2012 Half Yearly Financial Report

Abbey National Treasury Services plc

PART OF THE SANTANDER GROUP

Intentionally left blank

Abbey National Treasury Services plc
2012 Half Yearly Financial Report

Contents

Business and Financial Review – Interim Management Report

Forward-looking Statements 2
General Information 2
Introduction 3
Review of the development and performance of the business during the period 3
Key Performance Indicators 4
The position of the Group at the period end 4
Related Party Transactions 5
Principal Risks and Uncertainties 6

Financial Statements

Primary Financial Statements 8
Notes to the Condensed Financial Statements 11

Risk Factors 35

Guarantee 49

Shareholder Information
Directors' Responsibility Statement 52

Interim Management Report for the six months ended 30 June 2012

Forward-looking Statements

Abbey National Treasury Services plc (the 'Company') and its subsidiaries (together 'ANTS' or the 'Group') caution that this Half Yearly Financial Report may contain forward-looking statements. Section 27A of the U.S. Securities Act of 1933, as amended, and Section 21E of the U.S. Securities Exchange Act of 1934, as amended, contain a safe harbour for forward-looking statements on which we rely in making such statements in documents filed with the U.S. Securities and Exchange Commission. Forward-looking statements include, without limitation, financial projections or expectations, statements concerning our future business development and economic performance. Words such as "believes", "anticipates", "expects", "intends", "aims", "plans", "targets" and other similar expressions are intended to identify forward-looking statements, but they are not the exclusive means of identifying such statements. By their very nature, forward-looking statements are not statements of historical or current facts; they cannot be objectively verified, are speculative and involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. These forward-looking statements are based on management's current expectations, estimates and projections and the Company cautions that these statements are not guarantees of future performance. We also caution readers that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements. Some of these factors, which could affect the Group's business, financial condition and/or results of operations are described under 'Risk Factors' in the Group's 2011 Annual Report. A more detailed cautionary statement is also given on page 2 of the Group's 2011 Annual Report. Undue reliance should not be placed on forward-looking statements when making decisions with respect to ANTS and/or its securities. Investors and others should take into account the inherent risks and uncertainties of forward-looking statements and should carefully consider the factors mentioned above. Forward-looking statements speak only as of the date on which they are made and are based on the knowledge, information available and views taken on the date on which they are made. ANTS does not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise.

General Information

This announcement is not a form of statutory accounts. The information for the year ended 31 December 2011 does not constitute statutory accounts as defined in section 434 of the Companies Act 2006. A copy of the statutory accounts for that year has been delivered to the Registrar of Companies. The auditor's report on those accounts was unqualified, did not draw attention to any matters by way of emphasis and did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

This report is also available on the Santander Global Banking & Markets corporate website (www.santandergbm.com).

Introduction

The Directors submit their report together with the financial statements for the Company and its subsidiaries (together the 'Group') for the six months ended 30 June 2012.

The purpose of this report is to provide information to the members of the Company and as such it is only addressed to those members. The report may contain certain forward-looking statements with respect to the operations, performance and financial conditions of the Group. By their nature, these statements involve inherent risks and uncertainties since future events, circumstances and other factors can cause results and developments to differ materially from the plans, objectives, expectations and intentions expressed in such forward-looking statements. Members should consider this when relying on any forward-looking statements. The forward-looking statements reflect knowledge and information available at the date of preparation of this report and the Company undertakes no obligation to update any forward-looking statement during the period. Nothing in this report should be construed as a profit forecast.

Basis of results presentation

The information in this Business and Financial Review reflects the reporting structure in place at the reporting date in accordance with which the segmental information in Note 2 to the Condensed Consolidated Interim Financial Statements has been presented.

The Company's board of directors (the 'Board') is the chief operating decision maker for the Group. The segment information below is presented on the basis used by the Board to evaluate performance and allocate resources. The Board reviews discrete financial information for each segment of the business which follows the Group's normal accounting policies and principles, including measures of operating results, assets and liabilities.

In the first half of 2012, certain of the Santander UK group's non-core portfolios were transferred to Corporate Centre (formerly known as Group Infrastructure) where this was felt to be more appropriate for the management of these assets and liabilities. The non-core portfolios transferred into Corporate Centre included the Social Housing assets previously managed within Corporate Banking. With respect to these, even though there are no credit concerns, the terms of these loans are unfavourable in the current funding environment. The Group's intention is to hold these assets to maturity and as such the balances will gradually decrease over time. In addition, the management of hedging and other variances has been transferred to Corporate Centre.

The prior period's segmental analysis has been adjusted to reflect the fact that reportable segments have changed.

Review of the development and performance of the business during the period

The Company is required to set out in this report a fair review of the development and performance of the business of the Group during the six months ended 30 June 2012 and the position of the Group at the end of the period.

Summarised consolidated statutory income statement

	Six months ended 30 June 2012 £m	Six months ended 30 June 2011 £m
Net interest income	**(26)**	193
Non-interest income	**287**	218
Total operating income	**261**	411
Administrative expenses	**(105)**	(107)
Depreciation and amortisation	**(1)**	(3)
Total operating expenses excluding provisions and charges	**(106)**	(110)
Impairment losses on loans and advances	**(20)**	(37)
Total operating provisions and charges	**(20)**	(37)
Profit before tax	**135**	264
Taxation expense	**(15)**	(65)
Profit for the period	**120**	199

Profit before tax decreased by £129m to £135m (2011: £264m). Material movements by line include:

> Total operating income decreased by £150m to £261m (2011: £411m), primarily reflecting the increased cost of new medium-term funding issuances and higher costs of holding liquid assets.

> Administrative expenses decreased by £2m to £105m (2011: £107m). Reduced costs driven by efficiencies were largely offset by continued investment in growth initiatives.

> Depreciation and amortisation decreased by £2m to £1m (2011: £3m).

> Impairment losses on loans and advances decreased by £17m to £20m (2011: £37m) due to the credit quality of business written in the last three years continuing to perform better than expected to date.

Key performance indicators

Key performance indicators are set at the level of Santander UK plc and its subsidiaries ('Santander UK'), rather than separately for the Group. Detailed information of the key performance indicators of Santander UK, of which the Group is a part, is set out in the Business Review – Summary in the Santander UK plc 2011 Annual Report, which is available on the Santander UK corporate website (www.aboutsantander.co.uk).

Profit before tax by segment

This section contains a summary of the results, and commentary thereon, for each segment within the business.

	Six months ended 30 June 2012 £m	Six months ended 30 June 2011 £m
Corporate Banking	**113**	99
Markets	**79**	32
Corporate Centre	**(57)**	133
Profit before tax	**135**	264

Profit before tax decreased by £129m to £135m (2011: £264m). Material movements by segment consisted of:

> Corporate Banking profit before tax increased by £14m to £113m (2011: £99m). The key driver of the increase was continuing growth in corporate loans.

> Markets profit before tax increased by £47m to £79m (2011: £32m). Income increased largely due improvements in the Fixed Income business (especially in the first quarter) where there was a lack of highly profitable business in the market in the prior year. This was partially offset by an increase in administration expenses from continued investments in growth initiatives relating to new products, markets and customer segments.

> Corporate Centre profit before tax decreased by £190m to a loss of £57m (2011: profit of £133m). The decrease was primarily due to the increased cost of new term funding issuances and higher costs of holding liquid assets.

The position of the Group at the period end

Our balance sheet at 30 June 2012 is set out on page 9 of the Condensed Consolidated Interim Financial Statements. Net assets increased by 3% to £3,601m (31 December 2011: £3,500m). The main movements in the balance sheet items were:

> Trading assets increased by 50% to £32,833m (31 December 2011: £21,891m). The increase is mainly attributable to higher repurchase agreements activity during the period.

> Derivative assets increased by 1% to £33,520m (31 December 2011: £33,224m). The increase was driven by additional cross currency swaps entered during the period as a result of increased debt issuances offset by the negative effect of upward shifts in yield curves.

> Loans and advances to banks increased by 7% to £121,193m (31 December 2011: £113,222m). The increase was mainly attributable to increased amounts due from the immediate UK parent, Santander UK plc.

> Loans and advances to customers increased by 29% to £50,168m (31 December 2011: £38,826m). The increase was mainly attributable to increased lending to securitisation companies.

> Deposits by banks increased by 20% to £136,765m (31 December 2011: £114,019m). The increase was attributable to increased amount due to the immediate UK parent, Santander UK plc, arising mainly from funds received from debt issuances.

> Derivative liabilities decreased by 1% to £34,934m (31 December 2011: £35,417m). The decrease was driven by a decrease in the fair values of interest rate derivatives as a result of upward shifts in yield curves.

> Trading liabilities increased by 10% to £28,235m (31 December 2011: £25,745m). The increase was mainly attributable to higher repurchase agreements activity during the period.

> Debt securities in issue increased by 23% to £33,172m (31 December 2011: £26,980m). The increase reflected the Group's strategy of increasing the level of medium-term funding principally through the issuance of debt in the Covered Bond programme. These increases were partially offset by significant decreases in short term funding in the US$20bn Commercial Paper Programme and in Certificates of Deposit in issue.

Results and dividends

The results of the Group are discussed above. Interim dividends of £nil (2011: £nil) were paid during the period on the Company's ordinary shares. The Directors do not recommend the payment of a final dividend (2011: £nil) on the ordinary shares in issue.

Events after the balance sheet date

None.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out above. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. The Group's objectives, policies and processes for managing its capital are described in Note 46 of the Group's 2011 Annual Report.

Details of the Group's financial risk management objectives, its financial instruments and hedging activities; and its exposures to credit risk, interest rate risk, liquidity risk, operational risk and other risks are set out in the Risk Management section in Note 44 of the Group's 2011 Annual Report. In addition, the Risk Management Framework of Santander UK, which has been adopted by the Group, has been enhanced. Further details can be found in Note 25 Condensed Consolidated Interim Financial Statements.

The Group is reliant on Santander UK for a significant proportion of its funding. The Santander UK Board has confirmed that Santander UK plc is a going concern, and that it will provide funding to the Group for the foreseeable future. In giving this commitment to provide funding to the Group, the Santander UK Board has considered the uncertainties within the Group when preparing the forecasts and budgets of the combined business of Santander UK.

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

After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis of accounting in preparing the Half Yearly Financial Report.

Related Party Transactions

For a full description of related party activity at 31 December 2011, please refer to Note 41 of the Group's 2011 Annual Report. There have been no significant changes to these arrangements during the first half of the year, except for balances in Note 19. This is described in Note 24 to the Condensed Consolidated Interim Financial Statements.

Directors' Responsibility Statement

This Half Yearly Financial Report is the responsibility of the Directors. See 'Directors' Responsibility Statement' on page 52.

Principal risks and uncertainties

The Group's 2011 Annual Report outlines our assessment of the principal risks and uncertainties facing the Group, together with the processes that are in place to monitor and mitigate those risks where possible. Material risk factors are described in the Risk Factors section on page 121 to 134 of the Group's 2011 Annual Report. Financial risks are described in the Risk Management Section for each segment of the business by type of risk in Note 44 of the Group's 2011 Annual Report. There were no significant changes during the period.

Financial risks are:

- Credit risk;
- Market risk;
- Funding and Liquidity risk;
- Operational risk; and
- Other risks.

Material risk factors are:

- The Group's operating results, financial condition and prospects may be materially impacted by economic conditions in the UK;
- The Group's operating results, financial condition and prospects may be negatively affected by conditions in global financial markets;
- The Group may suffer adverse effects as a result of the ongoing economic and sovereign debt crisis in the eurozone;
- The Group may suffer adverse effects should eurozone member states exit the euro or the euro be totally abandoned;
- The Group's risk management measures may not be successful;
- Santander UK has a significant exposure to the UK real estate market;
- Risks concerning borrower credit quality are inherent in the Group's business;
- The soundness of other financial institutions could materially and adversely affect the Group's business;
- Risks associated with liquidity and funding are inherent in the Group's business;
- The Group is subject to regulatory capital and liquidity requirements that could limit its operations, and changes to these requirements may further limit and adversely affect its operating results, financial condition and prospects;
- Any reduction in the credit rating assigned to Santander UK, the Company or to any Santander UK group debt securities would be likely to increase Santander UK or the Group's cost of funding, require additional collateral to be placed and adversely affect its interest margins and liquidity position;
- Fluctuations in interest rates, bond and equity prices and other market factors are inherent in the Group's business;
- Currency fluctuations may adversely affect the Group's operating results, financial condition and prospects;
- Market conditions have, and could result, in material changes to the estimated fair values of financial assets of the Group. Negative fair value adjustments could have a material adverse effect on the Group's operating results, financial condition and prospects;
- A core strategy of Santander UK is to grow its operations and it may not be able to manage such growth effectively, which could have an adverse impact on its profitability;
- The Company may incur unanticipated losses related to Santander UK's business combinations;
- The Group may fail to realise the anticipated benefits of Santander UK plc's recent or proposed business combinations;
- Goodwill impairments may be required in relation to certain of Santander UK plc's acquired businesses;
- The Group's business is conducted in a highly competitive environment;
- Operational risks are inherent in the Group's business;
- The Group relies on recruiting, retaining and developing appropriate senior management and skilled personnel;
- Reputational risk could cause harm to the Group and its business prospects;
- Legislative, regulatory and governmental oversight and current banking reform initiatives and requirements could have a material adverse effect on the Group;
- Tax and Compliance changes (including the UK bank levy and FATCA) could have a material adverse effect on the Group's business;
- Santander UK and the Group are exposed to various forms of legal and regulatory risk which could have a material adverse effect on its operating results, financial condition and prospects or relations with its customers;
- The structure of the financial regulatory authorities in the UK and the UK regulatory framework that applies to members of Santander UK, including the Company is the subject of reform and reorganisation;
- Various reforms to the mortgage lending market have been proposed which could require significant implementation costs or changes to the business strategy of Santander UK;
- Potential intervention by the UK Financial Services Authority (or an overseas regulator) may occur, particularly in response to customer complaints;
- Members of Santander UK are responsible for contributing to compensation schemes in the UK in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers;
- The Banking Act may adversely affect the Group's business;
- The Group's operations are highly dependent on its information technology systems;
- Third parties may use the Group as a conduit for illegal activities without the Group's knowledge, which could have a material adverse effect on the Group;
- Changes in the pension liabilities and obligations of Santander UK could have a materially adverse effect on the Group;
- Risks concerning enforcement of judgements made in the United States.

Looking forward to the second half of the current financial year, we believe that the risks and uncertainties identified in the Group's 2011 Annual Report are still applicable.

Contents to Financial Statements

Condensed Financial Statements

8 Condensed Consolidated Income Statement for the six months ended 30 June 2012 and 2011
8 Condensed Consolidated Statement of Comprehensive Income for the six months ended 30 June 2012 and 2011
9 Condensed Consolidated Balance Sheet at 30 June 2012 and 31 December 2011
10 Condensed Consolidated Statement of Changes in Equity for the six months ended 30 June 2012 and 2011
10 Condensed Consolidated Cash Flow Statement for the six months ended 30 June 2012 and 2011
11 Notes to the Condensed Financial Statements

Condensed Consolidated Income Statement

For the six months ended 30 June 2012 and 2011

	Notes	**Six months ended 30 June 2012 £m**	Six months ended 30 June 2011 £m
Interest and similar income		**1,839**	1,936
Interest expense and similar charges		**(1,865)**	(1,743)
Net interest income		**(26)**	193
Net fee and commission income		**72**	30
Net trading and other income	3	**215**	188
Total operating income		**261**	411
Administration expenses		**(105)**	(107)
Depreciation and amortisation		**(1)**	(3)
Total operating expenses excluding provisions and charges		**(106)**	(110)
Impairment losses on loans and advances	4	**(20)**	(37)
Total operating provisions and charges		**(20)**	(37)
Profit before tax		**135**	264
Taxation charge	5	**(15)**	(65)
Profit for the period		**120**	199
Attributable to:			
Equity holders of the parent		**120**	199

The notes on pages 11 to 34 are an integral part of these Condensed Consolidated Interim Financial Statements.

All profits during the period were generated from continuing operations.

Condensed Consolidated Statement of Comprehensive Income

For the six months ended 30 June 2012 and 2011

	Six months ended 30 June 2012 £m	Six months ended 30 June 2011 £m
Profit for the period	**120**	199
Other comprehensive income/(expense):		
Losses on available-for-sale securities	**(25)**	-
Tax on above item	**6**	-
Net loss recognised directly in equity	**(19)**	-
Total comprehensive income for the period	**101**	199
Attributable to:		
Equity holders of the parent	**101**	199

The notes on pages 11 to 34 are an integral part of these Condensed Consolidated Interim Financial Statements.

Condensed Consolidated Balance Sheet

At 30 June 2012 and 31 December 2011

	Notes	**30 June 2012 £m**	31 December 2011 (Restated) [1] £m
Assets			
Cash and balances at central banks		**2,331**	7,013
Trading assets	7	**32,833**	21,891
Derivative financial instruments	8	**33,520**	33,224
Financial assets designated at fair value	9	**3,935**	4,429
Loans and advances to banks	10	**121,193**	113,222
Loans and advances to customers	11	**50,168**	38,826
Available for sale securities	13	**4,683**	-
Loans and receivables securities		**263**	278
Macro hedge of interest rate risk		**1,153**	1,141
Intangible assets		**2**	3
Property, plant and equipment	14	**6**	5
Deferred tax assets		**21**	17
Other assets		**61**	43
Total assets		**250,169**	220,092
Liabilities			
Deposits by banks	15	**136,765**	114,019
Deposits by customers	16	**8,033**	7,114
Derivative financial instruments	8	**34,934**	35,417
Trading liabilities	17	**28,235**	25,745
Financial liabilities designated at fair value	18	**4,977**	6,836
Debt securities in issue	19	**33,172**	26,980
Other liabilities		**182**	142
Provisions		**-**	20
Current tax liabilities		**270**	319
Total liabilities		**246,568**	216,592
Equity			
Share capital		**2,549**	2,549
Retained earnings		**1,055**	935
Other reserves		**(3)**	16
Total shareholders' equity		**3,601**	3,500
Total liabilities and equity		**250,169**	220,092

[1] See Note 27

The Notes on pages 11 to 34 are an integral part of these Condensed Consolidated Interim Financial Statements.

Condensed Consolidated Statement of Changes in Equity

For the six months ended 30 June 2012 and 2011

	Notes	Share Capital £m	Available for sale reserve £m	Foreign currency translation reserve £m	Retained earnings (Restated) [1] £m	Total (Restated) [1] £m
1 January 2012		**2,549**	**-**	**16**	**935**	**3,500**
Total comprehensive income/(expense):						
- Profit for the period		**-**	**-**	**-**	**120**	**120**
- Other comprehensive (expense) for the period		**-**	**(25)**	**-**	**-**	**(25)**
- Tax on other comprehensive (expense)		**-**	**6**	**-**	**-**	**6**
		-	**(19)**	**-**	**120**	**101**
30 June 2012		**2,549**	**(19)**	**16**	**1,055**	**3,601**
1 January 2011		2,549	-	16	798	3,363
Total comprehensive income:						
- Profit for the period		-	-	-	199	199
		-	-	-	199	199
30 June 2011		2,549	-	16	997	3,562

[1] See Note 27

Condensed Consolidated Cash Flow Statement

For the six months ended 30 June 2012 and 2011

	Notes	**Six months ended 30 June 2012 £m**	Six months ended 30 June 2011 £m
Net cash flow from/(used in) operating activities			
Profit for the period		**120**	199
Adjustments for:			
Non cash items included in net profit		**147**	337
Change in operating assets		**(13,054)**	(9,137)
Change in operating liabilities		**26,712**	(6,303)
Income taxes paid		**(2)**	(1)
Effect of exchange rate differences		**(802)**	480
Net cash flow from/(used in) operating activities	21	**13,121**	(14,425)
Net cash flow used in investing activities			
Purchase of property, plant and equipment and intangible assets	14	**(2)**	(3)
Purchase of securities		**(4,708)**	-
Net cash flow used in investing activities		**(4,710)**	(3)
Net cash flow from financing activities			
Issue of long-term debt		**16,805**	16,380
Repayments of long-term debt		**(12,911)**	(7,379)
Net cash flow from financing activities		**3,894**	9,001
Net increase/(decrease) in cash and cash equivalents		**12,305**	(5,427)
Cash and cash equivalents at beginning of the period		**79,858**	86,729
Effect of exchange rate changes on cash and cash equivalents		**(345)**	663
Cash and cash equivalents at the end of the period	21	**91,818**	81,965

The Notes on pages 11 to 34 are an integral part of these Condensed Consolidated Interim Financial Statements.

Notes to the Condensed Financial Statements

1. ACCOUNTING POLICIES

Going Concern

The Group's objectives, policies and processes for managing its capital are described in Note 46 of the Group's 2011 Annual Report. Details of the Group's financial risk management objectives, its financial instruments and hedging activities; and its exposures to credit risk, interest rate risk, liquidity risk, operational risk and other risks are set out in Note 44 of the Group's 2011 Annual Report. In addition, the Risk Management Framework of Santander UK, which has been adopted by the Group, has been enhanced. Further details can be found in Note 25 Condensed Consolidated Interim Financial Statements.

The Group is reliant on Santander UK for a significant proportion of its funding. The Santander UK Board has confirmed that Santander UK plc is a going concern, and that it will provide funding to the Group for the foreseeable future. In giving this commitment to provide funding to the Group, the Santander UK Board has considered the uncertainties within the Group when preparing the forecasts and budgets of the combined business of Santander UK.

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

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

General information

These Condensed Consolidated Interim Financial Statements are not a form of statutory accounts. The information for the year ended 31 December 2011 does not constitute statutory accounts as defined in section 434 of the Companies Act 2006. A copy of the statutory accounts for that year has been delivered to the Registrar of Companies. The auditor's report on those accounts was unqualified, did not draw attention to any matters by way of emphasis and did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Accounting Standard ('IAS') 34 'Interim Financial Reporting', as issued by the International Accounting Standards Board ('IASB') and as adopted for use in the European Union. Accordingly, certain information and disclosures normally required to be included in the notes to the annual financial statements have been omitted or condensed. The Condensed Consolidated Interim Financial Statements should be read in conjunction with the Consolidated Financial Statements of the Group for the year ended 31 December 2011 which were prepared in accordance with International Financial Reporting Standards ('IFRS') as issued by the IASB in addition to being consistent with IFRS as adopted for use in the European Union.

The same accounting policies, presentation and methods of computation are followed in these Condensed Consolidated Interim Financial Statements as were applied in the preparation of the Group's Consolidated Financial Statements for the year ended 31 December 2011 except as described below:

Recent accounting developments

The Group has adopted the following amendments to standards which became effective for financial years beginning on 1 January 2012.

a) IFRS 7 'Financial Instruments: Disclosures' – In October 2010, the IASB issued amendments to IFRS 7 that increase the disclosure requirements for transactions involving transfers of financial assets. The amendments are intended to provide greater transparency around risk exposures when a financial asset is transferred but the transferor retains some level of continuing exposure in the asset. The amendments also require disclosures where transfers of financial assets are not evenly distributed throughout the period. The amendments to IFRS 7 are effective for annual periods beginning on or after 1 July 2011, with earlier application permitted. Disclosures are not required for comparative periods before the date of initial application of the amendments.

   The Group does not anticipate that these amendments to IFRS 7 will have a significant impact on its disclosures regarding transfers of financial assets. However, if the Group enters into other types of transfers of financial assets in the future, disclosures regarding those transfers may be affected. Where appropriate, these disclosures will be made in the Group's financial statements for the year ended 31 December 2012.

b) There are a number of other changes to IFRS that were effective from 1 January 2012. Those changes did not have a significant impact on the Group's financial statements.

Notes to the Condensed Financial Statements continued

Future accounting developments

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

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

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

b) IFRS 10 ' Consolidated Financial Statements', IFRS 11 'Joint Arrangements', IFRS 12 'Disclosure of Interests in Other Entities', IAS 27 'Separate Financial Statements' and IAS 28 'Investments in Associates and Joint Ventures' – In May 2011, the IASB issued new and amended guidance on consolidated financial statements and joint arrangements. IFRS 10, IFRS 11 and IFRS 12 were new standards issued while IAS 27 and IAS 28 were amended. Each of the standards issued is effective for annual periods beginning on or after 1 January 2013 with earlier application permitted as long as each of the other standards is also applied earlier.

> Under IFRS 10 'Consolidated Financial Statements', control is the single basis for consolidation, irrespective of the nature of the investee; this standard therefore eliminates the risks-and-rewards approach. IFRS 10 identifies the three elements of control as power over the investee, exposure, or rights, to variable returns from involvement with the investee and the ability to use power over the investee to affect the amount of the investor's returns. An investor must possess all three elements to conclude that it controls an investee. The assessment of control is based on all facts and circumstances, and the conclusion is reassessed if there are changes to at least one of the three elements. Retrospective application is required subject to certain transitional provisions.

> IFRS 11 applies to all entities that are parties to a joint arrangement. A joint arrangement is an arrangement of which two or more parties have joint control. IFRS 11 establishes two types of joint arrangements, joint operations and joint ventures, which are distinguished by the rights and obligations of the parties to the arrangement. In a joint operation, the parties to the joint arrangement (referred to as 'joint operators') have rights to the assets and obligations for the liabilities of the arrangement. By contrast, in a joint venture, the parties to the arrangement (referred to as 'joint venturers') have rights to the net assets of the arrangement. IFRS 11 requires that a joint operator recognise its share of the assets, liabilities, revenues, and expenses in accordance with applicable IFRSs; however, a joint venturer would account for its interest by using the equity method of accounting under IAS 28 (2011). Transitional provisions vary depending on how an interest is accounted for under IAS 31 and what its nature is under IFRS 11.

> IFRS 12 integrates the disclosure requirements on interests in other entities, currently included in several standards to make it easier to understand and apply the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard also contains additional requirements on a number of topics. Under IFRS 12, an entity should disclose information about significant judgements and assumptions (and any changes to those assumptions) made in determining whether it has control, joint control, or significant influence over another entity and the type of joint arrangement. IFRS 12 also requires additional disclosures to make it easier to understand and evaluate the nature, extent, and financial effects of the Group's transactions with its subsidiaries, joint arrangements, associates and unconsolidated structured entities as well as any changes in and risks associated with these entities or arrangements. Disclosures shall be aggregated or disaggregated so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics. The standard applies prospectively from the beginning of the annual period in which it is adopted.

The Group anticipates that IFRS 10, IFRS 11 and IFRS 12 will be adopted in the Group's financial statements for the annual period beginning on 1 January 2013 and that the application of the new standards may have a significant impact on the Group's disclosures and on amounts reported in respect of the Group's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of that effect until a detailed review has been completed.

> IAS 27 was amended for the issuance of IFRS 10 but retains the current guidance on separate financial statements.

> IAS 28 was amended for conforming changes on the basis of the issuance of IFRS 10 and IFRS 11.

The Group anticipates that IAS 27 (2011) and IAS 28 (2011) will be adopted in the Group's financial statements for the annual period beginning on 1 January 2013. The Group does not anticipate that these amendments to IAS 27 and IAS 28 will have a significant impact on its disclosures and on amounts reported in respect of the Group's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of that effect until a detailed review has been completed.

Notes to the Condensed Financial Statements continued

c) IFRS 13 'Fair Value Measurement' - In May 2011, the IASB issued IFRS 13, which establishes a single source of guidance for fair value measurement. IFRS 13 defines fair value, establishes a framework for measuring fair value, and requires disclosures about fair value measurements. IFRS 13 applies to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except in specified circumstances. In general, the disclosure requirements in IFRS 13 are more extensive than those required in the current accounting standards. IFRS 13 is effective for annual periods beginning on or after 1 January 2013, with early adoption permitted, and applies prospectively from the beginning of the annual period in which it is adopted.

The Group anticipates that IFRS 13 will be adopted in the Group's financial statements for the annual period beginning on 1 January 2013 and that the application of the new standard may affect the amounts reported in the financial statements and result in more extensive disclosures in the financial statements. However, it is not practicable to provide a reasonable estimate of that effect until a detailed review has been completed.

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

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

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

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

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

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

The Group anticipates that IAS 19 (2011) will be adopted in the Group's financial statements for the annual period beginning on 1 January 2013. The Group does not anticipate that these amendments to IAS 19 will have a significant impact on its profit or loss or financial position as the Group does not utilise the 'corridor approach'.

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

Basis of Preparation

The Condensed Consolidated Interim Financial Statements have been prepared under the historical cost convention, as modified by the revaluation of available for sale financial assets, financial assets and financial liabilities held at fair value through profit or loss and all derivative contracts.

Notes to the Condensed Financial Statements continued

Critical Accounting Policies and Areas of Significant Management Judgement

The preparation of the Group's Condensed Consolidated Interim Financial Statements requires management to make estimates and judgements that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amount of income and expenses during the reporting period. Management evaluates its estimates and judgements on an ongoing basis. Management bases its estimates and judgements on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

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

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

(a) Impairment loss allowances for loans and advances

The Group estimates impairment losses for loans and advances to customers, loans and receivables securities, and loans and advances to banks as described in the accounting policy "Impairment of financial assets" on page 28 of the Group's 2011 Annual Report. The Group's assumptions about estimated losses are based on past performance, past customer behaviour, the credit quality of recent underwritten business and general economic conditions, which are not necessarily an indication of future losses.

(i) Loans and advances to customers
The net impairment loss (i.e. after recoveries) for loans and advances to customers recognised in 2012 was £20m (six months ended 30 June 2011: £37m). In calculating the impairment loss allowances, for each portfolio concerned the impairment loss allowance represents management's best estimate of likely loss levels and takes into account, amongst other factors, the total exposure and anticipated stressed levels in the relevant industry sector, estimates of probability of default and loss given default rates.

Had management used different assumptions, a larger or smaller impairment loss allowance would have resulted that could have had a material impact on the Group's reported profit before tax. Specifically, if management's conclusions as to the anticipated stressed levels, probability of default and loss given default rates were different, but within the range of what management deemed to be reasonably possible, the impairment loss for loans and advances could have decreased in 2012 from an actual impairment loss of £20m (six months ended 30 June 2011: £37m) by up to £3m (six months ended 30 June 2011: £6m), with a potential corresponding increase in the Group's profit before tax in 2012 of up to 3% (six months ended 30 June 2011: 2%), or increased by up to £3m (six months ended 30 June 2011: £5m), with a potential corresponding decrease in the Group's profit before tax in 2012 of up to 3% (six months ended 30 June 2011: 2%).

(ii) Loans and receivables securities
The impairment loss for loans and receivables securities of £nil (six months ended 30 June 2011: £nil) in the first half of 2012 was based on management's assessment of impairment of each individual asset based on data available at 30 June 2012.

(iii) Loans and advances to banks
In the six months ended 30 June 2012 and 2011, the Group did not incur any impairment losses in respect of loans and advances to banks. Based on the conditions at the balance sheet date, management determined that a reasonably possible change in any of its assumptions would not cause an impairment loss to be recognised.

(b) Valuation of financial instruments

The Group trades in a wide variety of financial instruments in the major financial markets. When estimating the value of its financial instruments, including derivatives where quoted market prices are not available, management therefore considers a range of interest rates, volatility, exchange rates, counterparty credit ratings, valuation adjustments and other similar inputs, all of which vary across maturity bands. These are chosen to best reflect the particular characteristics of each transaction.

Had management used different assumptions, a larger or smaller change in the valuation of financial instruments including derivatives where quoted market prices are not available would have resulted that could have had a material impact on the Group's reported profit before tax.

Detailed disclosures on financial instruments, including sensitivities, can be found in Note 26. Further information about sensitivities to market risk (including Value-at-Risk ('VaR')) arising from financial instrument trading activities can be found in the Financial Risks and Risk Management section in Note 44 of the Group's 2011 Annual Report.

2. SEGMENTS

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

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

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

The Group's segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. The Group has three segments:

- **Corporate Banking** provides a range of banking services principally to UK companies, with a focus on services for SMEs, providing a broad range of banking products including loans, bank accounts, deposits, treasury services, invoice discounts, cash transmission and asset finance. In addition, Corporate Banking includes specialist teams servicing Real Estate, Social Housing and UK infrastructure clients.

  Within Corporate Banking, the Large Corporates business is responsible for larger multinational corporate clients, including related activities principally comprising foreign exchange, money market and credit activities. These related activities are structured into two main product areas: Foreign exchange and money markets, and Credit. Foreign exchange offers a range of foreign exchange products and money markets runs the securities lending/borrowing and repo businesses. Credit originates loan and bond transactions in primary markets as well as their intermediation in secondary markets.
- **Markets** is a financial markets business focused on providing value added financial services to financial institutions, as well as to the rest of Santander UK's business. It is structured into two main product areas: Fixed income and Equity. Fixed Income covers sales and trading activity for fixed income products. Equity covers equity derivatives, property derivatives and commodities. Equity derivatives activities include the manufacture of structured products sold to both the Group and other financial institutions who sell or distribute them on to their customers.
- **Corporate Centre** (formerly known as Group Infrastructure) consists of Asset and Liability Management ('ALM'), which is responsible for the Group's capital, and certain of the Santander UK group's non-core and legacy portfolios being run-down and/or managed for value. ALM is responsible for managing the Group's structural balance sheet composition and strategic and tactical liquidity risk management. This includes short-term and medium-term funding, covered bond and securitisation programmes. ALM's responsibilities also include management of Santander UK's banking products and structural exposure to interest rates.

The Company's board of directors (the 'Board') is the chief operating decision maker for the Group. The segment information below is presented on the basis used by the Board to evaluate performance and allocate resources. The Board reviews discrete financial information for each segment of the business which follows the Group's normal accounting policies and principles including measures of operating results, assets and liabilities.

Transactions between the business segments are on normal commercial terms and conditions. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in the Group's 2011 Annual Report. Internal charges and transfer pricing adjustments have been reflected in the performance of each business. Revenue sharing agreements are used to allocate external customer revenues to a business segment on a reasonable basis. Funds are ordinarily reallocated between segments, resulting in funding cost transfers disclosed in operating income. Interest charged for these funds is based on the Group's cost of capital.

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

Notes to the Condensed Financial Statements continued

a) Segmental information

Six months ended 30 June 2012	Markets £m	Corporate Banking £m	Corporate Centre £m	Group Total £m
Net interest income	**(3)**	**29**	**(52)**	**(26)**
Non-interest income	**137**	**141**	**9**	**287**
Total operating income	**134**	**170**	**(43)**	**261**
Administration expenses	**(54)**	**(37)**	**(14)**	**(105)**
Depreciation and amortisation	**(1)**	**-**	**-**	**(1)**
Total operating expenses excluding provisions and charges	**(55)**	**(37)**	**(14)**	**(106)**
Impairment losses on loans and advances	**-**	**(20)**	**-**	**(20)**
Total operating provisions and charges	**-**	**(20)**	**-**	**(20)**
Profit before tax	**79**	**113**	**(57)**	**135**

Six months ended 30 June 2011	Markets £m	Corporate Banking £m	Corporate Centre £m	Group Total £m
Net interest income	(2)	42	153	193
Non-interest income	86	140	(8)	218
Total operating income	84	182	145	411
Administration expenses	(51)	(44)	(12)	(107)
Depreciation and amortisation	(1)	(2)	-	(3)
Total operating expenses excluding provisions and charges	(52)	(46)	(12)	(110)
Impairment losses on loans and advances	-	(37)	-	(37)
Total operating provisions and charges	-	(37)	-	(37)
Profit before tax	32	99	133	264

3. NET TRADING AND OTHER INCOME

	Six months ended 30 June 2012 £m	Six months ended 30 June 2011 £m
Net trading and funding of other items by the trading book	**227**	230
Income on assets designated at fair value through profit or loss	**100**	182
Expense on liabilities designated at fair value through profit or loss	**(11)**	(22)
Losses on derivatives managed with assets/liabilities held at fair value through profit or loss	**(87)**	(164)
Hedge ineffectiveness and other	**(14)**	(38)
	215	188

4. IMPAIRMENT LOSSES AND PROVISIONS

	Six months ended 30 June 2012 £m	Six months ended 30 June 2011 £m
Impairment losses on loans and advances:		
- loans and advances to customers (Note 11)	**20**	37
Recoveries of loans and advances	**-**	-
	20	37
Impairment losses on available-for-sale financial assets (Note 13)	**-**	-
Provisions for other liabilities and charges:		
- New and increased allowances	**-**	-
Total impairment losses and provisions charged to the income statement	**20**	37

5. TAXATION CHARGE

Interim period corporation tax is accrued based on the estimated average annual effective corporation tax rate for the year of 13.4% (2011: 26.2%). The standard rate of UK corporation tax was 24.5% (2011: 26.5%). The effective tax rate differed from the UK corporation tax rate principally because of the impact of non taxable income.

The standard rate of UK corporation tax was reduced from 26% to 24% with effect from 1 April 2012. Taxation for other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

The Finance Bill 2012 proposes a reduction in the main rate of UK corporation tax from 26% to 24% effective from 1 April 2012. This reduction in the rate to 24% was enacted on 26 March 2012 under the Provisional Collection of Taxes Act 1968. As this change in rate was substantively enacted prior to 30 June 2012, it has been reflected in the deferred tax balance at 30 June 2012. The UK Government has also indicated that it intends to enact future 1% reductions each year down to 22% by 1 April 2014. These changes in rate had not been substantively enacted at the balance sheet date and, therefore, are not included in these financial statements. The estimated financial effect of these changes is insignificant.

6. DIVIDENDS

No dividends were declared during the period (2011: £nil). No dividends were paid during the period (2011: none).

7. TRADING ASSETS

	30 June 2012 £m	31 December 2011 £m
Loans and advances to banks – securities purchased under resale agreements	**5,086**	3,056
Loans and advances to banks - other[1]	**2,941**	3,088
Loans and advances to customers – securities purchased under resale agreements	**18,120**	6,338
Loans and advances to customers – other[2]	**260**	349
Debt securities	**5,949**	8,711
Equity securities	**477**	349
	32,833	21,891

(1) Comprises short-term loans of £205m (2011: £84m) and cash collateral placed of £2,736m (2011: £3,004m).
(2) Comprises short-term loans

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

	30 June 2012 £m	31 December 2011 £m
Issued by public bodies:		
- Government securities	**3,868**	2,943
Issued by other issuers:		
- Fixed and floating rate notes[1]: Government guaranteed	**2,081**	5,754
- Fixed and floating rate notes[1]: Other	**-**	14
	5,949	8,711

(1) The FRNs are 40% AAA and 60% A rated (2011: 100% AAA rated).

Notes to the Condensed Financial Statements continued

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

	30 June 2012 £m	31 December 2011 £m
Debt securities:		
- Listed in the UK	**3,601**	5,904
- Listed elsewhere	**2,221**	1,165
- Unlisted	**127**	1,642
	5,949	8,711
Equity securities:		
- Listed in the UK	**426**	335
- Listed elsewhere	**51**	14
	477	349

8. DERIVATIVE FINANCIAL INSTRUMENTS

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

Details of the Group's uses of derivatives are set out in Note 15 of the Group's 2011 Annual Report.

30 June 2012

Derivatives held for trading	**Contract/notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**
Exchange rate contracts:			
- Cross-currency swaps	**140,526**	**2,502**	**3,854**
- Forward exchange swaps, options and forwards	**26,686**	**280**	**157**
	167,212	**2,782**	**4,011**
Interest rate contracts:			
- Interest rate swaps	**607,711**	**25,030**	**23,696**
- Caps, floors and swaptions(1)	**63,530**	**3,467**	**3,489**
- Futures	**45,348**	**59**	**25**
- Forward rate agreements	**129,445**	**10**	**12**
	846,034	**28,566**	**27,222**
Equity and credit contracts:			
- Equity index swaps and similar products	**31,666**	**1,293**	**1,526**
- Equity index options	**41,052**	**413**	**1,025**
- Credit default swaps and similar products	**1,191**	**36**	**17**
	73,909	**1,742**	**2,568**
Commodity contracts:			
- swaps	**417**	**21**	**20**
	417	**21**	**20**
Total derivative assets and liabilities held for trading	**1,087,572**	**33,111**	**33,821**

30 June 2012

Derivatives held for fair value hedging	**Contract/notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**
Interest rate contracts:			
- Interest rate swaps	**40,012**	**409**	**1,113**
Total derivative assets and liabilities held for fair value hedging	**40,012**	**33,520**	**34,934**
Total recognised derivative assets and liabilities	**1,127,584**	**33,520**	**34,934**

(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.

31 December 2011

Derivatives held for trading	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
Exchange rate contracts:			
- Cross-currency swaps	104,519	1,507	2,839
- Forward exchange swaps, options and forwards	19,497	149	248
	124,016	1,656	3,087
Interest rate contracts:			
- Interest rate swaps	566,365	25,949	24,700
- Caps, floors and swaptions(1)	63,100	3,484	3,522
- Futures	32,503	54	41
- Forward rate agreements	78,090	21	31
	740,058	29,508	28,294
Equity and credit contracts:			
- Equity index swaps and similar products	32,330	1,237	1,527
- Equity index options	43,708	406	1,240
- Credit default swaps and similar products	1,565	45	21
	77,603	1,688	2,788
Commodity contracts:			
- Swaps	542	12	11
	542	12	11
Total derivative assets and liabilities held for trading	942,219	32,864	34,180

31 December 2011

Derivatives held for fair value hedging	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
Exchange rate contracts			
- Cross-currency swaps	437	32	-
Interest rate contracts:			
- Interest rate swaps	35,848	328	1,237
Total derivative assets and liabilities held for fair value hedging	36,285	360	1,237
Total recognised derivative assets and liabilities	978,504	33,224	35,417

(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.

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

	Six months ended 30 June 2012 £m	Six months ended 30 June 2011 £m
Net gains/(losses):		
- on hedging instruments	**(34)**	203
- on hedged items attributable to hedged risks	**27**	(230)
	(7)	(27)

9. FINANCIAL ASSETS DESIGNATED AT FAIR VALUE

	30 June 2012 £m	31 December 2011 (Restated) (1) £m
Loans and advances to customers	**3,574**	4,050
Debt securities	**361**	379
	3,935	4,429

(1) See Note 27

The maximum exposure to credit risk on loans and advances designated as held at fair value through profit or loss at the balance sheet date was £3,574m (31 December 2011: £4,050m). The maximum exposure was mitigated by the Group having a charge over residential properties in respect of lending to housing associations amounting to £3,925m (31 December 2011: £4,556m).

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

	30 June 2012 £m	31 December 2011 £m
Mortgage-backed securities	**314**	328
Other asset-backed securities	**47**	51
	361	379

Notes to the Condensed Financial Statements continued

Debt securities can be analysed by listing status as follows:

	30 June 2012 £m	31 December 2011 £m
Listed UK	-	-
Listed elsewhere	47	58
Unlisted[(1)]	314	321
	361	379

(1) Comprises Social Housing.

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

	30 June 2012				31 December 2011				Income statement	
	Nominal value	Book value	Fair value	Fair value as % of nominal	Nominal value	Book value	Fair value	Fair value as % of nominal	Six months ended 30 June 2012	Six months ended 30 June 2011
Country	£m	£m	£m	%	£m	£m	£m	%	£m	£m
UK										
MBS	188	255	255	136	187	263	263	141	8	6
	188	255	255	136	187	263	263	141	8	6
US										
MBS	8	9	9	113	8	9	9	113	-	1
	8	9	9	113	8	9	9	113	-	1
Rest of Europe										
ABS	75	47	47	63	80	51	51	64	-	1
MBS	33	50	50	152	35	56	56	160	(10)	(1)
	108	97	97	90	115	107	107	93	(10)	-
Total	304	361	361	119	310	379	379	122	(2)	7

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

	30 June 2012				31 December 2011				Income statement	
	Nominal value	Book value	Fair value	Fair value as % of nominal	Nominal value	Book value	Fair value	Fair value as % of nominal	Six months ended 30 June 2012	Six months ended 30 June 2011
Credit rating	£m	£m	£m	%	£m	£m	£m	%	£m	£m
AAA										
ABS	-	-	-	-	28	16	16	57	-	1
MBS	68	97	97	143	175	247	247	141	-	7
	68	97	97	143	203	263	263	130	-	8
AA+										
ABS	3	2	2	67	46	30	30	65	-	-
	3	2	2	67	46	30	30	65	-	-
AA										
ABS	27	18	18	67	3	3	3	100	1	-
MBS	44	68	68	155	46	76	76	165	(5)	(1)
	71	86	86	121	49	79	79	161	(4)	(1)
A										
ABS	43	26	26	60	3	2	2	67	(1)	-
MBS	109	144	144	132	-	-	-	-	3	-
	152	170	170	112	3	2	2	67	2	-
Below BBB										
ABS	2	1	1	50	-	-	-	-	-	-
MBS	8	5	5	63	9	5	5	56	-	-
	10	6	6	60	9	5	5	56	-	-
Total	304	361	361	119	310	379	379	122	(2)	7

10. LOANS AND ADVANCES TO BANKS

	30 June 2012 £m	31 December 2011 £m
Amounts due from Santander UK group undertakings	119,581	110,004
Amounts due from Banco Santander, S.A.	438	2,082
Other loans and advances	1,174	1,136
	121,193	113,222

During the period, no impairment losses were incurred (six months ended 30 June 2011: £nil).

11. LOANS AND ADVANCES TO CUSTOMERS

	30 June 2012 £m	31 December 2011 £m
Amounts due from Santander UK group undertakings	**38,208**	27,831
Amounts due from Banco Santander group undertakings	**2**	5
Other loans and advances	**12,108**	11,120
Loans and advances to customers	**50,318**	38,956
Less: impairment loss allowances	**(150)**	(130)
Loans and advances to customers, net of impairment loss allowances	**50,168**	38,826

Movement in impairment loss allowances:

	£m
At 1 January 2012	**130**
Charge to the income statement:	
- Observed	**20**
- Incurred but not yet observed	**-**
	20
Write offs	**-**
At 30 June 2012	**150**
At 1 January 2011	108
Charge to the income statement:	
- Observed	50
- Incurred but not yet observed	4
	54
Write offs	(32)
At 31 December 2011	130

12. SPECIAL PURPOSE ENTITIES

Special Purpose Entities ('SPEs') are formed by the Group to accomplish specific and well-defined objectives. The Group consolidates these SPEs when the substance of the relationship indicates control, as described in Note 1 of the Group's 2011 Annual Report. There were no significant changes to the Group's consolidated special purpose entities during the period.

Off balance sheet special purpose entities

The only SPEs sponsored but not consolidated by the Group are SPEs which issue shares that back retail structured products. At 30 June 2012, the total value of products issued by these SPEs was £22m (31 December 2011: £36m). 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.

13. AVAILABLE-FOR-SALE SECURITIES

	30 June 2012 £m	31 December 2011 £m
Debt securities	**4,683**	-
Equity securities	**-**	-
	4,683	-

Notes to the Condensed Financial Statements continued

Debt securities consist of UK Government and French Government securities.

Debt securities can be analysed by listing status as follows:

	30 June 2012 £m	31 December 2011 £m
Debt securities:		
- Listed in the UK	**3,765**	-
- Listed Non-UK	**918**	-
	4,683	-

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

	£m
At 1 January 2012	**-**
Additions	**4,708**
Redemptions and maturities	**-**
Movement in fair value	**(25)**
At 30 June 2012	**4,683**

14. PROPERTY, PLANT AND EQUIPMENT

During the period, the Group spent approximately £nil (2011: £nil) on owner-occupied properties, £2m (2011: £3m) on additions to its office fixtures and equipment and £nil (2011: £1m) on computer software. The Group made no disposals in the period (2011: £nil).

15. DEPOSITS BY BANKS

	30 June 2012 £m	31 December 2011 £m
Amounts due to Santander UK undertakings	**126,310**	105,713
Amounts due to fellow Banco Santander subsidiaries (not with Banco Santander, S.A.)	**1,954**	603
Securities sold under agreements to repurchase	**4,901**	4,955
Amounts due to Banco Santander, S.A. - securities sold under agreements to repurchase	**3,200**	2,517
Time and demand deposits	**400**	231
	136,765	114,019

16. DEPOSITS BY CUSTOMERS

	30 June 2012 £m	31 December 2011 £m
Time deposits	**1**	10
Amounts due to Santander UK subsidiaries	**1,533**	1,847
Amounts due to fellow Banco Santander subsidiaries	**359**	345
Securities sold under agreements to repurchase	**404**	418
Wholesale funds and deposits	**5,736**	4,494
	8,033	7,114

Wholesale deposits by customers are interest bearing.

17. TRADING LIABILITIES

	30 June 2012 £m	31 December 2011 £m
Deposits by banks - securities sold under repurchase agreements	**3,724**	10,105
- other(1)	**4,245**	4,403
Deposits by customers - securities sold under repurchase agreements	**16,011**	5,519
- other(2)	**2,557**	4,963
Short positions in securities and unsettled trades	**1,698**	755
	28,235	25,745

(1) Comprises cash collateral held £2,633m (2011: £2,401m) and short-term deposits £1,612m (2011: £2,002m).
(2) Comprises short-term deposits £1,327m (2011: £3,662m) and equity linked deposits £1,230m (2011: £1,301m).

18. FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE

	30 June 2012 £m	31 December 2011 £m
Debt securities in issue:		
- US$10bn Euro Commercial Paper Programme	**1,516**	429
- US$20bn Euro Medium Term Note Programme	**1,568**	4,594
- Note, Certificate and Warrant Programme	**1,728**	1,744
- Other bonds	**-**	61
Warrants	**165**	8
	4,977	6,836

The net loss during the period attributable to changes in the Group's own credit risk on the above debt securities in issue was £23m (2011: net gain of £64m). The cumulative net gain attributable to changes in the Group's own credit risk on the above debt securities in issue at 30 June 2012 was £70m (2011: £93m).

The amount that would be required to be contractually paid at maturity of the debt securities in issue above was £387m (2011: £366m) higher than the carrying value.

Details of the Group's US$10bn Euro Commercial Paper Programme, US$20bn Euro Medium Term Note Programme and Warrants Programme are set out in Note 30 of the Group's 2011 Annual Report.

Note, Certificate and Warrant Programme (formerly known as the Euro 10bn structured note programme)

The Company may from time to time issue notes, redeemable certificates and warrants (together the ''Securities'') denominated in any currency as agreed between the Company and the relevant dealers under the note, Certificate and Warrant programme (the ''Omnibus Programme''). The Securities are direct, unsecured and unconditional obligations of the Company that rank pari passu without preference among themselves and, subject as to any applicable statutory provisions or judicial order, at least equally with all other present and future unsecured and unsubordinated obligations of the Company. The payments of all amounts due in respect of the Securities have been unconditionally and irrevocably guaranteed by Santander UK plc.

The Omnibus Programme provides for the issuance of commodity linked securities, credit linked securities, currency linked securities, equity linked securities, equity index linked securities, fixed rate securities, floating rate securities, fund linked securities, inflation linked securities, property linked securities, zero-coupon/discount securities and any other structured securities as agreed between the Company and the relevant dealers. Securities may be issued in bearer or global form and may be listed on the London Stock Exchange or any other or further stock exchange(s) or may be unlisted, as agreed between the Company and the relevant dealers.

The maximum aggregate nominal amount of all structured notes from time to time outstanding under the Omnibus programme will not exceed euro 10bn (or its equivalent in other currencies). The Securities and the Guarantee are governed by English Law.

German Note and Certificate programme

The Company may from time to time issue notes and redeemable certificates (together the "German Securities") denominated in any currency as agreed between the Company and the relevant dealers under the German Note and Certificate programme (the "German Programme"). The German Securities are direct, unsecured and unconditional obligations of the Company that rank pari passu without preference among themselves and, subject as to any applicable statutory provisions or judicial order, at least equally with all other present and future unsecured and unsubordinated obligations of the Company. The payments of all amounts due in respect of the Securities have been unconditionally and irrevocably guaranteed by Santander UK plc.

The German Programme provides for the issuance of commodity linked securities, currency linked securities, equity linked securities, equity index linked securities, fixed rate securities, floating rate securities, fund linked securities, inflation linked securities, zero-coupon/discount securities and any other structured securities as agreed between the Company and the relevant dealers. Securities are issued in bearer form and may be listed on the London Stock Exchange or any other or further stock exchange(s) or may be unlisted, as agreed between the Company and the relevant dealers.

Notes to the Condensed Financial Statements continued

The maximum aggregate nominal amount of all German Securities from time to time outstanding under the programme will not exceed euro 2bn (or its equivalent in other currencies). The Securities are governed by German law. The Guarantee is governed by English law. At 30 June 2012, no issuances had been made under this programme.

19. DEBT SECURITIES IN ISSUE

	30 June 2012 £m	31 December 2011 £m
Euro 35bn Global Covered Bond Programme	**21,907**	16,945
US$20bn Euro Medium Term Note Programme	**7,016**	4,295
US$20bn Commercial Paper Programme	**2,185**	3,069
Certificates of deposit in issue	**2,064**	2,671
	33,172	26,980

Included in the above balances are amounts owed by the Group to the ultimate parent undertaking and to fellow subsidiaries of £2,023m (31 December 2011: £nil) and £325m (31 December 2011: £nil) respectively.

Details of the euro 35bn Global Covered Bond Programme and US$20bn Commercial Paper Programme are set out in Note 31 of the Group's 2011 Annual Report.

20. CONTINGENT LIABILITIES AND COMMITMENTS

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

	30 June 2012 £m	31 December 2011 £m
Guarantees given to the Company's UK parent, fellow subsidiaries and subsidiaries	**150,493**	150,742
Guarantees given to third parties	**608**	457
Formal standby facilities, credit lines and other commitments:		
– Original term to maturity of one year or less	**633**	678
– Original term to maturity of more than one year	**8,535**	8,601
	160,269	160,478

Guarantees given to the Company's UK parent

The Company has fully and unconditionally guaranteed the obligations of Santander UK plc, its immediate parent company, that have been, or will be incurred before 30 June 2015.

Guarantees given to fellow subsidiaries

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

Overseas tax claim

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

Obligations under stock borrowing and lending agreements

Obligations under stock borrowing and lending agreements represent contractual commitments to return stock borrowed. These obligations totalled £8,735m at 30 June 2012 (31 December 2011: £10,850m) and are offset by a contractual right to receive stock under other contractual agreements.

Details of the Group's other standing commitments are set out in Note 35 of the Group's 2011 Annual Report.

21. CONSOLIDATED CASH FLOW STATEMENT

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

	Six months ended 30 June 2012 £m	Six months ended 30 June 2011 £m
Profit for the period	**120**	199
Non-cash items included in net profit		
Depreciation and amortisation	**1**	3
(Increase)/decrease in prepayments and accrued income	**(21)**	156
Increase in accruals and deferred income	**75**	63
Impairment losses	**20**	37
Corporation tax charge	**15**	65
Other non-cash items	**57**	13
Net cash flow from trading activities	**267**	536
Changes in operating assets and liabilities		
Net increase in cash and balances held at central banks	**(1)**	(3)
Net decrease/(increase) in trading assets	**1,295**	(2,651)
Net decrease/(increase) in financial assets designated at fair value	**494**	(678)
Net (increase)/decrease in derivative assets	**(296)**	1,270
Net increase in loans and advances to banks and customers	**(14,564)**	(7,415)
Net decrease in other assets	**18**	340
Net increase/(decrease) in deposits by banks and customers	**23,705**	(3,575)
Net (decrease)/increase in derivative liabilities	**(483)**	775
Net increase/(decrease) in trading liabilities	**2,495**	(1,664)
Net (decrease)/increase in financial liabilities designated at fair value	**(226)**	221
Net increase/(decrease) in debt issued	**1,264**	(1,889)
Net increase/(decrease) in other liabilities	**(43)**	(171)
Effects of exchange rate differences	**(802)**	480
Net cash flow from/(used in) operating activities before tax	**13,123**	(14,424)
Income tax paid	**(2)**	(1)
Net cash flow from/(used in) operating activities	**13,121**	(14,425)

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

	30 June 2012 £m	31 December 2011 £m
Cash and balances at central banks	**2,331**	7,013
Less: regulatory minimum cash balances	**(19)**	(18)
	2,312	6,995
Debt securities - Trading	**2,681**	4,093
Loans and advances to banks - Trading	**4,739**	3,140
Loans and advances to customers - Trading	**18,124**	6,360
Net trading other cash equivalents	**25,544**	13,593
Loans and advances to banks - Non trading	**63,962**	59,270
Net non-trading other cash equivalents	**63,962**	59,270
Cash and cash equivalents at period/year end	**91,818**	79,858

Notes to the Condensed Financial Statements continued

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

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

a) Financial assets pledged to secure liabilities

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

	30 June 2012 £m	31 December 2011 £m
On balance sheet:		
Treasury bills and other eligible securities	**5,949**	6,141
Cash	**2,736**	3,004
Debt securities	**3,120**	129
Equity securities	**477**	321
	12,282	9,595
Off balance sheet:		
Treasury bills and other eligible securities	**8,763**	14,046
Debt securities	**10,557**	17,217
Equity securities	**-**	196
	19,320	31,459

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

Sale and repurchase agreements
The Company and certain of its subsidiaries enter into sale and repurchase agreements and similar transactions of equity and debt securities, which are accounted for as secured borrowings. Upon entering into such transactions, the Company and subsidiaries provide collateral equal to 100%-131% of the borrowed amount. The carrying amount of assets that were so provided at 30 June 2012 was £30,505m (31 December 2011: £26,232m).

Stock borrowing and lending agreements
Asset balances under stock borrowing and lending agreements represent stock lent by the Group. These balances amounted to £8,337m at 30 June 2012 (31 December 2011: £12,180m) and are offset by contractual commitments to return stock borrowed or cash received.

Derivatives business
In addition to the arrangements described above, collateral is also provided in the normal course of derivative business to counterparties. At 30 June 2012, £2,736m (31 December 2011: £2,642m) of such collateral in the form of cash had been provided by the Group and is included in the table above.

b) Collateral held as security for assets:

	30 June 2012 £m	31 December 2011 £m
On balance sheet:		
Trading liabilities	**2,633**	3,004
	2,633	3,004
Off balance sheet:		
Trading liabilities	**46,791**	20,078
Deposits by banks	**423**	2,054
	47,214	22,132

Purchase and resale agreements
The Company and certain of its subsidiaries also enter into purchase and resale agreements and similar transactions of equity and debt securities, which are accounted for as collateralised loans. Upon entering into such transactions, the Company and subsidiaries receive collateral equal to 100%-105% of the loan amount. The level of collateral held is monitored daily and if required, further calls are made to ensure the market values of collateral remains at least equal to the loan balance. The Company and subsidiaries are permitted to sell or repledge the collateral held in the absence of default. At 30 June 2012, the fair value of such collateral received was £38,155m (31 December 2011: £11,776m), almost all of which was sold or repledged. The Company and its subsidiaries have an obligation to return collateral that they have sold or pledged.

Structured transactions
As part of structured transactions entered into by the Company and certain subsidiaries, assets are received as collateral. At 30 June 2012, the fair value of such collateral received was £325m (31 December 2011: £526m). Of the collateral received £325m (31 December 2011: £526m) was sold or repledged, which the subsidiaries have an obligation to return.

Stock borrowing and lending agreements
Obligations under stock borrowing and lending agreements represent contractual commitments to return stock borrowed. These obligations amounted to £8,735m at 30 June 2012 (31 December 2011: £10,850m) and are offset by contractual rights to receive stock lent by the Group.

Derivatives business
In addition to the arrangements described above, collateral is also received in the normal course of derivative business from counterparties. At 30 June 2012, £2,633m (31 December 2011: £2,642m) of such collateral in the form of cash had been received by the Group and is included in the table above.

Lending activities
In addition to the above collateral held as security for assets, the Group may obtain a charge over a customer's property in connection with its lending activities. Details of these arrangements are set out in the "Credit Risk" section of Note 44 of the Group's 2011 Annual Report.

23. EVENTS AFTER THE BALANCE SHEET DATE

None.

24. RELATED PARTY DISCLOSURES

ANTS acts as the treasury and funding vehicle for the Santander UK group and as such has substantial intercompany borrowing, lending and derivatives activities. All such transactions are on normal commercial terms. There have been no substantial changes in the level of such activity in the period, except as disclosed in Note 19.

25. FINANCIAL RISKS AND RISK MANAGEMENT

The Risk Management Report on pages 52 to 123 of the Santander UK 2012 Half Yearly Financial Report describes the Group's Risk Governance in detail. The Risk Management Framework has been enhanced, taking into account the increasing size and capacity of the Santander UK group and recent changes to regulation and best practice. The Santander UK 2012 Half Yearly Financial Report is available at www.aboutsantander.co.uk.

Notes to the Condensed Financial Statements continued

26. FINANCIAL INSTRUMENTS

a) Measurement basis of financial assets and liabilities

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. Note 1 of the Group's 2011 Annual Report describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following tables analyse the Group's financial instruments into those measured at fair value and those measured at amortised cost in the balance sheet:

30 June 2012	**Held at fair value**				**Held at amortised**			
	Trading	**Derivatives designated as hedges**	**Designated at fair value through profit or loss**	**Available-for-sale**	**Financial assets at amortised cost**	**Financial liabilities at amortised cost**	**Non-financial assets / liabilities**	**Total**
		£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Assets								
Cash and balances at central banks	**-**	**-**	**-**	**-**	**2,331**	**-**	**-**	**2,331**
Trading assets	**32,833**	**-**	**-**	**-**	**-**	**-**	**-**	**32,833**
Derivative financial instruments	**33,111**	**409**	**-**	**-**	**-**	**-**	**-**	**33,520**
Financial assets designated at FV	**-**	**-**	**3,935**	**-**	**-**	**-**	**-**	**3,935**
Loans and advances to banks	**-**	**-**	**-**	**-**	**121,193**	**-**	**-**	**121,193**
Loans and advances to customers	**-**	**-**	**-**	**-**	**50,168**	**-**	**-**	**50,168**
Available-for-sale securities	**-**	**-**	**-**	**4,683**	**-**	**-**	**-**	**4,683**
Loans and receivables securities	**-**	**-**	**-**	**-**	**263**	**-**	**-**	**263**
Macro hedge of interest rate risk	**-**	**-**	**-**	**-**	**1,153**	**-**	**-**	**1,153**
Intangible assets	**-**	**-**	**-**	**-**	**-**	**-**	**2**	**2**
Property, plant and equipment	**-**	**-**	**-**	**-**	**-**	**-**	**6**	**6**
Deferred tax assets	**-**	**-**	**-**	**-**	**-**	**-**	**21**	**21**
Other assets	**-**	**-**	**-**	**-**	**-**	**-**	**61**	**61**
	65,944	**409**	**3,935**	**4,683**	**175,108**	**-**	**90**	**250,169**
Liabilities								
Deposits by banks	**-**	**-**	**-**	**-**	**-**	**136,765**	**-**	**136,765**
Deposits by customers	**-**	**-**	**-**	**-**	**-**	**8,033**	**-**	**8,033**
Derivative financial liabilities	**33,821**	**1,113**	**-**	**-**	**-**	**-**	**-**	**34,934**
Trading liabilities	**28,235**	**-**	**-**	**-**	**-**	**-**	**-**	**28,235**
Financial liabilities at FVTPL	**-**	**-**	**4,977**	**-**	**-**	**-**	**-**	**4,977**
Debt securities in issue	**-**	**-**	**-**	**-**	**-**	**33,172**	**-**	**33,172**
Other liabilities	**-**	**-**	**-**	**-**	**-**	**182**	**-**	**182**
Current tax liabilities	**-**	**-**	**-**	**-**	**-**	**-**	**270**	**270**
	62,056	**1,113**	**4,977**	**-**	**-**	**178,152**	**270**	**246,568**

31 December 2011	Held at fair value			Held at amortised cost			
	Trading	Derivatives designated as hedges	Designated at fair value through profit or loss	Financial assets at amortised cost	Financial liabilities at amortised cost	Non-financial assets / liabilities	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Cash and balances at central banks	-	-	-	7,013	-	-	7,013
Trading assets	21,891	-	-	-	-	-	21,891
Derivative financial instruments	32,864	360	-	-	-	-	33,224
Financial assets designated at FV	-	-	4,429	-	-	-	4,429
Loans and advances to banks	-	-	-	113,222	-	-	113,222
Loans and advances to customers	-	-	-	38,826	-	-	38,826
Loans and receivables securities	-	-	-	278	-	-	278
Macro hedge of interest rate risk	-	-	-	1,141	-	-	1,141
Intangible assets	-	-	-	-	-	3	3
Property, plant and equipment	-	-	-	-	-	5	5
Deferred tax assets	-	-	-	-	-	17	17
Other assets	-	-	-	-	-	43	43
	54,755	360	4,429	160,480	-	68	220,092
Liabilities							
Deposits by banks	-	-	-	-	114,019	-	114,019
Deposits by customers	-	-	-	-	7,114	-	7,114
Derivative financial liabilities	34,180	1,237	-	-	-	-	35,417
Trading liabilities	25,745	-	-	-	-	-	25,745
Financial liabilities at FVTPL	-	-	6,836	-	-	-	6,836
Debt securities in issue	-	-	-	-	26,980	-	26,980
Other liabilities	-	-	-	-	142	-	142
Provisions	-	-	-	-	-	20	20
Current tax liabilities	-	-	-	-	-	319	319
	59,925	1,237	6,836	-	148,255	339	216,592

b) Fair values of financial instruments carried at amortised cost

The following tables analyse the fair value of financial instruments not measured at fair value in the balance sheet:

30 June 2012	**Carrying value £m**	**Fair value £m**	**Surplus/ (deficit) £m**
Assets			
Cash and balances at central banks	**2,331**	**2,331**	**-**
Loans and advances to banks	**121,193**	**123,483**	**2,290**
Loans and advances to customers	**50,168**	**54,923**	**4,755**
Loans and receivable securities	**263**	**258**	**(5)**
Liabilities			
Deposits by banks	**136,765**	**138,327**	**(1,562)**
Deposits by customers	**8,033**	**8,068**	**(35)**
Debt securities in issue	**33,172**	**34,650**	**(1,478)**

31 December 2011	Carrying value £m	Fair value £m	Surplus/ (deficit) £m
Assets			
Cash and balances at central banks	7,013	7,013	-
Loans and advances to banks	113,222	114,915	1,693
Loans and advances to customers	38,826	41,133	2,307
Loans and receivable securities	278	280	2
Liabilities			
Deposits by banks	114,019	115,060	(1,041)
Deposits by customers	7,114	7,213	(99)
Debt securities in issue	26,980	27,788	(808)

The surplus/(deficit) in the table above represents the surplus/(deficit) of fair value compared to the carrying amount of those financial instruments for which fair values have been estimated. The carrying value above of any financial assets and liabilities that are designated as hedged items in a portfolio (or macro) fair value hedge relationship excludes gains and losses attributable to the hedged risk, as this is presented as a single separate line item on the balance sheet.

c) Fair value valuation bases of financial instruments carried at fair value

The following tables summarise the fair values at 30 June 2012 and 31 December 2011 of the financial asset and liability classes accounted for at fair value, analysed by the valuation methodology used by the Group to determine their fair value. The tables also disclose the percentages that the recorded fair values of financial assets and liabilities represent of the total assets and liabilities, respectively, that are recorded at fair value in the balance sheet:

Notes to the Condensed Financial Statements continued

30 June 2012

Balance sheet category		Quoted prices in active markets (Level 1)		Internal models based on Market observable data (Level 2)		Internal models based on Significant unobservable data (Level 3)		Total		Valuation technique
		£m	%	£m	%	£m	%	£m	%	
Assets										
Trading assets	Loans and advances to banks	-	-	8,027	11	-	-	8,027	11	A
	Loans and advances to customers	-	-	18,380	24	-	-	18,380	24	A
	Debt securities	5,949	8	-	-	-	-	5,949	8	-
	Equity securities	477	1	-	-	-	-	477	1	-
Derivative assets	Exchange rate contracts	-	-	2,721	4	61	-	2,782	4	A
	Interest rate contracts	59	-	28,916	38	-	-	28,975	38	A&C
	Equity & credit contracts	140	-	1,235	2	367	1	1,742	3	B
	Commodity contracts	-	-	21	-	-	-	21	-	A
Financial assets at FVTPL	Loans and advances to customers	-	-	3,515	5	59	-	3,574	5	A
	Debt securities	-	-	314	-	47	-	361	-	A
Available for sale financial assets	Debt securities	4,683	6	-	-	-	-	4,683	6	B
Total assets at fair value		11,308	15	63,129	84	534	1	74,971	100	
Liabilities										
Trading liabilities	Deposits by banks	-	-	7,969	12	-	-	7,969	12	A
	Deposits by customers	-	-	18,568	27	-	-	18,568	27	A
	Short positions	1,698	2	-	-	-	-	1,698	2	-
Derivative liabilities	Exchange rate contracts	-	-	4,011	6	-	-	4,011	6	A
	Interest rate contracts	25	-	28,310	42	-	-	28,335	42	A&C
	Equity & credit contracts	1,025	2	1,468	2	75	-	2,568	4	B
	Commodity contracts	-	-	20	-	-	-	20	-	A
Financial liabilities at FVTPL	Debt securities in issue	-	-	4,850	7	127	-	4,977	7	A
Total liabilities at fair value		2,748	4	65,196	96	202	-	68,146	100	

31 December 2011

Balance sheet category		Quoted prices in active markets (Level 1)		Internal models based on Market observable data (Level 2)		Internal models based on Significant unobservable data (Level 3)		Total		Valuation technique
		£m	%	£m	%	£m	%	£m	%	
Assets										
Trading assets	Loans and advances to banks	-	-	6,144	10	-	-	6,144	10	A
	Loans and advances to customers	-	-	6,687	11	-	-	6,687	11	A
	Debt securities	8,711	15	-	-	-	-	8,711	15	-
	Equity securities	349	1	-	-	-	-	349	1	-
Derivative assets	Exchange rate contracts	-	-	1,618	3	70	-	1,688	3	A
	Interest rate contracts	54	-	29,782	50	-	-	29,836	50	A & C
	Equity & credit contracts	407	-	921	2	360	-	1,688	2	B
	Commodity contracts	-	-	12	-	-	-	12	-	A
Financial assets at FVTPL	Loans and advances to customers	-	-	3,992	7	58	-	4,050	7	A
	Debt securities	-	-	328	1	51	-	379	1	A
Total assets at fair value		9,521	16	49,484	84	539	-	59,544	100	
Liabilities										
Trading liabilities	Deposits by banks	-	-	14,508	21	-	-	14,508	21	A
	Deposits by customers	-	-	10,482	15	-	-	10,482	15	A
	Short positions	755	1	-	-	-	-	755	1	-
Derivative liabilities	Exchange rate contracts	-	-	3,087	5	-	-	3,087	5	A
	Interest rate contracts	41	-	29,490	44	-	-	29,531	44	A & C
	Equity & credit contracts	1,240	2	1,459	2	89	-	2,788	4	B
	Commodity contracts	-	-	11	-	-	-	11	-	A
Financial liabilities at FVTPL	Debt securities in issue	-	-	6,695	10	141	-	6,836	10	A
Total liabilities at fair value		2,036	3	65,732	97	230	-	67,998	100	

d) Valuation techniques

The main valuation techniques employed in the Group's internal models to measure the fair value of the financial instruments disclosed above at 30 June 2012 and 31 December 2011 are set out below. In substantially all cases, the principal inputs into these models are derived from observable market data. The Group did not make any material changes to the valuation techniques and internal models it used during the periods ended 30 June 2012 and 31 December 2011.

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

B In the valuation of equity financial instruments requiring dynamic hedging (principally equity securities, options and other structured instruments), proprietary local volatility and stochastic volatility models are used. These types of models are widely accepted in the financial services industry. Observable market inputs used in these models include the bid-offer spread, foreign currency exchange rates, volatility and correlation between indices. In limited circumstances, other inputs may be used in these models that are based on data other than observable market data, such as the Halifax's UK House Price Index ('HPI') volatility, HPI forward growth, HPI spot rate and mortality.

C In the valuation of financial instruments exposed to interest rate risk that require either static or dynamic hedging (such as interest rate futures, caps and floors, and options), the present value method (futures), Black's model (caps/floors) and the Hull/White and Markov functional models (Bermudan options) are used. These types of models are widely accepted in the financial services industry. The significant inputs used in these models are observable market data, including appropriate interest rate curves, volatilities, correlations and exchange rates. In limited circumstances, other inputs may be used in these models that are based on data other than observable market data, such as HPI volatility, HPI forward growth, HPI spot rate and mortality.

e) Fair value adjustments

The internal models incorporate assumptions that the Group believes would be made by a market participant to establish fair value. Fair value adjustments are adopted when the Group considers that there are additional factors that would be considered by a market participant in the determination of fair value of the instrument that are not incorporated in the valuation model. The magnitude of fair value adjustments depends upon many entity-specific factors, including modelling sophistication, the nature of products traded, and the size and type of risk exposures. For this reason, fair value adjustments may not be comparable across the banking industry.

The Group classifies fair value adjustments as either 'risk-related' or 'model-related'. The fair value adjustments form part of the portfolio fair value and are included in the balance sheet values of the product types to which they have been applied. The majority of these adjustments relate to Markets.

The magnitude and types of fair value adjustment adopted by Markets are listed in the following table:

	30 June 2012 £m	31 December 2011 £m
Risk-related:		
- Bid-offer and trade specific adjustments	**33**	71
- Uncertainty	**47**	47
- Credit valuation adjustment	**77**	70
	157	188
Model-related:		
- Model limitation	**17**	23
Day One profits	-	-
	174	211

g) Internal models based on observable market data (Level 2)

During the six months ended 30 June 2012 and the year ended 31 December 2011, there were no transfers between Level 1 and Level 2 financial instruments.

Notes to the Condensed Financial Statements continued

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

The table below provides an analysis of financial instruments valued using internal models based on information other than market data together with the subsequent valuation technique used for each type of instrument. Each instrument is initially valued at transaction price:

			Balance sheet value		Amount recognised in income/(expense)	
			30 June 2012	31December 2011	**Six months ended 30 June 2012**	Six months ended 30 June 2011
Balance sheet line item	**Category**	**Financial instrument product type**	**£m**	£m	**£m**	£m
1. Derivative assets	Exchange rate contracts	Cross-currency swaps	**61**	70	**(2)**	1
2. Derivative assets	Equity and credit contracts	versionary property interests	**77**	78	**1**	(1)
3. Derivative assets	Equity and credit contracts	Credit default swaps	**13**	16	**(3)**	-
4. Derivative assets	Equity contracts	Options and forwards	**277**	266	**4**	3
5. FVTPL	Loans and advances to customers	Roll-up mortgage portfolio	**59**	58	**1**	(1)
6. FVTPL	Debt securities	Mortgage-backed securities	**47**	51	**-**	1
7. Derivative liabilities	Equity contracts	Options and forwards	**(75)**	(89)	**2**	(2)
8. FVTPL	Debt securities in issue	Non-vanilla debt securities	**(127)**	(141)	**2**	(1)
Total net assets			**332**	309	**-**	-
Total income/(expense)			**-**	-	**5**	-

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

The following table provides a reconciliation of the movement between opening and closing balances of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

	Assets			**Liabilities**		
	Derivatives £m	**Fair value through P&L £m**	**Total £m**	**Derivatives £m**	**Fair value through P&L £m**	**Total £m**
At 1 January 2012	**430**	**109**	**539**	**(89)**	**(141)**	**(230)**
Total gains/(losses) recognised in profit/(loss):						
- Fair value movements	**-**	**1**	**1**	**2**	**2**	**4**
- Foreign exchange and other movements	**(5)**	**(2)**	**(7)**	**-**	**8**	**8**
Purchases	**8**	**-**	**8**	**-**	**-**	**-**
Settlements	**(5)**	**(2)**	**(7)**	**12**	**4**	**16**
At 30 June 2012	**428**	**106**	**534**	**(75)**	**(127)**	**(202)**
Total gains/(losses) recognised in profit/(loss) relating to those assets and liabilities held at the end of the period	**(5)**	**(1)**	**(6)**	**2**	**10**	**12**

	Assets			Liabilities		
	Derivatives £m	Fair value through P&L £m	Total £m	Derivatives £m	Fair value through P&L £m	Total £m
At 1 January 2011	408	118	526	(102)	(137)	(239)
Total gains/(losses) recognised in profit/(loss):						
- Fair value movements	3	-	3	(2)	(1)	(3)
- Foreign exchange and other movements	(4)	4	-	-	4	4
Purchases	23	-	23	-	-	-
Settlements	(33)	(4)	(37)	2	-	2
At 30 June 2011	397	118	515	(102)	(134)	(236)
Total gains/(losses) recognised in profit/(loss) relating to those assets and liabilities held at the end of the period	(1)	4	3	(2)	3	1

Notes to the Condensed Financial Statements continued

Financial instrument assets and liabilities at 30 June 2012
Financial instrument assets valued using internal models based on information other than market data were 1% (31 December 2011: 1%) of total assets measured at fair value and 0.2% (31 December 2011: 0.2%) of total assets at 30 June 2012.

Derivative assets decreased slightly in the first half of 2012 principally due to settlements and exchange rate movements partly offset by purchases. Assets designated at fair value through profit or loss decreased in the first half of 2012 principally due to settlements and exchange rate movements.

Financial instrument liabilities valued using internal models based on information other than market data were 0.3% (31 December 2011: 0.3%) of total liabilities measured at fair value and 0.1% (31 December 2011: 0.1%) of total liabilities at 30 June 2012.

Derivative liabilities decreased in the first half of 2012 due to settlements. Liabilities designated at fair value through profit or loss decreased due to fair value and foreign exchange movements and settlements.

Gains and losses for the six months ended 30 June 2012
Losses of £5m in respect of derivatives assets principally reflected in changes in credit spreads and the HPI Index offset by favourable movements in foreign exchange rates. Losses of £1m in respect of assets designated at fair value through profit or loss are mainly attributable to foreign exchange movements.

Gains of £2m in respect of derivatives liabilities principally reflected changes in credit spreads and the HPI Index. Gains of £10m in respect of liabilities designated at fair value through profit or loss principally reflected changes in foreign exchange and interest rates. They are fully matched with derivatives.

Gains and losses for the six months ended 30 June 2011
Losses of £1m in respect of derivatives assets valued using internal models based on information other than market data principally reflected a combination of changes in fair value and unfavourable movement in foreign exchange.

Gains of £3m in respect of liabilities designated at fair value through profit or loss valued using internal models based on information other than market data principally reflected movement in foreign exchange.

Effect of changes in significant unobservable assumptions to reasonably possible alternatives (Level 3)
As discussed above, the fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data and, as such require the application of a degree of judgement. Changing one or more of the inputs to the valuation models to reasonably possible alternative assumptions would change the fair values significantly. The following table shows the sensitivity of these fair values to reasonably possible alternative assumptions.

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable input as described in the table below. The potential effects do not take into effect any offsetting or hedged positions.

At 30 June 2012

Balance sheet note line item and product	Fair value £m	Assumptions	Shift	Reflected in income statement: Favourable changes £m	Reflected in income statement: Unfavourable changes £m
2. Derivative assets – Equity and credit contracts:	**77**	HPI Forward growth rate	**1%**	**11**	**(11)**
– Reversionary property derivatives		HPI Spot rate	**10%**	**8**	**(8)**
		Mortality rate	**2 yrs**	**1**	**(1)**
3. Derivative assets – Equity and credit contracts: – Credit default swaps	**13**	Probability of default	**20%**	**3**	**(3)**
4. Derivative assets – Equity and credit contracts:	**277**	HPI Forward growth rate	**1%**	**7**	**(7)**
– Options and forwards		HPI Spot rate	**10%**	**12**	**(11)**
		HPI Volatility	**1%**	**1**	**(1)**
5. FVTPL – Loans and advances to customers: – Roll-up mortgage portfolio	**59**	HPI Forward growth rate	**1%**	**2**	**(2)**
6. FVTPL – Debt securities: – Mortgage-backed securities	**47**	Credit spread	**10%**	**5**	**(5)**
7. Derivative liabilities - Equity and credit contracts:	**(75)**	HPI Forward growth rate	**1%**	**3**	**(3)**
– Options and forwards		HPI Spot rate	**10%**	**7**	**(11)**
		HPI Volatility	**1%**	**1**	**(1)**

Notes to the Condensed Financial Statements continued

At 31 December 2011

Balance sheet note line item and product	Fair value £m	Assumptions	Shift	Reflected in income statement: Favourable changes £m	Reflected in income statement: Unfavourable changes £m
2. Derivative assets – Equity and credit contracts: – Reversionary property derivatives	78	HPI Forward growth rate	1%	11	(11)
		HPI Spot rate	10%	8	(8)
		Mortality rate	2 yrs	-	-
3. Derivative assets – Equity and credit contracts: – Credit default swaps	16	Probability of default	20%	3	(3)
4. Derivative assets – Equity and credit contracts: – Options and forwards	266	HPI Forward growth rate	1%	7	(7)
		HPI Spot rate	10%	4	(3)
		HPI Volatility	1%	1	(1)
5. FVTPL – Loans and advances to customers: – Roll-up mortgage portfolio	58	HPI Forward growth rate	1%	2	(2)
6. FVTPL – Debt securities: – Mortgage-backed securities	51	Credit spread	10%	5	(5)
7. Derivative liabilities - Equity and credit contracts: – Options and forwards	(89)	HPI Forward growth rate	1%	4	(4)
		HPI Spot rate	10%	13	(17)
		HPI Volatility	1%	2	(2)

No sensitivities are presented for the FVTPL - debt securities in issue (instrument 8) and related exchange rate derivatives (instrument 1) as the terms of these instruments are fully matched. As a result, any changes in the valuation of the debt securities in issue would be exactly offset by an equal and opposite change in the valuation of the exchange rate derivatives.

27. RESTATEMENTS

The financial statements have been revised to correct an error in accounting for the Company's loans secured on residential property to UK housing associations that are designated at fair value. In 2012, certain clerical and administrative input errors were discovered in the models used to calculate the fair values of these loans at 31 December 2011 and the mark-to-market gains and losses recognised in the second half of 2011. These findings have resulted in restatements of the previously reported amounts in respect of "Financial assets designated at fair value" and "Retained earnings", and their related tax effects, as follows:

Financial assets designated at fair value

	31 December 2011 (Restated) £m	31 December 2011 (Original) £m
Loans and advances to customers	4,050	4,331
Debt securities	379	379
	4,429	4,710

Current tax liabilities

	31 December 2011 (Restated) £m	31 December 2011 (Original) £m
Current tax liabilities	319	393

Retained earnings

	31 December 2011 (Restated) £m	31 December 2011 (Original) £m
Retained earnings	935	1,142

An investment in Abbey National Treasury Services plc (the 'Company') and its subsidiaries (together, the 'Group') involves a number of risks, the material ones of which are set forth below. As a consequence of the reciprocal guarantee given by the Group in respect of the liabilities of Santander UK plc, the Group is exposed to the same risk factors as Santander UK, of which the Company and the Group are part.

The Group's operating results, financial condition and prospects may be materially impacted by economic conditions in the UK

Santander UK's business activities are concentrated in the UK and on the offering of mortgage and savings-related products and services. As a consequence, Santander UK's operating results, financial condition and prospects are significantly affected by economic conditions in the UK generally, and by the UK property market in particular.

In 2008 and 2009, the UK property market suffered a significant correction as a consequence of housing demand being constrained by a combination of rising unemployment, subdued earnings growth, greater pressure on disposable income, a decline in the availability of mortgage finance and the continued effect of global market volatility. Although the UK economy began to grow again in 2009 after the recession that followed the financial crisis, the ongoing sovereign debt crisis throughout the eurozone, elevated unemployment rates and high inflation (which hit real average earnings growth and consequently consumer spending) led to slower growth in 2011 of 0.8%. GDP fell by 0.4% in the final quarter of 2011, 0.3% in the first quarter and 0.7% in the second quarter of 2012, which raised the prospect of a renewed economic downturn in the UK. The Bank of England has held the base rate at a record low of 0.5% since March 2009, and announced a further quantitative easing programme in October 2011 and extensions to this in February and July 2012 to support economic activity. Consumer price inflation peaked at 5.2% in September 2011, falling to 2.4% in June 2012.

Adverse changes in the credit quality of the Group's borrowers and counterparties or a general deterioration in UK or global economic conditions could reduce the recoverability and value of the Group's assets and require an increase in the Group's level of provisions for bad and doubtful debts. Likewise, a significant reduction in the demand for the Group's products and services could negatively impact Santander UK's business and financial condition.UK economic conditions and uncertainties may have an adverse effect on the quality of Santander UK's loan portfolio and may result in a rise in delinquency and default rates. Santander UK recorded impairment loss allowances on loans and advances to customers of £1,600m and £1,563m at 30 June 2012 and 31 December 2011, respectively. There can be no assurance that Santander UK will not have to increase its provisions for loan losses in the future as a result of increases in non-performing loans or for other reasons beyond its control. Any increases in Santander UK's provisions for loan losses and write-offs/charge-offs could have a material adverse effect on Santander UK's operating results, financial condition and prospects.

As in several other economies, the UK Government has taken measures to address the exceptionally high level of national debt, including tax increases and public spending cuts. Political involvement in the regulatory process and in the major financial institutions in which the UK Government has a direct financial interest is set to continue. UK Government demands for financial institutions to increase lending to support the economic recovery will increase competition for deposits, potentially narrowing margins.

Although both the Office for Budget Responsibility and the Bank of England expect stronger economic growth in 2013 than in 2012, credit quality could be adversely affected by a further increase in unemployment. This plus the combination of slow economic recovery, UK Government intervention and competition for deposits, together with any related significant reduction in the demand for Santander UK's products and services, could have a material adverse effect on the Group's operating results, financial condition and prospects.

The Group's operating results, financial condition and prospects may be negatively affected by conditions in global financial markets

The extreme volatility and disruption in global capital and credit markets since 2008 has led to severe dislocation of financial markets around the world, an unprecedented reduction in available liquidity and increased credit risk premiums for many market participants. This has caused severe problems at many of the world's largest commercial banks, investment banks and insurance companies, a number of which are the Group's counterparties or customers in the ordinary course of business. These conditions have also resulted in a material reduction in the availability of financing, both for financial institutions and their customers, compelling many financial institutions to rely on central banks and governments to provide liquidity and, in some cases, additional capital during this period. Governments around the world have sought to provide this liquidity in order to stabilise financial markets and prevent the failure of financial institutions.

Although conditions have eased to some extent since 2009, the volatility of the capital and credit markets has continued and liquidity problems remain, exacerbated recently by fears concerning the financial health of a number of European governments. Greece and other eurozone economies came under increased pressure in 2011 which continues in 2012, with concerns focused on the sustainability of their sovereign debt. These continuing sovereign debt concerns and the related fiscal deterioration in eurozone economies may continue to accentuate the existing disruption in the capital and credit markets. The continuing market instability and reduction of available credit have contributed to lower consumer confidence, increased market volatility, increased funding costs, reduced business activity and, consequently, increasing commercial and consumer loan delinquencies, and market value declines on debt securities held by the Group, all of which could have a material adverse effect on the Group's operating results, financial condition and prospects.

The Group may suffer adverse effects as a result of the ongoing economic and sovereign debt crisis in the eurozone

The financial health of a number of European governments was shaken by a sovereign debt crisis that escalated throughout 2011, contributing to volatility of the capital and credit markets. The sustainability of the sovereign debt of Greece and certain other eurozone economies remains uncertain.

The risk of contagion throughout and beyond the eurozone remains. A significant number of financial institutions throughout Europe have substantial exposures to sovereign debt issued by nations which are under considerable financial pressure. Should any of those nations default on their debt, or experience a significant widening of credit spreads, major financial institutions and banking systems throughout Europe could be destabilised, resulting in the further spread of the ongoing economic crisis. Although the Group conducts the majority of its business in the UK, it has some limited direct and indirect exposure to financial and economic conditions throughout the eurozone economies. For further description of the Group's exposures to eurozone countries, eurozone banks and other financial institutions and corporates see 'Balance Sheet Business Review – Country Risk Exposure' on pages 28 to 32 of the Santander UK 2012 Half Yearly Financial Report. In addition, general financial and economic conditions in the UK, which directly affect Santander UK's operating results, financial condition and prospects, may deteriorate as a result of conditions in the eurozone.

While authorities throughout the European Union continue to work towards developing a political structure or economic plan to address the fiscal instability of certain eurozone nations, the ongoing economic crisis has increased the risk of a break-up of the eurozone. A break-up of the eurozone could have a dramatic impact on the whole financial sector, creating new challenges in sovereign and corporate lending and resulting in significant disruptions in financial activities at both the market and retail levels. This could materially and adversely affect the Group's operating results, financial position and prospects.

The Group may suffer adverse effects should eurozone member states exit the euro or the euro be totally abandoned

Concerns that the eurozone sovereign debt crisis could worsen may lead to the reintroduction of national currencies in one or more eurozone countries or possibly the abandonment of the euro. The departure or risk of departure from the euro by one or more eurozone countries and/or the abandonment of the euro as a currency could have major negative effects on both existing contractual relations and the fulfilment of obligations by the Group and/or customers of the Group, which would have a significant negative impact on the activity, operating results and capital and financial position of the Group.

There is currently no established legal framework within the European treaties to facilitate a member state exiting from the euro; consequently, it is not possible to accurately predict the course of events and legal consequences that would ensue. This redenomination risk stems from this uncertainty, including how an exiting member state would deal with its existing euro-denominated assets and liabilities, the valuation of any newly-adopted currency against the euro and any aspects of the way in which the exit takes place, meaning it is not possible to predict what the total consequential loss might be to Santander UK. For further details see "Redenomination Risk" on page 36 of the Santander UK 2012 Half Yearly Financial Report. The significant upheaval in the eurozone that might arise from any such member state exit, or the abandonment of the euro could materially and adversely affect the Group's operating results, financial condition and prospects.

The Group's risk management measures may not be successful

The management of risk is an integral part of all of the Group's activities. Risk constitutes the Group's exposure to uncertainty and the consequent variability of return. Specifically, risk equates to the adverse effect on profitability or financial condition arising from different sources of uncertainty including credit risk (retail, wholesale and corporate), market risk, operational risk, securitisation risk, non-traded market risk, concentration risk, liquidity and funding risk, reputational risk, strategic risk, pension obligation risk, residual value risk and regulatory risk. The Group seeks to monitor and manage its risk exposure through a variety of separate but complementary financial, credit, market, operational, compliance and legal reporting systems. For further description of our risk management policies see the Risk Management Report on pages 52 to 123 of the Santander UK 2012 Half Yearly Financial Report. While the Group employs a broad and diversified set of risk monitoring and risk mitigation techniques, such techniques, and the judgements that accompany their application, cannot anticipate every unfavourable event or the specifics and timing of every outcome. Accordingly, the Group's ability to successfully identify and balance risks and rewards, and to manage all material risks, is important. Failure to manage such risks appropriately could have a significant effect on the Group's operating results, financial condition and prospects. For example, failure to manage the credit risk (retail) associated with mortgage lending could result in the Group making mortgage loans outside of appropriate risk parameters and potentially resulting in higher levels of default or delinquency on Santander UK's mortgage loan assets.

Santander UK has a significant exposure to the UK real estate market

The residential mortgage loan portfolio is one of Santander UK's principal assets, comprising 85% of its loan portfolio as of 30 June 2012. As a result, Santander UK is highly exposed to developments in the residential property market in the UK.

From 2002 to 2006, demand for housing and mortgage finance in the UK increased significantly driven by, among other things, sustained economic growth, declining unemployment rates, restrictions on new residential property building, demographic trends and the increasing prominence of London as an international financial centre. During 2007, the housing market began to adjust in the UK as a result of deteriorating affordability, slower real income growth and some reduction in credit availability.

From 2007, economic growth stalled, recession hit and unemployment rose in the UK and as a consequence housing demand decreased and credit availability reduced. Real estate prices declined and mortgage delinquencies increased. This adversely affected the credit performance of real estate-related exposures, in residential mortgages and also loans to the real estate sector by Corporate Banking. These property market conditions may continue to affect consumer confidence levels and cause further adverse movements in real estate markets. In turn this may cause adverse changes in repayment patterns, causing increases in delinquencies and default rates, which may impact Santander UK's provision for credit losses and write-offs/charge-offs. Trends such as these could have a material adverse effect on Santander UK's operating results, financial condition and prospects.

Risks concerning borrower credit quality are inherent in the Group's business

Risks arising from changes in credit quality and the recoverability of loans and amounts due from borrowers and counterparties are inherent in a wide range of the Group's businesses. Adverse changes in the credit quality of the Group's borrowers and counterparties, as a result of a general deterioration in UK or global economic conditions, or arising from systemic risks in the financial systems, could reduce the recoverability and value of the Group's assets and require an increase in the Group's level of provisions for bad and doubtful debts.

The Group estimates and establishes reserves for credit risks and potential credit losses inherent in its credit exposure. This process, which is critical to its results and financial condition, requires difficult, subjective and complex judgements, including forecasts of how these economic conditions might impair the ability of its borrowers to repay their loans. As is the case with any such assessments, the Group may fail to estimate accurately the impact of factors that it identifies. Any such failure may have a material adverse impact on the Group's operating results, financial condition and prospects.

The soundness of other financial institutions could materially and adversely affect the Group's business

The Group's ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness, or perceived commercial soundness, of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. The Group has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, investment banks, mutual funds and other institutional clients. Defaults by or even rumours or questions about one or more financial services institutions, or the financial services industry generally, can lead to market-wide liquidity problems and could result in losses for the Group or other institutions as well as increased funding costs. Many transactions expose the Group to credit risk in the event of default of the Group's counterparty or client. In addition, the Group's credit risk may be exacerbated when the collateral held by the Group cannot be realised or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due to the Group. There is no assurance that any such losses would not materially and adversely affect the Group's operating results, financial condition and prospects.

Risks associated with liquidity and funding are inherent in the Group's business

Liquidity risk is the risk that the Group, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due or can secure them only at excessive cost. This risk is inherent in any retail and commercial banking business and can be heightened by a number of enterprise-specific factors, including over-reliance on a particular source of funding, changes in credit ratings or market-wide phenomena such as market dislocation. While the Group has implemented liquidity management processes to seek to mitigate and control these risks, unforeseen systemic market factors in particular make it difficult to eliminate completely these risks. Adverse and continued constraints in the supply of liquidity, including inter-bank lending, has affected and may materially and adversely affect the cost of funding the Group's business, and extreme liquidity constraints may affect the Group's current operations as well as limit growth possibilities. Such events may also have a material adverse effect on the market value and liquidity of bonds issued by the Group in the secondary markets. Global investor confidence also remains low and other forms of wholesale funding remain relatively scarce.

Continued or worsening disruption and volatility in the global financial markets could have a material adverse effect on the Group's ability to access capital and liquidity on financial terms acceptable to it.

The Group's cost of obtaining funding is directly related to prevailing market interest rates and to its credit spreads. Credit spreads are the amount in excess of the interest rate of Government benchmark securities, of the same maturity that the Group needs to pay to its funding providers. Increases in interest rates and its credit spreads can significantly increase the cost of the Group's funding. Changes in the Group's credit spreads are market-driven, and may be influenced by market perceptions of its creditworthiness. Changes to interest rates and its credit spreads occur continuously and may be unpredictable and highly volatile.

If wholesale markets financing ceases to become available, or becomes excessively expensive, the Group may be forced to raise the rates it pays on deposits, with a view to attracting more customers, and/or to sell assets, potentially at depressed prices. While central banks around the world have made coordinated efforts to increase liquidity in the financial markets, by taking measures such as increasing the amounts they lend directly to financial institutions, lowering interest rates and significantly increasing temporary reciprocal currency arrangements (or swap lines), it is not known how long central bank schemes will continue or on what terms. The Bank of England's Special Liquidity Scheme was not extended when it expired at the end of January 2012, although the Bank of England has since announced the Extended Collateral Term Repo facility ('ECTR') and Funding for Lending schemes with the aim to increase liquidity in the market. As yet it is not clear how banks might participate in these schemes and their effect on the market. There are no indications from the Monetary Policy Committee that policy interest rates are likely to be raised in the near future and financial markets do not expect rates to rise in 2012. If the Bank of England raises interest rates this would increase the cost of the Group's funding. The persistence or worsening of these adverse market conditions, and the lack of availability of such central bank schemes or an increase in base interest rates, could have a material adverse effect on the Group's ability to access liquidity and cost of funding (whether directly or indirectly).

The Group relies, and will continue to rely, primarily on commercial deposits to fund lending activities. The ongoing availability of this type of funding is sensitive to a variety of factors outside the Group's control, such as general economic conditions and the confidence of commercial depositors in the economy, in general, and the financial services industry in particular, and the availability and extent of deposit guarantees, as well as competition between banks for deposits. Any of these factors could significantly increase the amount of commercial deposit withdrawals in a short period of time, thereby reducing the Group's ability to access commercial deposit funding on appropriate terms, or at all, in the future. If these circumstances were to arise, this could have a material adverse effect on the Group's operating results, financial condition and prospects.

For additional information about the Group's liquidity position and other liquidity matters, including credit ratings and outlooks and the policies and procedures the Group uses to manage its liquidity risks, see 'Balance Sheet Business Review - Capital Management and Resources' on pages 40 to 44, 'Balance Sheet Business Review - Funding and Liquidity' on pages 45 to 49 and 'Risk Management Report – Funding and Liquidity Risk' on pages 110 to 114 of the Santander UK 2012 Half Yearly Financial Report.

The Group is subject to regulatory capital and liquidity requirements that could limit its operations, and changes to these requirements may further limit and adversely affect its operating results, financial condition and prospects

As a bank Santander UK plc is subject to capital adequacy requirements adopted by the UK Financial Services Authority (the 'FSA') which provide for a minimum ratio of total capital to risk-adjusted assets both on a consolidated basis and on a solo-consolidated basis (the basis used by the FSA solely for the purpose of the calculation of capital resources and capital resources requirements, which comprises Santander UK plc and certain subsidiaries), expressed as a percentage. Any failure by Santander UK to maintain its ratios may result in administrative actions or sanctions which may affect Santander UK's ability to fulfil its obligations.

In response to the recent financial crisis, the FSA has imposed, and may continue to impose, more stringent capital adequacy requirements across the UK banking industry, including increasing the minimum regulatory capital requirements imposed on Santander UK. For instance, the FSA has adopted a supervisory approach in relation to certain UK banks, including Santander UK plc, under which those banks are expected to maintain Tier 1 Capital in excess of the minimum levels required by the existing rules and guidance of the FSA. The FSA is currently considering, and in the process of consulting on, changes to the eligibility criteria for Tier 1 Capital as well as provisions that may result in banks being required to increase the level of regulatory capital held in respect of trading book risks. This consultation is taking place ahead of the UK implementation of the recent amendments and proposed amendments to the EU-wide capital adequacy requirements (as set out in the amended Directive 2006/48/EC and Directive 2006/49/EC, collectively referred to as the 'Capital Requirements Directive').

On 5 October 2009, the FSA published its new liquidity rules which significantly broadened the scope of the existing liquidity regime. These are designed to enhance regulated firms' liquidity risk management practices. As part of these reforms, the FSA has implemented requirements for financial institutions to hold prescribed levels of specified liquid assets and have in place other sources of liquidity to address the institution-specific and market-wide liquidity risks that institutions may face in short-term and prolonged stress scenarios.

On 16 December 2010 and 13 January 2011, the Basel Committee on Banking Supervision issued its final guidance on a number of fundamental reforms to the regulatory capital framework intended to strengthen minimum capital requirements (referred to as Basel III). The changes in Basel III include, among other things, phasing out Innovative Tier 1 Capital instruments with incentives to redeem and implementing a leverage ratio on institutions in addition to current risk-based regulatory capital requirements. As essentially a retail bank lending mostly on secured residential mortgages, Santander UK plc's current leverage ratio is high, reflecting the low risk-weighting of its assets. Basel III also requires institutions to build counter-cyclical capital buffers that may be drawn upon in stress scenarios, as well as increasing the amount and quality of Tier 1 Capital that institutions are required to hold. The changes brought about by Basel III will be phased in gradually between January 2013 and January 2019. The most recent Basel capital rules have raised the minimum level of tangible common equity capital from 2 to 7 per cent of risk-weighted assets, however it is not yet known whether the FSA will require UK banks to hold a further buffer above this level.

In the UK and world-wide a range of proposals for future legislative and regulatory changes have been produced which could force the Group to comply with certain operational restrictions or take steps to raise further capital, or could increase the Group's expenses, or otherwise adversely affect its operating results, financial condition and prospects. These changes have, among other things included:

> the introduction of recovery and resolution planning requirements (popularly known as 'living wills') for banks and other financial institutions as contingency planning for the failure of a financial institution that may affect the stability of the financial system;
> implementation of the Financial Services Act 2010, which enhances the FSA's disciplinary and enforcement powers;
> the introduction of more regular and detailed reporting obligations; and
> a proposal in the ICB's recommendations to require large UK retail banks to hold a minimum Core Tier 1 to risk-weighted assets ratio of at least 10 per cent., which is, broadly, 3 per cent. higher than the minimum capital levels required under Basel III.

These measures could have a material adverse effect on the Group's operating results, financial condition and prospects. There is a risk that changes to the UK capital adequacy regime (including any introduction of a minimum leverage ratio) may result in increased minimum capital requirements, which could reduce available capital and thereby adversely affect Santander UK's profitability and ability to pay dividends, continue organic growth (including increased lending), or pursue acquisitions or other strategic opportunities (unless Santander UK were to restructure its balance sheet in order to reduce the capital charges incurred pursuant to the FSA's rules in relation to the assets held, or alternatively raise additional capital but at increased cost and subject to prevailing market conditions). In addition, changes to the eligibility criteria for Tier 1 Capital may affect Santander UK's ability to raise Tier 1 Capital or the eligibility of existing Tier 1 Capital resources.

There is also a risk that implementing and maintaining enhanced liquidity risk management systems may incur significant costs and more stringent requirements to hold liquid assets may materially affect the Group's lending business as more funds may be required to acquire or maintain a liquidity buffer, thereby reducing future profitability.

Any reduction in the credit rating assigned to Santander UK, the Company or to any Santander UK group debt securities would be likely to increase Santander UK or the Group's cost of funding, require additional collateral to be placed and adversely affect its interest margins and liquidity position

Credit ratings affect the cost and other terms upon which Santander UK and the Group are able to obtain funding. Rating agencies regularly evaluate Santander UK and the Company, as well as their respective debt securities. Their ratings are based on a number of factors, including the perceived financial strength of Santander UK or the Company, sovereign perceived risk, as well as conditions affecting the financial services industry generally. There can be no assurance that the rating agencies will maintain Santander UK's or the Company's current ratings or outlook, or with regard to those rating agencies who may have a negative outlook on Santander UK or the Company, there can be no assurances that such agencies will revise such outlooks upwards, especially in light of the difficulties in the financial services industry and the financial markets.

Any reduction in those ratings and outlook would be likely to increase the cost of Santander UK or the Group's funding, limit access to capital markets, and require additional collateral to be placed, and consequently, adversely affect the Group's interest margins and/or affect its liquidity position. For example, a ratings downgrade could adversely affect the Group's ability to sell or market certain of its products, such as subordinated securities and engage in certain longer-term and derivatives transactions. It could also adversely affect Santander UK's or the Company's ability to retain customers or attract new investors, particularly those who look for a minimum rating threshold in order to invest. Any of these could, in turn, reduce Santander UK's and the Group's liquidity and have an adverse effect on Santander UK's and the Group's operating results, financial condition and prospects.

For example, at 30 June 2012, a hypothetical simultaneous one or two notch downgrade of Santander UK's long-term debt rating from all major rating agencies, triggering a short-term ratings downgrade, could have resulted in the following outflows of cash and liquidity which are more than covered by Santander UK's total liquid assets: an outflow of £3.2bn of cash, £6.5bn of collateral posting associated with secured funding and £1.2bn of collateral posting associated with derivative contracts for a one notch downgrade and an additional outflow of £nil of cash, £1.7bn of collateral posting associated with secured funding and £nil of collateral posting associated with derivative contracts for a two notch downgrade. Actual outflows could be higher or lower than this hypothetical example, depending upon certain factors including which rating agency had downgraded Santander UK's credit rating, any management or restructuring actions that could be taken to reduce cash outflows and the potential liquidity impact from loss of unsecured funding (such as from money market funds) or loss of secured funding capacity. However, unsecured and secured funding stresses are included in Santander UK's stress testing scenarios and a portion of Santander UK's total liquid assets is held against these risks.

Fluctuations in interest rates, bond and equity prices and other market factors are inherent in the Group's business

The Group faces significant interest rate and bond and equity price risks. Fluctuations in interest rates could adversely affect the Group's operations and financial condition in a number of different ways. An increase in interest rates generally may decrease the relative value of the Group's fixed rate loans and raise the Group's funding costs, although such an increase would be offset to some extent by an increase in income from variable rate loans. Such an increase could also generally decrease the relative value of fixed rate debt securities in the Group's securities portfolio. In addition, an increase in interest rates may reduce overall demand for new loans and increase the risk of customer default, while general volatility in interest rates may result in a gap between the Group's interest rate-sensitive assets and liabilities. Interest rates are sensitive to many factors beyond the Group's control, including the policies of central banks and, in particular, the Bank of England, as well as domestic and international economic conditions and political factors. It remains difficult to predict any changes in economic or financial market conditions.

Continued declines in housing markets over the past four years have adversely affected the credit performance of real estate-related loans and resulted in write-downs of asset values by many financial institutions (including Santander UK). These write-downs, initially of asset-backed securities but spreading to other securities and loans, have caused many financial institutions to seek additional capital, to reduce or eliminate dividends, to merge with larger and stronger institutions and, in some cases, to fail. Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced funding to borrowers, including to other financial institutions. As a result of these market forces, volatility in interest rates and basis spreads has increased, which has increased Santander UK's borrowing costs.

Any further increase in wholesale funding costs or deposit rates could precipitate a re-pricing of loans to customers, which could result in a reduction of volumes, and could also have an adverse effect on the Group's interest margins. While the Group would also expect to increase lending rates, there can be no assurance that it would be able to offset in full or at all its funding costs and, in addition, may face competitive pressure to pass on interest rate rises to retain existing and attract new customer deposits.

Santander UK also sponsors a number of defined benefit staff pension schemes, and its obligations to those schemes may increase depending on the performance of financial markets. Although Santander UK is taking measures to mitigate and control the effects of these conditions, there can be no assurances that such controls will insulate Santander UK from deteriorating market conditions.

Currency fluctuations may adversely affect the Group's operating results, financial condition and prospects

Santander UK and the Group is exposed to risk from fluctuations in exchange rates for currencies, particularly the US dollar and the euro. In particular, a substantial portion of the Group's outstanding debt is denominated in currencies other than the British pound sterling, which is the primary currency of the Group's financial reporting. The Group's capital is also stated in pound sterling and it does not fully hedge its capital position against changes in currency exchange rates. Although the Group seeks to hedge most of its currency risk through hedging and purchase of cross-currency swaps, these hedges do not eliminate currency risk and the Group can make no assurance that it will not suffer adverse financial consequences as a result of currency fluctuations. Significant exchange rate volatility and the depreciation of the pound sterling in particular could have an adverse impact on the Group's results of operations and its ability to meet its US dollar and euro-denominated obligations, and could have a material adverse effect on the Group's operating results, financial condition and prospects.

Market conditions have, and could result, in material changes to the estimated fair values of financial assets of the Group. Negative fair value adjustments could have a material adverse effect on the Group's operating results, financial condition and prospects

In the past four years, financial markets have been subject to significant stress resulting in steep falls in perceived or actual financial asset values, particularly due to the recent volatility in global financial markets and the resulting widening of credit spreads. The Group has material exposures to securities and other investments that are recorded at fair value and are therefore exposed to potential negative fair value adjustments. Asset valuations in future periods, reflecting then prevailing market conditions, may result in negative changes in the fair values of the Group's financial assets and these may also translate into increased impairments. In addition, the value ultimately realised by the Group on disposal may be lower than the current fair value. Any of these factors could require the Group to record negative fair value adjustments, which may have a material adverse effect on its operating results, financial condition or prospects.

In addition, to the extent that fair values are determined using financial valuation models, such values may be inaccurate or subject to change, as the data used by such models may not be available or may become unavailable due to changes in market conditions, particularly for illiquid assets, and particularly in times of economic instability. In such circumstances, the Group's valuation methodologies require it to make assumptions, judgements and estimates in order to establish fair value, and reliable assumptions are difficult to make and are inherently uncertain and valuation models are complex, making them inherently imperfect predictors of actual results. Any consequential impairments or write-downs could have a material adverse effect on the Group's operating results, financial condition and prospects.

A core strategy of Santander UK its operations and it may not be able to manage such growth effectively, which could have an adverse impact on its profitability

Santander UK allocates management and planning resources to develop strategic plans for organic growth, and to identify possible acquisitions and disposals and areas for restructuring Santander UK's businesses. Santander UK cannot provide assurance that it will, in all cases, be able to manage its growth effectively or deliver its strategic growth objectives. Challenges that may result from the strategic growth decisions include Santander UK's ability to:

- manage efficiently the operations and employees of expanding businesses;
- maintain or grow its existing customer base;
- assess the value, strengths and weaknesses of investment or acquisition candidates;
- finance strategic investments or acquisitions;
- fully integrate strategic investments, or newly-established entities or acquisitions in line with its strategy;
- align its current information technology systems adequately with those of an enlarged group;
- apply its risk management policy effectively to an enlarged group; and
- manage a growing number of entities without over-committing management or losing key personnel.

Any failure to manage growth effectively, including relating to any or all of the above challenges associated with Santander UK's growth plans, could have a material adverse effect on Santander UK's operating results, financial condition and prospects.

The Company may incur unanticipated losses related to Santander UK's business combinations

Santander UK plc has made several business acquisitions in recent years, including the acquisition of Alliance & Leicester plc in January 2009 and the retail deposits, branch network and related employees of Bradford & Bingley in September 2008. In October and November 2010, Santander UK plc also acquired the following Banco Santander, S.A. entities:

- Santander Cards Limited, Santander Cards UK Limited (and its subsidiaries) and Santander Cards Ireland Limited;
- Santander Consumer (UK) plc (of which Santander UK plc already held 49.9%); and
- Santander PB UK (Holdings) Limited (of which Santander UK plc already held 51%) and its subsidiaries.

In addition, in August 2010, Santander UK plc reached an agreement to acquire (subject to certain conditions) bank branches and business banking centres and associated assets and liabilities from the Royal Bank of Scotland Group (the 'RBS Acquisition').
Santander UK plc's assessment of the businesses acquired in October and November 2010 and to be acquired under the RBS Acquisition is based on certain assumptions with respect to operations, profitability, asset quality and other matters that may prove to be incorrect. In the case of the RBS Acquisition, this assessment was also based on limited information, as there were no standalone audited financial statements in respect of the relevant assets. There can be no assurance that Santander UK will not be exposed to currently unknown liabilities resulting from these business combinations. Any unanticipated losses or liabilities could have a material adverse effect on Santander UK's operating results, financial condition and prospects.

The Group may fail to realise the anticipated benefits of Santander UK plc's recent or proposed business combinations

The success of Santander UK's business combinations will depend, in part, on Santander UK's ability to realise the anticipated benefits from combining the businesses of Alliance & Leicester, Bradford & Bingley, those acquired in October and November 2010 and the assets to be acquired under the RBS Acquisition, with Santander UK's business. It is possible that the integration process could take longer or be more costly than anticipated. The eventual integration of the assets to be acquired under the RBS Acquisition is dependent upon, among other things, the successful transition to Partenon (the proprietary IT platform used by the Banco Santander group). Any delay could result in additional costs to Santander UK and mean that the Group does not receive the full benefit anticipated from such acquisition. Santander UK's efforts to integrate these businesses are also likely to divert management attention and resources. If Santander UK takes longer than anticipated or is not able to integrate these businesses, the anticipated benefits of Santander UK's business combinations may not be realised fully or at all. Any failure to realise all or any of the anticipated benefits of these business combinations could have a material adverse effect on Santander UK's operating results, financial condition and prospects.

Goodwill impairments may be required in relation to certain of Santander UK plc's acquired businesses

Santander UK plc has made business acquisitions in recent years and will acquire certain assets under the RBS Acquisition. It is possible that the goodwill which has been attributed, or will be attributed, to these businesses may have to be written-down if Santander UK plc's valuation assumptions are required to be reassessed as a result of any deterioration in their underlying profitability, asset quality and other relevant matters. In 2011 there was a £60m impairment related to Cater Allen Private Bank as a result of a reassessment of the value of certain parts of the business in light of recent market conditions and regulatory developments Impairment testing in respect of goodwill is performed annually, more frequently if there are impairment indicators present, and comprises a comparison of the carrying amount of the cash-generating unit with its recoverable amount. There can be no assurances that Santander UK plc will not have to write down the value attributed to goodwill in the future, which would adversely affect Santander UK's results and net assets.

The Group's business is conducted in a highly competitive environment

The market for UK financial services is highly competitive, and the recent financial crisis has reshaped the banking landscape in the UK, reinforcing both the importance of a retail deposit funding base and strong capitalisation. The Group expects such competition to intensify in response to consumer demand, technological changes, the impact of consolidation, regulatory actions and other factors. If financial markets remain unstable, financial institution consolidation may continue (whether as a result of the UK Government taking ownership and control over other financial institutions in the UK or otherwise). Financial institution consolidation could also result from the UK Government disposing of its stake in those financial institutions it currently controls. Such consolidation could adversely affect the Group's operating results, financial condition and prospects. The potential increase in competition could result in declining lending margins or competition for savings driving up funding costs that cannot be recovered from borrowers, all of which could adversely affect the Group's operating results, financial condition and prospects.

In addition, if the Group's customer service levels were perceived by the market to be materially below those of its UK competitor financial institutions, the Group could lose existing and potential business. If the Group is not successful in retaining and strengthening customer relationships, it may lose market share, incur losses on some or all of its activities or fail to attract new deposits or retain existing deposits, which could have a material adverse effect on its operating results, financial condition and prospects.

Operational risks are inherent in the Group's business

Operational Risk losses can result from many actions, including fraud, criminal acts, errors by employees, employee misconduct, unauthorised breaches of authorities, failure to document transactions properly or to obtain proper authorisation, failure to comply with regulatory requirements and conduct of business rules, failure or breakdown of accounting, data processing and other record keeping systems, natural disasters, or failure or breakdown of external systems, including those of the Group's suppliers or counterparties. Such operational losses could have a material adverse effect on the Group's operating results, financial condition and prospects.

The Group relies on recruiting, retaining and developing appropriate senior management and skilled personnel

The Group's continued success depends in part on the continued service of key members of its management team. The ability to continue to attract, train, motivate and retain highly qualified and talented professionals is a key element of the Company's strategy. The successful implementation of the Company's growth strategy depends on the availability of skilled management, both at its head office and at each of its business units. If the Company or one of its business units or other functions fails to staff their operations appropriately or loses one or more of its key senior executives, and fails to replace them in a satisfactory and timely manner, its operating results, financial condition and prospects, including control and operational risks, may be adversely affected. Likewise, if the Company fails to attract and appropriately train, motivate and retain qualified and talented professionals, its business may be affected.

Reputational risk could cause harm to the Group and its business prospects

The Group's ability to attract and retain customers and conduct business transactions with its counterparties could be adversely affected to the extent that its reputation, the reputation of Banco Santander, S.A. (as the majority shareholder in the Company), or the reputation of affiliates operating under the "Santander" or the "Abbey National Treasury Services" brand or any of its other brands is damaged. Failure to address, or appearing to fail to address, various issues that could give rise to reputational risk could cause harm to the Group and its business prospects. Reputational issues include, but are not limited to: appropriately addressing potential conflicts of interest; legal and regulatory requirements; ethical issues; adequacy of anti-money laundering processes; privacy issues; customer service issues; record-keeping; sales and trading practices; proper identification of the legal, reputational, credit, liquidity and market risks inherent in products offered; and general company performance (including the quality of the Company's customer services). A failure to address these issues appropriately could make customers unwilling to do business with the Group, which could adversely affect its operating results, financial condition and prospects.

Legislative, regulatory and governmental oversight and current banking reform initiatives and requirements could have a material adverse effect on the Group

The Group is subject to extensive financial services laws, regulations, administrative actions and policies in each location in which the Group operates (including in the US and, indirectly, in Spain as a result of being part of the Banco Santander, S.A. group). During the recent market turmoil, there have been unprecedented levels of government and regulatory intervention and scrutiny, and changes to the regulations governing financial institutions and the conduct of business. In addition, in light of the financial crisis, regulatory and governmental authorities are considering, or may consider, further enhanced or new legal or regulatory requirements intended to prevent future crises or otherwise assure the stability of institutions under their supervision. It is anticipated that this intensive approach to supervision will be continued by the successor regulatory authorities to the FSA.

Recent proposals and measures taken by governmental, tax and regulatory authorities and future changes in supervision and regulation, in particular in the UK, which are beyond the Group's control, could materially affect the Group's business, value of assets and the Group's operations, and result in significant increases in operational costs. Products and services offered by the Group could also be affected. The FSA is taking a more intrusive approach in respect of financial products and this power will be further enhanced with the introduction of the successor conduct regulatory authority to the FSA. Changes in UK legislation and regulation to address the stability of the financial sector may also affect the competitive position of the UK banks, including Santander UK and the Company, particularly if such changes are implemented before international consensus is reached on key issues affecting the industry, for instance in relation to the FSA's regulations on liquidity risk management and also the UK Government's introduction of the bank levy. Although the Group works closely with its regulators and continually monitors the situation, future changes in law, regulation, fiscal or other policies can be unpredictable and are beyond the control of the Group. No assurance can be given generally that laws or regulations will be adopted, enforced or interpreted in a manner that will not have an adverse effect on the Group's business.

On 16 June 2010, the Chancellor of the Exchequer announced the creation of the Independent Commission on Banking (the 'ICB'), chaired by Sir John Vickers. The ICB was asked to consider structural and related non-structural reforms to the UK banking sector to promote financial stability and competition, and to make recommendations to the Government by the end of September 2011. The ICB gave its recommendations on 12 September 2011 and proposed: (i) implementation of a retail ring fence, (ii) increased capital requirements and (iii) improvement of competition. The Government published its response to the ICB's recommendations on 19 December 2011, broadly endorsing them. A White Paper was published on 14 June 2012 detailing how the Government intend to implement the recommendations of the ICB. The Government expects the legislation to be in place by 2015 and to take effect by 2019. Implementation of the proposals may require the Group to make changes to its structure and business.

The resolution of a number of issues, including regulatory investigations and reviews and court cases, affecting the UK financial services industry could have an adverse effect on the Group's operating results, financial condition and prospects, or its relations with its customers and potential customers.

Tax and compliance changes (including the UK bank levy and FATCA) could have a material adverse effect on the Group's business

HM Treasury introduced an annual bank levy via legislation in the Finance Act 2011. The UK bank levy is imposed on (amongst other entities) UK banking groups and subsidiaries, and therefore applies to Santander UK. The amount of the bank levy is based on a bank's total liabilities, excluding (amongst other things) Tier 1 Capital, insured retail deposits and repos secured on sovereign debt. A reduced rate is applied to longer-term liabilities.

HM Treasury has emphasised that the bank levy will not be regarded as insurance against future bank failures and that it is exploring the costs and benefits of imposing a financial activities tax on the profits and remuneration of banking groups. 2011 receipts from the bank levy are expected to fall short of the £2.5 billion target, accordingly, periodic increases have been announced by HM Treasury to these bank levy rates from 1 January 2012.

The US published draft regulations on the proposed Foreign Account Tax Compliance Act ('FATCA') on 8 February 2012. FATCA may require members of Santander UK to undertake significant compliance activity and failure to comply may result in payments to Santander UK or the Group from the US being subject to a withholding tax. The exact scope of FATCA is still developing so its full effect is still uncertain.

The UK bank levy, FATCA and possible future changes in the taxation of banking groups in the European Union, including financial, transaction taxes or similar levies, could have a material adverse effect on Santander UK and the Group's operating results, financial condition and prospects, and the competitive position of UK banks, including the Company.

Santander UK and the Group are exposed to various forms of legal and regulatory risk which could have a material adverse effect on its operating results, financial condition and prospects or relations with its customers

Santander UK and the Group are exposed to many forms of legal and regulatory risk, which may arise in a number of ways. Primarily:

- certain aspects of Santander UK's business may be determined by the Bank of England, the FSA, HM Treasury, the Financial Ombudsman Service ('FOS') or the courts as not being conducted in accordance with applicable laws or regulations, or, in the case of the FOS, with what is fair and reasonable in the FOS's opinion;
- the alleged misselling of financial products, resulting in disciplinary action or requirements to amend sales processes, withdraw products, or provide restitution to affected customers, all of which may require additional provisions.
- Santander UK holds accounts for entities that might be or are subject to interest from various regulators, including the UK's Serious Fraud Office, those in the US and others. The Group is not aware of any current investigation into the Group as a result of any such enquiries, but cannot exclude the possibility of the Group's conduct being reviewed as part of any such investigations; and
- Santander UK or the Group may be liable for damages to third parties harmed by the conduct of its business.

The FSA carries out regular and frequent reviews of the conduct of business by financial institutions including banks. An adverse finding by the regulator could result in the need for extensive changes in systems and controls, business policies, and practices coupled with customer redress, fines and reputational damage. For a discussion of Santander UK's approach to its provision for payment protection insurance complaints in connection with the related FSA policy statement and April 2011 High Court ruling see "Potential intervention by the UK Financial Services Authority (or an overseas regulator) may occur, particularly in response to customer complaints" on page 196 of the Santander UK 2012 Half Yearly Financial Report.

In addition, Santander UK or the Group face both financial and reputational risk where legal or regulatory proceedings, or the Financial Ombudsman Service, or other complaints are brought against it in the UK High Court or elsewhere, or in jurisdictions outside the UK, including other European countries and the United States.

Failure to manage these risks adequately could have a material adverse effect on Santander UK or the Group's reputation, its operating results, financial condition and prospects.

The structure of the financial regulatory authorities in the UK and the UK regulatory framework that applies to members of Santander UK, including the Company is the subject of reform and reorganisation

The UK Government announced proposals in June 2010 to reform the institutional framework for UK financial regulation. Specifically, the UK Government intends to replace the FSA with two new successor bodies.

In July 2010 and February 2011, HM Treasury published consultations on proposals to replace the FSA with a new Prudential Regulation Authority (the 'PRA'), which will be responsible for micro-prudential regulation of financial institutions that manage significant risks on their balance sheets, and a new Financial Conduct Authority (the 'FCA') which will be responsible for regulation of conduct of business. HM Treasury proposes, amongst other things, that the FCA will have product intervention powers, and that cooperation will exist between the FCA and the FOS, particularly where issues identified potentially have wider implications. Draft guidance has also been published on how the FCA and PRA will interact.

In June 2011 HM Treasury published a further consultation document, including a draft Bill, which reiterated the proposal to replace the FSA with the PRA and the FCA and suggested that the regulatory approach under the new regime will be more intrusive than the existing regime and will challenge business models and governance culture in particular. HM Treasury intends that the Bill will become law by the end of 2012, with the new regime intended to come into effect in 2013. To prepare for this change, the FSA has adopted a 'twin peaks' model internally and now has two supervisors; one focusing on prudential matters and the other on conduct.

Substantial reorganisation of the regulatory framework could cause administrative and operational disruption for the regulatory authorities concerned. This disruption could impact on the resources which the FSA or the successor authorities are able to devote to the supervision of regulated financial services firms, the nature of their approach to supervision and accordingly, the ability of regulated financial sector firms (including members of Santander UK) to deal effectively with their supervisors and to anticipate and respond appropriately to developments in regulatory policy.

It is anticipated that future changes in the nature of, or policies for, prudential and conduct of business supervision, as performed by the successor authorities to the FSA, will differ from the current approach taken by the FSA and that this could lead to a period of some uncertainty for members of Santander UK. The Financial Services Bill, which has been put before Parliament, not only details proposals for the creation of the FCA and PRA but also contains provisions enabling consumer credit regulation to be transferred from the OFT to the FCA. This decision will be subject to further consultation. Should this change occur, its introduction will bring about another reform to the institutional framework.

No assurance can be given that further changes will not be made to the regulatory regime in the UK generally, Santander UK or the Group's particular business sectors in the market or specifically in relation to Santander UK or the Group. Any or all of these factors could have a material adverse effect on the conduct of the business of Santander UK or the Group and, therefore, also on its strategy and profitability, and its ability to respond to and satisfy the supervisory requirements of the relevant UK regulatory authorities.

Various reforms to the mortgage lending market have been proposed which could require significant implementation costs or changes to the business strategy of Santander UK

In March 2009, the Turner Review, "A regulatory response to the global banking crisis", was published and set out a detailed analysis of how the global financial crisis began along with a number of recommendations for future reforms and proposals for consultation. In the Turner Review, it was announced that the FSA would publish a discussion paper considering the possibility of a move towards the regulation of mortgage products (in addition to the product providers) and other options for reform of the mortgage market. This discussion paper (Discussion Paper 09/3) was published in October 2009 and launched the FSA's Mortgage Market Review ("MMR"). The review involved a consultation concerning various potential reforms to the regulatory framework applicable to mortgage lenders and mortgage intermediaries, including mortgage firms' conduct of business, product distribution and advice, and their handling of arrears and repossessions.

Separately, in January 2011, HM Treasury announced a package of measures with the aim of enhancing consumer protection in the mortgage market. The measures provide for the transfer of the regulation of new and existing second charge residential mortgages from the OFT to the FSA, and provide for consumer protection when a mortgage book is sold by a regulated mortgage lender to an unregulated firm.

On 19 December 2011, the FSA issued its latest MMR consultation containing proposals for a change in the rules relating to the UK mortgage market. Key changes will require lenders to (i) verify borrowers income; (ii) check that interest-only mortgages can be repaid; and (iii) make sure that borrowers can pay for their mortgage after retirement. The consultation closed on 30 March 2012 and the FSA hopes to make a final decision on the definitive form of rules by the end of Summer 2012, with implementation due in 2013. The ultimate impact of such measures on the Group is uncertain and no assurance can be given that such changes and any further reforms considered as part of the MMR will not adversely affect Santander UK and its business and operations. Further, it is possible that such reforms, if adopted, could lead to a period of change for Santander UK, particularly as regards changes that may be required to the operational strategy and capital management of Santander UK, and the supervisory approach taken by the FSA in relation to second charge mortgages, a portfolio of which Santander UK acquired as a result of its acquisition of Alliance & Leicester plc and any second charge mortgages which may be acquired under the RBS Acquisition.

As a consequence of such changes and any associated costs that may arise, it is possible that there could be a material adverse effect on the operating results, financial condition and prospects of Santander UK.

Potential intervention by the UK Financial Services Authority (or an overseas regulator) may occur, particularly in response to customer complaints.

Customers of financial services institutions, including customers of Santander UK, may seek redress if they consider that they have suffered loss as a result of the misselling of a particular product, or through incorrect application of the terms and conditions of a particular product. Given the inherent unpredictability of litigation and the evolution of judgements by the FOS, it is possible that an adverse outcome in some matters could have a material adverse effect on the operating results, financial condition and prospects of Santander UK arising from any penalties imposed or compensation awarded, together with the costs of defending such an action.

The Financial Services Act 2010 has provided a new power for the FSA which enables the FSA to require authorised firms, including members of Santander UK, to establish a consumer redress scheme if it considers that consumers have suffered loss or damage as a consequence of a widespread or regular regulatory failing, including misselling.

In recent years there have been several industry-wide issues in which the FSA has intervened directly. One such issue is the misselling of payment protection insurance ('PPI'), about which, in August 2010, the FSA published Policy Statement 10/12 entitled "The assessment and redress of Payment Protection Insurance complaints". This policy statement contains rules from the FSA which alter the basis on which the FSA regulated firms (including Santander UK plc and certain members of Santander UK) must consider and deal with complaints in relation to the sale of PPI and may potentially increase the amount of compensation payable to customers whose complaints are upheld. In October 2010 the British Bankers' Association (the 'BBA') applied for judicial review of these new rules and on 20 April 2011, the High Court rejected the BBA's legal challenge and upheld the FSA's policy statement about misselling of PPI. On 9 May 2011, the BBA announced its decision not to appeal against the High Court's PPI judgment. The High Court judgment on the misselling of PPI resulted in very significant provisions for customer redress being made by several UK financial services providers. Santander UK plc did not participate in the UK High Court case, and has taken a prudent approach in consistently settling claims over the last two years as they have arisen.

In light of the High Court ruling in April 2011, the BBA's decision not to appeal it and the consequent increase in claims levels Santander UK performed a detailed review of the provision requirement. As a result, Santander UK plc revised its provision for PPI complaint liabilities to reflect the new information. Previously, the provision for PPI complaint liabilities accounted for claims that were likely to be received over the next twelve months. The provision for PPI complaint liabilities has now been increased to reflect the total population of PPI customers who could file a claim.

The ultimate financial impact on Santander UK of the claims arising from PPI complaints is uncertain and will depend on a number of factors, including the implementation of the FSA's Policy Statement, the rate at which new complaints arise, the content and quality of the complaints (including the availability of supporting evidence), the role of claims management companies and the average uphold rates and redress costs. Santander UK can make no assurance that expenses associated with PPI complaints will not exceed the provision it has taken relating to these claims. More generally, Santander UK can make no assurance that its estimates for potential liabilities are correct, and the reserves taken as a result may prove inadequate. If Santander UK were to incur additional expenses that exceed provisions for PPI liabilities or other provisions, these expenses could have a material adverse effect on Santander UK's operating results, financial condition and prospects. For further information about the provision for PPI complaint liabilities see Note 25 to the Condensed Consolidated Interim Financial Statements.

The FSA may identify future industry-wide misselling or other issues that could affect Santander UK. This may lead from time to time to: (i) significant direct costs or liabilities (including in relation to misselling); and (ii) changes in the practices of such businesses which benefit customers at a cost to shareholders.

Decisions taken by the FOS (or any overseas equivalent that has jurisdiction) could, if applied to a wider class or grouping of customers, have a material adverse effect on the operating results, financial condition and prospects of Santander UK.

Members of Santander UK are responsible for contributing to compensation schemes in the UK in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers

In the UK, the Financial Services Compensation Scheme ('FSCS') was established under the Financial Services and Markets Act 2000 and is the UK's statutory fund of last resort for customers of authorised financial services firms. The FSCS can pay compensation to customers if an FSA-authorised firm is unable, or likely to be unable, to pay claims against it (for instance, an authorised bank is unable to pay claims by depositors). The FSCS is funded by levies on firms authorised by the FSA, including Santander UK plc and other members of Santander UK.

In the event that the FSCS raises funds from authorised firms, raises those funds more frequently or significantly increases the levies to be paid by such firms, the associated costs to Santander UK may have a material adverse effect on its operating results, financial condition and prospects. The recent measures taken to protect the depositors of deposit-taking institutions involving the FSCS have resulted in a significant increase in the levies made by the FSCS on the industry and such levies may continue to go up if similar measures are required to protect depositors of other institutions.

In addition, regulatory reform initiatives in the UK and internationally may result in further changes to the FSCS, which could result in additional costs and risks for Santander UK. For instance, the FSA announced in October 2011 that it was restarting its review of the funding of the FSCS and on 25 July 2012 it announced a consultation on proposed changes to the funding of the FSCS, with comments due by 25 October 2012. Changes as a result of this may affect the profitability of Santander UK plc (and other members of Santander UK required to contribute to the FSCS).

As a result of the structural reorganisation and reform of the UK financial regulatory authorities, it is proposed that the FSCS levies will be collected by the FCA under the new regime. It is possible that future policy of the FSCS and future levies on the firms authorised by the FSA may differ from those at present and that this could lead to a period of some uncertainty for members of Santander UK. In addition, it is possible that other jurisdictions where Santander UK operates could introduce similar compensation, contributory or reimbursement schemes. As a result of any such developments, Santander UK may incur additional costs and liabilities which may adversely affect its operating results, financial condition and prospects.

The Banking Act may adversely affect the Group's business

The Banking Act came into force on 12 February 2009. It provides HM Treasury, the Bank of England and the FSA with a variety of tools for dealing with UK institutions which are authorised deposit takers and are failing. If the position of a relevant entity in the Group were to decline so dramatically that it was considered to be failing, or likely to fail, to meet threshold authorisation conditions set out in FSMA (for example, if there were a mass withdrawal of deposits over solvency fears surrounding Santander UK, in a manner analogous to the situation that occurred at Northern Rock, adversely affecting the ability of Santander UK to continue to trade), it could become subject to the exercise of powers by HM Treasury, the Bank of England and the FSA under the special resolution regime set out in the Banking Act. The special resolution regime provides HM Treasury, the Bank of England and the FSA with a variety of powers for dealing with UK deposit taking institutions that are failing or likely to fail, including: (i) to take a bank or bank holding company into temporary public ownership; (ii) to transfer all or part of the business of a bank to a private sector purchaser; or (iii) to transfer all or part of the business of a bank to a "bridge bank". The special resolution regime also comprises a separate insolvency procedure and administration procedure each of which is of specific application to banks. These insolvency and administration measures may be invoked prior to the point at which an application for insolvency proceedings with respect to a relevant institution could be made.

If an instrument or order were made under the Banking Act in respect of Santander UK plc, such instrument or order (as the case may be) may (among other things): (i) result in a compulsory transfer of shares or other securities or property of Santander UK plc; (ii) impact on the rights of the holders of shares or other securities in Santander UK plc or result in the nullification or modification of the terms and conditions of such shares or securities; or (iii) result in the de-listing of Santander UK plc's shares and/or other securities. In addition, such an order may affect matters in respect of Santander UK plc and/or other aspects of Santander UK plc's shares or other securities which may negatively affect the ability of Santander UK plc to meet its obligations in respect of such shares or securities.

At present, no instruments or orders have been made under the Banking Act in respect of Santander UK and there has been no indication that any such order will be made, but there can be no assurance that holders of shares or other securities in Santander UK plc would not be adversely affected by any such order if made in the future.

The Group's operations are highly dependent on its information technology systems

The Group's business, financial performance and ability to meet its strategic objectives depend to a significant extent upon the functionality of its information technology systems (including Partenon, the global banking informational technology platform utilised by Banco Santander, S.A and the Group), and its ability to increase systems capacity. The proper functioning of the Group's financial control, risk management, credit analysis and reporting, accounting, customer service and other information technology systems, as well as the communication networks between its branches and main data processing centres, are critical to the Group's business and its ability to compete. For example, the Group's ability to process credit card and other electronic transactions for its customers is an essential element of its business. A disruption (even short-term) to the functionality of the Group's information technology system (whether as a result of so-called unintentional "cyber incidents" or targeted "cyber attacks," security breaches, the Company's own migration of new business onto Partenon or otherwise) could impose a significant financial loss, result in a disruption to the Group's businesses, liability to clients, regulatory intervention or reputational damage.

Likewise, delays or other problems in increasing the capacity of the information technology systems or increased costs associated with such systems could have a material adverse effect on the Group's operating results, financial condition and prospects. Although the Group has implemented certain preventative measures to protect its information and data systems, it can give no assurance that such measures will be effective in preventing a cyber attack or other IT disruption. Any such event could also require the Group to expend significant additional resources to modify its protective measures or to investigate and remediate vulnerabilities or other exposures, and may subject the Group to additional litigation and financial losses. Operation losses related to a successful cyber attack or other operational risks could have a material adverse effect on the Group's operating results, financial condition and prospects.

The Group relies upon certain outsourced services (including information technology support, maintenance and consultancy services in connection with Partenon) provided by certain other members of the Banco Santander, S.A. group. Any material change in the basis upon which these services are provided to the Group or the extent to which they are available to the Group could have a material adverse effect on the Group's operating results, financial condition and prospects.

In addition, if the Group fails to update and develop its existing information technology systems as effectively as its competitors, this may result in a loss of the competitive advantages that the Group believes its information technology systems provide, which could also have a material adverse effect on the Group's operating results, financial condition and prospects.

Third parties may use the Group as a conduit for illegal activities without the Group's knowledge, which could have a material adverse effect on the Group

The Group is required to comply with applicable anti-money laundering laws and regulations and has adopted various policies and procedures, including internal control and "know-your-customer" procedures, aimed at preventing use of the Group for money laundering. For example, a major focus of US governmental policy relating to financial institutions in recent years has been combating money laundering and enforcing compliance with US economic sanctions. The outcome of any proceeding or complaint is inherently uncertain and could have a material adverse effect on the Group's operations or financial condition, especially to the extent that the scope of any such proceedings expands beyond its original focus.

In addition, while the Group reviews its relevant counterparties' internal policies and procedures with respect to such matters, the Group, to a large degree, relies upon its relevant counterparties to maintain and properly apply their own appropriate anti-money laundering procedures. Such measures, procedures and compliance may not be completely effective in preventing third parties from using the Group (and its relevant counterparties) as a conduit for money laundering (including illegal cash operations) without the Group's (and its relevant counterparties') knowledge. If the Group is associated with, or even accused of being associated with, or becomes a party to, money laundering, then its reputation could suffer and/or it could become subject to fines, sanctions and/or legal enforcement (including being added to any "black lists'' that would prohibit certain parties from engaging in transactions with the Group), any one of which could have a material adverse effect on the Group's operating results, financial condition and prospects.

Changes in the pension liabilities and obligations of Santander UK could have a materially adverse effect on the Group

Santander UK provides retirement benefits for many of its former and current employees in the United Kingdom through a number of defined benefit pension schemes established under trust. Santander UK has only limited control over the rate at which it pays into such schemes. Under the UK statutory funding requirements, employers are usually required to contribute to the schemes at the rate they agree with the scheme trustees, although if they cannot agree, such rate can be set by the Pensions Regulator. The scheme trustees may, in the course of discussions about future valuations, seek higher employer contributions. The scheme trustees' power in relation to the payment of pension contributions depends on the terms of the trust deed and rules governing the pension schemes.

The UK Pensions Regulator has the power to issue a financial support direction to companies within a group in respect of the liability of employers participating in the UK defined benefit pension plans where that employer is a service company, or is otherwise "insufficiently resourced" (as defined for the purposes of the relevant legislation). As some of the employers within Santander UK are service companies, if they become insufficiently resourced, other companies within Santander UK which are connected with or an associate of those employers are at risk of a financial support direction in respect of those employers' liabilities to the defined benefit pension schemes in circumstances where the Pensions Regulator properly considers it reasonable to issue one. Such a financial support direction could require the companies to guarantee or provide security for the pension liabilities of those employers, or could require additional amounts to be paid into the relevant pension schemes in respect of them.

The UK courts have decided that liabilities under financial support directions issued by the Pensions Regulator against companies after they have gone into administration were payable as an expense of the administration, and did not rank as provable debts. This means that such liabilities will have to be satisfied before any distributions to unsecured creditors could be made. It is understood that leave to appeal to the Supreme Court has been requested and therefore it is likely that there will be a further decision to come.

The Pensions Regulator can also issue contribution notices if it is of the opinion that an employer has taken actions, or failed to take actions, deliberately designed to avoid meeting its pension promises or which are materially detrimental to the scheme's ability to meet its pension promises. A contribution notice can be moved to any company which is connected with or an associate of such employer in circumstances where the Regulator considers it reasonable to issue. The risk of a contribution notice being imposed may inhibit the freedom of Santander UK to restructure itself or to undertake certain corporate activities.

Changes in the size of the deficit in the defined benefit schemes operated by Santander UK, due to reduction in the value of the pension fund assets (depending on the performance of financial markets) or an increase in the pension fund liabilities due to changes in mortality assumptions, the rate of increase of salaries, discount rate assumptions, inflation, the expected rate of return on plan assets, or other factors, could result in Santander UK having to make increased contributions to reduce or satisfy the deficits which would divert resources from use in other areas of Santander UK's business and reduce Santander UK plc's capital resources. While a number of the above factors can be controlled by Santander UK, there are some over which it has no or limited control. Although the trustees of the defined benefit pension schemes are obliged to consult Santander UK before changing the pension schemes' investment strategy, the trustees have the final say. Increases in the pension liabilities and obligations of Santander UK could have a material adverse effect on the Group's operating results, financial condition and prospects.

The ongoing changes in the UK supervision and regulatory regime and particularly the implementation of the ICB's recommendations may require Santander UK to make changes to its structure and business which could have an impact on Santander UK's pension schemes or liabilities.

Risks concerning enforcement of judgements made in the United States

Abbey National Treasury Services plc is a public limited company registered in England and Wales. All of the Company's Directors live outside the United States of America. As a result, it may not be possible to serve process on such persons in the United States of America or to enforce judgements obtained in US courts against them or the Group based on the civil liability provisions of the US federal securities laws or other laws of the United States of America or any state thereof. The Directors' Report on pages 3 to 10 of the Group's 2011 Annual Report has been prepared and presented in accordance with and in reliance upon English company law and the liabilities of the Directors in connection with that Report shall be subject to the limitations and restrictions provided by such law. Under the UK Companies Act 2006, a safe harbour limits the liability of Directors in respect of statements in and omissions from the Directors' Report on pages 3 to 10 of the Group's 2011 Annual Report. Under this safe harbour, the Directors would be liable to the Company (but not to any third party) if the Directors' Report contains errors as a result of recklessness or knowing misstatement or dishonest concealment of a material fact, but would not otherwise be liable.

GUARANTEE

THIS INSTRUMENT by way of deed poll is executed on 10 May 2012 by **SANTANDER UK plc** (registered in England No. 2294747) whose registered office is at 2 Triton Square, Regent's Place, London NW1 3AN (the "**Guarantor**")

WHEREAS:

Abbey National Treasury Services plc, a company incorporated in England (number 2338548) whose registered office is at 2 Triton Square, Regent's Place, London NW1 3AN ("**ANTS**"), has requested the Guarantor and the Guarantor has agreed to guarantee payment of all Obligations (as hereinafter defined) in accordance with, and as limited by, the terms and conditions of this Deed (this "**Guarantee**").

NOW THEREOF the Guarantor hereby covenants and agrees as follows:

1. In this Guarantee, unless the context otherwise requires:

"**Creditor**" means any person (other than the Guarantor or any subsidiary of ANTS (as defined in section 1159 of the Companies Act 2006 (the "**Act**")) or any individual who is a connected person of ANTS (within the meaning of section 254 of the Act)) to whom an Obligation is from time to time owed.

"**Obligation**" means any obligation or liability (whether actual or contingent or for the payment of any amount or delivery of any property) incurred by ANTS (whether as principal or surety) to any person on or before 30 June 2015 (whether before or after the execution of this Guarantee) under or in respect of any dealing, transaction or engagement whatsoever, including without prejudice to the generality of the foregoing, for:

(i) any moneys lent, advanced or otherwise made available to ANTS (including, without limitation to the generality of the foregoing, the liability of ANTS for drawing or issuing bills of exchange, promissory notes, bonds, debentures, certificates of deposit, commercial paper or other negotiable instruments or securities);

(ii) any moneys lent, advanced or otherwise made available to any person, the repayment or payments in respect of which have been guaranteed by ANTS or in respect of which ANTS has given an indemnity (including, without limitation to the generality of the foregoing, guarantees and letters of credit issued by ANTS and bills of exchange or other negotiable instruments accepted or endorsed by ANTS);

(iii) any moneys which any person shall pay or become liable to pay, for or on account of ANTS, by reason of entering into or being party to any bond, indemnity, bill of exchange, guarantee, letter of credit or other engagement for the benefit or at the request of ANTS;

(iv) deposits made with ANTS (including, without limitation of the generality of the foregoing, certificates of deposit issued by ANTS);

(v) any rate swap transaction, swap option, basis swap, forward rate transaction, commodity swap, commodity option, equity or equity index swap, equity or equity index option, bond option, interest rate option, foreign exchange transaction, cap transaction, collar transaction, floor transaction, currency swap transaction, cross-currency rate swap transaction, currency option, credit protection transaction, credit swap, credit default swap, credit default option, total return swap, credit spread transaction, repurchase transaction, reverse repurchase transaction, buy/sell back transaction, securities lending transaction or forward purchase or sale of a security, commodity or other financial instrument or interest (including any option with respect to any such transactions) or any other derivative transaction on one or more rates, currencies, commodities, equity securities or other equity instruments, debt securities or other debt instruments, indices, or measures of economic risk or value, in each case, to which ANTS is party (including, for the avoidance of doubt, any obligation or liability under any master agreement that governs any such transactions);

(vi) any such obligation or liability assumed under or incurred pursuant to any novation, transfer, assignment or other similar agreement between ANTS and any other person; and

(vii) any obligation or liability under any transaction entered into by ANTS after 30 June 2015 as a result of the exercise of any right or option granted by or to ANTS on or prior to 30 June 2015;

(viii) any payments of interest due from ANTS with respect to any of the foregoing transactions (whether or not the liability to pay such interest arises on or before 30 June 2015) together with all reasonable costs, commissions and other expenses incurred by any person in connection with the enforcement of this Guarantee,

but excluding:

(a) any such obligations or liabilities of ANTS (including under any guarantee or indemnity given by ANTS) which by their terms are expressed (in whatever manner) to be conditional upon the solvency of ANTS or subordinated to, or payable only after full satisfaction of, all or any obligations of ANTS to all or any of its unsubordinated creditors; and

(b) any such obligations or liabilities of ANTS transferred to, or assumed by, any other person whether pursuant to any novation or transfer or other similar agreement, any statutory transfer (pursuant to Part VII of The Financial Services and Markets Act 2000 or otherwise), any scheme of arrangement or otherwise.

"**person**" means any person, firm, trust estate, corporation, association, cooperative, government or government agency or other entity.

2. (a) The Guarantor hereby unconditionally and irrevocably guarantees, for the benefit of each Creditor, in accordance with the terms and conditions of this Guarantee, the full payment or performance by ANTS when due (whether at stated maturity, upon acceleration or otherwise) of each and every Obligation and in the event that ANTS shall default in the due and punctual payment or performance of any Obligation, undertakes to pay, or procure the payment of, such Obligation in the currency in which the particular Obligation is denominated in the case of a payment or perform, or procure the performance of such Obligation, upon written demand being made under this Guarantee by the relevant Creditor.

   (b) The Guarantor waives any right it may have of first requiring any Creditor to make demand, proceed or enforce any rights or security against ANTS or any other person before making a claim against the Guarantor under this Guarantee.

3. A Creditor shall only be entitled to take or obtain the benefit of this Guarantee upon the condition that, after receipt by the Guarantor of a written demand from the Creditor, the Guarantor shall be entitled to deal with the Creditor, and the Creditor shall be obliged to deal with the Guarantor with respect to the Obligation due to the Creditor and this Guarantee without the necessity or duty to rely on, act through or otherwise involve or deal with ANTS to the intent that the Guarantor and the Creditor shall deal with one another as principals in relation to the same provided that the rights, powers, privileges and remedies of the Creditor under this Guarantee shall not thereby be in any way limited or otherwise affected.

4. No delay or omission on the part of the Creditor in exercising any right, power, privilege or remedy (hereinafter together called "**Rights**") in respect of this Guarantee shall impair any such Rights or be construed as a waiver of any thereof nor shall any single or partial exercise of any such Rights preclude any further exercise of any other Rights. The Rights herein provided are cumulative and not exclusive of any rights, powers, privileges or remedies provided by law. Nothing in this Guarantee shall be construed as voiding, negating or restricting any right of set-off or any other right whatsoever existing in favour of a Creditor or arising at common law, by statute or otherwise howsoever.

5. This Guarantee is a continuing guarantee and shall not be satisfied, discharged or affected by any intermediate payment or settlement of account.

6. The Guarantor will not exercise any rights of subrogation or any other rights or remedy (including, without limiting the generality of the foregoing, the benefit of any security or right of set-off) which it may acquire due to its payment or performance of any Obligation pursuant to the terms of this Guarantee and will not prove in the liquidation of ANTS in competition with any Creditor unless and until all Obligations in respect of the relevant Creditor hereby guaranteed have been satisfied in full by the Guarantor or ANTS. In the event that the Guarantor shall receive any payment on account of such rights while any Obligation remains outstanding, the Guarantor shall pay all amounts so received to the relevant Creditor.

7. Payments hereunder shall be made free and clear of any deduction or withholding other than those required by law and in that event the Guarantor shall pay such additional amount to the relevant Creditor as may be necessary in order that the actual amount received after all such deductions and withholdings shall equal the amount that would have been received if no such deduction or withholding were required provided that the Guarantor shall not be obliged to pay any such additional amount which would not have been payable if the payment which is the subject of the withholding or deduction had been made by ANTS. If the Guarantor makes a payment of an additional amount in compliance with its obligations under this paragraph and the Creditor determines that it has received or been granted a credit against or relief or payment of any tax paid or payable by it in respect thereof the Creditor shall to the extent that it can do so without prejudice to the retention of the amount of such credit, relief or repayment pay to the Guarantor such amount as shall be attributable to such deduction provided that nothing contained in this paragraph shall interfere with the right of any Creditor to arrange its tax affairs in whatsoever manner it thinks fit and, in particular, no Creditor shall be under any obligation to claim relief in respect of any such deduction in priority to any other claims for relief available to it.

8. Any demand or notice hereunder shall be given in writing or by cable, telex or facsimile transmission addressed to the Guarantor or to the person to or upon whom the demand is to be made or the notice served at the registered or principal office or last known place of abode of the Guarantor or of such person, as the case may be. A demand so made shall be deemed to have been duly made if left at such address on the day it was so left or, if sent by post, two working days after the time when the same was put in the post and in proving delivery it shall be sufficient to prove that the same was properly addressed and put in the post. Any such demand sent by cable, telex or facsimile transmission shall be deemed to have been duly made at the time of despatch.
9. The liability of the Guarantor under this Guarantee shall not be affected by the liquidation, winding-up or other incapacity of ANTS. In the event that any payment or delivery to a Creditor from ANTS in respect of an Obligation is avoided or reduced by virtue of any enactments for the time being in force relating to liquidation or insolvency of ANTS, the Creditor shall be entitled to recover the value or amount thereof from the Guarantor as if such payment or delivery by ANTS had not been made.
10. This Guarantee shall remain in full force and effect irrespective of:
    - (a) the validity, regularity, legality or enforceability against ANTS of, or of any defence or counter-claim whatsoever available to ANTS in relation to, any Obligation;
    - (b) whether or not any action has been taken to enforce any Obligation or any judgement obtained against ANTS or any other person;
    - (c) whether or not the terms of any Obligation has been modified, supplemented, extended or restated in any way (in each case, however fundamental and of whatsoever nature);
    - (d) whether or not any time or indulgence has been granted to ANTS or any other person by or on behalf of any Creditor;
    - (e) whether or not there have been any dealings or transactions between ANTS or any other person and any Creditor;
    - (f) whether or not ANTS or any other person has been dissolved, liquidated, merged, consolidated, become bankrupt or has changed its status, functions, control or ownership;
    - (g) whether or not ANTS or any other person has been prevented from making payment by foreign exchange provisions applicable at its place of registration or incorporation; and
    - (h) whether or not any circumstances have occurred which might otherwise constitute a legal or equitable discharge of or defence to a guarantor.
11. This Guarantee shall remain in full force and effect in relation to an Obligation notwithstanding that it becomes due for payment or performance after 30 June 2015.
12. In the event that any of the terms or provisions of this Guarantee are or shall become invalid, illegal or unenforceable, the remaining terms and provisions hereof shall survive unaffected.
13. The Guarantor shall be permitted from time to time and at any time to amend or vary the terms of this Guarantee PROVIDED THAT the liability of the Guarantor to a Creditor in respect of any Obligation incurred before, or arising out of an Obligation entered into before, the date of such variation or amendment, shall not be in any way reduced or limited by such variation or amendment. Any person shall be entitled to rely on a certificate given by a director or other duly authorised officer of the Guarantor as to the existence and extent of this Guarantee and any such variation and/or amendment of this Guarantee on entering into any dealing, transaction or arrangement with ANTS under or in respect of which an Obligation would or might be incurred by ANTS to that person.
14. This Guarantee and any non-contractual obligations arising out of or in connection with this Guarantee are governed by, and shall be construed in accordance with, the laws of England and the courts of England are to have exclusive jurisdiction to settle any disputes which may arise out of or in connection with this Guarantee (including in respect of any non-contractual obligations arising out of or in connection with this Guarantee) and accordingly any suit, action or proceedings arising out of or in connection with this Guarantee (including in respect of any non-contractual obligations arising out of or in connection with this Guarantee) shall be brought in such courts.

IN WITNESS whereof, this Guarantee has been executed as of the day and year first written above.

THE COMMON SEAL of)
SANTANDER UK PLC)
was hereunto affixed)
in the presence of:)

…………………………………………

Shaun Coles

Deputy Company Secretary

Directors' Responsibility Statement

The Half Yearly Financial Report is the responsibility of the Directors who confirm to the best of their knowledge:

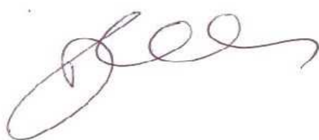
(a) the condensed set of financial statements prepared in accordance with IAS 34 'Interim Financial Reporting';

(b) the interim management report includes a fair review of the information required by DTR 4.2.7R (indication of important events during the first six months and description of principal risks and uncertainties for the remaining six months of the year); and

(c) the interim management report includes a fair review of the information required by DTR 4.2.8R (disclosure of related party transactions and changes therein).

The Directors of Abbey National Treasury Services plc are listed in the Group's 2011 Annual Report.

Approved by the Board of Abbey National Treasury Services plc and signed on its behalf by



David Green
Director

30 August 2012