Santander Financial Services plc

2023 Annual Report

PART OF THE BANCO SANTANDER GROUP

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Santander Financial Services plc
2023 Annual Report

Index

Important information for readers
Santander Financial Services plc (the Company or SFS) operates in the UK, the Isle of Man and Jersey, and is part of Banco Santander (comprising Banco Santander SA and its subsidiaries). Santander Financial Services plc is regulated by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The Isle of Man branch is regulated by the Isle of Man Financial Services Authority. The Jersey branch is regulated by the Jersey Financial Services Commission.

This Annual Report contains forward-looking statements that involve inherent risks and uncertainties. Actual results may differ materially from those contained in such forward-looking statements.

For more information see www.aboutsantander.co.uk.

Strategic report

Santander Financial Services plc (SFS or the Company) is a subsidiary of Santander UK Group Holdings plc (together with its subsidiaries, Santander UK or the Santander UK group). The Company is required to set out in this report a fair review of its business and a description of its principal risks and uncertainties, including a balanced and comprehensive analysis of the development and performance of the business in the year and of its position at the end of the year. This information can be found below and in the following sections of this Annual Report, which are incorporated into and form part of this Strategic report.

The Directors, in preparing this Strategic report, have complied with Section 414C of the Companies Act 2006.

Principal activities

SFS is an operating company whose principal activity is to provide banking and financial services for clients and customers through its presence in the UK, Jersey and the Isle of Man, whilst also holding a pool of residual assets and liabilities, which is intended to be run down and/or managed for value.

Under Santander UK's ring-fencing plans, the assets and liabilities of SFS (except for a portfolio of residual assets and liabilities) were transferred to Santander UK plc (the principal ring-fenced bank of the Santander UK group) and to Banco Santander SA, London Branch and SFS became a direct wholly owned subsidiary of Santander UK Group Holdings plc. The businesses of Santander UK plc's Jersey and Isle of Man branches were also transferred to Jersey and Isle of Man branches of the Company.

SFS is part of a core UK group with Santander UK Group Holdings plc and Santander Equity Investments Limited for capital ratio and large exposure purposes under the terms of the Non-RFB Capital Support Deed. For more on this agreement, see Note 18 to the Financial Statements.

SFS manages its own liquidity separately.

The Company purchased a portfolio of UK residential mortgages from Santander UK plc in 2020 and 2022, to allow it to efficiently deploy its excess liquidity and improve both the return from customer deposits and its balance sheet position.

In January 2022, the Company acquired Abbey National International Limited, a Jersey registered entity.

Our performance and key performance indicators

The directors of the Company's ultimate UK parent, Santander UK Group Holdings plc, monitor the performance of the Santander UK group (which includes SFS) on a business division basis. Key performance indicators are not set, monitored or managed at the Company level.

Risk management overview

Information on our principal risks and uncertainties is set out in the Risk review by type of risk.

Uncertain economic environment
In 2023, the UK economy saw weak economic growth (0.5% based off latest data available), as consumers experienced increases in the cost-of-living following two years of high inflation. This led to the Monetary Policy Committee (MPC) increasing the Base Rate five times in 2023 to 5.25% (175bps above 2022). As a result, the housing market slowed, with approvals below 2022 levels and prices reducing by around 0.8% in the year.

IT and Cybersecurity Risk Management
The importance of IT risk management and control remains at the centre of our activities. We experienced no material data or cybersecurity incidents in 2023. We continue to enhance our threat prevention controls, address IT obsolescence, and test our business recovery plans. We continue to invest in the right skills and resources to manage data and cybersecurity risks, and constantly monitor cybersecurity threats, particularly with evolving and elevated risks in the geopolitical environment. The SFS IT Cyber Security Forum (ITCSF) meets monthly and oversees all elements of cyber security within SFS, reporting to ExCo, ERCC and the Board as required.

Financial overview

Development and performance of our business in 2023
Information on the development and performance of our business in the year is set out in the 'Income statement review' section of the Financial review.

Our position at 31 December 2023
Information on our position at the end of the year is set out in the 'Balance sheet review' section of the Financial review.

Section 172 Statement

The Santander UK group is committed to ensuring that stakeholder interests continue to be embedded in all aspects of decision-making across the business, at both Board and management level. The Santander UK Corporate Governance Office continues to promote awareness and understanding of what is expected of Directors under section 172 of the Companies Act 2006. This includes briefing Directors on their statutory duties, as well as educating the business on ensuring the information they present to boards and management committees draws out the crucial points that will enable Directors to make fully informed decisions which factor in all relevant stakeholder impacts.

As a subsidiary of the Santander UK group, the Company adheres to the policies and standards set by the Santander UK Group Holdings plc Board. To support efficiency and ensure a consistent approach, engagement with stakeholders on issues and decisions which have an impact across the wider Santander UK group is conducted at Santander UK group level. You can find out more about the engagement undertaken with key stakeholder groups during the year and how their interests were considered as part of the Santander UK Group Holdings plc Board's deliberations and decision making in the Santander UK Group Holdings plc 2023 Annual Report, which does not form part of this report.

The Directors of the Company are fully aware of their responsibilities under section 172 of the Companies Act 2006 and take all appropriate steps to ensure they consider the likely impact of their decisions in the long-term, as well as the interests of the Company's stakeholders. In discharging its responsibility for the overall oversight of the Santander Financial Services plc business, the Board has continued to pay due regard to its duty to promote the long-term success of the Company for the benefit of its shareholder, by ensuring its decisions are in accordance with the agreed Santander UK group strategy. The Board also regularly reviews management information on the progress made by the Company in delivering on this strategy, as well as reporting on business, financial and operational performance and key risks and compliance issues which supports the Directors in staying sighted on stakeholder outcomes and feedback.

The Santander UK Group Holdings plc Board, along with the Company's Board, has identified five key stakeholder groups for Santander Financial Services plc whose interests and needs the Company regularly considers. These stakeholders are our customers, people, investors, regulators and communities. Set out below are some examples of how the Company's Directors have paid due regard to the interests of these stakeholders during the year under review.

Our customers are at the centre of the Company's business and the Board regularly monitors efforts by Management to enhance the quality of service that they receive. We pay particular attention to our vulnerable customers, identifying additional support that may be required or of assistance. The Company's services are also reaching an increasing number of customers and we are ensuring that the quality of service is maintained and improved. The Board considered FCA's Consumer Duty, challenging firms to raise the bar in terms of minimum standards of outcomes and value expected for their customers. The Board concluded that although the Company had no UK situs retail products being offered directly to retail customers in the UK, was in scope for Consumer Duty in its deposit aggregator space. The Board approved the Company's implementation plan and appointed Helen Hatton, independent Non-executive Director, as Consumer Duty Champion in April 2023.

Our people are essential to the provision of those services to our customers and the Board regularly monitors employee sentiment and wellbeing via engagement scores from our colleague survey, Peakon. Planning for appropriate levels of capacity is a key element of this and the Board pays close attention to resourcing levels to ensure our growth is supported and expected customer service levels are maintained. The Board regularly discusses the effect of any business decisions on the employees and considers whether it is in their best interests. The Board was presented with an update on the employee and culture dashboard in December, noting the engagement results, how staff are developed and retained and what the Company does to promote staff physical and mental wellbeing. The Board discussed in detail the importance of mental health in the workplace.

The Company is regulated by the UK Financial Conduct Authority, the Prudential Regulation Authority (as part of the Bank of England), the Jersey Financial Services Commission and the Isle of Man Financial Services Authority. At each quarterly Board Risk Committee (BRC) meeting, the BRC reviews the business' regulatory risk profile and discusses the steps being taken to ensure that we remain in regulatory compliance and continue effective engagement and consultation on key strategic developments and regulatory matters in our business.

As a growing component of the Channel Islands and Isle of Man's financial services infrastructure, the Board is aware of the positive contribution it is able to make to local communities. Following the success of the Santander Jersey Work Café, we have been pleased by the equal success of the Santander Isle of Man Work Café which opened in May 2023. Our people also regularly participate in fundraising events for local charities as well as supporting financial inclusion in the community through partnerships with the Jersey Community Savings Bank and the IOM Credit Union.

In terms of our shareholder, the Board ensures that the Company implements and acts in accordance with the Santander UK Group governance and risk frameworks and, as referred to above, that its business is managed in accordance with Santander UK Group policies. These policies include those in place to protect our people and provide a safe working environment, to ensure compliance with all regulatory requirements and adherence to the highest professional and ethical standards in dealing with customers, suppliers and colleagues, and to ensure that the Santander UK Group continues to operate in a socially responsible manner and manages environmental sustainability.

On behalf of the Board

James Pountney
Director
12 March 2024

INCOME STATEMENT REVIEW

SUMMARISED INCOME STATEMENT

	2023	2022
	£m	£m
Net interest income	**9.3**	49.2
Non-interest income[1]	**15.1**	12.4
Total operating income	**24.4**	61.6
Operating expenses before credit impairment charges, provisions and charges	**(25.1)**	(23.6)
Operating credit impairment losses, provisions and charges	**(2.3)**	(2.3)
(Loss)/Profit before tax	**(3.0)**	35.7
Tax on profit	**15.0**	4.0
Profit after tax	**12.0**	39.7

(1) Comprises 'Net fee and commission income' and 'Other operating income'.

A more detailed income statement is contained in the Financial Statements.

2023 compared to 2022

In 2023, the Company made a loss before tax of £(3.0)m compared to a profit before tax of £35.7m in 2022 due to the factors outlined below. By income statement line item, the movements were:

- Net interest income decreased to £9.3m in 2023 (2022: £49.2m), with the cost of deposits increasing faster than the predominantly fixed mortgage book due to Bank of England base rate increases.
- Non-interest income increased to £15.1m in 2023 (2022: £12.4m), due to an increase in the fair value of other loans (deferred consideration).
- Operating expenses before credit impairment losses, provisions and charges increased to £25.1m in 2023 (2022: £23.6m), driven by an increased number of staff and project spend to support revenue growth plans.
- Tax credit increased to £15.0m in 2023 (2022: £4.0m) driven by tax on the loss in the year and tax relief on dividends in respect of other equity instruments, partially offset by the effect of different tax rates in other jurisdictions and other disallowable items.

BALANCE SHEET REVIEW

SUMMARISED BALANCE SHEET

	2023 £m	2022 £m
Assets		
Cash and balances at central banks	**2,308**	2,445
Financial assets at fair value through profit or loss	**319**	309
Financial assets at amortised cost	**3,926**	4,237
Macro hedge of interest rate risk	**2**	—
Interest in other entities	**3**	3
Property, plant and equipment	**19**	13
Tax, intangibles and other assets	**13**	10
Total assets	**6,590**	7,017
Liabilities		
Financial liabilities at fair value through profit or loss	**69**	56
Financial liabilities at amortised cost	**6,154**	6,579
Tax, other liabilities and provisions	**12**	31
Total liabilities	**6,235**	6,666
Equity		
Total shareholders' equity	**355**	351
Total equity	**355**	351
Total liabilities and equity	**6,590**	7,017

A more detailed balance sheet is contained in the Financial Statements.

2023 compared to 2022

Assets

Cash and balances at central banks
Cash and balances at central banks decreased to £2,308m at 31 December 2023 (2022: £2,445m), due to lower customer deposits.

Financial assets at fair value through profit or loss
Financial assets at fair value through profit or loss increased to £319m at 31 December 2023 (2022: £309m) due to an increase in the fair value of other loans (deferred consideration).

Financial assets at amortised cost
Financial assets at amortised cost decreased to £3,926m at 31 December 2023 (2022: £4,237m), mainly driven by a decrease in mortgages as a result of repayments and redemptions.

Liabilities

Financial liabilities at amortised cost
Financial liabilities at amortised cost decreased to £6,154m at 31 December 2023 (2022: £6,579m), driven by a decrease in corporate savings, partially offset by time deposits and retail savings.

Equity

Total shareholders' equity increased to £355m at 31 December 2023 (2022: £351m) due to the profit after tax for the year and gains on cash flow hedges, partially offset by dividends paid of £9m (2022: £65m).

BOARD OF DIRECTORS

NON-EXECUTIVE DIRECTORS

Antonio Costa

Chair

Antonio Costa was appointed as Chair on 25 November 2020, following his appointment as a Non-Executive Director on 9 October 2020. He has over 20 years of experience in the banking and financial industry, having joined Banco Santander in 1996. Since 2009 he has been the Chief Executive Officer of Banco Santander International, SA in Switzerland and serves as a member of the Risk and Compliance Committees and is also a member of the Global Private Banking Committee of Santander Wealth Management and Insurance Division. Previously, he held the position of Regional Director for the Mexican desk in Banco Santander International in Miami as an Executive Vice-President. He also served as Deputy Representative for Banco Santander in Peru and also worked in Banco Santander de Negocios in Spain.

Helen Hatton

Independent Non-Executive Director

Helen Hatton was appointed as an Independent Non-Executive Director on16 December 2020. She has over 17 years of experience working for the regulators across the Crown Dependencies, effecting organisational change across governance, accountability and risk management amongst other areas, to enhance the effectiveness of Jersey regulation. In the Isle of Man, she was part of the senior management group with responsibility for strategic development and operational control of the Enforcement division and covered a number of disciplines during her tenure such as Anti Money Laundering, Enforcement, Compliance, and Inter-Regulatory relations.

Jennifer Houghton

Independent Non-Executive Director

Jennifer Houghton was appointed as an Independent Non-Executive Director on 13 October 2020. She is an experienced qualified accountant and chartered director who has worked as a managing director, finance director, company secretary, and MLRO, with a successful career in California, Luxembourg, Sweden and the Isle of Man, both in practice and in industry. She also worked for Deloitte & Touche for 18 years in the banking, insurance and financial services sectors.

Tom Ranger

Non-Executive Director

Tom Ranger was appointed as a Non-Executive Director on 21 December 2022. He is also Treasurer of Santander UK plc. Tom joined Santander UK plc in 2009 as part of the integration of Alliance & Leicester which he joined in 2007. Tom brings a breadth of experience on treasury and regulatory matters, having held senior positions for over 20 years in the banking sector.

Raúl Pou

Non-Executive Director

Raúl Pou was appointed as a Non-Executive Director on 17 May 2023. He is currently Group Executive Vice-President and Global Head of Risk of Wealth Management and Insurance at Banco Santander. Raúl brings a great amount of experience to the role having previously held the positions of Group Head of Operational Risk (2013-2018) with Banco Santander and prior to this he held several senior positions in Internal Audit also in Banco Santander. He also has been acting as a Director in several Banco Santander subsidiaries across the three businesses (private banking, asset management and insurance).

EXECUTIVE DIRECTORS

James Pountney

Chief Executive Officer

James Pountney was appointed as Executive Director, Chief Executive Officer, on 9 October 2020. James joined Santander UK plc in July 2015 as Managing Director for its Jersey and Isle of Man branches. He has extensive knowledge of the retail banking and wealth management industry having previously worked for Lloyds Bank and Citibank before joining Standard Chartered (Jersey) Limited, during which time he was appointed as an Executive Director on the subsidiary board and was Head of Private and International Banking, serving the bank's customers across Asia, Africa and the Middle East. Following that, James spent a brief period with HSBC International plc as Head of Premier and Wealth Management before joining Santander.

Richard Settle

Chief Risk Officer

Richard Settle was appointed as Executive Director and Chief Risk Officer on 8 December 2020. Richard has over 25 years of risk and audit experience in financial institutions and joined from Euroclear UK & Ireland where he was CRO. He previously held CRO or senior risk positions in Deutsche Bank, Shanghai Pudong Development Bank and Citi in London.

Directors' report

INTRODUCTION

The Directors submit their report together with the financial statements for the year ended 31 December 2023. The information in the Directors' report is unaudited, except where indicated.

HISTORY, CORPORATE STRUCTURE, SUBSIDIARIES AND BRANCHES

The Company's principal activity is to provide banking and financial services for clients and customers through its presence in the UK, Jersey and the Isle of Man, whilst also holding a pool of residual assets and liabilities, which is intended to be run down and/or managed for value.

The Company was established in 1989 for the purpose of managing the liquidity, risk management and wholesale banking needs of Abbey National plc (subsequently renamed Santander UK plc) and its subsidiaries.

On 12 November 2004, Banco Santander SA, a company incorporated in Spain, completed the acquisition of the entire issued ordinary share capital of the then parent company of the Company, Santander UK plc, at which point the Company became an indirect subsidiary of Banco Santander SA.

In 2018, as part of the implementation of ring-fencing in the Santander UK group, the assets and liabilities of the Company (except for a portfolio of residual assets and liabilities) were transferred to Santander UK plc (the principal ring-fenced bank of the Santander UK group) and to Banco Santander SA, London Branch and the Company became a direct wholly owned subsidiary of Santander UK Group Holdings plc. The businesses of Santander UK plc's Jersey and Isle of Man branches was also transferred to Jersey and Isle of Man branches of the Company.

On 30 September 2019, the Company changed its legal name to Santander Financial Services plc from Abbey National Treasury Services plc to better reflect its current business direction and strategy, and to align the Company's legal name to the Santander brand.

The Company remains a wholly owned direct subsidiary of Santander UK Group Holdings plc and a wholly owned indirect subsidiary of Banco Santander SA. As noted above, the Company has branch offices in Jersey and the Isle of Man.

In January 2022, the Company acquired Abbey National International Limited, a Jersey registered entity. For further information, see Note 13 to the Financial Statements.

RESULTS AND DIVIDENDS

The profit after tax for the year was £12.0m (2022: £39.7m). The Directors approved a final dividend for 2023 of £2m (2022: £nil) on the ordinary shares in issue. Interim dividends of £nil and £4m were paid in the year on the ordinary shares (2022: £7m and £58m).

Details of the Company's activities and business performance during 2023 are set out in the Strategic report on pages 2 to 3, and the Financial review on pages 4 to 6.

EVENTS AFTER THE BALANCE SHEET DATE

There have been no material post balance sheet events.

DIRECTORS

Directors who served during the year and to the date of signing the financial statements were as follows:

Name of Director	Date of appointment
Antonio Costa (Chair and Non-Executive)	9 October 2020
James Pountney (Chief Executive Officer)	9 October 2020
Richard Settle (Chief Risk Officer)	8 December 2020
Victor Matarranz (Non-Executive)	7 March 2020
Tom Ranger (Non-Executive)	21 December 2022
Jennifer Houghton (Independent Non-Executive)	13 October 2020
Helen Hatton (Independent Non-Executive)	16 December 2020
Raúl Pau (Non-Executive)	17 May 2023

During the year and to the date of signing the financial statements, the following Directors resigned:

Name of Director	Date of resignation
Victor Matarranz (Non-Executive)	16 May 2023

Two INEDs have contracts for services. The CEO and CRO are employed by the Company. The remaining Directors are employed by companies within the Banco Santander and Santander UK groups. Directors may be paid instead of being required to work during their notice period. None of the Directors' employment contracts provide for benefits to be paid on termination of employment other than for redundancy.

All Directors are appointed and retire in accordance with the Company's Articles of Association and the UK Companies Act 2006. The Company does not require the Directors to offer themselves for re-election every year, or that new Directors appointed by the Board offer themselves for election at the next Annual General Meeting.

Details of aggregate remuneration received by the Directors of the Company in 2023 and 2022 are set out in Note 23 to the Financial Statements. The remuneration, excluding pension contributions, of the highest paid Director and details of Director participation in defined benefit pension schemes are contained in Note 23 to the Financial Statements. For a description and details of related party transactions, see Note 24 to the Financial Statements.

Directors' indemnities
Enhanced indemnities are provided to certain Directors of the Company by Santander UK Group Holdings plc against liabilities and associated costs which they could incur in the course of their duties to the Company. All of the indemnities were in force during the financial year and at the date of approval of the Annual Report. All of the indemnities were qualifying third party indemnities. A copy of each of the indemnities is kept at the registered office address of Santander UK Group Holdings plc.

EMPLOYEES

All staff have employment contracts with the Company.

As part of the Santander UK group, we continue to ensure that our remuneration policies are consistent with our strategic objectives and are designed with the long-term success of the Company in mind. In doing so we aim to attract and retain the most talented and committed people.

Communication
The Company participates in Santander UK group's policies and aims to involve and inform employees on matters that affect them. The intranet is a focal point for communications and the 'AskHR' website connects employees to all the information they need about working for SFS. We also use face-to-face communication, such as team meetings and roadshows for updates. Santander UK group, including SFS, regularly considers employees' opinions and asks for their views on a range of issues through regular engagement and surveys.

Consultation with Employees
The Company has a successful history of working in partnership with its recognised trade union, Advance. The trade union is affiliated to the Trades Union Congress. We consult Advance on significant proposals including those relating to change across the business at both national and local levels.

Disability
The Company is committed to equality of employment, access and quality of service for disabled people and complies with the UK Equality Act 2010 throughout its business operations. SFS has processes in place to help train, develop, retain and promote employees with disabilities.

We are a Disability Confident Employer achieving the 'Leader' level. We are committed to giving full and fair consideration to employment applications by disabled people, having regard to their particular aptitudes and abilities, and for continuing the employment of employees who have become disabled by arranging appropriate training and making reasonable adjustments in the workplace.

STREAMLINED ENERGY AND CARBON REPORTING (SECR)

The Company meets the requirements under the Streamlined Energy and Carbon Reporting (SECR) reporting disclosures and this is the first year we are disclosing information in line with it. In 2023, we used 479,512 kWh of energy. Greenhouse gas emissions (market-based) were 140 tCO2e. Market based emissions are equal to location-based because SFS does not currently use any market-based instruments or contracts for its purchased electricity. Emissions per employee equate to 0.86tCO2e/ employee. In the next years, we will continue to monitor our energy consumption and emissions generated in order to analyse year-on-year trends. SFS GHG emissions are calculated using the UK Government department for Energy Security and Net Zero (DESNZ) conversion factors. Our total Scope 1, 2 and 3 emissions for 2023 were as shown in the table below.

	2023
Scope 1 tCO_2e	14
Scope 2 tCO_2e (Location-based)	84
Scope 2 tCO_2e (Market-based)	84
Scope 3 tCO_2e (Business travel)(1)	42
Total	140
YoY %	— %
Total emissions per employee (tCO_2e/FTE)	0.86

(1) Includes air and rail travel but excludes taxi travel. Business travel emissions are based on financial data taken from internal travel management systems. Assumptions have been made for the distance travelled and travel class and estimates were used to ensure full-year coverage.

POLITICAL CONTRIBUTIONS

In 2023 and 2022, no contributions were made for political purposes and no political expenditure was incurred.

SHARE CAPITAL

Details of the structure of the Company's share capital, including the rights and obligations attaching apply to each class of share in the Company, can be found in Note 19 to the Financial Statements which are incorporated by reference into this report. The powers of the Directors in relation to share capital are set out in the Company's Articles of Association as determined by the Companies Act 2006.

FINANCIAL INSTRUMENTS

The Company's risks are managed by the Company's Board with some oversight at group level by Santander UK Group Holdings plc, except for liquidity which is managed on a standalone basis. The financial risk management objectives and policies of the Company and the exposure of the Company to credit risk, market risk, liquidity risk and capital risk are set out in the Risk review.

RESEARCH AND DEVELOPMENT

New products, campaigns and business initiatives are reviewed by the Company's Project Steering Forum.

SUPERVISION AND REGULATION

The Company is authorised by the PRA and regulated by the FCA and the PRA. The Isle of Man branch is regulated by the Isle of Man Financial Services Authority. The Jersey branch is regulated by the Jersey Financial Services Commission. While the Company is a UK registered entity, it is also subject to the laws and regulations of the other jurisdictions in which it operates.

BOARD COMMITTEES

The Company maintains a standing Board Audit Committee, Board Risk Committee and Board Nomination Committee. The Board Audit Committee and Board Risk Committee met regularly throughout the year. The Board Nomination Committee meets as required. The Board Audit Committee is chaired by Jennifer Houghton, the Board Risk Committee is chaired by Helen Hatton and the Board Nomination Committee is chaired by Antonio Costa.

INTERNAL CONTROLS

Management is responsible for establishing and maintaining adequate internal control over the financial reporting of the Company.

Risk management and internal controls
The Board and its Committees are responsible for reviewing and ensuring the effectiveness of management's system of risk management and internal controls. We have carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. For further details, see the Risk review.

Management's report on internal control over financial reporting
Internal control over financial reporting is a component of an overall system of internal control. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting, and the preparation and fair presentation of financial statements for external purposes in accordance with UK-adopted international accounting standards (UK-adopted IAS).

The Company's internal control over financial reporting includes:
- Policies and procedures that pertain to the maintenance of records that fairly and accurately reflect the transactions and dispositions of assets
- Controls providing reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with UK-adopted IAS, and that receipts and expenditures are being made only as authorised by management
- Controls providing reasonable assurance regarding prevention or timely detection of unauthorised acquisition and use or disposition of assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or because the degree of compliance with policies or procedures may deteriorate.

GOING CONCERN (audited)

The going concern of the Company is reliant on preserving a sufficient level of capital and adequately funding the balance sheet. The Company's business activities and financial position, together with the factors likely to affect its future development and performance, are set out in the Strategic report on pages 2 to 3, and the Financial review on pages 4 to 6. The Company's objectives, policies and processes for managing the financial and other risks to which it is exposed, including capital, funding and liquidity, are described in the Risk review.

In assessing going concern, the Directors take account of all information of which they are aware about the future, which is at least, but is not limited to, 12 months from the date that the financial statements are approved.

As described in the Strategic Report, the Company is a wholly owned direct subsidiary of Santander UK Group Holdings plc, and its principal activity is to provide banking and financial services for clients and customers through its presence in the UK, Jersey and the Isle of Man, whilst also holding a pool of residual assets and liabilities, which is intended to be run down and/or managed for value.

At 31 December 2023, the Company, Santander UK Group Holdings plc and Santander Equity Investments Limited were party to a capital support deed dated 17 December 2021 and effective from 1 January 2022 (the Non-RFB Sub-Group Capital Support Deed). These parties were permitted by the PRA to form a core UK group as defined in the PRA Rulebook, a permission which expires on 31 December 2024. It is expected that this agreement will be extended when it expires. Exposures of each of the regulated entities to other members of the core UK group are exempt from large exposure limits that would otherwise apply and intra-group exposures are risk-weighted at 0% and excluded from leverage exposure. The purpose of the Non-RFB Sub-Group Capital Support Deed is to facilitate the prompt transfer of available capital resources from, or repayment of liabilities by the members, in the event that the Company breached or was at risk of breaching its capital resources.

The Company manages its own liquidity. At 31 December 2023, SFS had a liquidity surplus of 1.5, which was placed with the Bank of England and is reflected in the LCR of 240%. For more, see the Liquidity risk section of the Risk review.

Having assessed the principal risks and the other matters discussed above, the Directors consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

ETHICAL CODE OF CONDUCT

The Company is committed to ensuring we hold ourselves to high ethical standards. This means adhering to laws and regulations and also conducting business in a responsible way, and treating all stakeholders with fairness and respect. These principles are reflected in Santander UK's Ethical Code of Conduct, which sets the standards expected of all employees.

High standards of professional and personal conduct help the Company identify, manage and respond to risks, create a positive, collaborative working environment and ensure positive customer interactions and outcomes.

Among the requirements set out in the Ethical Code of Conduct we expect employees to:

– Act with integrity in all their business actions on behalf of the Company
– Not use their authority or position for personal gain
– Speak up and report risks
– Conduct business relationships in a transparent manner.

There are numerous policies which support colleagues to meet these expectations and to ensure Santander UK (including the Company) remains a Simple, Personal and Fair bank for its colleagues, customers, shareholders and the communities it serves. The Ethical Code of Conduct applies to all colleagues including permanent and temporary colleagues as well as Executive Directors and Non-Executive Directors.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable laws and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the financial statements in accordance with UK-adopted IAS.

Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing the financial statements, the Directors are required to:

– Select suitable accounting policies and then apply them consistently;
– State whether applicable UK-adopted IAS have been followed, subject to any material departures disclosed and explained in the financial statements;
– Make judgements and accounting estimates that are reasonable and prudent; and
– Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The Directors are responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are also responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company, and enable them to ensure that the financial statements comply with the Companies Act 2006.

The Directors are responsible for the maintenance and integrity of the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Directors consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

Directors' confirmations

Each of the Directors whose names and functions are listed in the Board of Directors section confirms that, to the best of their knowledge that the financial statements, which have been prepared in accordance with UK-adopted IAS, give a true and fair view of the assets, liabilities, financial position and profit of the Company.

DISCLOSURE OF INFORMATION TO AUDITORS

In the case of each Director in office at the date the Directors' report is approved:

- So far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- They have taken all steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the UK Companies Act 2006.

AUDITORS

PricewaterhouseCoopers LLP have confirmed their willingness to continue as external auditors and a resolution to reappoint them as the Company's external auditors will be proposed at the Company's forthcoming Annual General Meeting.

On behalf of the Board

James Pountney
Director
12 March 2024
2 Triton Square, Regent's Place, London NW1 3AN

This Risk review consists of unaudited financial information unless otherwise stated. The audited financial information is an integral part of the Financial Statements.

Risk governance

RISK FRAMEWORK

Our risk governance structure

We are committed to the highest standards of corporate governance in every part of our business, including risk management. For details of our governance, including the Board and its Committees, see the 'Governance' section of this Annual Report. The Company maintains a Board Audit Committee and a Board Risk Committee. The Board delegates certain responsibilities to Board Level Committees as needed and where appropriate.

Our risk governance structure strengthens our ability to identify, assess, manage and report risks, as follows:
- **Committees**: A number of Board and Executive committees are responsible for specific parts of the Risk Framework. SFS has chosen to adopt the Santander UK Risk Framework
- **Key senior management roles**: A number of senior roles have specific responsibilities for risk management
- **Risk organisational structure**: We have the 'three lines of defence' model built into the way we run our business.

The Company operates within a standalone Risk Appetite Statement approved by the SFS Board and noted by the Santander UK Executive Risk & Controls Committee.

Committees

The Santander UK Risk Framework states that operating companies of Santander UK should have a sufficient committee structure in place to allow them to discharge their risk responsibilities and escalate issues. The structure should be proportionate to the company's size and complexity.

The Board Level Committee responsibilities for risk in 2023 were:

Board Level Committee	Main risk responsibilities
The Board	– Has overall responsibility for business execution and for managing risk – Reviews the Company's adherence to the Risk Framework and Risk Appetite
Board Risk Committee (BRC)	– Assesses the Company's adherence to the Risk Framework and Risk Appetite – Advises the Board on our overall Risk Appetite, tolerance and strategy – Oversees our exposure to risk – Responsible for oversight of cybersecurity risks and receives regular updates on cybersecurity risk position including cybersecurity incidents
Board Audit Committee	– Monitors and reviews the financial statements integrity, and any formal announcements on financial performance – Reviews the adequacy and effectiveness of the internal financial controls and whistleblowing arrangements – Monitors and reviews the effectiveness of the internal audit function – Receives regular updates from the internal audit function which performs reviews of cybersecurity risk and controls

The Executive Level Committee responsibilities for risk in 2023 were:

Executive Level Committee	Main risk responsibilities
Executive Committee (ExCo)	– Sets and monitors performance against the Company's annual plan and budget – Ensures that adequate and effective risk control processes and reporting systems are in place to identify, assess, manage and report all the relevant risks in the Company as detailed in the Risk Framework and Risk Appetite – Monitors the risk profile of the Company – Manages the structural balance sheet risks, capital, funding and liquidity, in line with the policies, strategies and plans set by the Company.

The Santander UK Corporate Governance Framework and Risk Framework have been adopted by its subsidiaries, including the Company, to ensure consistency of application. As Santander UK Group Holdings plc is the immediate parent company of the Company, its Executive and Board level committees consider the impact on the Company, as a subsidiary, as part of their decision-making process.

Key senior management roles

Senior roles with specific responsibilities for risk management are:

Role	Main risk responsibilities
Chief Executive Officer (CEO)	The Board delegates responsibility for our business activities and managing risk on a day-to-day basis to the CEO. The CEO proposes our strategy and business plan, puts them into practice and manages the risks involved. The CEO must also ensure we have a suitable system of controls to manage risks and report to the Board on them.
Chief Risk Officer (CRO)	Oversees and challenges risk ensures new lending decisions are made within our Risk Appetite. Accountable for the control and oversight of credit, market, liquidity, capital, operational risk and risks associated with climate change.
Chief Financial Officer (CFO)	Responsible for developing strategy and supporting our corporate goals within our risk appetite. The CFO is responsible for managing interest, liquidity and capital risks.

Risk organisational structure

We use the 'three lines of defence' model to manage risk. This model is widely used in the banking industry and has a clear set of principles to put in place a cohesive operating model across an organisation. It does this by separating risk management, risk control and risk assurance.

Line 1: Risk management	Business Units and Business Support Units identify, assess and manage the risks which originate and exist in their area, within our Risk Appetite. It is under the executive responsibility of the CEO.
Line 2 - Risk control	Risk Control Units are independent monitoring, control and oversight functions. They make sure Business Units and Business Support Units manage risks effectively and within our Risk Appetite. The Risk Control units are: Risk - responsible for controlling credit, liquidity, capital, market, pension, strategic and business, operational, model and enterprise risks; Financial Crime; and Compliance, responsible for controlling reputational and conduct and regulatory risks. It is under the executive responsibility of the CEO, but responsible to the CRO for overseeing the first line of defence.
Line 3: Risk assurance	Internal Audit is an independent corporate function. It gives assurance on the design and effectiveness of our risk management and control processes.

RISK APPETITE

How we control the risks we are prepared to take

When our Board sets our strategic objectives, it is important that we are clear about the risks we are prepared to take to achieve them. We express this through our Risk Appetite Statement, which defines the amount and kind of risk we are willing to take. Our Risk Appetite and strategy are closely linked, and our strategy must be achievable within the limits set out in our Risk Appetite.

How we describe the limits in our Risk Appetite

Our Risk Appetite sets out detailed limits across all types of risk, using metrics and qualitative statements.

Metrics

We use metrics to set limits on capital, liquidity and credit risk. We set:
- Capital limits, reflecting the capital that regulators expect us to hold (regulatory capital)
- Liquidity limits according to a range of plausible stress scenarios for our business
- Credit limits, to control the credit quality of our mortgage and other loan portfolios.

These limits apply in normal business conditions, but also when we might be experiencing a far more difficult economic environment. We refer to conditions like this as being under stress. See more on stress scenarios on the next page.

Qualitative statements

For some types of risk, we also use qualitative statements that describe in words the appetite we want to set.

How we set our Risk Appetite, and stay within it

We control our Risk Appetite through our Risk Appetite Framework. Our Board approves and oversees our Risk Appetite Statement every year. This ensures it is consistent with our strategy and reflects changes in the markets and economic environment in which we operate. Our Executive Committee is responsible for ensuring that our risk profile (the level of risk we are prepared to accept) is consistent with our Risk Appetite Statement. To do this, they monitor our performance against our Risk Appetite regularly.

We also use stress testing to review how our business plan performs against our Risk Appetite Statement. This shows us if we would stay within our Risk Appetite under stress conditions. It also helps us to identify any adverse trends or inconsistencies.

We embed our Risk Appetite by setting more detailed risk limits for each business unit and key portfolios. These are set in a way so that if we stay within each detailed limit, we will stay within our overall Risk Appetite. When we use qualitative statements to describe our appetite for a risk, we link them to lower-level key risk indicators, so that we can monitor and report our performance against them.

STRESS TESTING

Stress testing is carried out in alignment with the Santander UK group stress testing exercises. The following sections therefore refer to the Santander UK group and the Company.

Stress testing helps us understand how different events and economic conditions could affect our business plan, earnings and risk profile. This helps us plan and manage our business.

Scenarios for stress testing

To see how we might cope with difficult conditions, we regularly develop challenging scenarios that we might face. We consult a broad range of internal stakeholders, including Board members, when we design and choose our most important scenarios. The scenarios cover a wide range of outcomes, risk factors, time horizons and market conditions. They are designed to test:

- The impact of shocks affecting the economy as a whole or the markets we operate in
- Key potential vulnerabilities of our business model, and the processes and systems which support it
- Potential impacts on specific risk types.

We describe each scenario using a narrative setting out how events might unfold, as well as a market and/or economic context. For example, the key economic factors we reflect in our ICAAP scenarios include house prices, interest rates, unemployment levels, inflation, and the size of the UK economy. We also explore sensitivities around several macro variables where there may be concerns or levels of uncertainty.
In 2023, the Company participated in the Santander UK group's completion of the Bank of England's (BoE) Annual Cyclical Scenario. The purpose of this exercise was to explore a 'tail risk' scenario designed to be severe and broad enough to assess the resilience of UK banks to a range of adverse shocks. In the scenario, weaker household real income growth, lower confidence and tighter financial conditions resulted in severe domestic and global recessions. Where appropriate, we also capture the economics in Jersey and Isle of Man in our scenarios.

How we use stress testing

We use stress testing to estimate the effect of these scenarios on our business and financial performance, including:

- Our business plan, and its assessment against our Risk Appetite
- Our capital strength, through our ICAAP
- Our liquidity position, through our ILAAP
- Our long term impacts of climate change, through regulatory exercises and CISA
- Impacts on other risk types.

We use a wide range of models, approaches and assumptions supported by robust governance. These help us interpret the links between factors in markets and the economy, and our financial performance. For example, one model looks at how changes to key macroeconomic variables like unemployment rates might affect the number of customers who might fall into arrears on their mortgage or other loans.

Our stress testing models are subject to a formal review, independent validation and approval process. We highlight the key weaknesses and related model assumptions in the approval process for each stress test. In some cases, we overlay expert judgement onto the results of our models. Where this is material to the outcome of the stress test, the approving governance committee reviews it. We take a multi-layered approach to stress testing to capture risks at various levels. This ranges from sensitivity analysis of a single factor to a portfolio, to wider exercises that cover all risks across our entire business. We use stress test outputs to design business plans that aim to mitigate potential impacts of possible stress scenarios.

We also conduct reverse stress tests. These are tests in which we identify and assess scenarios that are most likely to cause our business model to fail.

Board oversight of stress testing

The Santander UK ERCC approves the design of the scenarios in our ICAAP and ILAAP. The SFS Board Risk Committee ratifies the approach, stress testing framework and results of the ICAAP and ILAAP after ensuring there is proper and appropriate second line of defence oversight of the process. Scenarios are appropriately challenged and debated before Board approval is given.

Regulatory stress tests

We take part in a number of external stress testing exercises. These can include stress tests of the UK banking system conducted by the PRA and the BoE. We also contribute to stress tests of Banco Santander conducted by the European Banking Authority (EBA).

For more on capital and liquidity stress testing, see the 'Capital risk' and 'Liquidity risk' sections.

HOW RISK IS DISTRIBUTED ACROSS OUR BUSINESS

Economic capital

As well as assessing how much regulatory capital we need to hold, we use an internal EC model to measure our risk. We use EC to get a consistent measure across different risk types. EC also takes account of how concentrated our portfolios are, and how much diversification there is between our various businesses and risk types. As a consequence, we can use EC for a range of risk management activities. For example, we can use it to help us compare requirements in our ICAAP or to get a risk-adjusted comparison of income from different activities.

CREDIT RISK

Overview

Credit risk management
In this section, we set out how our exposures arise and our approach to credit risk across the credit risk lifecycle. We also discuss our expected credit losses (ECL) approach and the key inputs to our ECL model. We focus on our largest portfolio, UK residential mortgages, purchased from Santander UK plc, but also discuss our Crown Dependency residential mortgages that we originated.

Credit risk review
In this section, we analyse our maximum and net exposures to credit risk, including their credit quality and concentrations of risk.

CREDIT RISK MANAGEMENT

Exposures (audited)

Exposures to credit risk arise in our business from:

- Loans and advances to customers (mainly UK and Crown Dependency residential mortgages to individuals)
- Loans and advances to banks and other financial institutions

Our approach to credit risk

We manage our portfolios across the credit risk lifecycle, from drawing up our risk strategy, plans, budgets and limits to making sure the actual risk profile of our exposures stays in line with our business plans and within our Risk Appetite. We tailor the way we manage risk across the lifecycle to the type of product.

1. Risk strategy and planning (audited)
All relevant areas of the business work together to create our business plans. We aim to balance our strategy, goals, and financial and technical resources with our Risk Appetite. To do this, we focus on economic and market conditions and forecasts, regulations, conduct matters, profitability, returns and market share. The result is an agreed set of targets and limits that help us direct our business.

2. Assessment and origination (audited)
Managing credit risk begins with lending responsibly. That means only lending to customers who are committed to paying us back and can afford to, even if their circumstances change. We perform (or in the case of UK residential mortgages purchased from Santander UK plc, Santander UK plc performs) a thorough risk assessment to make sure customers can meet their obligations before a credit application is approved. These decisions are made with authority from the Board and consider:

- The credit quality of the customer
- The underlying risk and how we can mitigate it, such as through netting or collateral
- Our risk policy, limits and appetite
- Whether we can balance the amount of risk we face with the returns we expect, and
- Assessment of customer affordability.

Affordability
For Crown Dependency residential mortgages, we take proportionate steps to assess whether a customer will be able to repay the money borrowed. We do this by a series of initial affordability and credit risk assessments. We assess affordability by reviewing the customer’s income and spending, their other credit commitments, and what would happen if interest rates went up. We regularly review the way we calculate affordability and refine it when we need to. This can be due to changes in regulations, the economy or our risk profile. For UK residential mortgages purchased from Santander UK plc, Santander UK plc makes the affordability assessments in accordance with its policies and procedures.

Credit profile
For Crown Dependency residential mortgages, we access each customer’s credit profile and signs of how reliable they are at repaying credit. When they apply, we assess the data they give us, using the following:

- **Credit policy:** these are our rules and guidelines. We review them regularly to make sure our decisions are consistent and fair and align to the risk profile we want. We look at the property and the LTV as well as the borrower
- **Credit scores:** based on statistics about the reasons people fail to pay off debt. We use them to build models of what is likely to happen in the future. These models give a credit score to the customer for the loan they want, to show how likely it is to be repaid. We regularly review them
- **Credit reference agencies:** data from credit reference agencies about how the borrower has handled credit in the past
- **Other Santander accounts:** we look at how the customer is using their other accounts with us.

For UK residential mortgages purchased from Santander UK plc, it undertakes a similar assessment of the credit profile of the customer.

How we make the decision
For UK residential mortgages, Santander UK plc has originated the loan using its policies and process and the Company has subsequently acquired the loan and its associated credit risk. For Crown Dependencies mortgages, loans below a certain LTV and size are underwritten within delegated authorities by the mortgage underwriting team; any exceptions to policy or amounts above that are approved by the Company's Credit committee.

Credit risk mitigation

The types of credit risk mitigation, including collateral, across each of our portfolios are:

Portfolio	Description
Residential mortgages	Collateral is in the form of a first legal charge over the property. Before we or Santander UK plc grant a mortgage, the property is valued. We have our own guidelines for surveyor valuations, which build on guidance from the Royal Institution of Chartered Surveyors (RICS). But we also make use of automated valuation methodologies where our confidence in the accuracy of this method is high.
Loans and advances to banks and other financial institutions	We use the Credit Support Annex with the ISDA Master Agreement and other similar arrangements in relation to our derivatives and some of our loans and advances to banks and other financial institutions. This gives us collateral for our net exposures.

3. Monitoring (audited)

We measure and monitor changes in our credit risk profile on a regular and systematic basis against our budgets, limits and benchmarks. We monitor credit performance by portfolio, segment, customer or transaction. If our portfolios do not perform as we expect, we investigate to understand the reasons. Then we take action to mitigate it as far as possible and bring performance back on track. We monitor and review our risk profile through formal governance forums and committees across our business. These agree and track any steps we need to take to manage our portfolios, to make sure the impact is prompt and effective. This structure is a vital feedback tool to coordinate issues, trends and developments across each part of the credit risk lifecycle. In the case of UK residential mortgages purchased from Santander UK plc, we rely on Santander UK to monitor the portfolio in accordance with the servicing agreement with us.

Credit concentrations

Credit exposure metrics in line with the Board approved risk appetite are presented to the SFS Board Risk Committee, Board Audit Committee and ERCC as appropriate.

For residential mortgages, our risk assessment does not end once we have made the decision to lend or acquire a UK residential mortgage from Santander UK plc. We continue to monitor credit risk across the credit risk lifecycle, ensuring that early arrears are highlighted, and customers contacted to discuss potential problems. For residential mortgages, our monitoring also takes account of changes in property prices. We (or, in the case of UK residential mortgages, Santander UK plc) estimate the property's value every three months. In most cases, statistical models based on recent sales prices and valuations in that local area are used. Use of this model is subject to Model Risk Governance. Where a lack of data means the model's valuation is not available, the original surveyor valuation with a House Price Index (HPI) adjustment as appropriate is used.

Our Watchlist

For loans and advances to banks and other financial institutions, we use a Watchlist to help us identify potential problem debt early. Just because a customer is on our Watchlist does not mean they have defaulted. It just means their probability of default has increased, such as they have breached a covenant or lost a major contract.

We classify Watchlist cases as:
- Enhanced monitoring: for less urgent cases. We monitor these cases more often and where appropriate may consider more collateral.
- Proactive management: for more urgent or serious cases. We may take steps to restructure debt including extending the term, taking more collateral, agreeing a lower credit limit, or seeking repayment of the loan through refinancing or other means.

We assess Watchlist cases for impairment as set out in the 'Significant Increase in Credit Risk (SICR)' section. When a customer is in enhanced monitoring, we do not consider it has suffered a SICR for ECL purposes, so it remains in Stage 1 for our loss allowance calculations. When a customer is in proactive management, we consider it has suffered a SICR, so we transfer it to Stage 2 and apply a lifetime ECL for our loss allowance calculations. We take into account any forbearance we offer. This includes any extra security, guarantees or equity available and the potential to enhance value by asset management.

4. Arrears management (audited)

Sometimes our customers face financial difficulty and may fall into payment arrears or breach the conditions of their credit facility. If this happens, we work with them to get their account back on track. We aim to support our customers and keep our relationship with them. To do this, we:

- Find affordable and sustainable ways of repaying to fit their circumstances
- Monitor their finances and use models to predict how they will cope. This helps us put in place the right strategy to manage their debt
- Work with them to get their account back on track as soon as possible in a way that works for them and us
- Monitor agreements we make to manage their debt, so we know they are working.

For residential mortgages, we have several strategies to manage arrears that we can use as early as the day after a missed payment. We assess the problems a customer is having, so we can offer them the right help to bring their account up to date as soon as possible. The most common way to bring an account up to date is to agree an affordable repayment plan with the customer. The strategy we use depends on the risk and the customer's circumstances. We have a range of tools to help customers to reach an affordable and acceptable solution. This could mean visiting the customer or offering debt counselling by a third party.

For loans and advances to banks and other financial institutions, we identify problem debt by close monitoring, supported by our Watchlist process. When there is a problem, we take a collaborative approach, led by the relevant credit risk expert with our Credit risk team and the relationship managers.

We aim to act before a customer defaults, to prevent it, if possible. We aim to identify warning signs early by monitoring customers' financial and trading data, checking to make sure they are not breaching any covenants, and by having regular dialogue with them. The strategy we use depends on the type of customer, their circumstances and the level of risk. We try to help our customers find their own way out of financial difficulty and agree on a plan that works for both of us. We hold regular Watchlist meetings to agree a strategy for each portfolio.

Our Credit Risk team are engaged as appropriate on Watchlist cases and we may hand over more serious cases to them.

5. Debt recovery (audited)
Sometimes, even when we have taken all reasonable and responsible steps to manage arrears in our Financial Support area, they are not effective. If this happens, we may choose to end our agreement with the customer and try to recover the outstanding balance (with recourse to any associated collateral), or as much of it as we can.

For residential mortgages, when a customer cannot or will not keep to an agreement for paying off their arrears, we consider recovery options. We only do this once we have tried to get the account back in order. To recover what we are owed, we may initiate legal action that could ultimately lead to the customer facing court action for possession of the property. If the customer shows that they will be able to pay off the loan or the arrears, we can delay legal action. We may repossess the property as a last resort or to protect it from damage or third-party claims. We make sure our estimated losses from repossessed properties are realistic by getting two independent valuations and the estimated selling costs, and using them in our loss allowances calculations. Where we repossess a property, we do not take ownership. We use agents to realise the value and settle the debt. Any surplus funds are returned to the borrower or dealt with in line with insolvency regulations.

Santander UK plc undertakes the activities described above on our behalf in relation to residential mortgages we have purchased from it.

For loans and advances to banks, where we cannot find a way forward or reach a consensual arrangement, we consider recovery options. This can be through:

- The insolvency process
- Enforcing over any collateral
- Selling debt on the secondary market
- Considering other legal action available to recover what we are owed from debtors and guarantors.

If there is a shortfall, we write it off against loss allowances we hold. In very rare cases, we may act as mortgagee in possession of assets held as collateral against non-performing loans. In such cases, we carry the assets on our balance sheet and are classified in line with our accounting policies.

Risk measurement and control
We measure and control credit risk at all stages across the credit risk lifecycle. We have a range of tools, processes and approaches, but we rely mainly on:

- **Credit control:** as a core part of risk management we generate, extract and store accurate, comprehensive and timely data to track credit limits. We do this using internal data
- **Review:** we use formal and informal forums to approve, validate, review and challenge our risk management. We do this to help predict if our credit risk will worsen.

The Crown Dependency residential mortgage portfolio involves managing approximately 3,600 mortgages. This allows us to analyse the portfolio in detail at an individual account level in order to measure the risk. We assess and review our loss allowances regularly. We look at factors such as the cash flow available to service debt. We also use an agency to value the collateral. We risk manage the UK residential mortgage portfolio purchased via a risk transfer from Santander UK plc.

Key metrics(audited)
We use a number of key metrics to measure and control credit risk, as follows:

Metric	Description
Expected Credit Loss (ECL)	ECL tells us what credit risk is likely to cost us either over the next 12 months on qualifying exposures, or defaults over the lifetime of the exposure where there is evidence of a significant increase in credit risk (SICR) since origination. We explain how we calculate ECL below.
Stages 1, 2 and 3	We assess each facility's credit risk profile to determine which stage to allocate them to, and we monitor where there is a SICR and transfers between the stages. We explain how we allocate a facility to Stage 1, 2 or 3 below.
Stage 3 ratio	The Stage 3 ratio is the sum of Stage 3 drawn and Stage 3 undrawn assets divided by the sum of total drawn assets and Stage 3 undrawn assets. The Stage 3 ratio is a key indicator used to monitor underlying asset performance.
Expected Loss (EL)	EL is based on the CRD IV regulatory capital rules and gives us another view of credit risk. It is the product of the probability of default (PD), exposure at default and loss given default. We calculate each factor in accordance with CRD IV and include direct and indirect costs. We base them on our risk models and our assessment of each customer's credit quality. There are differences between regulatory EL and International Financial Reporting Standards (IFRS) 9 ECL, which we set out below. For the rest of our Risk review, impairments, losses and loss allowances refer to calculations in accordance with IFRS, unless we specifically say they relate to CRD IV. For our IFRS accounting policy on impairment, see Note1 to the Financial Statements.

We also assess risks from other perspectives, such as geography, business area, product and process to identify areas to focus on. We also use stress testing to establish vulnerabilities to economic deterioration. Our business segments tailor their approach to credit risk to their customers, as we explain later on.

Recognising ECL (audited)
The ECL approach estimates the credit losses arising from defaults in the next 12 months on qualifying exposures, or defaults over the lifetime of the exposure where there is evidence of a Significant Increase in Credit Risk (SICR) since the origination date. The ECL approach for UK residential mortgages considers forward-looking data, including a range of possible outcomes, which should be unbiased and probability-weighted to reflect the risk of a loss being incurred even when it is unlikely. The ECL approach for Crown Dependencies residential mortgages is similar to the approach for UK residential mortgages. We consider forward-looking data, including a wide array of possible outcomes which are unbiased and probability-weighted to reflect the risk of a loss being incurred even when it is unlikely. This process results in the production of a static table that assigns a provisioning percentage to each Loan-To-Value band and arrear stage combination. The provisioning table is updated each time there is a significant change in the modelling assumptions, and reviewed each quarter. SFS applies the percentages to the Crown Dependencies residential mortgages at a single mortgage advance level.

Multiple economic scenarios and probability weights (audited)
This work is led by Santander UK plc and approved by the Company as part of the modelling on the Company's mortgage book.

For UK residential and Crown Dependencies mortgages we use five forward-looking economic scenarios. For 2023, they consisted of a central base case, one upside scenario and three downside scenarios. We use five scenarios to reflect a wide range of possible outcomes for the UK economy.

Our forecasting approach
For UK residential mortgages we derive our scenarios in part by using a set of parameters in GDP fan charts published by the Office for Budget Responsibility (OBR). These fan charts reflect the probability distribution of a deviation from the OBR's central forecast to show the uncertainty about the outcome of a variable, in this case GDP.

Once we have established the GDP paths for each scenario, we run them through the Oxford Global Economic Model (OGEM) to derive the other macroeconomic variables, such as unemployment and house prices. These variables are the product of the GDP growth paths we have forecast and the output of the OGEM for these growth paths. We then review them to ensure consistency with the narrative of each scenario and so changes to the variables may be needed in some cases.

We then impose a Bank Rate profile for each scenario using expert judgement with the base case as the starting point and then adjusting this for each of the four other scenarios based on the narratives. We produce a range of Bank Rate profiles to reflect a range of possible outcomes the Bank of England may follow depending on how it sees the trade-off between growth and inflation evolving over the forecast period. For example, this might consist of higher rates initially in response to inflationary concerns followed by lower rates as inflation falls towards target, and that this may be sharper in the event of a deep recession.

We update the baseline in our economic scenarios at least twice a year in line with our annual budgeting and three-year planning processes, or sooner if there is a material change in current or expected economic conditions. We refresh all our economic scenarios quarterly to reflect the latest data and OBR fan charts if these changed, which are then reviewed and approved by the Credit Risk Provisions Forum (CRPF). The CRPF also assesses the probability weights at least once a quarter.

We do not use consensus forecasts as inputs to our models, but we do compare the outputs of our models against consensus views for the base case, to make sure that we understand any significant differences and address them where needed. At 31 December 2023, there were no significant differences between our base case forecasts and the consensus views.

In 2023, we undertook a further peer benchmarking analysis of the economic scenarios, which for Q423 included the mean weighted analysis for a selection of economic variables, including GDP, unemployment rate and HPI. This meant that we could compare our weighted scenarios against the average of our peers to understand what differences there may be. The conclusion of this analysis demonstrated that our economic scenarios were in line with our peers although, on a weighted basis, our house price inflation assumption reflected a more conservative view.

In 2023, we also considered any likely impact from climate risk on our forecasting approach and concluded that no adjustment to the multiple economic scenarios for climate risk was required. This is because climate change effects are generally regarded to be relevant over a longer timeframe than our forecast period of five years.

Our use of five scenarios is designed to reflect different possible outcomes to the base case, highlighting the upside and downside risks associated with the central scenario. The downside risks for the UK economy include a sharp downturn in global growth, a return to upside inflation surprises which raises the cost of living, a continuation of the very low productivity growth seen in the UK, a move to a more protectionist agenda for trade and further geopolitical events adding to challenging economic conditions. The upside risks were more muted at the end of 2023 and include a stronger recovery in global growth, a faster fall in inflation, coupled with further trade agreements with other countries.

Our forecasting period for GDP is five years and then we revert to the average trend growth over three years based on the OBR's long-run GDP forecast assumption. The reversion to mean for all macroeconomic variables is expected to take three years after the initial five-year forecast period.

For Crown Dependencies residential mortgages, the forecasting approach is similar. By mirroring UK provisioning for Crown Dependencies residential mortgages, SFS management take a prudent approach of assuming a more negative case scenario, which is consistent with stress testing principles. Crown Dependencies economics are not materially different to the UK, and our metrics have historically proved more resilient. So we use the UK economics as a basis for the Crown Dependencies metrics, and continue to monitor these to ensure that the relationship between the two remains appropriate.

Key changes to our forecasting approach in 2023
In 2023, there were no specific changes to our forecasting approach. We incorporated the OBR's March 2023 fan chart parameters to generate the GDP paths (excluding the base case).

Base case
We review the scenarios and associated weights every quarter to ensure they appropriately reflect the current economic circumstances and UK Government policy which is subject to change.
In summary, the outlook for the UK economy in 2024 remains challenging due to a lack of growth, weak investment and with continuing risks to the 2% inflation target, particularly if the situations in the Middle East and Ukraine trigger a renewed surge in oil and gas prices. Inflationary pressures could be further exacerbated by a tight UK labour market maintaining pressure on wage growth at a time when firms are struggling to match appropriately skilled workers to available vacancies.

Base case key macroeconomic assumptions
– House price growth: The sharp rise in mortgage rates triggered a slowdown in house price growth in recent months. With survey indicators pointing to a slump in buyer demand as confidence is hit by a squeeze on affordability from the sharp rise in mortgage rates, house prices are expected to continue declining in the near-term. However, as the supply of housing is also weak this has helped to limit the overall fall in house prices compared to previous downturns despite the sharp rise in interest rates. We forecast a c.2% year-on-year decline in house prices by the end of 2023, with a further fall of 1% by the end of 2024. Looser monetary policy from the second half of 2024 enables house price growth to recover with growth back to average levels by the end of the forecast period.
– GDP: While the monthly GDP estimate for October 2023 showed the economy shrinking marginally with a 0.3% month-on-month fall, this aligns to the picture of a stagnating UK economy. The PMI data for November 2023 is marginally above 50 and suggests growth to be modest in Q423. As such, the near-term outlook for growth remains broadly flat - but as the effects of higher interest rates filter through the economy this year and the bulk of fixed rate mortgages are renewed, consumer spending growth could fall back sharply and with business insolvencies expected to increase, there are still downside risks to our forecast of 0.4% growth in 2024.
– Unemployment rate: Unemployment remained flat in October 2023 at 4.2% based on the ONS experimental data and combined with other surveys such as REC, suggest that the labour market is slowly loosening. With companies under pressure from rising debt servicing costs and higher wages, it is likely that some will become insolvent and others find that demand for their goods and services reduces as households restrict their spending. We do not envisage a large rise in unemployment compared to previous recessions. The rate peaks at 4.8% by the end of 2024, in part impacted by the ongoing return of previously inactive workers to the labour force.
– Bank Rate: The Monetary Policy Committee (MPC) kept rates at 5.25% at the December 2023 meeting. Our base case assumes no further rate rises with the MPC expected to start loosening monetary policy in Q224, with rates ending 2024 at 4.50%. Further cuts through the rest of the 5-year forecast period leaves bank rate at 3.00% by the end of 2028.

In the medium-term, the projections assume that current demographic and productivity trends will continue, causing a reduction in the UK's growth potential. For instance, it is likely that the reduction in the UK workforce will continue and this will have a knock-on impact for the economy, particularly if there are shortages of skilled workers in particular sectors. This is reflected in an average annual growth expectation of 1.6%, in line with the OBR's latest estimate of the UK's long run average growth rate.

Key changes to our base case in 2023
For our base case, we no longer expect a short recession given that the economy has been more resilient than expected in 2023. However, risks around this assumption remain as the full effects of higher interest rates have yet to be felt across the UK economy which keeps growth in 2024 significantly below average.

Other scenarios
Based on this revised base case, we reviewed our suite of scenarios to ensure that they capture the wide range of potential outcomes for the UK economy. These include (i) persistent above target inflation over the forecast period; (ii) a slower recovery that is more akin to the 'U' shape of past recessions; (iii) labour market frictions due to skills mismatches and a shrinking workforce as some discouraged workers leave altogether (for example older UK-born workers retiring early and longer term sickness levels remaining above pre-pandemic levels); and (iv) the global economy recovering more swiftly from higher inflation.

To reflect these potential outcomes, we continue to use the base case and four additional scenarios, which we consider sufficient to reflect all the above potential outcomes. However, as the risks remain skewed to the downside, to reflect these outcomes sufficiently, we concluded that only one upside scenario would be needed to reflect the upside risks to the base case. As with the base case, the scenarios are forecast over a five-year period and then mean revert over the next three years to the OBR's latest estimate of the UK's long run average growth rate.

The other scenarios are:

One upside scenario
This scenario has a quicker recovery than the Baseline and is a bull case to the base forecasts. It assumes that inflation falls back more swiftly than in the base case, helped by lower growth in wages and pass through of lower commodity prices. This allows the Bank of England to cut rates earlier, bringing them back towards what might be considered the neutral rate. This results in higher consumer and business confidence enabling higher levels of spending with savings rates returning to levels consistent with economic growth as real earnings growth returns. Unemployment peaks at a slightly lower level than the base case and drops more quickly than the base, ending the 5-year forecast period at 3%. The Bank Rate profile is lower than the base case as inflation returns to target at a faster pace.

Three downside scenarios
Downside 1 - This scenario is a bear case to the baseline. It assumes that the fall in economic growth is sharper and that there is a recession. In this scenario, consumers keep savings rather than spend as consumer confidence remains extremely low while households are worried about the prospect of losing their jobs. House prices fall further than in the base case as more households look to downsize in order to lower their mortgage repayments. With inflation remaining above target, Bank Rate continues to increase as core inflation remains above the baseline view before cuts start as inflation falls back.

Stubborn inflation - This scenario considers the effect on the UK economy of a persistent inflationary environment. Here inflation remains above target for much of the forecast period. This persistent inflation is created by a combination of factors, including higher energy costs exacerbated by the Ukraine/ Russia crisis and curtailment of oil supply by OPEC countries; continuous wage rises resulting in a spiral effect pushed by increasing numbers of strikes and falling productivity. Despite the peak in inflation having already passed in Q422, inflation remains slightly above the 2% target over the 5-year forecast period. The 2.8% peak to trough fall in GDP is similar to the early 1980s recession due to inflation remaining higher for longer, which in turn reduces households' real incomes and therefore consumption. This is despite higher wage settlements due to increased strike action. Unemployment peaks at 6.2% in 2026 as although inflation eventually returns to target, Bank Rate remains at higher levels compared to recent history and growth is still muted due to weak productivity as investment levels remain low. The large increases in Bank Rate and falling real incomes result in house prices falling by c.26%.

Downside 2 - The scenario shows a marked fall in GDP, with rising unemployment and falling house prices reflecting the ongoing issues of a higher interest rate environment and above target inflation, which feeds across the whole economy. It also reflects the ongoing strike action by various unions pushing for stronger pay growth, alongside dealing with potential blackouts caused by an increase in energy shortage over the winter months in Q423 and into early 2024. It also assumes that major risk events continue to occur exposing risks to countries' fiscal position and the means to respond to such events. For this scenario, an overlay to the unemployment rate was also made to the model output from the OGEM. This was to account for the possibility of a recession of similar magnitude to that of 2008/09 where the unemployment rate peaked at 8.5%.

Key changes to our alternative scenarios in 2023
In 2023 we did not make any methodological changes to the scenarios.

Our macroeconomic assumptions and their evolution throughout the forecast period

Our macroeconomic assumptions and their evolution throughout the forecast period for each of the scenarios at 31 December 2023 were:

		Upside	Base case	Downside 1	Stubborn Inflation	Downside 2	Weighted[5]
		%	%	%	%	%	%
GDP[1]	2022 (actual)	4.3	4.3	4.3	4.3	4.3	4.3
	2023	0.6	0.5	0.5	0.5	0.3	0.5
	2024	1.0	0.4	(0.1)	(1.8)	(3.3)	(0.4)
	2025	2.1	1.3	0.2	(0.9)	(1.4)	0.6
	2026	2.4	1.5	0.5	0.4	0.6	1.1
	2027	2.4	1.4	0.3	0.7	2.2	1.4
	2028	2.4	1.4	0.3	0.8	2.6	1.4
	5-year average increase/decrease	2.1	1.2	0.3	(0.2)	0.1	N/A
	Peak/(trough) at[2][3]	—	—	(0.2)	(2.8)	(5.1)	(1.1)
Bank Rate[1]	2022 (actual)	3.50	3.50	3.50	3.50	3.50	3.50
	2023	5.25	5.25	5.25	5.25	5.25	5.25
	2024	4.25	4.50	5.25	6.50	3.75	4.88
	2025	3.25	3.50	4.00	5.00	2.00	3.68
	2026	2.75	3.25	3.25	3.75	2.00	3.18
	2027	2.75	3.00	3.00	3.00	2.50	2.93
	2028	2.75	3.00	3.00	3.00	2.50	2.93
	5-year end period	2.75	3.00	3.00	3.00	2.50	N/A
	Peak/(trough) at	5.25	5.25	5.75	6.50	5.25	5.55
HPI[1]	2022 (actual)	5.0	5.0	5.0	5.0	5.0	5.0
	2023	(1.7)	(2.2)	(4.7)	(6.3)	(7.8)	(3.8)
	2024	2.0	(1.0)	(11.7)	(18.8)	(25.8)	(7.8)
	2025	6.5	2.5	3.4	3.6	3.6	3.3
	2026	5.1	3.0	2.1	1.6	1.6	2.7
	2027	4.0	3.0	3.0	1.6	1.6	2.7
	2028	3.6	3.0	3.1	1.8	1.8	2.7
	5-year average increase/decrease	4.3	2.0	(0.8)	(3.3)	(5.4)	N/A
	Peak/(trough) at[2]	(3.7)	(6.5)	(17.5)	(25.5)	(33.0)	(13.8)
Unemployment[1]	2022 (actual)	3.7	3.7	3.7	3.7	3.7	3.7
	2023	4.3	4.3	4.3	4.3	4.4	4.3
	2024	4.3	4.8	4.8	5.6	8.5	5.3
	2025	3.7	4.4	4.9	5.9	8.0	5.1
	2026	3.4	4.3	5.2	6.2	7.4	5.0
	2027	3.0	4.3	5.4	6.1	6.8	4.9
	2028	3.0	4.2	5.3	5.8	6.2	4.7
	5-year end period	3.0	4.2	5.3	5.8	6.2	N/A
	Peak/(trough) at	4.5	4.8	5.5	6.2	8.5	5.5

The table below sets out our macroeconomic assumptions and their evolution throughout the forecast period for each of the five scenarios at 31 December 2022:

		Upside	Base case	Downside 1	Stubborn Inflation	Downside 2	Weighted[5]
		%	%	%	%	%	%
GDP[1]	2021 (actual)	7.5	7.5	7.5	7.5	7.5	7.5
	2022	4.4	4.4	4.3	4.2	3.7	4.3
	2023	(1.0)	(1.3)	(1.9)	(2.7)	(6.4)	(2.2)
	2024	0.8	0.5	(0.3)	(0.9)	(0.7)	—
	2025	2.0	1.6	0.5	0.2	1.7	1.2
	2026	2.0	1.5	0.4	0.6	1.5	1.2
	5-year average increase/decrease	1.2	0.8	(0.2)	(0.5)	(0.6)	0.3
	Cumulative growth/(fall) to peak/(trough)[2][4]	6.0	3.8	(0.8)	(2.2)	(3.1)	1.3
Bank Rate[1]	2021 (actual)	0.25	0.25	0.25	0.25	0.25	0.25
	2022	3.50	3.50	3.50	3.50	3.50	3.50
	2023	3.75	4.00	3.50	6.00	3.75	4.29
	2024	3.00	3.25	2.75	5.50	3.00	3.59
	2025	2.50	2.75	2.50	3.50	2.75	2.85
	2026	2.25	2.50	2.25	3.00	2.50	2.55
	5-year end period	2.25	2.50	2.25	3.00	2.50	2.55
	Peak/(trough) at[3]	3.75	4.00	3.50	6.00	4.00	4.31
HPI[1]	2021 (actual)	8.7	8.7	8.7	8.7	8.7	8.7
	2022	7.6	7.0	7.6	7.6	7.6	7.3
	2023	(8.8)	(10.0)	(10.0)	(10.9)	(15.8)	(10.7)
	2024	(4.3)	—	(6.7)	(8.8)	(14.3)	(4.4)
	2025	0.6	2.0	(3.1)	(4.9)	(4.1)	(0.8)
	2026	4.1	3.0	(0.2)	(0.6)	4.7	2.0
	5-year average increase/decrease	(0.7)	(0.6)	(3.8)	(4.7)	(4.8)	(2.3)
	Peak/(trough) at[3]	(12.8)	(11.2)	(19.0)	(23.1)	(30.7)	(16.8)
Unemployment[1]	2021 (actual)	4.0	4.0	4.0	4.0	4.0	4.0
	2022	3.7	3.8	3.7	3.7	4.4	3.8
	2023	4.7	4.7	5.1	5.5	8.5	5.3
	2024	4.5	5.1	5.4	5.9	8.0	5.6
	2025	4.5	4.5	5.8	6.4	7.4	5.4
	2026	4.4	4.3	6.1	6.6	6.8	5.3
	5-year end period	4.2	4.3	6.1	6.4	6.2	5.2
	Peak/(trough) at[3]	4.7	5.1	6.1	6.6	8.5	5.9

(1) GDP is the calendar year annual growth rate, HPI is Q4 annual growth rate and all other data points are at 31 December in the year indicated.
(2) This is the cumulative growth for the 5-year period.
(3) For GDP and house price growth it is the peak to trough change within the 5-year period; for the unemployment rate it is the peak; and for Bank Rate it is the peak or trough.
(4) If we had calculated GDP on the peak/(trough) basis as adopted for 2023 our upside scenario would have been (1.5%); base case scenario (1.9%); downside 1 (2.7%); stubborn inflation (4.0%); downside 2 (8.8%).
(5) The weighted peak to trough and 5-year peak calculations are based on the annual profiles shown.

Scenario weights

Each quarter, we undertake a full review of the scenario weights we apply. We consider the weighting of the economic scenarios as a whole, while ensuring that the scenarios capture the non-linear distribution of losses across a reasonable range. To support our initial assessment of the weighting of a scenario, we undertake a Monte Carlo analysis to ascertain the likelihood of a five-year average GDP forecast growth rate occurring based on the long run historically observed average. Creating a standard distribution bell curve around this long run average allows us to estimate the probability of a given GDP scenario occurring based on past experience and therefore assign a weight to that scenario.

We continue to use both the entire historical GDP data set available for the Monte Carlo analysis to smooth out the large GDP data swings seen in the pandemic as well as the data set from 2009 onwards. The CAGRs are now returning to more 'normal' levels associated with our scenarios as the economy unwinds from the 2020 shock. For H223, the base case using the 2009 data set show that the base case sits around the 50th probability path and that the downside scenarios sit between the 60th to 80th probability paths suggesting that a lower weight than the base case remains appropriate.

We also need to consider the UK economic and political environment when applying weights. Given the current cost of living crisis, we remain of the view that the risks to UK growth are still biased to the downside and include: further geopolitical events creating more challenges for economies both in the UK and abroad; the potential for further upside inflation surprises causing inflation to stay above target for longer, raising the cost of living and so reducing consumer demand; continuing weak investment reflecting the uncertain nature of the economic environment; and a continuing and significant mismatch between vacancies and skills along with a smaller labour force, which may bring disruption to any recovery in the latter years of the forecast.

In 2023, we increased the weight on the Upside scenario by 5% with a corresponding decrease in our Downside 1 to rebalance the overall weighted ECL. It was also to reflect both the change in the fan chart parameters used to determine the Upside and Downside 1 scenarios and the fact that the economic growth outlook has improved slightly since the end of 2022.

The scenario weights we applied for 2023 and 2022 were:

	Upside	Base case	Downside 1	Stubborn Inflation	Downside 2	Weighted
Scenario weights	**%**	**%**	**%**	**%**	**%**	**%**
2023	10	50	10	20	10	100
2022	5	50	15	20	10	100

Significant Increase in Credit risk (SICR)(audited)

Loans which have suffered a SICR since origination are subject to a lifetime ECL assessment which extends to a maximum of the contractual term of the loan, or the behavioural term for a revolving facility. Loans which have not experienced a SICR are provided for on a 12-month basis. We assess the credit risk profile of each facility to determine which of three stages to allocate them to:

- Stage 1: when there has been no SICR since initial recognition. We apply a loss allowance equal to a 12-month ECL i.e. the proportion of lifetime expected losses that relate to that default event expected in the next 12 months
- Stage 2: when there has been a SICR since initial recognition, but the exposure is not considered credit impaired. We apply a loss allowance equal to the lifetime ECL i.e. the expected loss resulting from all possible defaults throughout the residual life of a facility
- Stage 3: when the exposure is considered credit impaired. We apply a loss allowance equal to the lifetime ECL. Objective evidence of credit impairment is required. For more, see the section 'Definition of default (Credit impaired)' above.

We use quantitative, qualitative and backstop criteria to identify exposures that suffer a SICR. The Santander UK Credit Risk Provisions Forum (CRPF) reviews and approves our SICR thresholds periodically. The Santander UK Board Audit Committee reviews and challenges their appropriateness each year, or more often if we change them. Santander UK Board Audit Committee reviews definition of default for mortgages purchased by SFS from Santander UK plc and SFS Board Audit Committee reviews definition of default for SFS originated mortgages.

Quantitative criteria

We use quantitative criteria to identify where an exposure has increased in credit risk. We base our criteria on whether any increase in the lifetime PD since origination exceeds a threshold in relative and absolute terms. We base the value anticipated at origination on similar assumptions and data to the ones we use at the reporting date, adjusted to reflect the account surviving to that date. The comparison uses either an annualised lifetime PD, where the lifetime PD is divided by the forecast period, or the absolute change in lifetime PD since origination. These two sets of criteria are used to determine whether a significant increase of credit risk has concurred since origination.

The criteria for 2023 and 2022 were:

Residential mortgages	Loans and advances to banks(1)
30bps	400bps

(1) Loans and advances to banks use the comparison of lifetime PDs to determine Stage allocation, unlike other products which first turn the lifetime PD into an average yearly PD (annualised) and then do the comparison.

Qualitative criteria

We also use qualitative criteria to identify where an exposure has increased in credit risk, independent of changes in PD. The criteria for 2023 and 2022 were:

Residential mortgages	Loans and advances to banks
In forbearance	In forbearance
Default in last 24m	Watchlist – proactive management
£100+ arrears	>30 Days past due (DPD) in last 12m
Bankrupt	Default at proxy origination

Backstop criteria

As a backstop, we classify all exposures more than 30 or 90 DPD in at least Stage 2 or in Stage 3, respectively. This means that we do not rebut the backstop presumptions in IFRS 9 (i.e. credit risk has significantly increased if contractual payments are more than 30 DPD) relating to either a SICR or default.

Definition of default (Credit impaired) (audited)

We define a financial instrument as in default (i.e. credit impaired) for the purpose of calculating ECL if it is more than three months past due, or if we have data that suggests the customer is unlikely to pay. The data we have on customers varies across our business segments. It typically includes where:

Residential mortgages
– They have been reported bankrupt or insolvent and are in arrears
– Their loan term has ended, but they still owe us money more than three months later
– They have had forbearance while in default and have failed to perform under the new arrangement terms, or have had multiple forbearance. Performing forborne accounts while not in default are reported in Stage 2
– We have suspended their fees and interest because they are in financial difficulties
– We have repossessed the property.
Loans and advances to banks
– They have had a winding up notice issued, or something happens that is likely to trigger insolvency – such as another lender calls in a loan
– Something happens that makes them less likely to be able to pay us – such as they lose an important client or contract
– They have regularly missed or delayed payments, even though they have not gone over the three-month limit for default
– Their loan is unlikely to be refinanced or repaid in full on maturity
– Their loan has an excessive LTV that is unlikely to be resolved, such as by a change in planning policy, pay-downs, or increase in market value

Where we use the advanced internal ratings-based basis for a portfolio in our capital calculations, there are differences with the default definitions for ECL purposes. The main differences are as follows:

- Performing forborne accounts while not in default are in Stage 2 until they cure their forbearance status (measured as 12 consecutive months of successful payments).
- Performing non-forborne accounts, which under our internal rating-based basis are subject to a 3-month cure period. For accounting purposes, we classify them in Stage 2 until they cure all SICR triggers. The Santander UK Board Audit Committee reviews and challenges their appropriateness each year, or more often if we change them.

Measuring ECL (audited)

For accounts not in default at the reporting date, we estimate a monthly ECL for each exposure and for each month over the forecast period. The lifetime ECL is the sum of the monthly ECLs over the forecast period, while the 12-month ECL is limited to the first 12 months. We calculate each monthly ECL as the discounted value for the relevant forecast month of the product of the following factors:

Factor	Description
Survival rate (SR)	The probability that the exposure has not closed or defaulted since the reporting date.
Probability of default (PD)	The likelihood of a borrower defaulting in the following month, assuming it has not closed or defaulted since the reporting date. For each month in the forecast period, we estimate the monthly PD from a range of factors. These include the current risk grade for the exposure, which becomes less relevant further into the forecast period, as well as the expected evolution of the account risk with maturity and factors for changing economics. We support this with historical data analysis.
Exposure at default (EAD)	The amount we expect to be owed if a default event occurs. We determine EAD for each month of the forecast period by the expected payment profile, which varies by product. For amortising products, we base it on the borrower's contractual repayments over the forecast period. We adjust this for any expected overpayments on Stage 1 accounts that the borrower may make and for any arrears we expect if the account was to default. For revolving products, or amortising products with an off-balance sheet element, we determine EAD using the balance at default and the contractual exposure limit. We vary these assumptions by product and base them on analysis of recent default data.
Loss given default (LGD)	Our expected loss if a default event were to occur. We express it as a percentage and calculate it based on factors that we have observed to affect the likelihood and/or value of any subsequent write-offs, which vary according to whether the product is secured or unsecured. If the product is secured, we take into account collateral values as well as the historical discounts to market/book values due to forced sales type.

We use the original effective interest rate as the discount rate. For accounts in default, we use the EAD as the reporting date balance. We also calculate an LGD to reflect the default status of the account, considering the current DPD and loan-to-value. PD and SR are not required for accounts in default.

Forecast period
We base the forecast period for amortising facilities on the remaining contract term. For revolving facilities, we base it on the behavioural, rather than contractual, characteristics of the facility type. In some cases, we shorten the period to simplify the calculation. If we do this, we apply a Judgemental Adjustment to reflect our view of the full lifetime ECL.

Forward-looking information
Our assessments of a SICR and the calculation of ECL incorporate forward-looking data. We perform historical analysis and identify the key economic variables that impact credit risk and ECL for each portfolio. These can include house price growth, GDP, unemployment rate and BoE Bank Rate. Where applicable, we incorporate these economic variables and their associated impacts into our models.

Grouping of instruments for losses measured on a collective basis
We measure ECL at the individual financial instrument level. However, where we have used internal capital or similar models as the basis for our ECL models, this typically results in a large number of relatively small homogenous groups. We typically group instruments where they share risk characteristics using statistical models and assess them for impairment collectively. We use this approach for the Crown Dependencies and UK residential mortgage portfolios.

We calculate separate collective provisions for instruments in Stages 1, 2 and 3 where the instrument is not individually assessed. As described above, for all our other portfolios (whether we assess them for impairment individually or collectively) we use five forward-looking economic scenarios.

Management judgements and accounting estimates applied in calculating ECL (audited)

IFRS 9 recognises that management judgements and accounting estimates are an essential part of calculating ECL. Specifically, where the historical data that we use in our models does not reflect current or future expected conditions, or the data we have does not cover a sufficient period or is not robust enough. We consider the accounting estimates in calculating ECL to be:

- Determining an appropriate definition of default
- Forward-looking multiple economic scenario assumptions;
- Probability weights assigned to multiple economic scenarios; and
- Significant Increase in Credit Risk (SICR) thresholds.

Governance around ECL impairment allowances (audited)

Santander UK Risk Methodology team developed our ECL impairment models (except for the external models we use, such as OGEM which we described earlier in 'Our forecasting approach'), and our Independent Validations Team reviews all material models. As model owners, the Santander UK Risk Provisioning & Forecasting team run the models to calculate our ECL each month. The models are sensitive to changes in credit conditions and reflect management judgements that give rise to measurement uncertainty in our ECL as set out above. The following Santander UK committees and forums review the provision drivers and ensure that the ECL remains appropriate:

- **Model Risk Control Forum** (MRCF) reviews and approves new models and model changes. It also reviews the use of OGEM as a reliable model on which to base our other forecast macroeconomic variables. We use it across all stress testing and planning so it is subject to model risk criteria.
- **ALCO** reviews and approves the base case used in the economic scenarios we use to calculate forward-looking scenarios.
- **CRPF** reviews and approves the economic scenarios and probability weights we use to calculate forward-looking scenarios. It also reviews management judgements and approves ECL impairment allowances.
- **Board Audit Committee** reviews and challenges the appropriateness of the estimates and judgements made by management.

After the above governance process at Santander UK level is concluded, SFS accountable executives are engaged to approve the methodologies and outputs, which SFS have the oversight and accountability on. SFS ECL impairment allowances are then reviewed and approved by SFS committees and forums, including ALCO, ERCC, Board Risk and Audit Committee and Executive Committee.

For more on the governance around specific elements of the ECL impairment allowances, including the frequency of, and thresholds for, reviews, including by these committees and forums, see the detailed sections above.

How we assess the performance of our ECL estimation process

We assess the reasonableness of our ECL provisions and the results of our Staging analysis using a range of methods. These include:

- **Benchmarking:** we compare our coverage levels with our peers
- **Stand-back testing:** we monitor the level of our coverage against actual write-offs
- **Back-testing:** we compare key drivers periodically as part of model monitoring practices
- **Monitoring trends:** we track ECL and Staged assets over time and against our internal budgets and forecasts, with triggers set accordingly.

CREDIT RISK REVIEW

Our maximum and net exposure to credit risk (audited)

The tables below show the main differences between our maximum and net exposure to credit risk. The tables only show the financial assets that credit risk affects and to which the impairment requirements in IFRS 9 are applied.

For balance sheet assets, the maximum exposure to credit risk is the carrying value after impairment loss allowances. Off-balance sheet exposures are mortgage offers, guarantees, formal standby facilities, credit lines and other commitments. For off-balance sheet guarantees, the maximum exposure is the maximum amount that we would have to pay if the guarantees were called on. For formal standby facilities, credit lines and other commitments that are irrevocable over the life of the facility, the maximum exposure is the total amount of the commitment.

	Maximum exposure				
	Balance sheet asset				
	Gross amounts	Loss allowances	Net amounts	Off-balance sheet	Net exposure
2023	**£bn**	**£bn**	**£bn**	**£bn**	**£bn**
Cash and balances at central banks	**2.3**	**—**	**2.3**	**—**	**2.3**
Financial assets at amortised cost:					
– Loans and advances to customers[1]	**3.8**	**—**	**3.8**	**—**	**3.8**
– Crown Dependencies	**1.2**	**—**	**1.2**	**—**	**1.2**
– UK residential mortgages	**2.4**	**—**	**2.4**		**2.4**
– Other	**0.2**	**—**	**0.2**	**—**	**0.2**
– Loans and advances to banks	**0.1**	**—**	**0.1**	**—**	**0.1**
Total financial assets at amortised cost	**3.9**	**—**	**3.9**	**—**	**3.9**
Total	**6.2**	**—**	**6.2**	**—**	**6.2**
2022					
Cash and balances at central banks	2.4	—	2.4	—	2.4
Financial assets at amortised cost:					
– Loans and advances to customers[1]	4.2	—	4.2	—	4.2
– Crown Dependencies	1.1	—	1.1	—	1.1
– UK residential mortgages	2.8	—	2.8	—	2.8
– Other	0.3	—	0.3	—	0.3
– Loans and advances to banks	0.1	—	0.1	—	0.1
Total financial assets at amortised cost	4.3	—	4.3	—	4.3
Total	6.7	—	6.7	—	6.7

(1) Balances include interest we have charged to the customer's account and accrued interest that we have not charged to the account yet.

The tables below show the main differences between our maximum and net exposure to credit risk on the financial assets that credit risk affects and to which the impairment requirements in IFRS 9 are not applied.

	Maximum exposure				
	Balance sheet asset				
	Gross amounts	Loss allowances	Net amounts	Off-balance sheet	Net Exposure
2023	**£bn**	**£bn**	**£bn**	**£bn**	**£bn**
Financial assets at FVTPL:					
– Other financial assets at FVTPL	**0.3**	**—**	**0.3**	**—**	**0.3**
Total	**0.3**	**—**	**0.3**	**—**	**0.3**
2022					
Financial assets at FVTPL:					
– Other financial assets at FVTPL	0.3	—	0.3	—	0.3
Total	0.3	—	0.3	—	0.3

Single credit rating scale
In the table below, we have used a single rating scale for UK residential mortgages to ensure we are consistent across all our credit risk portfolios in how we report the risk of default. It has eight grades for non–defaulted exposures, from 9 (lowest risk) to 2 (highest risk). We define each grade by an upper and lower PD value and we scale the grades so that the default risk increases by a factor of ten every time the grade number drops by two steps. For example, grade 9 has an average PD of 0.010%, and grade 7 has an average PD of 0.100%. We give defaulted exposures a grade 1 and a PD value of 100%. In the final column of the table we show the approximate equivalent credit rating grade used by Standard & Poor's Ratings Services (S&P).

	PD range			
	Mid	Lower	Upper	S&P equivalent
Santander UK risk grade	%	%	%	
9	0.010	—	0.021	AAA to AA+
8	0.032	0.021	0.066	AA to AA-
7	0.100	0.066	0.208	A+ to BBB
6	0.316	0.208	0.658	BBB- to BB
5	1.000	0.658	2.081	BB-
4	3.162	2.081	6.581	B+ to B
3	10.000	6.581	20.811	B-
2	31.623	20.811	99.999	CCC to C
1 (Default)	100.000	100.000	100.000	D

The PDs in the table above are based on Economic Capital (EC) PD mappings, calculated based on the average PD over an economic cycle. This is different to the IFRS 9 PDs which are calculated at a point in time using forward looking economic scenarios. Where possible, the EC PD values are aligned to the regulatory capital models; however, any regulatory floors are removed and PDs are defined at every possible rating rather than grouped into rating buckets.

Rating distribution (audited)
The tables below show the credit rating of our financial assets to which the impairment requirements in IFRS 9 apply.

	SFS risk grade								
	9	8	7	6	5	4	1 to 3	Other(1)	Total
2023	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Cash and balances at central banks	**2.3**	—	—	—	—	—	—	—	**2.3**
Financial assets at amortised cost:									
Loans and advances to customers:(2)	—	**0.6**	**1.4**	**0.5**	**0.1**	—	—	**1.2**	**3.8**
– Crown Dependencies	—	—	—	—	—	—	—	**1.2**	**1.2**
– UK residential mortgages	—	**0.6**	**1.2**	**0.5**	**0.1**	—	—	—	**2.4**
– Other	—	—	**0.2**	—	—	—	—	—	**0.2**
Loans and advances to banks	—	—	—	—	—	—	—	**0.1**	**0.1**
Total on balance sheet exposures	**2.3**	**0.6**	**1.4**	**0.5**	**0.1**	—	—	**1.3**	**6.2**
Off-balance sheet exposures	—	—	—	—	—	—	—	—	—
Total	**2.3**	**0.6**	**1.4**	**0.5**	**0.1**	—	—	**1.3**	**6.2**
2022									
Cash and balances at central banks	2.4	—	—	—	—	—	—	—	2.4
Financial assets at amortised cost:									
Loans and advances to customers:(2)	—	0.6	1.6	0.6	0.1	0.1	—	1.2	4.2
– Crown Dependencies	—	—	—	—	—	—	—	1.1	1.1
– UK residential mortgages	—	0.6	1.4	0.6	0.1	0.1	—	—	2.8
– Other	—	—	0.2	—	—	—	—	0.1	0.3
Loans and advances to banks	—	—	—	—	—	—	—	0.1	0.1
Total on balance sheet exposures	2.4	0.6	1.6	0.6	0.1	0.1	—	1.3	6.7
Off-balance sheet exposures	—	—	—	—	—	—	—	—	—
Total	2.4	0.6	1.6	0.6	0.1	0.1	—	1.3	6.7

(1) We use scorecards for these items, rather than rating models.
(2) Includes interest we have charged to the customer's account and accrued interest we have not charged to the account yet

Credit quality (audited)

The following tables analyse the credit risk exposure of financial instruments for which an ECL allowance is recognised, and the corresponding ECL at 31 December 2023 and 31 December 2022:

	Stage 1	Stage 2	Stage 3	Total
2023	**£m**	**£m**	**£m**	**£m**
Exposures				
Loans and advances to customers	**3,542**	**285**	**9**	**3,836**
– Crown Dependencies	**1,254**	**1**	**1**	**1,256**
– UK residential mortgages	**2,088**	**284**	**8**	**2,380**
– Other	**200**	**—**	**—**	**200**
Total ECL	**—**	**1**	**1**	**2**
2022				
Exposures				
Loans and advances to customers	4,020	155	5	4,180
– Crown Dependencies	1,141	3	—	1,144
– UK residential mortgages	2,667	152	5	2,824
– Other	212	—	—	212
Total ECL	1	1	—	2

Reconciliation of exposures, loss allowance and net carrying amounts (audited)

The table below shows the relationships between disclosures in this Credit risk review section which refer to drawn exposures and the associated ECL.

	On-Balance Sheet			Off-Balance Sheet	
	Exposures	Loss allowance	Net carrying amount	Exposures	Loss allowance
2023	**£m**	**£m**	**£m**	**£m**	**£m**
Cash and balances at central banks	**2,308**	**—**	**2,308**	**—**	**—**
Loans and advances to customers	**3,836**	**2**	**3,834**	**11**	**—**
– Crown Dependencies	**1,256**	**—**	**1,256**	**11**	**—**
– UK residential mortgages	**2,380**	**2**	**2,378**	**—**	**—**
– Other	**200**	**—**	**200**	**—**	**—**
Loans and advances to banks	**92**	**—**	**92**	**—**	**—**
Total exposures	**6,236**	**2**	**6,234**	**11**	**—**
Assets classified at FVTPL			**319**		
Non-financial assets			**37**		
Total assets per the Balance Sheet			**6,590**		
2022					
Cash and balances at central banks	2,445	—	2,445	—	—
Loans and advances to customers	4,182	2	4,180	22	—
– Crown Dependencies	1,144	—	1,144	22	—
– UK residential mortgages	2,826	2	2,824	—	—
– Other	212	—	212	—	—
Loans and advances to banks	57	—	57	—	—
Total exposures	6,684	2	6,682	22	—
Assets classified at FVTPL			309		
Non-financial assets			26		
Total assets per the Balance Sheet			7,017		

Concentrations of credit risk exposures

Country risk exposures (audited)

We manage our country risk exposure under our global limits framework. We set our Risk Appetite for each country, considering factors that may affect its risk profile. These can include political events, macroeconomics and the nature of the risk. We actively manage exposures if we need to.

The tables below show our total exposures, which are the total of balance sheet and off–balance sheet values. We calculate balance sheet values in line with IFRS (i.e. after netting allowed under IAS 32) except for credit provisions which we add back. Off–balance sheet values are undrawn facilities and letters of credit. We classify location by country of risk – the country where each client has its main business or assets. That is unless there is a full risk transfer guarantee in place. If so, we use the guarantor's country of domicile. If a client has operations in many countries, we use their country of incorporation. The table below excludes balances with other Banco Santander group members. We show them separately in the section that immediately follows.

	2023					2022				
		Financial Institutions					Financial Institutions			
Country:	Governments	Banks(1)	Other	Retail	Total(2)	Governments	Banks(1)	Other	Retail	Total(2)
	£bn	**£bn**	**£bn**	**£bn**	**£bn**	£bn	£bn	£bn	£bn	£bn
UK	**2.3**	**—**	**0.6**	**2.4**	**5.3**	2.4	—	0.6	2.9	5.9
Jersey	**—**	**—**	**—**	**1.0**	**1.0**	—	—	—	0.8	0.8
Isle of Man	**—**	**—**	**—**	**0.3**	**0.3**	—	—	—	0.3	0.3
Total	**2.3**	**—**	**0.6**	**3.7**	**6.6**	2.4	—	0.6	4.0	7.0

(1) Excludes balances with central banks. Such balances are reported under Governments.
(2) Excludes cash at hand, interests in other entities, intangible assets, property, plant and equipment, tax assets, retirement benefit assets and other assets.

Balances with other Banco Santander companies (audited)
We deal with other Banco Santander group members in the ordinary course of business. We do this where we have a particular business advantage or expertise and where they can offer us commercial opportunities. These transactions also arise where we support the activities of, or with, larger multinational clients and financial institutions which may deal with other Banco Santander group members. We conduct these activities on the same terms as for similar transactions with third parties, and in a way that manages the credit risk within limits acceptable to the Board and the PRA.

At 31 December 2023 and 31 December 2022, we had gross balances with other Banco Santander group members as follows:

	2023	2022
	£bn	£bn
Assets:		
Spain	**0.1**	—
Liabilities:		
Spain	**0.1**	—

Credit performance (audited)

The customer loans in the table below are presented differently from the balances in the Balance Sheet. The main difference is that the customer loans below exclude inter-company balances. We disclose inter-company balances separately in the Notes to the Financial Statements. In addition, customer loans below are presented on an amortised cost basis.

	Customer Loans					
	Total	**Stage 1**	**Stage 2**	**Stage 3**	**Gross write-offs**	**Loan loss allowances**
2023	**£bn**	**£bn**	**£bn**	**£bn**	**£m**	**£m**
Drawn Balances	**3.8**	**3.5**	**0.3**	**—**	**—**	**2**
– Crown Dependencies	**1.3**	**1.3**	**—**	**—**	**—**	**—**
– UK residential mortgages	**2.3**	**2.0**	**0.3**	**—**	**—**	**2**
– Other	**0.2**	**0.2**	**—**	**—**	**—**	**—**
Undrawn Balances		**—**	**—**	**—**		
Stage 1, Stage 2, and Stage 3 ratios (%) (1)		**92.3**	**7.4**	**0.24**		
2022						
Drawn Balances	4.2	4.0	0.2	—	—	2
– Crown Dependencies	1.1	1.1	—	—	—	—
– UK residential mortgages	2.9	2.7	0.2	—	—	2
– Other	0.2	0.2	—	—	—	—
Undrawn Balances		—	—	—		
Stage 1, Stage 2, and Stage 3 ratios (%) (1)		95.0	5.0	—		

(1) From 2023, we calculate stage ratios including Goldman Sachs balances. The equivalent ratios for 2022 would have been: Stage 1: 96.1%, Stage 2: 3.7%, Stage 3: 0.16%

Credit risk review - UK and Crown Dependencies residential mortgages

The portfolio of UK residential mortgages is broadly representative of the wider UK mortgage book originated by Santander UK plc.

Borrower profile (audited)

In this table, 'Home movers' include both existing customers moving house and taking out a new mortgage with Santander UK plc, and customers who switch their mortgage to Santander UK plc when they move house. 'Remortgagers' are new customers taking a new mortgage with Santander UK plc.

	2023		2022	
	UK residential mortgages		UK residential mortgages	
	£m	**%**	£m	%
Home movers	**1,144**	**48.1**	1,351	47.8
Remortgagers	**609**	**25.6**	746	26.4
First-time buyers	**627**	**26.3**	727	25.7
	2,380	**100.0**	2,824	100.0

Interest rate profile (audited)

The interest rate profile of our maturing mortgage asset stock was:

	2023				2022			
	UK residential mortgages		**Crown Dependencies**		UK residential mortgages		Crown Dependencies	
	£m	**%**	**£m**	**%**	£m	%	£m	%
Fixed rate	**2,157**	**90.6**	**1,096**	**87.2**	2,659	94.2	1,088	95.1
Variable rate	**161**	**6.8**	**150**	**12.0**	81	2.9	40	3.8
Standard variable rate	**27**	**1.1**	**5**	**0.4**	37	1.3	8	0.7
Follow on rate	**35**	**1.5**	**5**	**0.4**	47	1.7	4	0.3
	2,380	**100.0**	**1,256**	**100.0**	2,824	100.0	1,140	100.0

Geographical distribution (audited)

The geographical distribution of our mortgage asset stock and new business was:

	2023		2022	
	UK residential mortgages	**Crown Dependencies**	UK residential mortgages	Crown Dependencies
	£bn	**£bn**	£bn	£bn
London	**0.6**	**—**	0.8	—
Midlands and East Anglia	**0.4**	**—**	0.4	—
North	**0.3**	**—**	0.4	—
South East excluding London	**0.8**	**—**	0.9	—
South West, Wales and other	**0.3**	**—**	0.3	—
Isle of Man	**—**	**0.3**	—	0.3
Jersey	**—**	**1.0**	—	0.8
	2.4	**1.3**	2.8	1.1

Loan-to-value analysis (audited)

This table shows the LTV distribution for the gross carrying amount and the related ECL of our mortgage portfolio. We also show the collateral value and average LTV. We use our estimate of the property value at the balance sheet date and include fees that have been added to the loan. For flexible products, we only include the drawn amount, not undrawn limits.

	2023				2022			
	UK residential mortgages		**Crown Dependencies**		UK residential mortgages		Crown Dependencies	
LTV	**Total £m**	**ECL £m**	**Total £m**	**ECL £m**	Total £m	ECL £m	Total £m	ECL £m
Up to 50%	**1,276**	**—**	**304**	**—**	1,462	—	250	—
>50-60%	**565**	**—**	**193**	**—**	692	—	162	—
>60-70%	**387**	**—**	**237**	**—**	482	—	238	—
>70-80%	**126**	**2**	**300**	**—**	153	2	288	—
>80-90%	**24**	**—**	**164**	**—**	30	—	175	—
>90-100%	**2**	**—**	**57**	**—**	3	—	27	—
>100%	**—**	**—**	**1**	**—**	2	—	—	—
	2,380	**2**	**1,256**	**—**	2,824	2	1,140	—
Collateral value of residential properties(1)	**2,379**		**1,256**		2,824		1,140	
	%		**%**		%		**%**	
Balance weighted average LTV(2)	47		**63**		47		64	

(1) Collateral value is limited to the balance of each loan and excludes the impact of any over-collateralisation.

(2) Balance weighted LTV = (Loan 1 balance x (Loan 1 Balance/Loan 1 latest property valuation) + (Loan 2 balance x (loan 2 balance/Loan 2 latest property valuation) + ...) /(Loan 1 balance + Loan 2 balance+...).

UK and Crown Dependencies residential mortgages - portfolios of particular interest

Introduction

All our mortgages are residential prime lending and we do not acquire or hold sub-prime or second charge mortgages. Despite that, some types of mortgages have higher risks and others stand out for different reasons. These are:

Product	Description
Interest-only loans	With an interest-only mortgage, the customer pays interest every month, but the principal is only repaid at the end of the mortgage term. Some mortgages have a part that is interest-only, with the rest being a normal repayment mortgage. We mitigate the risk from new interest-only mortgages by having lower maximum LTVs. For most applicants, the maximum LTV is 50%. For high net worth customers, it can be up to 75%. When a customer plans to repay their mortgage by selling the property, we require a minimum equity buffer of £250k. We also remind customers that they have to arrange to repay the principal at the end of the mortgage. We send them messages with their annual mortgage statements, and we contact them throughout the mortgage term to encourage them to tell us how they plan to repay. We increase the frequency of contact as the loan approaches maturity. If customers know they will not be able to repay their mortgage when it ends, or if their mortgage has already passed the date when it should have ended, we talk to them. If we think it is in their interests and they can afford it, we look at other ways to manage it, such as turning the mortgage into a repayment one and extending it. If the customer is waiting for their way to repay it, such as an investment plan, to mature, we may permit an extension.
Part interest-only, part repayment loans	Customers with part interest-only, part repayment mortgages still have to pay back a lump sum at the end of their mortgage for the interest-only part. This means these loans have a higher credit risk as we depend on the customers to pay back a lump sum. We design new account LTV maximums to mitigate this risk. We also make sure the customer has a plausible repayment plan before we lend to them and stays on track for the loan term. We mitigate the risk from these loans in similar ways to those used for interest-only mortgages. The maximum LTV for new loans is 85%. For most applicants, up to 50% of that can be interest-only. For high net worth customers, it can be up to 75%. When a customer plans to repay the interest-only element of their mortgage by selling the property, we require a minimum equity buffer of £250k. We manage communications and extension options in similar ways to those used for interest-only
Loans with an LTV >100%	In some cases, property prices have fallen, so mortgages we gave in the past with lower LTVs now have LTVs greater than 100%. Where the mortgage balance is more than the property is now worth, we cannot recover the full value of the loan by repossessing and selling the property. This means there is a higher credit risk on these loans, so we monitor them as part of our assessment of ongoing portfolio performance. We design new account LTV maximums to mitigate an increase in accounts with an LTV >100%.

Credit performance (audited)

	UK residential mortgages					Crown Dependencies		
		Portfolio of particular interest(1)					Portfolio of particular interest(1)	
	Total	Interest-only	Part interest-only, part repayment(2)	LTV>100%	Other portfolio	Total	Interest-only	Other portfolio
2023	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Mortgage portfolio	**2,380**	**279**	**204**	**—**	**1,897**	**1,256**	**448**	**808**
- Stage 1	**2,088**	**232**	**181**	**—**	**1,675**	**1,254**	**447**	**807**
- Stage 2	**284**	**45**	**23**	**—**	**216**	**1**	**1**	**—**
- Stage 3	**8**	**2**	**—**	**—**	**6**	**1**	**—**	**1**
Stage 3 ratio	**0.34%**	**0.72%**	**—%**	**—%**	**0.32%**	**0.08%**	**0.09%**	**0.08%**
Balance weighted average LTV	**47%**	**39%**	**49%**	**—%**	**48%**	**63%**	**61%**	**63%**
2022								
Mortgage portfolio	2,824	273	249	2	2,303	1,140	366	774
- Stage 1	2,667	255	237	1	2,176	1,137	366	771
- Stage 2	152	15	12	1	125	3	—	3
- Stage 3	5	3	—	—	2	—	—	—
Stage 3 ratio	0.21%	1.10%	—%	—%	0.09%	0.06%	0.05%	0.07%
Balance weighted average LTV	47%	36%	49%	112%	49%	64%	60%	65%

(1) Where a loan falls into more than one category, we include it in all the categories that apply. As a result, the sum of the mortgages in the segments of particular interest and the other portfolio does not agree to the total mortgage portfolio.
(2) Mortgage balance includes both the interest-only part of £153m (2022: £182m) and the non-interest-only part of the loan.

LIQUIDITY RISK

Overview
SFS oversees and manages liquidity separately but this is included as part of the ILAAP process driven by Santander UK Group Holdings plc, and we are considered as part of the overall UK framework. Under this model, SFS meets its regulatory requirements for the purpose of managing liquidity risk on an individual basis.

LIQUIDITY RISK MANAGEMENT

Risk appetite
Separate Liquidity Risk Appetites (LRAs) for Santander UK plc and for the Company are in place. These are appropriate to their individual business models and consistent with the strategy of Santander UK Group Holdings plc.

Our LRA is based on the principles of liquidity management we use to manage our balance sheet. It also supports our need to meet or exceed regulatory rules.

The Company has adopted the Santander UK Risk Management framework and the CFO and Risk Divisions within Santander UK, and through the respective service level agreements, provide information for the Company to manage and control liquidity risk on behalf of the Company. The relevant policy frameworks and procedures within Santander UK Group Holdings plc therefore also apply to the Company.

Our LRA is proposed to the Risk division, and reviewed and approved by the Board each year, or more often if needed.

The Company's Board approved the Internal Liquidity Adequacy Assessment Process (ILAAP) in December 2023.

Risk measurement
We use a number of metrics to manage liquidity risk. These include metrics that show the difference between cash and collateral inflows and outflows in different periods. Our liquidity stress testing framework is central to our LRA measurement and monitoring. To fit with our Risk Appetite, the liquidity outflows that come from these stress tests must be fully covered with high-quality liquid assets, other liquid assets and appropriate management actions.

Our Risk division runs a range of stress tests. Our LRA stress test consists of three tests that cover idiosyncratic, market-wide and combined scenarios.

We monitor our Liquidity Coverage Ratio (LCR) and our Net Stable Funding Ratio (NSFR) to ensure we continue to meet the requirements.

Risk mitigation (audited)
The Board aims to make our balance sheet resilient at all times and for it to be perceived as such by stakeholders. This preserves our short and long-term viability. The Board recognises that as we are involved in maturity transformation, we cannot hold enough liquidity to cover all possible stress scenarios. The Board requires us to hold enough liquidity to make sure we will survive three plausible but severe stress scenarios (our LRA stress test, described above). We do this by maintaining a prudent balance sheet structure and approved liquid resources.

Risk monitoring and reporting (audited)
We monitor liquidity risk daily, weekly and monthly. We do this through different committees and levels of management, including the SFS ALCO and the BRC.

LIQUIDITY RISK REVIEW

Liquidity risk for the Company is monitored and managed separately from the rest of the Santander UK group.

Liquidity Coverage Ratio
This table shows our LCR at 31 December 2023 and 31 December 2022.

	2023	2022
	£bn	£bn
Eligible liquidity pool (liquidity value)	2.6	2.7
Net stress outflows	(1.1)	(1.3)
Surplus	1.5	1.4
Eligible liquidity pool as a percentage of anticipated net cash flows	240%	218%

We also monitor the Net Stable Funding Ratio (NSFR), which was implemented in 2022 and we exceed the requirements. At 31 December 2023, the SFS NSFR was 142% (2022:127%).

LCR eligible liquidity pool
This table shows the carrying value of our eligible liquidity pool assets at 31 December 2023 and 31 December 2022. It also shows the weighted average carrying value in the year.

	Carrying value						Weighted average carrying value in the year	
	2023			2022			2023	2022
	Level 1	Level 2	Total	Level 1	Level 2	Total	Total	Total
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Cash and balances at central banks	2.3	—	2.3	2.4	—	2.4	2.4	2.0
Government bonds	0.3	—	0.3	0.3	—	0.3	0.3	0.4
	2.6	—	2.6	2.7	—	2.7	2.7	2.4

Currency analysis
The carrying value of our eligible liquidity pool was in Sterling only at £2.6bn (31 December 2022: £2.7bn). The composition of the pool is consistent with the currency profile of our net liquidity outflows.

FUNDING RISK MANAGEMENT

Deposit funding

The Company is primarily funded through deposits raised in the Jersey and Isle of Man branches (of SFS) and from External Asset manager deposits raised in the SFS UK subsidiary.

Wholesale funding

Wholesale funding from Santander UK Group Holdings plc was £2m at 31 December 2023 (2022: £4m), all of which was classified as Deposits by banks.

In December 2022, Santander Financial Services plc issued £50m 9.25% Fixed Rate Reset Perpetual Capital Securities, which were fully subscribed by the Company’s immediate parent company, Santander UK Group Holdings plc. For more, see Note 20.

CAPITAL RISK

THE SCOPE OF OUR CAPITAL ADEQUACY

Regulatory supervision

For capital purposes, we are subject to prudential supervision by the PRA, as a UK bank, and by the European Central Bank (ECB) as part of the Banco Santander group. The ECB supervises Banco Santander as part of the Single Supervisory Mechanism (SSM). Although we are part of the Banco Santander group, we do not have a guarantee from our ultimate parent Banco Santander SA. As we are regulated by the PRA, we have to meet the PRA capital requirements on a standalone basis. We also have to show the PRA that we can withstand capital stress tests without the support of our ultimate parent. Reinforcing our corporate governance framework, the PRA exercises oversight through its rules and regulations on the Board and senior management appointments.

Santander UK Group Holdings plc is the holding company of Santander Financial Services plc and is the head of the Santander UK group (including SFS) for regulatory capital and leverage purposes.

CAPITAL RISK MANAGEMENT

The Board is responsible for capital management strategy and policy and ensuring that we monitor and control our capital within regulatory and internal limits. We operate within the capital risk framework and appetite approved by the SFS and Santander UK Boards. This reflects the environment we operate in, our strategy for each material risk and the potential impact of adverse scenarios or stresses on our capital.

Management of capital requirements (audited)

Our capital risk appetite aims to maintain capital levels appropriate to the level of stress applied, and the expected regulatory response. In:
- An adverse economic stress, which we expect once in 20 years, the firm should remain profitable and exceed all regulatory capital minimums at all times.
- A very severe economic stress, which we expect once in 100 years, and which has been designed to test any specific weaknesses of a firm's business model, the firm should meet all regulatory capital minimums at all times. This is subject to using regulatory buffers designed to absorb losses in such a stress.

Management of capital resources (audited)

We use a mix of regulatory and Economic Capital (EC) ratios and limits, internal buffers and restrictions to manage our capital resources. We also take account of the costs of differing capital instruments and capital management techniques. We also use these to shape the best structure for our capital needs. We decide how to allocate our capital resources as part of our strategic planning process. We base this in part on the relative returns on capital using both EC and regulatory capital measures. We plan for severe stresses and we set out what action we would take if an extremely severe stress threatened our viability and solvency. This could include not paying dividends, selling assets, reducing our business and issuing more capital.

Risk measurement

We apply Banco Santander's approach to capital measurement and risk management for CRD IV. For more on the CRD IV risk measurement of our exposures, see Banco Santander's Pillar 3 report.

The main metrics we use to measure capital risk are CET1 capital ratio and total regulatory capital.

Risk mitigation

Santander UK has designed its capital risk framework, policies and procedures to ensure that we operate within our Risk Appetite. Santander UK manages capital transferability between its subsidiaries in line with its business strategy, its risk and capital management policies, and UK laws and regulations. There are no legal restrictions on Santander UK moving capital resources promptly, or repaying liabilities, between Santander UK and its subsidiaries except for loans and distributions between Santander UK entities in the ring-fenced bank sub-group and Santander UK entities that are not members of the ring-fenced bank sub-group (such as the Company), where the PRA is required to assess the impact of proposed distribution prior to payment.

At 31 December 2023, Santander UK Group Holdings plc, Santander Financial Services plc and Santander Equity Investments Limited were party to a capital support deed entered into on 17 December 2021 and effective from 1 January 2022 (the Non-RFB Sub-Group Capital Support Deed). These parties were permitted by the PRA to form a core UK group as defined in the PRA Rulebook, a permission which expires on 31 December 2024. Exposures of Santander Financial Services plc, the regulated entity, to other members of the core UK group are exempt from large exposure limits that would otherwise apply and these exposures are risk-weighted at 0%. Where applicable this permission also provides for intra-group exposures to be excluded from the leverage exposure measure. The purpose of the Non-RFB Sub-Group Capital Support Deed is to facilitate the prompt transfer of available capital resources from, or repayment of liabilities by, the non-regulated parties to the regulated party in the event that the regulated party breached or was at risk of breaching its capital resources or risk concentrations requirements.

Risk monitoring and reporting

We monitor and report regularly against our capital plan. We do this to identify any change in our business performance that might affect our capital. Each month, we also review the economic assumptions we use to create and stress test our capital plan. We do this to identify any potential reduction in our capital.

CAPITAL RISK REVIEW

Regulatory capital resources (audited)

This table shows our regulatory capital for Santander Financial Services plc.

	2023	2022
	£m	£m
CET1 capital before regulatory adjustments	**304**	301
CET1 regulatory adjustments [(1)]	**(16)**	(45)
CET1 capital	**288**	256
AT1 capital	**50**	50
Total regulatory capital	**338**	306

(1) Includes (£4m) unaudited other regulated adjustment.

CET1 regulatory adjustments

These are adjustments required by CRD IV.

MARKET RISK

Market risk comprises non-traded market risk and traded market risk. The Company has no traded market risk exposures.

NON-TRADED MARKET RISK MANAGEMENT

Risk appetite

Our framework for dealing with market risk is part of the overall Santander UK Risk Framework. Our Structural and Market Risk framework sets out our high-level arrangements and standards to manage, control and oversee non-traded market risk, and is part of our overall Risk Framework. The Santander UK Risk Appetite sets the controls, risk limits and key risk metrics for non-traded market risk. We show risk appetite by the income and value sensitivity limits we set in the Santander UK Risk Appetite, at both Santander UK and Banco Santander group levels.

Risk measurement

Net Interest Income (NII) sensitivity (audited)
NII sensitivity is an income-based measure we use to forecast the changes to interest income and interest expense in different scenarios. It gives us a combined impact on net interest income over a given period – usually 12 or 36 months. We calculate NII sensitivity as the change in NII for a defined set of instantaneous parallel and non-parallel shifts in the yield curve.

EVE sensitivity
We calculate EVE sensitivity as the change in the net present value of all the interest rate sensitive items in the banking book balance sheet for a defined set of instantaneous parallel and non-parallel shifts in the yield curve.

Risk mitigation (audited)

From 2023, we mitigate Income Statement volatility mainly through hedge accounting. We monitor any hedge accounting ineffectiveness that might lead to Income Statement volatility. For our accounting policies for derivatives and hedge accounting, see Note 1 to the Financial Statements.

NON-TRADED MARKET RISK REVIEW

Interest rate risk

Yield curve risk
The table below shows how our net interest income would be affected by a 100bps parallel shift (both up and down) applied instantaneously to the yield curve at 31 December 2023 and 31 December 2022.

	2023		2022	
	+100bps	**-100bps**	+100bps	-100bps
	£m	**£m**	£m	£m
NII sensitivity (audited)	**(1)**	**—**	(3)	4
EVE sensitivity	**(8)**	**5**	(20)	22

Independent auditors' report to the members of Santander Financial Services plc

Report on the audit of the financial statements

Opinion
In our opinion, Santander Financial Services plc's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2023 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with UK-adopted international accounting standards; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the 2023 Annual Report (the "Annual Report"), which comprise: the balance sheet as at 31 December 2023; the income statement, statement of comprehensive income, cash flow statement, and statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Board Audit Committee ("BAC").

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence
We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided.

Other than those disclosed in Note 6, we have provided no non-audit services to the company or its controlled undertakings in the period under audit.

Our audit approach

Overview
Audit scope
- The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment and other qualitative factors (including history of misstatement through fraud or error).
- We performed audit procedures over the company and its branches based on our assessment of their financial significance in the context of the company.
- Our audit plan was discussed with the BAC in October 2023 and updates were provided to the BAC at later stages of the audit. We executed the planned approach and concluded based on the results of our testing ensuring that sufficient audit evidence had been obtained to support our opinion. We discussed our approach and the results of our audit with the BAC. We also discussed the key audit matters with the BAC at the conclusion of the audit.

Key audit matters
- Expected credit loss allowance on mortgage portfolio acquired from Santander UK plc

Materiality
- Overall materiality: £32.9 million (2022: £32.5 million) based on 0.5% of total assets.
- Performance materiality: £24.7 million (2022: £24.4 million).

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

This is not a complete list of all risks identified by our audit.

The key audit matters below are consistent with last year.

<table>
<tr><th>Key audit matter</th><th>How our audit addressed the key audit matter</th></tr>
<tr><td><u>Expected credit loss allowance on mortgage portfolio acquired from Santander UK plc</u></td><td>Testing of key controls</td></tr>
<tr><td>Credit impairment allowances represent management's estimate of the expected credit loss ("ECL") within each portfolio at the balance sheet date. The identification and the determination of allowances is inherently judgemental. Management uses a number of models and judgemental adjustments ("JAs") to achieve compliance with the requirements of IFRS 9. The determination of ECLs is complex and a number of significant judgments are involved in the estimation process.

As at 31 December 2023, the company has recognised credit impairment loss allowances on loans and advances to customers of £2 million against loans and advances to customers of £2.4 billion on the residential mortgages acquired from Santander UK plc in October 2020 and May 2022. The majority (>87%) of loans are classified as Stage 1 as at 31 December 2023. This is referenced in the Santander Financial Services plc Annual Report in the Credit Risk Review section of the front half disclosures as well as Note 7 (Credit Impairment Losses and Provisions) and Note 12 (Loans and Advances to Customers).

There continues to be significant economic uncertainty driven by a number of factors including cost of living increases, higher interest rates and higher inflation. As a result, in relation to the residential mortgage portfolios, we consider the judgements and assumptions used in the determination of forward-looking macroeconomic scenarios and the probability weights applied to be significant.

In addition, there are a number of JAs (both within and outside models) to respond to the economic uncertainty not fully captured by the models, and also to address data and model limitations. Given the level of judgement involved we also deem the risk associated with the sufficiency and appropriateness of the following in model and post model JAs to be significant:
– JAs to recognise that the repossession rates in the model are not representative of expected repossessions (Long-term indeterminate arrears and 12+ months in arrears JAs);
– In model JAs to uplift repossession rates for certain interest-only mortgages and
– Mortgage refinancing risk JA.

Management have not identified ECL as a critical accounting estimate given the low level of ECL recognised in the company. However, given the judgments involved in calculating ECL and considering the current economic environment, we considered the valuation of ECL at 31 December 2023 to be a key audit matter.</td><td>We understood and evaluated the design of the key controls over the determination of ECLs and tested their operating effectiveness. These controls included:
- Model performance monitoring controls, including testing model estimates against actual outcomes;
- The Asset and Liability Committee's review and approval of the base case economic assumptions; and
- The Credit Risk Provisions Forum's review and approval of the outer economic scenarios and weightings; and significant judgements & estimates.

We identified no exceptions in performing this testing. In addition, we performed the substantive procedures described below.

Forward looking economic scenarios and scenario probability weightings
We used economics experts and credit risk modelling specialists to critically assess the reasonableness of the multiple economic scenarios and scenario probability weightings adopted by management. We considered external economic data and consensus forecasts to assess whether management's forecasts appropriately reflect the different possible paths that the economy could take, including the consequences of cost of living increases, a higher interest rate environment and higher inflation.

In addition, we compared the base case scenario assumptions to other external consensus forecasts and we considered the inferred GDP 'time to recovery' for each scenario based on historical distributions and made a comparison to other external consensus forecasts.

We found that the scenario weights appropriately captured the economic uncertainty and the non-linear distribution of losses across a reasonable range, and are broadly consistent with external forecasts.

JAs within models and outside models
We considered whether the JAs identified were sufficient to address material risks not captured in the modelled loss allowances, and whether they appropriately addressed the risk. This included adjustments in place to address modelling and operational limitations highlighted by the economic conditions caused by cost of living increases, higher interest rates and higher inflation.

We critically assessed management's JAs both within and outside models using our modelling specialists to assess the appropriateness of the significant assumptions and methodologies used in the adjustments for the UK mortgage portfolios. We performed audit procedures for a sample of JAs such as independent recalculation of the JAs and, where appropriate, built challenger models to assess the sufficiency and appropriateness of those JAs. In particular we challenged the appropriateness of:
– In-model JAs used to address data limitations in the mortgages model in relation to repossession rates; and
– JAs introduced to assess the impact of refinance risk on mortgages.

Overall, based on the procedures performed and the evidence obtained, we found management's determination of expected credit loss provision to be reasonable and materially compliant with the requirements of IFRS 9.</td></tr>
</table>

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

In our audit plan we identified that the Jersey and Isle of Man branches of the company contain balances which, in our view, require an audit of specific financial statement line items based on their size or their risk characteristics, in the context to the company's financial statements. We instructed PwC Jersey, who are familiar with the relevant businesses, to audit these and certain other balances where the controls and operational processes operate from Jersey.

Certain processes and controls supporting the group's operations are performed as part of the Banco Santander S.A's wider processes and controls in Spain, including the hosting and monitoring of certain IT systems. In such instances, we instructed PwC Spain to perform certain audit procedures over these group operations.

As part of the planning and execution of the audit, we worked closely with the PwC Spain and PwC Jersey teams throughout the year to ensure that the procedures performed on our behalf were sufficient for our purposes. We reviewed the results of their work and held meetings with the auditors to discuss their findings.

The impact of climate risk on our audit

The company, in alignment with their parent Santander UK Group Holdings plc and ultimate parent Banco Santander S.A ("the Group"), has set out commitments to be a net zero bank by 2050. Further information on this commitment is provided in the Sustainability and Banking section on page 34 of the Santander UK Group Holding plc annual report.

In planning and executing our audit, we considered the group's governance framework and preliminary risk assessment processes together with the group's discussions with climate change experts. We have also considered our understanding of the potential impact of climate change on the company's financial statements. We specifically considered the potential impact on mortgage lending. We determined that the key financial statement line items which were more likely to be materially impacted by climate risks were those associated with expected credit losses. In the current reporting period, the company concluded that there is no material impact on the financial statements and the more notable impacts of climate change on the business are expected to arise in the medium to long term.

Whilst the group is targeting net zero carbon emissions by 2050, they are continuing to refine their plans to achieve this. The group has started to quantify some of the impacts that may arise; however, the future financial impacts are uncertain given the medium to long term time horizon. We discussed with management and the BAC that the estimated financial impacts of climate change will need to be frequently reassessed and our expectation is that climate change disclosures will continue to evolve as greater understanding of the actual and potential impacts on the group's future operations is obtained.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall company materiality	£32.9 million (2022: £32.5 million).
How we determined it	0.5% of total assets
Rationale for benchmark applied	Consistent with last year, we have continued to apply an asset-based measure as we believe this is appropriate for the company. A balance sheet based measure is considered appropriate when considering the primary users of the financial statements.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% (2022: 75%) of overall materiality, amounting to £24.7 million (2022: £24.4 million) for the company financial statements.

In determining the performance materiality, we considered a number of factors - the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls - and concluded that an amount at the upper end of our normal range was appropriate.

We agreed with the BAC that we would report to them misstatements identified during our audit above £1.6 million (2022: £1.6 million) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included:

- A risk assessment to identify factors that could impact the going concern basis of accounting, including the current and forecast financial performance, regulatory metrics and the sector in which the company operates;
- Understanding and evaluation of the company's budget and stress testing of liquidity and regulatory capital performed by management;
- Review of regulatory correspondence and reports provided to governance forums, and testing of the total capital resources and liquidity financing facilities;
- Inspection of the Capital Support Deed issued by Santander UK Group Holdings plc to the company and another affiliate and review of the Santander UK Group Holdings plc's going concern and viability statements presented by management to its BAC to assess that support can be provided to the company; and
- Reviewing the appropriateness of the disclosures in the Annual Report.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate. However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the company's ability to continue as a going concern.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic report and Directors' report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on our work undertaken in the course of the audit, the Companies Act 2006 requires us also to report certain opinions and matters as described below.

Strategic report and Directors' report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Directors' report for the year ended 31 December 2023 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Directors' report.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the company and industry, we identified that the principal risks of non-compliance with laws and regulations related to banking, including regulatory reporting requirements and conduct of business, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as Companies Act 2006 and relevant tax legislation. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to management bias in significant accounting estimates and posting of journals. Audit procedures performed by the engagement team included:

- Discussions with management and those charged with governance in relation to known or suspected instances of non-compliance with laws and regulation and fraud;
- Evaluation and testing of the operating effectiveness of management's controls designed to prevent and detect fraud and errors in financial reporting;
- Attendance at selected key governance forums and reviewing the minutes of these meetings;
- Reviewing correspondence with key regulators;
- Challenging assumptions and judgements made by management in their significant accounting estimates which may be indicative of bias, in particular in relation to the expected credit loss allowance for loans and advances to customers;
- Identifying and testing selected journal entries, in particular any journal entries posted by senior management and period end adjustments; and
- Incorporating unpredictability into the nature, timing and/or extent of our testing.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

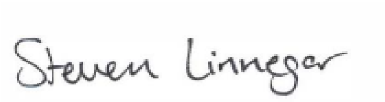
Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Board Audit Committee ("BAC"), we were appointed by the members on 31 March 2016 to audit the financial statements for the year ended 31 December 2016 and subsequent financial periods. The period of total uninterrupted engagement is 8 years, covering the years ended 31 December 2016 to 31 December 2023.



Steven Linnegar (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
12 March 2024

INCOME STATEMENT

For the year ended 31 December

	Notes	2023 £m	2022 £m
Interest and similar income		**235.1**	111.6
Interest expense and similar charges		**(225.8)**	(62.4)
Net interest income	2	**9.3**	49.2
Fee and commission income		**2.1**	1.9
Fee and commission expense		**(8.6)**	(8.4)
Net fee and commission expense	3	**(6.5)**	(6.5)
Other operating income	4	**21.6**	18.9
Total operating income		**24.4**	61.6
Operating expenses before credit impairment charges, provisions and charges	5	**(25.1)**	(23.6)
Credit impairment charges	7	**(0.6)**	(0.7)
Provisions for other liabilities and charges		**(1.7)**	(1.6)
Total operating credit impairment charges, provisions and charges		**(2.3)**	(2.3)
Profit/(loss) before tax		**(3.0)**	35.7
Tax on profit	8	**15.0**	4.0
Profit after tax		**12.0**	39.7
Attributable to:			
Equity holders of the parent		**12.0**	39.7
Profit after tax		**12.0**	39.7

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December

	2023 £m	2022 £m
Profit after tax	**12.0**	39.7
Cash flow hedges:		
- Effective portion of changes in fair value	**1.4**	—
Net other comprehensive income/(expense) that may be reclassified to profit or loss subsequently	**1.4**	—
Total other comprehensive income/(expense) net of tax	**1.4**	—
Total comprehensive income	**13.4**	39.7
Attributable to:		
Equity holders of the parent	**13.4**	39.7
Total comprehensive income	**13.4**	39.7

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

BALANCE SHEET

At 31 December 2023

	Notes	2023 £m	2022 £m
Assets			
Cash and balances at central banks		**2,308**	2,445
Derivative financial instruments	10	**10**	13
Other financial assets at fair value through profit or loss	11	**309**	296
Loans and advances to customers	12	**3,834**	4,180
Loans and advances to banks		**92**	57
Macro hedge of interest rate risk		**2**	—
Interests in other entities	13	**3**	3
Property, plant and equipment		**19**	13
Current tax assets	8	**3**	—
Deferred tax assets	8	**4**	5
Other assets		**6**	5
Total assets		**6,590**	7,017
Liabilities			
Derivative financial instruments	10	**69**	56
Deposits by customers	14	**6,152**	6,575
Deposits by banks	15	**2**	4
Other liabilities	16	**9**	14
Provisions	17	**3**	2
Current tax liabilities	8	**—**	15
Total liabilities		**6,235**	6,666
Equity			
Share capital	19	**250**	250
Other equity instruments		**50**	50
Retained earnings		**54**	51
Other reserves		**1**	—
Total equity		**355**	351
Total liabilities and equity		**6,590**	7,017

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

The Financial Statements were approved and authorised for issue by the Board on 12 March 2024 and signed on its behalf by:

James Pountney
Director

Company Registered Number: 02338548

CASH FLOW STATEMENT[1]

For the year ended 31 December

	2023	2022
	£m	£m
Cash flows from operating activities		
(Loss)/profit before tax	(3)	36
Adjustments for:		
Non-cash items included in profit:		
– Depreciation and amortisation	2	1
– Provisions for other liabilities and charges	2	2
– Impairment losses	1	1
– Other non-cash items	3	1
	8	5
Net change in operating assets and liabilities		
– Cash and balances at central banks	1	(1)
– Derivative assets	2	14
– Other financial assets at fair value through profit or loss	(14)	146
– Loans and advances to banks and customers	307	(650)
– Other assets	(2)	(2)
– Deposits by banks and customers	(443)	576
– Derivative liabilities	12	(181)
– Other liabilities	16	3
	(121)	(95)
Corporation taxes paid	(3)	7
Net cash flows from operating activities	(119)	(47)
Cash flows from investing activities		
Investments in other entities	—	(3)
Purchase of property, plant and equipment and Intangible assets	(13)	(8)
Net cash flows from investing activities	(13)	(11)
Cash flows from financing activities		
Issue of other equity instruments	—	50
Dividends paid on ordinary shares	(4)	(65)
Dividends paid on preference shares and other equity instruments	(5)	—
Net cash flows from financing activities	(9)	(15)
Change in cash and cash equivalents	(141)	(73)
Cash and cash equivalents at beginning of the year	2,460	2,532
Effects of exchange rate changes on cash and cash equivalents	(1)	1
Cash and cash equivalents at the end of the year	2,318	2,460
Cash and cash equivalents consist of:		
Cash and balances at central banks	2,308	2,445
Less: restricted balances	(17)	(18)
	2,291	2,427
Other cash equivalents	27	33
Cash and cash equivalents at the end of the year	2,318	2,460

(1)For more information on cash flows see Note 21.

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December

	Share capital	Other equity instruments	Other reserves Cash flow hedging	Retained earnings	Total
	£m	£m	£m	£m	£m
At 1 January 2023	**250**	**50**	**—**	**51**	**351**
Profit after tax	**—**	**—**	**—**	**12**	**12**
Other comprehensive expense net of tax:					
- Cash flow hedges	**—**	**—**	**1**	**—**	**1**
Total comprehensive income	**—**	**—**	**1**	**12**	**13**
Dividends on ordinary shares	**—**	**—**	**—**	**(4)**	**(4)**
Dividends on other equity instruments	**—**	**—**	**—**	**(5)**	**(5)**
At 31 December 2023	**250**	**50**	**1**	**54**	**355**
At 1 January 2022	250	—	—	76	326
Profit after tax	—	—	—	40	40
Total comprehensive income	—	—	—	40	40
Issue of other equity instruments	—	50	—	—	50
Dividends on ordinary shares	—	—	—	(65)	(65)
At 31 December 2022	250	50	—	51	351

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

1. ACCOUNTING POLICIES

These financial statements are prepared for Santander Financial Services plc (the Company or SFS) under the Companies Act 2006. The Company is exempt from the requirement to prepare group accounts by virtue of section 400 of the Companies Act 2006. These financial statements therefore present information about the company as an individual undertaking and not about its group.

Santander Financial Services plc is a public company, limited by shares and incorporated and registered in England and Wales having a registered office at 2 Triton Square, Regent's Place, London, NW1 3AN. The Company is an operating company whose principal activity is to provide banking and financial services for clients and customers through its presence in the UK, Jersey and the Isle of Man, whilst also holding a pool of residual assets and liabilities, which is intended to be run down and/or managed for value.

Basis of preparation

These financial statements have been prepared on the going concern basis using the historical cost convention, except for financial assets and liabilities that have been measured at fair value. An assessment of the appropriateness of the adoption of the going concern basis of accounting is disclosed in the statement of going concern in the Directors' report.

The financial statements comply with UK-adopted International Accounting Standards (IAS).

Disclosures required by IFRS 7 'Financial Instruments: Disclosure' relating to the nature and extent of risks arising from financial instruments, and IAS 1 'Presentation of Financial Statements' relating to objectives, policies and processes for managing capital, have been included in the Risk review section of this Annual Report. This information forms an integral part of these financial statements by this cross reference, is marked as audited, and is covered by the Independent auditors' report.

In the course of preparing the financial statements, no significant judgements have been made in the process of applying the Company's accounting policies, and there were no critical judgements and accounting estimates.

Future accounting developments

At 31 December 2023, there were no other significant new or revised standards and interpretations, and amendments thereto, which have been issued but which are not yet effective or which have otherwise not been early adopted where permitted.

The following material accounting policies have been applied in preparing these financial statements.

Revenue recognition

a) Interest income and expense

Interest and similar income and expense are recognised in the income statement using the effective interest rate method for: all financial instruments measured at amortised cost; debt instruments measured at FVOCI; and the effective part of any related accounting hedging instruments.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for financial assets that have subsequently become credit-impaired (i.e. Stage 3), for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e. net of the ECL provision). For more information on stage allocations of credit risk exposures, see 'Significant increase in credit risk' in the 'Credit risk management' section of the Risk review.

b) Fee and commission income and expense

Fees and commissions that are not an integral part of the effective interest rate are recognised when the service is performed. Most fee and commission income is recognised at a point in time. Certain commitment, upfront and management fees are recognised over time but are not material. Fee and commission income which forms an integral part of the effective interest rate of a financial instrument (for example certain loan commitment fees) is recognised as an adjustment to the effective interest rate and recorded in 'Interest income'.

c) Other operating income

Other operating income includes all gains and losses from changes in the fair value of financial assets and liabilities held at fair value through profit or loss (comprising financial assets and liabilities held for trading, trading derivatives and other financial assets and liabilities at fair value through profit or loss), together with related interest income, expense, dividends, and changes in fair value of any derivatives managed in conjunction with these assets and liabilities. Other operating income also includes hedge ineffectiveness arising from fair value and cash flow hedging, profits and losses arising on the sales of property, plant and equipment and subsidiary undertakings.

Property, plant and equipment

Property, plant and equipment include owner-occupied properties (including leasehold properties), office fixtures and equipment and computer software. It also includes right-of-use assets where the Company is the lessee. Internally developed software meeting the capitalisation criteria of having reliably measurable direct costs associated with an identifiable and unique software product that is expected to provide future economic benefits, and externally purchased software are classified in property, plant and equipment where the software is an integral part of the related computer hardware (for example, the operating system of a computer).

Classes of property, plant and equipment are depreciated on a straight-line basis over their useful life, as follows:

Owner-occupied properties	Not exceeding 50 years
Office fixtures and equipment	5 to 8 years
Computer software	3 years
Right-of-use assets (see 'Leases – SFS as lessee' below)	Shorter of the lease term or the useful life of the underlying asset

Depreciation is not charged on freehold land and assets under construction. Right-of-use assets where the company is the lessee are depreciated over the shorter of the lease term or the useful life of the underlying asset.

Financial Instruments

a) Initial recognition and measurement

Financial assets and liabilities are initially recognised when the Company becomes a party to the contractual terms of the instrument. The Company determines the classification of its financial assets and liabilities at initial recognition and measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at FVTPL, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs of financial assets and financial liabilities carried at FVTPL are expensed in profit or loss. Immediately after initial recognition, an expected credit loss (ECL) allowance is recognised for financial assets measured at amortised cost.

A regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the timeframe established generally by regulation or convention in the marketplace concerned. Regular way purchases and sales of financial assets measured at amortised cost are recognised on settlement date; all other regular way purchases and sales of financial assets are recognised on trade date.

b) Financial assets and liabilities

i) Classification and subsequent measurement

The Company classifies its financial assets in the measurement categories of amortised cost and FVTPL.

Financial assets and financial liabilities are classified as FVTPL where there is a requirement to do so or where they are otherwise designated at FVTPL on initial recognition. Financial assets and financial liabilities which are required to be held at FVTPL include:

- Financial assets and financial liabilities held for trading.
- Debt instruments that do not have solely payments of principal and interest (SPPI) characteristics. Otherwise, such instruments are measured at amortised cost.

Financial assets and financial liabilities are classified as held for trading if they are derivatives or if they are acquired or incurred principally for the purpose of selling or repurchasing in the near-term, or form part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking.

In certain circumstances, other financial assets and financial liabilities are designated at FVTPL where this results in more relevant information. This may arise because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains or losses on them on a different basis, where the assets and liabilities are managed and their performance evaluated on a fair value basis or, in the case of financial liabilities, where it contains one or more embedded derivatives which are not closely related to the host contract.

The classification and measurement requirements for financial assets and financial liabilities are set out below.

Financial assets: debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans and government and corporate bonds. Classification and subsequent measurement of debt instruments depend on the Company's business model for managing the asset, and the cash flow characteristics of the asset.

Business model

The business model reflects how the Company manages the assets in order to generate cash flows and, specifically, whether the Company's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of the assets. If neither of these is applicable, such as where the financial assets are held for trading purposes, then the financial assets are classified as part of an 'other' business model and measured at FVTPL. Factors considered in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the assets' performance is evaluated and reported to key management personnel and how risks are assessed and managed.

SPPI

Where the business model is to hold assets to collect contractual cash flows, the Company assesses whether the assets' cash flows represent SPPI. In making this assessment, the Company considers whether the contractual cash flows are consistent with a basic lending arrangement (i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement). Where the contractual terms introduce exposure to risk or volatility that is inconsistent with a basic lending arrangement, the related asset is classified and measured at FVTPL.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are SPPI.

Based on these factors, the Company classifies its debt instruments into one of the following measurement categories:

- Amortised cost – Financial assets that are held for collection of contractual cash flows where those cash flows represent SPPI, and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any ECL recognised and measured as presented in Note 12. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method. When estimates of future cash flows are revised, the carrying amount of the respective financial assets is adjusted to reflect the new estimate discounted using the original effective interest rate. Any changes are recognised in the income statement.
- FVTPL – Financial assets that do not meet the criteria for amortised cost are measured at FVTPL. A gain or loss on a debt instrument that is subsequently measured at FVTPL, including any debt instruments designated at fair value, is recognised in profit or loss and presented in the income statement in 'Other operating income' in the period in which it arises.

The Company reclassifies financial assets when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent.

Financial liabilities

Financial liabilities are classified as subsequently measured at amortised cost, except for:

- Financial liabilities at FVTPL: this classification is applied to derivatives and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at FVTPL are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability) and partially in profit or loss (the remaining amount of change in the fair value of the liability); and
- Financial guarantee contracts and loan commitments.

ii) Impairment of debt instrument financial assets
The Company assesses on a forward-looking basis the ECL associated with its debt instrument assets carried at amortised cost and with the exposure arising from financial guarantee contracts and loan commitments. The Company recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes.
- The time value of money, and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

For more on how ECL is calculated, see the Credit risk section of the Risk review.

- **Write-off**

  For secured loans, a write-off is only made when all collection procedures have been exhausted and the security has been sold and/or a claim made on any mortgage indemnity guarantee or other insurance. In the corporate loan portfolio, there may be occasions where a write-off occurs for other reasons, such as following a consensual restructure or refinancing of the debt or where the debt is sold for strategic reasons into the secondary market at a value lower than its face value.

  There is no threshold based on past due status beyond which all secured loans are written off as there can be significant variations in the time needed to enforce possession and sale of the security, especially due to the different legal frameworks that apply in different regions of the UK. For unsecured loans, a write-off is only made when all internal avenues of collecting the debt have been exhausted. Where appropriate the debt is passed over to external collection agencies. A past due threshold is applied to unsecured debt where accounts that are 180 days past due are written off unless there is a dispute awaiting resolution. Contact is made with customers with the aim to achieve a realistic and sustainable repayment arrangement. Litigation and/or enforcement of security is usually carried out only when the steps described above have been undertaken without success.

  All write-offs are assessed / made on a case-by-case basis, taking account of the exposure at the date of write-off, after accounting for the value from any collateral or insurance held against the loan. The exception to this is in cases where fraud has occurred, where the exposure is written off once investigations have been completed and the probability of recovery is minimal. The time span between discovery and write-off will be short and may not result in an impairment loss allowance being raised. The write-off policy is regularly reviewed. Write-offs are charged against previously established loss allowances.

- **Recoveries**

  Recoveries of credit impairment charges are not included in the impairment loss allowance but are taken to income and offset against credit impairment charges. Recoveries of credit impairment charges are classified in the income statement as 'Credit impairment charges'.

iii) Modifications of financial assets
The treatment of a renegotiation or modification of the contractual cash flows of a financial asset normally depends upon whether the renegotiation or modification is due to financial difficulties of the borrower or for other commercial reasons.

- *Contractual modifications due to financial difficulties of the borrower*: where the Company modifies the contractual conditions to enable the borrower to fulfil their payment obligations, the asset is not derecognised. The gross carrying amount of the financial asset is recalculated as the present value of the renegotiated/modified contractual cash flows that are discounted at the financial asset's original EIR and any gain or loss arising from the modification is recognised in the income statement.

- *Contractual modifications for other commercial reasons:* an assessment is performed to determine whether the terms of the new agreement are substantially different from the terms of the existing agreement, after considering changes in the cash flows arising from the modified terms and the overall instrument risk profile. Where terms are substantially different, such modifications are treated as a new transaction resulting in derecognition of the original financial asset, and the recognition of a 'new' financial asset with any difference between the carrying amount of the derecognised asset and the fair value of the new asset is recognised in the income statement as a gain or loss on derecognition. Where terms are not substantially different, the carrying value of the financial asset is adjusted to reflect the present value of modified cash flows discounted at the original EIR with any gain or loss arising from modification recognised immediately in the income statement.

Any other contractual modifications, such as where a regulatory authority imposes a change in certain contractual terms or due to legal reasons, are assessed on a case-by-case basis to establish whether or not the financial asset should be derecognised. For IBOR reform see Note 28.

iv) Derecognition other than on a modification
Financial assets are derecognised when the rights to receive cash flows have expired or the Company has transferred its contractual right to receive the cash flows from the assets and either: (1) substantially all the risks and rewards of ownership have been transferred; or (2) the Company has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

Financial liabilities are derecognised when extinguished, cancelled or expired.

c) Financial guarantee contracts and loan commitments
Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of the amount of the loss allowance, and the premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

Loan commitments are measured as the amount of the loss allowance (determined in accordance with IFRS 9 as described in Credit risk section of the Risk review). The Company has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

For financial guarantee contracts and loan commitments, the loss allowance is recognised as a provision and charged to credit impairment charges in the income statement. The loss allowance in respect of revolving facilities is classified in loans and advances to customers to the extent of any drawn balances. The loss allowance in respect of undrawn amounts is classified in provisions. When amounts are drawn, any related loss allowance is transferred from provisions to loans and advances to customers.

Derivative financial instruments (derivatives)

Derivatives are contracts or agreements whose value is derived from one or more underlying indices or asset values inherent in the contract or agreement, which require no or little initial net investment and are settled at a future date. Transactions are undertaken in interest rate, cross currency, equity, residential property and other index-related swaps, forwards, caps, floors, swaptions, as well as credit default and total return swaps, equity index contracts and exchange traded interest rate futures, and equity index options.

Derivatives are held for risk management purposes and classified as fair value through profit or loss.

Derivatives are classified as held for trading unless they are designated as being in a hedge accounting relationship. The Company chooses to designate certain derivatives as in a hedging relationship if they meet specific criteria, as further described in 'Hedge accounting' below.

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

All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative, except where netting is permitted. Gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement and included in Other operating income.

Offsetting financial assets and liabilities

Financial assets and liabilities including derivatives are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously. The Company is party to a number of arrangements, including master netting arrangements under industry standard agreements which facilitate netting of transactions in jurisdictions where netting agreements are recognised and have legal force. These netting arrangements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis.

Hedge accounting

The Company applies hedge accounting to represent, to the maximum possible extent permitted under accounting standards, the economic effects of its risk management strategies. Derivatives are used to hedge exposures to interest rates.

At the time a financial instrument is designated as a hedge (i.e. at the inception of the hedge), the Company formally documents the relationship between the hedging instrument(s) and hedged item(s), its risk management objective and strategy for undertaking the hedge. The documentation includes the identification of each hedging instrument and respective hedged item, the nature of the risk being hedged (including the benchmark interest rate being hedged in a hedge of interest rate risk) and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value attributable to the hedged risk is to be assessed. Accordingly, the Company formally assesses, both at the inception of the hedge and on an ongoing basis, whether the hedging derivatives have been and will be highly effective in offsetting changes in the fair value attributable to the hedged risk during the period that the hedge is designated. A hedge is normally regarded as highly effective if, at inception and throughout its life, the Company can expect, and actual results indicate, that changes in the fair value or cash flow of the hedged items are effectively offset by changes in the fair value or cash flow of the hedging instrument. If at any point it is concluded that it is no longer highly effective in achieving its documented objective, hedge accounting is discontinued.

Where derivatives are held for risk management purposes, and when transactions meet the required criteria for documentation and hedge effectiveness, the derivatives may be designated as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments (fair value hedges); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (cash flow hedges); or (iii) a hedge of a net investment in a foreign operation (net investment hedges). The Company applies fair value and cash flow hedge accounting, but not hedging of a net investment in a foreign operation.

a) Fair value hedge accounting

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. Where the hedged item is measured at amortised cost, the fair value changes due to the hedged risk adjust the carrying amount of the hedged asset or liability. Changes in the fair value of portfolio hedged items are presented separately in the consolidated balance sheet in macro hedge of interest rate risk and recognised in the income statement. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the income statement. For fair value hedges of interest rate risk, the cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement using the effective interest method over the period to maturity. For portfolio hedged items, the cumulative adjustment is amortised to the income statement using the straight-line method over the period to maturity.

b) Cash flow hedge accounting

The effective portion of changes in the fair value of qualifying cash flow hedges is recognised in other comprehensive income in the cash flow hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement. The Company is exposed to cash flow interest rate risk on its floating rate assets. Cash flow hedging is used to hedge the variability in cash flows arising from these risks.

Impairment of non-financial assets
At each balance sheet date, or more frequently when events or changes in circumstances dictate, non-financial assets are assessed for indicators of impairment. If indications are present, these assets are subject to an impairment review. The impairment review comprises a comparison of the carrying value of the asset with its recoverable amount: the higher of the asset's fair value less costs to sell and its value in use.

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Value in use is calculated by discounting management's expected future cash flows obtainable as a result of the asset's continued use, including those resulting from its ultimate disposal, at a market based discount rate on a pre-tax basis.

Income taxes, including deferred taxes
The tax expense represents the sum of the income tax currently payable and deferred income tax.

A current tax liability for the current or prior period is measured at the amount expected to be paid to the tax authorities. Where the amount of the final tax liability is uncertain or where a position is challenged by a taxation authority, the liability recognised is the most likely outcome. Where a most likely outcome cannot be determined, a weighted average basis is applied.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled, or the asset is realised based on rates enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items recognised in other comprehensive income or directly in equity, in which case the deferred tax is also recognised in other comprehensive income or directly in equity.

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

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

Provisions
Provisions are recognised for present obligations arising as consequences of past events where it is more likely than not that a transfer of economic benefits will be necessary to settle the obligation, and it can be reliably estimated.

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

When a leasehold property ceases to be used in the business, provision is made where the unavoidable costs of the future obligations relating to the lease are expected to exceed anticipated rental income. The net costs are discounted using market rates of interest to reflect the long-term nature of the cash flows.

Loan commitments are measured as the amount of the loss allowance, determined in line with IFRS 9 as set out in the Credit risk section of the Risk review.

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

Investment in other entities
Investment in other entities is carried at cost less any provision for impairment.

2. NET INTEREST INCOME

	2023	2022
	£m	£m
Interest and similar income:		
Loans and advances to Santander UK group undertakings	**1.1**	—
Residential mortgages	**109.3**	74.4
Other loans and advances	**124.7**	37.2
Total interest and similar income:	**235.1**	111.6
Interest expense and similar charges:		
Other deposits and borrowings	**(225.8)**	(62.4)
Total interest expense and similar charges	**(225.8)**	(62.4)
Net interest income	**9.3**	49.2

3. NET FEE AND COMMISSION EXPENSE

	2023	2022
	£m	£m
Fee and commission income:		
Current account and debit card fee income	**2.1**	1.9
Total fee and commission income	**2.1**	1.9
Total fee and commission expense	**(8.6)**	(8.4)
Net fee and commission expense	**(6.5)**	(6.5)

4. OTHER OPERATING INCOME

	2023	2022
	£m	£m
Net gains/(losses) on financial instruments designated at fair value through profit or loss(1)	**23.8**	(136.7)
Net (losses)/gains on financial instruments mandatorily at fair value through profit or loss(2)	**(2.0)**	155.6
Other	**(0.2)**	—
	21.6	18.9

(1) Net gains on financial assets designated at fair value through profit or loss includes gains on Debt Securities of £nil (2022: gains of £0.1m).
(2) Net losses on financial instruments mandatorily at fair value through profit or loss mainly includes losses on derivatives of £2.0m (2022: gains of £156.0m).

5. OPERATING EXPENSES BEFORE CREDIT IMPAIRMENT CHARGES, PROVISIONS AND CHARGES

	2023	2022
	£m	£m
Staff costs:		
Wages and salaries	**7.9**	8.0
Performance-related payments	**2.3**	2.1
Social security costs	**0.7**	0.6
Pensions costs – defined contribution plans	**0.7**	0.6
Other personnel costs	**0.4**	0.3
	12.0	11.6
Other administration expenses	**10.9**	10.7
Depreciation, amortisation and impairment	**2.2**	1.3
	25.1	23.6

All staff have employment contracts with the Company. The average number of full-time equivalent staff in 2023 was 157 (2022: 157).

The Company also uses the services of individuals who have employment contracts with Santander UK. The cost of their services is recharged by Santander UK to the Company. These recharges are classified as other administrative expenses and the individuals are excluded from the average number of full-time equivalent staff.

Depreciation, amortisation and impairment
SFS has no operating lease assets as lessor. In 2023, depreciation, amortisation and impairment included depreciation of £0.4m (2022: £0.3m) on right-of-use assets with a carrying amount of £2.7m at 31 December 2023 (2022: £3.1m).

6. AUDIT AND OTHER SERVICES

	2023	2022
	£m	£m
Audit fees:		
Fees payable to the Company's auditors and its associates for the audit of the annual accounts	**0.4**	0.4
Total audit fees	**0.4**	0.4
Non-audit fees:		
Audit-related assurance services	**0.1**	0.1
Total non-audit fees(1)	**0.1**	0.1

(1) Total non-audit fees comprised audit-related assurance services of £141,000 (2022: £101,000).

7. CREDIT IMPAIRMENT CHARGES

There were no material credit impairment charges on loans and advances to banks or loans and advances to customers.

8. TAXATION

	2023	2022
	£m	£m
Current tax:		
UK corporation tax on loss for the year	**(11.6)**	(1.9)
Overseas tax	**3.4**	4.4
Adjustments in respect of prior years	**(7.8)**	(8.0)
Total current tax	**(16.0)**	(5.5)
Deferred tax:		
Charge for the year	**1.0**	0.5
Adjustment in respect of prior years	**—**	1.0
Total deferred tax	**1.0**	1.5
Tax credit	**(15.0)**	(4.0)

The standard rate of UK corporation tax was 28% for banking entities (2022: 27%) following the introduction of a surcharge on banking companies in 2016. Tax for other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

The tax on profit before tax differs from the theoretical amount that would arise using the basic corporation tax as follows:

	2023	2022
	£m	£m
(Loss)/profit before tax	**(3.0)**	35.7
Tax calculated at a tax rate of 23.5% (2022: 19%)	**(0.7)**	6.8
Bank surcharge on profits	**(0.1)**	2.9
Effect of different tax rates in other jurisdictions	**(6.4)**	(7.4)
Other disallowable items	**1.3**	0.7
Tax relief on dividends in respect of other equity instruments	**(1.3)**	—
Effect of change in tax rate on deferred tax provision	**—**	1.0
Adjustment in respect of prior years	**(7.8)**	(8.0)
Tax credit	**(15.0)**	(4.0)

Movements in current tax assets and liabilities during the year were as follows:

	2023	2022
	£m	£m
Liabilities at 1 January	**(15)**	(14)
Income statement charge	**16**	6
Corporate income tax paid/(received)	**2**	(7)
Assets/(liabilities) at 31 December	**3**	(15)

The amount of corporation income tax paid differs from the tax charge for the period as a result of the timing of payments due to the tax authorities together with the effects of movements in deferred tax and adjustments to prior period current tax provisions.

The Company proactively engages and cooperates with relevant tax authorities in their oversight of the company's tax matters. The accounting policy for recognising provisions for any tax risks identified is described in Note 1 to the Financial Statements. It is not expected that there will be any material movement in such provisions within the next 12 months. The Company has applied the UK's Code of Practice on Taxation for Banks following its introduction in 2010.

On 20 June 2023, Finance (No.2) Act 2023 was substantively enacted in the UK to implement the OECD Pillar Two model rules and which introduces a global minimum effective tax rate of 15% with effect from 1 January 2024.

Santander Financial Services will therefore fall within the scope of these rules from 2024. However, since this legislation does not apply to earlier periods, the company has no related current tax exposure in 2023. Santander Financial Services has also applied the exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes, as provided in the amendments to IAS 12 issued in May 2023.

Santander Financial Services continues to assess its exposure to the Pillar Two legislation for when it comes into effect. This assessment currently indicates that there should be no impact on the UK activities but that an additional top up tax may apply to its operations in Jersey and the Isle of Man where both the statutory rate and effective tax rates are expected to be 10% for 2024. Had the top up tax applied in 2023, the tax credit would have reduced by £2m.

Deferred tax

The table below shows the deferred tax assets and liabilities including the movement in the deferred tax account during the year. Deferred tax balances are presented in the balance sheet after offsetting assets and liabilities where the Company has the legal right to offset and intends to settle on a net basis.

	Other temporary differences	Total
	£m	£m
At 1 January 2023	**5.0**	**5.0**
Income statement charge	**(1.0)**	**(1.0)**
At 31 December 2023	**4.0**	**4.0**
At 1 January 2022	6.0	6.0
Income statement charge	(1.0)	(1.0)
At 31 December 2022	5.0	5.0

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

9. DIVIDENDS ON ORDINARY SHARES

Dividends on ordinary shares declared and paid in the year were as follows:

	2023	2022	**2023**	2022
	Pence per share	Pence per share	**£m**	£m
In respect of current year – first interim	**—**	2.80	**—**	7
– second interim	**1.60**	23.20	**4**	58
– final dividend	**0.80**	—	**2**	—
Total	**2.40**	26.00	**6**	65

10. DERIVATIVE FINANCIAL INSTRUMENTS

a) Use of derivatives

The Company undertakes derivative activities primarily to manage and, starting in 2023, hedge its own risks. These derivative activities do not give rise to significant open positions in portfolios of derivatives. Any residual position is managed to ensure that it remains within acceptable risk levels, with matching transactions used to achieve this where necessary. When entering into derivatives, the Company employs the same credit risk management procedures to assess and approve potential credit exposures that are used for traditional lending.

b) Analysis of derivatives

The table below includes the notional amounts of transactions outstanding at the balance sheet date; they do not represent actual exposures.

	2023			2022		
		Fair value			Fair value	
	Notional amount	**Assets**	**Liabilities**	Notional amount	Assets	Liabilities
	£m	**£m**	**£m**	£m	£m	£m
Derivatives held for trading:						
Exchange rate contracts	**771**	**—**	**25**	808	6	18
Interest rate contracts	**455**	**8**	**44**	465	7	38
Total derivatives held for trading	**1,226**	**8**	**69**	1,273	13	56
Derivatives held for hedging						
Designated as fair value hedges:						
Interest rate contracts	**76**	**—**	**—**	—	—	—
	76	**—**	**—**	—	—	—
Designated as cash flow hedges:						
Interest rate contracts	**1,122**	**2**	**—**	—	—	—
	1,122	**2**	**—**	—	—	—
Total derivatives held for hedging	**1,198**	**2**	**—**	—	—	—
Total derivatives financial instruments	**2,424**	**10**	**69**	1,273	13	56

For information about the impact of netting arrangements on derivative assets and liabilities in the table above, see Note 26.

c) Analysis of derivatives designated as hedges

The Company applies hedge accounting on both a fair value and cash flow basis depending on the nature of the underlying exposure. We establish the hedge ratio by matching the notional of the derivative with the underlying position being hedged. Only the designated risk is hedged and therefore other risks, such as credit risk are managed but not hedged. For interest rate hedges, the designated hedged risk is determined with reference to the underlying benchmark rate.

Fair value hedges
Portfolio hedge of interest rate risk
The Company holds a portfolio of fixed rate assets which exposes it to changes in fair value due to movements in market interest rates. We manage these exposures by entering into interest rate swaps. The portfolio contains assets that are similar in nature and share the risk exposure that is designated as being hedged.

The interest rate risk component is the change in fair value of fixed rate instruments for changes in the designated benchmark rate. Such changes are usually the largest component of the overall change in fair value. Effectiveness is assessed by comparing changes in the fair value of the hedged item attributable to changes in the designated benchmark interest rate, with changes in the fair value of the interest rate swaps.

Cash flow hedges
Hedges of interest rate risk
The Company manages its exposure to the variability in cash flows of floating rate assets and liabilities attributable to movements in market interest rates by entering into interest rate swaps. The interest rate risk component is determined with reference to the underlying benchmark rate attributable to the floating rates asset or liability. Designated benchmark rate referenced currently is BoE base rate. Effectiveness is assessed by comparing changes in the fair value of the interest rate swap with changes in the fair value of the hedged item attributable to the hedged risk, applying a hypothetical derivative method using linear regression techniques.

Hedge effectiveness measurement
Hedge effectiveness is assessed by using either dollar offset or linear regression techniques to compare changes in the fair value of the hedged item attributable to changes in the designated hedged risk and the hedging instrument.

Possible sources of hedge ineffectiveness
For both fair value and cash flow hedges, hedge ineffectiveness can arise from hedging derivatives with a non-zero fair value at the date of initial designation. In addition, for:

Fair value hedges
Hedge ineffectiveness arises due to differences in the expected and actual volume of prepayments and where counterparty credit risk impacts the fair value of the derivative but not the hedged item.

Cash flow hedges
Hedge ineffectiveness can also arise due to differences in the timing of cash flows between the hedged item and the hedging instrument. For micro hedges of interest rate risk, it can also arise due to differences in the basis of cash flows between the hedged item and the hedging instrument.

Maturity profile and average price/rate of hedging instruments
The following table sets out the maturity profile and average price/rate of the hedging instruments used in the Company's hedging strategies:

2023	Hedging Instruments	≤1 month	>1 and ≤3 months	>3 and ≤12 months	>1 and ≤5 years	>5 years	Total
Fair value hedges:							
Interest rate risk	Interest rate contracts - Nominal amount (£m)	—	—	—	76	—	76
	Average fixed interest rate - GBP	— %	— %	— %	3.77 %	— %	
Cash flow hedges:							
Interest rate risk	Interest rate contracts - Nominal amount (£m)	—	90	901	131	—	1,122
	Average fixed interest rate - GBP	— %	5.21 %	5.30 %	4.80 %	— %	

Net gains or losses arising from fair value included in other operating income

	2023 £m
Fair value hedging:	
Losses on hedging instruments	**(2)**
Gains on hedged items attributable to hedged risks	**2**
	—

Hedge ineffectiveness can be analysed by risk category as follows:

	2023 Change in FV of hedging instruments £m	Change in FV of hedged items £m	Recognised in income statement £m
Fair value hedges:			
Interest rate risk	(2)	2	—
	(2)	2	—

	Income statement line item affected by reclassification	Hedging Instruments Change in FV £m	Recognised in OCI £m	Recognised in income statement £m	Reclassified from reserves to income £m
Cash flow hedges:					
2023					
Interest rate risk	Net interest income	2	(2)	—	1
		2	(2)	—	1

The following table provides a reconciliation by risk category of components of equity and analysis of OCI items (before tax) resulting from hedge accounting.

	2023 £m
Balance at 1 January	—
Effective portion of changes in fair value:	
– Interest rate risk	2
	2
Income statement transfers:	
– Interest rate risk	(1)
	(1)
Balance at 31 December	1

Hedged exposures

The Company hedges its exposures to various risks, including interest rate risk and foreign currency risk, as set out in the following table.

					2023
		Accumulated amount of FV hedge adjustments			
	Carrying value	Hedged item	Portfolio hedge of interest rate risks	Of which Discontinued hedges	Change in value to calculate hedge ineffectiveness
	£m	£m	£m	£m	£m
Fair value hedges					
Interest rate risk:					
Loans and advances to customers	76	—	2	—	2
	76	—	2	—	2

			2023
	Change in value to calculate hedge ineffectiveness	Cash flow hedge reserve	Balances on cash flow hedge reserve for discontinued hedges
Hedged item balance sheet line item	£m	£m	£m
Cash flow hedges:			
Interest rate risk:			
Cash and balances at central banks	(2)	1	—
	(2)	1	—

11. OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2023	2022
	£m	£m
Loans and advances to customers	**309**	295
Debt securities	**—**	1
	309	296

At 31 December 2023 and 2022, all other financial assets at fair value through profit or loss were designated as such.

Loans and advances to customers principally represent other loans, being deferred consideration, that is managed, and has its performance evaluated, on a fair value basis in accordance with a documented investment strategy, and information about it is provided on that basis to management. Since 2009, the Company's policy has been not to designate similar new loans at fair value through profit or loss.

12. LOANS AND ADVANCES TO CUSTOMERS

	2023	2022
	£m	£m
Loans and advances to customers	**3,836**	4,181
Credit impairment loss allowances on loans and advances to customers	**(2)**	(1)
Net loans and advances to customers	**3,834**	4,180

13. INTERESTS IN OTHER ENTITIES

The Company is incorporated and domiciled in the UK and had no associates or joint ventures at 31 December 2023. The Company has branch offices in Jersey and the Isle of Man. In January 2022, the Company acquired a subsidiary, Abbey National International Limited, a Jersey registered entity.

The movement in the Company's interests in subsidiaries was as follows:

	Cost	Impairment	Carrying amount
	£m	£m	£m
At 1 January 2023	3	—	3
At 31 December 2023	3	—	3
At 1 January 2022	—	—	—
Additions	3	—	3
At 31 December 2022	3	—	3

In accordance with Section 409 of the Companies Act 2006, details of the Company's subsidiary at 31 December 2023 are set out below.

Incorporated and registered outside England and Wales:

Name of subsidiary	Direct/Indirect ownership	Share class through which ownership is held	Proportion of ownership interest %
Abbey National International Limited	Direct	Ordinary £1	100 %

The registered office address of Abbey National International Limited is 13-15 Charing Cross, St. Helier, Jersey JE2 3RP.

14. DEPOSITS BY CUSTOMERS

	2023	2022
	£m	£m
Demand and time deposits	**6,149**	6,573
Amounts due to Santander UK subsidiaries and joint ventures	**3**	2
	6,152	6,575

15. DEPOSITS BY BANKS

	2023	2022
	£m	£m
Amounts due to Santander UK subsidiaries	**—**	3
Other deposits	**2**	1
	2	4

16. OTHER LIABILITIES

	2023	2022
	£m	£m
Lease liabilities	**3**	3
Other	**6**	11
	9	14

17. PROVISIONS

	2023	2022
	£m	£m
At 1 January	**2**	2
Additional provisions	**1**	2
Utilisation	**—**	(2)
At 31 December	**3**	2

Provisions expected to be settled within no more than 12 months after 31 December 2023 were £3m (2022: £nil).

Isle of Man and Jersey Bank Depositor Compensation Schemes (DCSs)

The Isle of Man branch of the Company is a participant in the Isle of Man Depositors' Compensation Scheme and the Jersey branch of the Company is a participant in the Jersey Bank Depositors Compensation Scheme. These DCSs are independent statutory compensation funds for customers of Isle of Man and Jersey banks and pay compensation if a bank is unable to pay claims against it.

The DCSs are funded, if and when required, by contributions from covered banks in the Isle of Man or Jersey that are participants in the DCSs. The cost to the Company in respect of the DCSs for 2023 was £32k (2022: £nil).

UK Bank Levy

In 2023 the Bank Levy charge was £2m (2022: £2m). A rate of 0.05% (2022: 0.05%) is charged on long term chargeable equity and liabilities and 0.10% (2022: 0.10%) on short-term chargeable liabilities.

18. CONTINGENT LIABILITIES AND COMMITMENTS

	2023	2022
	£m	£m
Formal standby facilities, credit lines and other commitments	11	22
	11	22

At 31 December 2023, the Company had no significant credit impairment loss provisions relating to guarantees given to third parties and undrawn loan commitments. Where the items set out below can be reliably estimated, they are disclosed in the table above.

Formal standby facilities, credit lines and other commitments

Credit lines are granted as part of normal product facilities which are offered to customers.

Capital Support Deed

At 31 December 2023, the Company, Santander UK Group Holdings plc and Santander Equity Investments Limited were party to a capital support deed dated 17 December 2021 and effective from 1 January 2022 (the Non-RFB Sub-Group Capital Support Deed). These parties were permitted by the PRA to form a core UK group as defined in the PRA Rulebook, a permission which expires on 31 December 2024. It is expected that this agreement will be extended when it expires. Exposures of each of the regulated entities to other members of the core UK group are exempt from large exposure limits that would otherwise apply and intra-group exposures are risk-weighted at 0% and excluded from leverage exposure. The purpose of the Non-RFB Sub-Group Capital Support Deed is to facilitate the prompt transfer of available capital resources from, or repayment of liabilities by the members, in the event that the Company breached or was at risk of breaching its capital resources.

Isle of Man and Jersey DCSs

As described in Note 17, the Company participates in the Isle of Man and Jersey DCSs, and is thus subject to levies to fund the DCSs. In the event that the DCSs significantly increase the levies to be paid by firms, the associated costs to the Company would rise.

Other legal actions and regulatory matters

The Company engages in discussion, and co-operates, with the FCA, PRA, CMA and other regulators and government agencies in various jurisdictions in their supervision and review of Company including reviews exercised under statutory powers, regarding its interaction with past and present customers, both as part of general thematic work and in relation to specific products, services and activities. During the ordinary course of business, the Company is also subject to complaints and threatened legal proceedings brought by or on behalf of current or former employees, customers, investors or other third parties, in addition to legal and regulatory reviews, challenges and tax or enforcement investigations or proceedings by relevant regulators or government agencies in various jurisdictions. All such matters are assessed periodically to determine the likelihood of the Company incurring a liability.

In those instances where it is concluded that it is not yet probable that a quantifiable payment will be made, for example because the facts are unclear or further time is required to fully assess the merits of the case or to reasonably quantify the expected payment, no provision is made. In addition, where it is not currently practicable to estimate the possible financial effect of these matters, no provision is made.

German dividend tax arbitrage transactions

In June 2018 the Cologne Criminal Prosecution Office and the German Federal Tax Office commenced an investigation in relation to the historical involvement of Santander UK plc, Santander Financial Services plc and Cater Allen International Limited (all subsidiaries of Santander UK Group Holdings plc) in German dividend tax arbitrage transactions (known as cum/ex transactions). These transactions allegedly exploited a loophole of a specific German settlement mechanism through short-selling and complex derivative structuring which resulted in the German government either refunding withholding tax where such tax had not been paid or refunding it more than once. The German authorities are investigating numerous institutions and individuals in connection with alleged transactions and practices which may be found to be illegal under German law.

During 2023 we continued to cooperate with the German authorities and, with the assistance of external experts, to progress an internal investigation into the matters in question. The investigation is focused principally on the period 2009-2011 and remains on-going. There remain factual issues to be resolved which may have legal consequences including potentially material financial penalties. These issues create uncertainties which mean that it is difficult to predict the resolution of the matter including timing or the significance of the possible impact. These uncertainties mean it is not currently practicable to make a reliable assessment of the size of any related potential liability. Any potential losses, claims or expenses suffered or incurred by the Company in respect of these matters have been fully indemnified by Santander UK plc, as part of the ring-fencing transfer scheme between Santander UK plc, the Company and Banco Santander SA.

Other

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

Other off-balance sheet commitments

The Company has commitments to lend at fixed interest rates which expose it to interest rate risk. For further information, see the Risk review.

19. SHARE CAPITAL

	Ordinary shares of £1 each		Tracker shares of £1 each		B Tracker shares of £1 each		Total
Authorised issued and fully paid share capital	No.	£m	No.	£m	No.	£m	£m
At 31 December 2022, 1 January 2023 and 31 December 2023	249,998,000	250	1,000	—	1,000	—	**250**

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

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

20. OTHER EQUITY INSTRUMENTS

	Interest Rate		2023	2022
	%	Next call date	£m	£m
AT1 Securities:				
– £50m Fixed Rate Reset Perpetual Capital Securities	**9.25**	**Jun 2028**	**50**	50
			50	50

AT1 securities

In December 2022, Santander Financial Services plc issued £50m 9.25% Fixed Rate Reset Perpetual Capital Securities, which were fully subscribed by the Company's immediate parent company, Santander UK Group Holdings plc.

The AT1 securities are perpetual and pay a quarterly distribution. At each distribution payment date, the Company can decide whether to pay the distribution, which is non-cumulative, in whole or in part. The distribution rate resets every five years. The securities will be automatically written down and the investors will lose their entire investment in the securities should the CET1 capital ratio of the Company, calculated on a solo basis, fall below 7%.

The AT1 securities are redeemable at the option of the Company at any time between 24 December 2027 and 24 June 2028, and on each quarterly distribution payment date thereafter. No redemption may be made without the consent of the PRA.

21. NOTES TO CASH FLOWS

Changes in liabilities arising from financing activities

The table below shows the changes in liabilities arising from financing activities:

	2023				2022			
	Balance sheet item				Balance sheet item			
	Other equity instruments	Lease liabilities	Dividends paid	Total	Other equity instruments	Lease liabilities	Dividends paid	Total
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January	**50.0**	**3.0**	**—**	**53.0**	—	2.0	—	2.0
Issue of other equity instruments	**—**	**—**	**—**	**—**	50.0	—	—	50.0
Dividends paid	**—**	**—**	**(9.0)**	**(9.0)**	—	—	(65.0)	(65.0)
Liability-related other changes	**—**	**—**	**—**	**—**	—	1.0	—	1.0
Non-cash changes:								
– Other changes	**—**	**—**	**9.0**	**9.0**	—	—	65.0	65.0
At 31 December	**50.0**	**3.0**	**—**	**53.0**	50.0	3.0	—	53.0

Footnotes to the cash flow

Total cash outflow for leases was £nil (2022: £0.2m).

Net cash flows from operating activities includes interest received of £232.1m (2022: £106.6m) and interest paid of £208.8m (2022: £59.4m).

Other cash equivalents are third party accounts which are classified as on demand.

22. ASSETS CHARGED AS SECURITY FOR LIABILITIES AND COLLATERAL ACCEPTED AS SECURITY FOR ASSETS

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

a) Assets charged as security for liabilities

The financial assets below are analysed between those assets accounted for on-balance sheet and off-balance sheet.

	2023	2022
	£m	£m
On-balance sheet:		
Loans and advances to customers	—	9
Loans and advances to banks	**63**	33
Total on-balance sheet	**63**	42
Total off-balance sheet	**71**	76

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

Stock borrowing and lending agreements
Asset balances under stock borrowing and lending agreements represent stock lent by the Company. These balances amounted to £71m at 31 December 2023 (2022: £76m) and are offset by contractual commitments to return stock borrowed or cash received.

Derivatives business
In addition to the arrangements described above, collateral is also provided in the normal course of derivative business to counterparties. At 31 December 2023, £63m (2022: £42m) of such collateral in the form of cash had been provided by the Company and is included in the table above.

Collateralised Loan Agreement
The Company has pledged collateral of £71m (2021: £76m) with a clearing house. In the event of the Company defaulting, this would be paid to the counterparty of a collateralised loan agreement.

b) Collateral accepted as security for assets

The table below shows collateral held as security for assets, analysed between those liabilities accounted for on the balance sheet and off-balance sheet.

	2023	2022
	£m	£m
Total on-balance sheet	—	—
Total off-balance sheet	**505**	478

Stock borrowing and lending agreements
Obligations under stock borrowing and lending agreements represent contractual commitments to return stock borrowed. These obligations totalled £505m at 31 December 2023 (2022: £478m) and are offset by a contractual right to receive stock lent by the Company. This off-balance sheet collateral is in relation to the loans and advances to customers at fair value through profit or loss.

Lending activities
In addition to the collateral held as security for assets, the Company may obtain a charge over a customer's property in connection with its lending activities. Details of these arrangements are set out in the 'Credit risk' section of the Risk review.

23. TRANSACTIONS WITH DIRECTORS AND OTHER KEY MANAGEMENT PERSONNEL

a) Remuneration of Directors and Other Key Management Personnel

The remuneration of the Directors and Other Key Management Personnel is set out in aggregate below.

	2023	2022
Directors' remuneration	£	£
Salaries and fees	**584,526**	551,193
Performance-related payments	**376,468**	389,678
Other fixed remuneration (pension and other allowances & non-cash benefits)	**48,942**	49,195
Total remuneration(1)	**1,009,936**	990,066

Directors' and Other Key Management Personnel compensation	2023 £	2022 £
Short-term employee benefits	**1,823,977**	1,855,637
Post-employment benefits	**81,558**	100,720
Compensation for loss of office	**—**	156,747
Total compensation(1)	**1,905,535**	2,113,104

(1) No termination payments were made in 2023. In 2022, one termination payment of £156,747 was made in 2022 to a Director or member of the Key Management Personnel.

Of the Directors and Key Management Persons that served during the year, seven (2022: eight) were remunerated in relation to their services to this Company.

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

In 2023, the remuneration, excluding pension contributions and compensation for loss of office, of the highest paid Director was £557,631 (2022: £520,403) of which £267,624 (2022: £262,553) was performance-related. In 2023 and 2022, no contributions were made to a defined contribution scheme on behalf of the highest paid Director.

At 31 December 2023 and 2022, there was no accrued pension benefit for the highest paid Director and there was no lump sum accrued by the highest paid Director.

b) Retirement benefits

In 2023 no Director received benefits under a defined benefit scheme (2022: none) and two Directors (2022: two) received benefits under a defined contribution scheme (employee funded).

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

Directors, Other Key Management Personnel who served during the year and their connected persons have undertaken the following transactions with the Company in the ordinary course of business.

	2023		2022	
	No.	£	No.	£
Secured loans, unsecured loans and overdrafts				
At 1 January	**6**	**8,505,604**	6	7,160,098
Net movements	**(1)**	**(154,712)**	—	1,345,506
At 31 December	**5**	**8,350,892**	6	8,505,604
Deposit, bank and instant access accounts and investments				
At 1 January	**6**	**1,085,142**	6	959,416
Net movements	**(1)**	**(576,607)**	—	125,726
At 31 December	**5**	**508,535**	6	1,085,142

In 2023 and 2022, no Director held any interest in, nor exercised or was granted any rights to subscribe for, shares of the Company. In addition, in 2023 and 2022, no Directors exercised share options over shares in Banco Santander SA, the ultimate parent company of the Company.

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

In 2023, loans were made to two Directors (2022: two), with a principal amount of £4,739,086 outstanding at 31 December 2023 (2022: £4,740,000). In 2023, loans were made to three Other Key Management Personnel (2022: four), with a principal amount of £3,611,805 outstanding at 31 December 2023 (2022: £3,765,604).

In 2023 and 2022, there were no other transactions, arrangements or agreements with the Company in which Directors, Other Key Management Personnel or their connected persons had a material interest. In addition, in 2023 and 2022, no Director had a material interest in any contract of significance with the Company other than a service contract or appointment letter, as appropriate.

24. RELATED PARTY DISCLOSURES

a) Parent undertaking and controlling party

The Company's immediate parent is Santander UK Group Holdings plc, a company incorporated in England and Wales. The ultimate parent and controlling party is Banco Santander SA, a company incorporated in Spain. The smallest and largest groups into which the Company's results are included are the group accounts of Santander UK Group Holdings plc and Banco Santander SA, respectively, copies of which may be obtained from Shareholder Relations, 2 Triton Square, Regent's Place, London NW1 3AN, on the corporate website (www.aboutsantander.co.uk) or on the Banco Santander corporate website (www.santander.com).

b) Transactions with related parties

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

	Interest, fees and other income received		Interest, fees and other expense paid		Amounts owed by related parties		Amounts owed to related parties	
	2023	2022	**2023**	2022	**2023**	2022	**2023**	2022
	£m	£m	**£m**	£m	**£m**	£m	**£m**	£m
Ultimate parent	**(2)**	(152)	**39**	—	**74**	40	**(68)**	(38)
Subsidiaries	**—**	—	**—**	—	**—**	1	**(3)**	(2)
Fellow subsidiaries	**—**	—	**7**	7	**3**	1	**(2)**	(3)
	(2)	(152)	**46**	7	**77**	42	**(73)**	(43)

Further information on balances due from/(to) other Banco Santander companies is set out in the section 'Balances with other Banco Santander companies' in the Risk review. In addition, details of the Capital Support Deed are described in Note 18.

The above transactions were made in the ordinary course of business, on substantially the same terms as for comparable transactions with third party counterparties, and within limits acceptable to the PRA. Such transactions do not involve more than the normal risk of collectability or present any unfavourable features.

In December 2022, Santander Financial Services plc issued £50m 9.25% Fixed Rate Reset Perpetual Capital Securities, which were fully subscribed by the Company's immediate parent company, Santander UK Group Holdings plc. For further information, see Note 20.

In May 2022, Santander Financial Services plc purchased a portfolio of mortgage assets with a carrying amount of £624m from Santander UK plc for a cash consideration of £631m, including a purchase price premium of £7m.

25. FINANCIAL INSTRUMENTS

a) Measurement basis of financial assets and liabilities

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. Note 1 describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised.

b) Fair value measurement and hierarchy

(i) Fair value measurement

The fair value of financial instruments is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Company has access at that date. The fair value of a liability reflects its non-performance risk.

Financial instruments valued using observable market prices

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

Financial instruments valued using a valuation technique

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

The Company manages certain groups of financial assets and liabilities on the basis of its net exposure to either market risks or credit risk. As a result it has elected to use the exception under IFRS 13 which permits the fair value measurement of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position for a particular risk exposure or paid to transfer a net short position for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions.

(ii) Fair value hierarchy

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

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

Level 1 Unadjusted quoted prices for identical assets or liabilities in an active market that the Company can access at the measurement date. Active markets are assessed by reference to average daily trading volumes in absolute terms and, where applicable, by reference to market capitalisation for the instrument.

Level 2 Quoted prices in inactive markets, quoted prices for similar assets or liabilities, recent market transactions, inputs other than quoted market prices for the asset or liability that are observable either directly or indirectly for substantially the full term, and inputs to valuation techniques that are derived principally from or corroborated by observable market data through correlation or other statistical means for substantially the full term of the asset or liability.

Level 3 Significant inputs to the pricing or valuation techniques are unobservable. These unobservable inputs reflect the assumptions that market participants would use when pricing assets or liabilities and are considered significant to the overall valuation.

Changes in the observability of significant valuation inputs during the reporting period may result in a transfer of assets and liabilities within the fair value hierarchy. The Company recognises transfers between levels of the fair value hierarchy when there is a significant change in either its principal market or the level of observability of the inputs to the valuation techniques as at the end of the reporting period.

c) Valuation techniques

The main valuation technique employed in internal models to measure the fair value of the financial instruments at 31 December 2023 and 2022 is set out below. In substantially all cases, the principal inputs into these models are derived from observable market data. The Company did not make any material changes to the valuation techniques and internal models it used in 2023 and 2022.

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

The fair values of the financial instruments arising from the Company’s internal models take into account, among other things, contract terms and observable market data, which include such factors as bid-offer spread, interest rates, credit risk and exchange rates. In all cases, when it is not possible to derive a valuation for a particular feature of an instrument, management uses judgement to determine the fair value of the particular feature. In exercising this judgement, a variety of tools are used including proxy observable data, historical data and extrapolation techniques. Extrapolation techniques take into account behavioural characteristics of equity markets that have been observed over time, and for which there is a strong case to support an expectation of a continuing trend in the future. Estimates are calibrated to observable market prices when they become available.

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

d) Control framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker. To this end, ultimate responsibility for the determination of fair values lies with the Risk Department. For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or verification is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the Company will source alternative market information to validate the financial instrument’s fair value, with greater weight given to information that is considered to be more relevant and reliable.

The factors that are considered in this regard include:

- The extent to which prices may be expected to represent genuine traded or tradeable prices
- The degree of similarity between financial instruments
- The degree of consistency between different sources
- The process followed by the pricing provider to derive the data
- The elapsed time between the date to which the market data relates and the balance sheet date
- The manner in which the data was sourced.

The source of pricing data is considered as part of the process that determines the classification of the level of a financial instrument. Consideration is given to the quality of the information available that provides the current mark-to-model valuation and estimates of how different these valuations could be on an actual trade, taking into consideration how active the market is. For spot assets that cannot be sold due to illiquidity, forward estimates are discounted to estimate a realisable value over time. Adjustments for illiquid positions are regularly reviewed to reflect changing market conditions.

For fair values determined using a valuation model, the control framework may include as applicable, independent development and / or validation of: (i) the logic within the models; (ii) the inputs to those models; and (iii) any adjustments required outside the models. Internal valuation models are validated independently within the Risk Department. A validation report is produced for each model-derived valuation that assesses the mathematical assumptions behind the model, the implementation of the model and its integration within the trading system.

e) Fair values of financial instruments carried at amortised cost

The following tables analyse the fair value of the financial instruments carried at amortised cost at 31 December 2023 and 2022, including their levels in the fair value hierarchy – Level 1, Level 2 and Level 3. It does not include fair value information for financial assets and financial liabilities carried at amortised cost if the carrying amount is a reasonable approximation of fair value. Cash and balances at central banks which consist of demand deposits with the Bank of England. There were no financial instruments carried at amortised cost whose fair values would be classified in Level 1.

	2023				2022			
	Fair value				Fair value			
	Level 2	Level 3	Total	Carrying value	Level 2	Level 3	Total	Carrying value
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Loans and advances to customers	—	3,785	3,785	3,834	—	4,034	4,034	4,180
Loans and advances to banks	92	—	92	92	57	—	57	57
	92	3,785	3,877	3,926	57	4,034	4,091	4,237
Liabilities								
Deposits by customers	6	6,123	6,129	6,152	1	6,575	6,576	6,575
Deposits by banks	—	1	1	2	2	3	5	4
	6	6,124	6,130	6,154	3	6,578	6,581	6,579

Valuation methodology for financial instruments carried at amortised cost

The valuation approach to specific categories of financial instruments is described below.

Assets:

Loans and advances to customers

The approach to estimating the fair value of loans and advances to customers has been determined by discounting expected cash flows to reflect either current market rates or credit spreads relevant to the specific industry of the borrower. The determination of their fair values is an area of considerable estimation and uncertainty as there is no observable market and values are significantly affected by customer behaviour.

The fair value of the mortgage portfolio is calculated by discounting contractual cash flows by different spreads for each LTV Band, after taking account of expected customer prepayment rates. The spread is based on new business interest rates derived from publicly available competitor market information.

Loans and advances to banks

These comprise secured loans, short-term placements with banks including collateral and unsettled financial transactions. The secured loans have been valued based on a discounted spread for the term of the loans using valuation technique A as described above. The carrying amount of the other items is deemed a reasonable approximation of their fair value, as the transactions are very short-term in duration.

Liabilities:

Deposits by customers

The majority of deposit liabilities are payable on demand and therefore can be deemed short-term in nature with the fair value equal to the carrying value. Certain of the deposit liabilities are at a fixed rate until maturity. The deficit/surplus of fair value over carrying value of these liabilities has been estimated by reference to the market rates available at the balance sheet date for similar deposit liabilities of similar maturities. The fair value of such deposit liabilities has been estimated using valuation technique A as described above.

Deposits by banks

The fair value of deposits by banks, including repos, has been estimated using valuation technique A as described above, discounted at the appropriate credit spread.

f) Fair values of financial instruments measured at fair value

The following tables summarise the fair values of the financial assets and liabilities accounted for at fair value at 31 December 2023 and 2022, analysed by their levels in the fair value hierarchy – Level 1, Level 2 and Level 3.

		2023				2022				
		Level 1	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total	Valuation technique
		£m	**£m**	**£m**	**£m**	£m	£m	£m	£m	
Assets										
Derivative financial instruments	Exchange rate contracts	**—**	**—**	**—**	**—**	—	6	—	6	A
	Interest rate contracts	**—**	**10**	**—**	**10**	—	7	—	7	A
		—	**10**	**—**	**10**	—	13	—	13	
Other financial assets at FVTPL	Loans and advances to customers	**—**	**309**	**—**	**309**	—	295	—	295	A
	Debt securities	**—**	**—**	**—**	**—**	—	1	—	1	A
		—	**309**	**—**	**309**	—	296	—	296	
Total assets at fair value		**—**	**319**	**—**	**319**	—	309	—	309	
Liabilities										
Derivative financial instruments	Exchange rate contracts	**—**	**25**	**—**	**25**	—	18	—	18	A
	Interest rate contracts	**—**	**44**	**—**	**44**	—	38	—	38	A
Total liabilities at fair value		**—**	**69**	**—**	**69**	—	56	—	56	

Transfers between levels of the fair value hierarchy

In 2023, there were no significant (2022: no significant) transfers of financial instruments between levels of the fair value hierarchy.

g) Fair value adjustments

The internal models incorporate assumptions that the Company believes would be made by a market participant to establish fair value. Fair value adjustments are adopted when the Company considers that there are additional factors that would be considered by a market participant that are not incorporated in the valuation model.

The Company classifies fair value adjustments as either 'risk-related' or 'model-related'. The fair value adjustments form part of the portfolio fair value and are included in the balance sheet values of the product types to which they have been applied. The magnitude and types of fair value adjustment are listed in the following table:

	2023	2022
	£m	£m
Risk-related:		
- Uncertainty	**22**	15
- Credit risk adjustment	**(3)**	(3)
	19	12

Risk-related adjustments

Risk-related adjustments are driven, in part, by the magnitude of the Company's market or credit risk exposure, and by external market factors, such as the size of market spreads.

Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, a range of possible values exists that the financial instrument or market parameter may assume, and an adjustment may be needed to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model.

h) Internal models based on information other than market data (Level 3)

At 31 December 2023 and 31 December 2022, there were no financial instruments classified as Level 3.

i) Maturities of financial liabilities and off-balance sheet commitments

The table below analyses the maturities of the undiscounted cash flows relating to financial liabilities and off-balance sheet commitments of the Company based on the remaining period to the contractual maturity date at the balance sheet date. Deposits by customers largely consist of retail deposits. This table is not intended to show the liquidity of the Company.

	On demand	Not later than 3 months	Later than 3 months and not later than 1 year	Later than 1 year and not later than 5 years	Later than 5 years	Total
2023	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Financial liabilities						
Derivative financial instruments	**—**	**25**	**1**	**1**	**53**	**80**
Deposits by customers	**1,913**	**555**	**3,652**	**80**	**1**	**6,201**
Deposits by banks	**2**	**—**	**—**	**—**	**—**	**2**
Lease liabilities	**—**	**—**	**—**	**1**	**1**	**2**
Total financial liabilities	**1,915**	**580**	**3,653**	**82**	**55**	**6,285**
Off-balance sheet commitments given	**11**	**—**	**—**	**—**	**—**	**11**
2022						
Financial liabilities						
Derivative financial instruments	—	19	—	2	48	69
Deposits by customers	2,298	2,396	1,819	73	—	6,586
Deposits by banks	4	—	—	—	—	4
Lease liabilities	—	—	—	1	2	3
Total financial liabilities	2,302	2,415	1,819	76	50	6,662
Off-balance sheet commitments given	22	—	—	—	—	22

26. OFFSETTING FINANCIAL ASSETS AND LIABILITIES

Financial assets and financial liabilities are reported on a net basis on the balance sheet only if there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. The following table shows the impact of netting arrangements on:

- All financial assets and liabilities that are reported net on the balance sheet
- All derivative financial instruments and repurchase agreements and other similar secured lending and borrowing agreements that are subject to enforceable master netting arrangements or similar agreements, but do not qualify for balance sheet netting.

No amounts have been offset in the balance sheet. The table identifies the amounts that have been offset in the balance sheet and also those amounts that are covered by enforceable netting arrangements (offsetting arrangements and financial collateral) but do not qualify for netting under the requirements described above.

For derivative contracts, the 'Financial instruments' column identifies financial assets and liabilities that are subject to set off under netting agreements, such as the ISDA Master Agreement or derivative exchange or clearing counterparty agreements, whereby all outstanding transactions with the same counterparty can be offset and close-out netting applied across all outstanding transactions covered by the agreements if an event of default or other predetermined events occur. Financial collateral refers to cash and non-cash collateral obtained, typically daily or weekly, to cover the net exposure between counterparties by enabling the collateral to be realised in an event of default or if other predetermined events occur.

The Company engages in a variety of counterparty credit mitigation strategies in addition to netting and collateral arrangements. Therefore, the net amounts presented in the tables below do not purport to represent the Company's actual credit exposure.

	Amounts subject to enforceable netting arrangements							
	Effects of offsetting on balance sheet			Related amounts not offset				
	Gross amounts	Amounts offset	Net amounts on the balance sheet	Financial instruments	Financial collateral [1]	Net amount	Assets not subject to enforceable netting arrangements [2]	Balance sheet total [3]
2023	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Assets								
Derivative financial instruments	**7**	**—**	**7**	**(8)**	**—**	**(1)**	**3**	**10**
Loans and advances to customers and banks [4]	**243**	**—**	**243**	**—**	**(180)**	**63**	**3,683**	**3,926**
Total assets	**250**	**—**	**250**	**(8)**	**(180)**	**62**	**3,686**	**3,936**
Liabilities								
Derivative financial instruments	**69**	**—**	**69**	**(8)**	**(61)**	**—**	**—**	**69**
Deposits by customers and banks [4]	**4**	**—**	**4**	**—**	**—**	**4**	**6,150**	**6,154**
Total liabilities	**73**	**—**	**73**	**(8)**	**(61)**	**4**	**6,150**	**6,223**
2022								
Assets								
Derivative financial instruments	10	—	10	(10)	—	—	3	13
Loans and advances to customers and banks [4]	34	—	34	—	—	34	4,203	4,237
Total assets	44	—	44	(10)	—	34	4,206	4,250
Liabilities								
Derivative financial instruments	56	—	56	(10)	(43)	3	—	56
Deposits by customers and banks [4]	4	—	4	—	—	4	6,575	6,579
Total liabilities	60	—	60	(10)	(43)	7	6,575	6,635

(1) Financial collateral is reflected at its fair value but has been limited to the net balance sheet exposure so as not to include any over-collateralisation.
(2) This column includes contractual rights of set-off that are subject to uncertainty under the laws of the relevant jurisdiction.
(3) The balance sheet total is the sum of 'Net amounts reported on the balance sheet' that are subject to enforceable netting arrangements and 'Amounts not subject to enforceable netting arrangements'.
(4) The amounts offset within loans and advances to customers/banks or deposits by customers/banks relate to intercompany balances that are subject to netting.

27. EVENTS AFTER THE BALANCE SHEET DATE

There have been no significant events between 31 December 2023 and the date of approval of these financial statements which would require a change to or additional disclosure in the financial statements.

28. INTEREST RATE BENCHMARK REFORM

At 31 December 2023, SFS had no remaining exposures which reference LIBOR settings. At 31 December 2022, SFS held £189m Financial assets at amortised cost which referenced USD LIBOR settings.