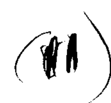


Risk Management

The Risk Management report contains audited financial information except for the discussion of Operational Risk on page 52 that, in accordance with the guidance in paragraph BC65 of IFRS 7, is unaudited. 2008 data has been updated to reflect the transfer of Alliance & Leicester plc to the Company as described in Note 47 to the Consolidated Financial Statements.

Summary

This Risk Management report describes the Risk Governance Framework of Santander UK plc (formerly Abbey National plc) (the 'Company', and together with its subsidiaries, the 'Group'), and includes more detail on the Group's key risks, on a segmental basis or aggregated where relevant. It is divided into the following sections:

Introduction - A description of the Group's Risk Governance Framework, including the three tiers of the Risk Governance structure.

Financial Risks and Risk Management - Group-wide disclosures about specific risks which do not originate in any single operating segment, such as operational risk and pension obligation risk, as well as Group-wide disclosures about market risk and credit risk are described on pages 51 to 58.

Liquidity Risk – A description of the liquidity risks the Group faces, along with their management and activity in 2009 and 2008, can be found on pages 58 to 60.

Discussion of Key Risks by Operating Segment- Detailed discussions about risk exposures, measurement information and management policies presented by operating segment can be found on pages 61 to 76:

- **Risks in Retail Banking** - The risks in this segment are described on pages 61 to 67, comprising:
  - **Credit risk**, including its management, an analysis of types and credit quality of retail lending and disclosures relating to provisioning, arrears and recoveries.
  - **Market risk**, including its management.
- **Risks in Corporate Banking** - The risks in this segment are described on pages 67 to 70, comprising:
  - **Credit risk**, including its management, mitigation and the disclosure of exposure by rating of counterparty.
  - **Market risk**, including its management.
- **Risks in Global Banking & Markets -** The risks in this segment are described on pages 70 to 73, comprising:
  - **Credit risk**, including its management, mitigation and the disclosure of exposure by rating of counterparty.
  - **Market risk**, including its management and disclosures on short-term market risk, structural market risk and trading market risk.
- **Risks in Private Banking -** The risks in this segment are described on page 73 to 74, comprising a description of credit risk and market risk in the entities which this segment incorporates.
- **Risks in Group Infrastructure** - The risks in this segment are described on pages 74 to 76, comprising:
  - **Credit risk**, including its management and the disclosure of exposure by rating of counterparty.
  - **Market risk**, including its management and disclosure of Net Interest Margin Sensitivity and the Market Value of Equity sensitivity.
  - A description of the types of derivative contracts used to hedge risks in this segment.

The Impact of the Current Credit Environment – Detailed disclosures can be found on pages 77 to 85, including a description of the Group's exposures to certain classes of financial assets and off-balance sheet entities.

Introduction

The Group accepts that risk arises from its full range of activities, and actively manages and controls it. The management of risk is an integral part of the Group's activities. Risk is defined as the uncertainty around the Group's ability to achieve its business objectives and execute its strategy effectively. Risk constitutes the Group's exposure to uncertainty and the consequent variability of return. Specifically, risk equates to the adverse impacts on profitability arising from different sources of uncertainty. The key risks Santander UK is exposed to are Credit (Retail, Corporate & Commercial, Wholesale), Market (Traded and Non-Traded), Operational, Pension Obligation, Concentration, Residual Value, Liquidity, Asset Backed Funding (including Encumbrance), Reputational and Business Strategic. Risk measurement is used to capture the source of the uncertainty and the magnitude of its potential effect on the profitability and solvency of the Group. Effective risk management and control is therefore of fundamental importance to the Group's long-term success.

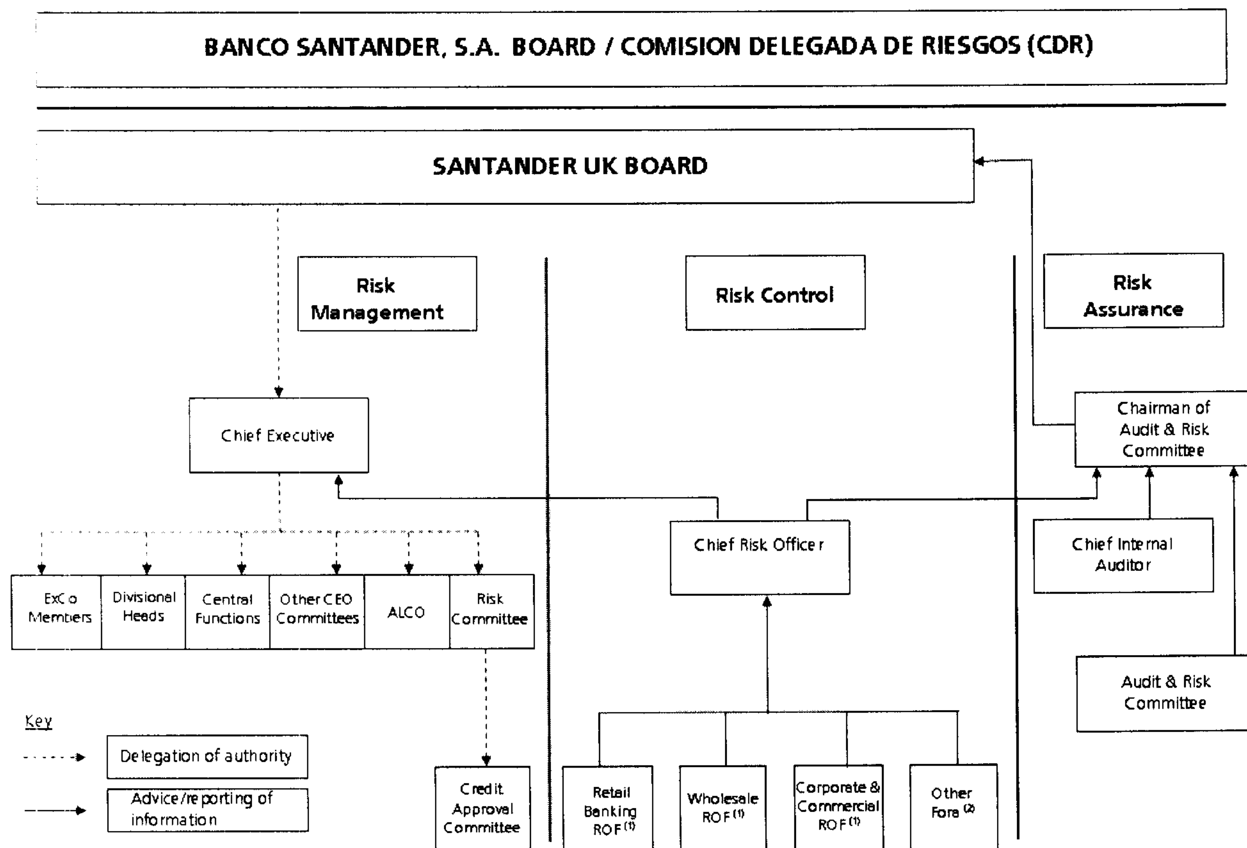
Understanding and controlling risk is critical for the effective management of the business. The Group's Risk Framework aims to ensure that risk is managed and controlled on behalf of shareholders, customers, depositors, employees and the Group's regulators. Effective and efficient risk governance and oversight provide management with assurance that the Group's business activities will not be adversely impacted by risks that could have been reasonably foreseen. This in turn reduces the uncertainty of achieving the Group's strategic objectives.

Risk Management continued

Authority for Risk Management flows from the Santander UK plc Board of Directors (the 'Board') to the Chief Executive and from him to specific individuals. Formal standing committees are maintained for effective management or oversight. Their authority is derived from the person they are intended to assist.

Risk Governance Framework

The diagram below shows the Risk Governance Framework in operation in respect of risk management and oversight.



(1) Risk Oversight Forum ('ROF').
(2) Other Fora include Stress Testing ROF, Capital ROF, Mortgage Backed Funding ROF, FEVE Forum, Risk School Board and IT Risk Board.

FEVE is a Spanish acronym for "Firmas En Vigilancia Especial", which means business under special watch.

The Risk Division at Banco Santander, S.A. reports to the President of the Comisión Delegada de Riesgos ('CDR' or Delegated Risk Committee).

The main elements of risk governance within the Group are as follows:

First tier of risk governance

Risk management is provided by the Board. It approves the Group's risk appetite in consultation with Banco Santander, S.A. as appropriate, approves the strategy for managing risk and is responsible for the Group's system of internal control. The Board is supported by the Chief Executive and Executive Management, who have primary responsibility for understanding, identifying, and owning the risks generated by their lines of business and establishing a framework for managing those risks within the Board-approved risk appetite of the Group. In addition, understanding, identifying, and owning the risks generated by the Group's operations are the responsibility of the Divisional Heads and central functions. These functions provide technical support and advice to assist in the management and control of risk. Within this tier, there is a process for transaction review and approval within certain thresholds, discharged by the Credit Approval Committee. Transactions reviewed which exceed the threshold limits set are subject to prior review by Banco Santander, S.A.'s Risk Division before final approval by the Credit Approval Committee.

Risk Committee

The Risk Committee is a management committee, established under the authority of and chaired by the Chief Executive. The Risk Committee reviews risk issues, gives advice and recommendations to the Chief Executive, the Executive Committee, or other parties as appropriate and makes decisions on risk issues within its sphere of responsibility.

Second tier of risk governance

Risk control is provided by the Board independently supported by the Risk Division. The roles of the Chief Risk Officer, the Head of Wholesale Risk, and the Risk Division include development of risk measurement methodologies, risk approval, risk monitoring, risk reporting and escalation of risk issues in line with the relevant risk policy for all risks across all lines of Retail Banking, Corporate Banking, Global Banking & Markets, Private Banking and Group Infrastructure business.

Dedicated Business ROFs advise and support the Chief Risk Officer in fulfilling his risk control responsibilities and help to ensure that risks are suitably understood, managed and controlled.

The Risk Division provides independent challenge to all business areas in respect of risk management and compliance with policies and advises the business when they are approaching the limits of the Group's risk appetite.

The Board, as supported by the Risk Division, is responsible for ensuring compliance with Group policies and limits imposed by Banco Santander, S.A. including:

- Group-wide risk policies;
- Group-wide risk limits/parameters;
- Approval processes relating to transactions that exceed local risk limits;
- The systematic review of large exposures to clients, sectors, geographical areas and different risk types; and
- Reporting to Banco Santander, S.A..

Third tier of risk governance

Risk assurance provides independent objective assurance on the effectiveness of the management and control of risk across the Group This is provided through the Non–Executive Directors, the Audit and Risk Committee and the Internal Audit function.

Non-Executive Directors

The Non-Executive Directors are members of the Board who have a particular responsibility for constructively challenging and contributing to the development of strategy, scrutinising the performance of management in meeting agreed goals and objectives and monitoring reporting performance, and assuring themselves that the financial controls and systems of risk management are robust and defensible.

Audit and Risk Committee

The Audit and Risk Committee is made up of Non-Executive Directors, and is a committee of the Board. The Committee has responsibility for:

- The oversight of the risk governance framework;
- Review of the effectiveness of the Group's internal and external audit processes;
- Review of control policies and procedures including regulatory compliance and financial reporting;
- The identification, assessment and reporting of risks; and
- The risk governance structure and associated compliance with risk control policies and procedures.

Internal Audit

The Internal Audit function supports the Audit and Risk Committee by providing independent and objective opinions on the effectiveness and integrity of the Group's risk governance arrangements. It does this via a systematic programme of risk-based audits of the controls established and operated by the "first tier" risk management functions and those exercised by the "second tier" risk control functions.

The audit opinions and underlying rationale of findings and recommendations form the basis upon which the Audit and Risk Committee can take reasonable (but not absolute) assurance that the risk governance arrangements are fit for purpose and working properly. The Audit and Risk Committee also receive reports from management, the risk control functions and the external auditors to help them to discharge their risk governance oversight responsibilities.

Financial Risks and Risk Management

The financial risks affecting the Group are discussed below. Risks are generally managed through tailored management policies within the business division or operating segment in which they are originated.

Group-wide disclosures including those relating to specific risks which do not originate in any single operating segment, are described separately at the beginning of this section, apart from liquidity risk which is discussed at the end of the section, following the detailed disclosures about the impact of the current credit environment.

The Group-wide disclosures are followed by detailed discussions about risk exposures, measurement information and management policies presented by operating segment, being Retail Banking, Corporate Banking, Global Banking & Markets, Private Banking, and Group Infrastructure (which includes Asset and Liability Management ('ALM') and the Treasury asset portfolio).

The risk exposure and management information relating to the Company principally arise in Retail Banking, Corporate Banking and Group Infrastructure. Following the outsourcing of key IT and operations processes to group companies, risk governance of these entities is crucial. The use of service level agreements and key metrics support this governance.

Risk Management continued

Financial Instruments

The Group uses financial instruments to manage the structural balance sheet exposures that arise from its banking activities, in accordance with Risk policies and the Asset and Liability Management Committee's direction. The Group also trades in financial instruments where it takes positions in exchange-traded and over the counter instruments, including derivatives, to take advantage of short-term market movements in the equity and bond markets and in currency and interest rates.

Operational Risk – Group-wide (unaudited)

Operational risk is the risk of loss to the Group, resulting from inadequate or failed internal processes, people and systems, or from external events. Such risks can materialise as frauds, process failures, system downtime or damage to assets due to fire, floods etc. When such risks materialise they have not only immediate financial consequences for the Group but also an effect on its business objectives, customer service, regulatory responsibilities and reputation. Operational risk exposures arise across the Group's business divisions and operating segments, and are managed on a consistent basis.

Managing operational risk (unaudited)

The Group undertakes extensive activity to minimise the impacts operational risks may have on business areas. An independent central operational risk function (Enterprise and Operational Risk) has responsibility for establishing the framework within which these risks are managed and is aligned to operational risk professionals within business areas to ensure consistent approaches are applied across the Group. The primary purpose of the framework, which is approved by the Risk Committee and Board, is to define and articulate the Group-wide policy, processes, roles and responsibilities. The framework incorporates industry practice and regulatory requirements, particularly those emanating from the Basel Committee, European Union Directives, the UK Financial Services Authority and the parent regulator (Banco d'Espana or The Bank of Spain).

The day-to-day management of operational risk is the responsibility of business managers who identify, assess and monitor the risks, in line with the processes described in the framework. The operational risk function ensures that all key risks are regularly reported to Risk Fora, the Risk Committee and Board.

Key operational risk activity in 2009 (unaudited)

During 2009, the Group has continued to respond to the developing operational risk environment with coordinated responses, and the Group continues to perform detailed control reviews in response to major industry events.

Following many high profile customer data security lapses experienced by other organisations in the UK, the Group has continued to take proactive steps to minimise similar risks. A corporate information security programme was established which involved the strengthening of controls for the management of sensitive data and included the implementation of encryption standards across the Group.

The Group continues to strengthen its point of sale compliance and control procedures to minimise risk and serve its customers. To this end, work continues to progress in implementing new systems which are already successfully operating in Banco Santander, S.A.. In 2009, implementations have concentrated on integrating Bradford & Bingley savings business and Alliance & Leicester group systems, with further focus on Alliance & Leicester throughout 2010.

Internet frauds were greatly reduced throughout 2009 by developing and implementing improvements to fraud detection rates and introducing a Santander Group transactional model which increased the volume of cases that were intercepted. As part of integration activity, these controls were replicated throughout all Santander UK companies.

In line with UK Financial Services Authority guidance and industry practice, the Group has crisis management and disaster recovery arrangements to ensure that critical business processes are maintained in the event of an unforeseen interruption. Insurance policies are also purchased to provide cover for a range of potential operational risk losses. In response to the increased threats of terrorism, flooding, and pandemic disasters, contingency strategies continue to be refined and key progress has included the development of dispersed contingency sites and automated system switch over facilities.

Corporate operational risk frameworks have been implemented throughout all Santander companies during the year, integrating approaches across the Bradford & Bingley savings business, Alliance & Leicester and Santander UK. To highlight awareness of Operational Risk issues, appropriate training is available for management and staff involved in control functions throughout the Group.

Credit Risk – Group-wide

Credit risk is the risk that counterparties will not meet their financial obligations resulting in the Group losing the monies lent, including any interest accrued, or having to close out transactions prematurely, which may incur losses after realising collateral held.

Significant concentrations of credit risk

During 2009, the Group's most significant exposures to credit risk derived from:

- the residential mortgage portfolio and unsecured personal lending businesses in Retail Banking;
- secured lending and derivatives exposures to companies, real estate entities and social housing associations in Corporate Banking;
- unsecured lending and derivatives exposure to banks and other financial institutions in Global Banking & Markets; and
- portfolios of assets in Group Infrastructure inconsistent with the Group's future strategy such as shipping, aviation, and the Treasury asset portfolio acquired as a result of the transfer of Alliance & Leicester plc to the Company.

The residential mortgage portfolio comprises loans to private individuals secured against residential properties in the UK. This is a prime portfolio with total exposure of £161bn at 31 December 2009 (2008: £152bn). The Unsecured Personal Loan portfolio comprises unsecured loans to private individuals issued in the UK. Total exposure stood at £4.9bn at 31 December 2009 (2008: £6.3bn). The commercial loan, real estate and social housing portfolios in Corporate Banking comprise loans secured on UK property, corporate loans and associated derivatives. The total committed facilities exposure to these portfolios was £24.9bn at 31 December 2009 (2008: £24.8bn).

Although Global Banking & Markets', Corporate Banking's and Group Infrastructure's operations are based mainly in the UK, they have built up exposures to various entities around the world and are therefore exposed to concentrations of risk related to geographic area. At 31 December 2009, 2% (2008: 9%) of Global Banking & Markets' credit exposures were to counterparties from the United States, and 77% (2008: 47%) were to counterparties from the UK. 2% (2008: 1%) of Global Banking & Markets' exposures were to countries that are not members of the Organisation for Economic Co-operation and Development ('OECD'). The remaining exposures were mainly to European counterparties. At 31 December 2009, 87% (2008: 81%) of Corporate Banking's credit exposures were to counterparties from the UK, and 2% (2008: 3%) were to counterparties from the United States, and 11% (2008: 16%) of Corporate Banking's exposures were to other countries. Group Infrastructure's exposures result from its asset portfolios, including the Treasury asset portfolio. At 31 December 2009, treasury investment securities stood at £9.9bn (2008: £14.1bn). Details of credit ratings and geographic analysis can be found on pages 78 to 85.

Geographical exposures are governed by country limits set by Banco Santander, S.A. ('Santander') centrally and determined according to the classification of the country (whether it is a developed OECD country or not), the rating of the country and its gross domestic product. The Group is further constrained in its country risk exposure, within the group limits, and by its capital base.

Maximum exposure to credit risk

The following table presents the amount that best represents the Group's estimated maximum exposure to credit risk at the reporting date without taking account of any collateral held or other credit enhancements:

	2009 £m	2008 £m
Trading assets	**21,688**	25,008
Purchase and resale agreements	**14,685**	1,256
Derivative financial instruments	**22,827**	35,125
Financial assets designated at fair value	**12,358**	11,377
Available-for-sale securities	**797**	2,663
Loan and receivable securities	**9,898**	14,107
Loans and advances to customers	**186,804**	180,176
Loans and advances to banks	**6,069**	16,001
Other	**4,334**	3,977
Third party exposures(1) (2)	**279,460**	289,690

(1) In addition, the Group is exposed to credit risk in respect of guarantees granted, loan commitments and stock borrowing and lending agreements. The estimated maximum exposure to credit risk is described in Note 37 to the Consolidated Financial Statements on page 157.
(2) Excludes loan to other members of the Santander UK and Santander groups.

In managing the gross exposures, the Group uses the policies and processes described in the Credit Risk sections below. Collateral, when received, can be held in the form of security over the mortgaged property, full debentures over a company's assets and through market standard collateral agreements in its treasury business.

Loans and advances

The following tables categorise the Group's loans and advances into three categories as: neither past due nor impaired, past due but not individually impaired, or individually impaired. For certain homogeneous portfolios of loans and advances, impairment is assessed on a collective basis and each loan is not individually assessed for impairment. Loans in this category are classified as neither past due nor impaired, or past due but not individually impaired, depending upon their arrears status. The impairment allowance includes allowances against financial assets that have been individually assessed for impairment and those that are subject to collective assessment for impairment.

Risk Management continued

Group

2009 Statutory balance sheet line items	Neither past due nor impaired £m	Past due but not individually impaired £m	Individually Impaired £m	Total £m	Impairment Allowance £m	Total Carrying Value £m
Trading assets						
- Loans and advances to banks	5,252	-	-	5,252	-	5,252
- Loans and advances to customers	10,628	-	-	10,628	-	10,628
Financial assets designated at fair value through profit and loss						
- Loans and advances to customers	6,379	-	-	6,379	-	6,379
Loans and advances to banks						
- Placements with other banks	1,606	-	-	1,606	-	1,606
- Amounts due from parent	5,995	-	-	5,995	-	5,995
- Amounts due from associates	1,551	-	-	1,551	-	1,551
Loans and advances to customers						
- Advances secured on residential property	155,619	4,107	1,076	160,802	(484)	160,318
- Corporate Loans	11,500	166	507	12,173	(357)	11,816
- Finance Leases	1,566	19	17	1,602	(2)	1,600
- Other secured advances	3,571	127	121	3,819	(62)	3,757
- Other unsecured advances	4,505	220	525	5,250	(394)	4,856
- Amounts due from fellow subsidiaries	4,457	-	-	4,457	-	4,457
Loans and receivables securities	9,870	-	34	9,904	(6)	9,898
Total loans and advances	222,499	4,639	2,280	229,418	(1,305)	228,113

Company

2009 Statutory balance sheet line items	Neither past due nor impaired £m	Past due but not individually impaired £m	Individually Impaired £m	Total £m	Impairment Allowance £m	Total Carrying Value £m
Financial assets designated at fair value through profit and loss						
- Loans and advances to banks	160	-	-	160	-	160
- Loans and advances to customers	45	-	-	45	-	45
Loans and advances to banks						
- Placements with other banks	995	-	-	995	-	995
- Amounts due from parent	1	-	-	1	-	1
- Amounts due from associates	1	-	-	1	-	1
- Amounts due from subsidiaries	108,659	-	-	108,659	-	108,659
Loans and advances to customers						
- Advances secured on residential property	118,240	3,626	880	122,746	(395)	122,351
- Other secured advances	3,530	117	112	3,759	(55)	3,704
- Other unsecured advances	4,362	188	486	5,036	(351)	4,685
- Amounts due from fellow subsidiaries	71	-	-	71	-	71
- Amounts due from subsidiaries	938	-	98	1,036	(98)	938
Total loans and advances	237,002	3,931	1,576	242,509	(899)	241,610

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

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

Group

	Good 2009 £m	Satisfactory 2009 £m	Higher Risk 2009 £m	Total 2009 £m
Trading assets				
- Loans and advances to banks	5,071	181	-	5,252
- Loans and advances to customers	10,628	-	-	10,628
Financial assets designated at fair value in P&L				
- Loans and advances to customers	6,379	-	-	6,379
Loans and advances to banks				
- Placements with other banks	1,606	-	-	1,606
- Amounts due from parent	5,995	-	-	5,995
- Amounts due from associates	1,551	-	-	1,551
Loans and advances to customers				
- Advances secured on residential property	142,116	13,050	453	155,619
- Corporate Loans	6,940	4,444	116	11,500
- Finance Leases	1,452	114	-	1,566
- Other secured advances	1,412	2,065	94	3,571
- Other unsecured advances	1,212	3,184	109	4,505
- Amounts due from fellow subsidiaries	4,457	-	-	4,457
Loans and receivables securities	4,217	5,645	8	9,870
Total loans and advances	193,036	28,683	780	222,499

	Good 2009 £m	Satisfactory 2009 £m	Higher Risk 2009 £m	Company Total 2009 £m
Financial assets designated at fair value in P&L				
- Loans and advances to banks	160	-	-	160
- Loans and advances to customers	45	-	-	45
Loans and advances to banks				
- Placements with other banks	995	-	-	995
- Amounts due from parent	1	-	-	1
- Amounts due from associates	1	-	-	1
- Amounts due from subsidiaries	108,659	-	-	108,659
Loans and advances to customers				
- Advances secured on residential property	105,848	11,939	453	118,240
- Other secured advances	1,531	1,912	87	3,530
- Other unsecured advances	1,172	3,084	106	4,362
- Amounts due from fellow subsidiaries	71	-	-	71
- Amounts due from subsidiaries	938	-	-	938
Total loans and advances	219,421	16,935	646	237,002

Internal measures of credit quality have been used in the table analysing credit quality, above. Different measures are applied to retail and wholesale lending, as follows:

	Retail Lending			Wholesale Lending
	Probability of default	Probability of default	Expected loss	Probability of default
Financial statements description	**Secured**[1]	**Commercial**[2]	**Unsecured**[3]	
Good	0.0 - 0.5%[4]	0.0 - 0.5%	0.0 - 0.5%	0.0 - 0.5%
Satisfactory	0.5 - 12.5%	0.5 - 35%	0.5 - 12.5%	0.5 - 12.5%
Higher Risk	12.5%+[5]	35%+	12.5%+	12.5%+

(1) "Secured" consists of Advances secured on residential property.
(2) "Commercial" consists of Other secured advances and certain unsecured advances.
(3) "Unsecured" consists of Other unsecured advances excluding those included within the "Commercial" category.
(4) Or a loan-to-value ratio of less than 75%.
(5) Or a loan-to-value ratio exceeding 75%.

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

Good There is a very high likelihood that the asset will not default and will be recovered in full. The exposure has a negligible or low probability of default. Such exposure also exhibits a strong capacity to meet financial commitments and only exceptionally shows any period of delinquency.

Satisfactory There is a high likelihood that the asset will be recovered and is therefore of no cause for concern to the Group. The asset has low to moderate probability of default, strong recovery rates and may typically show only short periods of delinquency. Typically these are high loan to value mortgages or most unsecured lending. Moderate to high application scores, credit bureau scores or behavioural scores characterise this credit quality.

Higher Risk All rated accounts that not viewed as "Good" or "Satisfactory" are rated as "Higher Risk". The assets are characterised by some concern over the obligor's ability to make payments when due. However, the assets have not yet converted to actual delinquency. There may also be doubts over the value of collateral or security provided. However, the borrower or counterparty is continuing to make payments when due and is expected to settle all outstanding amounts of principal and interest.

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

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

In the retail loans book, a loan or advance is considered past due when any contractual payments have been missed. The amounts disclosed in the table are the total financial asset of the account, not just the past due payments. All retail accounts are classified as non-impaired as they are provisioned collectively with the exception of properties in possession, which are provisioned on a case by case basis and hence are not included in the table below.

In the corporate loans book a loan or advance is considered past due when 90 days past due, and also when the Group has reason to believe that full repayment of the loan is in doubt.

2009	Past due up to 1 month £m	Past due 1-2 months £m	Past due 2-3 months £m	Past due 3-6 months £m	Past due 6 months and over £m	Group Total £m
Loans and advances to customers						
- Advances secured on residential property	-	1,536	889	1,113	569	4,107
- Corporate Loans	-	-	-	166	-	166
- Finance Leases	-	-	-	19	-	19
- Other secured advances	-	41	13	17	56	127
- Other unsecured advances	99	43	20	30	28	220
Total loans and advances	99	1,620	922	1,345	653	4,639

Risk Management continued

2009	Past due up to 1 month £m	Past due 1-2 months £m	Past due 2-3 months £m	Past due 3-6 months £m	Past due 6 months and over £m	Company Total £m
Loans and advances to customers						
- Advances secured on residential property	-	1,369	803	992	462	3,626
- Other secured advances	-	38	12	16	51	117
- Other unsecured advances	94	39	19	24	12	188
Total loans and advances	94	1,446	834	1,032	525	3,931

Analysis of provisions on loans and advances to customers

An analysis of the Group's provisions on loans and advances to customers is presented below.

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Observed provisions					
Advances secured on residential properties - UK	313	174	74	45	21
Corporate advances - UK	185	13	-	-	-
Finance leases - UK	1	-	-	1	3
Other secured advances - UK	50	37	32	73	123
Unsecured personal advances - UK	341	227	250	243	158
Total observed provisions	890	451	356	362	305
Incurred but not yet observed provisions					
Advances secured on residential properties - UK	171	184	102	60	35
Corporate advances - UK	172	289	-	-	-
Finance leases - UK	1	1	-	-	-
Other secured advances - UK	12	11	8	3	-
Unsecured personal advances - UK	53	65	85	111	54
Total incurred but not yet observed provisions	409	550	195	174	89
Total provisions	1,299	1,001	551	536	394

Movements in provisions for impairment losses on loans and advances

An analysis of movements in the Group's provisions for impairment losses on loans and advances is presented below.

	2009 £m	2008 £m	2007 £m	2006 £m	2005 (1) £m
Provisions at 31 December	1,001	551	536	394	467
IFRS reclassifications	-	-	-	-	(40)
Provisions at 1 January	1,001	551	536	394	427
Amounts written off					
Advances secured on residential properties – UK	(84)	(32)	(9)	(11)	(5)
Finance leases UK	(4)	-	(1)	-	-
Other secured advances – UK	(17)	(9)	(24)	(27)	(36)
Unsecured personal advances – UK	(425)	(262)	(339)	(205)	(247)
Total amounts written off	(530)	(303)	(373)	(243)	(288)
Observed provisions charged against profit					
Advances secured on residential properties – UK	223	132	38	35	12
Corporate advances – UK	172	13	-	-	-
Finance leases UK	5	-	-	-	-
Other secured advances – UK	30	14	(17)	(25)	11
Unsecured personal advances – UK	539	239	346	289	218
Total observed provisions charged against profit	969	398	367	299	241
Incurred but not yet observed provisions charged against profit	(141)	(4)	21	86	14
Total provisions charged against profit (including discontinued operations)	828	394	388	385	255
Acquisition of business	-	359	-	-	-
Provisions at the end of the year	1,299	1,001	551	536	394

(1) IFRS reclassifications related primarily to provisions on certain corporate loans in businesses and portfolios that were inconsistent with the Group's strategy, and were sold during 2005 or transferred to Corporate Banking.

Group recoveries

An analysis of the Group's recoveries is presented below.

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Advances secured on residential properties - UK	1	1	2	2	3
Corporate advances - UK	23	-	-	-	-
Finance leases - UK	1	-	-	-	-
Other secured advances - UK	-	12	6	7	7
Unsecured personal advances - UK	30	33	36	32	27
Total amount recovered	55	46	44	41	37

Group non-performing loans and advances [1]

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Group non-performing loans and advances that are impaired	**1,833**	1,142	296	375	314
Group non-performing loans and advances that are not impaired	**1,780**	1,236	596	451	568
Total non-performing loans and advances[2]	**3,613**	2,378	892	826	882
	%	%	%	%	%
Non-performing loans and advances as a % of loans and advances to customers[3]	**1.86**	1.28	0.75	0.76	0.88
Provision as a percentage of total non-performing loans and advances	**35.95**	42.10	61.77	64.89	44.67

(1) Loans and advances are classified as non-performing typically when the counterparty fails to make payments when contractually due for three months or longer.
(2) All non-performing loans are UK and continue accruing interest.
(3) Loans and advances to customers include social housing loans and finance leases, and exclude trading assets.

Group restructured loans

Loans have been restructured or renegotiated by capitalising the arrears where customers in arrears have maintained an agreed monthly repayment for a specified period. For further information, refer to the discussions of restructured loans in the Retail Banking and Corporate Banking sections.

Basel II (unaudited)

Throughout 2009, the Group applied the retail internal ratings-based (IRB) approach for credit risk to its key retail portfolios. During the course of 2009, regulatory approval was received to apply a refined approach to the residential mortgage portfolio which addressed the effects of procyclicality evident in the estimates for probability of default (PD).

A combination of the advanced and foundation internal ratings-based approaches was employed for the principal wholesale and corporate portfolios. For the remaining credit exposures, currently on the Basel II standardised approach, a rolling programme of transition to the appropriate IRB approach is underway. The standardised approach for Operational Risk continued to be applied during 2009.

The Group applied Basel II to its Internal Capital Adequacy Assessment Process (ICAAP) and to the risk and capital disclosures made to the market. The Group has applied Banco Santander S.A.'s approach to risk management in its application of Basel II. Further information on the Group's capital position under Basel II is included in Note 50 to the Consolidated Financial Statements. Further information on the Basel II risk measurement of the Group's exposures will be included in Banco Santander S.A.'s Pillar 3 report. The Group's Pillar 3 disclosures are set out in the Balance Sheet Business Review on pages 41 to 43.

Market risk – Group-wide

Market risk is the potential for loss of income or decrease in the value of net assets caused by movements in the levels and prices of financial instruments including interest rate and foreign currency risks. The Group accepts that market risk arises from its full range of activities. The Group aims to actively manage and control market risk by limiting the adverse impact of market movements whilst seeking to enhance earnings within clearly defined parameters. The Market Risk Manual, which is reviewed and approved by the Head of Wholesale Risk on an annual basis, sets the framework under which market risks are managed and controlled. Business area policies, risk limits and mandates are established within the context of the Market Risk Manual.

Executive directors are responsible for ensuring that they have sufficient expertise to manage the risks originated and retained within their business divisions. The business areas are responsible for ensuring that they have sufficient expertise to manage the risks associated with their operations. The independent Risk function, under the direction of the Head of Wholesale Risk, aims to ensure that risk-taking and risk control occur within the framework prescribed by the Market Risk Manual. The Risk function also provides oversight of all risk-taking activities through a process of reviews.

The Group aims to ensure that exposure to market risks is measured and reported on an accurate and timely basis to senior management. In addition to the regular reporting for the purposes of active risk management, the Board also receives reporting of all significant market risk exposures on a monthly basis where actual exposure levels are measured against limits. Senior management recognise that different risk measures are required to best reflect the risks faced in different types of business activities. In measuring exposure to market risk, the Group uses a range of complementary measures, covering both value and income as appropriate.

Pension obligation risk – Group-wide

The Group has statutory funding obligations as the sponsoring employer for a number of defined benefit staff pension schemes. The schemes are managed by independent trustees in accordance with legislation and trust deeds and rules, for the benefit of members. The Group accepts that it is exposed to pension obligation risk that could give rise to an unexpected increase in the Group's obligations to fund the schemes, either because of a loss of net asset value or because of changes in legislation or regulatory action. The principal risks to the net asset value of the schemes are an increase in the value of the liabilities arising from adverse changes in the longevity assumptions, increases in inflation or reductions in the discount rate used, and scheme assets being adversely affected by market movements. Further information on pensions can be found in "Critical Accounting Policies" within the Accounting Policies on page 122 and in Note 36 to the Consolidated Financial Statements.

Risk management

The Chief Financial Officer is responsible for managing the Group's exposure to pension obligation risk, in conjunction with the trustees. Further details of the funding arrangements for the pension schemes can be found on page 122.

Risk Management continued

Liquidity risk – Group wide

Liquidity risk is the potential that the Group has insufficient financial resources to meet its payment and collateral obligations (to the extent that they will be settled by delivering cash or another financial asset) as they fall due, or can do so only at excessive cost. Liquidity risks arise throughout the Group. Its primary business activity is commercial banking and, as such, it engages in maturity transformation, whereby callable and short-term commercial deposits are invested in longer-term customer loans.

The majority of funding is raised from retail deposits with the balance raised in wholesale markets. The traditional sources of wholesale funding were:

> Secured and unsecured money-market funding (including unsecured cash, repo, CD and CP issuance);
> Senior debt issuance (including discrete bond issues and MTNs);
> Mortgage-backed funding (including securitisation and covered bond issuance); and
> Subordinated debt and capital issuance (although the primary purpose is not funding).

For accounting purposes, wholesale funding is classified as deposits by banks, deposits by customers, debt securities in issue, other borrowed funds and subordinated liabilities.

As a result of market conditions, the mortgage-backed funding markets, which have traditionally been important sources of funding and had been effectively closed to new external issuances since the end of 2007, except for private placements with a small number of investors, have started to reopen. Despite these difficult market conditions, in October 2009, the Group issued a 7-year euro 1.75bn covered bond, followed in March 2010 with a 3-year euro 1bn transaction. In March 2010 the Group issued a £1.4bn mortgage backed securitisation transaction using Fosse Master Trust. This was the first publicly-placed mortgage-backed securitisation transaction from a UK bank since 2007; other recent transactions from UK banks had included an investor put. The Group benefited both from the conservative proportion of retail assets that are funded in wholesale markets, as well as having entered the period of market stress in a strong liquidity position. All internal and external liquidity ratios were maintained during this period.

The Group has access to the Bank of England's, the Swiss National Bank's and the US Federal Reserve's lending facilities. In addition, it can access indirectly the European Central Bank's repo facilities. The key on-going liquidity risks are:

> Loss of customer deposits;
> Loss of access to wholesale funding markets (including foreign exchange swaps) or counterparties;
> Intra-day payments systems dislocation; and
> Contingent liabilities arising from mortgage-backed or other funding, such as collateral calls or early amortisation.

Liquidity risk management

The Board is responsible for the liquidity risk management and control framework and defines the liquidity risk appetite. Funding and liquidity risk management are the responsibility of the Chief Financial Officer who delegates day-to-day responsibility to the Treasurer, Head of ALM. The Group has a centralised liquidity risk management approach whereby all liquidity/funding is managed centrally by the Treasurer, Head of ALM, under the direction of the Asset & Liability Management Committee and within the framework of the Liquidity Risk Manual. In addition to daily reporting of business level and consolidated liquidity risk information to senior management, the Asset and Liability Management Committee and the Risk Committee monitor the Group's liquidity position on a monthly basis. The Board also receives a monthly update on key liquidity issues and the Group's liquidity position is reported to the UK Financial Services Authority on a weekly basis.

The Group views the essential elements of funding and liquidity management as controlling potential cash outflows, maintaining prudent levels of highly liquid assets and ensuring that access to funding is available from a diversity of sources. A management and monitoring process, and a series of liquidity limits within which liquidity is managed, underpin these elements. The Board targets a funding strategy that avoids excessive reliance on wholesale funding and attracts enduring commercial deposits by understanding the liquidity persistence of customer deposits under different scenarios, appropriately reflecting product features and types of customers. The funding strategy aims to provide effective diversification in the sources and tenor of funding as well as establishing the capacity to raise additional unplanned funding from those sources quickly. An excessive concentration in either liquid assets or contractual liabilities also contributes to potential liquidity risk, and so limits have been defined under the Liquidity Risk Appetite. Management also monitors the Group's compliance with limits set by the UK Financial Services Authority. In addition to such limits, liquidity ratios have trigger-review levels that require the Treasurer, Head of ALM and Head of Wholesale Risk to initiate appropriate reviews of current exposure when such levels are exceeded.

In line with the policy of Banco Santander, S.A., the Group manages its funding and maintains adequate liquidity on a stand-alone basis. Nevertheless, the Group co-ordinates issuance plans with Banco Santander, S.A., where appropriate. While the Group's liquidity risk is consolidated and centrally controlled, liquidity risk is also measured, monitored and controlled within the specific business area or the subsidiary where it arises.

The Group holds, at all times, an unencumbered liquid asset buffer to mitigate liquidity risk. The size and composition of this buffer is determined both by internal stress tests as well as the appropriate UK Financial Services Authority liquidity regime; a surplus is maintained in both cases. Since 31 December 2008, the Group has increased its holding of Individual Liquidity Adequacy Standards (ILAS) eligible assets (as defined within the UK Financial Services Authority liquidity regime), held exclusively for liquidity purposes, by 44% to £15.3bn. This excludes other ILAS-eligible assets which are being held for trading purposes.

The Group benefitted both from the conservative proportion of retail assets that are funded in wholesale markets, as well as having entered the period of market stress in a strong liquidity position. All internal and external liquidity ratios were maintained during this period.

Within the framework of prudent funding and liquidity management, the Group manages its activities to minimise liquidity risk. The key elements of the Group's liquidity risk management are:

Short-term, tactical liquidity management:

> **Liquid assets** – a buffer of liquid assets is held to cover unexpected demands on cash in extreme but plausible stress scenarios. In the Group's case, the largest stress events include large and unexpected deposit withdrawals by retail customers and a loss of unsecured wholesale funding.

> **Intra-day collateral management** – to ensure that adequate collateral is available to support payments in each payment or settlement system in which the Group participates, as they fall due.

Strategic liquidity management:

> **Structural balance sheet shape** – to manage the extent of maturity transformation (investment of shorter term funding in longer term assets), the funding of non-marketable assets with wholesale funding and the extent to which non-marketable assets can be used to generate liquidity.

> **Wholesale funding strategy** – to avoid over-reliance on any individual counterparty, currency, market or product, or group of counterparties, currencies, markets or products that may become highly correlated in a stress scenario; and to avoid excessive concentrations in the maturity of wholesale funding.

> **Wholesale funding capacity** – to maintain and promote counterparty relationships, monitor line availability and ensure funding capacity is maintained through ongoing use of lines and markets.

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

The Contingency Funding Plan becomes operational when the demand for cash, whether from demands for repayment, from wholesale funding or from retail deposits, exceeds the normal liquidity management process capacity. The circumstances that cause this to happen will tend to be sudden, unexpected events that trigger demands for cash that cannot be managed within the procedures, limits and controls defined in the Liquidity Risk Manual.

To be effective, the management of liquidity in a crisis must be timely, proactive and flexible enough to respond to a variety of different circumstances. The management structure for the Contingency Funding Plan, which is structured around a small team of individuals with the authority to agree, co-ordinate and implement actions that will control a volatile, dynamic situation, has two key elements:

> the Treasurer, Head of ALM is responsible for the rapid assessment of the implications of a sudden, unexpected event on the day-to-day liquidity of the Group, and for the decision to activate the Contingency Funding Plan; and;

> the liquidity crisis management team, under the chairmanship of the Chief Financial Officer, is the decision-making authority in the event of a liquidity crisis, and is responsible for implementing the Liquidity Contingency Plan.

Risk limits or triggers are set for the key tactical and strategic liquidity risk drivers. These are monitored by the Treasurer, Head of ALM and Risk Division and reported monthly to the Asset & Liability Management Committee, Risk Committee and the Board.

Maturities of financial liabilities

The table below analyses the maturities of the undiscounted cash flows relating to financial liabilities of the Group based on the remaining period to the contractual maturity date at the balance sheet date. Deposits by customers are largely made up of Retail Deposits. In particular the 'Demand' grouping includes current accounts and other variable rate savings products. The 'Up to 3 months' grouping largely constitutes wholesale funding of wholesale assets of a similar maturity. There are no significant financial liabilities related to financial guarantee contracts. This table is not intended to show the liquidity of the Group.

Risk Management continued

At 31 December 2009 (Group)	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits by banks	3,716	1,918	25	159	-	5,818
Deposits by customers	105,157	7,169	18,228	13,476	654	144,684
Trading liabilities	2,864	37,554	3,204	2,430	443	46,495
Financial liabilities designated at fair value	-	1,012	619	2,318	487	4,436
Debt securities in issue	-	12,327	7,313	5,856	23,859	49,355
Loan commitments	35,723	11,835	963	1,734	2,323	52,578
Other borrowed funds	-	54	72	382	3,184	3,692
Subordinated liabilities	-	206	258	1,368	7,222	9,054
	147,460	72,075	30,682	27,723	38,172	316,112
Derivative financial instruments	-	54	341	1,723	255	2,373
Total financial liabilities	147,460	72,129	31,023	29,446	38,427	318,485

At 31 December 2009 (Company)	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits by banks	3,333	24,000	10,564	73,944	7,567	119,408
Deposits by customers	77,240	15,933	12,468	15,302	44,581	165,524
Loan commitments	8,441	-	34	-	-	8,475
Other borrowed funds	-	40	30	161	678	909
Subordinated liabilities	-	158	260	1,379	7,316	9,113
	89,014	40,131	23,356	90,786	60,142	303,429
Derivative financial instruments	-	-	-	-	437	437
Total financial liabilities	89,014	40,131	23,356	90,786	60,579	303,866

At 31 December 2008 (Group)	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits by banks	2,375	8,537	691	3,123	-	14,726
Deposits by customers	102,170	9,430	15,294	3,519	834	131,247
Trading liabilities	5,071	31,253	1,817	1,667	1,554	41,362
Financial liabilities designated at fair value	-	1,816	1,330	1,858	1,230	6,234
Loan commitments	40,082	689	337	836	792	42,736
Debt securities in issue	-	13,350	9,650	14,254	55,282	92,536
Other borrowed funds	-	60	93	493	4,110	4,756
Subordinated liabilities	-	234	308	2,428	8,322	11,292
	149,698	65,369	29,520	28,178	72,124	344,889
Derivative financial instruments	80	319	412	746	1,521	3,078
Total financial liabilities	149,778	65,688	29,932	28,924	73,645	347,967

At 31 December 2008 (Company)	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits by banks	2,907	18,354	19,638	58,758	36,477	136,134
Deposits by customers	67,856	14,944	14,516	14,001	59,490	170,807
Trading liabilities	4	22	748	-	-	774
Loan commitments	9,732	-	35	-	-	9,767
Other borrowed funds	-	45	46	245	1,247	1,583
Subordinated liabilities	-	232	288	2,316	8,651	11,487
	80,499	33,597	35,271	75,320	105,865	330,552
Derivative financial instruments	56	-	-	660	1,678	2,394
Total financial liabilities	80,555	33,597	35,271	75,980	107,543	332,946

As the above table is based on contractual maturities, no account is taken of call features related to subordinated liabilities. The repayment terms of the debt securities may be accelerated in line with the covenants contained within the individual loan agreements, as described in Note 33 to the Consolidated Financial Statements.

In addition, no account is taken of the possible early repayment of the Group's mortgage-backed non-recourse finance which is redeemed by the Group as funds become available from redemptions of the residential mortgages. The Group has no control over the timing and amount of redemptions of residential mortgages.

The maturity analyses above for derivative financial liabilities include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows. These consist of interest rate swaps and cross-currency swaps which are used to hedge the Group's exposure to interest rates and exchange rates, and all loan commitments.

Risk Management in Retail Banking

Credit risk in Retail Banking

Credit risk is the risk that counterparties will not meet their financial obligations, which may result in Retail Banking losing the principal amount lent, the interest accrued and any unrealised gains (less any security held). Credit risk occurs mainly in Retail Banking's loan and investment assets (including residential mortgages and secured lending, personal and business banking). Retail Banking actively manages and controls credit risk.

Managing credit risk
The Board has approved a set of risk appetite limits to cover credit risk arising in Retail Banking. The management of Retail Banking credit risk is aligned with the processes and procedures used within Santander UK's Retail Banking and is managed on a Group basis. Within these limits, credit mandates and policies are approved with respect to products sold by the Santander UK group.

Residential mortgages and secured lending
Retail Banking lends on many types of property but only after a credit risk assessment of the borrower, including affordability modelling and an assessment of the property is undertaken. The systems used to manage and monitor the quality of the mortgage assets are reviewed in accordance with policy to ensure they perform as expected. Residential lending is subject to lending policy and lending authority levels, which are used to structure lending decisions to the same standard across the retail network, a process further improved by mortgage credit scoring, underwriter accreditation and regular compliance reviews. Details concerning the prospective borrower and the mortgage are subject to a criteria-based decision-making process. Criteria for assessment include credit references, loan-to-value ratio, borrower status and the mortgage credit score.

All mortgages provided by Retail Banking are secured on UK properties. All properties must be permanent in construction; mobile homes are not generally acceptable. The Group can provide a loan for the purchase of properties outside the UK where the property is a second home and the loan is secured on the main property located in the UK.

Prior to granting any first mortgage loan on a property, the Group has the property valued by an approved and qualified surveyor. The valuation is based on set Group guidelines, which build upon the Royal Institution of Chartered Surveyors guidance on valuation methods. In the case of re-mortgages, where the loan-to-value ('LTV') is 75% or lower, and the risk judged by the size of the advance requested and the credit score of the applicant is considered medium or low, and an accurate, reputable automated valuation is available, this may substitute for a surveyor's valuation.

For existing mortgages, the current values of the properties on which individual mortgages are secured are estimated quarterly. For each individual property, details such as address, type of property and number of bedrooms are supplied to an independent agency that estimates current property valuations using information from recent property transactions and valuations.

Until 2008, for additional lending where a first-charge mortgage is already held with the Group and the loan-to-value is less than 90%, the original property value used to be subject to indexation and no further survey carried out. During 2008, this practice was phased-out, with all additional loans requiring an automated valuation or surveyor's valuation. The use of an automated valuation depends upon the availability of a reliable automated valuation, and the level of credit risk posed by the proposed loan.

Higher risk loans
The Group is principally a retail prime lender and does not originate second charge mortgages. A £37m portfolio of second charge mortgages was acquired as a result of the transfer of Alliance & Leicester plc to the Company as described in Note 47 to the Consolidated Financial Statements. This portfolio is in run-down.

Certain mortgage products may be considered higher risk. Operating as a prime lender in the UK mortgage market, the Group does not have any material sub-portfolio demonstrating very poor performance. The portfolio's arrears performance has remained relatively stable and favourable to industry benchmarks. Arrears rates and loss rates remain very low. Nonetheless, there are some mortgage types that present higher risks than others. These products consist of:

Interest-only loans – Interest-only mortgages require monthly interest payments and the repayment of principal at maturity. This can be arranged via investment products including Individual Savings Accounts and pension policies, or by the sale of the property. It is the customer's responsibility to ensure that they have sufficient funds to repay the principal in full at maturity.

Interest-only mortgages are well-established and common in the UK market. Lending policies to mitigate the risks inferred by this repayment structure are in place and mature. While the risks are higher than capital repayment mortgages, they are only modestly so. The performance of this significant sub-portfolio has been quite acceptable and stable.

Flexible loans – Flexible mortgages allow the customers to vary their monthly payment, or take payment holidays, within predetermined criteria and/or up to an agreed credit limit. Customers are also permitted to draw down additional funds at any time up to the limit or redraw amounts that have been previously overpaid.

Loans with original LTV >100% – Progressively stricter lending criteria are applied to mortgages above a loan-to-value of 75%. Historically, in limited circumstances, customers were able to borrow more than 100% of the value of the property against which the loan was secured, within certain limits. However, in 2009 no loans were made with a loan-to-value of more than 100% (2008 and 2007: less than 0.1%). In 2009, less than 0.1% of new secured loan advances were made with a loan-to-value of more than 90% (2008: 2%, 2007: 3%).

Risk Management continued

Loans with higher loan-to-value ratios carry a higher risk due to the increased likelihood that liquidation of the collateral will not yield sufficient funds to cover the loan advanced, arrears and the costs of liquidation. These loans generally attract higher margins as a result.

Sub-prime lending – The Group has no appetite or product offering for sub-prime business. The Group's credit policy explicitly prohibits such lending and is designed to ensure that any business written is responsible, affordable (both initially and an on-going basis) and of a good credit quality.

Mortgage credit quality and credit risk mitigation(1)

	2009	2008	2007
Loan-to-value analysis:			
New business			
< 75%	**83%**	62%	52%
75% - 90%	**17%**	36%	45%
> 90%	**-**	2%	3%
	100%	100%	100%
Average loan-to-value of new business (at inception)	**61%**	65%	64%
Stock			
< 75%	**61%**	67%	76%
75% - 90%	**22%**	22%	20%
90% - 100%	**10%**	7%	4%
>100% i.e. negative equity	**7%**	4%	-
	100%	100%	100%
Average loan-to-value of stock	**52%**	51%	46%
Borrower profile:			
New business			
First-time buyers	**17%**	11%	13%
Home movers	**37%**	25%	37%
Remortgagers	**46%**	64%	50%
	100%	100%	100%
Of which:(2)			
- Interest-only loans	**36%**	53%	53%
- Flexi loans	**9%**	14%	8%
- Loans with original LTV >100%	**-**	-	-
Stock			
First-time buyers	**17%**	16%	15%
Home movers	**38%**	39%	42%
Remortgagers	**45%**	45%	43%
	100%	100%	100%
Of which:(2)			
- Interest-only loans	**43%**	43%	41%
- Flexi loans	**18%**	18%	14%
- Loans with original LTV >100%	**-**	-	1%
Average earnings multiple (at inception)	**2.8**	3.0	3.0

(1) Excludes any fees added to the loan, and only includes the drawn loan amount, not drawdown limits.
(2) Where a loan exhibits more than one of the "higher risk" criteria, it is included in all the applicable categories.

Loan-to-value analysis

The residential mortgage portfolio showed an increasing trend of payment arrears with the deterioration in economic conditions, which has stabilised in the second half of the year. During 2009, LTV on new business completions declined during the first half of the year. However, this slightly increased during the second half of the year, with the fourth quarter 2009 LTV at 64% (Q3 09: 62%, Q4 08: 60%). The indexed stock LTV increased to 52% from 2008 (Q3 09: 52%, Q4 08: 50%) due to net lending mix, and mitigated by rising house prices evidenced by portfolio revaluation towards the end of the year. Although credit criteria continued to be tightened for higher risk segments, targeted policy relaxation and competitive pricing at higher LTV began to result in a slight uplift in new business average LTV in 2009.

- Arrears more than 90 days past due have increased from 0.93% in December 2008 to 1.37% at the end of 2009.
- Monthly mortgage completions in excess of 75% LTV fell from 14% in December 2008 to 23% in December 2009.

7% (2008: 4%) of the retail mortgage portfolio was over 100% LTV, based on the re-evaluation performed in December 2009. The increase was due to the general decline in property prices during the year. However, the impact was partly mitigated by the reduced LTV profile of new business and increased control of the retention process.

Borrower profile

During 2009, the proportion of new business from remortgages decreased. This trend was seen across the UK market as lower interest rates and stricter lending criteria reduced the incentives for customers to remortgage to another lender.

Mortgage arrears and repossessions

The Collections & Recoveries Department is responsible for all debt management initiatives on the secured portfolio for Retail Banking. Debt management strategies, which include negotiating repayment arrangements and concessions and debt counselling, can start as early as the day after a repayment is past due and will continue until legal action. Different collection strategies are applied to different segments of the portfolio subject to the perceived levels of risk for example, loan-to-value, collections score and account characteristics.

If the agreed repayment arrangement is not maintained, legal proceedings may be taken and may result in the property being taken into possession. The Group sells the repossessed property at market price and uses the sale proceeds, net of costs, to pay off the outstanding value of the mortgage. The stock of repossessed properties held by the Group varies according to the number of new possessions and the buoyancy of the housing market.

A programme of forbearance designed to enable borrowers experiencing short to medium term repayment difficulties to remain in their home has been in place during 2009. On average, each month less than 1% of accounts in arrears either have their term extended or convert to interest only. Levels of adherence to revised payment terms are currently high at approximately 70%.

The following tables set forth information on UK residential mortgage arrears at 31 December 2009, 2008, and 2007 for Retail Banking compared to the industry average as provided by the Council of Mortgage Lenders ('CML').

					Group[1]	CML[2] (unaudited)
	Higher risk loans[3]			Remaining		
Mortgage arrears	**Interest-only loans**	**Flexible loans**	**Loans with original LTV > 100%**	**loan portfolio**	**Total[3]**	
	(Percentage of total mortgage loans by number)					
31 to 60 days in arrears:						
31 December 2007	0.61	0.13	-	0.80	1.48	-
31 December 2008	0.57	0.11	-	0.56	1.19	-
31 December 2009	**0.45**	**0.07**	**0.01**	**0.51**	**1.00**	-
61 to 90 days in arrears:						
31 December 2007	0.25	0.06	-	0.31	0.59	-
31 December 2008	0.32	0.06	-	0.30	0.65	-
31 December 2009	**0.27**	**0.04**	**-**	**0.29**	**0.58**	-
3 to 5 months in arrears:						
31 December 2007	0.21	0.04	-	0.24	0.49	0.62
31 December 2008	0.31	0.06	-	0.28	0.62	1.01
31 December 2009	**0.41**	**0.05**	**0.01**	**0.36**	**0.80**	**0.97**
6 to 11 months in arrears:						
31 December 2007	0.08	0.02	-	0.08	0.17	0.35
31 December 2008	0.13	0.03	-	0.11	0.26	0.62
31 December 2009	**0.22**	**0.04**	**-**	**0.16**	**0.40**	**0.81**
12 months or more in arrears:						
31 December 2007	0.02	-	-	0.01	0.03	0.13
31 December 2008	0.02	-	-	0.02	0.05	0.25
31 December 2009	**0.09**	**0.03**	**-**	**0.07**	**0.17**	**0.60**

(1) Group data is not readily available for arrears less than 31 days.
(2) Council of Mortgage Lenders data is not available for arrears less than 3 months.
(3) Where a loan exhibits more than one of the "higher risk" criteria, it is included in all the applicable categories. As a result, the total of the mortgage arrears for "higher risk" loans and remaining loan portfolio will not agree to the total mortgage arrears percentages.

The following tables set forth information on UK properties in possession, at 31 December 2009, 2008, and 2007 for Retail Banking compared to the industry average as provided by the Council of Mortgage Lenders, as well as the carrying amount of assets obtained as collateral.

	Group	CML (unaudited)
Properties in possession	(Percentage of total mortgage loans by number)	
31 December 2007	0.05	0.10
31 December 2008	0.06	0.21
31 December 2009	**0.05**	**0.14**

Carrying amount of assets obtained as collateral	Group £m
31 December 2007	64
31 December 2008	130
31 December 2009	**110**

Risk Management continued

The table below analyses Residential mortgages that have been restructured or renegotiated by capitalising the arrears where customers in arrears have maintained an agreed monthly repayment for an agreed period.

	2009 £m	2009 %	2008 £m	2008 %
Mortgages restructured during the year[1, 2]	**325**	**100**	348	100
Of which[3]:				
- Interest only loans	**157**	**48**	156	45
- Flexi loans	**15**	**5**	24	7
- Loans with original LTV >100%	**1**	**-**	1	-

(1) All mortgages originated by the Group are first charge.
(2) Mortgages are included within the year that they were restructured.
(3) Where a loan exhibits more than one of the "higher risk" criteria, it is included in all the applicable categories.

Banking and Consumer Credit. Retail Banking uses systems and processes to manage the risks involved in providing unsecured personal loans and overdraft lending or in granting bank account facilities. These include the use of application and behavioural scoring systems to assist in the granting of credit facilities as well as regular monitoring of scorecard performance and the quality of the unsecured lending portfolios. Behavioural scoring examines the lending relationships that a customer has with Retail Banking and how the customer uses their bank account. This information generates a score that is used to assist in deciding the level of risk (in terms of overdraft facility amount, card facilities granted and preferred unsecured personal loan value) for each customer that Retail Banking is willing to accept. Individual customer scores are normally updated on a monthly basis. Retail Banking has successfully extended the use of behavioural scoring into other areas of the business, including the refinement of debt management strategies and bank account transaction processing.

Personal Financial Services banking and unsecured personal loan arrears

	2009 £m	2008 £m	2007 £m
Total banking and unsecured personal loan arrears[1,2]	**257**	371	134
Total banking and unsecured personal loan asset	**4,830**	6,225	3,119
Banking and unsecured personal loan arrears as a % of asset	**5.31%**	5.96%	4.30%

(1) From 2008, banking arrears is defined as customers that had been in arrears for greater than 90 days. In prior years, it was defined as customers whose borrowings exceed their overdraft by over £100. If the prior year definition were applied to 2008 data, the total arrears would increase by £53m.
(2) Unsecured personal loan and credit card arrears are defined as the balances of accounts that are three or more months in arrears (> 4 instalments).

Provisions on loans and advances to customers

The charge for provisions on loans and advances to customers adjusts the balance sheet provisions to the level that management deems adequate to absorb actual and inherent losses in Retail Banking's loan portfolio from homogeneous portfolios of assets and individually identified loans. A proportion of Retail Banking's provisions on loans and advances to customers relate to loans and advances secured either by a first charge on residential property in the UK, or by other appropriate security depending on the nature of the loan.

The Group's provisioning policy is as follows. Further information is set out in the Accounting Policies in the Consolidated Financial Statements:

> **Observed provision** - an observed provision is established for all past due loans after a specified period of repayment default where it is likely that some of the capital will not be repaid or recovered through enforcement of any applicable security. The length of the default period depends on the nature of the advance and is generally no more than three months. Once a loan misses a payment (breach of contractual terms) an assessment of the likelihood of collecting the principal and overdue payments is made. This assessment is generally made using statistical techniques developed on previous experience and on projections of current market conditions to the time the loss is expected to crystallise. These techniques estimate the propensity of loans to go to write-off and, as a separate exercise, the loss incurred on written off debt is monitored. For advances secured on residential property, the propensity of loans to reach repossession is determined with repossessed properties assessed on an individual basis through the use of an external valuation, anticipated disposal costs and the current exposure.

> **Incurred but not yet observed provision** - an incurred but not yet observed provision is made against loans, which have not missed a payment but are known from past experience to have deteriorated since the initial decision to lend was made. Based on historical evidence, the number of accounts likely to default in the future as a result of events present at the balance sheet date are identified through use of statistical techniques. Further detailed examination is performed on the losses that emerge over a defined period of time after the reporting date called the emergence period. This period is determined to ensure that only those accounts which have credit deterioration at the reporting date are captured and excludes accounts which will suffer credit deterioration after the reporting period. The emergence period is two to three months for unsecured lending and 12 months for secured lending. The provision methodology outlined for observed provisions is then applied to accounts identified as impaired in the performing portfolios.

> **Amounts written off** - unsecured loans are written off when all internal avenues of collecting the debt have failed and the debt is passed onto external collection agencies. On secured loans, the write-off takes place on ultimate realisation of collateral value, or from claiming on any mortgage indemnity guarantee or other insurance. All write-offs are 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 write-off policy is regularly reviewed.

Security is realised in accordance with the Group's internal debt management programme. 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. As a result of the write-off policy, the provisions will be made significantly in advance of the related write-off on all products. The exception to this rule is the discovery of fraud, where the exposure is written off once full investigations have been completed and the probability of recovery is minimal. The time span between the discovery and write-off will be short and may not result in a provision being raised.

Retail Banking analysis of provisions on loans and advances to customers

An analysis of the Retail Banking provisions on loans and advances to customers is presented below.

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Observed provisions					
Advances secured on residential properties - UK	**313**	175	74	45	21
Finance leases - UK	**-**	-	-	1	3
Other secured advances - UK	**50**	36	32	73	123
Unsecured personal advances - UK	**341**	227	250	243	158
Total observed provisions	**704**	438	356	362	305
Incurred but not yet observed provisions					
Advances secured on residential properties - UK	**171**	184	102	60	35
Finance leases - UK	**-**	-	-	-	-
Other secured advances - UK	**12**	11	8	3	-
Unsecured personal advances - UK	**53**	65	85	111	54
Total incurred but not yet observed provisions	**236**	260	195	174	89
Total provisions	**940**	698	551	536	394

Retail Banking movements in provisions for impairment losses on loans and advances

An analysis of movements in the Retail Banking provisions for impairment losses on loans and advances is presented below.

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Provisions at 31 December	**698**	551	536	394	467
IFRS reclassifications	**-**	-	-	-	(40)
Provisions at 1 January	**698**	551	536	394	427
Amounts written off					
Advances secured on residential properties - UK	**(84)**	(32)	(9)	(11)	(5)
Other secured advances - UK	**(17)**	(9)	(25)	(27)	(36)
Unsecured personal advances - UK	**(399)**	(262)	(339)	(205)	(247)
Total amounts written off	**(500)**	(303)	(373)	(243)	(288)
Observed provisions charged against/(released into) profit					
Advances secured on residential properties – UK	**223**	132	38	35	12
Other secured advances – UK	**30**	14	(17)	(25)	11
Unsecured personal advances – UK	**513**	239	346	289	221
	766	385	367	299	244
Advances secured on residential properties - non-UK	**-**	-	-	-	(3)
Total observed provisions charged against profit	**766**	385	367	299	241
Incurred but not yet observed provisions (released into)/charged against profit	**(24)**	(17)	21	86	14
Total provisions charged against profit (including discontinued operations)	**742**	368	388	385	255
Acquired through business combinations	**-**	82	-	-	-
Provisions at the end of the year	**940**	698	551	536	394

IFRS reclassifications related primarily to provisions on certain corporate loans in businesses and portfolios that were inconsistent with the Group's strategy, and were sold during 2005 or transferred to Corporate Banking.

Retail Banking recoveries

An analysis of the Retail Banking recoveries is presented below.

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Advances secured on residential properties - UK	**1**	1	2	2	3
Other secured advances - UK	**-**	12	6	7	7
Unsecured personal advances - UK	**30**	33	36	32	27
Total amount recovered	**31**	46	44	41	37

Risk Management continued

Retail Banking non-performing loans and advances [1]

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Retail Banking non-performing loans and advances that are impaired[2]	**1,343**	745	296	375	314
Retail Banking non-performing loans and advances that are not impaired	**1,561**	1,236	596	451	568
Total non-performing loans and advances[3]	**2,904**	1,981	892	826	882
	%	%	%	%	%
Non-performing loans and advances as a % of loans and advances to customers	**1.67**	1.19	0.80	0.80	0.92
Provision as a percentage of total non-performing loans and advances	**32.37**	35.24	61.77	64.89	44.67

(1) Loans and advances are classified as non-performing typically when the counterparty fails to make payments when contractually due for three months or longer
(2) Non-performing loans against which a provision for impairment losses has been established
(3) All non-performing loans are UK and continue accruing interest

Retail Banking non-performing loans and advances by higher risk loan type[1] [2]

	2009 £m	2008 £m	2007 £m
Total non-performing loans and advances	**2,904**	1,981	892
Of which:			
- Interest only loans	**1,665**	1,001	375
- Flexi loans	**251**	218	76
- Loans with original LTV > 100%	**25**	11	1

(1) No reliable data is available prior to 2007.
(2) Where a loan exhibits more than one of the "higher risk" criteria, it is included in all the applicable categories.

In 2009, non-performing loans and advances as a percentage of loans and advances to customers ncreased from 1.19 to 1.67%. This primarily reflects the impact of the continued market deterioration on the performance of the residential mortgage portfolio. This has also further increased the proportion of non-performing loans secured against residential property in the non-performing loan balance, which has in turn further reduced the overall provision coverage as the distribution shifts towards mortgages that require a lower level of coverage due to inherent securities held against the non-performing loans.

In 2008, non-performing loans and advances as a percentage of loans and advances to customers increased from 0.80% to 1.19%. This primarily reflects the impact of the deteriorating market environment on the performance of the residential mortgage portfolio. This has also increased the proportion of non-performing loans secured against residential property in the non-performing loan balance, which has in turn further reduced the average provision coverage required in respect of the eventual credit losses that are expected to emerge from these loans.

In 2007, non-performing loans and advances as a percentage of loans and advances to customers remained unchanged at 0.80%. This is a reflection of the continued strength in the credit quality of the Group's loans. The overall provision coverage ratio decreased from 64.89% to 61.77% due to the change in the proportions of mortgages and unsecured loans in the non-performing loan balance, where a greater proportion represented mortgages (which have a lower provision as a percentage of the asset).

In 2006, non-performing loans and advances as a percentage of loans and advances to customers decreased from 0.92% to 0.80%. This reflected the continuing strength of the credit quality of the Group's loans, particularly on the secured mortgages. Provisions as a percentage of total non-performing loans and advances increased from 44.67% to 64.89% in 2006, which reflected the change in macro-economic factors such as interest rate rises.

Interest income recognised on impaired loans amounted to £101m (2008: £51m, 2007: £36m).

Retail Banking restructured loans

Loans have been restructured or renegotiated by capitalising the arrears where customers in arrears have maintained an agreed monthly repayment for a specified period. The value of capitalised arrears on these loans during 2009 was £6m (2008: £7m).

The table below shows the Group's loans not included in non-performing loans that have been restructured or renegotiated by capitalising the arrears.

	2009 £m	2008 £m
Restructured loans	**377**	371

Santander Business Banking (formerly known as Abbey Business)

Santander Business Banking provides a range of products to assist with the finance requirements of small businesses, including overdrafts and loans. Risk management policies are specific to and reflect the risks inherent in each product set. Approval processes for credit risk include the use of judgement, assisted by the use of probability of default and loss given default data, and the use of credit scoring. Business Banking operates within policies and authority levels approved by the Chief Risk Officer. Business Banking has a dedicated risk team, reflecting the desire for risk control to be close to the business needs and risks. Business Banking provides mortgages to borrowers on a range of mainly non-residential property. Agreed credit assessment criteria include serviceability ratios, loan-to-value ratios, and quality of tenants, with stress testing against interest rate movements. Concentration limits per borrower and business sector are also employed to ensure a balanced loan portfolio. The management of defaulting accounts and the repossession and sale of properties is handled by a dedicated function within the risk operation.

The strategic plan to extend the customer proposition into the SME market is being supported by a workstream which aims to manage all risks within this market and throughout the risk cycle. The development of the risk framework is overseen by the Chief Risk Officer.

Market risk in Retail Banking

Market risks are originated in Retail Banking only as a by-product of writing customer business and are transferred out of Retail Banking insofar as possible. Only prepayment and launch risk exposures are retained within Retail Banking, as these behavioural risks are influenced by internal marketing and pricing activity and are managed by Asset Business and Customer Funds Committees. Other market risks are transferred to the Asset and Liability Management ('ALM') operation within Group Infrastructure, where they can be managed in conjunction with exposures arising from the funding, liquidity or capital management activities of ALM. Funds received with respect to deposits taken are lent on to Group Infrastructure on matching terms as regards interest rate re-pricing and maturity. Similarly, loans are funded through matching borrowings from Group Infrastructure. Market risks arising from structured products, including exposure to changes in the levels of equity markets, are hedged within Global Banking & Markets.

Risk Management in Corporate Banking

Credit risk in Corporate Banking

Credit risk is the risk that counterparties will not meet their financial obligations resulting in Corporate Banking losing the monies lent, including any interest accrued, or having to close out transactions prematurely, which may result in losses even after realising the value of any collateral held. Credit risk arises by Corporate Banking making loans, investing in other financial instruments or entering into financing transactions or derivative contracts. Corporate Banking actively manages and controls credit risk.

Managing credit risk

The Board has approved a set of risk appetite limits to cover different types of risk, including credit risk, arising in Corporate Banking. The Group's credit risk appetite is measured and controlled by a maximum Economic Capital value, which is defined as the maximum level of unexpected loss that the Group is willing to sustain over a one-year period. Within these limits, credit mandates and policies are approved to cover detailed industry, sector and product limits. All transactions falling within these mandates and policies are accommodated under credit limits approved by the appropriate credit authority. Specific approval is usually required by the Credit Approval Committee (a specific committee established under the authority of the Chief Executive) for any transaction that falls outside the mandates.

Analysis of credit exposures and credit risk trends are provided each month to the Corporate and Commercial Banking Risk Oversight Forum, with key issues escalated to the Risk Committee as required. Large Exposures (as defined by the UK Financial Services Authority) are reported quarterly to the Risk Committee and the UK Financial Services Authority.

Credit risk on derivative instruments is calculated using the potential future mark-to-market exposure of the instruments at a 97.5% statistical confidence level and adding this value to the current value. The resulting "loan equivalent" or credit risk is then included against credit limits, along with other non-derivative exposures. In addition, there is a policy framework to enable the collateralisation of derivative instruments including swaps. If collateral is deemed necessary to reduce credit risk, any unsecured risk threshold, and the nature of any collateral to be accepted, is determined by management's credit evaluation of the counterparty.

Corporate Banking has been targeted as an area where the Group aims to achieve controlled growth, mainly through the expansion of a regional network supporting lending to the Real Estate, Corporate (including SME), Education and Health sectors. Focus is being given to the control of credit risks within this expansion with, amongst other things, the development and implementation of robust Credit Policy Mandates and models covering both risk appetite and ratings.

Risk Management continued

Corporate Banking loans

	Gross loans & advances £m	Impairment allowance £m	Loans & advances net of impairment allowance £m	Impaired loans £m	Impaired loans as % of gross loans & advances %	Impairment charge for the period £m	% Collateral held against impaired loans %
Group[1]:							
- 2009	**20,122**	**(359)**	**19,763**	**618**	**3.07**	**60**	**47**
- 2008	19,888	(302)	19,586	882	4.43	26	43
Company:							
- 2009	**-**	**-**	**-**	**-**	**-**	**-**	**-**
- 2008	24	-	24	-	-	-	-

(1) Excludes social housing loans and operating lease assets.

Corporate Banking committed facilities exposure by credit rating of the issuer or counterparty[1]

2009	Corporate £m	Real Estate £m	Social housing £m	Non-growth £m	Total £m
AAA	**-**	**60**	**-**	**-**	**60**
AA	**206**	**-**	**997**	**310**	**1,513**
A	**799**	**463**	**5,484**	**639**	**7,385**
BBB	**2,688**	**1,585**	**1,791**	**3,027**	**9,091**
BB	**1,462**	**2,043**	**100**	**1,726**	**5,331**
B	**124**	**180**	**-**	**204**	**508**
CCC	**16**	**5**	**-**	**66**	**87**
D	**111**	**95**	**-**	**199**	**405**
Other[2]	**921**	**-**	**-**	**-**	**921**
Total	**6,327**	**4,431**	**8,372**	**6,171**	**25,301**

2008	Corporate £m	Real Estate £m	Social housing £m	Non-growth £m	Total £m
AAA	30	95	-	-	125
AA	182	-	1,008	939	2,129
A	247	270	5,222	711	6,450
BBB	2,372	1,792	1,821	3,488	9,473
BB	1,309	1,724	100	1,895	5,028
B	176	-	9	221	406
CCC	1	-	-	136	137
D	197	49	-	322	568
Other[2]	1,088	-	-	-	1,088
Total	5,601	3,931	8,160	7,712	25,404

(1) All exposures are internally rated. External ratings are taken into consideration in the rating process, where available.
(2) Individual exposures of £1m or less.

Corporate Banking committed facilities exposure by geographical area

2009	Corporate £m	Real Estate £m	Social Housing £m	Non-growth £m	Total £m
United Kingdom	**6,019**	**4,202**	**8,372**	**3,353**	**21,946**
US	**-**	**65**	**-**	**511**	**576**
Rest of the world	**308**	**164**	**-**	**2,307**	**2,779**
Total	**6,327**	**4,431**	**8,372**	**6,171**	**25,301**

2008	Corporate £m	Real Estate £m	Social Housing £m	Non-growth £m	Total £m
United Kingdom	5,408	3,598	8,160	3,576	20,742
US	-	72	-	617	689
Rest of the world	193	261	-	3,519	3,973
Total	5,601	3,931	8,160	7,712	25,404

The increase in Corporate and Real Estate exposures in 2009 arose from the continued development of a UK corporate banking franchise and was offset by a reduction in the non growth portfolios, both in the UK and overseas. There are no significant exposures to Dubai, Portugal, Greece, Spain, Argentina and Iceland within the Corporate Banking book.

Corporate Banking – Watchlist

The entire corporate risk portfolio of new, emerging and serious circumstances relating to the portfolio (i.e. those loans on a 'Watchlist') and those in Collections are managed at the FEVE Corporate Risk forum. FEVE is a Spanish acronym for "Firmas En Vigilancia Especial", which means businesses under special watch.

A summary of the Watchlist cases at 31 December 2009 by portfolio and assessment of risk is as follows:

2009	Portfolio £m	Watch £m	Watch %	Workout £m	Workout %	NPL £m	NPL %
Corporate	5,895	377	6	204	3	135	2
Real Estate	4,431	672	15	331	7	206	5
Non-growth	6,172	1,232	20	502	8	368	6
Total	**16,498**	**2,281**	**14**	**1,037**	**6**	**709**	**4**

Exposures are classified as "workout" if they are being actively managed by the Risk Division.

Corporate Banking arrears

	2009 £m	2008 £m	2007 £m
Total Corporate lending arrears	**533**	143	-
Total Corporate lending assets	**20,707**	20,516	7,003
Corporate lending arrears as a % of assets	**2.57%**	0.70%	-

Corporate Banking analysis of provisions on loans and advances to customers

An analysis of the Corporate Banking provisions on loans and advances to customers is presented below.

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Observed provisions					
Corporate advances - UK	**185**	13	-	-	-
Finance leases - UK	**1**	-			
Total observed provisions	**186**	13	-	-	-
Incurred but not yet observed provisions					
Corporate advances - UK	**172**	289	-	-	-
Finance leases - UK	**1**	1			
Total incurred but not yet observed provisions	**173**	290	-	-	-
Total provisions	**359**	303	-	-	-

Corporate Banking movements in provisions for impairment losses on loans and advances:

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Provisions at the start of the year	**303**	-	-	-	-
Amounts written off:					
- Corporate Loans	-	-	-	-	-
- Finance Leases	**(4)**	-	-	-	-
Total amounts written off	**(4)**	-	-	-	-
Observed provisions charged against profit:					
- Corporate Loans	**172**	13	-	-	-
- Finance Leases	**5**	-	-	-	-
Total observed provisions charged against profit	**177**	13	-	-	-
Incurred but not yet observed provisions charged against profit	**(117)**	13	-	-	-
Total provisions charged against profit	**60**	26	-	-	-
Acquired through business combinations	-	277			
Provisions at the end of the year	**359**	303	-	-	-

Corporate Banking recoveries

	2009 £m	2008 £m	2007 £m
Secured	**1**	-	-
Unsecured	**23**	-	-
Total amount recovered	**24**	-	-

Corporate Banking non-performing loans and advances[1]

	2009 £m	2008 £m	2007 £m
Non-performing loans and advances that are impaired	**490**	397	-
Non-performing loans and advances that are not impaired	**219**	-	-
Total non-performing loans and advances[2]	**709**	397	-
Non-performing loans and advances as a percentage of loans and advances to customers[3]	**3.52%**	2.00%	-
Provision as a percentage of total non-performing loans and advances	**51%**	76%	-

(1) Loans and advances are classified as non-performing typically when the counterparty fails to make payments when contractually due for three months or longer
(2) All non-performing loans are UK and continue accruing interest.
(3) Loans and advances to customers include social housing loans and finance leases.

Risk Management continued

In 2009, non-performing loans and advances as a percentage of loans and advances to customers increased to 3.52% as market conditions continued to deteriorate. This reflects the consolidation of the Alliance & Leicester Corporate Lending business which included assets with generally higher risk characteristics as well as the more challenging economic environment on customers especially in the Real Estate and shipping markets.

In 2008, non-performing loans and advances as a percentage of loans and advances to customers increased to 2.00%. This reflects the impact of the deteriorating market environment on the performance of the corporate and real estate portfolios, and the transfer of Alliance & Leicester's Corporate Banking portfolio.

Interest income recognised on impaired loans amounted to £4m (2008: £2m). In 2007, there were no impaired loans.

Credit risk mitigation

Collateralisation

The corporate portfolio is largely unsecured but typically incorporates guarantee structures underpinned by both financial and non-financial covenants. The Social Housing portfolio is secured on residential real estate owned and let by UK Housing Associations. In the real estate portfolio, collateral is in the form of commercial real estate assets. Within the non-growth portfolios of assets inconsistent with the Group's future strategy, collateral is regularly held through a charge over the underlying asset and in some circumstances, cash. There are also a small number of PFI transactions where collateral is held in the form of a charge over the underlying concession contract.

Restructured loans

Loans may be restructured or renegotiated by capitalising the arrears where customers in arrears have maintained an agreed monthly repayment for a specified period. Loans have been restructured during 2009 by way of debt for equity swaps, through new equity being raised or in some cases an exit has been achieved through the sale of debt.

Market risk in Corporate Banking

Market risks arising in the Corporate Banking division are transferred from the originating business to ALM within Group Infrastructure, where they can be managed in conjunction with exposures arising from the funding, liquidity or capital management activities of ALM. Funds received with respect to deposits taken are lent on to Group Infrastructure on matching terms as regards interest rate repricing and maturity. Similarly, loans are funded though matching borrowings from Group Infrastructure. Any permitted retained market risk exposure is minimal, and is monitored against limits approved by the Head of Wholesale Risk.

Risk Management in Global Banking & Markets

Credit risk in Global Banking & Markets

Credit risk is the risk that counterparties will not meet their financial obligations resulting in Global Banking & Markets losing the monies lent, including any interest accrued, or having to close out transactions prematurely, which may incur losses after realising collateral held. Credit risk arises by Global Banking & Markets making loans, investing in debt securities or other financial instruments or entering into financing transactions or derivative contracts. Global Banking & Markets actively manages and controls credit risk.

Managing credit risk

The Board has approved a set of risk appetite limits to cover different types of risk, including credit risk, arising in Global Banking & Markets. The Group's credit risk appetite is measured and controlled by a maximum Economic Capital value, which is defined as the maximum level of unexpected loss that the Group is willing to sustain over a one-year period. Within these limits, credit mandates and policies are approved to cover detailed industry, sector and product limits.

All transactions are accommodated under credit limits approved by the appropriate credit authority. Specific approval is usually required from the Credit Approval Committee (a specific committee established under the authority of the Chief Executive) for any transaction that falls outside the mandates.

Analysis of credit exposures and credit risk trends are provided each month to the Wholesale Risk Oversight and Control Forum with key issues escalated to the Risk Committee as required. Large Exposures (as defined by the UK Financial Services Authority) are reported monthly to the Risk Committee and the UK Financial Services Authority.

Credit risk on derivative instruments is calculated using the potential future mark-to-market exposure of the instruments at a 97.5% statistical confidence level and adding this value to the current value. The resulting "loan equivalent" or credit risk is then included against credit limits, along with other non-derivative exposures.

In addition, there is a policy framework to enable the collateralisation of derivative instruments including swaps. If collateral is deemed necessary to reduce credit risk, any unsecured risk threshold, and the nature of any collateral to be accepted, is determined by management's credit evaluation of the counterparty.

Credit risk mitigation

(i) Netting arrangements

The Group restricts its credit risk by entering into transactions under industry standard agreements which facilitate netting of transactions in the jurisdictions where netting agreements are recognised and have legal force. The netting arrangements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis.

However, there is scope for the credit risk associated with favourable contracts to be reduced by netting arrangements embodied in the agreements to the extent that if an event of default occurs, all amounts with the counterparty under the specific agreement can be terminated and settled on a net basis. Derivatives, repurchase and reverse repurchase transactions, stock borrowing/lending transactions and securities financing transactions are governed by industry standard agreements that facilitate netting.

(ii) Collateralisation

The Group also mitigates its credit risk to counterparties with which it primarily transacts financial instruments through collateralisation, using industry standard collateral agreements. Under these agreements, net exposures with counterparties are collateralised with cash, securities or equities. Exposures and collateral are generally revalued daily and collateral is adjusted accordingly to reflect deficits/surpluses. Collateral taken must comply with the Group's collateral parameters policy. This policy is designed to control the quality and concentration risk of collateral taken such that collateral held can be liquidated when a counterparty defaults. Cash collateral in respect of derivatives held at the year-end was £1.5bn (2008: £3.4bn), not all derivative arrangements being subject to collateral agreements. Collateral obtained during the year in respect of purchase and resale agreements (including securities financing) is equal to at least 100% of the amount of the exposure.

Global Banking & Markets net exposure by credit rating of the issuer or counterparty[1]

	2009 £m	2008 £m
AAA	**12,068**	5,904
AA	**512**	5,905
A	**2,596**	2,326
BBB	**403**	251
BB	**172**	91
B	**-**	1
Total	**15,751**	14,478

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

In the securities financing businesses, credit risk arises on both assets and liabilities and on both on and off-balance sheet transactions. Consequently, the above credit risk exposure arises not only from the on balance sheet assets, but also from securities financing trades classified as liabilities and off-balance sheet assets.

Market risk in Global Banking & Markets

Market risk-taking is performed within the framework established by the Market Risk Manual. A major portion of the market risk arises from exposures to changes in the levels of interest rates, equity markets and credit spreads. Interest rate exposure is generated from trading activities. Exposure to equity markets is generated by the creation and risk management of structured products by Global Banking & Markets for the Personal Financial Services market and trading activities. Credit spread exposure arises from credit risk management and trading activities within Global Banking & Markets.

Managing market risk

Risks are managed within limits approved by the Head of Wholesale Risk or Banco Santander, S.A.'s Board Risk Committee and within the risk control framework defined by the Market Risk Manual. For trading activities the primary risk exposures for Global Banking & Markets are interest rate, equity, credit spread and residual exposure to property indices. Interest rate risks are managed via interest rate swaps, futures and options (caps, floors and swaptions). Equity risks are managed via equity stock, index futures, options and structured equity derivatives. Credit-spread risks are managed via credit derivatives (credit default swaps, total return swaps). Property index risk is managed via insurance contracts and property derivatives.

To facilitate understanding and communication of different risks, risk categories have been defined. Exposure to all market risk factors is assigned to one of these categories. The Group considers two categories:

> **Short-term liquid market risk** covers activities where exposures are subject to frequent change and could be closed out over a short-time horizon. Most of the exposure is generated by Global Banking & Markets.

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

Risk Management continued

Global Banking & Markets operates within a market risk framework designed to ensure that it has the capability to manage risk in a well-controlled manner. A comprehensive set of policies, procedures and processes have been developed and implemented to identify, measure, report, monitor and control risk across Global Banking & Markets.

Trading market risk

For trading activities the standardised risk measure adopted is Value at Risk. From 1 January 2010, this has been calculated at a 99% confidence level over a one-day time horizon in accordance with the standard used throughout Santander. Prior to this date, a 95% confidence level was used. On a daily basis, market risk factor sensitivities, Value at Risk measures and stress tests are produced, reported and monitored against limits for each major activity and at the aggregate Global Banking & Markets level. These limits are used to align risk appetite with the business' risk-taking activities and are reviewed on a regular basis.

Measurement of risks can involve the use of complex quantitative methods and mathematical principles to model and predict the changes in instruments and portfolio valuation. These methods are essential tools to understand the risk exposures. Trading market risk exposure arises only in the Abbey National Treasury Services plc group. Exposures are managed on a continuous basis, and are marked to market daily.

The following table shows the Value at Risk-based consolidated exposures for the major risk classes as at 31 December 2009, together with the highest, lowest and average exposures for the year. Exposures within each risk class reflect a range of exposures associated with movements in that financial market. For example, interest rate risks include the impact of absolute rate movements, movements between interest rate bases and movements in implied volatility on interest rate options. The range of possible statistical modelling techniques and assumptions mean these measures are not precise indicators of expected future losses, but are estimates of the potential change in the value of the portfolio over a specified time horizon and within a given confidence interval. Historical simulation models are used with appropriate add-ons to reflect unobservable inputs.

From time to time, losses may exceed the amounts stated where the movements in market rates fall outside the statistical confidence interval used in the calculation of the value at risk analysis. The 95% confidence interval means that the theoretical loss at a risk factor level is likely to be exceeded in one period in twenty. This risk is addressed by monitoring stress-testing measures across the different business areas. For trading instruments the actual, average, highest and lowest value at risk exposures shown below are all calculated to a 95% level of confidence using a simulation of actual one day market movements over a one-year period. The effect of historic correlations between risk factors is additionally shown below. The use of a one-day time horizon for all risks associated with trading instruments reflects the horizon over which market movements will affect the measured profit and loss of these activities.

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

	Actual Exposure at 31 December		
Group trading instruments	**2009 £m**	2008 £m	2007 £m
Interest rate risks	**2.4**	5.3	3.0
Equity risks	**1.0**	1.2	2.2
Spread risks	**1.1**	1.9	1.9
Property risks	**6.0**	6.8	3.4
Other risks[1]	**0.4**	0.9	0.3
Correlation offsets[2]	**(2.3)**	(2.5)	(2.3)
Total correlated one-day Value at Risk	**8.6**	13.6	8.5

	Exposure for the year ended 31 December								
	Average exposure			Highest exposure			Lowest exposure		
Group trading instruments	**2009 £m**	2008 £m	2007 £m	**2009 £m**	2008 £m	2007 £m	**2009 £m**	2008 £m	2007 £m
Interest rate risks	**3.9**	3.6	1.7	**6.2**	5.6	3.7	**1.6**	2.5	0.9
Equity risks	**1.4**	2.0	2.4	**2.7**	3.5	3.7	**0.8**	1.0	1.6
Spread risks	**2.5**	1.3	0.9	**3.4**	2.8	2.0	**1.1**	0.5	0.4
Property risks	**6.1**	4.7	2.3	**6.9**	7.4	3.5	**5.5**	3.2	1.0
Other risks[1]	**0.7**	0.6	0.3	**1.0**	1.0	1.2	**0.3**	0.2	0.1
Correlation offsets[2]	**(3.1)**	(2.2)	(1.6)	**-**	-	-	**-**	-	-
Total correlated one-day Value at Risk	**11.5**	10.0	6.0	**14.0**	14.5	8.8	**8.3**	8.0	4.1

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

Property risks have increased over the last two years. The largest factor in the Value at Risk increase is from an equity release business funded by the Group, as total equity advances increased over the three-year period. A secondary factor is the significant fall in interest rates in the same period. The present value of all the cash flows has increased significantly as a result of the lower discount rates, increasing sensitivity and hence Value at Risk.

Derivatives held for Trading Purposes

Global Banking & Markets is the only area of the Group actively trading derivative products and is additionally responsible for implementing most Group derivative hedging with the external market. For trading activities, Global Banking & Markets objectives are to gain value by marketing derivatives to end users and hedging the resulting exposures efficiently; and the management of trading exposure reflected on the Group's balance sheet. Trading derivatives include interest rate, cross currency, equity, 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.

Credit Derivatives

Previously, Global Banking & Markets also operated a credit derivatives business. The business traded in single-name credit derivatives, credit derivative indices and a limited number of portfolio credit derivative transactions. The credit derivatives trading function operated within the same framework as other trading functions. Risk limits were established and monitored. Given the lack of activity in the credit markets in 2007 and early 2008, the business was closed and its activities consolidated in Spain with the equivalent Banco Santander, S.A. business area with effect from 1 January 2008. Any residual positions have been hedged with Banco Santander, S.A..

Risk Management in Private Banking

Credit risk in Private Banking

Cater Allen

Cater Allen provides a limited range of products to assist with the finance requirements of individuals and businesses. Risk management policies are specific to and reflect the risks inherent in each product set. Approval processes for credit risk include the use of judgement, assisted by the use of credit scoring and credit ratings. Cater Allen operates within policies and authority levels approved by the Chief Risk Officer. Cater Allen has a dedicated risk team, reflecting the desire for risk control to be close to the business needs and risks.

The following table presents Cater Allen's estimated maximum exposure to credit risk at the reporting date without taking account of any collateral held or other credit enhancements:

	2009 £m	2008 £m
Loans and advances to customers	**3.1**	3.8
Other	**0.2**	0.2
Third party exposures	**3.3**	4.0

Abbey International

Abbey International's office is in Jersey, with a focus on attracting deposits by offering a range of savings accounts denominated in sterling, US dollars and euros. There is no credit risk associated in taking deposits.

Alliance & Leicester International

Alliance & Leicester International's office is in the Isle of Man, with a focus on attracting deposits by offering a range of savings accounts denominated in sterling, US dollars and euros. There is no credit risk associated in taking deposits.

Bradford & Bingley International

Bradford & Bingley International Limited is based in the Isle of Man with a focus on attracting deposits from both retail and corporate customers via savings accounts predominantly denominated in sterling. There is no credit risk associated in taking deposits.

James Hay

James Hay provides administration services for self-invested pension plans and the WRAP portfolio management product to end customers mainly via independent financial advisers and branded financial service providers. With the exception of fees receivable, there is no credit risk associated with this type of service. On 10 March 2010, Santander Private Banking UK Limited completed the disposal of James Hay Holdings Limited, together with its five subsidiary companies, by the sale of 100% of James Hay Holdings Limited's shares to IFG UK Holdings Limited, a subsidiary of IFG Group for a cash consideration of approximately £39m. The IFG Group provides independent financial advisory, fund management and pension administration services in Ireland and the UK.

Abbey Stockbrokers

Abbey Stockbrokers Limited, trading as Abbey Sharedealing, provides a direct share dealing service to customers. Customers buy and sell shares on their account with the help of the dealers at Abbey Stockdealing. No advice is provided and all trades are on an execution only basis, account customers are required to provide funds before settlement. As such there is no credit risk associated with this type of activity.

Risk Management continued

Market risk in Private Banking

Market risk arises from exposures to changes in the levels of interest rates, foreign exchange rates and equity markets. Market risk arises through the provision of retail and other banking products and services, as well as structural exposures arising in the balance sheet of the entities in Private Banking.

Managing market risk

Market risks in Private Banking arising from exposure to changes in the levels of interest rates and foreign exchanges rates are substantially transferred from the original business to ALM. Risks not transferred are managed within a series of market risk mandates, which set triggers for reporting on the extent of market risk that may be retained. These limits are defined in terms of nominal amounts, sensitivity, earnings-at-risk or value-at-risk. The permitted retained market risk exposure is minimal. Market risks arising from structured products, including exposure to changes in the levels of equity markets, are hedged with Global Banking & Markets. It is the current intention for market risk from some structured products to be retained within Private Banking, after the implementation of further market risk controls and processes.

Risk Management in Group Infrastructure

Group Infrastructure consists of ALM, which is also responsible for Group Capital and Funding, as well as the Treasury asset portfolio. ALM is responsible for managing the Group's structural balance sheet shape and, in conjunction with Risk Division, tactical liquidity risk management. This includes short-term and medium-term funding, covered bond and securitisation programmes. ALM's responsibilities also include Retail Banking's product and structural exposure to interest rates and, in that role, is a link between the Retail Banking and Global Banking & Markets. ALM recommends and helps to implement Board, Asset and Liability Management Committee and Risk Committee policies for all aspects of balance sheet management - formulating guidance for, and monitoring, the overall balance sheet shape, including maturity profile. Group Capital represents the return on the Group's capital, reserves, preference shares and subordinated debt. Funding represents the provision of funding, both to other businesses within the Group and to fellow subsidiaries of Banco Santander, S.A..

Credit risk in Group Infrastructure

Credit risk is the risk that counterparties will not meet their financial obligations resulting in Group Infrastructure losing the monies lent, including any interest accrued, or having to close out transactions prematurely, which may incur losses after realising collateral held. Credit risk arises by Group Infrastructure making loans, investing in debt securities or other financial instruments or entering into financing transactions or derivative contracts.

Managing credit risk

Credit risk arises in Group Infrastructure with respect to the division's holdings of externally rated asset-backed securities and residential mortgage-backed securities principally issued by Santander Group entities, bank floating rate notes, other assets held for liquidity purposes, and lending to fellow subsidiaries of the Santander Group.

All credit risk meets the criteria approved by the Board in respect to risk appetite parameters and all exposure, including intra-group, is captured on the global risk management systems and falls within limits approved by Santander Risk Division. The exposure is managed by the Group's Wholesale Risk Team.

Group Infrastructure net exposure by credit rating of the issuer or counterparty(1)

	2009 £m	2008 £m
AAA	**10,130**	17,994
AA	**7,540**	10,662
A	**10,531**	12,429
BBB+	**2,507**	1,174
BBB	**375**	789
Below BBB	**430**	440
D	**-**	10
Total	**31,513**	43,498

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

Risks are managed in accordance with limits, asset quality plans and criteria set out in the relevant policy statement. Decisions are based on independent credit risk analysis, supplemented by the output of internal ratings tools and external rating agency analysis. An internal ratings model is used to grade financial institution exposures and to generate probability of default and expected loss. The Group uses external ratings supplemented by internal analysis to assess the risks associated with structured credit and securitisation investments. Individual exposures are reviewed at least annually. Asset quality monitoring is reported by regular executive and management reporting, and exception reporting against a range of asset quality triggers, which include expected loss analysis.

The Treasury asset portfolio is monitored for potential impairment as soon as an event occurs to suggest a counterparty's creditworthiness merits attention. Once specific events give rise to a reasonable expectation that future anticipated cash flows may not be received, the asset originating these doubtful cash flows will be deemed to be impaired.

For structured investment vehicles ('SIVs'), Collateralised Debt Obligations ('CDOs') and Collateralised Loan Obligations ('CLOs') impairment is deemed to have occurred when one or more of the following events have occurred:

- the vehicle has realised losses arising from sale of assets that make it probable that the note-holders will not receive principal and base coupon in full;
- the vehicle has been restructured and the terms of the restructuring make it probable that the note-holders will not receive principal and base coupon in full;
- the Group expects to participate in a restructuring or refinancing of the vehicle which has been proposed by the vehicle's manager or sponsor and the likely terms make it probable that the note-holders will not receive principal and base coupon in full;
- the vehicle has entered into enforcement; or
- the funding and market conditions are such that the vehicle is expected either to sell assets or restructure such that it is probable that the note-holders will not receive principal and base coupon in full.

CDOs containing sub-prime US mortgage assets and other structured credit assets are deemed impaired if estimated losses on the underlying assets exceed the level of credit support. Asset backed securities are assessed on an individual basis.

Market risk in Group Infrastructure

Most market risks arising from the Retail Banking, Corporate Banking, and Private Banking divisions are transferred from the originating business to the ALM function within Group Infrastructure, where they can be managed in conjunction with exposures arising from the funding, liquidity or capital management activities of ALM. As a consequence, non-trading risk exposures are substantially transferred to Group Infrastructure. Market risks mainly arise through the provision of banking products and services to personal and corporate/business customers, as well as structural exposures arising in the Group's balance sheet. These risks impact the Group's current earnings and economic value.

The most significant market risks in Group Infrastructure are interest rate and credit spread risks. Yield curve risk arises from the timing mismatch in the repricing of fixed and variable rate assets, liabilities and off-balance sheet instruments, as well as the investment of non-interest-bearing liabilities in interest-bearing assets. Credit spread risk arises principally on Group Infrastructure's holdings of mortgage-backed securities.

Basis risk arises, to the extent that the volume of administered variable rate assets and liabilities are not precisely matched, which exposes the balance sheet to changes in the relationship between administered rates and market rates.

The Group is also exposed to risks arising from features in retail products that give customers the right to alter the expected cash flows of a financial contract. This creates prepayment risk, for example where customers may prepay loans before their contractual maturity. In addition, the Group is exposed to product launch risk, for example where the customers may not take up the expected volume of new fixed rate mortgages or other loans.

Managing market risk

The Asset and Liability Management Committee is responsible for managing the Group's overall balance sheet position. Natural offsets are used as far as possible to mitigate yield curve exposures but the overall balance sheet position is generally managed using derivatives that are transacted through Global Banking & Markets. The Treasurer, Head of ALM is responsible for managing risks in accordance with the Asset and Liability Management Committee's direction.

Risks are managed within limits approved either by the Head of Wholesale Risk or Banco Santander, S.A.'s Board Risk Committee, and within the risk control framework defined by the Market Risk Manual. The key risk limits relate to yield curve risk. They are:

- Net Interest Margin sensitivity: the sensitivity of annual net interest margin to an instantaneous and unexpected adverse 100 basis point parallel shock to the yield curve.
- Market Value of Equity sensitivity: the sensitivity of the net present value of interest rate sensitive positions to an instantaneous and unexpected adverse 100 basis point parallel shock to the yield curve.

These two measures provide complementary views of potential losses from interest rate movements. Market Value of Equity sensitivity provides a long-term view covering the present value of all future cash flows, whereas Net Interest Margin sensitivity considers only the impact on net interest margin over the next 12 months. Calculation of these two measures requires modelling of expected customer and other behaviours. These models are regularly reviewed and updated.

The following table shows the results of these measures as at 31 December 2009 and 2008:

	2009 **£m**	2008 £m
Net interest margin sensitivity (100 basis points adverse parallel shock)	**(38)**	(64)
Market value of equity sensitivity (100 basis points adverse parallel shock)	**2**	(153)

Market risk on the Group's Santander-issued mortgage-backed securities portfolio is managed against credit spread triggers approved by the Head of Wholesale Risk and sensitivity analysis is disclosed in Note 49 to the Consolidated Financial Statements.

Risk Management continued

Derivatives

Derivative financial instruments ('derivatives') are contracts or agreements whose value is derived from one or more underlying indices or asset values inherent in the contract or agreement, which require no or little initial net investment and are settled at a future date. They include interest rate, cross-currency and equity related swaps, forward rate agreements, caps, floors, options and swaptions (see below). In Group Infrastructure, derivatives are used for economic hedging.

All derivatives are classified as held at fair value through profit or loss. For accounting purposes under IFRS, the Group chooses to designate certain derivatives as in a hedging relationship if they meet specific criteria set out in IAS 39 "Financial Instruments: Recognition and measurement".

The main hedging derivatives are interest rate and cross-currency swaps, which are used to hedge fixed-rate lending and structured savings products and medium-term note issuances, capital issuances and other capital markets funding.

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

The following table summarises the activities undertaken within Group Infrastructure, the related risks associated with such activities and the types of hedging derivatives used in managing such risks. These risks may also be managed using on-balance sheet instruments as part of an integrated approach to risk management. Further information is contained in Note 13 to the Consolidated Financial Statements.

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

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

Impact of the Current Credit Environment

The Group aims to actively manage its exposure to financial institutions and non-bank financial institutions such as pension and investment funds, monoline insurers and general insurers. This exposure arises from investment in floating rate notes, short-term money market placements, derivative transactions and margin posting on securities borrowing transactions.

At 31 December 2009, the Group is not exposed to sovereign debt of countries currently experiencing liquidity problems. The Group has exposure to banks in those countries limited to a £13m (2008: £13m) exposure through a Floating Rate Note issued by a bank in Dubai and a £36m exposure to a bank in Greece (2008: £187m). Since the balance sheet date, exposure to banks in Greece has reduced to £5m.

Details of the Group's investing and lending arrangements with respect to floating rate notes ('FRNs'), asset-backed securities ('ABS') including mortgage-backed securities ('MBS'), Collateralised Debt Obligations ('CDOs'), Collateralised Loan Obligations ('CLOs'), Structured Investment Vehicles ('SIVs'), monoline insurers, off-balance sheet entities, other holdings for liquidity purposes, and lending activities are set out below.

Classification in the Consolidated Balance Sheet

The classification of these assets in the Group consolidated balance sheet is as follows:

2009		Type of Financial Instrument analysed further						OECD Govt	Bank & building	
	Note	FRNs	ABS	CDO	CLO	Other	Sub-total	debts	society CDs	Total
Balance sheet line item		£m	£m	£m	£m	£m	£m	£m	£m	£m
Trading assets – debt securities	12	**11,128**	-	-	-	**13**	**11,141**	**2,856**	**1,935**	**15,932**
Financial assets designated at fair value – debt securities	14	-	**3,446**	**50**	-	**263**	**3,759**	-	**2,220**	**5,979**
Available for sale – debt securities	18	-	-	-	-	-	-	**749**	-	**749**
Loans and receivables securities	19	**6,749**	**2,245**	**80**	**639**	**185**	**9,898**	-	-	**9,898**
		17,877	**5,691**	**130**	**639**	**461**	**24,798**	**3,605**	**4,155**	**32,558**

2008		Type of Financial Instrument analysed further						OECD Govt	Bank and building	
	Note	FRNs	ABS	CDO	CLO	Other	Sub-total	debts	society CDs	Total
Balance sheet line item		£m	£m	£m	£m	£m	£m	£m	£m	£m
Trading assets – debt securities	12	5,277	-	-	-	-	5,277	3,139	8,385	16,801
Financial assets designated at fair value – debt securities	14	-	4,690	-	-	-	4,690	-	-	4,690
Available for sale – debt securities	18	-	-	-	-	-	-	2,618	-	2,618
Loans and receivables securities	19	9,936	3,507	164	321	179	14,107	-	-	14,107
		15,213	8,197	164	321	179	24,074	5,757	8,385	38,216

Additional analysis is presented below of the above financial instruments, except for the category "OECD Govt debts" and "Bank & building society CDs". Further detail on those assets is set out in Note 12 to the Consolidated Financial Statements.

Summary

2009				2009 movement[1]		
	Nominal	Book value	Fair value	Income statement	Reserves	Provisions[1]
	£m	£m	£m	£m	£m	£m
Floating rate notes	**17,932**	**17,877**	**17,787**	**137**	**(89)**	**(4)**
Asset backed securities	**5,893**	**5,691**	**5,424**	**103**	**(118)**	**(15)**
Collateralised debt obligations	**215**	**130**	**130**	**(11)**	**(4)**	**(3)**
Collateralised loan obligations	**703**	**639**	**606**	**(1)**	**(20)**	-
Other investments	**466**	**461**	**462**	**16**	-	**(4)**
	25,209	**24,798**	**24,409**	**244**	**(231)**	**(26)**

2008				2008 movement[1]		
	Nominal	Book value	Fair value	Income statement	Reserves	Provisions[1]
	£m	£m	£m	£m	£m	£m
Floating rate notes	15,234	15,213	14,731	(25)	-	-
Asset backed securities	8,373	8,197	7,167	(328)	-	-
Collateralised debt obligations	366	164	130	-	-	-
Collateralised loan obligations	352	321	247	-	-	-
Other investments	197	179	187	(2)	-	-
	24,522	24,074	22,462	(355)	-	-

(1) Amounts in respect of assets held at the balance sheet date i.e. not including amounts relating to assets sold during the year.

Risk Management continued

Fair value of debt securities by credit rating of the issuer or counterparty(1)

2009	FRNs £m	Other £m	Total £m
AAA	10,486	4,474	14,960
AA+	83	-	83
AA	2,271	749	3,020
A	3,803	778	4,581
BBB	550	168	718
Below BBB	594	191	785
Unrated	-	262	262
Total	**17,787**	**6,622**	**24,409**

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

2008	FRNs £m	Other £m	Total £m
AAA	-	6,993	6,993
AA+	-	266	266
AA	6,475	289	6,764
A	7,307	94	7,401
BBB	661	30	691
Below BBB	288	59	347
Total	14,731	7,731	22,462

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

Floating Rate Notes

(a) Fair value movements by geographical location of issuer or counterparty

2009

	Nominal value		Book value	Fair value	Fair value as % of nominal	2009 movement		
						Income statement	Reserves	Provisions
Country	£m	%	£m	£m	%	£m	£m	£m
UK	9,578	53	9,611	9,596	100	95	(11)	(4)
Italy	653	4	650	650	100	1	(4)	-
Spain	1,546	9	1,527	1,510	98	4	(20)	-
Rest of Europe	3,943	22	3,910	3,897	99	30	(29)	-
US	699	4	651	633	91	(4)	(20)	-
Rest of the world	1,513	8	1,528	1,501	99	11	(5)	-
Total	**17,932**	**100**	**17,877**	**17,787**	**99**	**137**	**(89)**	**(4)**

2008

	Nominal value		Book value	Fair value	Fair value as % of nominal	2008 Movement		
						Income statement	Reserves	Provisions
Country	£m	%	£m	£m	%	£m	£m	£m
UK	3,093	20	3,107	3,069	99	(4)	-	-
Italy	1,316	9	1,314	1,288	98	(1)	-	-
Spain	2,860	19	2,831	2,744	96	(2)	-	-
Rest of Europe	5,115	34	5,160	5,016	98	(15)	-	-
US	1,102	7	1,057	934	85	-	-	-
Rest of the world	1,748	11	1,744	1,680	96	(3)	-	-
Total	15,234	100	15,213	14,731	97	(25)	-	-

(b) Fair value movements by credit rating of issuer or counterparty

2009

	Nominal value		Book value	Fair value	Fair value as % of nominal	2009 movement		
						Income statement	Reserves	Provisions
Credit rating	£m	%	£m	£m	%	£m	£m	£m
AAA	10,422	58	10,486	10,486	101	136	-	-
AA+	83	-	83	83	100	-		
AA	2,297	13	2,270	2,271	99	3	(19)	-
A	3,925	22	3,865	3,802	97	(1)	(51)	-
BBB	589	3	570	551	94	-	(16)	-
Below BBB	616	4	603	594	96	(1)	(3)	(4)
Total	**17,932**	**100**	**17,877**	**17,787**	**99**	**137**	**(89)**	**(4)**

2008

	Nominal value		Book value	Fair value	Fair value as % of nominal	2008 Movement Income statement	Reserves	Provisions
Credit rating	£m	%	£m	£m	%	£m	£m	£m
AA and above	6,433	42	6,574	6,475	101	(17)	-	-
A	7,722	51	7,635	7,307	95	(8)	-	-
BBB	735	5	712	661	90	-	-	-
Below BBB	344	2	292	288	84	-	-	-
Total	15,234	100	15,213	14,731	97	(25)	-	-

The FRNs held are principally issued by banks and other financial institutions. On average, the FRNs have 18 months to maturity (2008: 23 months).

Structured Investment Vehicles

The Group has insignificant holdings in SIVs, with a nominal value of £14m (2008: £17m) against which provisions of £11m (2008: £12m) are held, giving a book value of £3m (2008: £5m). The SIVs are classified as floating rate notes in the balance sheet and included in the tables above.

Asset-Backed Securities

The Group has a portfolio of structured assets, which is diversified by issuer, underlying asset type and geography. Further details on structured asset exposures are set out in the tables below.

(a) Fair value movements by geographical location of issuer or counterparty

2009

	Nominal value		**Book value**	**Fair value**	**Fair value as % of nominal**	**2009 movement Income Statement**	**Reserves**	**Provisions**
Country	**£m**	**%**	**£m**	**£m**	**%**	**£m**	**£m**	**£m**
UK								
ABS	**142**	**2**	**141**	**140**	**99**	**-**	**-**	**-**
MBS	**912**	**16**	**878**	**791**	**87**	**2**	**(28)**	**-**
	1,054	**18**	**1,019**	**931**	**88**	**2**	**(28)**	**-**
US								
ABS	**553**	**9**	**506**	**483**	**87**	**(8)**	**(37)**	**-**
MBS	**292**	**5**	**218**	**125**	**43**	**(8)**	**(29)**	**(9)**
	845	**14**	**724**	**608**	**72**	**(16)**	**(66)**	**(9)**
Rest of Europe								
ABS	**300**	**5**	**288**	**283**	**94**	**14**	**(2)**	**(6)**
MBS	**3,542**	**60**	**3,511**	**3,463**	**98**	**104**	**(20)**	**-**
	3,842	**65**	**3,799**	**3,746**	**98**	**118**	**(22)**	**(6)**
Rest of the world								
MBS	**152**	**3**	**149**	**139**	**91**	**(1)**	**(2)**	**-**
Total	**5,893**	**100**	**5,691**	**5,424**	**92**	**103**	**(118)**	**(15)**

2008

	Nominal value		Book value	Fair value	Fair value as % of nominal	2008 movement Income Statement	Reserves	Provisions
Country	£m	%	£m	£m	%	£m	£m	£m
UK								
ABS	31	-	31	28	90	-	-	-
MBS	1,156	14	1,531	950	82	-	-	-
	1,187	14	1,562	978	82	-	-	-
US								
ABS	962	11	881	732	76	-	-	-
MBS	393	5	277	191	49	-	-	-
	1,355	16	1,158	923	68	-	-	-
Rest of Europe								
ABS	461	6	432	426	92	(23)	-	-
MBS	5,084	61	4,764	4,568	90	(305)	-	-
	5,545	67	5,196	4,994	90	(328)	-	-
Rest of the world								
ABS	36	-	36	34	94	-	-	-
MBS	250	3	245	238	95	-	-	-
	286	3	281	272	95	-	-	-
Total	8,373	100	8,197	7,167	86	(328)	-	-

Risk Management continued

(b) Vintage of asset-backed securities by geographical location of issuer or counterparty

2009	Nominal	Original credit enhancements	Original sub-prime exposure	Original vintage Pre-2005	2005	2006	2007	2008	2009
Country	£m	£m	£m	%	%	%	%	%	%
UK									
ABS	142	3	-	27	4	54	15	-	-
MBS	912	68	-	35	10	26	29	-	-
	1,054	71	-	34	9	30	27	-	-
US									
ABS	553	31	-	27	66	6	1	-	-
MBS	292	35	11	23	37	26	14	-	-
	845	66	11	26	56	13	5	-	-
Rest of Europe									
ABS	300	5	-	25	3	42	30	-	-
MBS	3,542	46	-	80	1	9	10	-	-
	3,842	51	-	76	1	11	12	-	-
Rest of the world									
MBS	152	6	-	34	3	3	60	-	-
Total	5,893	194	11	60	11	15	14	-	-

(c) Fair value movements by credit rating of issuer or counterparty

2009	Nominal value		Book value	Fair value	Fair value as % of nominal	2009 movement Income statement	Reserves	Provisions
Credit rating	£m	%	£m	£m	%	£m	£m	£m
AAA								
ABS	803	14	761	734	91	8	(32)	-
MBS	3,730	63	3,667	3,553	95	100	(42)	-
	4,533	77	4,428	4,287	95	108	(74)	-
AA								
ABS	10	-	8	7	70	-	(1)	-
MBS	364	6	348	313	86	2	(10)	-
	374	6	356	320	86	2	(11)	-
A								
ABS	56	1	51	50	89	(1)	(3)	-
MBS	582	10	574	564	97	1	(6)	-
	638	11	625	614	96	-	(9)	-
BBB								
ABS	67	1	66	65	98	-	(1)	-
MBS	51	1	42	34	67	(1)	(6)	-
	118	2	108	99	84	(1)	(7)	-
Below BBB								
ABS	59	1	49	49	83	(1)	(2)	(6)
MBS	171	3	125	55	32	(5)	(15)	(9)
	230	4	174	104	45	(6)	(17)	(15)
Total	5,893	100	5,691	5,424	92	103	(118)	(15)

2008	Nominal value		Book value	Fair value	Fair value as % of nominal	2008 movement Income statement	Reserves	Provisions
Credit rating	£m	%	£m	£m	%	£m	£m	£m
AAA								
ABS	1,404	17	1,316	1,163	83	(23)	-	-
MBS	6,336	75	6,084	5,544	88	(266)	-	-
	7,740	92	7,400	6,707	87	(289)	-	-
AA+								
ABS	11	-	10	10	91	(1)	-	-
MBS	300	4	256	256	85	(38)	-	-
	311	4	266	266	86	(39)	-	-
AA								
ABS	18	-	15	12	67	-	-	-
MBS	91	1	107	50	55	-	-	-
	109	1	122	62	57	-	-	-
A								
ABS	83	1	67	59	71	-	-	-
MBS	38	-	283	18	47	-	-	-
	121	1	350	77	64	-	-	-
BBB								
ABS	17	-	12	12	71	-	-	-
MBS	33	1	22	12	36	-	-	-
	50	1	34	24	48	-	-	-
Below BBB								
MBS	42	1	25	31	74	-	-	-
	42	1	25	31	74	-	-	-
Total	8,373	100	8,197	7,167	86	(328)	-	-

The fair value movements above exclude the effects of changes in foreign exchange rates.

(d) Vintage of asset-backed securities by credit rating of issuer or counterparty

2009	Nominal	Original credit enhancements	Original sub-prime exposure	Original vintage Pre-2005	2005	2006	2007	2008	2009
Credit rating	£m	£m	£m	%	%	%	%	%	%
AAA									
ABS	803	37	-	27	45	18	10	-	-
MBS	3,730	115	-	71	4	9	16	-	-
	4,533	152	-	63	11	11	15	-	-
AA									
ABS	10	1	-	29	41	30	-	-	-
MBS	364	15	6	5	6	65	24	-	-
	374	16	6	6	7	63	24	-	-
A									
ABS	56	1	-	-	-	100	-	-	-
MBS	582	3	-	95	3	-	2	-	-
	638	4	-	86	3	9	2	-	-
BBB									
ABS	67	-	-	55	-	11	34	-	-
MBS	51	4	-	49	40	11	-	-	-
	118	4	-	53	17	11	19	-	-
Below BBB									
ABS	59	-	-	-	27	47	26	-	-
MBS	171	18	6	22	23	35	20	-	-
	230	18	6	16	24	38	22	-	-
Total	5,893	194	12	60	11	15	14	-	-

Included in the tables above are holdings of ALT-A US asset-backed securities of £107m.

The following table shows the vintages of the collateral assets supporting the Group's holdings of asset-backed securities and mortgage-backed securities at 31 December 2009.

Asset Type	Nominal	Original vintage Pre-2005	2005	2006	2007	2008	2009
	£m	%	%	%	%	%	%
Prime lending	5,663	61	10	15	14	-	-
ALT-A	224	34	40	17	9	-	-
Sub-prime	6	-	-	-	100	-	-
Total	5,893	60	11	15	14	-	-

Monoline Insurers

The Group has a £219m (2008: £255m) exposure to securitisations which are wrapped by monoline insurers. The principal risk exposures are recorded against the securitisations, with the monoline wraps being viewed as contingent exposures. The exposures to monoline insurers are classified as asset-backed securities in the balance sheet and are included in the tables above.

Collateralised Debt Obligations

(a) Fair value movements by geographical location of issuer or counterparty

2009	Nominal value		Book value	Fair value	Fair value as % of nominal	2009 movement Income statement	Reserves	Provision	Original exposure to sub-prime	Original Credit enhancement
Country	£m	%	£m	£m	%	£m	£m	£m	%	%
UK	-	-	-	-	-	-	-	-	-	-
Rest of Europe	2	1	2	2	100	(1)	-	-	-	-
US	212	99	127	127	60	(10)	(4)	(3)	11	30
Rest of the world	1	-	1	1	100	-	-	-	-	-
Total	215	100	130	130	60	(11)	(4)	(3)	11	30

2008	Nominal value		Book value	Fair value	Fair value as % of nominal	2008 movement Income statement	Reserves	Provision	Original exposure to sub-prime	Original Credit enhancement
Country	£m	%	£m	£m	%	£m	£m	£m	%	%
UK	24	7	17	13	54	-	-	-	-	27
Rest of Europe	3	1	3	4	133	-	-	-	-	-
US	339	92	144	113	33	-	-	-	21	28
Rest of the world	-	-	-	-	-	-	-	-	-	-
Total	366	100	164	130	36	-	-	-	19	27

Risk Management continued

(b) Vintage of collateralised debt obligations by geographical location of issuer or counterparty

2009	Nominal	Original credit enhancements	Original sub-prime exposure	Original vintage Pre-2005	2005	2006	2007	2008	2009
Country	£m	£m	£m	%	%	%	%	%	%
ABS CDO									
UK	-	-	-	-	-	-	-	-	-
Rest of Europe	2	-	-	50	50	-	-	-	-
US	48	15	14	33	65	2	-	-	-
	50	15	14	34	64	2			
Synthetic CDO									
US	95	11	-	100	-	-	-	-	-
	95	11	-	100	-	-	-	-	-
Other CDO									
US	70	8	1	38	5	24	33	-	-
	70	8	1	38	5	24	33	-	-
Total	215	34	15	64	17	8	11	-	-

(c) Fair value movements by credit rating of issuer or counterparty

2009	Nominal value		Book value	Fair Value	Fair value as % of nominal	2009 movement Income statement	Reserves	Provisions	Original exposure to sub-prime	Original credit enhancement
Credit rating	£m	%	£m	£m	%	£m	£m	£m	%	%
AAA	16	7	8	8	50	(1)	-	-	-	26
AA	64	30	48	48	75	(1)	(4)	-	1	13
A	17	8	7	7	41	(1)	-	-	10	-
BBB	23	11	15	15	65	(1)	-	-	1	1
Below BBB	95	44	52	52	55	(7)	-	(3)	6	2
Total	215	100	130	130	60	(11)	(4)	(3)	4	7

2008	Nominal value		Book value	Fair Value	Fair value as % of nominal	2008 movement Income statement	Reserves	Provisions	Original exposure to sub-prime	Original credit enhancement
Credit rating	£m	%	£m	£m	%	£m	£m	£m	%	%
AAA	147	40	91	75	51	-	-	-	1	34
AA	38	10	18	17	45	-	-	-	10	35
A	11	3	4	4	36	-	-	-	13	23
BBB	18	5	7	6	33	-	-	-	14	8
Below BBB	152	42	44	28	18	-	-	-	41	21
Total	366	100	164	130	36	-	-	-	19	27

(d) Vintage of collateralised debt obligations by credit rating of issuer or counterparty

2009	Nominal	Original credit enhancements	Original sub-prime exposure	Original vintage Pre-2005	2005	2006	2007	2008	2009
Credit rating	£m	£m	£m	%	%	%	%	%	%
ABS CDO									
AAA	12	6	-	-	100	-	-	-	-
AA	12	3	2	100	-	-	-	-	-
A	1	-	-	100	-	-	-	-	-
BBB	5	1	2	100	-	-	-	-	-
Below BBB	20	5	10	-	95	5	-	-	-
	50	15	14	35	63	2	-	-	-
Synthetic CDO									
AAA	-	-	-	-	-	-	-	-	-
AA	-	-	-	-	-	-	-	-	-
A	15	1	-	100	-	-	-	-	-
BBB	16	3	-	100	-	-	-	-	-
Below BBB	64	7	-	100	-	-	-	-	-
	95	11	-	100	-	-	-	-	-
Other CDO									
AAA	3	1	-	67	-	33	-	-	-
AA	51	7	1	39	-	11	50	-	-
A	1	-	-	-	100	-	-	-	-
BBB	2	-	-	50	50	-	-	-	-
Below BBB	13	-	-	31	-	69	-	-	-
	70	8	1	39	3	22	36	-	-
Total	215	34	15	64	17	8	11	-	-

In addition, in the ordinary course of business, the Group entered into long-term interest rate hedging contracts with five investment vehicles whose underlying assets comprise debt securities, bank loans and energy and infrastructure financings. Although the vehicles themselves are not externally rated, the counterparty exposure ranks super-senior to the most senior notes issued by the vehicles and these notes are rated AAA or AA. The total mark-to-market exposure at 31 December 2009 was £100m (2008: £186m).

Collateralised Loan Obligations

(a) Fair value movements by geographical location of issuer or counterparty

2009

	Nominal value		Book value	Fair value	Fair value as % of nominal	2009 movement Income statement	Reserves	Provisions
Country	**£m**	**%**	**£m**	**£m**	**%**	**£m**	**£m**	**£m**
UK	**93**	**13**	**87**	**82**	**88**	**(1)**	**(4)**	**-**
Rest of Europe	**42**	**6**	**36**	**28**	**67**	**-**	**(5)**	**-**
US	**568**	**81**	**516**	**496**	**87**	**-**	**(11)**	**-**
Total	**703**	**100**	**639**	**606**	**86**	**(1)**	**(20)**	**-**

2008

	Nominal value		Book value	Fair value	Fair value as % of nominal	2008 movement Income statement	Reserves	Provisions
Country	£m	%	£m	£m	%	£m	£m	£m
UK	115	33	108	94	82	-	-	-
Rest of Europe	47	13	41	30	64	-	-	-
US	190	54	172	123	65	-	-	-
Total	352	100	321	247	70	-	-	-

(b) Vintage of collateralised loan obligations by geographical location of issuer or counterparty

2009

	Nominal	Original credit enhancements	Original sub-prime exposure	Original vintage Pre-2005	2005	2006	2007	2008	2009
Country	**£m**	**£m**	**£m**	**%**	**%**	**%**	**%**	**%**	**%**
UK	**93**	**13**	**-**	**14**	**59**	**14**	**13**	**-**	**-**
Rest of Europe	**42**	**8**	**-**	**22**	**5**	**42**	**31**	**-**	**-**
US	**568**	**122**	**-**	**82**	**4**	**10**	**4**	**-**	**-**
Total	**703**	**143**	**-**	**70**	**11**	**12**	**7**	**-**	**-**

(c) Fair value movements by credit rating of issuer or counterparty

2009

	Nominal value		Book value	Fair value	Fair Value as % of nominal	2009 movement Income statement	Reserves	Provisions
Credit rating	**£m**	**%**	**£m**	**£m**	**%**	**£m**	**£m**	**£m**
AAA	**202**	**29**	**185**	**176**	**87**	**(1)**	**(6)**	**-**
AA	**254**	**36**	**225**	**218**	**86**	**-**	**(1)**	**-**
A	**181**	**26**	**161**	**157**	**87**	**-**	**(4)**	**-**
BBB	**56**	**8**	**49**	**39**	**70**	**-**	**(7)**	**-**
Below BBB	**10**	**1**	**19**	**16**	**160**	**-**	**(2)**	**-**
Total	**703**	**100**	**639**	**606**	**86**	**(1)**	**(20)**	**-**

2008

	Nominal value		Book value	Fair value	Fair Value as % of nominal	2008 movement Income Statement	Reserves	Provisions
Credit rating	£m	%	£m	£m	%	£m	£m	£m
AAA	276	78	257	211	76	-	-	-
AA	42	12	36	23	55	-	-	-
A	30	9	26	13	43	-	-	-
BBB	4	1	2	-	-	-	-	-
Below BBB	-	-	-	-	-	-	-	-
Total	352	100	321	247	70	-	-	-

Risk Management continued

(d) Vintage of collateralised loan obligations by credit rating of issuer or counterparty

2009	Nominal	Original credit enhancements	Original sub-prime exposure	Original vintage					
				Pre-2005	2005	2006	2007	2008	2009
Credit rating	£m	£m	£m	%	%	%	%	%	%
AAA	202	40	-	43	28	24	5	-	-
AA	254	50	-	92	6	2	-	-	-
A	181	38	-	84	-	8	8	-	-
BBB	56	12	-	24	-	34	42	-	-
Below BBB	10	1	-	70	30	-	-	-	-
Total	703	141	-	70	11	12	7	-	-

Other investments

	Book value 2009 £m	Fair value 2009 £m	Book value 2008 £m	Fair value 2008 £m
Principal Protected Notes	24	26	34	31
Other	437	436	145	156
	461	462	179	187

The Principal Protected Notes are backed by highly rated bank counterparties and are due to mature by the end of 2016. Other investments of £437m (2008: £145m) consisted primarily of Corporate lending transactions that were completed by Corporate Banking.

Exposure to Off-Balance Sheet Entities sponsored by the Group

Secured Loan to Conduit

The Group's Conduit facility is funded by the Group via secured loans. Prior to 2009, the Conduit was not consolidated into the Group accounts on the basis that the Special Purpose Entities ('SPEs') within the Conduit were not controlled by the Group. However, in the second half of 2009, the Group took an active role in the management of the Conduit's assets. Although there has been no change in the terms and conditions of the Group's loans to the Conduit, management has concluded that the Group is now required to consolidate the assets of the Conduit vehicles, rather than recognising the loans to the Conduit vehicles and treating the assets of the Conduit vehicles as off-balance sheet.

Consolidation of the assets of the Conduit vehicles has not had a significant impact on the Group's income statement and balance sheet. The assets of the Conduit vehicles consist of ABS (including Alt-A US residential mortgage-backed securities), CLOs and CDOs, and are consolidated in the respective tables above as at 31 December 2009.

The underlying assets within the Conduit vehicles at 31 December 2008 analysed by asset type and credit rating were as follows:

31 December 2008

Asset Type	Credit rating	Nominal	Cumulative Impairment	Original credit enhancement	Original sub-prime exposure	Original vintage Pre-2005	2005	2006	2007
		£m	£m	%	%	%	%	%	%
ABS									
US RMBS	AAA	46	-	32	-	39	61	-	-
(ALT-A)	AA	5	-	18	-	100	-	-	-
	Below BBB	-	-	-	-	-	-	-	-
Total ABS		51	-	30	-	45	55	-	-
CLO									
	AAA	442	-	24	-	99	-	-	1
	AA	33	-	29	-	82	18	-	-
	A	30	-	26	-	100	-	-	-
Total CLO		505	-	24	-	98	1	-	1
CDO									
ABS CDO	AAA	19	-	24	36	100	-	-	-
	AA	26	-	28	44	100	-	-	-
	BBB	28	4	26	45	100	-	-	-
	Below BBB	45	17	30	65	100	-	-	-
		118	21	28	51	100	-	-	-
Synthetic CDO									
	AAA	27	-	19	-	-	100	-	-
	A	76	6	10	-	32	68	-	-
	BBB	17	14	10	-	-	100	-	-
	Below BBB	34	31	5	-	-	100	-	-
		154	51	10	-	16	84	-	-
Other									
	AAA	73	-	45	-	45	-	55	-
	AA	17	-	61	-	-	41	59	-
	A	11	-	49	-	-	100	-	-
		101	-	48	-	32	18	50	-
Total CDO		373	72	26	16	47	40	13	-
Total Conduit assets		929	72			74	19	6	1

The only other SPEs sponsored but not consolidated by the Group are SPEs which issue shares that back retail structured products. The Group's arrangements with these entities comprise the provision of equity derivatives and a secondary market-making service to those retail customers who wish to exit early from these products. The total value of products issued by the SPEs is £5,798m (2008: £3,213m), and the total value of repurchases held by the Group is £234m (2008: £254m).

Credit Derivatives

As noted above, previously, Global Banking & Markets operated a credit derivatives business. The business traded in single-name credit derivatives, credit derivative indices and a limited number of portfolio credit derivative transactions. The credit derivatives trading function operated within the same framework as other trading functions. Risk limits were established and monitored. There is a limited number of remaining credit derivative transactions with a nominal value of £772m (2008: £1.1bn) where the Group faces external counterparties and the risk has been hedged with Banco Santander, S.A. in Spain.

Lending Activities

The Group is principally a retail prime lender and has no appetite or product offering for sub-prime business. The Group's credit policy explicitly prohibits such lending and is specifically designed to ensure that any business written is responsible, affordable (both initially and an on-going basis) and of a good credit quality. The Group's principal lending activities arise in the Retail Banking division. For further information, see Risk Management in Retail Banking.

Liquidity

In addition to funding customer loans and advances, the Group also holds available liquid assets, in the form of cash and short-term deposits, to manage the day-to-day requirements of the business. The Group holds a higher level of liquid assets than in 2008, in recognition of the current market conditions.