the return on investment of shareholders' funds and net non-interest bearing liabilities.	Reduced profitability due to falls in interest rates.	Receive fixed interest rate swaps. Purchased interest rate floors.
Fixed-rate mortgage lending.	Sensitivity to increase in interest rates.	Pay fixed interest rate swaps. Purchased interest rate caps.
Management of other net interest income on retail activities.	Sensitivity of returns to changes in interest rates.	Interest rate swaps and caps/floors according to the type of risk identified.
Fixed-rate funding (e.g. medium-term note issuance).	Sensitivity to falls in interest rates.	Receive fixed interest rate swaps.
Fixed-rate asset investments.	Sensitivity to increases in interest rates.	Pay fixed interest rate swaps.
Investment in foreign currency assets.	Sensitivity to strengthening of sterling against other currencies.	Cross-currency swaps. Foreign currency funding.
Profits earned in foreign currencies.	Sensitivity to strengthening of sterling against other currencies.	Forward foreign exchange contracts. Purchased options.
Investment in, and issuance of, products with embedded options.	Sensitivity to changes in underlying rate and rate volatility causing option exercise.	Interest rate swaps plus caps/floors, and other matched options.
Investment in, and issuance of, bonds with put/call features.	Sensitivity to changes in rates causing option exercise.	Swaptions*.
Firm commitments (e.g. asset purchases, issues arranged).	Sensitivity to changes in rates between arranging a transaction and completion.	Hedges are arranged at the time of commitments if there is exposure to rate movements.

* A swaption is an option on a swap which gives the holder the right but not the obligation to buy or sell a swap.

Exchange-traded futures may be used as hedges in any of the above activities in lieu of interest rate swaps.

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 designed to match exactly the risks of the underlying asset or liability. Exposure to market risk on such contracts is therefore fully hedged.

Derivatives used for non-trading activities are accounted for on an accruals basis consistent with the assets, liabilities or positions being hedged.

Trading Derivatives

ANFP is the only area of Abbey National Group actively trading derivative products and is additionally responsible for implementing Group derivative hedging with the external market. ANFP's objective is to gain margin value by marketing derivatives to end-users and hedging the resulting exposures efficiently. Products offered by ANFP include interest rate

47. Derivatives (Continued)

and cross-currency swaps, caps, floors and swaptions. ANFP has established clear guidelines for staff to ensure that end-users are aware of the potential risk of entering into complex derivative transactions. ANFP also uses these products, together with exchange-traded options and futures, for hedging purposes.

A comprehensive limit structure has been established for ANFP which includes exposures to interest rates, yield curve shape, volatility and spreads. In addition to the normal limits, additional limits covering sensitivity to large changes in the underlying variables have been imposed. Substantially no foreign exchange risk is currently run within ANFP, other than that accruing through profits earned in currencies other than sterling. Direct interest rate exposure is also maintained at low levels, but exact hedges are often not available in the market and this will give rise to a combination of yield curve, volatility and spread risk within the established limits. The overall management and control policy framework at ANFP is consistent with the Group of 30 recommendations regarding derivatives.

ANTS additionally uses derivatives as part of trading activity hedging interest rate exposures created within asset backed and other bond portfolios.

Derivatives used in trading activities are stated at fair value.

Quantitative disclosures

The table below shows the contract or underlying principal amounts, credit risk weighted amounts, and replacement costs of non-trading and trading derivatives analysed by type of contract. Contract or underlying principal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The replacement cost represents the cost of replacing contracts with positive values, calculated at market rates current at the balance sheet date. The credit risk weighted amount, which is calculated according to rules specified by the Bank of England, is based on the replacement cost, but also takes into account measures of the extent of potential future exposure and the nature of the counterparty.

	Group 1996 Contract or underlying principal amount	Group 1996 Credit risk weighted amount	Group 1996 Net replacement cost	Group 1995 Contract or underlying principal amount	Group 1995 Credit risk weighted amount	Group 1995 Net replacement cost
	£m	£m	£m	£m	£m	£m
Non-trading derivatives:						
Exchange rate contracts						
Cross currency swaps	10,850	198	372	9,016	269	675
Forward foreign exchange	6,545	35	12	5,775	23	1
Options (OTC)	—	—	—	—	—	—
	<u>17,395</u>	<u>233</u>	<u>384</u>	<u>14,791</u>	<u>292</u>	<u>676</u>
Interest rate contracts						
Interest rate swaps	56,563	268	1,278	53,300	242	751
Caps, floors and swaptions	7,174	42	2	5,555	55	—
Futures (exchange traded)	2,725	—	1	3,378	—	—
Forward rate agreements	519	—	1	1,943	1	1
	<u>66,981</u>	<u>310</u>	<u>1,282</u>	<u>64,176</u>	<u>298</u>	<u>752</u>

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

47. Derivatives (Continued)

	Group 1996 Contract or underlying principal	Group 1996 Credit risk weighted amount	Group 1996 Positive fair values	Group 1996 Negative fair values	Group 1995 Contract or underlying principal	Group 1995 Credit risk weighted amount	Group 1995 Positive fair values	Group 1995 Negative fair values
	£m	£m	£m	£m	£m	£m	£m	£m
Trading derivatives:								
Exchange rate contracts								
Cross currency swaps	1,344	51	115	131	1,234	59	143	144
	<u>1,344</u>	<u>51</u>	<u>115</u>	<u>131</u>	<u>1,234</u>	<u>59</u>	<u>143</u>	<u>144</u>
Interest rate contracts								
Interest rate swaps	44,254	279	961	1,185	36,802	278	1,071	979
Forward rate agreements	7,184	1	4	3	10,277	7	29	27
Futures (exchange traded)	8,160	—	—	1	9,296	—	22	2
Caps floors and swaptions	4,998	15	44	—	4,382	11	45	—
	<u>64,596</u>	<u>295</u>	<u>1,009</u>	<u>1,189</u>	<u>60,757</u>	<u>296</u>	<u>1,167</u>	<u>1,008</u>
Equity contracts: futures	7	—	—	—	—	—	—	—
Total			<u>1,124</u>	<u>1,320</u>			<u>1,310</u>	<u>1,152</u>
Effect of netting			(865)	(865)			—	—
Translation differences on foreign exchange derivatives used for hedging purposes			350	945			(403)	(656)
Unamortised premiums			<u>91</u>	<u>8</u>			—	—
Amount included in Other assets/Other liabilities			<u>700</u>	<u>1,408</u>			<u>907</u>	<u>496</u>

Positive fair values arise where gross positive fair values exceed gross negative fair values on a contract by contract basis. Negative fair values arise where gross negative fair values exceed gross positive fair values on a contract by contract basis. The BBA SORP on Derivatives has interpreted the requirements in Financial Reporting Standard No. 5, "Reporting the Substance of Transactions" in relation to the netting of asset and liability balances in the context of derivatives. As a result of this interpretation, the totals of positive and negative fair values arising on trading derivatives as at 31 December 1996 have been netted where the Group has a legal right of offset with the relevant counterparty. This netting adjustment is shown on the "effect of netting" line in the above table. It has not been practicable, however, to restate comparative amounts because they cannot be determined without unreasonable expense.

Included in the above analyses of non-trading and trading derivatives are exchange rate contracts and interest rate contracts with underlying principal amounts of £782m (£580m) and £21,692m (£19,956m) respectively, which were undertaken by Group entities for non-trading purposes with ANFP, which in turn entered into similar contracts with external counterparties. Comparative amounts have been restated following the publication of the BBA SORP on Derivatives in February 1996. Amounts relating to contracts undertaken by Group entities for non-trading purposes with ANFP were previously not shown in the above disclosure instead of being included as non-trading items.

Substantially all of the Group's derivatives activity is contracted with financial institutions.

All exchange-traded instruments are subject to cash requirements under the standard margin arrangements applied by the individual exchanges. Such instruments are not subject to significant credit risk. Other derivative contracts are not subject to these cash requirements.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

47. Derivatives (Continued)

The following table analyses OTC and other non-exchange traded derivatives held for non-trading purposes by remaining maturity:

	Group 1996 Contract or underlying principal <u>£m</u>	Group 1996 Net replacement cost <u>£m</u>	Group 1995 Contract or underlying principal <u>£m</u>	Group 1995 Net replacement cost <u>£m</u>
Derivatives maturing:				
In not more than one year	31,555	398	29,541	360
In more than 1 year but not more than 5 years	36,452	650	33,951	644
In more than 5 years	13,644	617	12,097	424
	<u>81,651</u>	<u>1,665</u>	<u>75,589</u>	<u>1,428</u>

Non-trading Swap Activity

The tables below sets forth, by contract amount, the activity in non-trading interest rate and cross-currency swaps used for hedging purposes.

	Interest rate swaps	1996 Cross-currency swaps	Total	Interest rate swaps	1995 Cross-currency swaps	Total
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
At January 1 (third party contracts)	33,738	8,436	42,174	32,398	8,472	40,870
At January 1 (contracts with ANFP)	19,562	580	20,142	15,486	510	15,996
New contracts (1)	21,157	5,494	26,651	15,681	3,004	18,685
Matured and amortized contracts	(14,262)	(2,380)	(16,642)	(11,878)	(2,855)	(14,733)
Terminated contracts	(1,827)	(71)	(1,898)	(3,022)	(475)	(3,497)
Effect of foreign exchange rate and other movements	(2,257)	(1,411)	(3,668)	559	290	849
Net increase in contracts with ANFP	452	202	654	4,076	70	4,146
At December 31	<u>56,563</u>	<u>10,850</u>	<u>67,413</u>	<u>53,300</u>	<u>9,016</u>	<u>62,316</u>

(1) Includes £3,516 million of interest rate swaps and £268 million of cross-currency swaps acquired with N&P in 1996.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

47. Derivatives (Continued)

The Group uses interest rate swaps and cross-currency swaps predominantly for hedging fixed rate assets and liabilities effectively into floating rate. For interest rate swaps and cross-currency swaps used for these purposes, the weighted average pay fixed rates, receive fixed rates, pay variable rates and receive variable rates by maturity and contract amount at 31 December 1996 were as follows:

	Pay fixed		Receive fixed		Pay variable		Receive variable	
	Contract amount	Rate	Contract amount	Rate	Contract amount	Rate	Contract amount	Rate
	£m	%	£m	%	£m	%	£m	%
Contracts maturing: (1)								
Less than 1 year	7,438	7.09	12,959	7.44	16,486	5.89	10,994	6.13
1 to 3 years	8,876	8.11	7,107	7.12	12,003	6.24	13,523	5.87
3 to 5 years	4,404	7.88	4,148	5.60	6,244	6.51	6,466	6.09
Over 5 years	2,910	8.20	5,892	7.53	9,322	5.77	6,324	6.06
Total (2)	23,628		30,106		44,055		37,307	

- (1) For the purpose of this analysis, the maturity date has been taken to be the date when the swap contract expires.
- (2) The total pay fixed contract amount comprises £22,211m in respect of interest rate swaps and £1,417m in respect of cross-currency swaps. The total receive fixed contract amount comprises £25,980m in respect of interest rate swaps and £4,126m in respect of cross-currency swaps. The total pay variable contract amount comprises £34,350m in respect of interest rate swaps and £9,705m in respect of cross-currency swaps. The total receive variable contract amount comprises £30,583m in respect of interest rate swaps and £6,724m in respect of cross-currency swaps.

A difference arises when comparing nominal contract assets and nominal contract liabilities. Whereas with single currency swaps one would expect equal and opposite nominal balances on either side of the swap leg, this is not necessarily the case with cross-currency swaps. At contract date sterling equivalent nominal amounts should be equal and opposite, however, subsequent exchange rate movements will result in divergence in the nominal amounts. This exchange rate divergence explains the difference between nominal contract asset balances and nominal contract liability balances.

The weighted average interest rates presented in the tables above reflect interest rates in a range of currencies. These rates should not be analysed in isolation from the rates on the underlying instruments.

47. Derivatives (Continued)

The contract amount of each type of end-user contract (excluding cross-currency swaps which are included in the swaps detailed above) at 31 December 1996 are set forth by currency in the table below. All hedging foreign exchange contracts mature during 1997.

	Forward Foreign Exchange	Forward Rate Agreements	Options, Caps and Floors (OTC)(1)(2)	Futures (Exchange - Traded)
	£m	£m	£m	£m
Sterling	—	160	2,286	879
U.S. dollars	4,949	206	2,476	1,595
European currency units	—	63	—	—
Swiss francs	798	—	—	—
Canadian dollars	102	—	—	177
Deutsche marks	215	23	—	—
French francs	170	31	—	74
Spanish pesetas	10	36	—	—
Netherlands guilders	77	—	—	—
Italian lire	190	—	2,412	—
Japanese yen	23	—	—	—
Austrian schilling	11	—	—	—
Total	<u>6,545</u>	<u>519</u>	<u>7,174</u>	<u>2,725</u>

(1) All OTC options, caps and floors are interest rate related instruments.

(2) Included in Options, Caps and Floors are sterling-denominated caps sold with contract amounts totalling £20m.

The impact on the income statement attributable to end-user derivative activities for the year ended 31 December 1996 was an £80m decrease in interest receivable and a £14m decrease in interest payable. However, these figures should not be analysed in isolation since there are compensating movements arising from the underlying assets, liabilities and positions against which the hedges were placed.

For the year ended 31 December, 1996, ANFP contributed £9 million to the dealing profits of the Group, and the average net mark-to-market profit amounted to £14 million. For the year ended 31 December 1996, the average net mark to market loss of £62 million on the derivatives used in portfolio management within the ANTS trading book was offset by a corresponding average net mark-to-market gain on the underlying trading securities.

Gains and losses arising from the hedging of investment transactions are released to the profit and loss account over the life of the asset, liability or position against which the hedge is held. Gains and losses arising from the hedging of assets which are not held for the purpose of investment are taken directly to the profit and loss account. Where a transaction originally entered into as a hedge no longer represents a hedge, its value is restated and any change in value is taken to the profit and loss account. Gains and losses on instruments purchased or sold for trading and market making purposes are taken directly to the profit and loss account. Any such transactions outstanding at the balance sheet date are stated at market value.

The following table sets forth the deferred gains and losses relating to terminated hedging contracts as at 31 December 1996, being released to the profit and loss account within one year and after one year.

	1996 Deferred gains	1996 Deferred losses	1995 Deferred gains	1995 Deferred losses
	£m	£m	£m	£m
Being released within 1 year	5	9	5	11
Being released after 1 year	1	10	1	27
Total	<u>6</u>	<u>19</u>	<u>6</u>	<u>38</u>

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

47. Derivatives (Continued)

Deferred cap premium expense amounted to £59 million as at 31 December 1996 (1995: £70 million). Of this balance, £10 million will be released to the profit and loss account within one year (1995: £8 million), and £49 million will be released to the profit and loss account after one year (1995: £62 million).

Risk management of derivatives

As described under "Risk Management" included elsewhere in this Document, Abbey National has a formal structure for managing risk, limits, reporting lines, mandates and other control procedures. This structure is reviewed regularly by the Asset and Liability Committee ("ALCO"), which is charged with the responsibility for monitoring and controlling the level of structural balance sheet risk in the Group. The minutes of Alco are available to the Board.

In order to manage the market risks arising within Abbey National plc and its subsidiaries, authorised personnel within each subsidiary are able to use specified derivative instruments within mandated limits. The Group Credit Committee regularly monitors and reviews credit exposures arising in subsidiary companies, and approves all Group credit policies.

Market risk management within trading portfolios

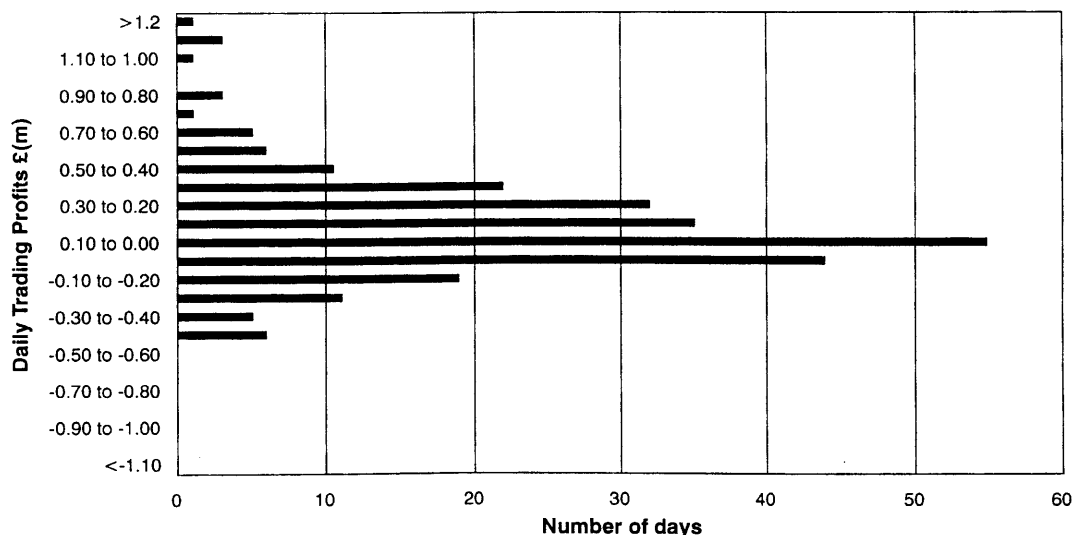
Trading portfolios are held within ANTS and ANFP. The amount of market risk is controlled through limits on positions which are expressed as the maximum likely loss with a given 95% confidence interval in a one day holding period. These limits are set for each risk factor contained within the portfolio, including inter-alia the absolute levels of interest rates, spreads between interest rate swap rates and government bond yields, the relationship between interest rates for different maturities, the variability of corporate and asset-backed bond spreads and government bond spreads.

The estimated Value at risk ("VAR") thus calculated makes no assumptions about correlation between risk factors except that between the absolute levels of interest rates in different currencies, but takes account of diversification effects. At 31 December 1996 the limit applied to the VAR in the trading portfolios was £19.7m. During the year, the average exposure was £5.5m and maximum exposure was £8.0m. The VAR as at 31 December 1996 was £7.2m.

The effects of instruments whose value does not change linearly with changes in interest rates is fully incorporated into the VAR measures. VAR controls are supplemented by stress testing the portfolios to large instantaneous shocks in market rates and volatilities. The volatilities and correlations applied to the portfolios are revised periodically, and are set using two years of data (where this is available). All the data is equally weighted.

The distribution of daily trading profits on the trading portfolios had a mean of £0.1m, a standard deviation of £0.3m, and the frequency distribution of daily trading profits is shown below:

Frequency distribution of daily trading profit on trading portfolios



NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

47. Derivatives (Continued)

Market risk management within non-trading portfolios

Similar VAR controls are applied to interest rate risk occurring in the non-trading portfolios. As these portfolios are designed to earn interest rate margins, the risk factors included are those which affect the margin of the portfolio, and not necessarily all factors affecting portfolio fair value. Factors which are included are sensitivity to the absolute level of interest rates and distortions in the yield curves. VAR measures are applied using the same one day holding period and based on a 95% confidence interval.

48. Consolidated cash flow statement

a) Reconciliation of profit before tax to net cash inflow from operating activities

	<u>1996</u>	<u>1995</u>	<u>1994</u>
	£m	£m	£m
Profit on ordinary activities before tax	1,167	1,026	932
Decrease (increase) in interest receivable and prepaid expenses	60	(117)	(577)
Decrease in interest payable and accrued expenses	(687)	(125)	930
Provisions for bad and doubtful debts	127	72	74
Provisions for contingent liabilities and commitments	4	7	—
Net advances written off	(155)	(128)	(166)
Increase in the value of long term assurance business	(97)	(88)	(98)
Depreciation	93	87	84
Profit on sale of tangible fixed assets and investments	(3)	(10)	(17)
Loss on disposal of subsidiary undertakings	—	7	—
Effect of other deferrals and accruals of cash flows from operating activities	<u>72</u>	<u>68</u>	<u>22</u>
Net cash inflow from trading activities	581	799	1,184
Net decrease (increase) in loans and advances	292	(2,931)	(28)
Net increase in investment in finance leases	(1,466)	(566)	(25)
Net increase in bills and securities	(3,716)	(320)	(655)
Net (decrease) increase in deposits and customer accounts	(3,195)	4,028	2,461
Net increase in debt securities in issue	6,920	2,005	2,765
Net increase (decrease) in other liabilities less assets	887	(338)	158
Exchange movements	<u>2,936</u>	<u>(490)</u>	<u>483</u>
Net cash inflow from operating activities	<u>3,239</u>	<u>2,187</u>	<u>6,343</u>

All cash flows from derivatives are included in profit on ordinary activities before tax, except where gains and losses have been deferred. Such deferred gains and losses are included within net increase (decrease) in other liabilities less other assets.

Exchange movements represent exchange movements on cash equivalent balances and on investing and financing activities. The movements are not indicative of the Group's exposure to foreign exchange risk on these items, because foreign currency positions in such balances are substantially hedged by other on-balance sheet and off-balance sheet foreign currency amounts. All other exchange movements, including movements on hedges, are included in the relevant captions in the above reconciliation.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

48. Consolidated cash flow statement (Continued)

b) Analysis of cash and cash equivalents

Included in the balance sheet are the following amounts of cash and cash equivalents:

	<u>1996</u>	<u>1995</u>	<u>1994</u>
	£m	£m	£m
Cash and balances with central banks	228	145	166
Treasury and other eligible bills	3	120	10
Loans and advances to banks	1,715	1,472	1,789
Debt securities	<u>1,222</u>	<u>1,136</u>	<u>939</u>
	<u>3,168</u>	<u>2,873</u>	<u>2,904</u>

The Group is required to maintain balances with the Bank of England which at 31 December 1996 amounted to £221m (1995: £182m, 1994: £175m). These are shown in loans and advances to banks, and are not included in cash equivalents.

c) Analysis of changes in cash and cash equivalents during the year

	<u>1996</u>	<u>1995</u>	<u>1994</u>
	£m	£m	£m
At 1 January	2,873	2,904	2,916
Net cash inflow (outflow) before adjustment for the effect of foreign exchange rate changes	907	(91)	51
Effect of foreign exchange rate changes	<u>(612)</u>	<u>60</u>	<u>(63)</u>
At 31 December	<u>3,168</u>	<u>2,873</u>	<u>2,904</u>

d) Analysis of changes in financing during the year

	<u>1996</u> Share capital inc. Share premium	<u>1996</u> Subordinated liabilities	<u>1995</u> Share capital inc. Share premium	<u>1995</u> Subordinated liabilities	<u>1994</u> Share capital inc. Share premium	<u>1994</u> Subordinated liabilities
	£m	£m	£m	£m	£m	£m
At 1 January	1,088	2,127	971	1,520	967	868
Net cash inflow from financing	236	290	115	587	4	659
Shares issued for a non-cash consideration	462	—	2	—	—	—
Effect of foreign exchange adjustments	(4)	(157)	—	20	—	(6)
Acquisitions of subsidiary undertakings/purchase of business	<u>—</u>	<u>114</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(1)</u>
At 31 December	<u>1,782</u>	<u>2,374</u>	<u>1,088</u>	<u>2,127</u>	<u>971</u>	<u>1,520</u>

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

48. Consolidated cash flow statement (Continued)

g) Sale of subsidiary undertakings

	1996	1995	1994
	£m	£m	£m
Net assets disposed of:			
Fixed assets	—	2	—
Debtors	—	2	—
Cash at bank and in hand	—	1	—
Creditors	—	(1)	—
	—	4	—
Provisions made for future liabilities retained	—	4	—
Goodwill recognised on disposal	—	1	—
Loss on disposal	—	(7)	—
Consideration received	—	2	—
Satisfied by:			
Cash	—	2	—

h) Analysis of the net inflow of cash and cash equivalents in respect of the sale of subsidiary undertakings

	1996	1995	1994
	£m	£m	£m
Cash received as consideration	—	2	—
Cash and cash equivalents disposed of	—	(1)	—
Net inflow of cash and cash equivalents in respect of sale of subsidiary undertakings	—	1	—

49. Retirement benefits

The Abbey National Amalgamated Pension Fund is the principal pension scheme within the Group, covering 60% of the Group's employees, and is a funded defined benefits scheme.

The latest formal actuarial valuation carried out by an independent professionally qualified actuary was made as at 31 March 1996, at which date the market value of the scheme assets was £774m.

The valuation was prepared by using the projected unit funding method. As a result of this valuation, and subsequent assessment as at 31 December 1996, a funding level of 108% is disclosed. The regular employer's contribution rate in respect of benefits accruing after the valuation date is 21.9% of pensionable salaries.

The main long term financial assumptions used in the valuation were:

	<u>% Nominal per annum</u>
Investment return	9.0
Equity dividend growth	4.5
Pension increases	4.25
General salary increases	6.5
General price inflation	4.5

The pension cost of £32m (1995: £28m, 1994: £34m) reflects the regular contribution rate less an amount in respect of the surplus being recognised over the expected remaining service lives of the members of the fund in accordance with SSAP 24 on accounting for pension costs. Contributions of £44m (1995: £41m, 1994: £39m) were made to the fund in 1996 and a provision of £32m (1995: £44m, 1994: £57m) has been included in the balance sheet (see note 38). Formal actuarial valuations of the assets and liabilities of the scheme to determine its financial position are carried out on a triennial basis and, in addition, there is an annual review by the appointed actuary. The results of these reviews are included in the accounts. The next formal valuation will be made not later than 31 March 1999.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

49. Retirement benefits (Continued)

The National and Provincial Building Society Pension Fund is a funded defined benefits scheme which covers 13% of the Group's employees, and includes employees who joined the Group with the transfer of the business of N&P. The latest actuarial valuation was made as at 31 March 1994 using the projected unit funding method and disclosed a funding level of 117%. A provision of £1m was transferred in on 5 August 1996. A pension cost of £3m has been charged to the profit and loss account in respect of the five months to 31 December 1996, and contributions to the fund for the period were £5m. Included in other assets as at 5 August 1996 was an amount of £29m in respect of the pension scheme surplus, in accordance with FRS7, "Fair Values in Acquisition Accounting", based on an actuarial assessment of the scheme at that date. This balance is being amortised over the average remaining service lives of employees in the scheme, and £1m was charged to the profit and loss account over the five months to 31 December 1996.

The First National Finance Corporation Pension and Life Assurance Plan covers the employees of First National Finance Corporation plc amounting to 4% of the Group's employees and is also a funded defined benefits scheme. The latest actuarial valuation was made as at 1 May 1996 and disclosed a funding level of 122.5%.

The Scottish Mutual Assurance plc Staff Pension Scheme covers the employees of the Life Assurance Division amounting to 6% of the Group's employees and is also a funded defined benefits scheme. The latest actuarial valuation was made as at 31 December 1994 and disclosed a funding level of 122%. It is estimated that the surplus will be removed by 30 June 2001.

50. Related party disclosures

a) Transactions with directors, executive officers and their close family members

Directors, executive officers and members of their close families have undertaken the following transactions with Abbey National in the course of normal banking business. These transactions were made on the same terms and conditions as applicable to other employees within the Group, or on normal commercial terms.

	<u>No. of directors and executive officers</u>	<u>Amounts in respect of directors, executive officers (1) and their close family members</u>
		£000
Secured loans		
Amounts advanced during the year	1	8
Capital amounts repaid during year	6	217
Balances outstanding as at 31 December 1996	11	814
Unsecured loans and overdrafts		
Net amounts advanced during the year	8	3
Balances outstanding as at 31 December 1996	6	14
Deposit and investment accounts		
Amounts deposited in the year	14	497
Amounts withdrawn in the year	10	245
Balances outstanding as at 31 December 1996	16	990
Bank and instant access accounts		
Net amounts withdrawn during the year	16	56
Balances outstanding as at 31 December 1996	16	231
Life assurance policies and investments		
Premiums paid/amounts invested during the year	4	233
Total sum insured/value of investment	4	426

(1) Executive officers are defined as those officers who report directly to the Group Chief Executive.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

50. Related party disclosures (Continued)

Secured and unsecured loans are made by Abbey National to directors, executive officers and their close family members on the same terms and conditions as applicable to other employees within the Group.

Amounts deposited by directors, executive officers and their close family members with Abbey National earn interest at the same rates as those offered to the market.

Directors, executive officers and their close family members have entered into life assurance policies and investments with life assurance subsidiaries of the Group, on normal market terms and conditions, or on the same terms and conditions as applicable to other employees within the Group.

b) Transactions with associated undertakings

Abbey National plc acts as agent for Commercial Union Underwriting Limited (CUUL), under which it passes insurance premiums to CUUL and earns an agent's margin. The agency margin amounted to £108m for the year ended 31 December 1996.

Balances outstanding between the Group and associated companies as at 31 December 1996 are detailed in Note 18 and Note 31.

c) Transactions with long term assurance funds

The long term assurance funds are related parties for the purposes of this disclosure because the assets and liabilities of the long term assurance funds are included in the balance sheet.

During the year there were transfers of £41m from the shareholders' funds to the long term assurance funds to support the growth in life assurance business. Additionally, the long term assurance funds transferred a surplus of £36m to shareholders' funds. Further details are provided in note 22.

Included in fees and commissions receivable in the year is an amount of £19m receivable from the long term assurance fund of Abbey National Life in respect of life assurance products sold through the retail branch network.

During the year Abbey National Financial Investment Services incurred costs amounting to £72m on behalf of the long term assurance funds. All such costs were recharged to the long term assurance funds.

As at 31 December 1996, £188m was due to the long term assurance funds and £89m was due from the long term assurance funds by Group entities. Of these respective amounts £184m relates to amounts deposited by the long term assurance funds with Abbey National plc or Abbey National Treasury Services plc, and £47m relates to amounts owed by the long term assurance funds to Abbey National plc. The remaining amounts represent balances between the long term assurance funds and the shareholders' funds of the life assurance businesses within the Group.

Net interest paid to long term assurance funds during the year was £19m.

Included within Assets of long term assurance funds and Liabilities of long term assurance funds are amounts owing between the long term assurance funds of £11m.

d) Transactions with N&P

On 5 August 1996, the business of N&P was transferred to Abbey National, as detailed in note 25.

As at 4 August 1996, the Group had £150m on short term deposit with N&P, and investments totalling £192m in debt securities issued by N&P, while N&P had £722m on short term deposit with the Group.

51. Post balance sheet events

On 31 January 1997, the Group acquired shares in Dah Sing Financial Holdings Limited for HK\$381m, representing a 5% holding in the company.

On 21 February 1997, the Group signed an agreement with Hambros Bank and Dah Sing Financial Holdings Limited to form a joint venture international private banking operation, to be based in Hong Kong. A newly formed company, DAH Holdings Limited, will be established, in which the Group will own 24.5% of the equity capital.

52. Differences between U.K. generally accepted accounting principles ("U.K. GAAP") and U.S. generally accepted accounting principles ("U.S. GAAP")

The accounts presented in this report have been prepared in accordance with U.K. GAAP. Such principles vary in significant respects from U.S. GAAP. The significant differences applicable to Abbey National's accounts are summarised below.

U.K. GAAP

Goodwill

Goodwill arising on consolidation as a result of the acquisition of subsidiary and associated undertakings and goodwill arising on the purchase of businesses are taken direct to reserves in the year in which they occur. On disposal of a business, the goodwill previously taken to reserves is recognised in the profit and loss account balanced by an equal credit to reserves. Where the directors believe that the purchased goodwill in continuing businesses has suffered a permanent diminution in value, a similar recognition in the profit and loss account and credit to reserves is made.

Pension costs

Where pensions are provided by means of a funded defined benefits scheme, annual contributions are based on actuarial advice. The expected cost of providing pensions is recognized on a systematic basis over the expected average remaining service lives of members of the scheme. Variations from regular cost are spread over the average remaining service lives of current employees, on a straight line basis.

Leasing

Income from finance leases, including benefits from declining tax rates, is credited to the profit and loss account using the actuarial after tax method to give a constant periodic rate of return on the net cash investment.

Loan origination fees

Where "introducers" are the primary form of distribution for lending business, related commissions payable are charged to the profit and loss account over the anticipated life of the loans.

Other loan origination fees are recognized in income in the period in which they are receivable.

U.S. GAAP

Goodwill

Goodwill is capitalised and amortised in the consolidated statement of income over the period in which the benefits are estimated to accrue. In Abbey National's case, a period of 20 years has been used. Goodwill is written off when judged to be irrecoverable.

Core deposit intangible

The element of goodwill relating to retail depositor relationships purchased on the acquisition of a savings entity is capitalised separately and amortised in the consolidated statement of income over the estimated average life of the retail customer relationships.

The net assets of businesses acquired have been restated for all material differences between U.K. and U.S. GAAP that existed on acquisition. This has resulted in an adjustment of £15 million to the fair value of net assets transferred with the business of N&P in 1996, and a corresponding adjustment to goodwill, for U.S. GAAP purposes.

Pension costs

Under Statement of Financial Accounting Standards (SFAS) No. 87, the same basic actuarial method is used as under U.K. GAAP, but certain assumptions differ, assets are assessed at fair value and liabilities are assessed at current settlement rates. Certain variations from regular cost are allocated in equal amounts over the average remaining services lives of current employees.

Leasing

Application of SFAS No. 13 gives rise to a level rate of return on the investment in the lease, but without taking into account tax payments and receipts. This results in income being recognised in different periods than under U.K. GAAP.

Loan origination fees

Fee income from originating a loan is spread over the life of the loan in accordance with SFAS No. 91.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

52. Differences between U.K. GAAP and U.S. GAAP (Continued)

U.K. GAAP

Shareholders' interest in long-term assurance policies

The Shareholders' interest in the long-term assurance fund is valued at the net present value of the surplus expected to emerge in the future from business currently in force, together with the Group's interest in the surplus retained within the long-term assurances funds.

In determining this value, assumptions relating to future mortality, persistency and levels of expenses are based on experience of the business concerned. Surplus expected to emerge in the future is discounted at a risk-adjusted discount rate after provision has been made for taxation. Changes in the value, which is determined on a post-tax basis, are included in the profit and loss account grossed up at the standard rate of corporation tax. The post-tax increase in the value is treated as non-distributable until it emerges as part of the surplus arising during the year.

Stock-Based Compensation

Equity based instruments, such as share options, issued under compensation plans are accounted for within the called up share capital and share premium accounts on the balance sheet when exercised.

U.S. GAAP

Shareholders' interest in long-term assurance policies

The net present value of the profits inherent in the long term assurance policies is not recognised by Abbey National under U.S. GAAP.

For contracts valued in accordance with SFAS No. 60 (which covers conventional products such as endowment and term assurance policies) premiums are recognised as revenue when due from the policyholders. Costs of claims are recognised when insured events occur. A liability for future policy benefits to be paid to or on behalf of policyholders is established based upon the present value of future benefits less the present value of future net premiums. Acquisition costs are charged to the profit and loss account in proportion to premium revenue recognised.

For contracts valued under SFAS No. 97 (which covers unit-linked products) premiums and front-end load type charges receivable from customers, and acquisition costs relating to the acquisition of new contracts are capitalised and amortised in proportion to the present value of estimated gross profits. Estimated gross profits are projected on best estimate assumptions with no provisions for adverse deviation. The liability for policy benefits is set equal to the nominal policyholders' account balance. Cost of claims are recognised when insured events occur.

In previous years, the net present value of the surplus expected to emerge in future from business currently in force was excluded. Following an exercise to refine the application of US GAAP, these comparative adjustments have been restated.

Stock-Based Compensation

SFAS No. 123, "Accounting for Stock-Based Compensation," encourages companies to account for equity based instruments issued under compensation plans at their fair value, measured at the date at which the instruments are granted. However, the statement also permits the intrinsic value-based method of accounting, under which the compensation cost, being the excess, if any, of the quoted market price of the stock at grant date over the exercise price, must be recognised in the profit and loss account over the vesting period. On the balance sheet this is offset by a corresponding adjustment to share

52. Differences between U.K. GAAP and U.S. GAAP (Continued)

U.K. GAAP

Dividend payable

Dividends declared after the period end are recorded in the period to which they relate.

Investments in securities

Securities held for investment purposes are stated at cost adjusted for any amortisation of premium or discount. All securities not held for investment purposes are stated at market value and profits and losses arising from this revaluation are taken to the profit and loss account.

Deferred tax

Deferred taxation is accounted for only where it is probable that a liability or asset will arise. Provision is calculated at rates expected to be applicable when the liability or asset crystallises.

No deferred tax asset is created in respect of general allowances for lending losses which are not deductible in arriving at U.K. taxable profits.

Provisions against lending losses

Specific provisions, determined using statistical techniques, are made against loans and advances when, as a result of regular appraisals of the assets, it is considered that recovery is doubtful. Statistical techniques are used for large groups of small balance homogenous loans. General provisions are made against loans and advances to cover bad and doubtful debts which have not been separately identified but are known from experience to be present in any portfolio of loans and advances.

U.S. GAAP

premium. Abbey National has chosen to continue to adopt the intrinsic value-based method for the purposes of the reconciliation between U.K. and U.S. GAAP.

Dividend payable

Dividends are recorded in the period in which they are declared.

Investments in securities

Securities are classified as trading securities, available for sale securities, and held to maturity securities in accordance with SFAS No. 115. Held to maturity securities are accounted for in the same way as securities held for investment purposes under U.K. GAAP. Trading securities are accounted for in the same way as securities not held for investment purposes under U.K. GAAP. Available for sale securities are reported at market value, with unrealised gains and losses excluded from earnings, but reported in a separate component of shareholders' funds.

Deferred tax

Provision for deferred tax under the liability method is required in full for all timing differences, including general allowances for loan losses and tax loss carry forwards.

Deferred tax assets are recognised subject to any adjustment for valuation allowances.

Provisions against lending losses

The approach described under UK GAAP also applies under US GAAP for almost all of the Group's loan balances. However, for loans within the scope of SFAS No. 114, allowances for lending losses are determined based on the present value of expected future cashflows discounted at the loan's effective rate, or as a practical expedient, on the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Leases and large groups of smaller balance homogenous loans that are collectively evaluated for impairment, such as residential mortgage loans and consumer instalment loans, are outside the scope of the SFAS No. 114. Abbey National has reviewed SFAS No. 114 and concludes that it has no material effect on the reconciliation of net income and shareholders' funds between U.K. and U.S. GAAP.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

52. Differences between U.K. GAAP and U.S. GAAP (Continued)

Future Developments

SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities," requires that entities recognise the financial and servicing assets they control and liabilities they have incurred, and derecognise assets when control has been surrendered, and liabilities when extinguished. SFAS No. 125 is required to be adopted for transactions entered into after 31 December, 1996. Abbey National is currently reviewing this statement to determine what effect it may have on the reconciliation of net income and shareholders' funds between UK and US GAAP.

Abbey National has reviewed SFAS No. 128, "Earnings per share" and considers that it is unlikely to have a material effect on the level of disclosure provided.

In 1996, the U.K. Accounting Standards Board revised Financial Reporting Standard 1 ("FRS 1"), "Cash Flow Statements." Under FRS 1 (revised) cash equivalents will no longer be included within cash flows. Changes will also be made to the presentation of cash flows which will be shown under the headings of operating activities, returns on investments and servicing of finance, taxation, capital expenditure and financial investment, acquisitions and disposals, equity dividends paid, management of liquid resources and financing. FRS 1 is required to be adopted in respect of accounting periods ending on or after 23 March 1997. Abbey National is currently reviewing the standard to determine the effect it may have on the level of additional disclosure provided in order to reconcile to U.S. GAAP.

Differences between U.K. and U.S. accounting principles

The following table summarises the significant adjustments to consolidated net income or loss and shareholders' Fund which would result from the application of U.S. GAAP instead of U.K. GAAP.

	1996	1995	1994
	£m	£m	£m
Consolidated Net Income of Abbey National plc (U.K. GAAP)	754	681	610
Goodwill	(29)	(15)	(6)
Core deposit intangible	(19)	—	—
Pensions cost	(6)	(13)	(14)
Leasing	(12)	(16)	(7)
Loan origination fees	(17)	2	—
Shareholders' interest in long-term insurance business	(27)	(1)	(95)
Stock-based compensation costs	(8)	—	—
Deferred tax effect of the above U.S./U.K. GAAP adjustments	23	9	39
Deferred tax	3	1	—
Consolidated Net Income of Abbey National plc (U.S. GAAP)	<u>662</u>	<u>648</u>	<u>527</u>
per 10 pence ordinary share	<u>49.6p</u>	<u>49.2p</u>	<u>40.0p</u>

52. Differences between U.K. GAAP and U.S. GAAP (Continued)

	<u>1996</u>	<u>1995</u>	<u>1994</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Shareholders' funds including non-equity interests (U.K. GAAP)	4,393	3,941	3,704
Goodwill	683	403	138
Core deposit intangible	298	—	—
Net assets of businesses acquired	(15)	—	—
Pensions cost	(38)	(32)	(19)
Leasing	(68)	(56)	(40)
Loan origination fees	(17)	—	(2)
Shareholders' interest in long-term insurance business	(105)	(101)	(61)
Stock-based compensation costs	(8)	—	—
Share premium	8	—	—
Dividend payable	245	191	158
Unrealised surplus on securities available for sale	783	706	24
Deferred tax effect of the above U.S./U.K. GAAP adjustments	(195)	(172)	39
Deferred tax	29	22	14
Shareholders' funds including non-equity interests (U.S. GAAP)	<u>5,993</u>	<u>4,902</u>	<u>3,955</u>

Securities and Investments

- (a) Under U.S. GAAP, SFAS No. 115 requires certain disclosures relating to securities and investments as at 31 December 1996. The following table provides an analysis of the relevant balance sheet total under both U.S. and U.K. GAAP.

	<u>As at 31 December</u> <u>1996</u>	
	<u>UK GAAP</u>	<u>US GAAP</u>
	<u>£m</u>	<u>£m</u>
Trading securities	12,925	12,925
Available for sale securities	25,873	26,632
Securities held to maturity	<u>1,000</u>	<u>1,000</u>
	39,798	40,557
Less general provision against available for sale securities	(24)	—
	<u>39,774</u>	<u>40,557</u>

Further disclosures required by SFAS No. 115 are as follows:

- (b) Available for sale securities

	<u>Amortized</u> <u>cost</u>	<u>Gross</u> <u>unrealised</u> <u>gains</u>	<u>Gross</u> <u>unrealised</u> <u>losses</u>	<u>Fair</u> <u>value</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Equity securities	36	23	—	59
Debt securities issued or backed by US Treasury and other US government corporations and agencies	4,006	59	(10)	4,055
Debt securities issued or backed by foreign governments	7,771	494	(4)	8,261
Corporate debt securities	6,819	205	(15)	7,009
Mortgage backed securities	4,582	16	(9)	4,589
Other debt securities	<u>2,659</u>	<u>9</u>	<u>(9)</u>	<u>2,659</u>
	25,873	806	(47)	26,632
General provision against debt securities	(24)			—
	<u>25,849</u>			<u>26,632</u>

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

52. Differences between U.K. GAAP and U.S. GAAP (Continued)

The majority of Corporate debt securities are guaranteed by banks or other financial institutions.

<u>Maturity analysis</u>	Not more than 1 year	In more than 1 year but not more than 5 years	In more than 5 years but not more than 10 years	In more than 10 years	Total
	£m	£m	£m	£m	£m
Book value before general provision	2,166	10,786	3,748	9,173	25,873
Fair value before general provision	2,204	11,212	3,944	9,272	26,632

(c) Held to maturity securities

	Amortised cost	Gross unrealised gains	Gross unrealised losses	Fair value
	£m	£m	£m	£m
Corporate debt securities	1,000	—	—	1,000

<u>Maturity analysis</u>	Not more than 1 year	In more than 1 year but not more than 5 years	In more than 5 years but not more than 10 years	In more than 10 years	Total
	£m	£m	£m	£m	£m
Book value	100	900	—	—	1,000
Fair value	100	900	—	—	1,000

(d) Sales of available for sale securities during the year to 31 December 1996.

	£m
Gross proceeds from sales	12,325
Gross realised losses on sales	124
Gross realised gains on sales	(130)
Amortised cost of sales	<u>12,319</u>

The cost of available for sale securities is determined by using the weighted average cost basis, with premium/discount arising on purchase being amortised to profit and loss over the expected life of the security.

(e) Redemptions and purchases of held to maturity securities during the year to 31 December 1996

	£m
Amortised cost b/f	1,021
Acquisitions — cost	200
Maturities	(200)
Exchange adjustments	(21)
Amortised cost c/f	<u>1,000</u>
	£m
Value on redemption	200
Gross realised losses on redemption	—
Gross realised gains on redemption	—
Amortised cost of securities redeemed	<u>200</u>

(f) Unrealised gains and losses on transfers from available for sale securities to trading securities during the year to 31 December 1996 were as follows:

	£m
Gross unrealised gains	10
Gross unrealised losses	(1)
	<u>9</u>

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

52. Differences between U.K. GAAP and U.S. GAAP (Continued)

- (g) The net change in unrealised holding gains (losses) on trading securities, before the effect of associated hedges, included in income for the year to 31 December 1996 is a gain of £186m.

Pension Costs

For the reconciliation above, the Group adopts the provisions of SFAS No 87, "Employers Accounting for Pensions", in respect of its principal pension plans, The Abbey National Amalgamated Pension Fund, the Scottish Mutual Assurance plc Staff Pension Scheme, the First National Finance Corporation Pension and Life Assurance Plan and the N&P Pension Fund. Estimated pension costs computed under SFAS No 87 are as follows:

	Year ended 31 December		
	1996	1995	1994
	£m	£m	£m
Service cost	65	52	54
Interest cost	66	55	43
Actual (return)/loss on plan assets	(142)	(109)	(36)
Net amortisation and deferral	61	49	(7)
Pension costs	50	47	54

The estimated funded status of the above pension plans was as follows:

	Year ended 31 December	
	1996	1995
	£m	£m
Projected benefit obligation	1,115	751
Plan assets at fair value	1,204	815
Plan assets in excess (less than) projected benefit obligation	89	64
Amounts available to be applied as an increase (reduction) to future pension cost:		
Balance of initial transition amount	(56)	(58)
Net unrecognised losses	(125)	(100)
Unrecognised prior service cost	14	16
(Accrued) prepaid pension cost	(78)	(78)

The estimated accumulated benefit obligation at 30 September 1996 amounted to £906m (30 September 1995: £632m), of which £797m was vested (30 September 1995: £566m). The actuarial value placed upon the vested benefit obligation (VBO) is lower than that placed upon the accumulated benefit obligation primarily because the statistical assumptions used in calculating the projected and accumulated benefit obligations made provision for members to retire prior to the age from which vested benefits are payable, in view of the terms on which such retirement may, with the consent of the relevant Group company, take place. It is not appropriate to reflect such an assumption in the calculation of the VBO.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

52. Differences between U.K. GAAP and U.S. GAAP (Continued)

Under SFAS No. 87, the excess of plan assets over the projected benefit obligation at the transition date would be recognised as a reduction to pension expense on a prospective basis over approximately 14 years. The average of the financial assumptions used to calculate the projected benefit obligations for the principal pension plans listed above, at 30 September 1996 and 1995 were as follows:

	Year ended 31 December	
	1996	1995
	%	%
	pa	pa
Discount rate	8.0	8.5
Rate of pay escalation	6.0	6.0
Rate of pension increase	4.0	4.0
Rate of return on assets	8.5	8.5

The assets of the schemes are invested primarily in equities and fixed interest securities.

The schemes' retirement benefits are generally based on the final year's pensionable salary and the number of years pensionable service with the Group at retirement.

The £50m U.S. GAAP pension cost (1995: £47m, 1994: £53m) compares with £44m (1995: £34m, 1994: £40m) under U.K. GAAP. The difference, net of U.K. corporation tax at 33% results in an additional charge to net income of £4m (1995: £9m charge, 1994: £9m charge) under U.S. GAAP.

Abbey National plc operates other pension schemes within the Group. These schemes are small and the difference in pension costs under U.K. and U.S. accounting principles is not material.

Stock-based compensation costs

Abbey National grants share options to executive officers and employees under the Executive Share option scheme, Sharesave schemes and the All Employee Share option scheme.

Options granted under the Executive Share option scheme are generally exercisable between the third and tenth anniversaries of the grant date, provided that certain performance criteria are met. See "Management — Directors remuneration" elsewhere in this document for a description of this scheme.

Under the Sharesave scheme, eligible employees can elect to exercise their options either five years or seven years after the grant date. See Note 40 to the Consolidated Financial Statements for a description of the options granted under this scheme.

The number of options authorised to be granted is currently limited to 10% of the total number of shares issued since Conversion.

Proforma net income and Earnings Per Share Ratio

Abbey National has adopted the intrinsic value based method to measure compensation cost, for the purposes of the reconciliation of net income between U.K. and U.S. GAAP. The impact of this method on prior years' income was not material. The 1996 adjustment includes the cumulative prior year effect.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

52. Differences between U.K. GAAP and U.S. GAAP (Continued)

If the compensation cost for the two plans had been determined based on the fair value at the grant dates consistent with the method encouraged by SFAS 123, net income and earnings per share would have been as shown on a pro forma basis below:

		1996 £m	1995 £m
Net income under U.S. GAAP	As reported	662	648
	Proforma	661	648
Earnings per share under U.S. GAAP	As reported	49.6p	49.2p
	Proforma	49.5p	49.2p

The fair value of each option has been estimated as at the grant date using the Black-Scholes option pricing model using the following assumptions for 1996 and 1995.

Risk free interest rate	6.4%-8.0%
Dividend growth, based solely upon average growth since 1989	15.0%
Volatility of underlying shares based upon historical volatility over 5 years	23.9%-24.7%
Expected lives of options granted under:	
Employee Sharesave and share option scheme	5 and 7 years*
Executive Share option scheme	6 years
Employee share participation scheme	5 years

* For five and seven year schemes respectively.

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

	Executive Share Option scheme (1)		Employee Sharesave scheme		Employee share participation scheme	
	Number of options granted	Weighted average Exercise Price (2)	Number of options granted	Weighted average Exercise Price (2)	Number of options granted	Weighted average Exercise Price
Options outstanding at the beginning of the year	3,616,721	5.36	20,243,732	2.93	—	—
Options granted during the year	1,696,139	5.69	3,116,296	4.66	3,326,100	5.90
Options exercised during the year	(179,531)	4.01	(3,059,683)	2.31	—	—
Options forfeited during the year	(80,516)	9.16	(1,458,652)	3.51	—	—
Options expired during the year	(74,635)	7.55	—	—	—	—
Options outstanding at the end of the year	4,978,178	5.43	18,841,693	3.27	3,326,100	5.90
Options exercisable at the end of the year	1,570,689	5.86	113,038	2.32	—	—
The weighted-average grant-date fair value of options granted during the year	£11,460,366		£18,113,160		£23,004,182	

(1) The information presented above for the Executive Share Option scheme includes replacement options granted to executive officers of FNFC upon the acquisition of FNFC by Abbey National in 1995. As at 31 December, 1996, there were 584,195 such options outstanding, with exercise prices ranging from £4.02 to £13.53. Substantially all of these share options have exercise prices set at more than the market prices of the stock on the relevant grant dates. These options expire on various dates between July 1997 and February 2004.

(2) Where there are parallel discounted options offered to executive officers, the weighted average exercise price for such options reflects the option price which is the most likely outcome. See "Management — Directors' share interests" elsewhere in this Document for a description of such options.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

52. Differences between U.K. GAAP and U.S. GAAP (Continued)

The following table summarises information about the options outstanding at 31 December 1996.

Executive Share Option	Options Outstanding			Options Exercisable	
	Number Outstanding at 31/12/96	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Prices (£)	Number Exercisable at 31/12/96	Weighted-Average Exercise Prices (£)
Range of Exercise Prices					
Between £2 and £3	282,545	5.33	2.99	282,545	2.99
Between £3 and £4	537,009	6.25	3.69	537,009	3.69
Between £4 and £5	1,795,886	7.92	4.77	115,680	4.78
Between £5 and £6	1,793,904	8.18	5.68	66,621	5.65
Between £8 and £9	186,580	3.66	8.25	186,580	8.25
Between £9 and £10	319,269	2.29	9.59	319,269	9.59
Between £13 and £14	62,985	0.63	13.53	62,985	13.53
Employee Sharesave					
Range of Exercise Prices					
Between £1 and £2	1,989,375	1.00	1.49	—	—
Between £2 and £3	4,692,042	1.69	2.37	113,038	2.32
Between £3 and £4	5,070,712	3.26	3.18	—	—
Between £4 and £5	7,089,564	4.73	4.44	—	—

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

Taxes

(i) No significant element of the tax expense in each of the three years ended 31 December 1996, 1995 and 1994 is attributable to discontinued operations.

(ii) The significant components of tax expense attributable to continuing operations are shown in Note 12.

(iii) A reconciliation of taxes payable at the standard UK corporation tax rate and the Group's effective tax rate for each of the three years ended 31 December 1996, 1995, and 1994 is shown as follows.

	Year ended 31 December		
	1996	1995	1994
	£m	£m	£m
Taxation at standard U.K. corporation tax rate (33%, 33%, 33.25%)	385	339	308
Effect of non-allowable provisions	42	15	8
Goodwill on disposals previously written off	—	—	3
Effect of non-U.K. losses	(7)	(15)	—
Adjustment to prior year tax provisions	—	7	3
Effect of dividend income taxed at different rates	(10)	(2)	—
U.K. Advanced Corporation Tax written back	(7)	—	—
Taxes	403	344	322
Effective tax rate	34.5%	33.5%	34.5%

52. Differences between U.K. GAAP and U.S. GAAP (Continued)

(iv) The tax effects of the principal components of deferred tax liabilities and deferred tax assets at 31 December 1996 and 1995 were as follows:

	1996	1995
	£m	£m
<i>Deferred Tax Liabilities recognised in U.K. financial statements</i>		
Excess of capital allowances over depreciation	23	19
Capital allowances on finance lease receivables	758	455
Other	108	86
	<u>889</u>	<u>560</u>
<i>Additional Deferred tax assets arising from application of U.S. GAAP</i>		
Operating loss carry forwards	112	125
Deductible temporary differences	44	49
Advance Corporation Tax	—	7
	<u>156</u>	<u>181</u>
Less valuation allowance	<u>(127)</u>	<u>(159)</u>
<i>Deferred tax assets (U.S. GAAP)</i>	<u>29</u>	<u>22</u>
<i>Deferred tax assets/(liabilities) arising from U.S. GAAP adjustments</i>	<u>(195)</u>	<u>(172)</u>
<i>Net deferred tax liabilities</i>	<u>1,055</u>	<u>710</u>

Of the additional deferred tax asset in respect of operating loss carryforwards shown above, £2m is expected to expire at the end of 1998, £9m at the end of 1999, £6m at the end of 2000, £6m at the end of 2001 and £1m at the end of 2003.

Consolidated Cash Flow Statement

The UK Financial Reporting Standard 1 ("FRS1"), "Cash Flow Statements", and SFAS No. 95 as amended by SFAS No. 104, are substantially similar in approach. The principal differences are in the classification of certain transactions under the categories prescribed by the statements, as follows:

	Classification under FRS1	Classification under SFAS No. 95
Dividends received	Returns on investment and servicing of finance	Investing activities
Dividends paid	Returns on investment and servicing of finance	Financing activities
Taxation paid	Taxation paid	Operating activities
Net change in loans and advances	Operating activities	Investing activities
Net change in investment in finance leases	Operating activities	Investing activities
Net change in deposits and customer accounts	Operating activities	Financing activities
Net change in debt securities in issue	Operating activities	Financing activities

Presentation of the Consolidated Profit and Loss account.

The presentation of the profit and loss accounts for the years ended 31 December 1996, 1995 and 1994, as shown on page F-4, would be no different under U.S. GAAP except that interest relating to trading activities would be shown within net interest income under U.S. GAAP instead of being included within dealing profits.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

53. Significant group concentrations of credit risk

Under SFAS No. 105 group concentrations of credit risk exist if a number of counterparties are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

The Group's significant exposures to credit risk arise mainly in the residential mortgage portfolio of U.K. Retail Banking and in the wholesale lending and investment activities completed within Treasury & Offshore.

The Group's balance sheet still strongly reflects its history as a U.K. building society, with 49% (1995:47%) of total assets at 31 December 1996 being residential mortgages. 99% (1995:98%) of the residential mortgage asset is in the U.K. In U.K. Retail Banking a national mortgage lending policy is applied, supported by a number of processes, including credit scoring, which enhance the ability to manage and monitor the credit risk quality of mortgage assets, manage arrears and collections and optimise the values raised from properties in possession.

Although the Group's Treasury & Offshore operations are based mainly in the U.K., it has built up exposures to various entities around the world.

Of total ANTS exposures, 44% was to counterparties from the United States, and 20% was to counterparties from the U.K. The remaining exposures were mainly to counterparties from Europe. ANTS has only insignificant exposures to countries which are not members of the Organization for Economic Co-operation and Development. More than 75% of ANTS assets rated AA- or better, with approximately 80% of exposures being to banks and financial institutions and approximately 13% being to governments. Counterparty risk is controlled by a team of specialists who analyse and monitor credit risk exposures within pre-set limits.

See Risk Management — Credit Risk elsewhere in this Document for further discussion of controls over credit risk.

54. Fair values of financial instruments

The following disclosures are made in accordance with SFAS No. 107 'Disclosures about Fair Value of Financial Instruments'.

The fair values have been estimated using quoted market prices where available. Where no ready markets exist and hence quoted market prices are not available, appropriate techniques are used to estimate fair values which typically take account of the characteristics of the instruments, including the future cash flows, the market interest rate and prices available for similar instruments.

By its nature, the estimation of fair values is highly subjective and the results will depend largely upon the assumptions made. Considerable caution should therefore be used in interpreting the fair values and particularly if comparing with fair values presented by other financial institutions.

The Group attaches great value to its branch network, to its profile in the U.K. personal financial services market and to its relationships with its customers. However, such intangible assets are not recognised for the purposes of SFAS No. 107. Furthermore, the concept of fair values assumes that the financial instruments will be realised by way of sale. However, with the exception of certain securities, the Group intends to realise its assets through collection over time. Consequently, the directors believe that the fair values significantly understate the true value of the group as a going concern.

SFAS 107 does not apply to non financial assets and liabilities. Accordingly, tangible fixed assets and balances relating to long-term assurance business are excluded.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

54. Fair values of financial instruments (Continued)

The carrying values and estimated fair values of financial instruments are as follows:

	1996 Carrying Amount	1996 Fair Value	1996 Surplus/ (Deficit)	1995 Carrying Amount	1995 Fair Value	1995 Surplus/ (Deficit)
	£m	£m	£m	£m	£m	£m
Assets						
Non-Trading Activities						
Cash and balances at central banks	228	228	—	145	145	—
Treasury bills and other eligible bills	111	111	—	246	245	(1)
Loans and advances to banks	2,825	2,855	30	3,579	3,577	(2)
Loans and advances to customers	64,227	64,378	151	51,090	51,309	219
Debt securities	26,813	27,573	760	31,239	31,941	702
Equity shares and other variable yield securities	36	59	23	51	66	15
Trading activities						
Debt securities	12,917	12,917	—	4,004	4,004	—
Equity shares and other variable yield securities	8	8	—	3	3	—
Liabilities						
Non-Trading Activities						
Deposits by banks	17,718	17,794	76	19,393	19,406	13
Customer accounts	49,678	49,768	90	40,962	41,105	143
Debt securities in issue	35,193	35,469	276	26,095	26,276	181
Short positions in government debt securities	355	358	3	19	19	—
Subordinated liabilities including convertible debt	2,374	2,568	194	2,127	2,273	146
Trading activities						
Short positions in government debt securities	—	—	—	330	330	—
			325			450
Off balance sheet financial instruments						
Non-trading — surplus / (deficit) of fair values over carrying amounts (1)	139	(226)	(365)	(5)	(52)	(47)
Trading — surplus / (deficit) of fair values over carrying amounts	(196)	(196)	—	158	158	—
Total surplus / (deficit)			(40)			403

(1) Fair value figures exclude fair values of derivatives undertaken by Group entities for non-trading purposes with ANFP.

Other assets, Prepayments and accrued income, Dividend proposed, Other liabilities, Accruals and deferred income and Provisions for liabilities and charges may contain financial instruments which fall within the scope of SFAS No. 107. Unless specifically included, these financial instruments have been excluded from the above analysis as their fair values approximate to carrying values.

The total surplus (deficit) in the table above represents the surplus (deficit) of fair value compared to carrying amount of those financial instruments for which fair values have been estimated under SFAS No. 107.

Financial instruments that are held for trading purposes, comprising long positions in securities and derivative financial instruments, are included in the balance sheet at fair value.

Unless otherwise specified, fair values of financial instruments have been estimated by discounting anticipated future cash flows using available market interest rates offered at 31 December 1996 for similar instruments.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

54. Fair values of financial instruments (Continued)

Assets

Debt securities and equity shares and other variable yield securities

Where available, securities and investments have been valued using quoted market prices. Where market prices are not available the directors' valuation has been used. The directors' valuation takes into consideration discounted cash flows, market prices of comparable securities and other appropriate valuation techniques.

Loans and advances to customers

Loans and advances to personal customers are made both at variable and at fixed rates. As there is no active market in the U.K. for such loans and advances, there is no reliable market value available for such a significant portfolio. However, if a market value could be ascertained, the directors believe it would reflect the expectation of a long-term and continuing relationship with a majority of the customers. Although substantial, this value is intangible and it cannot therefore be included in the fair value. Consequently the directors believe that, for the purposes of SFAS No. 107, the carrying value of the variable rate loans is assumed to be their fair value.

Certain of the loans secured on residential properties are at a fixed rate for a limited period, typically two to three years from their commencement. At the end of this period these loans revert to the relevant variable rate. The excess fair value over carrying value of each of these loans has been estimated by reference to the market rates available on 31 December 1996 for similar loans of maturity equal to the remaining fixed period. The fixed element of such loans is substantially hedged such that any movement in the value of the loan as a result of market interest rate changes will be offset by an equivalent movement in the value of instrument used as a hedge.

SFAS No. 107 does not require an estimate of the fair value of finance lease receivables. They are therefore excluded from the table.

Liabilities

Deposits by banks and customers

SFAS No. 107 states that the fair value of deposit liabilities payable on demand is equal to the carrying value. However, given the long-term and continuing nature of the relationships with the Group's customers, the directors believe there is significant value in this source of funds.

Debt securities in issue and subordinated liabilities

Where available the fair value of debt securities in issue and subordinated liabilities has been calculated using quoted market prices.

Financial commitments and contingent liabilities

The directors believe that, given the lack of an established market, the diversity of fee structures and the estimation required to separate the value of the instruments from the value of the overall transaction, it is generally difficult to estimate the fair value of financial commitments and contingent liabilities. These are therefore excluded from the above table. However, since the majority of these are at floating rates the book value may be a reasonable approximation to fair value. The book values of these instruments are disclosed in notes 44 and 46.

Off-balance sheet financial instruments

The group uses various market-related off-balance sheet financial instruments, as explained in Note 47 above. The fair value of these instruments is measured as the net replacement cost at the balance sheet date, which is estimated using market prices where available or pricing models consistent with standard market practice.

It should be noted that, where these instruments are designated as hedges, a rise or fall in the fair value of the hedge is offset by a substantially equivalent reduction or increase in the fair value of the asset or liability against which the hedge was placed.

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

55. Further rental commitments under operating leases

	<u>1996</u> <u>Property</u> <u>£m</u>	<u>1996</u> <u>Equipment</u> <u>£m</u>	<u>1995</u> <u>Property</u> <u>£m</u>	<u>1995</u> <u>Equipment</u> <u>£m</u>
Annual commitments under non-cancellable operating leases expiring:				
Not more than one year	3	4	1	3
Over one but not more than five years	3	9	2	5
Over five years	49	—	35	—
	<u>55</u>	<u>13</u>	<u>38</u>	<u>8</u>

56. Operating lease commitments

At 31 December 1996 the Group held various leases on land and buildings, many for extended periods, and other leases for equipment, which require the following aggregate rental payments.

Year ended 31 December	£m
1997	68
1998	65
1999	64
2000	63
2001	63
Total thereafter	631

	<u>1996</u> <u>£m</u>	<u>1995</u> <u>£m</u>	<u>1994</u> <u>£m</u>
Rental expense comprises:			
In respect of minimum rentals	56	36	36
Less sub-lease rentals	(2)	(4)	(4)
	<u>54</u>	<u>32</u>	<u>32</u>

57. Summary operating results of Abbey National Treasury Services plc

The following selected information of Abbey National Treasury Services plc ("ANTS") has been included to comply with the filing requirements of the Securities and Exchange Commission. The data has been compiled using U.K. GAAP.

Summary of statement of income

	For the year ended 31 December		
	1996	1996	1995
	\$m	£m	£m
Total interest income	5,116	2,988	3,053
Total interest expense	(4,692)	(2,740)	(2,826)
Net interest income	424	248	227
Other operating income	103	60	22
Operating expenses	(92)	(54)	(53)
Income before taxes	435	254	196
Taxes	(173)	(101)	(73)
Net income	<u>262</u>	<u>153</u>	<u>123</u>

NOTES TO THE CONSOLIDATED ACCOUNTS (Continued)

57. Summary operating results of Abbey National Treasury Services plc (Continued)

Summary of balance sheet data

	As at 31 December		
	1996	1996	1995
	\$m	£m	£m
Total assets	105,651	61,701	51,836
including:			
Loans to banks and customers	26,633	15,554	12,179
Securities and investments	67,182	39,235	33,663
Net investment in finance leases	7,442	4,346	2,859
Total liabilities excluding shareholders' equity	103,452	60,417	50,705
including:			
Deposits by banks and customers	37,260	21,760	22,538
Debt securities in issue	54,955	32,094	22,826
Subordinated liabilities	3,421	1,998	2,094
Shareholders' equity	2,199	1,284	1,131

The above summary information has been extracted from the consolidated financial statements of ANTS. This information differs from that disclosed for the Treasury Operations segment in note 1 as a result of the inclusion of certain intra-group transactions in ANTS' consolidated financial statements, and the inclusion of the results of Abbey National North America Corporation and Abbey National (Gibraltar) Ltd in the Treasury Operations segment.

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