Abbey National Treasury Services plc
2010 Annual Report

Contents

Forward-looking Statements

Abbey National Treasury Services plc (the 'Company') and its subsidiaries (together the 'Group') may from time to time make written or oral forward-looking statements. Examples of such forward-looking statements include, but are not limited to:

> projections or expectations of revenues, costs, profit (or loss), earnings (or loss) per share, dividends, capital structure or other financial items or ratios;
> statements of plans, objectives or goals of the Group or its management, including those related to products or services;
> statements of future economic performance; and
> statements of assumptions underlying such statements.

Words such as 'believes', 'anticipates', 'expects', 'intends', 'aims', 'plans', 'targets' and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

By their very nature, forward-looking statements 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. The Group cautions 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 made by the Group or on the Group's behalf. Some of these factors are considered in detail in the Risk Management section in Note 43 and the Risk Factors section on page 114 may include:

> the effects of UK economic conditions (e.g. recent decline in housing market, rising unemployment, increased taxation and reduced public spending);
> the effects of conditions in global financial markets (e.g. increased market volatility, reduced credit availability and increased commercial and consumer loan delinquencies);
> the credit quality of borrowers and the soundness of other financial institutions;
> the Group's ability to access liquidity and funding on financial terms acceptable to it;
> the extent to which regulatory capital and liquidity requirements and any changes to these requirements may limit the Group's operations;
> the effects of any changes to the credit rating assigned to the Group, any member of the Group or any of their respective debt securities;
> the effects of fluctuations in interest rates, foreign exchange rates, basis spreads, bond and equity prices and other market factors;
> the extent to the Group may be required to record negative fair value adjustments for its financial assets due to changes in market conditions;
> the ability of the Group to manage any future growth effectively (e.g. efficiently managing the operations and employees of expanding businesses and maintaining or growing its existing customer base)
> the ability of the Group to realise the anticipated benefits of its business combinations and the exposure, if any, of the Group to any unknown liabilities or goodwill impairments relating to the acquired businesses;
> the effects of competition, or intensification of such competition, in the financial services markets in which the Group conducts business and the impact of customer perception of the Company's customer service levels on existing or potential new business;
> the extent which the Group may be exposed to operational losses (e.g. failed internal or external processes, people and systems);
> the ability of the Group to recruit, retain and develop appropriate senior management and skilled personnel;
> the effects of any changes to the reputation of the Group, any member of the Group or any affiliate operating under the Group's brands;
> the effects of the financial services laws, regulations, administrative actions and policies and any changes thereto in each location in which the Group operates;
> the effects of taxation requirements and any changes thereto in each location in which the Group operates (e.g. the bank levy in the UK);
> the effects of the proposed reform and reorganisation of the structure of the UK financial regulatory authorities and of the UK regulatory framework that applies to members of the Group;
> the effects of any new reforms to the UK mortgage lending market;
> the power of the UK Financial Services Authority (or any overseas regulator) to intervene in response to attempts by customers to seek redress from financial service institutions, including the Group, in case of industry-wide issues;
> the extent to which members of the Group may be 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 effects which the UK Banking Act 2009 may have, should the HM Treasury, the Bank of England and/or the FSA exercise their powers under this Act in the future against the Company;
> the Group's dependency on its information technology systems;
> the risk of third parties using the Group as a conduit for illegal activities without the Group's knowledge;
> the effects of any changes in the pension liabilities and obligations of the Group; and
> Santander UK's success at managing the risks to which the Group is exposed, including the above items.

The Group cautions that the foregoing list of important factors is not exhaustive. When relying on forward-looking statements to make decisions with respect to the Group, investors and others should carefully consider the foregoing factors and other uncertainties and events. Such 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; such knowledge, information and views may change at any time. The Group does not undertake any obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Written forward-looking statements may appear in documents filed with the US Securities and Exchange Commission, reports to shareholders and other communications. The US Private Securities Litigation Reform Act of 1995 contains a safe harbour for forward-looking statements on which the Group relies in making such disclosures.

Directors' Report

Introduction

The Directors submit their report together with the financial statements for the Company and its subsidiaries (together 'the Group') for the year ended 31 December 2010.

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 Group undertakes no obligation to update any forward-looking statement during the year. Nothing in this report should be construed as a profit forecast.

Corporate structure

The Company is a wholly-owned subsidiary of Santander UK plc and the shares of the Company are not traded on the London Stock Exchange. The Company and its subsidiaries are part of Banco Santander, S.A. (together with its subsidiaries, 'Santander'), which is the ultimate parent company. The Company is incorporated in England and has its registered office at 2 Triton Square, Regent's Place, London NW1 3AN.

Note 22 to the Consolidated Financial Statements provides a list of the principal subsidiaries of the Company and the nature of each subsidiary's business as well as details of overseas branches. As it does not have listed shares, the Company is exempt from the requirement to make certain disclosures that are normally part of the continuing obligations of listed companies in the UK. This exemption applies, among other things, to corporate governance and certain Directors' remuneration disclosures.

In October 2010, all of the existing activities of Cater Allen International Limited (a subsidiary of the Company) were transferred to the Company. The principal purpose of the transfer was to increase the efficiency of the Santander UK plc group. No gain or loss was recognised on the transfer.

Santander UK plc has given a full and unconditional guarantee in respect of the liabilities of the Company incurred prior to 31 July 2012. The Company has given a reciprocal guarantee in respect of the liabilities of Santander UK plc.

Santander Global Banking & Markets is a brand name for the global wholesale banking business of Santander. The remaining parts of the Company, including Asset and Liability Management ('ALM'), which is responsible for managing Santander UK plc's treasury function and the Corporate Banking business have not adopted this brand.

The Company contains parts of three divisions of the Santander UK plc group ('Santander UK').

> **Global Banking & Markets** – provides financial market sales, trading and risk management services, as well as manufacturing retail structured products. This division is headed by Luis de Sousa.

> **Corporate Banking** – offers banking services principally to small and medium sized UK companies. It also contains operations in run down. This division is headed by Steve Pateman.

> **Asset and Liability Management** – responsible for managing the Group's structural balance sheet. This division is headed by Justo Gómez.

Global Banking & Markets

Global Banking & Markets is a financial markets business focused on providing value added financial services to large corporates not serviced by Corporate Banking (being, in general, very large multinationals) and financial institutions, as well as to the rest of Santander UK's business (including the Retail Banking and Corporate Banking divisions). It is structured into five main product areas: Rates, Foreign exchange and money markets, Equity, Credit and Transaction Banking. In addition, large and complex clients are covered by teams organised along industry lines. Rates 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 retail and corporate customers of both the Group and of other financial institutions who sell them on to their customers. Foreign exchange offers a range of foreign exchange products and money markets runs the securities lending/borrowing and repurchase agreement ("repo") businesses. Credit originates loan and bond transactions in primary markets as well as their intermediation in secondary markets. Transaction Banking provides lending and cash management services, including deposit taking and trade finance.

Corporate Banking

Corporate Banking provides a range of banking services through specialist businesses, and supports the Santander UK plc network of Regional Business Centres through which a broad range of banking products is now offered including loans, current accounts, deposits, treasury services and trade finance. The specialist businesses service customers in various business sectors including Real Estate, Social Housing, and Infrastructure.

Directors' Report continued

Asset and Liability Management

ALM is responsible for managing the Santander UK structural balance sheet shape and, in conjunction with Santander UK's Risk Division, strategic and tactical liquidity risk management. This includes short-term and medium-term funding, covered bond and securitisation programmes. ALM's responsibilities also include Santander UK's banking products and structural exposure to interest rates and, in that role, is a link between Santander UK Global Banking & Markets and all other divisions. ALM recommends and helps to implement Santander UK plc Board of Directors (the 'Santander UK Board'), Asset and Liability Management Committee and Risk Committee policies for all aspects of balance sheet management - formulating guidance for, and monitoring, the overall balance sheet shape, including maturity profile.

Santander UK plc and Abbey National Treasury Services plc had a shelf registration statement with the US Securities and Exchange Commission, which expired in December 2008. It is intended to file a new shelf registration statement with the US Securities and Exchange Commission in the first half of 2011. Additionally, as part of its prudent contingent funding arrangements, ALM ensures that Santander UK has access to the central bank facilities made available by the Bank of England, the Swiss National Bank, and the US Federal Reserve.

Principal Activity and Business Review

The principal activity of Abbey National Treasury Services plc, company number 2338548, is to provide treasury, corporate and wholesale banking services. The Group also provides Santander UK with these services as well as liquidity, funding, capital and risk management products. As part of this activity the Group provides a treasury function, incorporating liquidity, funding, capital and risk management products to Santander UK. It also provides treasury services, supplying products and risk management services for other financial services companies, and corporate banking services principally to small and medium sized UK companies.

Competitive environment, future trends and outlook

The economic environment in 2010 remained uncertain, albeit more stable than in 2009, with unemployment, arrears levels and house prices all relatively stable.

The Group's main competitors are investment banks and universal banks. The market remains highly competitive, driven largely by market incumbents. Management expects such competition to continue in response to competitor behaviour, consumer demand, technological changes, the impact of consolidation, regulatory actions and other factors.

2011 is expected to be another difficult year for the UK economy, but one in which we expect to see signs of recovery as we progress through the year. However, unemployment is predicted to remain high, resulting in continuing difficulties for banks, homeowners and savers, and the outlook for interest rates remains uncertain.

Abbey National Treasury Services plc continues to benefit from the strength of its parent companies, Santander UK plc and Banco Santander, S.A., and as part of Santander, management remains confident of Santander UK's strength and potential to continue growing despite continuing challenging conditions in some of its core financial services markets. A detailed description of management's basis for concluding that Santander UK remains a going concern is set out in Going Concern on page 8.

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

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 year ended 31 December 2010 and the position of the Group at the end of the year.

Summarised consolidated statutory income statement

	2010 **£m**	2009 £m
Net interest income	**403**	376
Non-interest income	**490**	275
Total operating income	**893**	651
Administrative expenses	**(209)**	(162)
Depreciation and amortisation	**(6)**	(3)
Total operating expenses excluding provisions and charges	**(215)**	(165)
Impairment losses on loans and advances	**(69)**	(30)
Profit before tax	**609**	456
Taxation expense	**(149)**	(78)
Profit for the year	**460**	378

Directors' Report continued

2010 compared to 2009
Profit before tax of £609m increased by £153m from £456m in 2009. Material movements by line include:

> Total operating income of £893m increased by £242m from £651m in 2009, reflecting the non recurrence in 2010 of the mark-to-market volatility in 2009.
>
> In addition Global Banking & Markets income increased, reflecting the strong development of underlying customer revenue streams and a number of non-recurring releases of fair value adjustments following the successful de-risking of underlying positions. These benefits were partly offset by a less favourable trading environment resulting from lower spread volatility.
>
> Income for the Corporate Bank increased reflecting the growth in the lending portfolios over the year and increased margins on these portfolios, albeit this increase in margins was offset by an increase in the higher cost of new term funding which is being passed onto the Corporate Bank.

> Administrative expenses of £209m increased by £47m from £162m in 2009, reflecting ongoing investment in Global Banking & Markets growth initiatives relating to new products, markets and customer segments. There was a 38% increase in headcount across the customer transaction business, including the new Gilt Edge Market Making desk. In addition, pension recharges from Santander UK plc increased reflecting a recharge of actuarial pension losses during the year.

> Depreciation and amortisation increased slightly to £6m (2009: £3m).

> Impairment losses on loans and advances of £69m increased by £39m from £30m in 2009 due to growth and maturity in asset balances over the last two years and some deterioration arising from market conditions. The increase was also influenced by a small number of large value transactions which defaulted late in the year but are expected to be restructured during 2011.

Adjustments between the statutory basis and the trading basis

The Group's Board of Directors (the 'Board') reviews discrete financial information for each of its segments that includes measures of operating results and assets. The segments are managed primarily on the basis of their results, which are measured on a 'trading' basis. The trading basis differs from the statutory basis as a result of the application of an adjustment in respect of hedging and other variances, as presented below. Management considers that the trading basis provides the most appropriate way of reviewing the performance of the business. The adjustment consists of:

> **Hedging and other variances** - The Balance Sheet and Income Statement are subject to mark-to-market volatility including that arising from the accounting for elements of derivatives deemed under IFRS rules to be ineffective as hedges. Volatility also arises on certain assets previously managed on a fair value basis, and hence classified as fair value through profit or loss under IFRS, that are now managed on an accruals basis. Where appropriate, such volatility is separately identified to enable management to view the underlying performance of the business.

A reconciliation between trading profit before tax and statutory profit before tax is set out below.

Profit before tax by segment

	2010 £m	2009 £m
Global Banking & Markets	**281**	277
Corporate Banking	**21**	40
Asset and Liability Management	**319**	320
Trading profit before tax	**621**	637
Adjust for:		
- Hedging and other variances	**(12)**	(181)
Profit before tax	**609**	456

Trading profit before tax of £621m decreased by £16m on the previous year (2009: £637m), reflecting a an increase in Corporate Banking impairments charges and one-off pension recharge partially offset by a stronger performance in income Global Banking & Markets, Corporate Banking and Asset and Liability Management.

Directors' Report continued

> Global Banking & Markets trading profit before tax increased by £4m to £281m (2009: £277m). Trading income increased, reflecting the strong development of underlying customer revenue streams and a number of non-recurring releases of fair value adjustments following the successful de-risking of underlying positions. These benefits were partly offset by a less favourable trading environment resulting from lower spread volatility. Trading expenses reflected ongoing investment in growth initiatives relating to new products, markets and customer segments.

> Corporate Banking trading profit before tax decreased by £19m to £21m (2009: £40m). This movement was due to higher impairment losses reflecting the growth and maturity of the lending portfolio and some deterioration arising from market conditions. This was partially offset by an increase in income reflecting the growth in the lending portfolios over the year and increased margins on these portfolios, albeit this increase in margins was offset by an increase in the higher cost of new term funding which is being passed onto the Corporate Bank.

> Asset and Liability Management trading profit before tax decreased by £1m to £319m (2009: £320m) reflecting the benefit of higher historic medium-term interest rates being earned on capital, and the impact of the application of marginal medium-term funding rates to new business and an increasing proportion of the back book to the extent that there has been customer repricing activity by the business.
This was offset by an increase in administrative expenses as a result pension recharges from Santander UK plc increasing reflecting a recharge of actuarial pension losses.

Directors' Report continued

Other Material Items - Adjustments between the statutory basis and the trading basis

The Board reviews discrete financial information for each of its segments that includes measures of operating results and assets, which are measured on a 'trading' basis. The trading basis differs from the statutory basis as a result of the application of an adjustment in respect of hedging and other variances, as presented below. Management considers that the trading basis provides the most appropriate way of reviewing the performance of the business. The trading adjustment consists of:

Hedging and other variances

	2010	2009
	£m	£m
	(12)	(181)

The Balance Sheet and Income Statement are subject to mark-to-market volatility including that arising from the accounting for elements of derivatives deemed under IFRS rules to be ineffective as hedges. Volatility also arises on certain assets previously managed on a fair value basis, and hence classified as fair value through profit or loss under IFRS, that are now managed on an accruals basis.

2010 compared to 2009
In 2010 the hedging and other variances balance was not significant. However, In 2008 and 2009 there was substantial mark-to-market volatility which affected asset and liability positions and related derivatives. The impact of this volatility in 2009 was a loss of £181m. Substantial mark-to-market gains arose in the second half of 2008 from movements in interest rates. These were more than offset by losses due to widening asset spreads. In 2009, the mark-to-market gains reversed leading to losses only partially offset by a slight narrowing of credit spreads.

Key performance indicators

Key performance indicators are set at the Santander UK level, 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 2010 Annual Report, which is available on the Santander UK corporate website (www.aboutsantander.co.uk).

The position of the Group at the year end

Our balance sheet as at 31 December 2010 is set out on page 14 of the Consolidated Financial Statements. Net assets decreased by 4% to £3,363m at 31 December 2010 (2009: £3,503m). The main movements in the balance sheet items were:

> Trading assets of £35,461m (2009: £33,290m) increased by £2,171m and trading liabilities of £42,827m (2009: £46,139m) decreased by £3,312m. The increase in trading assets reflected higher holdings of debt securities and greater repurchase agreement ('reverse repo') activity relating to OECD government securities as part of the Santander UK group's liquidity management activities. Other reverse repo activity reduced in view of the focus on government security repo activity. Trading liabilities decreased by 7% to £42,827m as at 31 December 2010 (2009: £46,139m). The decrease in trading liabilities reflected lower non government security repo activity.

> Derivative assets of £23,237m (2009: £23,201m) and derivative liabilities of £25,043m (2009: £24,455m) both increased slightly. This an increase in interest rate derivatives and reflected changes in yield curves and movements in the US dollar and euro exchange rates.

> Loans and advances to banks of £146,412m (2009: £191,749m), decreased by £45,337m, and deposits by banks of £136,753m (2009: £166,305m) decreased by £29,552m. These decreases were principally driven by the restructure of the Holmes Securitisation Programme. The restructure involved the company redeeming all of the associated outstanding loans and deposits with the Holmes securitisation vehicles and Santander UK plc.

> Deposits by customers of £7,061m (2009: £9,461m) decreased by £2,400m, reflecting increased deposits from retail structured products and a £2,500m increase in placements from fellow subsidiaries of Santander.

> Debt securities in issue of £33,659m (2009: £27,997m) increased by £5,662m primarily reflecting issuances of £5bn from the covered bond programme. This increase reflected the Santander UK Group's strategy of increasing the level of medium-term funding.

Directors' Report continued

Principal risks and uncertainties

The Group's principal risks and uncertainties together with the processes that are in place to monitor and mitigate those risks where possible can be found in the Risk Management section in Note 43 of the Consolidated Financial Statements for each segment of the business by type of risk and material risk factors are described in the Risk Factors section on pages 114 to 124.

Results and dividends

The results of the Group are discussed above. Interim dividends of £600m were paid during the year on the Company's ordinary shares. The Directors do not recommend the payment of a final dividend (2009: £nil) on the ordinary shares in issue.

Events after the balance sheet date

Material events that have occurred after the Balance Sheet date are disclosed in Note 41 of the Consolidated Financial Statements.

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 45 to the financial statements.

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 43.

The Group is reliant on Santander UK plc and other companies in Santander UK for a significant proportion of its funding. The Santander UK Board has confirmed that Santander UK plc and Santander UK are going concerns, 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 31 July 2012 under a deed poll guarantee entered into by the Company on 29 January 2008. Santander UK plc has given a reciprocal guarantee in respect of the unsubordinated liabilities of the Company incurred prior to 31 July 2012.

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 Annual Report and Accounts.

Directors

The Directors who served throughout the year and to the date of this report, except as noted, were:
Mr B W Morrison
Mr D M Green
Mr L de Sousa
Mr S Pateman

Third party indemnities

Enhanced indemnities are provided to the Directors of the Company by Santander UK plc against liabilities and associated costs which they could incur in the course of their duties to the Company. All of the indemnities remain in force as at the date of this Annual Report and Accounts. A copy of each of the indemnities is kept at the registered office address of Santander UK plc.

Directors' Report continued

Financial Instruments

The Group's risks are managed on a group level by the ultimate UK parent company, Santander UK plc. The financial risk management objectives of and policies of the Group; the policy for hedging each major type of forecasted transaction for which hedge accounting is used; and the exposure of the Company to price risk, market risk, credit risk, liquidity risk and cash flow risk are outlined in Note 43 to the Consolidated Financial Statements.

Employees

As at 31 December 2010 the total number of employees calculated on a full time basis was 679 (2009: 537). Details of the related costs can be found in Note 6 to the Consolidated Financial Statements.

The Group is committed to equality of access and quality of service for disabled people and embraces the spirit of the Equality Act 2010 throughout its business operations. The Group has processes in place to help recruit, train, develop, retain and promote employees with disabilities and is committed to giving full and fair consideration to applications for employment made by disabled persons, and for continuing the employment of, and arranging appropriate training for, existing employees who have become disabled.

The Group participates in Santander UK's policies and wants to involve and inform employees on matters that affect them. Santander UK publishes a magazine every quarter for employees, and almost all employees have access to the Santander UK intranet. Santander UK also uses face-to-face communication, such as team meetings, regional roadshows and an annual staff convention. All these channels are designed to keep employees fully informed of news and developments which may have an impact on them, and also to keep them up to date on financial, economic and other factors which affect the Group's performance. Santander UK considers employees' opinions and asks for their views on a range of issues through regular company-wide surveys.

Donations

The Group supports a wide range of charitable projects, particularly through Santander UK Foundation Limited, details of which are reported in the Annual Report and Accounts of Santander UK plc. There were £nil direct donations by the Company or its subsidiaries in 2010 (2009: £nil). No contributions were made for political purposes and no political expenditure was incurred.

Suppliers

The Group has a clear Cost Management & Procurement Policy and process that is enforced across all significant purchases from suppliers to provide a consistent approach. Corporate and social responsibility is a key factor throughout the purchasing process. All new suppliers must adhere to the Group's Corporate & Social Responsibility Protocol, unless it is not relevant to the type of work being undertaken. The protocol covers human rights, labour standards, environment and anti-corruption, in line with the principles in the UN Global Compact.

Policy and practice on payment of creditors

It is the Group's policy to ensure payments are made in accordance with the terms and conditions agreed, except where the supplier fails to comply with those terms and conditions. The Group's practice on payment of creditors has been quantified under the terms of Schedule 7 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. Based on the ratio of the aggregate amounts owed to trade creditors at the end of the year to the aggregate amounts invoiced by suppliers during the year at 31 December 2010, trade creditor days for the Group were 8 days (2009: 8 days).

Corporate governance

As it does not have listed ordinary shares, the Company is exempt from the requirement to make certain disclosures that are normally part of the continuing obligations of listed companies in the UK. This exemption applies, amongst other things, to corporate governance and certain Directors' remuneration disclosures.

Directors' Report continued

Relevant Audit Information

Each of the Directors at the date of approval of this report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- the Directors has taken all steps that he ought to have taken as director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

Auditors

Deloitte LLP have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the Company's forthcoming Annual General Meeting.

Statement of Directors' responsibilities

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

Company law requires the Directors to prepare financial statements for each financial year. The Directors are required by the International Accounting Standards ('IAS') Regulation to prepare the group financial statements under IFRS, as adopted by the European Union, and have also elected to prepare the parent company financial statements in accordance with IFRS, as adopted by the European Union. The financial statements are also required by law to be properly prepared in accordance with the UK Companies Act 2006 and Article 4 of the IAS Regulation.

The Directors acknowledge their responsibility to ensure the financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss presented and that the management report, which is incorporated into this report, includes a fair review of the development and performance of the business and the position presented in these financial statements, together with a description of the principal risks and uncertainties the business faces.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRS.

However, the Directors are also required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping proper accounting records that are sufficient to show and explain the Company's transactions and that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the UK Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By Order of the Board

Karen M. Fortunato
Company Secretary
17 March 2011

Registered office address: 2 Triton Square, Regent's Place, London NW1 3AN

Contents to Financial Statements

Financial Statements

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

We have audited the financial statements of Abbey National Treasury Services plc (the 'Company') and its subsidiaries (together the 'Group') for the year ended 31 December 2010 which comprise the Consolidated Income Statement, the Consolidated and Company Statements of Comprehensive Income, the Consolidated and Company Balance Sheets, the Consolidated and Company Statements of Changes in Equity, the Consolidated and Company Cash Flow Statements and the related Notes 1 to 45. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of directors and auditor

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and the parent Company's affairs as at 31 December 2010 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS regulation.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in the Accounting Policies section of the financial statements, the Group, in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB). In our opinion the Group financial statements comply with IFRSs as issued by the IASB.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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

Matthew Perkins (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
17 March 2011

Consolidated Income Statement

For the years ended 31 December 2010 and 2009

	Notes	2010 £m	2009 £m
Interest and similar income		**3,045**	3,805
Interest expense and similar charges		**(2,642)**	(3,429)
Net interest income	3	**403**	376
Net fee and commission income	4	**28**	25
Net trading and other income	5	**462**	250
Total operating income		**893**	651
Administration expenses	6	**(209)**	(162)
Depreciation and amortisation	7	**(6)**	(3)
Total operating expenses excluding provisions and charges		**(215)**	(165)
Impairment losses on loans and advances	8	**(69)**	(30)
Total operating provisions and charges		**(69)**	(30)
Profit before tax		**609**	456
Taxation charge	11	**(149)**	(78)
Profit for the year		**460**	378
Attributable to:			
Equity holders of the parent		**460**	378

The notes on pages 18 to 113 are an integral part of these Consolidated Financial Statements.

All profits during the year were generated from continuing operations.

Consolidated Statement of Comprehensive Income

For the years ended 31 December 2010 and 2009

	2010 £m	2009 £m
Profit for the year	**460**	378
Other comprehensive expense		
Exchange differences on translation of foreign operations	**-**	(4)
Tax on above items	**-**	-
Net loss recognised directly in equity	**-**	(4)
Total comprehensive income for the year	**460**	374
Attributable to:		
Equity holders of the parent	**460**	374

The notes on pages 18 to 113 are an integral part of these Consolidated Financial Statements.

Consolidated Balance Sheet

As at 31 December 2010 and 2009

	Notes	2010 £m	2009 £m
Assets			
Cash and balances at central banks	13	**5,088**	448
Trading assets	14	**35,461**	33,290
Derivative financial instruments	15	**23,237**	23,201
Financial assets designated at fair value	16	**6,468**	12,000
Loans and advances to banks	17	**146,412**	191,749
Loans and advances to customers	18	**34,550**	20,175
Held-to-maturity securities	20	**331**	300
Loans and receivables securities	21	**626**	896
Macro hedge of interest rate risk		**908**	682
Intangible assets	23	**26**	8
Property, plant and equipment	24	**22**	6
Current tax assets		**40**	3
Deferred tax assets	25	**26**	21
Other assets	26	**65**	67
Total assets		**253,260**	282,846
Liabilities			
Deposits by banks	27	**136,753**	166,305
Deposits by customers	28	**7,061**	9,461
Derivative financial instruments	15	**25,043**	24,455
Trading liabilities	29	**42,827**	46,139
Financial liabilities designated at fair value	30	**3,657**	4,340
Debt securities in issue	31	**33,659**	27,997
Subordinated liabilities	32	**331**	331
Other liabilities	33	**191**	147
Current tax liabilities		**374**	167
Deferred tax liabilities	25	**1**	1
Total liabilities		**249,897**	279,343
Equity			
Share capital	35	**2,549**	2,549
Retained earnings		**798**	938
Other reserves		**16**	16
Total shareholders' equity		**3,363**	3,503
Total liabilities and equity		**253,260**	282,846

The Notes on pages 18 to 113 are an integral part of these Consolidated Financial Statements.

The Financial Statements on pages 13 to 113 were approved and authorised for issue by the Board on 17 March 2011 and signed on its behalf by:

David Green
Director

Company Registered Number 2338548

Consolidated Statement of Changes in Equity

For the years ended 31 December 2010 and 2009

	Notes	Share Capital £m	Foreign currency translation reserve £m	Retained earnings £m	Total £m
1 January 2009		2,549	21	704	3,274
Profit for the year		-	-	378	378
Other comprehensive income for the year		-	(5)	-	(5)
Tax of other comprehensive income		-	-	-	-
Dividends declared and amounts representative of contractual obligations	36	-	-	(144)	(144)
31 December 2009		2,549	16	938	3,503
1 January 2010		**2,549**	**16**	**938**	**3,503**
Profit for the year		**-**	**-**	**460**	**460**
Other comprehensive income for the year		**-**	**-**	**-**	**-**
Tax of other comprehensive income		**-**	**-**	**-**	**-**
Dividends declared and amounts representative of contractual obligations	36	**-**	**-**	**(600)**	**(600)**
31 December 2010		**2,549**	**16**	**798**	**3,363**

Consolidated Cash Flow Statement

For the years ended 31 December 2010 and 2009

	Notes	**2010 £m**	2009 £m
Net cash flow from operating activities			
Profit for the year		**460**	378
Adjustments for:			
Non cash items included in net profit		**125**	791
Change in operating assets		**38,039**	(5,135)
Change in operating liabilities		**(36,856)**	41,163
Income taxes paid		**(28)**	-
Effect of exchange rate differences		**399**	(1,423)
Net cash flow from operating activities	37	**2,139**	35,774
Net cash flow used in investing activities			
Purchase of tangible and intangible fixed assets	23, 24	**(40)**	(3)
Proceeds from sale of fixed assets		**-**	1
Net cash flow used in investing activities		**(40)**	(2)
Net cash flow from financing activities			
Issue of long-term debt		**11,419**	-
Repayments of long-term debt		**(4,840)**	-
Dividends paid		**(600)**	-
Net cash flow from financing activities		**5,979**	-
Net increase in cash and cash equivalents		**8,078**	35,772
Cash and cash equivalents at beginning of the year		**78,510**	43,790
Effect of exchange rate changes on cash and cash equivalents		**141**	(1,052)
Cash and cash equivalents at the end of the year	37	**86,729**	78,510

The Notes on pages 18 to 113 are an integral part of these Consolidated Financial Statements.

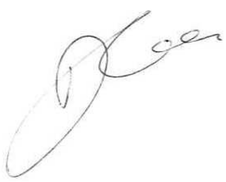
Company Balance Sheet

As at 31 December 2010 and 2009

	Notes	2010 £m	2009 £m
Assets			
Cash and balances at central banks	13	**5,088**	448
Trading assets	14	**35,110**	24,976
Derivative financial instruments	15	**23,277**	23,129
Financial assets designated at fair value	16	**6,468**	12,000
Loans and advances to banks	17	**146,398**	166,020
Loans and advances to customers	18	**34,935**	20,266
Loans and receivable securities	21	**626**	896
Macro hedge of interest rate risk		**908**	682
Investment in subsidiary undertakings	22	**2,187**	2,185
Intangible assets	23	**26**	8
Property, plant and equipment	24	**22**	6
Current tax assets		**40**	3
Deferred tax assets	25	**25**	21
Other assets	26	**65**	67
Total assets		**255,175**	250,707
Liabilities			
Deposits by banks	27	**136,701**	166,169
Deposits by customers	28	**13,989**	17,601
Derivative financial instruments	15	**25,043**	24,330
Trading liabilities	29	**42,827**	13,315
Financial liabilities designated at fair value	30	**3,595**	4,282
Debt securities in issue	31	**29,226**	21,631
Other liabilities	33	**182**	136
Current tax liabilities		**357**	57
Total liabilities		**251,920**	247,521
Equity			
Share capital	35	**2,549**	2,549
Retained earnings		**692**	622
Other reserves		**14**	15
Total shareholders equity		**3,255**	3,186
Total liabilities and equity		**255,175**	250,707

The Notes on pages 18 to 113 are an integral part of these Consolidated Financial Statements.

The Financial Statements on pages 13 to 113 were approved and authorised for issue by the Board on 17 March 2011 and signed on its behalf by:



David Green
Director

Company Registered Number 2338548

Company Statement of Comprehensive Income

For the years ended 31 December 2010 and 2009

	2010 £m	2009 £m
Profit for the year	**670**	555
Other comprehensive expense:		
Exchange differences on translation of foreign operations	**(1)**	(2)
Tax on items taken directly to equity	**-**	-
Net expense recognised directly in equity	**(1)**	(2)
Total comprehensive income for the year	**669**	553
Attributable to:		
Equity holders of the parent	**669**	553

Company Statement of Changes in Equity

For the years ended 31 December 2010 and 2009

	Notes	Share Capital £m	Foreign currency translation reserve £m	Retained earnings £m	Total £m
1 January 2009		2,549	17	211	2,777
Profit for the year		-	-	555	555
Other comprehensive income for the year		-	(2)	-	(2)
Tax of other comprehensive income		-	-	-	-
Dividends declared and amounts representative of contractual obligations	36	-	-	(144)	(144)
31 December 2009		2,549	15	622	3,186
1 January 2010		**2,549**	**15**	**622**	**3,186**
Profit for the year		**-**	**-**	**670**	**670**
Other comprehensive income for the year		**-**	**(1)**	**-**	**(1)**
Tax of other comprehensive income		**-**	**-**	**-**	**-**
Dividends declared	36	**-**	**-**	**(600)**	**(600)**
31 December 2010		**2,549**	**14**	**692**	**3,255**

Company Cash Flow Statement

For the years ended 31 December 2010 and 2009

	Notes	2010 £m	2009 £m
Net cash flow from operating activities			
Profit for the year		**670**	555
Adjustments for:			
Non cash items included in net profit		**157**	676
Change in operating assets		**33,019**	(13,063)
Change in operating liabilities		**(2,824)**	24,852
Income taxes received		**(17)**	-
Effects of exchange rate differences		**154**	(870)
Net cash flow from operating activities	37	**31,159**	12,150
Net cash flow from investing activities			
Capital repatriation		**-**	129
Purchase of tangible and intangible fixed assets	23, 24	**(40)**	(3)
Net cash flow from investing activities		**(40)**	126
Net cash flow used in financing activities			
Issue of long term debt		**11,419**	-
Repayments of long term debt		**(4,840)**	-
Dividends paid		**(600)**	-
Net cash flow used in financing activities		**5,979**	-
Net decrease in cash and cash equivalents		**37,098**	12,276
Cash and cash equivalents at beginning of the year		**49,327**	38,020
Effect of exchange rate changes on cash and cash equivalents		**287**	(969)
Cash and cash equivalents at the end of the year	37	**86,712**	49,327

The Notes on pages 18 to 113 are an integral part of these Consolidated Financial Statements.

Notes to the Financial Statements

1. Accounting policies

These financial statements are prepared for Abbey National Treasury Services plc (the 'Company') and the Abbey National Treasury Services plc group (the 'Group') under the Companies Act 2006. The principal activity of the Group is to provide treasury, corporate and wholesale banking services.

Abbey National Treasury Services plc is a public limited company, incorporated in England and Wales, having a registered office in England and is the holding company of the Group.

Compliance with International Financial Reporting Standards

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board ('IASB'), and interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') of the IASB that, under European Union Regulations, are effective and available for early adoption at the Group's reporting date. The Company and the Group have complied with IFRS as issued by the IASB in addition to complying with its legal obligation to comply with IFRS as adopted for use in the European Union.

Recent accounting developments

In 2010, the Group adopted the following significant new or revised standards or amendments to standards:

a) IFRS 3 'Business Combinations' – In January 2008, the IASB issued an amendment to IFRS 3 which clarifies and changes certain elements of accounting for a business combination, including the measurement and accounting for non-controlling interests, contingent consideration, step acquisitions and acquisition-related costs and also widens the scope of the standard. There are also associated amendments to IAS 27, IAS 28 and IAS 31.

   IFRS 3 (2008) has been applied in the current year prospectively to business combinations for which the acquisition date is on or after 1 January 2010. Its adoption has affected the accounting for business combinations in the current year as follows:

   > IFRS 3 (2008) allows a choice on a transaction-by-transaction basis for the measurement of non-controlling interests at the date of acquisition (previously referred to as 'minority' interests) either at fair value or at the non-controlling interests' share of recognised identifiable net assets of the acquiree.

   > IFRS 3 (2008) changes the recognition and subsequent accounting requirements for contingent consideration. Previously, contingent consideration was recognised at the acquisition date only if payment of the contingent consideration was probable and it could be measured reliably; any subsequent adjustments to the contingent consideration were always made against the cost of the acquisition. Under the revised Standard, contingent consideration is measured at fair value at the acquisition date; subsequent adjustments to the consideration are recognised against the cost of the acquisition only to the extent that they arise from new information obtained within the measurement period (a maximum of 12 months from the acquisition date) about the fair value at the date of acquisition. All other subsequent adjustments to contingent consideration classified as an asset or a liability are recognised in profit or loss.

   > Any adjustments to contingent considerations for acquisitions made prior to 1 January 2010 which result in an adjustment to goodwill continue to be accounted for under IFRS 3 (2004) and IAS 27 (2005).

   > IFRS 3 (2008) requires the application of acquisition accounting only at the point where control is achieved, for a business combination achieved in stages (step acquisition). If an acquirer has a pre-existing equity interest in an acquiree and increases its equity interest sufficiently to achieve control, it must remeasure its previously-held equity interest in the acquiree at acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. Once control is achieved, all other increases and decreases in ownership interests are treated as transactions among equity holders and reported within equity. Goodwill does not arise on any increase, and no gain or loss is recognised on any decrease.

   > IFRS 3 (2008) requires acquisition-related costs to be accounted for separately from the business combination, generally leading to those costs being recognised as an expense in profit or loss as incurred, whereas previously they were accounted for as part of the cost of the acquisition.

   > IFRS 3 (2008) requires the recognition of a settlement gain or loss when the business combination in effect settles a pre-existing relationship between the Group and the acquiree.

   The adoption of IFRS 3 (2008) did not affect the Group.

Notes to the Financial Statements continued

b) IAS 27 'Consolidated and Separate Financial Statements' – In January 2008, the IASB issued an amendment to IAS 27, to reflect the amendment in IFRS 3. The changes in the accounting policy have been applied prospectively from 1 January 2010. The application of IAS 27 (2008) has resulted in changes in the Group's accounting policies for changes in ownership interests in subsidiaries.

> Specifically, the revised Standard has affected the Group's accounting policies regarding changes in ownership interests in its subsidiaries that do not result in loss of control. In prior years, in the absence of specific requirements in IFRSs, increases in interests in existing subsidiaries were treated in the same manner as the acquisition of subsidiaries, with goodwill or a bargain purchase gain being recognised, when appropriate; for decreases in interests in existing subsidiaries that did not involve a loss of control, the difference between the consideration received and the adjustment to the non-controlling interests was recognised in profit or loss. Under IAS 27 (2008), all such increases or decreases are dealt with in equity, with no impact on goodwill or profit or loss.

> When control of a subsidiary is lost as a result of a transaction, event or other circumstance, the revised Standard requires the Group to derecognise all assets, liabilities and non-controlling interests at their carrying amount and to recognise the fair value of the consideration received. Any retained interest in the former subsidiary is recognised at its fair value at the date control is lost. The resulting difference is recognised as a gain or loss in profit or loss.

The adoption of IAS 27 (2008) did not affect the Group.

c) IAS 28 'Investment in Associates' and IAS 31 'Interest in Joint Ventures' – In January 2008, the IASB made consequential amendments to IAS 28 and IAS 31 to extend the changes in IAS 27.

The principle adopted in IAS 27 (2008) that a change in accounting basis is recognised as a disposal and re-acquisition of any retained interest at fair value is extended to IAS 28 and IAS 31 as follows:

> IAS 28 is amended such that for a change in equity interest in an associate, the investor remeasures at acquisition date fair value any investment retained in the former associate, with any consequential gain or loss compared to its carrying amount under IAS 28 recognised in profit or loss.

> IAS 31 is amended such that for a change in joint control interest in an entity, the investor remeasures at fair value any investment retained in the former jointly controlled entity, with any consequential gain or loss compared to its carrying amount under IAS 31 recognised in profit or loss.

> Any amount that has previously been recognised in other comprehensive income, and that would be reclassified to profit or loss following a disposal, is similarly reclassified to profit or loss.

The adoption of IAS 28 (2008) did not affect the Group.

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) IFRS 9 'Financial Instruments' – In November 2009, the IASB issued IFRS 9 and in October 2010, issued an amendment to IFRS 9 which introduce new requirements for the classification and measurement of financial assets and financial liabilities and for derecognition. IFRS 9 is effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.

> IFRS 9 requires all recognised financial assets that are within the scope of IAS 39 'Financial Instruments: Recognition and Measurement' to be subsequently measured at amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair values at the end of subsequent accounting periods.

> The most significant effect of IFRS 9 regarding the classification and measurement of financial liabilities relates to the accounting for changes in fair value of a financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability. Specifically, under IFRS 9, for financial liabilities that are designated as at fair value through profit or loss, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is recognised in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit or loss was recognised in profit or loss.

The Group anticipates that IFRS 9 will be adopted in the Group's financial statements for the annual period beginning on or after 1 January 2013 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.

Notes to the Financial Statements continued

b) 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.

The Group does not anticipate that these amendments to IFRS 7 will have a significant effect on the Group's 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.

c) IAS 24 'Related Party Transactions' – In November 2009, the IASB issued amendments to IAS 24, effective for annual periods beginning on or after 1 January 2011, with earlier application permitted. The revised standard modifies the definition of a related party and simplifies disclosures for government-related entities.

The disclosure exemptions introduced in IAS 24(2009) do not affect the Group because the Group is not a government-related entity. However, disclosures regarding related party transactions and balances in these consolidated financial statements may be affected when the revised version of the Standard is applied in future accounting periods because some counterparties that did not previously meet the definition of a related party may come within the scope of the Standard.

Basis of preparation

The Consolidated Financial Statements have been prepared under the historical cost convention, as modified by the revaluation of available for sale financial assets, financial assets and financial liabilities held at fair value through profit or loss and all derivative contracts, and on the going concern basis of accounting as set out below.

Going concern

The Group's objectives, policies and processes for managing its capital are described in Note 45. 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 43.

The Group is reliant on Santander UK plc and other companies in Santander UK for a significant proportion of its funding. The Santander UK Board has confirmed that Santander UK plc and Santander UK are going concerns, 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 31 July 2012 under a deed poll guarantee entered into by the Company on 29 January 2008. Santander UK plc has given a reciprocal guarantee in respect of the unsubordinated liabilities of the Company incurred prior to 31 July 2012.

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.

Consolidation

Subsidiaries, which are those companies and other entities (including Special Purpose Entities) over which the Group, directly or indirectly, has power to govern the financial and operating policies, are consolidated. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. The Company recognises investments in subsidiaries at cost less impairment.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured at the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition. Acquisition related costs are expensed as incurred. The excess of the cost of acquisition over the fair value of the tangible and intangible net assets of the subsidiary acquired is recorded as goodwill. Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The accounting reference date of the Company and its subsidiary undertakings is 31 December, with the exception of those investment and funding companies which, because of commercial considerations, have various accounting reference dates. The Financial Statements of these subsidiaries have been consolidated on the basis of interim Financial Statements for the period to 31 December.

Notes to the Financial Statements continued

In the context of Special Purpose Entities ('SPE's), the following circumstances may indicate a relationship in which, in substance, the Group controls and consequently consolidates an SPE:

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

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

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

Foreign currency translation

Items included in the Financial Statements of each entity (including foreign branch operations) of the Group are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity ('the functional currency'). The Consolidated Financial Statements are presented in pounds sterling, which is the functional currency of the parent.

Income statements and cash flows of foreign entities are translated into the Group's reporting currency at average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December. Exchange differences arising from the translation of the net investment in foreign entities are taken to shareholders' equity. When a foreign entity is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.
Foreign currency transactions are translated into the functional currency of the entity involved at the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

The amount of exchange rate differences recognised in profit or loss on items not at fair value through profit and loss was £(175)m credit (2009: £242m charge). This was offset by income/charges on items held at fair value.

Revenue recognition

(a) Interest income and expense
Interest income on financial assets that are classified as loans and receivables or held to maturity, and interest expense on financial liabilities other than those at fair value through profit and loss are determined using the effective interest method. The effective interest rate is the rate that discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument excluding future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of the financial instrument and all other premiums or discounts. Interest income on assets classified as loans and receivables or held to maturity, interest expense on liabilities classified at amortised cost and interest income and expense on hedging derivatives are recognised in interest and similar income and interest expense and similar charges in the income statement.

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

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

(d) Net trading and other income
Net trading and other income comprises all gains and losses from changes in the fair value of financial assets and liabilities held at fair value through profit or loss (including financial assets and financial liabilities held for trading and designated as fair value through profit or loss), together with related interest income, expense and dividends. It also includes income from operating lease assets, and profits/(losses) on the sales of fixed assets and subsidiary undertakings.

Notes to the Financial Statements continued

Changes in the fair value of financial assets and liabilities held for trading, including trading derivatives, are recognised in the income statement as net trading and other income together with dividends and interest receivable and payable. Changes in the fair value of assets and liabilities designated as fair value through profit or loss are recognised in net trading and other income together with dividends, interest receivable and payable and changes in fair value of derivatives managed in conjunction with these assets and liabilities. Changes in fair value of derivatives in a designated hedging relationship are recognised in net trading and other income along with the fair value of the hedged item.

Pensions and other post retirement benefits

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

Intangible assets

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

Property, plant and equipment

Property, plant and equipment include owner-occupied properties (including leasehold properties), office fixtures and equipment and computer software. Property, plant and equipment are carried at cost less accumulated depreciation and accumulated impairment losses. A review for indications of impairment is carried out at each reporting date. Gains and losses on disposal are determined by reference to the carrying amount and are reported in other operating income. Repairs and renewals are charged to the income statement when the expenditure is incurred.

Software development costs are capitalised when they are direct costs associated with identifiable and unique software products that are expected to provide future economic benefits and the cost of these products can be measured reliably. These costs include payroll, the costs of materials and services, and directly attributable overheads. Internally developed software meeting these criteria and externally purchased software are classified in property, plant and equipment on the balance sheet where the software is an integral part of the related computer hardware. Capitalisation of costs cease when the software is capable of operating as intended. Costs associated with maintaining software programmes are expensed as incurred. Classes of property, plant and equipment are depreciated on a straight-line basis over their useful life as follows:

Owner-occupied properties	Not exceeding 50 years
Office fixtures and equipment	5 to 8 years
Computer software	3 years

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

Financial assets

The Group classifies its financial assets as: financial assets at fair value through profit or loss, loans and receivables and held-to-maturity financial assets. Management determines the classification of its investments at initial recognition. Financial assets that are classified at fair value through profit or loss, which have not been designated as such or are not accounted for as derivatives, may subsequently in rare circumstances, be reclassified from the fair value through profit or loss category to the loans and receivables, available for sale or held to maturity categories.

In order to meet the criteria for reclassification, the asset must no longer be held for the purpose of selling or repurchasing in the near term and must also meet the definition of the category into which it is to be reclassified had it not been required to classify it at fair value through profit or loss at initial recognition. The reclassified value is the fair value of the asset at the date of reclassification. The Group has not utilised this option and therefore has not reclassified any assets from the fair value through profit or loss category that were classified as such at initial recognition.

Notes to the Financial Statements continued

(a) Financial assets at fair value through profit or loss
Financial assets are classified as fair value through profit or loss if they are either held for trading or otherwise designated at fair value through profit or loss on initial recognition. A financial asset is classified as held for trading if it is a derivative or it is acquired principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking.

In certain circumstances financial assets other than those that are held for trading are designated at fair value through profit or loss where this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets or recognising the gains or losses on them on a different basis, where the assets are managed and their performance evaluated on a fair value basis, or where a financial asset contains one or more embedded derivatives which are not closely related to the host contract.

Trading assets, derivative financial instruments and financial assets designated at fair value are classified as fair value through profit or loss. They are derecognised when the rights to receive cash flows from the asset have expired or when the Group has transferred substantially all the risks and rewards of ownership.

(b) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments, that are not quoted in an active market and which are not classified as available for sale or fair value through profit or loss. They arise when the Group provides money or services directly to a customer with no intention of trading the loan. Loans and receivables are initially recognised at fair value including direct and incremental transaction costs. They are subsequently valued at amortised cost, using the effective interest method. They are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all of the risks and rewards of ownership. Loans and receivables consist of loans and advances to banks and loans and advances to customers and Loans and receivables securities.

(c) Held to maturity investments
Held to maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity. Held to maturity investments are initially recognised at fair value including direct and incremental transaction costs. They are subsequently valued at amortised cost, using the effective interest method. They are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all of the risks and rewards of ownership. Were the Group to sell other than an insignificant amount of held to maturity assets, the entire category would be tainted and reclassified as available for sale.

Valuation of financial instruments

Financial instruments that are classified at fair value through profit or loss ('FVTPL'), including those held for trading purposes and all derivatives are stated at fair value. The fair value of such financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing parties, knowledgeable parties, other than in a forced or liquidation sale.

Initial measurement
The best evidence of the fair value of a financial instrument at initial recognition is the transaction price unless the instrument is evidenced by comparison with other observable current market transactions in the same instrument or based on a valuation technique whose variables include significant data from observable markets. Any difference between the transaction price and the value based on a valuation technique where the inputs are not based on data from observable current markets is not recognised in profit or loss on initial recognition. Subsequent gains or losses are only recognised to the extent that they arise from a change in a factor that market participants would consider in setting a price.

Subsequent measurement

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

Notes to the Financial Statements continued

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

Level 1: Unadjusted quoted prices for identical assets or liabilities in an active market that the Group has the ability to access at the measurement date. Level 1 measurements include debt securities, equity securities, exchange rate derivatives, interest rate derivatives, equity and credit derivatives and short positions in securities.

Level 2: Quoted prices in markets that are not active, quoted prices for similar assets or liabilities, recent market transactions, inputs other than quoted market prices for the asset or liability that are observable either directly or indirectly for substantially the full term, and inputs to valuation techniques that are derived principally from or corroborated by observable market data through correlation or other statistical means for substantially the full term of the asset or liability. Level 2 measurements include loans and advances to banks, loans and advances to customers, exchange rate derivatives, interest rate derivatives, equity and credit derivatives, debt securities in issue, deposits by banks, deposits by customers and debt securities in issue.

Level 3: Inputs to the pricing or valuation techniques that are significant to the overall fair value measurement of the asset or liability are unobservable. Level 3 measurements include equity securities, exchange rate derivatives, equity and credit derivatives, loans and advances to customers, debt securities, and debt securities in issue.

The Group assesses active markets for equity instruments based on the average daily trading volume both in absolute terms and relative to the market capitalisation for the instrument. The Group assesses active markets for debt instruments based on both the average daily trading volume and the number of days with trading activity. The Group assesses active markets for exchange traded derivatives based on the average daily trading volume both in absolute terms and relative to the market capitalisation for the instrument. Market activity and liquidity is discussed in the relevant monthly Risk Forum as well as being part of the daily update given by each business at the start of the trading day. This information, together with the observation of active trading and the magnitude of the bid/offer spreads allow consideration of the liquidity of a financial instrument. All underlying assets and liabilities are reviewed to consider the appropriate adjustment to mark the mid price reported in the trading systems to a realisable value. This process takes into account the liquidity of the position in the size of the adjustment required. These liquidity adjustments are presented and discussed at the monthly Risk Forum.

In determining the appropriate measurement levels, the Group performs regular analyses on the assets and liabilities. All underlying assets and liabilities are regularly reviewed to determine whether a position should be regarded as illiquid; the most important practical consideration being the observability of trading. Where the bid-offer spread is observable, this is tested against actual trades. Changes in the observability of significant valuation inputs during the reporting period may result in a reclassification of certain assets and liabilities within the fair value hierarchy.

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

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

Unrecognised gains as a result of the use of valuation models using unobservable inputs ("Day One profits")
The timing of recognition of deferred day one profit and loss is determined individually. It is deferred until either the instrument's fair value can be determined using market observable inputs or is realised through settlement. The financial instrument is subsequently measured at fair value, adjusted for the deferred day one profit and loss. Subsequent changes in fair value are recognised immediately in the consolidated income statement without immediate reversal of deferred day one profits and losses.

"Regular way" purchases of financial assets and issues of financial liabilities

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

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

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

Notes to the Financial Statements continued

Offsetting financial assets and liabilities

Financial assets and liabilities including derivatives are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Sale and repurchase agreements (including stock borrowing and lending)

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

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

Derivative financial instruments

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

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and option pricing models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative, except where netting is permitted.

Certain derivatives embedded in other financial instruments, such as the conversion option in a convertible bond, are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the hybrid contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement. Contracts containing embedded derivatives are not subsequently reassessed for separation unless there has been a change in the terms of the contract which significantly modifies the cash flows, or where assets have been reclassified where they are reassessed at the time of reclassification.

Hedge accounting

The Group designates certain derivatives as hedging instruments of the fair value of recognised assets or liabilities or firm commitments (fair value hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

At the time a financial instrument is designated as a hedge, the Group formally documents the relationship between the hedging instrument(s) and hedged item(s). Documentation includes risk management objectives and the strategy in undertaking the hedge transaction, together with the methods that will be used to assess the effectiveness of the hedging relationship. Accordingly, the Group formally assesses, both at the inception of the hedge and on an ongoing basis, whether the hedging derivatives have been and will be highly effective in offsetting changes in the fair value of the hedged items. A hedge is normally regarded as highly effective if, at inception and throughout its life, the Group can expect, and actual results indicate, that changes in the fair value of the hedged items are effectively offset by changes in the fair value of the hedging instrument, and actual results are within a range of 80% to 125%.

The Group discontinues hedge accounting when it is determined that: a derivative is not, or has ceased to be, highly effective as a hedge; when the derivative expires, or is sold, terminated or exercised; or when the hedged item matures or is sold or repaid. On discontinuance of hedge accounting amortisation of the adjustment to the hedged item is included in net trading and other income.

The hedge adjustment for fair value hedges is classified in the balance sheet in the same category as the hedged item, unless it relates to a macro hedging relationship where the hedge adjustment is recognised as a macro hedge on the face of the balance sheet.

For fair value hedges, changes in the fair value of the hedging instrument and hedged item are recognised in net trading and other income. Hedge ineffectiveness represents the amount by which the changes in the fair value of the hedging derivative differ from changes in the fair value of the hedged item. Such gains and losses are recorded in current period earnings within net trading and other income. Gains and losses on components of a hedging derivative that are excluded from assessing hedge effectiveness are also included in net trading and other income.

Notes to the Financial Statements continued

Impairment of financial assets

At each balance sheet date, the Group assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset or group of financial assets classified as loans and receivables and held to maturity have become impaired. Evidence of impairment may include indications that the borrower or group of borrowers have defaulted, are experiencing significant financial difficulty, or the debt has been restructured to reduce the burden to the borrower.

Financial assets carried at amortised cost
(a) Corporate assets
Impairment losses are assessed individually for the financial assets that are individually significant and individually or collectively for assets that are not individually significant. For individually assessed assets, impairment reviews are conducted monthly for those assets on the Group's 'Watchlist' of new, emerging and serious circumstances relating to the asset, with a particular focus on the following scenarios: (1) where an asset has a payment default which has been outstanding for 90 days or more; (2) where non-payment defaults have occurred and/or where it has become evident that some sort of workout or rescheduling exercise is to be undertaken; or (3) where for example with Real Estate Finance, it has become evident that the value of the Group's security is no longer considered adequate.

In such situations the asset is transferred to the Corporate Banking Workouts team within Credit Risk. As part of their impairment reviews, an assessment of the expected future cash flows in relation to the relevant asset, appropriately discounted, is undertaken and the result compared to the current net book value of the asset. Any shortfall evidenced as a result of such a review results in an impairment loss allowance.

Collective impairment assessment is used for portfolios classified as 'performing assets' where it is felt that market events, either specific or general, are likely to have determined that losses are already inherent in a portfolio (IBNO) notwithstanding that these events may not have manifested themselves in specific defaults or other triggers that would lead to an individual impairment assessment. The amount of any such collective impairment loss allowance, for each portfolio concerned 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. The level of IBNO for each portfolio is calculated, based on these factors, and is applied to the total value of unimpaired assets within the portfolio (i.e. excluding any assets for which an observed impairment loss allowance already exists). The impairment loss allowance assessment is regularly reviewed for any material change in the dynamics of the portfolio (e.g. volume, mix, observed losses) and market conditions (including comparison of the current IBNO impairment loss allowance level to the range of IBNO impairment loss allowances across similar loans in the industry).

Once a financial asset or a group of financial assets has been written down as a result of an impairment loss, the assets are not placed onto a non-accrual status. Subsequent interest income continues to be recognised on an effective interest rate basis, though on the asset value after impairment loss allowances have been deducted.

For secured loans, a write-off is made when all collection procedures have been exhausted and the security has been sold. For unsecured loans, a write-off is made when all avenues for collecting the debt have been exhausted. There may be occasions where a write-off occurs for other reasons, for example, following a consensual restructure of the debt or where the debt is sold for strategic reasons into the secondary market at a value lower than the face value of the debt. Write-offs are charged against previously established impairment loss allowances.

(b) Loans and receivables securities
Loans and receivables securities are assessed individually for impairment. An impairment loss is incurred if there is objective evidence that an event has occurred since initial recognition of the assets that has an impact in the estimated future cash flows of the loans and receivables securities. Loans and receivables securities are monitored for potential impairment through a detailed expected cashflow analysis taking into account the structure and underlying assets of each individual security. Once specific events give rise to a reasonable expectation that future anticipated cash flows may not be received, the asset originating these doubtful cash flows will be deemed to be impaired. Objective evidence of loss events includes significant financial distress of the issuer and default or delinquency in interest and principal payments (breach of contractual terms).

Impairment of non-financial assets

At each balance sheet date, or more frequently when events or changes in circumstances dictate, property plant and equipment (including operating lease assets) and intangible assets are assessed for indicators of impairment. If indications are present, these assets are subject to an impairment review. The impairment review comprises a comparison of the carrying amount of the asset or cash generating unit with its recoverable amount: the higher of the asset's or cash-generating unit's fair value less costs to sell and its value in use. Net selling price is calculated by reference to the amount at which the asset could be disposed of in a binding sale agreement in an arm's length transaction evidenced by an active market or recent transactions for similar assets, less costs to sell. Value in use is calculated by discounting the expected future cash flows obtainable as a result of the asset's continued use, including those resulting from its ultimate disposal, at a market based discount rate on a pre tax basis.

Notes to the Financial Statements continued

The carrying values of fixed assets are written down by the amount of any impairment and the loss is recognised in the income statement in the period in which it occurs. Impairment of a cash generating unit is allocated first to goodwill and then to other assets held within the unit on a pro-rata basis. An impairment loss recognised in an interim period is not reversed at the balance sheet date. A previously recognised impairment loss relating to a fixed asset may be reversed in part or in full when a change in circumstances leads to a change in the estimates used to determine the fixed asset's recoverable amount. The carrying amount of the fixed asset will only be increased up to the amount that would have been had the original impairment not been recognised. Impairment losses on goodwill are not reversed. For conducting impairment reviews, cash generating units are the lowest level at which management monitors the return on investment on assets.

Leases

The Group as lessor **–** Operating lease assets are recorded at deemed cost and depreciated over the life of the asset after taking into account anticipated residual values. Operating lease rental income and depreciation is recognised on a straight-line basis over the life of the asset.

The Group as lessee **–** The Group enters into operating leases for the rental of equipment or real estate. Payments made under such leases are charged to the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

If the lease agreement transfers the risk and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and depreciated over the lower of the estimated useful life and the life of the lease. The corresponding rental obligations are recorded as borrowings. The aggregate benefit of incentives, if any, is recognised as a reduction of rental expense over the lease term on a straight-line basis.

Income taxes, including deferred income taxes

The tax expense represents the sum of the income tax currently payable and deferred income tax.

Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

The liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred income tax is provided in full, using the liability method, on income tax losses available to carry forward and on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Consolidated Financial Statements. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which the assets may be utilised as they reverse. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill and the initial recognition of other assets (other than in a business combination) and liabilities in a transaction that affects neither the taxable profit nor the accounting profit. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on rates enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity. Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the Group is able to control reversal of the temporary difference and it is probable that it will not reverse in the foreseeable future.

The Company reviews the carrying amount of deferred tax assets at each balance sheet date and reduces it to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

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

Cash and cash equivalents

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

Financial liabilities

Financial liabilities are initially recognised when the Group becomes contractually bound to the transfer of economic benefits in the future.

Notes to the Financial Statements continued

(a) Financial liabilities at fair value through profit or loss
Financial liabilities are classified as fair value through profit or loss if they are either held for trading or otherwise designated at fair value through profit or loss on initial recognition. A financial liability is classified as held for trading if it is a derivative or is incurred principally for the purpose of repurchasing or being unwound in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short term profit taking. Intercompany balances held by the Company with its trading subsidiaries are classified as held for trading.

In certain circumstances financial liabilities other than those that are held for trading are designated at fair value through profit or loss where this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets and liabilities or recognising the gains or losses on them on a different basis, or where a financial liability contains one or more embedded derivatives which are not closely related to the host contract. These liabilities are initially recognised at fair value and transactions costs are taken directly to the income statement. Gains and losses arising from changes in fair value are included directly in the income statement.

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

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

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

Equity index-linked deposits

Contracts involving the receipt of cash on which customers receive an index-linked return are accounted for as equity index-linked deposits, and classified as deposits by customers within trading liabilities. Equity index-linked deposits are managed within the equity derivatives trading book as an integral part of the equity derivatives portfolio.

There are two principal product types.

(i) Capital at Risk
These products are designed to replicate the investment performance of an equity index, subject to a floor. In the event the index falls under a certain predetermined level, customers forfeit a predetermined percentage of principal up to a predetermined amount.

(ii) Capital Guaranteed/Protected
These products give the customers a limited participation in the upside growth of an equity index. In the event the index falls in price, a cash principal element is guaranteed/protected.

Equity index-linked deposits are remeasured at fair value at each reporting date with changes in fair values recognised in the income statement. The equity index-linked deposits contain embedded derivatives. These embedded derivatives, in combination with the principal cash deposit element, are designed to replicate the investment performance profile tailored to the return agreed in the contracts with customers. Other than new capital guaranteed products, which are treated as deposits by customers with any associated embedded derivatives bifurcated, embedded derivatives are not separated from the host instrument and are not separately accounted for as a derivative instrument, as the entire contract embodies both the embedded derivative and the host instrument and is remeasured at fair value at each reporting date. As such, there is no requirement to bifurcate the embedded derivatives in the equity index-linked deposits.

Borrowings

Borrowings, including subordinated liabilities, are recognised initially at fair value, being the proceeds (fair value of consideration received) net of transaction costs incurred. Borrowings are subsequently stated at amortised cost or fair value dependent on designation at initial recognition.

Share capital

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

Provisions

Provisions are recognised for present obligations arising as consequences of past events where it is more likely than not that a transfer of economic benefits will be necessary to settle the obligation, and it can be reliably estimated. When a leasehold property ceases to be used in the business, provision is made where the unavoidable costs of the future obligations relating to the lease are expected to exceed anticipated rental income. The net costs are discounted using market rates of interest to reflect the long-term nature of the cash flows.

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

Notes to the Financial Statements continued

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

Financial guarantee contracts

The Group accounts for guarantees that meet the definition of a financial guarantee contract at fair value on initial recognition. In subsequent periods, these guarantees are measured at the higher of the initial fair value less cumulative amortisation and the amount that would be recognised as a provision as described in the Accounting Policies above.

Dividends

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

Critical accounting policies and areas of significant management judgement

The preparation of the Group's Consolidated Financial Statements requires management to make estimates and judgements that affect the reported amount of assets and liabilities at the date of the Financial Statements and the reported amount of income and expenses during the reporting period. Management evaluates its estimates and judgements on an ongoing basis.

Management bases its estimates and judgements on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

The following estimates and judgements are considered important to the portrayal of the Group's financial condition.

Valuation of financial instruments

The Group considers that the accounting estimate related to the valuation of financial assets and financial liabilities including derivatives where quoted market prices are not available is a 'critical accounting estimate' because: (i) it is highly susceptible to change from period to period because it requires management to make assumptions about interest rates, volatility, exchange rates, the credit rating of the counterparty, valuation adjustments and specific features of the transactions; and (ii) the impact that recognising a change in the valuations would have on the assets reported on its balance sheet as well as its net profit/(loss) could be material.

Changes in the valuation of financial assets and financial liabilities including derivatives where quoted market prices are not available are accounted for in the line item 'Net trading and other income' in the income statement and the 'Trading assets', 'Financial assets designated at fair value', 'Trading liabilities', 'Financial liabilities designated at fair value' and 'Derivative financial instruments' line items in the Group's balance sheet.

The Group trades in a wide variety of financial instruments in the major financial markets and 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 regarding the interest rates, volatility, exchange rates, the credit rating of the counterparty, and valuation adjustments, a larger or smaller change in the valuation of financial assets and financial liabilities 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 in 2010. Detailed disclosures on financial instruments, including sensitivities, can be found in Note 44 on page 96. Further information about sensitivities (including value-at-risk) to market risk arising from financial instrument trading activities can be found in Note 44 on page 96.

Notes to the Financial Statements continued

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:

> Global Banking & Markets;
> Corporate Banking; and
> Asset and Liability Management ('ALM').

A new transfer pricing mechanism was implemented in 2009 to calculate the profitability of customer assets and deposits in each business segment to reflect the market environment and rates at that point. The changes applied a higher funding cost / return to new customer assets / deposits respectively, taking into consideration both customer type and term.

In the second half of 2010, a further refinement of these adjustments was made to reflect the persistently low interest rates, higher cost of new term funding and the increased cost of higher regulatory liquidity balances. These changes have been applied to all periods, but had a significantly more material impact in 2009 and 2010. The impact was to improve income reported in ALM, offset by reduced income in Corporate Banking. The positive earnings reported in ALM as a result reflect any excess over normal yields from hedging against interest rate risk, which was previously reported in the business units. The balance of these hedging benefits continues to be reported in the business units. The positive earnings reported in ALM also include the impact of the application of marginal medium-term funding rates to new business and an increasing proportion of the back book to the extent that there has been customer repricing activity by the business. In addition, the cost allocations process has been further refined to recharge more costs previously held centrally from ALM to the other business segments.

Further, the management of services to small and medium-sized companies was refined to ensure that companies with revenues of less than £1m were principally managed within Santander UK's Retail Banking, Corporate Banking principally manages companies with revenues of between £1m and £25m, and large multinationals and financial institutions were managed within Global Banking & Markets.

Prior years' segmental analyses have 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. Global Banking & Markets provides financial markets sales, trading and risk management services, as well as manufacturing retail structured products. Corporate Banking offers banking services principally to small and mid-sized (SME) UK companies. It also contains operations in run down. ALM provides asset and liability management services to Santander UK.

> **Global Banking & Markets** is a financial markets business focused on providing value added financial services to large corporates not serviced by Corporate Banking (being, in general, very large multinationals) and financial institutions, as well as to the rest of Santander UK's business (including the Retail Banking and Corporate Banking divisions). It is structured into five main product areas: Rates, Foreign exchange and money markets, Equity, Credit and Transaction Banking. In addition, large and complex clients are covered by teams organised along industry lines. Rates 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 retail and corporate customers of both the Group and of other financial institutions who sell them on to their customers. Foreign exchange offers a range of foreign exchange products and money markets runs securities lending/borrowing and repurchase agreement ("repo") businesses. Credit originates loan and bond transactions in primary markets as well as their intermediation in secondary markets. Transaction Banking provides lending and cash management services, including deposit taking and trade finance.

> **Corporate Banking** provides a range of banking services principally to small and mid-sized ('SME') UK companies (with turnover principally between £1m and £25m) through a network of Corporate Business Centres and specialist businesses. A broad range of banking products is offered including loans, current accounts, deposits, treasury services and trade finance. The specialist businesses within Corporate Banking service customers in various business sectors including Real Estate, Social Housing, and Infrastructure.

> **ALM** is responsible for managing the Group's structural balance sheet composition and, in conjunction with the Risk Division, strategic and tactical liquidity risk management. This includes short-term, medium-term, covered bond and securitisation funding programmes. ALM's responsibilities also include management of Santander UK's banking products and structural exposure to interest rates and managing the run down of the Treasury Asset Portfolio.

Notes to the Financial Statements continued

The Company's board of directors (the ''Board'') has been determined to be the chief operating decision maker for the Group. The segment information below is presented on the basis used by the Board to evaluate performance. The segment information below is presented on the basis used by the Company's Board to evaluate performance, in accordance with IFRS 8. The Board reviews discrete financial information for each of its business segments, including measures of operating results, assets and liabilities. The segments are managed primarily on the basis of their results, which are measured on a 'trading' basis. The trading basis differs from the statutory basis (described in Note 1) as a result of the application of an adjustment in respect of hedging and other variances, as presented below. Management considers that the trading basis provides the most appropriate way of reviewing the performance of the business. The adjustment consists of:

> **Hedging and other variances** - The Balance Sheet and Income Statement are subject to mark-to-market volatility including that arising from the accounting for elements of derivatives deemed under IFRS rules to be ineffective as hedges. Volatility also arises on certain assets previously managed on a fair value basis, and hence classified as fair value through profit or loss under IFRS, that are now managed on an accruals basis. Where appropriate, such volatility is separately identified to enable management to view the underlying performance of the business.

A reconciliation between trading profit before tax and statutory profit before tax is set out below.

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

Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balance sheet.

a) Segmental information

2010	**Global Banking & Markets £m**	**Corporate Banking £m**	**ALM £m**	**Total £m**	**Adjustments £m**	**Group Total £m**
Net interest income	**1**	**81**	**321**	**403**	**-**	**403**
Non-interest income	**410**	**46**	**46**	**502**	**(12)**	**490**
Total trading income	**411**	**127**	**367**	**905**	**(12)**	**893**
Administration expenses	**(128)**	**(36)**	**(45)**	**(209)**	**-**	**(209)**
Depreciation and amortisation	**(2)**	**(1)**	**(3)**	**(6)**	**-**	**(6)**
Total trading expenses	**(130)**	**(37)**	**(48)**	**(215)**	**-**	**(215)**
Impairment losses on loans and advances	**-**	**(69)**	**-**	**(69)**	**-**	**(69)**
Total operating provisions and charges	**-**	**(69)**	**-**	**(69)**	**-**	**(69)**
Trading profit before tax	**281**	**21**	**319**	**621**	**(12)**	**609**
Adjust for:						
- Hedging and other mark to market variances	**-**	**-**	**(12)**	**(12)**		
Profit before tax	**281**	**21**	**307**	**609**		
Average number of staff	**316**	**213**	**92**	**621**		
Total assets	**49,450**	**11,426**	**192,384**	**253,260**		

2009	Global Banking & Markets £m	Corporate Banking £m	ALM £m	Total £m	Adjustments £m	Group Total £m
Net interest income	1	68	307	376	-	376
Non-interest income	380	41	35	456	(181)	275
Total trading income	381	109	342	832	(181)	651
Administration expenses	(101)	(39)	(22)	(162)	-	(162)
Depreciation and amortisation	(3)	-	-	(3)	-	(3)
Total trading expenses	(104)	(39)	(22)	(165)	-	(165)
Impairment losses on loans and advances	-	(30)	-	(30)	-	(30)
Total operating provisions and charges	-	(30)	-	(30)	-	(30)
Trading profit before tax	277	40	320	637	(181)	456
Adjust for:						
- Hedging and other mark to market variances	-	-	(181)	(181)		
Profit before tax	277	40	139	456		
Average number of staff	265	220	74	559		
Total assets	44,180	10,451	228,215	282,846		

Notes to the Financial Statements continued

Changes in interest and exchange rates mean that period on period comparisons of gross interest and other trading income and expense are not meaningful and therefore management only consider these items on a net basis. Similarly, management consider the trading income generated by each segment on the basis of the margin earned on the customer relationship. There is therefore no split which is meaningful of trading income between external customers and intra-group. No analysis of total trading income from external customers and intra-group is therefore presented.

b) By geographical region

	Group	
Total operating income/(expenses)	**2010 £m**	2009 £m
United Kingdom	**903**	654
Other	**(9)**	(3)
	894	651
Total assets other than financial instruments and current and deferred tax assets		
United Kingdom	**48**	14
Other	**-**	-
	48	14

Revenue by products and services
Details of revenue by product or service are disclosed in Notes 3 to 5.

3. Net interest income

	Group	
	2010 £m	2009 £m
Interest and similar income:		
Loans and advances to Group undertakings	**2,835**	3,673
Other interest earning financial assets	**210**	132
Total interest and similar income	**3,045**	3,805
Interest expense and similar charges:		
On deposits by Group undertakings	**(1,424)**	(2,218)
Other interest bearing financial liabilities	**(1,218)**	(1,211)
Total interest expense and similar charges	**(2,642)**	(3,429)
Net interest income	**403**	376

4. Net fee and commission income

	Group	
	2010 £m	2009 £m
Fee and commission income:		
Retail Products	**28**	25

5. Net trading and other income

	Group	
	2010 £m	2009 £m
Net trading and funding of other items by the trading book	**378**	128
Income on assets designated at fair value through profit or loss	**246**	69
Expense on liabilities designated at fair value through profit or loss	**(111)**	(117)
(Losses)/gains on derivatives managed with assets/liabilities held at fair value through profit or loss	**(150)**	225
Hedge ineffectiveness and other	**99**	(55)
	462	250

Notes to the Financial Statements continued

6. Administration expenses

	Group	
	2010	2009
	£m	£m
Staff costs:		
Wages and salaries	**91**	91
Social security costs	**11**	10
Pensions costs:		
- defined contribution plans	**41**	5
Other personnel costs	**4**	3
	147	109
Property and equipment expenses	**5**	4
Information technology expenses	**37**	40
Other administrative expenses	**20**	9
	209	162

7. Depreciation and amortisation

	Group	
	2010	2009
	£m	£m
Depreciation of property, plant and equipment	**3**	3
Amortisation of intangible fixed assets	**3**	-
	6	3

8. Impairment losses/(recoveries) on loans and advances

	Group	
	2010	2009
	£m	£m
Impairment losses on loans and advances:		
- loans and advances to customers (Note 18)	**80**	51
Recoveries of loans and advances	**(11)**	(21)
	69	30

9. Audit and other services

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

	Group	
	2010	2009
	£m	£m
Fees payable to the Company's auditor for the audit of the Group's annual accounts	**0.4**	0.4
Non-audit fees – Debt issuance	**0.4**	0.2
Total fees	**0.8**	0.6

Notes to the Financial Statements continued

10. Directors' remuneration and interests

The aggregate remuneration received by the Directors of the Group was:

	Group	
	2010	2009
	£	£
Salaries and fees	**509,931**	734,722
Performance-related payments	**832,374**	758,600
Total remuneration excluding pension contributions	**1,342,305**	1,493,322
Pension contributions	**44,523**	41,000
	1,386,828	1,534,322

The aggregate emoluments above exclude emoluments received by Directors in respect of their primary duties as Directors or officers of Banco Santander, S.A. and Santander UK plc. Salaries and performance-related payments comprise payments to three (2009: five) Directors serving during the year.

Remuneration of highest paid Director

The remuneration, excluding pension contributions, of the highest paid Director was £990,993 (2009: £801,791) of which £650,001 (2009: £500,000) was performance-related. The amount paid with respect to a defined contribution scheme by the highest paid director was £nil (2009: £nil).

The accrued pension benefit for the highest paid Director was £nil (2009: £nil). The accrued lump sum of the highest paid director as at 31 December 2010 was £nil (2009: £nil). Two Directors will be receiving benefits under a defined benefit scheme (2009: two) and no Director (2009: nil) will be receiving benefits under a defined contribution scheme.

Long-Term Incentive Plan

In 2010, three Directors (2009: three) were granted conditional awards of shares in Banco Santander, S.A. under the Santander Long-Term Incentive Plan for a total fair value of £59,414 (2009: £63,820) based on a share price on 1 July 2010 of euro 5.57 (2009: euro 8.14). The value attributable to the current year of these conditional awards is included in share-based payments. Under the Santander Long-Term Incentive Plans granted on 1 July 2010 and 2009, 21 June 2008 and 31 December 2007, certain Executive Directors, Key Management Personnel (as defined above) and other nominated individuals were granted conditional awards of shares in Banco Santander, S.A..

The number of shares participants will receive depends on the performance of Banco Santander, S.A. during this period. The vesting of awards under the Santander Long-Term Incentive Plan depends on Santander's Total Shareholder Return performance against a competitor benchmark group. Awards made prior to 2009 also depend on Santander's Earnings Per Share performance against a competitor benchmark group. 90.79% of the 40% of the 2007 conditional award of shares vested in July 2009 and 90.79% of the remaining 60% of the 2007 conditional award vested in July 2010. Subject to performance conditions being met, 100% of the 2008 conditional award will vest in July 2011, 100% of the 2009 conditional award will vest in July 2012 and 100% of the 2010 conditional award will vest in July 2013.

Following publication of the UK Financial Services Authority Revised Remuneration Code (the 'Code'), the Company operates a remuneration policy, designed to promote effective risk management, applicable to all employees including a number of senior staff whose professional activities have a material impact on the Company's risk profile (known as 'Code Staff'). In accordance with the Code, an element of the 2010 variable remuneration of Code Staff was deferred. For Code Staff earning more than £500,000 in variable remuneration (comprising the annual bonus and Long Term Incentive Plan), at least 60% was deferred and for Code Staff earning less than £500,000 in variable remuneration, at least 40% was deferred, both for a period of three years.

11. Taxation expense

	Group	
	2010	2009
	£m	£m
Current tax:		
UK corporation tax on profit for the year	**175**	117
Adjustments in respect of prior years	**(21)**	(95)
Total current tax	**154**	22
Deferred tax (Note 25)		
Origination and reversal of temporary differences	**(7)**	1
Change in rate of UK corporation tax	**1**	-
Adjustments in respect of prior years	**1**	55
Total deferred tax	**(5)**	56
Tax on profit for the year	**149**	78

Notes to the Financial Statements continued

UK income tax is calculated at 28% (2009: 28%) of the estimated assessable profits for the year. Taxation for other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

The Finance (No 2) Act 2010, which provides for a reduction in the main rate of UK corporation tax from 28% to 27% effective from 1 April 2011, was enacted on 27 July 2010. The effect of the rate reduction was to increase the income tax expense by £1m and to reduce the deferred tax asset by the same amount. The UK Government has also indicated that it intends to enact future reductions in the main tax rate of 1% each year down to 24% by 1 April 2014.

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the parent as follows:

	Group	
	2010	2009
	£m	£m
Profit before tax	**609**	456
Tax calculated at a tax rate of 28% (2009: 28%)	**171**	128
Non-taxable dividend income	**(4)**	(4)
Effect of non-allowable impairment losses, provisions and other non-equalised items	**1**	(3)
Utilisation of capital losses for which credit not previously recognised	**-**	(3)
Effect of change in tax rate on deferred tax provision	**1**	-
Adjustment in respect of prior periods	**(20)**	(40)
Income tax expense	**149**	78

The effective tax rate for 2010, based on profit before tax was 24.5% (2009: 17.1%). The effective tax rate differed from the UK tax rate of 28% (2009: 28%) principally because of the effect of adjustments to prior year provisions.

Further information about deferred income tax is presented in Note 25.

12. Profit on ordinary activities after tax

The profit after tax of the Company attributable to the shareholders was £670m (2009: £555m). As permitted by Section 408 of the UK Companies Act 2006, the Company's individual income statement has not been presented in these Consolidated Financial Statements.

13. Cash and balances at central banks

	Group		Company	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
	5,088	448	**5,088**	448

For regulatory purposes, certain minimum cash balances are required to be maintained with the Bank of England. At 31 December, these amounted to £13m (2009: £nil) for the Group and £13m (2009: £nil) for the Company.

Balances with central banks above represent amounts which are held with the Bank of England and the US Federal Reserve as part of the Group's policy of managing liquidity risk and maintaining core liquid assets as required by the UK Financial Services Authority.

14. Trading assets

	Group		Company	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Loans and advances to banks – securities purchased under resale agreements	**5,775**	4,320	**5,775**	65
Loans and advances to banks - other	**2,506**	2,471	**2,506**	2,177
Loans and advances to customers – securities purchased under resale agreements	**8,652**	8,827	**8,652**	-
Loans and advances to customers – other	**7**	262	**3**	228
Amounts due from Group undertakings	**-**	-	**-**	19,023
Debt securities	**17,821**	15,932	**17,821**	3,124
Equity securities	**700**	1,478	**353**	359
	35,461	33,290	**35,110**	24,976

Notes to the Financial Statements continued

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

	Group		Company	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Issued by public bodies:				
- Government securities	**6,630**	2,869	**6,630**	2,111
Issued by other issuers:				
- Bank and building society certificates of deposit: Government guaranteed	**-**	205	**-**	52
- Bank and building society certificates of deposit: Other	**290**	1,730	**290**	-
- Floating rate notes: Government guaranteed	**9,447**	8,090	**9,447**	-
- Floating rate notes: Other	**1,454**	3,038	**1,454**	961
	17,821	15,932	**17,821**	3,124

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

	Group		Company	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Debt securities:				
- Listed UK	**13,322**	12,803	**13,322**	912
- Listed elsewhere	**4,499**	3,129	**4,499**	2,212
	17,821	15,932	**17,821**	3,124
Equity securities:				
- Listed UK	**698**	1,183	**351**	73
- Listed elsewhere	**2**	295	**2**	286
	700	1,478	**353**	359

15. Derivative financial instruments

Derivatives are financial instruments whose prices are derived from the price of underlying items which may include interest rates, foreign exchange, equities, bonds, market indices, credit spreads, commodities or a combination of several underlying items.

The Company is the principal area of the Group actively trading derivative products and is additionally responsible for implementing Group derivative hedging with the external market. All derivatives are required to be classified as held for trading and held at fair value through profit or loss. A description of how the fair values of derivatives are derived is set out in Note 44. Derivatives are held for trading or for risk management purposes. The Group chooses to designate certain derivatives as in a hedging relationship if they meet specific criteria.

Derivatives held for trading purposes

Global Banking & Markets is the only area of the Company actively trading derivatives and is additionally responsible for implementing Group derivative hedging with the external market.

For trading activities, its objectives are to gain value by:

> Marketing derivatives to end users and hedging the resulting exposures efficiently; and
> The management of trading exposure reflected on the Group's balance sheet.

Trading derivatives include interest rate, cross currency, equity, property and other index related swaps, forwards, caps, floors, swaptions, as well as credit default and total return swaps, equity index contracts and exchange traded interest rate futures and equity index options.

Derivatives held for risk management purposes

The main derivatives are interest rate and cross-currency swaps, which are used to hedge the Group's exposures to interest rates and exchange rates. These risks are inherent in non-trading assets, liabilities and positions, including fixed-rate lending and structured savings products within the relevant operations throughout the Group, including medium-term note issues, capital issues and fixed rate asset purchases.

The derivatives table in the Market Risk discussion within the ALM section of Note 43 Financial risks and risk management summarises activities undertaken by the Group, the related risks associated with such activities and the types of derivatives used in managing such risks. Such risks may also be managed using natural offsets within balance sheet instruments as part of an integrated approach to risk management.

Derivative products which are combinations of more basic derivatives (such as swaps with embedded option features), or which have leverage features, may be used in circumstances where the underlying position being hedged contains the same risk features. In such cases, the derivative used will be structured to match the risks of the underlying asset or liability. Exposure to market risk on such contracts is therefore hedged. The fair values of derivative instruments held both for trading and hedging purposes are set out in the following tables.

Notes to the Financial Statements continued

The tables below show the contract or underlying principal amounts, positive and negative fair values of derivatives analysed by contract. Contract or notional amounts indicate the volume of business outstanding at the balance date and do not represent amounts of risk. The fair values represent the amount at which a contract could be exchanged in an arm's length transaction, calculated at market rates at the balance sheet date.

Derivatives classified as held for trading or held for risk management purposes that have not been designated as in a hedging relationship are classified as derivatives held for trading in the table below. Derivatives that have been designated as in a hedging relationship are classified as derivatives held for fair value hedging below.

			Group
2010 Derivatives held for trading	**Contract/notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**
Exchange rate contracts:			
- Cross-currency swaps	**57,499**	**1,160**	**1,727**
- Forward exchange swaps and forwards	**16,802**	**86**	**381**
	74,301	**1,246**	**2,108**
Interest rate contracts:			
- Interest rate swaps	**551,259**	**16,675**	**15,033**
- Caps, floors and swaptions(1)	**69,242**	**2,680**	**2,747**
- Futures (exchange traded)	**39,840**	**3**	**10**
- Forward rate agreements	**37,479**	**8**	**18**
	697,820	**19,366**	**17,808**
Equity and credit contracts:			
- Equity index and similar products	**41,397**	**1,214**	**2,814**
- Equity index options (exchange traded)	**40,279**	**740**	**145**
- Credit default swaps and similar products	**3,314**	**385**	**293**
	84,990	**2,339**	**3,252**
Total derivative assets and liabilities held for trading	**857,111**	**22,951**	**23,168**

(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.

			Group
2010 Derivatives held for fair value hedging	**Contract/notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**
Interest rate contracts:			
- Interest rate swaps	**39,083**	**286**	**1,875**
Total derivative assets and liabilities held for fair value hedging	**39,083**	**286**	**1,875**
Total recognised derivative assets and liabilities	**896,194**	**23,237**	**25,043**

			Company
2010 Derivatives held for trading	**Contract/notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**
Exchange rate contracts:			
- Cross-currency swaps	**57,499**	**1,160**	**1,727**
- Forward exchange swaps and forwards	**16,802**	**86**	**381**
	74,301	**1,246**	**2,108**
Interest rate contracts:			
- Interest rate swaps	**551,259**	**16,675**	**15,033**
- Caps, floors and swaptions(1)	**69,242**	**2,680**	**2,747**
- Futures (exchange traded)	**39,840**	**3**	**10**
- Forward rate agreements	**37,479**	**8**	**18**
	697,820	**19,366**	**17,808**
Equity and credit contracts:			
- Equity index and similar products	**41,998**	**1,254**	**2,814**
- Equity index options (exchange traded)	**40,279**	**740**	**145**
- Credit default swaps and similar products	**3,377**	**385**	**293**
	85,654	**2,379**	**3,252**
Total derivative assets and liabilities held for trading	**857,775**	**22,991**	**23,168**

			Company
2010 Derivatives held for fair value hedging	**Contract/notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**
Interest rate contracts:			
- Interest rate swaps	**39,083**	**286**	**1,875**
Total derivative assets and liabilities held for fair value hedging	**39,083**	**286**	**1,875**
Total recognised derivative assets and liabilities	**896,858**	**23,277**	**25,043**

Notes to the Financial Statements continued

2009 Derivatives held for trading	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
			Group
Exchange rate contracts:			
- Cross-currency swaps	122,743	3,927	4,074
- Forward exchange swaps and forwards	22,072	161	139
	144,815	4,088	4,213
Interest rate contracts:			
- Interest rate swaps	646,122	15,464	12,919
- Caps, floors and swaptions(1)	79,629	1,676	2,562
- Futures (exchange traded)	89,379	4	-
- Forward rate agreements	77,170	56	61
	892,300	17,200	15,542
Equity and credit contracts:			
- Equity index and similar products	47,002	1,075	1,589
- Equity index options (exchange traded)	30,160	563	871
- Credit default swaps and similar products	3,884	40	55
	81,046	1,678	2,515
Total derivative assets and liabilities held for trading	1,118,161	22,966	22,270

2009 Derivatives held for fair value hedging	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
			Group
Interest rate contracts:			
- Interest rate swaps	42,280	235	2,185
Total derivative assets and liabilities held for fair value hedging	42,280	235	2,185
Total recognised derivative assets and liabilities	1,160,441	23,201	24,455

(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.

2009 Derivatives held for trading	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
			Company
Exchange rate contracts:			
- Cross-currency swaps	122,710	3,926	4,074
- Forward exchange swaps and forwards	13,134	114	93
	135,844	4,040	4,167
Interest rate contracts:			
- Interest rate swaps	626,155	15,433	12,878
- Caps, floors and swaptions(1)	79,496	1,676	2,562
- Futures (exchange traded)	74,402	2	-
- Forward rate agreements	77,170	56	61
	857,223	17,167	15,501
Equity and credit contracts:			
- Equity index and similar products	45,892	1,084	1,588
- Equity index options (exchange traded)	30,160	563	841
- Credit default swaps and similar products	3,884	40	48
	79,936	1,687	2,477
Total derivative assets and liabilities held for trading	1,073,003	22,894	22,145

2009 Derivatives held for fair value hedging	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
			Company
Interest rate contracts:			
- Interest rate swaps	42,280	235	2,185
Total derivative assets and liabilities held for fair value hedging	42,280	235	2,185
Total recognised derivative assets and liabilities	1,115,283	23,129	24,330

(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.

The contract/notional amounts of derivatives presented above indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent actual exposures.

Net gains/(losses) arising from fair value hedges included in net trading and other income

	2010 £m	2009 £m
		Group
Net gains/(losses):		
- on hedging instruments	**171**	661
- on hedged items attributable to hedged risks	**(169)**	(696)
	2	(35)

Notes to the Financial Statements continued

The Group hedges its exposures to various risks, including interest rate risk and foreign currency risk, in connection with covered bond issuances, and subordinated and senior debt securities in issue. The gains/(losses) arising on these assets and liabilities are presented in the table above on a combined basis.

16. Financial assets designated at fair value

	Group		Company	
	2010 **£m**	2009 £m	**2010** **£m**	2009 £m
Loans and advances to customers	**5,422**	6,334	**5,422**	6,334
Debt securities	**1,046**	5,666	**1,046**	5,666
	6,468	12,000	**6,468**	12,000

Financial assets are designated at fair value through profit or loss where this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis, or where the assets are managed and their performance evaluated on a fair value basis.

The following assets have been designated at fair value through profit or loss:

> **Loans and advances to customers,** representing certain loans secured on residential property to housing associations. These would otherwise have been measured at amortised cost with the associated derivatives used to economically hedge the risk held for trading and measured at fair value through profit or loss.

> **Debt securities,** representing holdings of bank and building society certificates of deposit of £nil (2009: £2,220m) and asset-backed securities of £1,046m (2009: £3,446m):

> > The bank and building society certificates of deposit were held for yield purposes. They were managed and their performance evaluated on a fair value basis in accordance with a documented investment strategy, and information about them was provided on that basis to the Group's key management personnel.

> > Asset-backed securities of £977m (2009: £207m) are managed and their performance evaluated on a fair value basis in accordance with a documented investment strategy, and information about them is provided on that basis to the Group's key management personnel.

> > Other asset-backed securities of £69m (2009: £3,239m) which, at the date of their acquisition, were managed, and their performance evaluated, on a fair value basis in accordance with a documented investment strategy, and information about them was provided on that basis to the Group's key management personnel. Almost all of these securities are now managed on an accruals basis, but are not eligible for reclassification under IAS 39.

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 £6,639m (2009: £6,217m) for the Group and £6,639m (2009: £6,217m) for the Company. The maximum exposure was mitigated by the Group having a charge over residential properties in respect of lending to housing associations amounting to £7,828m (2009: £7,452m) for the Group and £7,828m (2009: £7,452m) for the Company.

The net loss during the year attributable to changes in credit risk for loans and advances designated at fair value was £26m (2009: net loss of £72m) for the Group. The cumulative net loss attributable to changes in credit risk for loans and advances designated at fair value as at 31 December 2010 was £231m (2009: net loss of £205m).

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

	Group	
	2010 **£m**	2009 £m
Bank and building society certificates of deposit	**-**	2,220
Other issuers:		
- Mortgage-backed securities	**859**	574
- Other asset-backed securities	**187**	2,872
	1,046	5,666

Debt securities can be analysed by listing status as follows:

	Group		Company	
	2010 **£m**	2009 £m	**2010** **£m**	2009 £m
Listed UK	**647**	-	**647**	-
Listed elsewhere	**75**	3,174	**75**	3,174
Unlisted	**324**	2,492	**324**	2,492
	1,046	5,666	**1,046**	5,666

Notes to the Financial Statements continued

17. Loans and advances to banks

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Amounts due from Santander UK group undertakings	**143,789**	185,560	**143,783**	162,911
Amounts due from ultimate parent	**643**	5,993	**643**	2,989
Other loans and advances	**1,980**	196	**1,972**	120
	146,412	191,749	**146,398**	166,020

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Repayable:				
On demand	**24,417**	10,120	**24,403**	10,116
In not more than 3 months	**40,806**	52,269	**40,806**	28,126
In more than 3 months but not more than 1 year	**28,825**	19,066	**28,825**	19,058
In more than 1 year but not more than 5 years	**41,697**	92,743	**41,697**	92,743
In more than 5 years	**10,667**	17,551	**10,667**	15,977
	146,412	191,749	**146,398**	166,020

18. Loans and advances to customers

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Amounts due from Santander group undertakings	**26,950**	15,292	**27,344**	15,393
Other loans and advances	**7,708**	4,960	**7,699**	4,950
Loans and advances to customers	**34,658**	20,252	**35,043**	20,343
Less: loan loss allowances	**(108)**	(77)	**(108)**	(77)
Loans and advances to customers, net of loan loss allowances	**34,550**	20,175	**34,935**	20,266

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Repayable:				
On demand	**81**	340	**424**	405
In no more than 3 months	**6,799**	5,451	**6,812**	5,451
In more than 3 months but not more than a year	**1,674**	572	**1,694**	571
In more than 1 year but not more than 5 years	**11,398**	4,133	**11,398**	4,155
In more than 5 years	**14,706**	9,756	**14,715**	9,761
Loans and advances to customers	**34,658**	20,252	**35,043**	20,343
Less: loan loss allowance	**(108)**	(77)	**(108)**	(77)
Loans and advances to customers, net of loan loss allowances	**34,550**	20,175	**34,935**	20,266

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

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Fixed rate	**12,815**	4,179	**12,900**	4,188
Variable rate	**21,843**	16,073	**22,143**	16,155
Less: loan loss allowances	**(108)**	(77)	**(108)**	(77)
	34,550	20,175	**34,935**	20,266

Notes to the Financial Statements continued

Movement in loan loss allowances:

	Group £m
As at 1 January 2010	**77**
Charge to the income statement:	
- Individually assessed	**65**
- Collectively assessed	**15**
	80
Write offs	**(49)**
At 31 December 2010	**108**
As at 1 January 2009	26
Charge to the income statement:	
- Individually assessed	50
- Collectively assessed	1
	51
Write offs	-
At 31 December 2009	77

	Company £m
As at 1 January 2010	**77**
Charge to the income statement	**80**
Transfer from CAIL (See Note 42)	**-**
Write offs	**(49)**
At 31 December 2010	**108**
As at 1 January 2009	26
Charge to the income statement	51
Write offs	-
At 31 December 2009	77

19. Special purpose entities

Special Purpose Entities ('SPE's) 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.

Consolidated special purpose entities

The only SPEs sponsored and consolidated by the Group are described below. All the external assets in these entities are included in the relevant Notes in these Consolidated Financial Statements.

a) Guaranteed Investment Products 1 PCC
Guaranteed Investment Products 1 PCC Limited is a Guernsey-incorporated, closed-ended, protected cell company. The objective of each cell is to achieve capital growth. In order to achieve the investment objective, Guaranteed Investment Products 1 PCC Limited, on behalf of the respective cells, invests in a derivative asset entered into with the Group. Santander UK plc also guarantees the shareholders of selected cells a fixed return on their investment and/or the investment amount. Guaranteed Investment Products 1 PCC Limited has no third party assets.

b) Marylebone Road 3 CBO B.V.
Marylebone Road 3 was established with the specific purpose of housing Collateralised Bond Obligation structures under which the Group raises funds, and transfers credit risk to third parties. This entity issues credit linked notes to third parties and issues repos and credit default swaps to other Group companies. Marylebone Road 3 has no third party assets.

Notes to the Financial Statements continued

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. As at 31 December 2010, the total value of products issued by these SPEs was £111m (2009: £138m). The Group's arrangements with these entities comprise the provision of equity derivatives and a secondary market-making service to those retail customers who wish to exit early from these products.

The maximum exposure to the SPEs sponsored but not consolidated by the Group is set out in the table below:

		Group
	2010	2009
	£m	£m
Trading assets	**39**	94

20. Held to maturity securities

		Group		Company
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
	331	300	**-**	-

The balance above primarily represents two issuances of £150m each of subordinated bonds in pounds sterling made by a subsidiary company. It also includes accrued interest. The key terms of these subordinated bonds are:

- £150m issued on 30 December 1991 due on 4 January 2017. Interest is payable annually in arrears, at a rate of 11.5%.
- £150m issued on 4 February 1993, due on 4 January 2023. Interest is payable annually in arrears, at a rate of 10.125%.

21. Loans and receivable securities

		Group		Company
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Loans and receivable securities	**626**	896	**626**	896

These securities have determinable payments and are not quoted in an active market. In 2010 further assets were acquired as part of the transfer of the Credit Portfolio to the Group as described in Note 43. The securities consist of residential mortgage-backed securities issued by a fellow subsidiary of Santander UK plc, and in 2009 a debenture issued by a fellow subsidiary in the Banco Santander, S.A., group.

22. Investment in subsidiary undertakings

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

			Company
	Cost	**Impairment**	**Net book value**
	£m	**£m**	**£m**
At 1 January 2010	**2,213**	**(28)**	**2,185**
Reversal of impairment	**-**	**2**	**2**
At 31 December 2010	**2,213**	**(26)**	**2,187**

			Company
	Cost	Impairment	Net book value
	£m	£m	£m
At 1 January 2009	2,342	(7)	2,335
Additions	-	(21)	(21)
Capital reduction of subsidiary	(129)	-	(129)
At 31 December 2009	2,213	(28)	2,185

Notes to the Financial Statements continued

The principal subsidiaries of Abbey National Treasury Services plc at 31 December 2010 are shown below, all of which are directly held, except where noted, and unlisted.

The Directors consider that to give full particulars of all subsidiary undertakings would lead to a statement of excessive length. In accordance with Section 410(2) of the UK Companies Act 2006, the following information relates to those subsidiary undertakings whose results or financial position, in the opinion of the Directors, principally affect the results of the Group. Full particulars of all subsidiary undertakings will be annexed to the Company's next annual return in accordance with Section 410(3)(b) of the UK Companies Act 2006.

	Nature of business	% Interest held	Country of Incorporation or registration
Abbey National Treasury Services Overseas Holdings	Investment	100	England & Wales
Abbey National Sterling Capital plc	Funding	100	England & Wales
Abbey National North America LLC *	Funding	100	United States

* Held indirectly through subsidiary companies.

All the above companies are included in the Consolidated Financial Statements. All companies operate principally in their country of incorporation or registration. Abbey National Treasury Services plc also has branch offices in the US and the Cayman Islands.

23. Intangible assets

	Group 2010 £m	Company 2010 £m
Cost		
At 1 January 2010	**24**	**8**
Additions	**21**	**21**
At 31 December 2010	**45**	**29**
Accumulated amortisation / impairment		
At 1 January 2009	**16**	**-**
Charge for the year	**3**	**3**
31 December 2010	**19**	**3**
Net book value	**26**	**26**

	Group 2009 £m	Company 2009 £m
Cost		
At 1 January 2009	22	6
Additions	2	2
At 31 December 2009	24	8
Accumulated amortisation / impairment		
At 1 January and 31 December 2009	16	-
Net book value	8	8

The intangible assets of the Group and the Company consist of computer software.

24. Property, plant and equipment

				Group
	Owner-occupied properties £m	Office fixtures and equipment £m	Computer software £m	Total £m
Cost				
At 1 January 2010	**1**	**15**	**61**	**77**
Additions	**-**	**14**	**5**	**19**
At 31 December 2010	**1**	**29**	**66**	**96**
Accumulated depreciation				
At 1 January 2010	**1**	**10**	**60**	**71**
Charge for the year	**-**	**3**	**-**	**3**
At 31 December 2010	**1**	**13**	**60**	**74**
Net book value				
At 31 December 2010	**-**	**16**	**6**	**22**

Notes to the Financial Statements continued

	Owner-occupied properties £m	Office fixtures and equipment £m	Computer software £m	Group Total £m
Cost				
At 1 January 2009	1	18	61	80
Additions	-	-	1	1
Disposals	-	(3)	(1)	(4)
At 31 December 2009	1	15	61	77
Accumulated depreciation				
At 1 January 2009	1	10	60	71
Charge for the year	-	3	-	3
Disposals	-	(3)	-	(3)
At 31 December 2009	1	10	60	71
Net book value				
At 31 December 2009	-	5	1	6

	Owner-occupied properties £m	**Office fixtures and equipment £m**	**Computer software £m**	**Company Total £m**
Cost				
At 1 January 2010	**-**	**13**	**60**	**73**
Additions	**-**	**14**	**5**	**19**
At 31 December 2010	**-**	**27**	**65**	**92**
Accumulated depreciation				
At 1 January 2010	**-**	**8**	**59**	**67**
Charge for the year	**-**	**3**	**-**	**3**
At 31 December 2010	**-**	**11**	**59**	**70**
Net book value				
At 31 December 2010	**-**	**16**	**6**	**22**

	Owner-occupied properties £m	Office fixtures and equipment £m	Computer software £m	Company Total £m
Cost				
At 1 January 2009	-	16	60	76
Additions	-	-	1	1
Disposals	-	(3)	(1)	(4)
At 31 December 2009	-	13	60	73
Accumulated depreciation				
At 1 January 2009	-	8	59	67
Charge for the year	-	3	-	3
Disposals	-	(3)	-	(3)
At 31 December 2009	-	8	59	67
Net book value				
At 31 December 2009	-	5	1	6

At 31 December 2010, capital expenditure contracted, but not provided for was £nil (2009: £1m) in respect of property, plant and equipment. Of the carrying value at the balance sheet date £nil (2009: £nil) related to assets under construction.

25. Deferred tax

Deferred income taxes are calculated on temporary differences under the liability method using the tax rates expected to apply when the liability is settled or the asset is realised.

The movement on the deferred tax account is as follows:

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
At 1 January	**20**	76	**21**	75
Income statement (charge)/credit	**5**	(56)	**4**	(54)
At 31 December	**25**	20	**25**	21

Notes to the Financial Statements continued

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

	Group		Company	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Deferred income tax liabilities				
Capital allowances on operating lease receivables	**-**	-	**-**	-
Other temporary differences	**(1)**	(1)	**-**	-
	(1)	(1)	**-**	-
Deferred income tax assets				
Accelerated book depreciation	**2**	2	**2**	2
IAS 32 & 39 transition adjustments	**11**	13	**10**	12
Other temporary differences	**13**	6	**13**	7
	26	21	**25**	21

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

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

	Group	
	2010	2009
	£m	£m
Accelerated tax depreciation	**-**	-
IAS 32 & 39 transitional adjustments	**(2)**	(2)
Other temporary differences	**7**	(54)
	5	(56)

26. Other assets

	Group		Company	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Trade and other receivables	**65**	67	**65**	67

27. Deposits by banks

	Group		Company	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Amounts due to Santander group undertakings	**132,933**	165,487	**132,881**	165,448
Deposits by banks - securities sold under repurchase agreements	**2,548**	-	**2,548**	-
Amounts due to ultimate parent	**830**	614	**830**	518
Time and demand deposits	**442**	204	**442**	203
Total deposits by banks	**136,753**	166,305	**136,701**	166,169

	Group		Company	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Repayable:				
On demand	**4,484**	8,355	**4,433**	8,354
In not more than 3 months	**48,374**	65,753	**48,394**	65,623
In more than 3 months but not more than 1 year	**29,022**	28,250	**29,004**	28,235
In more than 1 year but not more than 5 years	**39,792**	38,697	**39,792**	38,706
In more than 5 years	**15,081**	25,250	**15,078**	25,251
	136,753	166,305	**136,701**	166,169

Notes to the Financial Statements continued

28. Deposits by customers

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Retail deposits	**8**	12	**8**	12
Amounts due to Santander group undertakings	**2,104**	5,900	**9,032**	14,040
Wholesale funds and deposits	**4,949**	3,549	**4,949**	3,549
	7,061	9,461	**13,989**	17,601
Repayable:				
On demand	**476**	1,416	**479**	1,400
In no more than 3 months	**609**	1,987	**4,715**	10,016
In more than 3 months but no more than 1 year	**252**	229	**3,009**	292
In more than 1 year but no more than 5 years	**5,524**	5,133	**5,586**	5,197
In more than 5 years	**200**	696	**200**	696
	7,061	9,461	**13,989**	17,601

Wholesale deposits by customers are interest bearing.

29. Trading liabilities

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Deposits by banks - securities sold under repurchase agreements	**21,411**	35,794	**21,411**	1,135
Deposits by banks - other	**4,327**	5,030	**4,327**	4,739
Deposits by customers - securities sold under repurchase agreements	**11,112**	69	**11,112**	198
Deposits by customers - other	**4,859**	4,033	**4,859**	4,033
Amounts due to Group undertakings	**-**	-	**-**	2,900
Short positions in securities and unsettled trades	**1,118**	1,071	**1,118**	168
Debt securities in issue	**-**	142	**-**	142
	42,827	46,139	**42,827**	13,315

The total fair value of equity index-linked deposits included above at the balance sheet date was £1,657m (2009: £2,144m).

30. Financial liabilities designated at fair value

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
US$4bn Euro Commercial Paper Programme (subsequently US$10bn)	**898**	662	**898**	662
US$20bn Euro Medium Term Note Programme	**1,820**	3,002	**1,758**	2,944
Euro 2bn structured notes	**930**	676	**930**	676
Warrants	**9**	-	**9**	-
	3,657	4,340	**3,595**	4,282

Financial liabilities are designated at fair value through profit or loss where this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets and liabilities or recognising the gains or losses on them on a different basis, or where a contract contains one or more embedded derivatives that would otherwise require separate recognition. The 'fair value option' has been used where debt securities in issue and warrants would otherwise be measured at amortised cost, and any embedded derivatives or associated derivatives used to economically hedge the risk are held at fair value.

The net gain during the year attributable to changes in the Group's own credit risk on the above debt securities in issue was £2m (2009: net loss of £62m) for the Group and £2m (2009: net loss of £62m) for the Company. The cumulative net gain attributable to changes in the Group's own credit risk on the above debt securities in issue as at 31 December 2010 was £29m (2009: £27m) for the Group and £29m (2009: £27m) for the Company. This was calculated by applying current spreads at the next call date or maturity date to the nominal value of the security to determine the extra cost of the debt security for the remaining period of the debt security were it to have been issued at current spreads.

The amount that would be required to be contractually paid at maturity of the debt securities in issue above is £141m (2009: £129m) higher than the carrying value.

Notes to the Financial Statements continued

US$4bn Euro Commercial Paper Programme (subsequently increased to US$10bn)

Abbey National Treasury Services plc may from time to time issue the commercial paper under the US$4bn Euro-Commercial Paper Programme that may be denominated in any currency as agreed between Abbey National Treasury Services plc and the relevant dealer. The Notes rank at least pari passu with all other unsecured and unsubordinated obligations of Abbey National Treasury Services plc. The payments of all amounts due in respect of the Notes have been unconditionally and irrevocably guaranteed by the Company.

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

US$20bn Euro Medium Term Note Programme

Abbey National Treasury Services plc may from time to time issue notes denominated in any currency as agreed between the relevant Issuer and the relevant dealer under the US$20bn Euro Medium Term Note Programme. The payment of all amounts payable in respect of the Senior Notes is unconditionally and irrevocably guaranteed by Santander UK plc. The Programme provides for issuance of Fixed Rate Notes, Floating Rate Notes, Index Linked Notes, Credit Linked Notes, Equity Linked Notes and any other structured Notes, and also Dual Currency Notes, Zero Coupon/Discount Notes and Non-Interest Bearing Notes.

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

Euro 2bn structured notes

Abbey National Treasury Services plc may from time to time issue structured notes denominated in any currency as agreed between Abbey National Treasury Services plc and the relevant dealers under the euro 2bn structured note programme. Structured notes are direct, unsecured and unconditional obligations of Abbey National Treasury Services plc 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 Abbey National Treasury Services plc. The payments of all amounts due in respect of the structured notes have been unconditionally and irrevocably guaranteed by Santander UK plc.

The structured note programme provides for the issuance of Commodity Linked Notes, Credit Linked Notes, Currency Linked Notes, Equity Linked Notes, Equity Index Linked Notes, Fixed Rate Notes, Floating Rate Notes, Fund Linked Notes, Inflation Linked Notes, Property Linked Notes, Zero Coupon/Discount Notes and any other structured notes as agreed between Abbey National Treasury Services plc and the relevant dealers. Structured notes may be issued in bearer or registered (or inscribed) 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 Abbey National Treasury Services plc and the relevant dealers. Structured notes issued in bearer form may also be issued in new global note form.

The maximum aggregate nominal amount of all structured notes from time to time outstanding under the Programme will not exceed euro 2bn (or its equivalent in other currencies).

Warrant programme

Abbey National Treasury Services plc may from time to time issue warrants denominated in any currency as agreed between the issuer and the relevant dealer under the warrant programme. Warrants are direct, unsecured and unconditional obligations of Abbey National Treasury Services plc that rank pari passu without preference among themselves and, subject as to any applicable statutory provisions or judicial order, rank at least equally with all other present and future unsecured and unsubordinated obligations of Abbey National Treasury Services plc. The payments of all amounts due in respect of the warrants have been unconditionally and irrevocably guaranteed by the Company.

The warrant programme provides for the issuance of Commodity Linked Warrants, Currency Linked Warrants, Equity Linked Warrants, Equity Index Linked Warrants, Fund Linked Warrants, Inflation Index Linked Warrants, Property Index Linked Warrants, Debt Linked Warrants and any other warrants as agreed between the issuer and the relevant dealer. Warrants are issued in global form and can be listed on the London Stock Exchange or any other or further stock exchange(s) as agreed between the issuer and the relevant dealer.

Notes to the Financial Statements continued

31. Debt securities in issue

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Euro 25bn Global Covered Bond Programme	**15,408**	10,276	**15,408**	10,276
US$20bn Euro Medium Term Note Programme (see Note 30)	**4,893**	2,167	**4,893**	2,167
US$20bn Commercial Paper Programme	**4,433**	6,366	**-**	-
Certificates of deposit in issue	**8,925**	9,188	**8,925**	9,188
	33,659	27,997	**29,226**	21,631

Euro 25bn Global Covered Bond Programme

Abbey National Treasury Services plc issues the Covered Bonds under the euro 25bn Global Covered Bond Programme that may be denominated in any currency as agreed between Abbey National Treasury Services plc and the relevant dealers under the Programme. The Programme provides that Covered Bonds may be listed or admitted to trading, on the official list of the UK Listing Authority and on the London Stock Exchange's Regulated Market or any other stock exchanges or regulated or unregulated markets. Abbey National Treasury Services plc may also issue unlisted Covered Bonds and/or Covered Bonds not admitted to trading on any regulated or unregulated market.

The payments of all amounts due in respect of the Covered Bonds have been unconditionally guaranteed by Santander UK plc. Abbey Covered Bonds LLP ("LLP"), together with Santander UK plc has guaranteed payments of interest and principal under the Covered Bonds pursuant to a guarantee which is secured over the LLP's portfolio of mortgages and its other assets. Recourse against the LLP under its guarantee is limited to its portfolio of mortgages and such assets. Covered Bonds may be issued in bearer or registered form. The maximum aggregate nominal amount of all Covered Bonds from time to time outstanding under the Programme will not exceed euro 25bn (or its equivalent in other currencies), subject to increase in accordance with the Programme. On 2 July 2008, the size of the global covered bond programme established in 2005 was increased from euro 12bn to euro 25bn. On 8 July 2008, the Group issued a series of Covered Bonds totalling approximately £13bn. All notes were denominated in sterling and were subscribed for by Santander UK plc.

On 11 November 2008, Abbey National Treasury Services plc was admitted to the register of issuers and the Programme and the Covered Bonds issued previously under the Programme were admitted to the register of regulated covered bonds, pursuant to Regulation 14 of the Regulated Covered Bonds Regulations 2008 (SI 2008/346).

US$20bn Commercial Paper Programme

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

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

			Group		Company	
	Interest Rate	Maturity	**2010 £m**	2009 £m	**2010 £m**	2009 £m
euro	0.00% - 3.99%	Up to 2010	**-**	1,518	**-**	1,518
		2010 - 2011	**1,230**	-	**1,230**	-
		2012 - 2019	**7,350**	3,372	**7,350**	3,372
		2020 - 2029	**83**	-	**83**	-
		2030 - 2039	**103**	-	**103**	-
	4.00% - 4.99%	2020 - 2029	**1,316**	1,362	**1,316**	1,362
US dollar	0.00% - 3.99%	Up to 2011	**11,145**	14,279	**6,712**	7,913
		2012 - 2019	**2,166**	-	**2,166**	-
Pounds sterling	0.00% - 3.99%	Up to 2010	**-**	843	**-**	843
		2010 - 2011	**1,532**	-	**1,532**	-
		2012 - 2019	**2,274**	990	**2,274**	990
		2020 - 2029	**5,013**	5,011	**5,013**	5,011
	4.00% - 5.99%	2012 - 2019	**999**	600	**999**	600
Other currencies	0.00% - 5.99%	Up to 2011	**9**	-	**9**	-
		2012 - 2019	**249**	9	**249**	9
		2020 - 2029	**177**	-	**177**	-
	6.00% - 6.99%	Up to 2011	**8**	-	**8**	-
		2012 - 2019	**5**	13	**5**	13
			33,659	27,997	**29,226**	21,631

Notes to the Financial Statements continued

32. Subordinated liabilities

	Group 2010 £m	2009 £m
Dated subordinated liabilities:		
11.50% Subordinated guaranteed bond 2017	**166**	166
10.125% Subordinated guaranteed bond 2023	**165**	165
	331	331

In common with other debt securities issued by Group companies, the subordinated liabilities are redeemable in whole at the option of the respective Group companies, on any interest payment date, in the event of certain tax changes affecting the treatment of payments of interest on the subordinated liabilities in the UK, at their principal amount together with any accrued interest. The subordinated liabilities are guaranteed by Santander UK plc.

The securities in this Note will, in the event of the winding-up of the issuer, be subordinated to the claims of all other creditors of the issuer, other than creditors whose claims rank equally with, or are junior to, the claims of the holders of the subordinated liabilities. The subordination of specific subordinated liabilities is determined in respect of the issuer and any guarantors of that liability.

The Group has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during the year (2009: none). No repayment or purchase by the issuer of the subordinated liabilities may be made prior to their stated maturity without the consent of the UK Financial Services Authority.

Subordinated liabilities are repayable:

	Group 2010 £m	2009 £m
In more than 5 years	**331**	331

The Company did not hold any subordinated liabilities during the year (2009: £nil).

33. Other liabilities

	Group 2010 £m	Group 2009 £m	Company 2010 £m	Company 2009 £m
Trade and other payables	**91**	74	**82**	63
Accrued expense	**100**	73	**100**	73
	191	147	**182**	136

34. Contingent liabilities and commitments

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

	Group 2010 £m	Group 2009 £m	Company 2010 £m	Company 2009 £m
Guarantees given on behalf of the Company's UK parent, fellow subsidiaries and subsidiaries	**151,558**	147,597	**155,993**	190,349
Guarantees given to third parties	**112**	57	**112**	57
Formal standby facilities, credit lines and other commitments:				
– Original term to maturity of one year or less	**684**	133	**684**	133
– Original term to maturity of more than one year	**6,983**	3,106	**6,983**	3,106
	159,337	150,893	**163,772**	193,645

Overseas tax claim

A claim was filed against Abbey National Treasury Services plc by tax authorities abroad in relation to the refund of certain tax credits and other associated amounts. Following modifications to the demand, its nominal amount stands at £71m at the balance sheet exchange rate (2009: £74m). At 31 December 2010, additional interest in relation to the demand could amount to £35m at the balance sheet exchange rate (2009: £34m). A favourable judgement was handed down at first instance in September 2006 which was appealed against by the tax authorities in January 2007. In June 2010, the Court ruled in favour of tax authorities. Abbey National Treasury Services plc is appealing that ruling.

Notes to the Financial Statements continued

Regulatory
The Group engages in discussion, and fully co-operates with the UK Financial Services Authority in their enquiries, including those exercised under statutory powers, regarding its interaction with past and present customers and policyholders both as part of the UK Financial Services Authority's general thematic work and in relation to specific products and services.

Other
As part of the sale of subsidiaries, and as is normal in such circumstances, the Group has given warranties and indemnities to the purchasers.

Obligations under stock borrowing and lending agreements
Obligations under stock borrowing and lending agreements represent contractual commitments to return stock borrowed. These obligations totalled £9,751m as at 31 December 2010 (2009: £37,525m) are offset by a contractual right to receive stock under other contractual agreements.

Operating lease commitments

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Rental commitments under non-cancellable operating leases expiring:				
No later than 1 year	**5**	4	**5**	4
Later than 1 year but no later than 5 years	**16**	16	**16**	16
Later than 5 years	**21**	24	**21**	24
	42	44	**42**	44

At 31 December 2010 the Group held various leases on land and buildings, many for extended periods, and other leases for equipment, which require the following aggregate minimum lease payments:

	Group	Company
	2010 £m	**2010 £m**
Year ended 31 December:		
2011	**5**	**5**
2012	**4**	**4**
2013	**4**	**4**
2014	**4**	**4**
2015	**4**	**4**
Total thereafter	**21**	**21**

Group rental expense comprises:

	Group	
	2010 £m	2009 £m
In respect of minimum rentals	**5**	9
Less: sub-lease rentals	**-**	-
	5	9

Appropriate provisions are maintained to cover the above matters.

35. Share capital

	Ordinary shares of £1 each £m	**Tracker shares of £1 each £m**	**B Tracker shares of £1 each £m**	**Total £m**
Issued and fully paid share capital:				
At 1 January and 31 December 2010 and 2009	**2,549**	**-**	**-**	**2,549**

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

Notes to the Financial Statements continued

During 2009, the Company entered into contractual arrangements relating to a proposed issue of B Tracker Shares. On 5 January 2010, the Company issued 1,000 B Tracker Shares of £1 each at par to its parent company for £1,000. The B Tracker Shares entitle the holders to dividends related to certain cashflows expected to be received by the Company in the period up to 31 December 2011. The B Tracker Shares are not redeemable and do not confer any rights to participate in the assets of the company on a winding up (beyond the amount subscribed). The B Tracker Shares carry no voting rights.

36. Dividends

Analysis of dividends declared is as follows:

	Group and Company		Group and Company	
	2010 Pence per share	2009 Pence per share	**2010 £m**	2009 £m
Ordinary shares (equity):				
Interim dividend	**23.54**	-	**600**	-
	23.54	-	**600**	-

In addition, the terms of the Tracker Shares and the B Tracker Shares are such that the issue of those shares (or, in the case of the B Tracker Shares, entry by the Company into contractual arrangements relating to the future issue of such shares) caused a derecognition of certain cashflows expected to be received by the Company. The amounts derecognised equate to the fair value of the cashflows involved and are shown in the Statement of Changes to Equity as amounts representative of contractual obligations for the year in which the derecognition occurs. Subsequent declaration and payment of dividends in respect of these cashflows is not further reflected in the Company's financial statements. Amounts representative of such contractual obligations in respect of the Tracker Shares during the year were nil (2009: nil). Amounts representative of such contractual obligations in respect of the B Tracker shares during the year were £nil per share (2009: £144,000 per share).

37. Consolidated cash flow statement

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

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Profit for the year	**460**	378	**670**	555
Non-cash items included in net profit				
Depreciation and amortisation	**6**	3	**6**	3
(Increase)/decrease in prepayments and accrued income	**(191)**	1,097	**(205)**	943
Increase/(decrease) in accruals and deferred income	**197**	(1,257)	**252**	(1,187)
Impairment losses	**80**	52	**80**	72
Other non-cash items	**33**	896	**24**	845
	585	1,169	**827**	1,231
Changes in operating assets and liabilities				
Net increase in trading assets	**(1,453)**	(1,631)	**(4,711)**	(4,154)
Net decrease/(increase) in financial assets designated at fair value	**5,560**	(995)	**5,560**	(995)
Net (increase)/decrease in derivative assets	**(36)**	9,665	**(148)**	9,031
Net decrease/(increase) in loans and advances to banks and customers	**34,002**	(12,208)	**32,320**	(16,954)
Net (increase)/decrease in other assets	**(34)**	34	**(2)**	9
Net (decrease)/increase in deposits by banks and customers	**(32,097)**	50,173	**(33,265)**	51,539
Net increase/(decrease) in derivative liabilities	**588**	(9,677)	**713**	(9,181)
Net (decrease)/increase in trading liabilities	**(3,310)**	6,260	**29,500**	(9,674)
Net decrease in financial liabilities designated at fair value	**(669)**	(588)	**(673)**	(599)
Net (decrease)/increase in debt issued	**(1,413)**	(4,344)	**761**	(6,921)
Net increase/(decrease) in other liabilities	**45**	(661)	**140**	(312)
Effects of exchange rate differences	**399**	(1,423)	**154**	(870)
Net cash flow from operating activities before tax	**2,167**	35,774	**31,176**	12,150
Income tax paid	**(28)**	-	**(17)**	-
Net cash flow from operating activities	**2,139**	35,774	**31,159**	12,150

Notes to the Financial Statements continued

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

	Group		Company	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Cash and balances at central banks	**5,088**	448	**5,088**	448
Less: regulatory minimum cash balances (See Note 13)	**(13)**	-	**(13)**	-
	5,075	448	**5,075**	448
Debt securities - Trading	**2,604**	1,966	**2,604**	779
Loans and advances to banks - Trading	**5,171**	4,881	**5,171**	2,193
Loans and advances to customers - Trading	**8,656**	8,827	**8,653**	7,665
Net trading other cash equivalents	**16,431**	15,674	**16,428**	10,637
Loans and advances to banks - Non trading	**65,223**	62,388	**65,209**	38,242
Net non-trading other cash equivalents	**65,223**	62,388	**65,209**	38,242
Cash and cash equivalents at year end	**86,729**	78,510	**86,712**	49,327

38. Assets charged as security for liabilities and collateral accepted as security for assets

a) Financial assets pledged to secure liabilities were as follows:

	Group	
	2010	2009
	£m	£m
Treasury bills and other eligible securities	**36,144**	38,973
Cash	**1,820**	2,014
Loans and advances to banks	**-**	-
Debt securities	**11,565**	513
Equity securities	**543**	**-**
	50,072	41,500

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

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

Sale and repurchase agreements

The Company and certain of its subsidiaries enter into sale and repurchase agreements and similar transactions of equity and debt securities, which are accounted for as secured borrowings. Upon entering into such transactions, the Company and subsidiaries provide collateral equal to 100%-131% of the borrowed amount. The carrying amount of assets that were so provided at 31 December 2010 was £48,252m (2009: £39,486m).

Derivatives business

Collateral is also provided in the normal course of derivative business to counterparties. As at 31 December 2010 £1,820m (2009: £2,014m) of such collateral in the form of cash had been provided by the Group and £1,820m (2009: £2,014m) by the Company.

Notes to the Financial Statements continued

b) Collateral held as security for assets:

These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse repurchase agreements.

Purchase and resale agreements

The Company and certain of its subsidiaries also enter into purchase and resale agreements, of debt and equity 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 equal to the loan balance. The Company and subsidiaries are permitted to sell or repledge the collateral held. At 31 December 2010, the fair value of such collateral received was £40,860m (2009: £58,589m). Of the collateral received £40,860m (2009: £58,589m) was sold or repledged. The company and subsidiaries have an obligation to return collateral that they have sold or pledged with a fair value of £40,860m (2009: £58,589m).

Structured transactions

As part of structured transactions entered into by the Company and certain subsidiaries, assets are received as collateral. At 31 December 2010, the fair value of such collateral received was £nil (2009: £253m). Of the collateral received £nil (2009: £nil) was sold or repledged. The Company and subsidiaries have an obligation to return collateral that they have sold or pledged with a fair value of £nil (2009: £nil).

39. Pensions and other post-retirement benefits

The Group participates in various Santander UK plc group defined benefit and defined contribution pension schemes in operation. Details of the schemes are disclosed in the Annual Report and Accounts of Santander UK plc. There is no contractual agreement of stated policy for charging the net defined benefit cost of the Santander UK defined benefit schemes. Therefore, in accordance with IAS 19 the defined benefit asset or liability has been recognised in the financial statements of the sponsoring employer of the scheme and the Group accounts for its contributions as a defined contribution scheme. The contribution to be paid by the Group is calculated as the contributions made by Santander UK plc to the schemes in respect of the Group's employees. An amount of £41m (2009: £5m) was recognised as an expense for these contributions and is included in staff costs within administration expenses in the income statement.

40. Related party disclosures

Transactions with directors, key management personnel and their connected persons

There were no other related party transactions during the year, or existing at the balance sheet date other than those disclosed below with the Company or parent company's Key Management Personnel. Key Management Personnel are defined as the Directors of the Company.

Remuneration of key management personnel

The remuneration of the Directors, and other Key Management Personnel of the Company, is set out in aggregate for each of the categories specified in IAS 24 Related Party Disclosures. Further information about the aggregate remuneration of the Directors is provided in Note 10.

Key management compensation	**2010** **£**	2009 £
Short-term employee benefits	**1,342,305**	1,493,322
Post employment benefits	**44,523**	41,000
Share-based payments	**116,711**	152,450
Total key management compensation	**1,503,539**	1,686,772

Of the Directors that served during the year, three were remunerated in relation to their services as directors of this Company and the amounts included above are based on an estimated time allocation basis.

Santander Long-Term Incentive Plan

Information about the Santander Long-Term Incentive Plan is provided in Note 10.

Notes to the Financial Statements continued

Parent undertaking and controlling party

The Company's immediate parent is Santander UK plc. The ultimate parent and controlling party is Banco Santander, S.A., a company incorporated in Spain. The smallest and largest groups into which the Company's results are included are the group accounts of Santander UK plc and Banco Santander S.A. respectively. A copy of the accounts of Santander UK plc may be obtained from Secretariat, Santander UK plc, 2 Triton Square, Regent's Place, London NW1 3AN. A copy of the accounts of Banco Santander, S.A. may be obtained from Santander Shareholder Services, 2 Triton Square, Regent's Place, London NW1 3AN.

Transactions with related parties

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

								Group
	Interest, fees and other income received		Interest, fees and other expense paid		Amounts owed by related parties		Amounts owed to related parties	
	2010 £m	2009 £m	**2010 £m**	2009 £m	**2010 £m**	2009 £m	**2010 £m**	2009 £m
Ultimate parent company	**(322)**	(67)	**12**	25	**2,539**	7,439	**(2,326)**	(1,921)
Immediate parent	**(3,280)**	(3,525)	**1,998**	2,645	**144,799**	126,485	**(122,054)**	(115,868)
Fellow subsidiaries	**(499)**	(1,151)	**349**	480	**28,623**	83,165	**(20,921)**	(66,156)
	(4,101)	(4,743)	**2,359**	3,150	**175,961**	217,089	**(145,301)**	(183,945)

								Company
	Interest, fees and other income received		Interest, fees and other expense paid		Amounts owed by related parties		Amounts owed to related parties	
	2010 £m	2009 £m	**2010 £m**	2009 £m	**2010 £m**	2009 £m	**2010 £m**	2009 £m
Ultimate parent company	**(313)**	(13)	**11**	23	**2,539**	4,434	**(2,326)**	(1,824)
Immediate parent	**(3,188)**	(3,414)	**1,998**	2,643	**144,467**	115,377	**(122,003)**	(115,867)
Subsidiaries	**(323)**	(119)	**29**	61	**433**	19,143	**(6,928)**	(11,415)
Fellow subsidiaries	**(496)**	(965)	**346**	433	**28,619**	71,324	**(20,910)**	(65,887)
	(4,320)	(4,511)	**2,384**	3,160	**176,058**	210,278	**(152,167)**	(194,993)

The balances above in 2009 included debt securities in issue held by related parties. During the year, euro 3,265m (2009: euro 225m) of the Group's holdings of AAA-rated prime mortgage-backed securities were sold to Banco Santander, S.A. (2009: sold to the issuer, Banco Santander Totta, S.A.). Although Banco Santander, S.A. and Banco Santander Totta, S.A. are related parties of the Group, the transactions are considered to be commercial deals, with a normal sharing of profits.

In October 2010, all of the existing activities of Cater Allen International Limited (a subsidiary of the Company) were transferred to the Company. In accordance with the Company's accounting policy of accounting for internal reorganisations, the assets and liabilities of Cater Allen International Limited were transferred to the Company at their book values in Cater Allen International Limited (after adjusting for inter-company balances) as described in Note 42.

In November 2010, the Group acquired a portfolio of loans to banks, asset-backed securities and related credit derivatives, as part of an alignment of portfolios across the Banco Santander, S.A. group, this is described further in Note 43.

In December 2010, the Group acquired a £2.2bn portfolio of loan facilities, consisting of £0.5bn drawn balances and £1.7bn of undrawn facilities, from Banco Santander, S.A., as part of an alignment of portfolios across the Banco Santander, S.A. group.

The above transactions were made in the ordinary course of business and substantially on the same terms as for comparable transactions with third-party counterparties.

41. Events after the balance sheet date

None.

Notes to the Financial Statements continued

42. Transfer of the activities of Cater Allen International Ltd to Abbey National Treasury Services plc

In October 2010, all of the existing activities of Cater Allen International Limited (a subsidiary of the Company) were transferred to the Company. In accordance with the Company's accounting policy of accounting for internal reorganisations, the assets and liabilities of Cater Allen International Limited were transferred to the Company at their book values in Cater Allen International Limited.

The principal purpose of the transfer was to increase the efficiency of the Santander UK plc group. A summary of the net assets transferred to the Company, after adjusting for inter-company balances is as follows:

Net assets transferred:	Company £m
Assets	
Cash and balances at central banks	**103**
Trading assets	**281**
Liabilities	
Trading liabilities	**384**
Net assets	**-**

43. Financial risks and risk management

This Note contains audited financial information except for the discussion of Operational Risk and Other Risks on pages 85 to 87.

Summary

The Group's risks are managed at a Santander UK level. This Risk Management section describes the Company and the Group's Risk Governance Framework, and includes more detail on the Group's key risks, on a segmental basis or aggregated where relevant. It is divided into the following sections:

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

Economic capital – including analyses of the global risk profile, Return on Risk Adjusted Capital ('RORAC') and value creation.

Principal Risks and Risk Management – Definitions and key features of the principal risks facing the Group, together with responsibility for risk management, control and assurance are described on pages 62 and 63, consisting of:

> **Credit Risk**
> **Market Risk**
> **Funding and Liquidity Risk**
> **Operational Risk** and
> **Other Risks**

Notes to the Financial Statements continued

Credit Risk - Disclosures about credit risk are described on pages 64 to 79, consisting of Group-wide disclosures followed by additional segmental disclosures:

> **Total credit risk exposures and maximum exposure to credit risk** – including discussions of measurement tools, the credit risk cycle, and credit risk from other standpoints, particularly significant concentrations.

> **Segmental disclosures about credit risk:**

- > **Global Banking & Markets** - including its management, exposures by credit rating and geographical area, and the Watchlist.
- > **Corporate Banking** - including its management, exposures by credit rating and geographical area, the Watchlist, and impairment loss allowances, arrears, recoveries and non-performing loans.
- > **Asset and Liability Management** - including its management and exposures by credit rating and geographical area, and the Watchlist.

Market Risk – Segmental disclosures about market risk are described on pages 80 to 83, consisting of:

> **Global Banking & Markets -** including its management and disclosures on short-term, structural and trading market risk.

> **Corporate Banking** - including its management.

> **Asset and Liability Management** - including its management and disclosure of Net Interest Margin Sensitivity and the Market Value of Equity sensitivity, and a description of the types of derivative contracts used.

Funding and Liquidity Risk – A description of the funding and liquidity risk the Group faces, along with their management and activity can be found on pages 84 to 85.

Operational Risk – Descriptions of operational risk management and key operational risk activity, as well as regulatory, legal and compliance risk (including Basel II) can be found on page 85 to 87.

Other Risks – Descriptions of how business/strategic risk and reputational risk are managed can be found on pages 87.

The Impact of the Current Credit Environment – Detailed disclosures can be found on pages 88 to 96, including a description of the Group's exposures to certain classes of financial assets and off-balance sheet entities.

Introduction

The Group follows the same risk management structure of Santander UK. The Group is driven by the core Santander Global Banking & Markets UK businesses and UK Corporate Bank. In addition the ALM business is booked in the Company. In terms of governance, authority for risk management flows from the Santander UK Board to the Board of Directors of the Group.

In addition, Santander UK plc has given a full and unconditional guarantee in respect of the liabilities of the Group incurred prior to 31 July 2012. The Group has given a reciprocal guarantee in respect of the liabilities of Santander UK plc. As a consequence of this cross guarantee the Group is exposed to the same risk factors as Santander UK.

The Group accepts that risk arises from its full range of activities and actively manages and controls it. The management of risk is an integral part of the Group's activities. Risk is defined as the uncertainty around the Group's ability to achieve its business objectives and execute its strategy effectively. Risk constitutes the Group's exposure to uncertainty and the consequent variability of return. Specifically, risk equates to the adverse impacts on profitability arising from different sources of uncertainty. The key risks Santander UK is exposed to are credit (including residual credit and concentration), market (including trading and non-traded), funding and liquidity, operational and other risks (including business/strategic and reputational). Risk measurement is used to capture the source of the uncertainty and the magnitude of its potential effect on the profitability and solvency of the Group. Effective risk management and control is therefore of fundamental importance to Santander UK's long-term success.

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

Notes to the Financial Statements continued

Principles of Risk Management

Risk management at Santander UK is based on the following principles:

> **Involvement of senior management.** Santander UK's risk committee and the Group units' senior management committees are structured so as to involve senior management in the overall risk oversight process.

> **Independence of the risk function with respect to the business.** The segregation of functions between the business areas (which assume risk) and the risk areas entrusted with risk measurement, analysis, control and reporting provides sufficient independence and autonomy for proper risk control.

> **Risk as a decision maker.** Decisions on credit transactions jointly reviewed by the risk and commercial areas. However, as Risk is independent, it is ultimately the decision maker.

> **Definition of powers.** The type of activities to be performed, segments, risks to be assumed and risk decisions to be made are clearly defined for each risk taking unit and, if appropriate, for each risk management unit, based on their delegated powers. How transactions and products should be structured, arranged and managed and where they should be accounted for is also defined.

> **Risk measurement.** Risk measurement takes into account all risk exposures assumed across the business spectrum and uses measures based on risk components and dimensions, over the entire risk cycle, for the management of risk at any given time. From a qualitative standpoint, this integrated vision translates into the use of certain integrating measures, which are mainly the risk capital requirement and return on risk-adjusted capital ('RORAC').

> **Limitation of risk.** The limitation of risk is intended to limit, in an efficient and comprehensive manner, the maximum levels of risk for the various risk measures, based on a knowledge of the risks incurred and supported by the necessary infrastructure for risk management, control and reporting, and to ensure that no undesired risks are assumed and that the risk-based-capital charge, risk exposures and losses do not exceed, in any case, the approved maximum levels.

> **Establishment of risk policies and procedures.** The risk policies and procedures represent the basic regulatory framework, consisting of frameworks, manuals and operating rules, through which risk activities and processes are regulated.

> **Definition and assessment of risk methodologies.** Risk methodologies provide the definitions of the internal risk models applicable to the Group and, therefore, stipulate the risk measures, product valuation methods, yield curve and market data series building methods, calculation of risk-based capital requirements and other risk analysis methods, and the respective calibration and testing processes.

Phases of risk management

The risk management and control process at Santander UK is structured into the following phases:

> Establishment of risk management frameworks and policies that reflect the principles and standards governing the general modus operandi of Santander UK's risk activities, based on a corporate risk management framework, which comprises the organisational model and the management model, and on a series of more specific corporate frameworks of the functions reporting to the risk unit. Risk units transpose corporate risk regulations into their internal policies and develop the procedures required to implement them.

> Identification of risks, through the constant review and monitoring of exposures, the assessment of new products and businesses and the specific analysis of singular transactions.

> Measurement of risks using methodologies and models implemented subject to a validation and approval process.

> Definition of the Group's risk appetite by setting overall and specific limits for the various types of risks, products, customers, groups, sectors and geographical locations.

> Preparation and distribution of reports that are reviewed by the heads of Santander UK management.

Notes to the Financial Statements continued

Key techniques and tools

For many years, Santander UK has managed risk using a number of techniques and tools which are described in detail in various sections of this report. The key techniques and tools used are as follows:

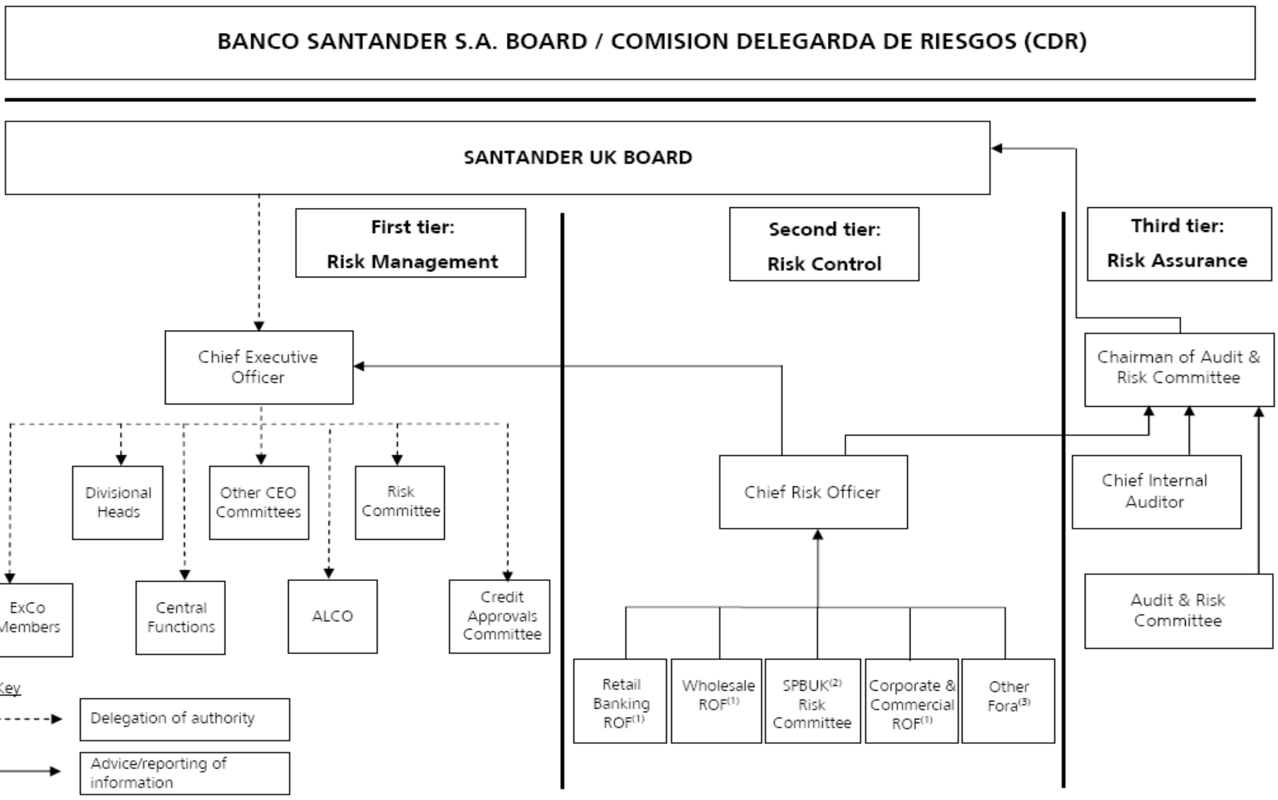
> Internal ratings and scorings-based models which, by assessing the various qualitative and quantitative risk components by customer and transaction or product, make it possible to estimate, firstly, the probability of default and, subsequently, the expected loss, based on estimates of loss given default.
> Economic capital, as a homogeneous measure of the risk assumed and a basis for the measurement of the management performed.
> RORAC, which is used both as a transaction and product pricing tool (bottom-up approach) and in the analysis of portfolios and units (top-down approach).
> Value at Risk, which is used for controlling market risk and setting the market risk limits for the various trading portfolios.
> Scenario analysis and stress testing to supplement market and credit risk analyses in order to assess the impact of alternative scenarios, even on impairment loss allowances and capital.

Risk Governance Framework

The Group adopts a three-tier risk governance framework that establishes responsibilities for:
> Risk management;
> Risk control; and
> Risk assurance.

This ensures segregation of duties between those who take on risk, those who control risk and those who provide assurance. The framework is based on the following five principles:
> Clearly allocating accountability for risk;
> Embedded risk culture, starting at the highest levels of our organisation;
> Creating shareholder value;
> Independent risk assurance and transparency; and
> Embedding UK Financial Services Authority 'Treating Customers Fairly' principles into policies and processes.

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



(1) Risk Oversight Forum ('ROF')
(2) Santander Private Banking UK ('SPBUK')
(3) Other Fora include Stress Testing ROF, Capital Risk ROF, Mortgage Backed Funding ROF, FEVE Forum, Risk School Board & IT Risk Board. FEVE is a Spanish acronym for 'Firmas En Vigilancia Especial', which means business under special watch.

Notes to the Financial Statements continued

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

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

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

First tier of risk governance in Santander UK

Risk management is provided by the Santander UK Board. It approves Santander UK's Risk Appetite Statement which is set principally through economic capital measures for each risk type in consultation with Banco Santander, S.A. as appropriate. The Santander UK Board also approves the strategy for managing risk and is responsible for Santander UK's system of internal control. The Santander UK Board is supported by the Chief Executive Officer and Executive Committee members who have primary responsibility for understanding, identifying, and owning the risks generated by their lines of business and establishing a framework for managing those risks within the Board-approved risk appetite of Santander UK. In addition, understanding, identifying and owning the risks generated by Santander UK's operations are the responsibility of the Divisional Heads and central functions. These functions provide technical support and advice to assist in the management and control of risk. Within this tier, there is a process for transaction review and approval within certain thresholds, discharged by the Credit Approvals Committee ('CAC'), a specific committee established under the authority of the Chief Executive Officer. Transactions reviewed which exceed the threshold limits set are subject to prior review by Banco Santander, S.A.'s Risk Division before final approval by the CAC.

Risk Committee

The Risk Committee is a management committee, established under the authority of and chaired by the Chief Executive Officer.

The Risk Committee is responsible for a more detailed allocation of the Group's risk appetite, proposing the Group's risk policy for approval by the Chief Executive Officer, the Executive Committee, the Board or other parties as appropriate and makes decisions on risk issues within its governing and supervisory powers. Furthermore, the Risk Committee ensures that the Group's activities are consistent with its risk tolerance level and, in this regard, it sets limits for the main risk exposures, which it reviews systematically.

The Chief Risk Officer advises the Risk Committee in connection with its work on the following matters:

a) Review

The Risk Committee:

- Reviews the Risk Report on a monthly basis. The Risk Report is prepared by the Risk Division and highlights all significant risk issues affecting Santander UK;
- Reviews any recommendations made by the Chief Risk Officer and the Risk Oversight Fora, and elevates them to the Board or the Executive Committee as appropriate;
- Reviews risk mandates, where appropriate, on an annual basis;
- Reviews changes in risk policy or appetite that may be recommended by relevant parties from time to time; and
- Reviews proposals for new products or business lines as appropriate.

b) Give advice and recommendations

The Risk Committee gives advice and recommends action relating to all risk issues to Executive Committee members (individually and collectively). After review, it recommends approval of the:

- Risk Framework;
- Risk Appetite; and
- Escalation of risk policy issues that lie outside its authority to approve.

c) Make decisions

The Risk Committee:

- Approves risk delegations;
- Approves risk policy changes that do not require Board approval; and
- Approves risk mandates, where appropriate.

In addition, with respect to the Basel II Internal Rating Based approach, the Risk Committee:

- Approves all material aspects of the rating and estimation process, where an Internal Rating Based model has been developed locally and is therefore subject to local validation and local supervisory review;
- Reviews the roles and responsibilities of the relevant risk functions and the internal/external audit functions; and
- Reviews the associated management reports.

Where an Internal Rating Based model has been developed and approved by the Banco Santander, S.A. group and therefore has been approved by the Banco de Espana, the responsibility of the Risk Committee is to ratify the model, noting its applicability and relevance to the local environment.

Notes to the Financial Statements continued

Second tier of risk governance in Santander UK

Risk control is provided by the Santander UK Board independently supported by the Risk Division. The roles of the Chief Risk Officer, the Deputy Chief Risk Officer and the Risk Division include development of risk measurement methodologies, risk approval, risk monitoring, risk reporting and escalation of risk issues in line with the relevant risk policy for all risks across the Group's lines of Global Banking & Markets, Corporate Banking, and Asset and Liability Management businesses.

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

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

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

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

Third tier of risk governance in Santander UK

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

Non-Executive Directors

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

Audit and Risk Committee

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

- Oversight of the risk governance framework;
- Review of the effectiveness of Santander UK internal and external audit processes;
- Review of control policies and procedures including regulatory compliance and financial reporting;
- Identification, assessment and reporting of risks; and
- The risk governance structure and associated compliance with risk control policies and procedures.

Internal Audit

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

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

Notes to the Financial Statements continued

Economic capital

Economic capital is an internal measure of the minimum equity and preference capital required for the Group to maintain its credit rating based upon its risk profile. The concept of economic capital differs from that of regulatory capital, the latter being the capital required by capital adequacy regulations. Economic capital is calculated using the Banco Santander S.A. economic capital model and is managed by Santander UK.

The economic capital model enables the Group to quantify the consolidated risk profile taking into account the significant risks of the business, as well as the diversification effect inherent in a multi-business group. The Group uses this model to prepare the economic capital forecasts as part of its internal capital adequacy assessment report in accordance with the UK Financial Services Authority regulations within the framework of Pillar 2 of Basel II. Santander UK monitors the economic capital utilisation and its sufficiency on a monthly basis at Risk Committee.

The concept of diversification is fundamental to the proper measurement of the risk profile of a multi-business group. Diversification can be explained in terms of the imperfect correlation between the various risks, which means that the largest loss events do not occur simultaneously in all portfolios or for all types of risk. Consequently, the sum of the economic capital of the various portfolios and types of risk, taken separately, is higher than the Group’s total economic capital. In other words, the risk borne by the Group as a whole is less than the risk arising from the sum of its various components considered separately.

The economic capital measurement and aggregation model also considers the concentration risk for wholesale portfolios (large corporations, banks and sovereigns), in terms of both the size of their exposure and their sector or geographic concentration. Product concentration in retail portfolios is captured through the application of an appropriate correlation model.

Risk appetite

The risk appetite is principally set by defining the economic capital limits by risk types. The Santander UK board agrees on high level limits for each principal risk type. The authority for managing and monitoring the risk appetite then flows to the Chief Executive Officer and from her to specific individuals. The Chief Risk Officer is responsible for setting other limits to support the monitoring of Board-approved limits, which is in turn supported by the Risk Division and the Risk Oversight Fora.

The Risk Appetite Statement is recommended by the Chief Executive Officer and approved by the Santander UK board, under advice from the Risk Committee. The Risk Appetite Statement is reviewed by the Santander UK board at least annually or more frequently if necessary (e.g. in the case of significant methodological change). This ensures that the risk appetite continues to be consistent with the Group’s current and planned business activities. The Chief Executive Officer under advice from the Risk Committee approves the detailed allocation of risk appetite to different businesses or portfolios. The Chief Risk Officer, supported by the Risk Division, is responsible for the ongoing maintenance of the Risk Appetite Statement.

Return on risk-adjusted capital and value creation

Santander UK uses the RORAC methodology in its credit risk management, with the following activities and objectives:

> Calculation of economic capital requirement and of the return thereon for the Group's business units and for business segments and portfolios in order to facilitate an optimal allocation of economic capital.

> Budgeting of capital requirement and RORAC of the Group's business units.

> Analysis and setting of prices in the decision-making process for transactions or products, such as loan approval.

The RORAC methodology facilitates the comparison, on a consistent basis, of the performance of transactions, customers, portfolios and businesses. It also identifies those which achieve a risk-adjusted return higher than the Group’s cost of capital, thus aligning risk management and business management with the aim of maximising value creation.

Notes to the Financial Statements continued

Principal Risks and Risk Management

Principal risks

The principal risks affecting the Group are discussed below. Risks are generally managed through tailored management policies within the business division or operating segment in which they are originated. Within Santander UK, these risks are divided into two populations:

> **Population 1**: Risks that are deemed to be material and are mitigated by a combination of internal controls and allocation of capital (both regulatory and economic).

> **Population 2**: Risks that are deemed to be material but where Santander UK seeks to mitigate its exposure primarily by its internal control arrangements rather than by allocation of capital.

The principal risks are:

Risk type	Definition	Population
Credit Risk (including residual credit and concentration)	**Credit risk** is the risk of financial loss arising from the default of a customer or counterparty to which the Group has directly provided credit, or for which the Group has assumed a financial obligation, after realising collateral held. Credit risk includes residual credit risk, which arises when credit risk measurement and mitigation techniques prove less effective than expected. In addition, concentration risk, which is part of credit risk, includes large (connected) individual exposures, and significant exposures to groups of counterparties whose likelihood of default is driven by common underlying factors, e.g. sector, economy, geographical location or instrument type.	1
Market Risk (including trading and non-traded)	**Market risk** is the risk of a reduction in economic value or reported income resulting from a change in the variables of financial instruments including interest rate, equity, credit spread, property and foreign currency risks. Market risk consists of trading and non-traded market risks. Trading market risk includes risks on exposures held with the intention of benefiting from short term price differences in interest rate variations and other market price shifts. Non-traded market risk includes interest rate risk in investment portfolios.	1
Funding and Liquidity Risk	**Funding risk** is the risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient or a funding programme such as debt issuance subsequently fails. For example, a securitisation arrangement may fail to operate as anticipated or the values of the assets transferred to a funding vehicle do not emerge as expected creating additional risks for the Group and its depositors. Risks arising from the encumbrance of assets are also included within this definition. **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.	2
Operational Risk	**Operational risk** is the risk of loss to the Group resulting from inadequate or failed internal processes, people and systems, or from external events. This includes regulatory, legal and compliance risk.	1
Other Risks	Other risks consist of business/strategic risk and reputational risk.	
	Business/strategic risk is the current or prospective risk to earnings and capital arising from changes in the business environment and from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment. This includes pro-cyclicality and capital planning risk. The internal component is the risk related to implementing the strategy. The external component is the risk of the business environment change on the Group's strategy.	1
	Reputational risk is the risk of financial loss or reputational damage arising from treating customers unfairly, a failure to manage risk, a breakdown in internal controls, or poor communication with stakeholders. This includes the risk of decline in the value of the Group's franchise potentially arising from reduced market share, complexity, tenor and performance of products and distribution mechanisms. The reputational risk arising from operational risk events is managed within the operational risk framework.	2

Notes to the Financial Statements continued

Responsibility for risk management, control and assurance

Responsibility for supporting the Board in risk management and control and responsibility for risk assurance may be summarised by principal risk as follows:

	Risk Management	Risk Control	Risk Assurance
	Board		
Credit (including residual credit and concentration)	Retail Banking, Corporate Banking, Global Banking & Markets and Asset and Liability Management ('ALM' within Group Infrastructure)	Risk Division - Credit Risk Department	Audit and Risk Committee Internal Audit
Market (including trading and non-traded)	Global Banking & Markets and ALM	Risk Division - Market Risk Department	
Funding and Liquidity			
- Funding	ALM	Risk Division – Market Risk Department	
- Liquidity	ALM	Risk Division - Market Risk Department	
Operational			
- Non-regulatory	All	Risk Division - Enterprise & Operational Risk Department	
- Regulatory	All	Finance Department Legal & Compliance	
Other			
- Business/strategic	CEO supported by Executive Committee	Chief Risk Officer	
- Reputational	CEO supported by Executive Committee	Chief Risk Officer	

Risk exposures relating to the Company principally arise in Corporate Banking and ALM. Following the outsourcing of key IT and operations processes to Banco Santander, S.A. group companies, risk governance of these entities is crucial. The use of service level agreements and key metrics support this governance. Santander UK works closely, and continues to enhance its interaction, with outsourced service providers via the application of appropriate risk frameworks.

Notes to the Financial Statements continued

Credit Risk

Definition

Credit risk is the risk of financial loss arising from the default of a customer or counterparty to which the Group has directly provided credit, or for which the Group has assumed a financial obligation, after realising collateral held. Credit risk includes residual credit risk, which arises when credit risk measurement and mitigation techniques prove less effective than expected. In addition, concentration risk which is part of credit risk, includes large (connected) individual exposures, and significant exposures to groups of counterparties whose likelihood of default is driven by common underlying factors, e.g. sector, economy, geographical location or instrument type.

Treatment of credit risk

The specialisation of Santander UK's risk division is based on the type of customer and, accordingly, a distinction is made between non-standardised customers and standardised customers in the risk management process:

> Non-standardised customers are defined as those to which a risk analyst has been assigned. This category includes wholesale banking customers, medium and large corporate customers and financial institutions. Risk management is performed through expert analysis supplemented by decision-making support tools based on internal risk assessment models.

> Standardised customers are those which have not been expressly assigned a risk analyst. This category generally includes individuals and individual entrepreneurs and small businesses not classified as non-standardised customers. Management of these risks is based on internal risk assessment and automatic decision-making models, and supported by teams of analysts specialising in this type of risk when the model is not comprehensive enough or is not sufficiently accurate.

Total credit risk exposures

The Group's exposures to credit risk arise in the following businesses:

> Corporate exposures consist of loans, bank accounts, treasury services, asset finance, cash transmission, trade finance and invoice discounting to small and medium-sized ('SME') UK companies and specialist businesses. Corporate exposures are managed by the Corporate Banking division.

> Wholesale exposures consist of deposits with central banks, loans and debt securities issued or guaranteed by central and local governments ('sovereign exposures') and other exposures. Sovereign exposures are managed by the Asset and Liability Management Committee in Asset and Liability Management ('ALM') and by the Short Term Markets desk in Global Banking & Markets. The Group's other exposures arise in connection with a variety of purposes:

> As part of its treasury trading and global corporates lending activities, which are managed by the Global Banking & Markets division;
> For yield and liquidity purposes, including the Asset and Liability Management Committee portfolio of asset-backed securities, which are managed by the ALM division; and
> In the Treasury asset portfolio which is being run down. This is managed by the ALM division.

Maximum exposure to credit risk

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

	2010 £m	2009 £m
Trading assets	**21,034**	20,143
Securities purchased under resale agreements	**34,510**	44,755
Derivative financial instruments	**23,237**	23,201
Financial assets designated at fair value	**6,468**	12,000
Held-to-maturity securities	**331**	-
Loans and advances to customers	**34,550**	20,174
Loans and advances to banks	**126,329**	160,141
Other	**4,761**	2,695
Total exposure(1)	**251,220**	283,109

(1) In addition the Group is exposed to credit risk in respect of guarantees granted, loan commitments and stock borrowing and lending agreements. The estimated maximum exposure to credit risk is described in Note 34 to the Consolidated Financial Statements

Notes to the Financial Statements continued

Measures and measurement tools

Rating tools

The Group uses proprietary internal rating models to measure the credit quality of a given customer or transaction. Each rating relates to a certain probability of default or non-payment, determined on the basis of the Company's historical experience, with the exception of certain portfolios classified as "low default portfolios".

Global rating tools are applied to the sovereign risk, financial institution and global corporates segments. Management of the rating tools for these segments is centralised at Group level, with rating calculation and risk monitoring purposes devolved to the local units under Group supervision. These tools assign a rating to each customer, which is obtained from a quantitative or automatic module, based on balance sheet ratios or macroeconomic variables, supplemented by the analyst's expert judgement.

For non-standardised corporates and financial institutions, Banco Santander, S.A. has defined a single methodology for the construction of a rating in each country, based on an automatic module which includes an initial participation of the analyst that can be supplemented subsequently if required. The automatic module determines the rating in two phases, a quantitative phase and a qualitative phase. The latter is based on a corrective questionnaire which enables the analyst to modify the automatic score up or down by up to 2 rating points. The quantitative rating is determined by analysing the credit performance of a sample of customers and the correlation with their financial statements. Ratings assigned to customers are reviewed periodically to include any new financial information available and the Group's experience in its banking relationship with the customer. The frequency of the reviews is increased when customers reach certain levels in the automatic warning systems or are classified as requiring special monitoring. The rating tools are also reviewed in order to progressively fine-tune the ratings they provide.

For standardised customers, both legal entities and individuals, the Group has scoring tools that automatically assign a score to the proposed transactions.

These loan approval systems are supplemented by performance rating models. These tools provide enhanced predictability of the risk assumed and are used for preventive and marketing activities.

Credit risk parameters

The assessment of customers or transactions using rating or scoring systems constitutes a judgement of their credit quality, which is quantified through the probability of default ('PD'), in accordance with Basel II terminology. In addition to PD, the quantification of credit risk requires the estimation of other parameters, such as exposure at default ('EAD') and the percentage of EAD that will not be recovered (loss given default or 'LGD'). In estimating the risk involved in transactions, other factors such as any off-balance sheet exposure and collateral valuations are also taken into account.

The combination of these risk parameters (i.e. PD, LGD and EAD) enables calculation of the probable loss or expected loss ('EL'). The risk parameters also make it possible to calculate the regulatory capital requirement in accordance with the Basel II Capital Accord.

For portfolios with limited internal default experience (e.g. banks) parameter estimates are based on alternative sources, such as market prices or studies conducted by external agencies gathering the shared experience of a sufficient number of entities. These portfolios are known as low default portfolios.

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

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

Credit risk cycle

The risk management process consists of identifying, measuring, analysing, controlling, negotiating and deciding on, as appropriate, the risks incurred in the Group's operations. The parties involved in this process are the risk taking areas, senior management and the risk units.

The process begins at senior management level, through the Board of Directors, the Executive Committee and the Risk Committee, which establishes the risk policies and procedures, and the limits and delegations of authorities, and approves and supervises the scope of action of the risk function.

Notes to the Financial Statements continued

The risk cycle comprises three different phases:

> **Pre-sale:** this phase includes the risk planning and target setting processes, determination of the Group’s risk appetite, approval of new products, risk analysis and credit rating process, and limit setting per counterparty. Limits can be established either through the framework of pre-approved or pre-classified limits or by the granting of a specific approval.
> **Sale:** this is the decision-making phase for both transactions under pre-classified limits and those which have received specific approval.
> **Post-sale:** this phase comprises the risk monitoring, measurement and control processes and the recovery process.

Risk limit planning and setting
Risk limit setting is a dynamic process that identifies the Group’s risk appetite through the discussion of business proposals and the attitude to risk. This process is defined in the global risk limit plan, a comprehensive document for the integrated management of the balance sheet and its inherent risks, which establishes risk appetite on the basis of the various factors involved. The risk limits are founded on two basic structures: customers/segments and products.

For non-standardised risks, a top-level risk limit is approved if the quantum of risk required to support the customer is material when compared to its overall financing needs. These limits cover a variety of products (such as lending, trade finance or derivatives) enabling the Group to define a total risk appetite with that customer based on its current and expected financial needs. For global corporate groups, a pre-classification model based on an economic capital measurement and monitoring system is used. For the corporate segment, a simplified pre-classification model is applied for customers meeting certain requirements.

For standardised risks, the risk limits are planned and set using the credit management programme, a document agreed upon by the business areas and the risk units and approved by the Risk Committee or its delegated committees, which contains the expected results of transactions in terms of risk and return, as well as the limits applicable to the activity and the related risk management.

Risk analysis and credit rating process
Risk analysis is a pre-requisite for the approval of credit to customers by the Group. This analysis consists of examining the customer's ability to meet its contractual obligations to the Group, which involves analysing the customer’s credit quality, its risk transactions, its solvency and the return to be obtained in view of the risk assumed.

The risk analysis is conducted when a new customer or transaction arises or with a pre-established frequency, depending on the segment involved. Additionally, the credit rating is examined and reviewed whenever a warning is triggered or an event affecting the credit risk of the customer or transaction occurs.

Transaction decision-making
The purpose of the transaction decision-making process is to analyse transactions and then make a decision, taking into account the risk appetite and any transaction elements that are important in achieving a balance between risk and return. The Group uses, among others, the RORAC methodology for risk analysis and pricing in the decision-making process on transactions and deals.

Risk monitoring and control
In order to ensure adequate credit quality control in addition to the tasks performed by the internal audit division, the Risk Division has a specific risk monitoring function to which specific resources and persons in charge have been assigned.

This monitoring function is based on an ongoing process of observation to enable early detection of any incidents that might arise in the evolution of the risk, the transactions, the customers and their environment, with a view to adopting mitigating actions. The risk monitoring function is specialised by customer segment.

For this purpose a system called “companies under special surveillance” (FEVE, using the Spanish acronym) has been designed that distinguishes four categories, three of which are considered as Active (extinguish, secure and reduce) and one of which is considered Passive (monitor). The inclusion of a company in the FEVE system does not mean that there has been a default, but rather that it is deemed advisable to adopt a specific policy for this company, to place a person in charge and to set the policy implementation period. Customers classified as FEVE are reviewed at least every six months, or every three months for those classified in the most severe categories. A company can be classified as FEVE as a result of the monitoring process itself, a review performed by internal audit, a decision made by the sales manager responsible for that company or the triggering of the automatic warning system.

Assigned ratings are reviewed at least annually, but should any weakness be detected, or depending on the rating itself, more frequent reviews are performed. For exposures to standardised customers, the key indicators are monitored in order to detect any variance in the performance of the loan portfolio with respect to the forecasts contained in the credit management programmes.

Notes to the Financial Statements continued

Risk control function

Supplementing the management process, the risk control function obtains a global view of the Group's loan portfolio, through the various phases of the risk cycle, with a sufficient level of detail to permit the assessment of the current risk position and any changes therein. Changes in the Group's risk position are controlled on an ongoing and systematic basis against budgets, limits and benchmarks, and the impacts of these changes in future situations, both of an external nature and those arising from strategic decisions, are assessed in order to establish measures that place the profile and amount of the loan portfolio within the parameters set by the Group.

The risk control function is performed by assessing risks from various complementary perspectives, the main pillar being control by geographical location, business area, management model, product and process, thus facilitating the detection of specific areas of action requiring decision-making.

In 2009 one of the focus points of the risk control function was to ensure compliance with the corporate criteria for the classification of refinanced portfolios and to monitor production volumes and their performance. In 2010, additional monitoring of restructured debts was implemented, which was used to improve the performance of portfolios.

Scenario analysis

As part of the ongoing risk monitoring and control management process, the Group performs simulations of the portfolio performance in different adverse and stress scenarios (stress testing) which enable it to assess the Group's capital adequacy in certain future situations. These simulations cover the Group's main portfolios and are conducted systematically using a corporate methodology with the following features:

> It determines the sensitivity of risk factors (PD, LGD) to macroeconomic variables.
> It characterises benchmark scenarios.
> It identifies "break-off scenarios" (the levels above which the sensitivity of the risk factors to macroeconomic variables is more accentuated) and the distance of these break-off scenarios from the current situation and the benchmark scenarios.
> It estimates the expected loss associated with each scenario and the changes in the risk profile of each portfolio arising from variations in macroeconomic variables.

The simulation models used by the Group use data of a full business cycle to calibrate the performance of risk factors, given certain movements in macroeconomic variables. In the wholesale and corporate banking areas, since low-default portfolios are involved, there is insufficient historical default data available to perform the calibration and, therefore, expert judgment is used.

The main macroeconomic variables contained in the Group's scenarios are as follows:

> Unemployment rate
> GDP
> Interest rates
> Inflation rate

The scenario analysis enables management to better understand the expected performance of the portfolio given certain changing market conditions and situations. The analyses performed, both in base and in stressed scenarios, with a time horizon of five years, show the strength of the balance sheet against the various market and macroeconomic situations simulated.

Recovery process

Recovery management is defined as a strategic, integrated business activity. Banco Santander, S.A. has a global model which is applied and implemented locally by the Group, considering the specific features of the business in each area of activity.

The specific objectives of the recovery process are as follows:

> To collect payments in arrears so that accounts return to performing status. If this is not possible within a reasonable time period, the aim is to fully or partially recover debts, regardless of their status for accounting or management purposes.
> To maintain and strengthen the relationship with customers, paying attention to customer payment behaviour.

Notes to the Financial Statements continued

Credit risk from other standpoints

Certain areas and/or specific views of credit risk deserve specialist attention, complementary to global risk management.

Significant concentrations of credit risk

During 2010, the Group's most significant exposures to credit risk derived from:

> unsecured lending and derivatives exposure to banks and other financial institutions in Global Banking & Markets;

> secured lending and derivatives exposures to companies, real estate entities and social housing associations in Corporate Banking; and

> the Treasury asset portfolio in ALM.

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

	2010	2009
	Global Banking & Markets	Global Banking & Markets
Country	**%**	%
UK	**81**	81
Rest of Europe	**18**	13
US	**-**	2
Other, including non-OECD	**1**	4
	100	100

ALM's exposures result from its asset portfolios, including the Treasury asset portfolio. Details of credit ratings and geographic analysis can be found on pages 78 and 79.

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

Credit risk mitigation

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

Group restructured loans

As at 31 December 2010, there were no financial assets that would otherwise be past due or impaired whose terms have been renegotiated (2009: £54m).

Notes to the Financial Statements continued

Credit Risk - Global Banking & Markets

Definition
Credit risk is the risk of financial loss arising from the default of a customer or counterparty to which the Group has directly provided credit, or for which the Group has assumed a financial obligation, after realising collateral held. Credit risk arises by Global Banking & Markets making loans, investing in debt securities or other financial instruments or entering into financing transactions or derivative contracts.

Managing credit risk
Global Banking & Markets aims to actively manage and control credit risk. The Santander UK Board has approved a set of risk appetite limits to cover different types of risk, including credit risk, arising in Global Banking & Markets. Santander UK's credit risk appetite is measured and controlled by a maximum Economic Capital value, which is defined as the maximum level of unexpected loss that the Group is willing to sustain over a one-year period. Global Banking & Markets exposures, including intra-group items, are captured on the global risk management systems and fall within limits approved by Santander Risk Division.

All transactions are accommodated under credit limits approved by the appropriate credit authority. For transactions that fall under Santander UK's delegated authority, approval is required from the CAC or those individuals directly mandated by CAC. Transactions or exposures above this local limit will be referred by CAC to the relevant approval authorities in Santander. The Wholesale Credit Risk department is responsible for managing credit risk in Global Banking & Markets portfolios.

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

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

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

Global Corporates in Global Banking & Markets
During 2010, following an alignment of portfolios across the Banco Santander, S.A. group, Global Banking & Markets' activities in the UK expanded to include the granting of credit facilities and the provision of treasury services to major corporations based in the UK.

Global Banking & Markets exposure by credit rating of the issuer or counterparty(1)

In Global Banking & Markets, credit risk arises on both assets and liabilities and on both on and off-balance sheet transactions. Consequently, the credit risk exposure below arises from on balance sheet assets, securities financing trades classified as liabilities, OTC derivatives and off-balance sheet assets such as committed and undrawn credit facilities or guarantees.

2010	**Sovereign £m**	**Global Corporates £m**	**Banks and Financial Institutions £m**	**Total £m**
AAA	**18,421**	**-**	**9**	**18,430**
AA	**87**	**194**	**287**	**568**
A	**-**	**1,654**	**643**	**2,297**
BBB and below	**-**	**2,439**	**236**	**2,675**
Total	**18,508**	**4,287**	**1,175**	**23,970**

2009	Sovereign £m	Global Corporates £m	Banks and Financial Institutions £m	Total £m
AAA	11,857	-	228	12,085
AA	2	-	592	594
A	26	69	2,433	2,528
BBB and below	-	219	358	577
Total	11,885	288	3,611	15,784

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

Notes to the Financial Statements continued

Global Banking & Markets exposure by geographical area

2010	Sovereign £m	Global Corporates £m	Banks and Financial Institutions £m	Total £m
UK	**14,876**	**3,696**	**755**	**19,327**
Rest of Europe	**3,496**	**453**	**344**	**4,293**
US	**-**	**-**	**44**	**44**
Rest of the world	**136**	**138**	**32**	**306**
Total	**18,508**	**4,287**	**1,175**	**23,970**

2009	Sovereign £m	Global Corporates £m	Banks and Financial Institutions £m	Total £m
UK	10,208	149	2,366	12,723
Rest of Europe	1,313	67	729	2,109
US	181	1	193	375
Rest of the world	183	71	323	577
Total	11,885	288	3,611	15,784

OTC derivative exposure by credit rating of the issuer or counterparty(1)

2010	Sovereign £m	Global Corporates £m	Banks and Financial Institutions £m	Total £m
AAA	**34**	**-**	**-**	**34**
AA	**-**	**-**	**75**	**75**
A	**-**	**53**	**164**	**217**
BBB and below	**-**	**273**	**66**	**339**
Total	**34**	**326**	**305**	**665**

2009	Sovereign £m	Global Corporates £m	Banks and Financial Institutions £m	Total £m
AAA	50	-	8	58
AA	-	-	54	54
A	-	-	181	181
BBB and below	-	150	226	376
Total	50	150	469	669

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

Global Banking & Markets – Watchlist

In order to ensure adequate credit quality control, in addition to the tasks performed by the internal audit division, the Wholesale Credit Risk Department analysts monitor the exposures within their assigned portfolios through an ongoing process of observation to enable early detection of any incidents that might arise in the evolution of the risk, the transactions, the customers and their environment, with a view to implement mitigating actions.

For this purpose, the Wholesale Credit Risk Department follows the Santander UK's risk monitoring and control processes for FEVE, where risks are classified into four levels of monitoring, three of which are considered as Active (through the implementation of actions that can be classified as extinguish, secure and reduce) and one of which is considered Passive (monitor). This is further explained in the 'Credit risk cycle – Risk monitoring and control' section above. Global Banking & Markets Banks and Financial Institutions and Global Corporates exposures are managed at the FEVE Corporate Risk forum.

At 31 December 2010 and 2009, there were no impaired or non-performing loans or exposures and the assets in the Active category were £573m (2009: £166m).

Notes to the Financial Statements continued

Credit risk mitigation in Global Banking & Markets

(i) Netting arrangements for derivative transactions
The Group restricts its credit risk by entering into transactions under industry standard agreements (i.e. the International Swaps and Derivatives Association ('ISDA') Master Agreements) which facilitate netting of transactions in the jurisdictions where netting agreements are recognised and have legal force. The netting arrangements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis.

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

(ii) Collateralisation for derivative transactions
The Group also mitigates its credit risk to counterparties with which it primarily transacts financial instruments through collateralisation, using industry standard collateral agreements (i.e. the Credit Support Annex ('CSA')) in conjunction with the ISDA Master Agreement. Under these agreements, net exposures with counterparties are collateralised with cash, securities or equities. Exposures and collateral are generally revalued daily and collateral is adjusted accordingly to reflect deficits/surpluses. Collateral taken must comply with the Group's collateral parameters policy. This policy is designed to control the quality and concentration risk of collateral taken such that collateral held can be liquidated when a counterparty defaults. Cash collateral in respect of derivatives held at the year-end was £0.7bn (2009: £1.1bn), not all derivative arrangements being subject to collateral agreements. Collateral obtained during the year in respect of purchase and resale agreements (including securities financing) is equal to at least 100% of the amount of the exposure.

(iii) Collateralisation for lending activities
The Global Corporate portfolio is largely unsecured but credit agreements are underpinned by both financial and non-financial covenants. There is also a small number of acquisition financing transactions where collateral is held in the form of a charge over the assets being acquired.

Restructured loans

As at 31 December 2010 and 2009, there were no financial assets that would otherwise be past due or impaired whose terms have been renegotiated.

Notes to the Financial Statements continued

Credit Risk - Corporate Banking

Definition
Credit risk is the risk of financial loss arising from the default of a customer or counterparty to which the Group has directly provided credit, or for which the Group has assumed a financial obligation, after realising collateral held. Credit risk arises by Corporate Banking making loans, investing in other financial instruments or entering into financing transactions or derivative contracts.

Managing credit risk
Corporate Banking aims to actively manage and control credit risk. The Santander UK Board has approved a set of risk appetite limits to cover different types of risk, including credit risk, arising in Corporate Banking. Santander UK's credit risk appetite is measured and controlled by a maximum Economic Capital value, which is defined as the maximum level of unexpected loss that Santander UK is willing to sustain over a one-year period. Within these limits, credit mandates and policies are approved to cover detailed industry, sector and product limits. All transactions falling within these mandates and policies are accommodated under credit limits approved by the appropriate credit authority. Specific approval is usually required by the CAC for any transaction that falls outside the mandates.

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

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

Corporate Banking is an area where the Group aims to achieve controlled growth, mainly through the expansion of a regional network supporting lending to the Corporate (including SME), Real Estate, Education and Health sectors. Focus is continuing to be given to the control of credit risks within this expansion based on robust Credit Policy Mandates and models covering both risk appetite and ratings.

Corporate Banking committed facilities exposure by credit rating of the issuer or counterparty (1) (2)

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

2010	**Corporate - SME £m**	**Corporate - Other £m**	**Real Estate £m**	**Social Housing £m**	**Total £m**
AAA	**-**	**26**	**92**	**-**	**118**
AA	**162**	**-**	**-**	**1,865**	**2,027**
A	**227**	**604**	**798**	**6,153**	**7,782**
BBB	**125**	**2,367**	**2,310**	**1,206**	**6,008**
BB	**69**	**169**	**733**	**10**	**981**
B	**1**	**6**	**71**	**-**	**78**
D	**-**	**-**	**57**	**-**	**57**
Total	**584**	**3,172**	**4,061**	**9,234**	**17,051**

2009	Corporate - SME £m	Corporate - Other £m	Real Estate £m	Social Housing £m	Total £m
AAA	-	27	89	-	116
AA	176	-	-	1,009	1,185
A	176	511	487	5,687	6,861
BBB	131	1,751	1,547	1,801	5,230
BB	66	117	879	100	1,162
B	-	7	70	-	77
D	-	40	73	-	113
Total	549	2,453	3,145	8,597	14,744

(1) The committed facilities exposure includes OTC derivatives and commercial mortgages.
(2) All exposures are internally rated. External ratings are taken into consideration in the rating process, where available.

Notes to the Financial Statements continued

Corporate Banking committed facilities exposure by geographical area

2010	Corporate - SME £m	Corporate - Other £m	Real Estate £m	Social Housing £m	Total £m
UK	**520**	**2,990**	**4,061**	**9,234**	**16,805**
Rest of Europe	**64**	**171**	**-**	**-**	**235**
US	**-**	**-**	**-**	**-**	**-**
Other, including non-OECD	**-**	**11**	**-**	**-**	**11**
Total	**584**	**3,172**	**4,061**	**9,234**	**17,051**

2009	Corporate - SME £m	Corporate - Other £m	Real Estate £m	Social Housing £m	Total £m
UK	529	2,199	3,145	8,597	14,470
Rest of Europe	20	211	-	-	231
US	-	-	-	-	-
Other, including non-OECD	-	43	-	-	43
Total	549	2,453	3,145	8,597	14,744

The increase in Corporate and Real Estate exposures in 2010 arose from the continued development of a UK corporate banking franchise.

Corporate Banking – Watchlist

The entire corporate risk portfolio of new, emerging and serious circumstances relating to the portfolio (i.e. those loans on a 'watchlist') and those in 'workout' are managed at the FEVE Corporate Risk forum.

Summaries of the watchlist and workout cases at 31 December 2010 and 2009 by portfolio and assessment of risk are:

										Impairment loss allowances(2)	
2010	Portfolio £m	Monitor £m	Monitor %	Active £m	Active %	Workout £m	Workout %	NPL(1) £m	NPL %	Observed £m	IBNO £m
Corporate – SME	**584**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Corporate – Other	**3,172**	**23**	**1**	**6**	**-**	**83**	**3**	**23**	**1**	**3**	**-**
Real Estate	**4,061**	**293**	**7**	**309**	**8**	**544**	**13**	**369**	**9**	**77**	**29**
Social Housing	**9,234**	**179**	**2**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total	**17,051**	**495**	**3**	**315**	**2**	**627**	**4**	**392**	**2**	**80**	**29**

										Impairment loss allowances(2)	
2009	Portfolio £m	Monitor £m	Monitor %	Active £m	Active %	Workout £m	Workout %	NPL(1) £m	NPL %	Observed £m	IBNO £m
Corporate – SME	549	-	-	-	-	-	-	-	-	-	-
Corporate – Other	2,453	42	2	-	-	66	3	53	2	34	-
Real Estate	3,145	249	8	348	11	164	5	164	5	30	14
Social Housing	8,597	500	6	-	-	-	-	-	-	-	-
Total	14,744	791	5	348	2	230	2	217	1	64	14

(1) Includes committed facilities and swaps.
(2) Includes impairment loss allowances on commercial mortgages managed by Corporate Banking Credit Risk.

Exposures are classified as 'workout' if they are non-performing loans or have been passed for management to the Risk Division. Exposures are classified as 'active' if they are included in the three categories (extinguish, secure and reduce) being actively managed. Exposures are classified as 'monitor' if they are being passively managed. These are described in 'Risk monitoring and control' above. Non-performing loans are discussed in 'Corporate Banking non-performing loans and advances' below.

Corporate Banking arrears

	2010 £m	2009 £m
Total Corporate Banking customer assets in arrears	**287**	123
Total Corporate Banking customer assets(1)	**12,118**	11,097
Corporate Banking customer assets in arrears as a % of Corporate Banking customer assets	**2.4%**	1.1%

(1) Corporate Banking customer assets include large corporate customer assets managed within Global Banking & Markets, social housing loans and finance leases. Accrued interest is excluded for purposes of these analyses.

Notes to the Financial Statements continued

Loan arrears, collection and rehabilitation of accounts

When a loan is in arrears, the account is considered due and classified in the "Workouts and Collections" category. The Workouts & Collections department, as well as credit partners, are responsible for debt management initiatives on the loan portfolio for Corporate Banking. Debt management strategies, which include negotiating restructuring or repayment arrangements and concessions, often commence prior to actual payment default. Different collection strategies are applied to different segments of the portfolio subject to the perceived levels of risk and the individual circumstances of each case.

Workouts & Collections activities exist to ensure customers who have failed or are likely to fail to make their contractual payments when due or have exceeded their agreed credit limits are encouraged to pay back the required amounts, and in the event they are unable to do so to pursue recovery of the debt in order to maximise the net recovered balance.

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

Restructuring approaches

Problem debt management activity is performed within Santander UK:

> Initially by the relationship manager and, for non standardised cases, the credit partner, and
> Subsequently by Workouts & Collections where the circumstances of the case become more critical or specialist expertise is required.

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

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

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

Loans restructured or renegotiated

Loans may be restructured or renegotiated by capitalising the arrears on the customer's account. Strategies are bespoke to each individual case and achieved through negotiation with the customer. The aim of agreeing to a restructuring with a customer is to bring the Group's exposure back within acceptable risk levels by negotiating suitable revised terms, conditions and pricing, including reducing the amount of the outstanding debt or increasing the amount of collateral provided to the Group. The Group seeks to retain the customer relationship where possible, provided the Group's risk position is not unduly compromised.

Solutions in a restructuring may include:

a) **Payment arrangements** – discretion exists to vary the repayment schedule to allow customers to bring the account up to date. Repayments may be re-profiled to better reflect the forecast cashflows of the business or pending asset disposals. The objective is to bring the account up to date as soon as possible.

b) **Refinancing** – The Group may offer a term extension or interest only concession provided that the forecasts indicate that the borrower will be able to meet the revised payment arrangements.

> **Term Extensions** - the term of the credit facility may be extended to reduce the regular periodic repayments if all other collections tools have been exhausted, and where as a minimum, the interest can be serviced and there is a realistic prospect of full or improved recoveries in the foreseeable future. Customers may be offered a term extension where they are up-to-date but showing evidence of financial difficulties, or are already in the Workouts & Collections process.
> **Interest Only Concessions** – the regular periodic repayment may be reduced to interest payment only for a limited period with capital repayment deferred if all other collections tools have been exhausted and a term extension is either not possible or affordable. Customers may be offered an interest only concession where they are up-to-date but showing evidence of financial difficulties, or are already in the Workouts & Collections process. Periodic reviews of the customer financial situation are undertaken to assess when the customer can afford to return to the repayment method.

c) **Other** – The Group may also pursue other solutions, in limited circumstances, as follows:

> **Provision of additional security or guarantees** – Where a borrower has unencumbered assets, these may be charged as new or additional security in return for the Group restructuring existing facilities. Alternatively, the Group may take a guarantee from other companies within the borrower's group and/or major shareholders provided it can be established the proposed guarantor has the resources to support such a commitment.

Notes to the Financial Statements continued

- **Resetting of covenants and trapping surplus cashflow** – Financial covenants may be reset at levels which more accurately reflect the current and forecast trading position of the borrower. This may also be accompanied by a requirement for all surplus cash after operating costs to be trapped and used in reduction of the Group's lending.
- **Seeking additional equity** – Where a business is over-leveraged, fresh equity capital will be sought from existing or new investors to adjust the capital structure in conjunction with the Group agreeing to restructure the residual debt.
- **Debt-for-equity swaps** – In circumstances where a borrower's balance sheet is materially over-leveraged but the underlying business is viewed as capable of being turned around, the Group may agree to reduce the debt by exchanging a portion of it for equity in the company. This will typically only be done alongside new cash equity being raised, the implementation of a detailed business plan to effect a turnaround in the prospects of the business, and satisfaction with management's ability to deliver the strategy.

Where a restructuring has been agreed, the case is initially retained in the "non-performing" loan category, if it was so categorised prior to the restructuring until evidence of consistent compliance with the new terms is demonstrated (typically a minimum of three months) before being reclassified as "substandard". If the loan was not categorised as non-performing at the time the revised arrangements were agreed, the case is considered to be a renegotiation and may be reclassified to substandard. Once a substandard case has demonstrated continued compliance with the new terms and the risk profile is deemed to have improved it may be reclassified as "performing".

The majority of corporate loan restructurings to date have been by way of term extensions and payment reprofiling (e.g. interest only concessions), with only a limited number of debt for equity swaps. Loan loss allowances are assessed on a case by case basis taking into account amongst other factors, the value of collateral held as confirmed by third party professional valuations as well as the cashflow available to service debt over the period of the restructuring. These loan loss allowances are assessed regularly and are independently reviewed both at quarterly provision review forum, as well as by the internal audit department. In the case of a debt for equity conversion, the converted debt is written off against the existing loan loss allowance upon completion of the restructuring. The value of the equity acquired is reassessed periodically in light of subsequent performance of the restructured company. At 31 December 2010, the restructured corporate loans remain in compliance with the revised terms agreed.

Exit the position consensually

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

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

Litigation and recovery

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

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

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

Notes to the Financial Statements continued

Impairment losses on loans and advances to customers

The Group's impairment loss allowances policy for corporate assets is set out in Note 1 to the Consolidated Financial Statements.

Corporate Banking analysis of impairment loss allowances on loans and advances to customers

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

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Observed impairment loss allowances					
Corporate loans - UK	**79**	63	13	-	-
Total observed impairment loss allowances	**79**	63	13	-	-
Incurred but not yet observed impairment loss allowances					
Corporate loans - UK	**29**	14	13	-	-
Total incurred but not yet observed impairment loss allowances	**29**	14	13	-	-
Total impairment loss allowances	**108**	77	26	-	-

Corporate Banking movements in impairment loss allowances on loans and advances

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

	2010 £m	2009 £m
Impairment loss allowances at the start of the year	**77**	26
Amounts written off:		
- Corporate Loans – UK	**(49)**	-
Total amounts written off	**(49)**	-
Observed impairment losses charged against profit:		
- Corporate Loans – UK	**65**	50
Total observed impairment losses charged against profit	**65**	50
Incurred but not yet observed impairment losses charged against profit	**15**	1
Total impairment losses charged against profit	**80**	51
Impairment loss allowances at the end of the year	**108**	77

Corporate Banking recoveries

An analysis of the Corporate Banking recoveries is presented below.

	2010 £m	2009 £m
Corporate Loans – UK	**11**	21
Total amount recovered	**11**	21

Corporate Banking non-performing loans and advances(1)

	2010 £m	2009 £m
Corporate Banking non-performing loans and advances that are impaired	**288**	122
Corporate Banking non-performing loans and advances that are not impaired	**84**	76
Total Corporate Banking non-performing loans and advances(2)	**372**	198
Total Corporate Banking customer assets(3)	**12,118**	11,097
Total Corporate Banking impairment loan loss allowances	**117**	92
	%	%
Non-performing loans and advances as a % of customer assets	**3.07%**	1.78%
Coverage ratio(4)	**31.45%**	46.46%

(1) Loans and advances are classified as non-performing typically when the counterparty fails to make payments when contractually due for three months or longer or where it is deemed unlikely that the counterparty will be able to maintain payments.
(2) All non-performing loans continue accruing interest.
(3) Corporate Banking customer assets include large corporate customer assets managed within Global Banking & Markets, social housing loans and finance leases. Accrued interest is excluded for purposes of these analyses.
(4) Impairment loan loss allowances as a percentage of non-performing loans and advances.

In 2010, non-performing loans and advances as a percentage of customers assets increased to 3.07% from 1.78% at 31 December 2009 due to some deterioration arising from market conditions. This particularly affected customers in the real estate.

Notes to the Financial Statements continued

In 2010, both non-performing loans and advances and impairment loss allowances increased. While the level of new non-performing loans was broadly in line with expectations, the options available for managing them were reduced compared to 2009, particularly the ability to raise equity capital, to sell the asset or to conclude refinancing. The real estate market became more challenging as the year progressed, with reduced sales activity especially for development finance and land-bank transactions and for older transactions underwritten in 2008 and earlier years. The year-end position was also influenced by a small number of large value transactions which defaulted late in the year but are expected to be restructured during 2011.

Interest income recognised on impaired loans amounted to £4m (2009: £3m).

Credit risk mitigation

Collateralisation

The Social Housing portfolio is secured on residential real estate owned and let by UK Housing Associations. In the real estate portfolio, collateral is in the form of commercial real estate assets. The corporate portfolio is largely unsecured but typically incorporates guarantee structures underpinned by both financial and non-financial covenants and in the case of SME clients debenture security is typically held. There are also a small number of Private Finance Initiative ('PFI') transactions where collateral is held in the form of a charge over the underlying concession contract.

Lending to commercial real estate is undertaken against an approved mandate setting minimum criteria including such aspects as the quality (e.g. condition and age) and location of the property, the quality of the tenant, the terms and length of the lease, and the experience and creditworthiness of the sponsors. Properties are viewed by the Group prior to lending and annually thereafter. An independent professional valuation is obtained prior to lending, providing both a value and an assessment of the property, tenant and future demand for the property (e.g. market rent compared to the current rent). Loan agreements permit bi-annual valuations thereafter or more frequently if it is likely that the covenants may be breached.

When a commercial real estate loan is transferred to FEVE or Workouts and Collections, the Group typically undertakes a revaluation of the collateral as part of the process for determining the strategy to be pursued (e.g. whether to restructure the loan or to realise the collateral). An assessment is made of the need to establish an impairment loss allowance based on the valuation in relation to the loan amount outstanding, while also taking into consideration any loan restructuring solution to be adopted (e.g. whether provision of additional security or guarantees is available, the prospects of additional equity and the ability to enhance value through asset management initiatives).

Restructured loans

As described above, loans may be restructured or renegotiated where customers in arrears have maintained an agreed monthly repayment for a specified period. As at 31 December 2010, there were no financial assets that would otherwise be past due or impaired whose terms have been renegotiated (2009: £54m).

Notes to the Financial Statements continued

Credit Risk - ALM

The Group is responsible for managing Santander UK's structural balance sheet shape, the Treasury asset portfolio and, in conjunction with Risk Division, strategic and tactical liquidity risk management. This includes short-term and medium-term funding, covered bond and securitisation programmes. ALM's responsibilities also include Santander UK's banking products and structural exposure to interest rates and, in that role, is a link between the Santander UK Global Banking & Markets and all other divisions. ALM recommends and helps to implement Board, Asset and Liability Management Committee and Risk Committee policies for all aspects of balance sheet management - formulating guidance for, and monitoring, the overall balance sheet shape, including maturity profile.

Definition

Credit risk is the risk of financial loss arising from the default of a customer or counterparty to which the Group has directly provided credit, or for which the Group has assumed a financial obligation, after realising collateral held. Credit risk arises by ALM making loans (including to other businesses within the Group) and investing in debt securities. Credit risk also arises by ALM investing in other financial instruments (including assets held for liquidity purposes and assets held in the Treasury asset portfolio which is being run down) or entering into financing transactions or derivative contracts.

Managing credit risk

ALM aims to actively manage and control credit risk. Credit risk is managed by Santander UK's Wholesale Credit Risk Team in accordance with limits, asset quality plans and criteria approved by the Board with respect to risk appetite parameters, and as set out in other relevant policy statements. All exposures, including intra-group items, are captured on the global risk management systems and fall within limits approved by Santander Risk Division. Decisions are based on independent credit risk analysis, supplemented by the output of internal ratings tools and external rating agency analysis.

The Treasury asset portfolio is monitored for potential impairment through a detailed expected cashflow analysis taking into account the structure and underlying assets of each individual security. Once specific events give rise to a reasonable expectation that future anticipated cash flows may not be received, the asset originating these doubtful cash flows will be deemed to be impaired. Objective evidence of loss events includes significant financial distress of the issuer and default or delinquency in interest and principal payments (breach of contractual terms).

ALM exposure by credit rating of the issuer or counterparty(1)

2010	**Sovereign £m**	**Corporates £m**	**Banks and Financial Institutions £m**	**Total £m**
AAA	**5,373**	**342**	**14**	**5,729**
AA	**183**	**8**	**29**	**220**
A	**-**	**1**	**97**	**98**
BBB and below	**-**	**-**	**1**	**1**
Total	**5,556**	**351**	**141**	**6,048**

2009(2)	Sovereign £m	Corporates £m	Banks and Financial Institutions £m	Total £m
AAA	1,977	2,731	-	4,708
AA	89	762	5,239	6,090
A	-	-	3,718	3,718
BBB and below	-	1	1,343	1,344
Total	2,066	3,494	10,300	15,860

(1) External ratings are applied to all exposures where available.
(2) 2009 included exposures to subsidiaries previously outside the Santander UK plc Group, Santander Cards Limited and Santander Consumer (UK) plc. In 2010, the Company acquired those businesses and the Group's exposures to them were eliminated on consolidation. Following consolidation, credit exposures arising in those businesses have been reported within the Retail Banking and Corporate Banking divisions.

Notes to the Financial Statements continued

ALM exposure by geographical area

2010	Sovereign £m	Corporates £m	Banks and Financial Institutions £m	Total £m
UK	**49**	**5**	**18**	**72**
Rest of Europe	**183**	**181**	**121**	**485**
US	**5,139**	**165**	**1**	**5,305**
Rest of the world	**185**	**-**	**1**	**186**
Total	**5,556**	**351**	**141**	**6,048**

2009(1)	Sovereign £m	Corporates £m	Banks and Financial Institutions £m	Total £m
UK	144	1	3,932	4,077
Rest of Europe	1,085	3,483	5,300	9,868
US	446	10	1,040	1,496
Rest of the world	391	-	28	419
Total	2,066	3,494	10,300	15,860

(1) External ratings are applied to all exposures where available.
(2) 2009 included exposures to subsidiaries previously outside the Santander UK plc Group, Santander Cards Limited and Santander Consumer (UK) plc. In 2010, the Company acquired those businesses and the Group's exposures to them were eliminated on consolidation. Following consolidation, credit exposures arising in those businesses have been reported within the Retail Banking and Corporate Banking divisions.

The increase in exposure to issuers and counterparties rated AAA during 2010 principally reflected increased holdings of liquid assets.

OTC derivative exposure by credit rating of the issuer or counterparty(1)

2010	Sovereign £m	Corporates £m	Banks and Financial Institutions £m	Total £m
AAA	**-**	**-**	**-**	**-**
AA	**-**	**-**	**19**	**19**
A	**-**	**-**	**15**	**15**
BBB and below	**-**	**-**	**-**	**-**
Total	**-**	**-**	**34**	**34**

2009(2)	Sovereign £m	Corporates £m	Banks and Financial Institutions £m	Total £m
AAA	-	-	-	-
AA	-	-	43	43
A	-	-	8	8
BBB and below	-	-	-	-
Total	-	-	51	51

(1) External ratings are applied to all exposures where available.
(2) 2009 included exposures to subsidiaries previously outside the Santander UK plc Group, Santander Cards Limited and Santander Consumer (UK) Plc. In 2010, the Company acquired those businesses and the Group's exposures to them were eliminated on consolidation. Following consolidation, credit exposures arising in those businesses have been reported within the Retail Banking and Corporate Banking divisions.

ALM – Watchlist

The ALM exposures are managed by the Wholesale Credit Risk Department using the same process as for the Global Banking & Markets Banks and Financial Institutions and Global Corporates exposures described in 'Global Banking & Markets – Watchlist' above. ALM exposures are managed at the FEVE Corporate Risk forum.

At 31 December 2010 and 2009, there were no impaired or non-performing loans or exposures and the assets in the Active category were nil (2009: £2.6m).

Restructured loans

As at 31 December 2010 and 2009, there were no financial assets that would otherwise be past due or impaired whose terms have been renegotiated.

Notes to the Financial Statements continued

Market Risk

Definition

Market risk is the risk of a reduction in economic value or reported income resulting from a change in the variables of financial instruments including interest rate, equity, credit spread, property and foreign currency risks. Market risk consists of trading and non-traded market risks. Trading market risk includes risks on exposures held with the intention of benefiting from short term price differences in interest rate variations and other market price shifts. Non-traded market risk includes, inter alia, interest rate risk in investment portfolios.

Interest rate risks primarily result from exposures to changes in the level, slope and curvature of the yield curve, the volatility of interest rates and mortgage prepayment rates. Equity risks result from exposures to changes in prices and volatilities of individual equities, equity baskets and equity indices. Credit spread risk arises from the possibility that changes in credit spreads will affect the value of financial instruments. Property risks result from exposures to changes in property prices. Foreign currency risks result from exposures to changes in spot prices, forward prices and volatilities of currency rates. The Group accepts that market risk arises from its full range of activities.

Managing market risk

The Group aims to actively manage and control market risk by limiting the adverse impact of market movements whilst seeking to enhance earnings within clearly defined parameters. The Market Risk Manual, which is reviewed and approved by the Head of Wholesale Risk on an annual basis, sets the framework under which market risks are managed and controlled. Business area policies, risk limits and mandates are established within the context of the Market Risk Manual.

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

The Group aims to ensure that exposure to market risks is measured and reported on an accurate and timely basis to senior management. In addition to the regular reporting for the purposes of active risk management, the Santander UK Board also receives reporting of all significant market risk exposures on a monthly basis where actual exposure levels are measured against limits. Market activity and liquidity of financial instruments are discussed in the relevant monthly Risk Forum as well as being part of the daily update given by each business at the start of the trading day. Senior management recognise that different risk measures are required to best reflect the risks faced in different types of business activities. In measuring exposure to market risk, the Group uses a range of complementary measures, covering both value and income as appropriate.

Market risk - Global Banking & Markets

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

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

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

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

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

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

Notes to the Financial Statements continued

Trading market risk

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

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

The following table shows the Value at Risk-based consolidated exposures for the major risk classes at 31 December 2010, 2009 and 2008, together with the highest, lowest and average exposures for the year. Exposures within each risk class reflect a range of exposures associated with movements in that financial market. For example, interest rate risks include the impact of absolute rate movements, movements between interest rate bases and movements in implied volatility on interest rate options. The range of possible statistical modelling techniques and assumptions mean these measures are not precise indicators of expected future losses, but are estimates of the potential change in the value of the portfolio over a specified time horizon and within a given confidence interval. Historical simulation models are used with appropriate add-ons to reflect unobservable inputs.

From time to time, losses may exceed the amounts stated where the movements in market rates fall outside the statistical confidence interval used in the calculation of the Value at Risk analysis. The 99% confidence interval means that the theoretical loss at a risk factor level is likely to be exceeded in one period in a hundred. This risk is addressed by monitoring stress-testing measures across the different business areas. For trading instruments the actual, average, highest and lowest value at risk exposures shown below are all calculated to a 99% level of confidence using a simulation of actual one day market movements over a one-year period. The effect of historic correlations between risk factors is additionally shown below. The use of a one-day time horizon for all risks associated with trading instruments reflects the horizon over which market movements will affect the measured profit and loss of these activities.

The amounts below represent the potential change in market values of trading instruments. Since trading instruments are recorded at market value, these amounts also represent the potential effect on income. All amounts presented below are based on a 99% confidence level and the comparatives have been updated accordingly.

	Actual Exposure at 31 December		
Group trading instruments	**2010 £m**	2009 £m	2008 £m
Interest rate risks	**3.0**	3.4	7.4
Equity risks	**1.9**	1.4	1.7
Credit spread risks	**0.6**	1.6	2.7
Property risks	**2.9**	8.5	9.6
Other risks(1)	**0.3**	0.6	1.3
Correlation offsets(2)	**(1.4)**	(3.3)	(3.5)
Total correlated one-day Value at Risk	**7.3**	12.2	19.2

	Exposure for the year ended 31 December								
	Average exposure			Highest exposure			Lowest exposure		
Group trading instruments	**2010 £m**	2009 £m	2008 £m	**2010 £m**	2009 £m	2008 £m	**2010 £m**	2009 £m	2008 £m
Interest rate risks	**3.5**	5.5	5.1	**6.1**	8.8	7.9	**2.2**	2.3	3.5
Equity risks	**1.9**	2.0	2.8	**2.7**	3.8	5.0	**1.4**	1.1	1.4
Credit spread risks	**1.1**	3.6	1.8	**1.6**	4.8	4.0	**0.6**	1.6	0.7
Property risks	**5.6**	8.6	6.6	**9.1**	9.8	10.5	**2.9**	7.8	4.5
Other risks(1)	**0.3**	1.0	0.9	**0.8**	1.4	1.4	**0.2**	0.4	0.3
Correlation offsets(2)	**(2.2)**	(4.4)	(3.1)	**-**	-	-	**-**	-	-
Total correlated one-day Value at Risk	**10.2**	16.3	14.1	**15.4**	19.8	20.5	**6.6**	11.7	11.3

(1) Other risks include foreign exchange risk.

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

Property risks reduced significantly in 2010 due to the sale of a significant portion of one of the equity release portfolios to a third party. The increase in property risks between 2008 and 2009 was mainly due to higher equity release business funded by the Group during the two-year period. This was also due to the significant fall in interest rates (and consequently the discount rate used) in 2008 and 2009, which led to the increase in the present value of cash flows. As a result, there was an increase in sensitivity and hence, Value at Risk.

Value at Risk is not the only measure used by the Group. It is used because it is easy to calculate and because it provides a good reference of the level of risk incurred by the Group. However, other measures are also used to enable the Group to exercise greater risk control in the markets in which it operates.

Notes to the Financial Statements continued

One of these measures is scenario analysis, which consists of defining behaviour scenarios for various financial variables and determining the impact on results of applying them to the Group's activities. These scenarios can replicate past events (such as crises) or, conversely, determine plausible scenarios that are unrelated to past events. A minimum of three types of scenarios are defined (plausible, severe and extreme) which, together with Value at Risk, make it possible to obtain a more complete spectrum of the risk profile.

In addition, the market risk area, in accordance with the principle of independence of the business units, monitors daily the positions of each unit and the global positions, through an exhaustive control of changes in the portfolios, the aim being to detect possible incidents and correct them immediately. The daily preparation of an income statement is an important risk indicator, insofar as it allows the Group to identify the impact of changes in financial variables on the portfolios.

All activities are controlled daily using specific measures. Sensitivities to price fluctuations are calculated for cash instruments, while sensitivities to changes in underlyings, volatilities, correlations and time (theta) are calculated for derivatives.

Derivatives held for Trading Purposes

Global Banking & Markets is the only area of the Group actively trading derivative products and is additionally responsible for implementing most Group derivative hedging with the external market. For trading activities, Global Banking & Markets objectives are to gain value by marketing derivatives to end users and hedging the resulting exposures efficiently; and the management of trading exposure reflected on the Group's balance sheet. Trading derivatives include interest rate, cross currency, equity, residential property and other index related swaps, forwards, caps, floors, swaptions, as well as credit default and total return swaps, equity index contracts and exchange traded interest rate futures and equity index options.

Derivatives classified as held for trading or held for risk management purposes that have not been designated as in a hedging relationship (also known as economic hedges) are classified as derivatives held for trading in the Consolidated Financial Statements.

Market risk - Corporate Banking

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

Market risk - ALM

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

The most significant market risk in ALM is interest rate risk which includes yield curve and basis risks. Yield curve risk arises from the timing mismatch in the repricing of fixed and variable rate assets, liabilities and off-balance sheet instruments, as well as the investment of non-interest-bearing liabilities in interest-bearing assets. Basis risk arises, to the extent that the volume of administered variable rate assets and liabilities are not precisely matched, which exposes the balance sheet to changes in the relationship between administered rates and market rates.

Other risks that are inherent in ALM include credit spread, foreign currency, prepayment and launch risks. Credit spread risk arises principally on ALM's holdings of mortgage-backed securities. Foreign exchange risk arises from differences in the present value of existing foreign–currency denominated assets and liabilities, and future known cashflows. The Group is also exposed to risks arising from features in Santander UK's retail products that give customers the right to alter the expected cash flows of a financial contract. This creates prepayment risk, for example where customers may prepay loans before their contractual maturity. In addition, the Group is exposed to product launch risk, for example where the customers may not take up the expected volume of new fixed rate mortgages or other loans.

Managing market risk

The Asset and Liability Management Committee is responsible for managing the Group's overall balance sheet position. Natural offsets are used as far as possible to mitigate yield curve exposures but the overall balance sheet position is generally managed using derivatives that are transacted through Global Banking & Markets and with external counterparties. The Treasurer is responsible for managing risks in accordance with the Asset and Liability Management Committee's direction. Risks are managed within a three-tier limit structure defined by the Market Risk Manual:

- Global limits approved by Banco Santander, S.A.'s Board Risk Committee;
- Limits and triggers approved by Head of Wholesale Risk; and
- Local sub-limits set to control the exposures retained within individual business areas.

Notes to the Financial Statements continued

The key risk metrics, Net Interest Margin ('NIM') and Market Value of Equity ('MVE'), measure the Group's exposure to yield curve risk. The following table shows the results of these measures as at 31 December 2010 and 2009:

	2010 £m	2009 £m
Net Interest Margin Sensitivity to +100 basis points shift in yield curve	**309**	(38)
Market Value of Equity Sensitivity to +100 basis points shift in yield curve	**410**	2

Net Interest Margin and Market Value of Equity sensitivities are calculated based on market rate paths implied by the current yield curve, and based on contractual product features including re-pricing and maturity dates. The NIM and MVE sensitivities reflect how the base case valuations would be affected by a 100 basis point parallel shift applied instantaneously to the yield curve, and provide complementary views of the Group's exposure to interest rate movements.

MVE Sensitivity provides a long-term view covering the present value of all future cash flows, whereas NIM Sensitivity considers the impact on net interest margin over the next 12 months. The calculations for NIM and MVE sensitivities involve many assumptions, including expected customer behaviour (e.g. early repayment of loans) and how interest rates will evolve. The assumptions are reviewed and updated on a regular basis.

The movements in the sensitivities between 2009 and 2010 are largely explained by enhancements made to the assumptions and the closer alignment of the sensitivity calculations on certain portfolios during 2010 with the Santander risk modelling approach.

Derivatives

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

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

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

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

The following table summarises the activities undertaken within ALM including those executed on its behalf by Global Banking & Markets, the related risks associated with such activities and the types of hedging derivatives used in managing such risks. These risks may also be managed using on-balance sheet instruments as part of an integrated approach to risk management. Further information is contained in Note 15 of the Consolidated Financial Statements.

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

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

Notes to the Financial Statements continued

Funding and Liquidity Risk

Funding risk

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

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

For accounting purposes, wholesale funding comprises deposits by customers, deposits by banks, debt securities in issue and subordinated liabilities. Retail and Corporate funding is primarily classified as deposits by customers.

The funding risks of the Group are managed on a combined basis with Santander UK plc. For further information please refer to the funding risk discussion in the Risk Management Report in Santander UK plc's Consolidated Financial Statements.

Liquidity risk

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. Liquidity risks arise throughout the Group. Its primary business activity is commercial banking and, as such, it engages in maturity transformation, whereby callable and short-term commercial deposits are invested in longer-term customer loans.

The liquidity risks of the Group are managed on a combined basis with Santander UK plc. For further information please refer to the liquidity risk discussion in the Risk Management Report in Santander UK plc's Consolidated Financial Statements.

Maturities of financial liabilities

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

						Group
At 31 December 2010	**Demand £m**	**Up to 3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Deposits by banks	**4,484**	**48,457**	**29,120**	**40,196**	**15,291**	**137,548**
Deposits by customers	**476**	**615**	**261**	**5,580**	**204**	**7,136**
Trading liabilities	**1,329**	**35,088**	**4,229**	**1,770**	**705**	**43,121**
Financial liabilities designated at fair value	**-**	**1,299**	**542**	**860**	**1,058**	**3,759**
Loan commitments	**4**	**79**	**605**	**1,816**	**5,163**	**7,667**
Debt securities in issue	**-**	**10,745**	**4,702**	**11,121**	**10,246**	**36,814**
Subordinated liabilities	**-**	**8**	**24**	**130**	**424**	**586**
	6,293	**96,291**	**39,483**	**61,473**	**33,091**	**236,631**
Derivative financial instruments	**-**	**74**	**16**	**199**	**1,908**	**2,197**
Total financial liabilities	**6,293**	**96,365**	**39,499**	**61,672**	**34,999**	**238,828**

						Company
At 31 December 2010	**Demand £m**	**Up to 3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Deposits by banks	**4,433**	**48,467**	**29,102**	**40,196**	**15,288**	**137,486**
Deposits by customers	**479**	**4,726**	**3,023**	**5,642**	**204**	**14,074**
Trading liabilities	**1,329**	**35,088**	**4,229**	**1,770**	**705**	**43,121**
Financial liabilities designated at fair value	**-**	**1,237**	**542**	**860**	**1,058**	**3,697**
Loan commitments	**4**	**79**	**605**	**1,816**	**5,163**	**7,667**
Debt securities in issue	**-**	**6,847**	**4,162**	**11,121**	**10,246**	**32,376**
	6,245	**96,444**	**41,663**	**61,405**	**32,664**	**238,421**
Derivative financial instruments	**-**	**74**	**16**	**199**	**1,908**	**2,197**
Total financial liabilities	**6,245**	**96,518**	**41,679**	**61,604**	**34,572**	**240,618**

Notes to the Financial Statements continued

At 31 December 2009	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Group Total £m
Deposits by banks	8,355	66,042	28,587	40,077	26,358	169,419
Deposits by customers	1,416	1,996	240	5,202	712	9,566
Trading liabilities	2,851	37,554	3,204	2,430	443	46,482
Financial liabilities designated at fair value	-	996	590	2,279	487	4,352
Loan commitments	27,050	10,765	12	1,042	2,055	40,924
Debt securities in issue	-	11,852	5,175	2,620	10,604	30,251
Subordinated liabilities	-	40	24	130	457	651
	39,672	129,245	37,832	53,780	41,116	301,645
Derivative financial instruments	-	54	341	1,719	255	2,369
Total financial liabilities	39,672	129,299	38,173	55,499	41,371	304,014

At 31 December 2009	Demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Company Total £m
Deposits by banks	8,354	65,913	28,572	40,087	26,359	169,285
Deposits by customers	1,400	10,030	304	5,266	710	17,710
Trading liabilities	1,758	5,498	1,019	5,110	443	13,828
Financial liabilities designated at fair value	-	996	590	2,279	429	4,294
Loan commitments	98	32	12	1,042	2,055	3,239
Debt securities in issue	-	5,548	5,111	2,620	10,604	23,883
	11,610	88,017	35,608	56,404	40,600	232,239
Derivative financial instruments	-	54	341	1,719	255	2,369
Total financial liabilities	11,610	88,071	35,949	58,123	40,855	234,608

As the above table is based on contractual maturities, no account is taken of call features related to subordinated liabilities. The repayment terms of the debt securities may be accelerated in line with the covenants, as described in Note 32 to the Consolidated Financial Statements. The maturity analyses above for derivative financial liabilities include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows. These consist of interest rate swaps and cross-currency swaps which are used to hedge the Group's exposure to interest rates and exchange rates, and all loan commitments.

Operational Risk (unaudited)

The Group's operational risks are managed at a Santander UK level.

Definition

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

Objectives

The basic aim pursued by the Group in operational risk control and management is to identify, measure/assess, control/mitigate and inform about this risk. The Group's priority, therefore, is to identify and eliminate any clusters of operational risk, irrespective of whether losses have been incurred. Measurement of this risk also contributes to the establishment of priorities in operational risk management.

For the purpose of calculating regulatory capital for operational risk, Santander UK currently employs the standardised approach provided for under the Basel II rules in line with the Banco Santander, S.A. group:

> use of Risk Self-Assessments;
> use of Key Risk Indicators to monitor risks and set tolerance levels;
> capture and analysis of losses and incidents; and
> scenario analysis.

The Group continues to assess the most appropriate time to shift to the advanced measurement approach ('AMA').

Notes to the Financial Statements continued

Managing operational risk

Santander UK undertakes extensive activity to minimise the impacts operational risks may have on business areas. An independent central operational risk function (Enterprise and Operational Risk) has responsibility for establishing the framework within which these risks are managed and is aligned to operational risk professionals within business areas (co-ordinated by IT and Operational Risk) to ensure consistent approaches are applied across Santander UK. The primary purpose of the framework is to define and articulate the Santander UK-wide policy, processes, roles and responsibilities. The framework incorporates industry practice and regulatory requirements.

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

Key operational risk activity in 2010

During 2010, Santander UK continued to manage its key operational risk in the interest of all its stakeholders, responding to critical developments both within the organisation and in the environment in which it operated.

Over recent years, Santander UK has grown significantly. It has integrated Abbey, the Bradford & Bingley savings business and Alliance & Leicester into its UK operations. In 2009, Santander UK concentrated on integrating the Bradford & Bingley savings business and Alliance & Leicester group systems, with further focus on Alliance & Leicester throughout 2010. This period of growth was challenging in a time of turbulence in financial markets and many actions were taken to minimise the operational risks arising whilst meeting key customer requirements. For example:

> The creation of 1,000 UK-based customer-facing roles in branches and call centres to help improve customer service at the busiest times.

> All of Santander UK's 25 million customers were brought together from the three different banks and given access to more than 1,400 branches (including agencies) in the UK.

> A dedicated complaints helpline was set up, staffed by a team of complaints experts to deal with problems that arise both quickly and decisively.

> Improvements to the bank account switcher process were made to make it quicker and simpler for customers, and to reduce the likelihood of errors.

Santander UK has taken advantage of the growth it has generated to make customer service a priority, striving to ensure its processes meet customers' requirements not only now, but also for the future. In October 2010, all of the existing activities of Cater Allen International Limited (a subsidiary of the Company) were transferred to the Company. This was a main operational change due to the process and system integration of Cater Allen International Limited's businesses into the Company.

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

Santander UK has also invested heavily in fraud prevention systems, processes and controls as well as in the education of front line and back office staff in order to counter the increasing threat of financial crime and to safeguard the investments of the Group's customers and assets.

Regulatory, legal and compliance risk

Regulatory, legal and compliance risk is the risk of reductions in earnings and/or value, through financial or reputational loss, from failing to comply with the laws, regulations or codes applicable.

Regulatory, legal and compliance exposure is driven by the significant volume of current legislation and regulation with which the Group has to comply, along with new legislation and regulation which needs to be reviewed, assessed and embedded into day-to-day operational and business practices across the Group as a whole. Following the financial crisis, the pace and extent of regulatory reform proposals both in the UK and internationally have increased significantly, and can be expected to remain at high levels. Future changes in regulation, fiscal or other policies are unpredictable and beyond the control of the Group, but could for instance affect the Group's future business strategy, structure or approach to funding. Further uncertainties arise where regulations are principles-based without the regulator defining supporting minimum standards either for the benefit of the consumer or firms. This gives rise to both the risk of retrospection from any one regulator and also to the risk of differing interpretation by individual regulators.

For legal and regulatory issues there are significant reputational impacts associated with potential censure which drive the Group's stance on the appetites referred to above. There are clear accountabilities and processes in place for reviewing new and changing requirements. Each division and significant business areas have a nominated individual with 'compliance oversight' responsibility under UK Financial Services Authority rules. The role of such individuals is to advise and assist management to ensure that each business has a control structure which creates awareness of the rules and regulations, to which the Group is subject, and to monitor and report on adherence to these rules and regulations.

Notes to the Financial Statements continued

Basel II

The Group's risk management complies with Basel principles. A combination of the advanced and foundation internal ratings-based approaches was employed for the principal portfolios. For the remaining credit exposures, currently on the Basel II standardised approach, a rolling programme of transition to the appropriate IRB approach is underway. The standardised approach for Operational Risk continued to be applied during 2010.

The Group applied Basel II to its Internal Capital Adequacy Assessment Process ('ICAAP') and to the risk and capital disclosures made to the market. This includes the amendments introduced to the Capital Requirements Directive that were applicable in 2010.

The Group has applied Banco Santander S.A.'s approach to risk management in its application of Basel II. Further information on the Group's capital position under Basel II is included in Note 45 to the Consolidated Financial Statements. Further information on the Basel II risk measurement of the Group's exposures will be included in Banco Santander S.A.'s Pillar 3 report. The Pillar 3 disclosures for Santander UK, of which the Group is part, can be found in the Santander UK plc Consolidated Financial Statements.

Forthcoming regulatory changes

In forecasting the Group's capital and liquidity positions, the implications of forthcoming regulatory changes (commonly referred to as Basel III), have been taken into account. In cases where proposed rules are still in the formative stage, the Group has applied appropriately conservative assumptions. Similarly, a conservative approach has been adopted in respect of the proposed implementation timescales, to allow for acceleration by the regulatory authorities.

Other Risks (Unaudited)

Business/strategic risk

Definition

Business/strategic risk is the current or prospective risk to earnings and capital arising from changes in the business environment and from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment. This includes pro-cyclicality and capital planning risk. The internal component is the risk related to implementing the strategy. The external component is the risk of the business environment change on the firm's strategy.

Managing business/strategic risk

Business/strategic risk is managed on a monthly basis by the Risk Committee via the Economic Capital model. This is further discussed in the 'Economic capital' section.

Reputational risk

Definition

Reputational risk is the risk of financial loss or reputational damage arising from treating customers unfairly, a failure to manage risk, a breakdown in internal controls, or poor communication with stakeholders. This includes the risk of decline in the value of the Group's franchise potentially arising from reduced market share, complexity, tenor and performance of products and distribution mechanisms.

Managing reputational risk

Reputational risk is managed within the operational risk framework and other internal control and approval processes.

Notes to the Financial Statements continued

Impact of the Current Credit Environment

Introduction

This section contains disclosures about the effect of the current credit environment on the Group's financial instruments including structured products. The Group aims to actively manage these exposures.

The Group's financial instruments which have been most affected by the current credit environment include floating rate notes ('FRNs') (including the Group's exposures to Structured Investment Vehicles ('SIVs')), asset-backed securities ('ABS') (including mortgage-backed securities ('MBS') and the Group's exposures to monoline insurers), Collateralised Debt Obligations ('CDOs'), Collateralised Loan Obligations ('CLOs'), loans to banks, certain credit derivatives and off-balance sheet entities. Details of the Group's investing and lending arrangements with respect to these instruments are set out below.

In November 2010, the Group acquired a portfolio of loans to banks, asset-backed securities and certain credit derivatives, as part of an alignment of portfolios across the Banco Santander, S.A. group. The following disclosures include the financial instruments recognised as a result of the acquisition of that portfolio.

Classification in the Consolidated Balance Sheet

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

2010

		Type of Financial Instrument analysed further								
Balance sheet line item	Note	**FRNs £m**	**ABS £m**	**Loans £m**	**Deriv-atives £m**	**Other £m**	**Sub-total £m**	**OECD Govt debts £m**	**Bank & building society CDs £m**	**Total £m**
Trading assets – debt securities	14	**10,901**	**-**	**-**	**-**	**-**	**10,901**	**6,630**	**290**	**17,821**
Derivatives – equity & credit contracts	15	**-**	**-**	**-**	**38**	**-**	**38**	**-**	**-**	**38**
Financial assets designated at fair value – debt securities	16	**-**	**1,046**	**-**	**-**	**-**	**1,046**	**-**	**-**	**1,046**
Loans and advances to banks	17	**-**	**-**	**146,412**	**-**	**-**	**146,412**	**-**	**-**	**146,412**
Loans and receivables securities	21	**-**	**626**	**-**	**-**	**-**	**626**	**-**	**-**	**626**
		10,901	**1,672**	**146,412**	**38**	**-**	**159,023**	**6,630**	**290**	**165,943**

2009

		Type of Financial Instrument analysed further								
Balance sheet line item	Note	FRNs £m	ABS £m	Loans £m	Deriv-atives £m	Other £m	Sub-total £m	OECD Govt debts £m	Bank & building society CDs £m	Total £m
Trading assets – debt securities	14	11,128	-	-	-	13	11,141	2,856	1,935	15,932
Derivatives – equity & credit contracts	15	-	-	-	-	-	-	-	-	-
Financial assets designated at fair value – debt securities	16	-	3,446	-	-	-	3,446	-	2,220	5,666
Loans and advances to banks	17	-	-	191,749	-	-	191,749	-	-	191,749
Loans and receivables securities	21	-	736	-	-	160	896	-	-	896
		11,128	4,182	191,749	-	173	207,232	2,856	4,155	214,243

Additional analysis is presented below of the above financial instruments, except for the categories "OECD Govt debts" and "Bank & building society CDs". Further detail on those assets is set out in Note 14 to the Consolidated Financial Statements. The income statement movement below excludes the effects of changes in foreign exchange rates.

Summary

The balance sheet position at the year end and income statement movements during the year for these financial instruments may be summarised as follows. In respect of the income statement movement during the year, fair value changes relate to financial instruments accounted for at fair value, and impairment losses relate to financial instruments accounted for at amortised cost, subject to impairment loss allowances.

2010

				2010 Income statement movement[1]	
	Nominal £m	**Book value £m**	**Fair value £m**	**Fair value changes £m**	**Impairment losses £m**
Floating rate notes	**10,835**	**10,901**	**10,901**	**27**	**-**
Asset backed securities	**1,679**	**1,672**	**1,683**	**64**	**-**
Loans	**146,412**	**146,412**	**146,412**	**-**	**-**
Derivatives	**657**	**38**	**38**	**-**	**-**
Other investments	**-**	**-**	**-**	**-**	**-**
Total	**159,583**	**159,023**	**159,034**	**91**	**-**

Notes to the Financial Statements continued

2009	Nominal	Book value	Fair value	2009 Income statement movement[1] Fair value changes	Impairment losses
	£m	£m	£m	£m	£m
Floating rate notes	11,077	11,128	11,128	141	-
Asset backed securities	4,187	4,182	4,182	131	-
Loans	191,749	191,749	191,749	-	-
Other investments	173	173	173	2	-
Total	207,186	207,232	207,232	274	-

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

The fair value of these financial instruments may be analysed by credit rating of the issuer or counterparty as follows:

2010[1]	**FRNs £m**	**Others £m**	**Total £m**
AAA	**10,794**	**1,303**	**12,097**
AA^+	**-**	**325**	**325**
AA	**107**	**145,402**	**145,509**
A	**-**	**1,050**	**1,050**
BBB	**-**	**40**	**40**
Below BBB	**-**	**13**	**13**
Total	**10,901**	**148,133**	**159,034**

2009[1]	FRNs £m	Others £m	Total £m
AAA	10,449	3,394	13,843
AA^+	83	-	83
AA	559	190,563	191,122
A	32	2,016	2,048
BBB	4	142	146
Below BBB	1	-	1
Total	11,128	196,115	207,243

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

The remainder of this section further analyses each major type of these financial instruments by:

> Income statement movement by geographical location of issuer or counterparty;
> Vintage by geographical location of issuer or counterparty, where applicable;
> Income statement movement by credit rating of issuer or counterparty; and
> Vintage by credit rating of issuer or counterparty, where applicable.

Floating Rate Notes

(a) Income statement movement by geographical location of issuer or counterparty

2010	**Nominal value**		**Book value**	**Fair value**	**Fair value as % of nominal**	**2010 Income statement movement Fair value changes**	**Impairment losses**
Country	**£m**	**%**	**£m**	**£m**	**%**	**£m**	**£m**
UK	**9,776**	**90**	**9,891**	**9,891**	**101**	**24**	**-**
Spain	**14**	**-**	**14**	**14**	**100**	**-**	**-**
Rest of Europe	**767**	**7**	**701**	**701**	**91**	**2**	**-**
Rest of World	**278**	**3**	**295**	**295**	**106**	**1**	**-**
Total	**10,835**	**100**	**10,901**	**10,901**	**101**	**27**	**-**

2009	Nominal value		Book value	Fair value	Fair value as % of nominal	2009 Income statement movement Fair value changes	Impairment Losses
Country	£m	%	£m	£m	%	£m	£m
UK	8,975	81	9,025	9,025	101	95	-
Italy	-	-	-	-	-	1	-
Spain	44	-	44	44	100	4	-
Rest of Europe	1,482	14	1,482	1,482	100	30	-
US	22	-	4	4	18	-	-
Rest of World	554	5	573	573	103	11	-
Total	11,077	100	11,128	11,128	100	141	-

Notes to the Financial Statements continued

(b) Income statement movement by credit rating of issuer or counterparty

2010

						2010 Income statement movement	
	Nominal value		Book value	Fair value	Fair value as % of nominal	Fair value changes	Impairment losses
Credit rating	**£m**	**%**	**£m**	**£m**	**%**	**£m**	**£m**
AAA	**10,728**	**99**	**10,794**	**10,794**	**101**	**26**	**-**
AA	**107**	**1**	**107**	**107**	**100**	**1**	**-**
Total	**10,835**	**100**	**10,901**	**10,901**	**101**	**27**	**-**

2009

						2009 Income statement movement	
	Nominal value		Book value	Fair value	Fair value as % of nominal	Fair value changes	Impairment Losses
Credit rating	£m	%	£m	£m	%	£m	£m
AAA	10,385	94	10,449	10,449	101	136	-
AA+	83	1	83	83	100	-	-
AA	566	5	559	559	99	4	-
A	32	-	32	32	100	1	-
BBB	4	-	4	4	100	-	-
Below BBB	7	-	1	1	14	-	-
Total	11,077	100	11,128	11,128	100	141	-

Substantially all the AAA-rated FRNs held are issued by UK banks and guaranteed by the UK Government. The other FRNs held are principally issued by other banks and financial institutions. On average, the FRNs have 13 months to maturity (2009: 18 months).

Structured Investment Vehicles
As at 31 December 2010, the Group had no holdings in SIVs. As at 31 December 2009, the Group had SIV holdings with a nominal value of £14m against which impairment loss allowances of £11m had been raised, giving a book value of £3m. These SIV holdings were sold in 2010. The SIVs were formerly classified as floating rate notes in the balance sheet and included in the tables above.

Asset-Backed Securities

(a) Income statement movement by geographical location of issuer or counterparty

2010

						2010 Income statement movement	
	Nominal value		Book value	Fair value	Fair value as % of nominal	Fair value changes	Impairment losses
Country	**£m**	**%**	**£m**	**£m**	**%**	**£m**	**£m**
UK							
ABS	**79**	**5**	**76**	**76**	**98**	**-**	**-**
MBS	**1,095**	**65**	**1,134**	**1,145**	**105**	**22**	**-**
	1,174	**70**	**1,210**	**1,221**	**104**	**22**	**-**
US							
ABS	**37**	**2**	**29**	**29**	**78**	**-**	**-**
MBS	**9**	**1**	**14**	**14**	**156**	**6**	**-**
	46	**3**	**43**	**43**	**93**	**6**	**-**
Rest of Europe							
ABS	**125**	**7**	**119**	**119**	**95**	**35**	**-**
MBS	**175**	**10**	**163**	**163**	**93**	**1**	**-**
	300	**17**	**282**	**282**	**94**	**36**	**-**
Rest of World							
ABS	**43**	**3**	**35**	**35**	**81**	**-**	**-**
MBS	**116**	**7**	**102**	**102**	**88**	**-**	**-**
	159	**10**	**137**	**137**	**86**	**-**	**-**
Total	**1,679**	**100**	**1,672**	**1,683**	**100**	**64**	**-**

Notes to the Financial Statements continued

2009

Country	Nominal value £m	%	Book value £m	Fair value £m	Fair value as % of nominal %	2009 Income statement movement: Fair value changes £m	Impairment losses £m
UK							
MBS	1,012	24	1,012	1,012	100	9	-
	1,012	24	1,012	1,012	100	9	-
US							
MBS	23	1	23	-	-	-	-
	23	1	23	-	-	-	-
Rest of Europe							
ABS	232	6	227	227	98	14	-
MBS	2,920	70	2,920	2,943	101	108	-
	3,152	75	3,147	3,170	101	122	-
Total	4,187	100	4,182	4,182	100	131	-

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

2010

Country	Nominal £m	Original credit enhancements £m	Original sub-prime exposure £m	Original vintage: Pre-2005 %	2005 %	2006 %	2007 %	2008-2010 %
UK								
ABS	**79**	**-**	**-**	**-**	**-**	**100**	**-**	**-**
MBS	**1,095**	**-**	**-**	**18**	**1**	**24**	**57**	**-**
	1,174	**-**	**-**	**16**	**1**	**29**	**54**	**-**
US								
ABS	**37**	**-**	**-**	**100**	**-**	**-**	**-**	**-**
MBS	**9**	**-**	**-**	**100**	**-**	**-**	**-**	**-**
	46	**-**	**-**	**100**	**-**	**-**	**-**	**-**
Rest of Europe								
ABS	**125**	**-**	**-**	**32**	**47**	**18**	**3**	**-**
MBS	**175**	**-**	**-**	**1**	**1**	**56**	**42**	**-**
	300	**-**	**-**	**14**	**20**	**40**	**26**	**-**
Rest of World								
ABS	**43**	**-**	**-**	**100**	**-**	**-**	**-**	**-**
MBS	**116**	**-**	**-**	**-**	**-**	**-**	**100**	**-**
	159	**-**	**-**	**27**	**-**	**-**	**73**	**-**
Total	**1,679**	**-**	**-**	**19**	**4**	**27**	**50**	**-**

2009

Country	Nominal £m	Original credit enhancements £m	Original sub-prime exposure £m	Original vintage: Pre-2005 %	2005 %	2006 %	2007 %	2008-2009 %
UK								
MBS	1,012	-	-	25	16	26	33	-
	1,012	-	-	25	16	26	33	-
US								
MBS	23	-	-	100	-	-	-	-
	23	-	-	100	-	-	-	-
Rest of Europe								
ABS	232	-	-	22	-	42	36	-
MBS	2,920	-	-	88	-	7	5	-
	3,152	-	-	83	-	10	7	-
Total	4,187	-	-	69	4	14	13	-

Notes to the Financial Statements continued

(c) Income statement movement by credit rating of issuer or counterparty

2010

	Nominal value		Book value	Fair value	Fair value as % of nominal	2010 Income statement movement: Fair value changes	2010 Income statement movement: Impairment losses
Credit rating	**£m**	**%**	**£m**	**£m**	**%**	**£m**	**£m**
AAA							
ABS	**139**	**8**	**122**	**122**	**88**	**29**	**-**
MBS	**1,137**	**69**	**1,169**	**1,180**	**104**	**26**	**-**
	1,276	**77**	**1,291**	**1,302**	**102**	**55**	**-**
AA+							
ABS	**107**	**6**	**105**	**105**	**98**	**6**	
MBS	**214**	**13**	**200**	**200**	**93**	**3**	**-**
	321	**19**	**305**	**305**	**95**	**9**	**-**
A							
ABS	**22**	**1**	**19**	**19**	**86**	**-**	
MBS	**4**	**-**	**4**	**4**	**100**	**-**	**-**
	26	**1**	**23**	**23**	**88**	**-**	**-**
BBB							
MBS	**40**	**2**	**40**	**40**	**100**	**-**	**-**
	40	**2**	**40**	**40**	**100**	**-**	**-**
Below BBB							
ABS	**16**	**1**	**13**	**13**	**81**	**-**	**-**
	16	**1**	**13**	**13**	**81**	**-**	**-**
Total	**1,679**	**100**	**1,672**	**1,683**	**100**	**64**	**-**

2009

	Nominal value		Book value	Fair value	Fair value as % of nominal	2009 Income statement movement: Fair value changes	2009 Income statement movement: Impairment losses
Credit rating	£m	%	£m	£m	%	£m	£m
AAA							
ABS	230	5	225	225	98	14	-
MBS	3,056	73	3,056	3,079	101	110	-
	3,286	78	3,281	3,304	101	124	-
AA							
MBS	218	5	218	218	100	5	-
	218	5	218	218	100	5	-
A							
MBS	531	13	531	531	100	2	-
	531	13	531	531	100	2	-
BBB							
ABS	2	-	2	2	100	-	-
MBS	127	3	127	127	100	-	-
	129	3	129	129	100	-	-
Below BBB							
MBS	23	1	23	-	-	-	-
Total	23	1	23	-	-	-	-
	4,187	100	4,182	4,182	100	131	-

Notes to the Financial Statements continued

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

2010	Nominal	Original credit enhancements	Original sub-prime exposure	Original vintage				
				Pre-2005	2005	2006	2007	2008-2010
Credit rating	£m	£m	£m	%	%	%	%	%
AAA								
ABS	138	-	-	21	5	71	3	-
MBS	1,138	-	-	16	1	25	58	-
	1,276	-	-	16	2	30	52	-
AA+								
ABS	107	-	-	49	48	3	-	-
MBS	214	-	-	11	-	35	54	-
	321			23	16	25	36	-
A		-	-					
ABS	22	-	-	100	-	-	-	-
MBS	4			-	-	-	100	-
	26	-	-	86	-	-	14	-
BBB		-	-					
MBS	40	-	-	-	-	-	100	-
	40			-	-	-	100	-
Below BBB		-	-					
ABS	16	-	-	100	-	-	-	-
	16	-	-	100	-	-	-	-
Total	1,679	-	-	19	4	27	50	-

2009	Nominal	Original credit enhancements	Original sub-prime exposure	Original vintage				
				Pre-2005	2005	2006	2007	2008-2009
Credit rating	£m	£m	£m	%	%	%	%	%
AAA								
ABS	230	-	-	22	-	44	34	-
MBS	3,056	-	-	75	5	8	12	-
	3,286	-	-	71	5	10	14	-
AA								
MBS	218	-	-	-	-	89	11	-
	218	-	-	-	-	89	11	-
A								
MBS	531	-	-	100	-	-	-	-
	531	-	-	100	-	-	-	-
BBB								
ABS	2	-	-	100	-	-	-	-
MBS	127	-	-	-	-	16	84	-
	129	-	-	2	-	16	82	-
Below BBB								
MBS	23	-	-	100	-	-	-	-
	23	-	-	100	-	-	-	-
Total	4,187	-	-	69	4	14	13	-

Included above are ALT-A US asset-backed securities with book values of nil (2009: nil) and fair values of nil (2009: nil).

Collateral supporting asset-backed securities including mortgage-backed securities

The following table shows the vintages of the collateral assets supporting the Group's holdings of asset-backed securities and mortgage-backed securities at 31 December 2010 and 2009.

2010		Original vintage				
Asset Type	Nominal	Pre-2005	2005	2006	2007	2008-2010
	£m	%	%	%	%	%
Prime lending	1,679	19	4	27	50	-

2009		Original vintage				
Asset Type	Nominal	Pre-2005	2005	2006	2007	2008-2009
	£m	%	%	%	%	%
Prime lending	4,187	69	4	14	13	-

Notes to the Financial Statements continued

Monoline Insurers
The Group has a £42m (2009: £42m) exposure to corporate bonds and securitisations which are wrapped by monoline insurers. The principal risk exposures are recorded against the securitisations, with the monoline wraps being viewed as contingent exposures. The exposures to monoline insurers are classified as asset-backed securities in the balance sheet and are included in the tables above.

Collateralised Debt and Loan Obligations

The Group has no investments in Collateralised Debt Obligations or Collateralised Loan Obligations. However, in the ordinary course of business, the Group entered into long-term interest rate hedging contracts with five investment vehicles whose underlying assets comprise debt securities, bank loans and energy and infrastructure financings. Although the vehicles themselves are not externally rated, the counterparty exposure ranks super-senior to the most senior notes issued by the vehicles and these notes are rated AAA or AA. The total mark-to-market exposure at 31 December 2010 was £81m (2009: £100m).

Loans to banks

In November 2010, the Group acquired a portfolio of loans to banks, asset-backed securities and related credit derivatives, as part of an alignment of portfolios across the Banco Santander, S.A. group. The following disclosures relate to all the loans to banks held by the Group, including those recognised as a result of the acquisition of that portfolio.

(a) Income statement movement by geographical location of issuer or counterparty

2010

						2010 Income statement movement	
	Nominal value		Book value	Fair value	Fair value as % of nominal	Fair value changes	Impairment losses
Country	**£m**	**%**	**£m**	**£m**	**%**	**£m**	**£m**
UK	**144,080**	**99**	**144,080**	**144,080**	**100**	**-**	**-**
France	**727**	**-**	**727**	**727**	**100**	**-**	**-**
Spain	**643**	**-**	**643**	**643**	**100**	**-**	**-**
Rest of Europe	**-**	**-**	**-**	**-**	**-**	**-**	**-**
US	**962**	**1**	**962**	**962**	**100**	**-**	**-**
Rest of the world	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total	**146,412**	**100**	**146,412**	**146,412**	**100**	**-**	**-**

2009

						2009 Income statement movement	
	Nominal value		Book value	Fair value	Fair value as % of nominal	Fair value changes	Impairment losses
Country	£m	%	£m	£m	%	£m	£m
UK	184,341	96	184,341	184,341	100	-	-
France	-	-	-	-	-	-	-
Spain	5,993	3	5,993	5,993	100	-	-
Rest of Europe	1,412	1	1,412	1,412	100	-	-
US	3	-	3	3	100	-	-
Rest of the world	-	-	-	-	-	-	-
Total	191,749	100	191,749	191,749	100	-	-

(b) Income statement movement by credit rating of issuer or counterparty

2010

						2010 Income statement movement	
	Nominal value		Book value	Fair value	Fair value as % of nominal	Fair value changes	Impairment losses
Credit rating	**£m**	**%**	**£m**	**£m**	**%**	**£m**	**£m**
AAA	**-**	**-**	**-**	**-**	**-**	**-**	**-**
AA	**145,402**	**99**	**145,402**	**145,402**	**100**	**-**	**-**
A^{+}	**90**	**-**	**90**	**90**	**100**	**-**	**-**
A	**920**	**1**	**920**	**920**	**100**	**-**	**-**
BBB	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Below BBB	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total	**146,412**	**100**	**146,412**	**146,412**	**100**	**-**	**-**

Notes to the Financial Statements continued

2009

	Nominal value		Book value	Fair value	Fair value as % of nominal	2009 Income statement movement	
						Fair value changes	Impairment losses
Credit rating	£m	%	£m	£m	%	£m	£m
AAA	79	-	79	79	100	-	-
AA	190,167	99	190,167	190,167	100	-	-
AA-	18	-	18	18	100	-	-
A+	73	-	73	73	100	-	-
A	1,412	1	1,412	1,412	100	-	-
BBB	-	-	-	-	-	-	-
Below BBB	-	-	-	-	-	-	-
Total	191,749	100	191,749	191,749	100	-	-

Certain credit derivatives

In November 2010, the Group acquired a portfolio of loans to banks, asset-backed securities and related credit derivatives, as part of an alignment of portfolios across the Banco Santander, S.A. group. The following disclosures relate to the credit derivatives recognised as a result of the acquisition of that portfolio. Further information on all the Group's holdings of derivatives (including these credit derivatives) is set out in Note 15 to the Consolidated Financial Statements.

(a) Income statement movement by geographical location of issuer or counterparty

2010

	Contract/notional amount		**Fair value**	**2010 Income statement movement**	
				Fair value changes	**Impairment losses**
Country	**£m**	**%**	**£m**	**£m**	**£m**
UK	**-**	**-**	**-**	**-**	**-**
Rest of Europe	**584**	**89**	**25**	**-**	**-**
US	**73**	**11**	**13**	**-**	**-**
Total	**657**	**100**	**38**	**-**	**-**

(b) Income statement movement by credit rating of issuer or counterparty

2010

	Contract/notional amount		**Fair value**	**2010 Income statement movement**	
				Fair value changes	**Impairment losses**
Credit rating	**£m**	**%**	**£m**	**£m**	**£m**
AAA	**-**	**-**	**-**	**-**	**-**
AA+	**559**	**85**	**21**	**-**	**-**
AA	**-**	**-**	**-**	**-**	**-**
A	**98**	**15**	**17**	**-**	**-**
BBB	**-**	**-**	**-**	**-**	**-**
BB	**-**	**-**	**-**	**-**	**-**
B	**-**	**-**	**-**	**-**	**-**
CCC	**-**	**-**	**-**	**-**	**-**
Total	**657**	**100**	**38**	**-**	**-**

No comparatives are presented as the Group acquired these financial instruments during the year.

Other investments

	Book value 2010 £m	**Fair value 2010 £m**	Book value 2009 £m	Fair value 2009 £m
Loans and receivable securities	**-**	**-**	160	160
Other	**-**	**-**	13	13
	-	**-**	173	173

In 2009, loans and receivable securities consisted of a debenture issued by a fellow subsidiary in the Banco Santander, S.A., group that matured in 2010.

Notes to the Financial Statements continued

Exposure to Off-Balance Sheet Entities sponsored by the Group

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

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

44. 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. The Accounting Policies Note 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:

At 31 December 2010

								Group
	Held at fair value				**Held at amortised cost**			
	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**	**£m**
Assets								
Cash and balances at central banks	**-**	**-**	**-**	**-**	**5,088**	**-**	**-**	**5,088**
Trading assets	**35,461**	**-**	**-**	**-**	**-**	**-**	**-**	**35,461**
Derivative financial instruments	**22,951**	**286**	**-**	**-**	**-**	**-**	**-**	**23,237**
Financial assets designated at FV	**-**	**-**	**6,468**	**-**	**-**	**-**	**-**	**6,468**
Loans and advances to banks	**-**	**-**	**-**	**-**	**146,412**	**-**	**-**	**146,412**
Loans and advances to customers	**-**	**-**	**-**	**-**	**34,550**	**-**	**-**	**34,550**
Held-to-maturity securities	**-**	**-**	**-**	**-**	**331**	**-**	**-**	**331**
Loans and receivables securities	**-**	**-**	**-**	**-**	**626**	**-**	**-**	**626**
Macro hedge of interest rate risk	**-**	**-**	**-**	**-**	**908**	**-**	**-**	**908**
Intangible assets	**-**	**-**	**-**	**-**	**-**	**-**	**26**	**26**
Property, plant and equipment	**-**	**-**	**-**	**-**	**-**	**-**	**22**	**22**
Current tax assets	**-**	**-**	**-**	**-**	**-**	**-**	**40**	**40**
Deferred tax assets	**-**	**-**	**-**	**-**	**-**	**-**	**26**	**26**
Other assets	**-**	**-**	**-**	**-**	**-**	**65**	**-**	**65**
	58,412	**286**	**6,468**	**-**	**187,915**	**65**	**114**	**253,260**
Liabilities								
Deposits by banks	**-**	**-**	**-**	**-**	**-**	**136,753**	**-**	**136,753**
Deposits by customers	**-**	**-**	**-**	**-**	**-**	**7,061**	**-**	**7,061**
Derivative financial liabilities	**23,168**	**1,875**	**-**	**-**	**-**	**-**	**-**	**25,043**
Trading liabilities	**42,827**	**-**	**-**	**-**	**-**	**-**	**-**	**42,827**
Financial liabilities at FVTPL	**-**	**-**	**3,657**	**-**	**-**	**-**	**-**	**3,657**
Debt securities in issue	**-**	**-**	**-**	**-**	**-**	**33,659**	**-**	**33,659**
Subordinated liabilities	**-**	**-**	**-**	**-**	**-**	**331**	**-**	**331**
Other liabilities	**-**	**-**	**-**	**-**	**-**	**191**	**-**	**191**
Current tax liabilities	**-**	**-**	**-**	**-**	**-**	**-**	**374**	**374**
Deferred tax liabilities	**-**	**-**	**-**	**-**	**-**	**-**	**1**	**1**
	65,995	**1,875**	**3,657**		**-**	**177,995**	**375**	**249,897**

Notes to the Financial Statements continued

At 31 December 2010

Company

	Held at fair value				Held at amortised cost			
	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**	**£m**
Assets								
Cash and balances at central banks	**-**	**-**	**-**	**-**	**5,088**	**-**	**-**	**5,088**
Trading assets	**35,110**	**-**	**-**	**-**	**-**	**-**	**-**	**35,110**
Derivative financial instruments	**22,991**	**286**	**-**	**-**	**-**	**-**	**-**	**23,277**
Financial assets designated at FV	**-**	**-**	**6,468**	**-**	**-**	**-**	**-**	**6,468**
Loans and advances to banks	**-**	**-**	**-**	**-**	**146,398**	**-**	**-**	**146,398**
Loans and advances to customers	**-**	**-**	**-**	**-**	**34,935**	**-**	**-**	**34,935**
Loans and receivables securities	**-**	**-**	**-**	**-**	**626**	**-**	**-**	**626**
Macro hedge of interest rate risk	**-**	**-**	**-**	**-**	**908**	**-**	**-**	**908**
Investment in subsidiary undertakings	**-**	**-**	**-**	**-**	**-**	**-**	**2,187**	**2,187**
Intangible assets	**-**	**-**	**-**	**-**	**-**	**-**	**26**	**26**
Property, plant and equipment	**-**	**-**	**-**	**-**	**-**	**-**	**22**	**22**
Current tax assets	**-**	**-**	**-**	**-**	**-**	**-**	**40**	**40**
Deferred tax assets	**-**	**-**	**-**	**-**	**-**	**-**	**25**	**25**
Other assets	**-**	**-**	**-**	**-**	**-**	**65**	**-**	**65**
	58,101	**286**	**6,468**	**-**	**187,955**	**65**	**2,300**	**255,175**
Liabilities								
Deposits by banks	**-**	**-**	**-**	**-**	**-**	**136,701**	**-**	**136,701**
Deposits by customers	**-**	**-**	**-**	**-**	**-**	**13,989**	**-**	**13,989**
Derivative financial liabilities	**23,168**	**1,875**	**-**	**-**	**-**	**-**	**-**	**25,043**
Trading liabilities	**42,827**	**-**	**-**	**-**	**-**	**-**	**-**	**42,827**
Financial liabilities at FVTPL	**-**	**-**	**3,595**	**-**	**-**	**-**	**-**	**3,595**
Debt securities in issue	**-**	**-**	**-**	**-**	**-**	**29,226**	**-**	**29,226**
Other liabilities	**-**	**-**	**-**	**-**	**-**	**182**	**-**	**182**
Current tax liabilities	**-**	**-**	**-**	**-**	**-**	**-**	**357**	**357**
	65,995	**1,875**	**3,595**	**-**	**-**	**180,098**	**357**	**251,920**

At 31 December 2009

Group

	Held at fair value				Held at amortised cost			
	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	£m
Assets								
Cash and balances at central banks	-	-	-	-	448	-	-	448
Trading assets	33,290	-	-	-	-	-	-	33,290
Derivative financial instruments	22,966	235	-	-	-	-	-	23,201
Financial assets designated at FV	-	-	12,000	-	-	-	-	12,000
Loans and advances to banks	-	-	-	-	191,749	-	-	191,749
Loans and advances to customers	-	-	-	-	20,175	-	-	20,175
Held-to-maturity securities	-	-	-	-	300	-	-	300
Loans and receivables securities	-	-	-	-	896	-	-	896
Macro hedge of interest rate risk	-	-	-	-	682	-	-	682
Intangible assets	-	-	-	-	-	-	8	8
Property, plant and equipment	-	-	-	-	-	-	6	6
Current tax assets	-	-	-	-	-	-	3	3
Deferred tax assets	-	-	-	-	-	-	21	21
Other assets	-	-	-	-	67	-	-	67
	56,256	235	12,000	-	214,317	-	38	282,846
Liabilities								
Deposits by banks	-	-	-	-	-	166,305	-	166,305
Deposits by customers	-	-	-	-	-	9,461	-	9,461
Derivative financial liabilities	22,270	2,185	-	-	-	-	-	24,455
Trading liabilities	46,139	-	-	-	-	-	-	46,139
Financial liabilities at FVTPL	-	-	4,340	-	-	-	-	4,340
Debt securities in issue	-	-	-	-	-	27,997	-	27,997
Subordinated liabilities	-	-	-	-	-	331	-	331
Other liabilities	-	-	-	-	-	147	-	147
Current tax liabilities	-	-	-	-	-	-	167	167
Deferred tax liabilities	-	-	-	-	-	-	1	1
	68,409	2,185	4,340	-	-	204,241	168	279,343

Notes to the Financial Statements continued

At 31 December 2009

	Held at fair value				Held at amortised cost		Company	
	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	£m
Assets								
Cash and balances at central banks	-	-	-	-	448	-	-	448
Trading assets	24,976	-	-	-	-	-	-	24,976
Derivative financial instruments	22,894	235	-	-	-	-	-	23,129
Financial assets designated at FV	-	-	12,000	-	-	-	-	12,000
Loans and advances to banks	-	-	-	-	166,020	-	-	166,020
Loans and advances to customers	-	-	-	-	20,266	-	-	20,266
Loans and receivables securities	-	-	-	-	896	-	-	896
Macro hedge of interest rate risk	-	-	-	-	682	-	-	682
Investment in subsidiary undertakings	-	-	-	-	-	-	2,185	2,185
Intangible assets	-	-	-	-	-	-	8	8
Property, plant and equipment	-	-	-	-	-	-	6	6
Current tax assets	-	-	-	-	-	-	3	3
Deferred tax assets	-	-	-	-	-	-	21	21
Other assets		-	-	-	67	-	-	67
	47,870	235	12,000	-	188,379	-	2,223	250,707
Liabilities								
Deposits by banks	-	-	-	-	-	166,169	-	166,169
Deposits by customers	-	-	-	-	-	17,601	-	17,601
Derivative financial liabilities	22,145	2,185	-	-	-	-	-	24,330
Trading liabilities	13,315	-	-	-	-	-	-	13,315
Financial liabilities at FVTPL	-	-	4,282	-	-	-	-	4,282
Debt securities in issue	-	-	-	-	-	21,631	-	21,631
Other liabilities	-	-	-	-	-	136	-	136
Current tax liabilities	-	-	-	-	-	-	57	57
	35,460	2,185	4,282	-	-	205,537	57	247,521

b) Fair values of financial instruments carried at amortised cost

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

			Group
At 31 December 2010	**Carrying value £m**	**Fair value £m**	**Surplus/ (deficit) £m**
Assets			
Cash and balances at central banks	**5,088**	**5,088**	**-**
Loans and advances to banks	**146,412**	**148,141**	**1,729**
Loans and advances to customers	**34,550**	**35,525**	**975**
Held-to-maturity	**331**	**495**	**164**
Loans and receivable securities	**626**	**638**	**12**
Liabilities			
Deposits by banks	**136,753**	**137,583**	**(830)**
Deposits by customers	**7,061**	**6,911**	**150**
Debt securities in issue	**33,659**	**33,948**	**(289)**
Subordinated liabilities	**331**	**495**	**(164)**

			Company
At 31 December 2010	**Carrying value £m**	**Fair value £m**	**Surplus/ (deficit) £m**
Assets			
Cash and balances at central banks	**5,088**	**5,088**	**-**
Loans and advances to banks	**146,398**	**148,127**	**1,729**
Loans and advances to customers	**34,935**	**35,910**	**975**
Loans and receivable securities	**626**	**638**	**12**
Liabilities			
Deposits by banks	**136,701**	**137,531**	**(830)**
Deposits by customers	**13,989**	**13,839**	**150**
Debt securities in issue	**29,226**	**29,515**	**(289)**

Notes to the Financial Statements continued

At 31 December 2009	Carrying value £m	Fair value £m	Group Surplus/ (deficit) £m
Assets			
Cash and balances at central banks	448	448	-
Loans and advances to banks	191,749	195,449	3,700
Loans and advances to customers	20,175	20,629	454
Held-to-maturity	300	458	158
Loans and receivable securities	896	907	11
Liabilities			
Deposits by banks	166,305	168,109	(1,804)
Deposits by customers	9,461	9,527	(66)
Debt securities in issue	27,997	27,820	177
Subordinated liabilities	331	488	(157)

At 31 December 2009	Carrying value £m	Fair value £m	Company Surplus/ (deficit) £m
Assets			
Cash and balances at central banks	448	448	-
Loans and advances to banks	166,020	169,720	3,700
Loans and advances to customers	20,266	20,721	455
Loans and receivable securities	896	907	11
Liabilities			
Deposits by banks	166,169	167,973	(1,804)
Deposits by customers	17,601	17,667	(66)
Debt securities in issue	21,631	21,454	177
Subordinated liabilities	-	-	-

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

Valuation methodology

The fair value of financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. If a quoted market price is available for an instrument, the fair value is calculated based on the market price. Where quoted market prices are not available, fair value is determined using pricing models which use a mathematical methodology based on accepted financial theories, depending on the product type and its components. Further information on fair value measurement can be found in the Group's Accounting Policies in Note 1 and the valuation techniques section below on page 101 to the Consolidated Financial Statements.

Fair value management

The fair value exposures, as tabled above, are managed by using a combination of hedging derivatives and offsetting on balance sheet positions. The approach to specific categories of financial instruments is described below.

Assets

Cash and balances at central banks/Loans and advances to banks

The carrying amount is deemed a reasonable approximation of the fair value, because the loans are at variable rates.

Loans and advances to customers

The carrying amount is deemed a reasonable approximation of the fair value, because the loans are at variable rates.

Loan and receivable securities

Where reliable prices are available, the fair value of investment securities has been calculated using indicative market prices. Other market values have been determined using in-house pricing models.

Liabilities

Deposits by banks

The carrying amount is deemed a reasonable approximation of the fair value, because the deposits are at variable rates.

Notes to the Financial Statements continued

Deposits by customers
The majority of deposit liabilities are payable on demand and therefore can be deemed short term in nature with the fair value equal to the carrying value. However, given the long-term and continuing nature of the relationships with the Group's customers, the Directors believe there is significant value to the Group in this source of funds. Certain of the deposit liabilities are at a fixed rate until maturity. The deficit of fair value over carrying value of these liabilities has been estimated by reference to the market rates available at the balance sheet date for similar deposit liabilities of similar maturities.

Debt securities in issue and subordinated liabilities
Where reliable prices are available, the fair value of debt securities in issue and subordinated liabilities has been calculated using quoted market prices. Other market values have been determined using in-house pricing models.

Intra Group balances
Included in the asset and liability categories on the Group and Company balance sheet are outstanding intra group balances. The fair value of these balances has been estimated using in-house pricing models.

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

The following tables summarise the fair values at 31 December 2010 and 2009 of the financial asset and liability classes accounted for at fair value, 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:

At 31 December 2010

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	-	-	8,281	13	-	-	8,281	13	A
	Loans and advances to customers	-	-	8,659	13	-	-	8,659	13	A
	Debt securities	17,821	27	-	-	-	-	17,821	27	-
	Equity securities	699	1	-	-	1	-	700	1	B
Derivative assets	Exchange rate contracts	-	-	1,185	2	61	-	1,246	2	A
	Interest rate contracts	3	-	19,649	30	-	-	19,652	30	A & C
	Equity & credit contracts	500	1	1,492	2	347	1	2,339	4	B
Financial assets at FVTPL	Loans and advances to customers	-	-	5,372	8	50	-	5,422	8	A
	Debt securities	-	-	978	2	68	-	1,046	2	A
Total assets at fair value		19,023	29	45,616	70	527	1	65,166	100	
Liabilities										
Trading liabilities	Deposits by banks	-	-	25,738	36	-	-	25,738	36	A
	Deposits by customers	-	-	15,971	22	-	-	15,971	22	A
	Short positions	1,118	2	-	-	-	-	1,118	2	-
Derivative liabilities	Exchange rate contracts	-	-	2,108	3	-	-	2,108	3	A
	Interest rate contracts	-	-	19,683	28	-	-	19,683	28	A & C
	Equity & credit contracts	55	-	3,095	4	102	-	3,252	4	B
Financial liabilities at FVTPL	Debt securities in issue	-	-	3,520	5	137	-	3,657	5	A
Total liabilities at fair value		1,173	2	70,115	98	239	-	71,527	100	

Notes to the Financial Statements continued

At 31 December 2009

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	-	-	6,791	10	-	-	6,791	10	A
	Loans and advances to customers	-	-	9,089	14	-	-	9,089	14	A
	Debt securities	15,932	23	-	-	-	-	15,932	23	-
	Equity securities	1,471	2	-	-	7	-	1,478	2	B
Derivative assets	Exchange rate contracts	-	-	4,051	6	37	-	4,088	6	A
	Interest rate contracts	4	-	17,431	25	-	-	17,435	25	A & C
	Equity & credit contracts	259	-	1,073	2	346	1	1,678	3	B
Financial assets at FVTPL	Loans and advances to customers	-	-	6,072	9	262	-	6,334	9	A
	Debt securities	-	-	4,497	6	1,169	2	5,666	8	A
Total assets at fair value		17,666	25	49,004	72	1,821	3	68,491	100	
Liabilities										
Trading liabilities	Deposits by banks	-	-	40,824	54	-	-	40,824	54	A
	Deposits by customers	-	-	4,102	5	-	-	4,102	5	A
	Short positions	1,071	1	-	-	-	-	1,071	1	-
	Debt securities in issue	-	-	142	-	-	-	142	-	A
Derivative liabilities	Exchange rate contracts	-	-	4,213	6	-	-	4,213	6	A
	Interest rate contracts	-	-	17,727	24	-	-	17,727	24	A & C
	Equity & credit contracts	28	-	2,227	3	260	1	2,515	4	B
Financial liabilities at FVTPL	Debt securities in issue	-	-	4,231	6	109	-	4,340	6	A
Total liabilities at fair value		1,099	1	73,466	98	369	1	74,934	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 31 December 2010 and 2009 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 years ended 31 December 2010 and 2009.

A In the valuation of financial instruments requiring static hedging (for example interest rate and currency derivatives) and in the valuation of loans and advances and deposits, the 'present value' method is used. Expected future cash flows are discounted using the interest rate curves of the applicable currencies. 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.

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 are used in these models to generate variables such as the bid-offer spread, foreign currency exchange rates, credit risk, volatility and correlation between indices and market liquidity as appropriate. 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 Markov functional model (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 the Halifax's UK House Price Index ('HPI') volatility, HPI forward growth, HPI spot rate and mortality and the specific credit spread for that instrument.

D In the valuation of linear instruments such as credit risk and fixed-income derivatives, credit risk is measured using dynamic models similar to those used in the measurement of interest rate risk. In the case of non-linear instruments, if the portfolio is exposed to credit risk such as credit derivatives, the probability of default is determined using the par spread level. The main inputs used to determine the underlying cost of credit of credit derivatives are quoted credit risk premiums and the correlation between the quoted credit derivatives of various issuers.

Notes to the Financial Statements continued

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

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

e) Fair value adjustments

The internal models incorporate assumptions that the 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 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 Global Banking & Markets. The magnitude and types of fair value adjustment adopted by Global Banking & Markets are listed in the following table:

	2010 £m	2009 £m
Risk-related:		
- Bid-offer and trade specific adjustments	**62**	139
- Uncertainty	**49**	68
- Credit risk adjustment	**15**	8
	126	215
Model-related:		
- Model limitation	**25**	21
Day One profits	**-**	-
	151	236

Risk-related adjustments

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

(i) Bid-offer and trade specific adjustments

IAS 39 requires that portfolios are marked at bid or offer, as appropriate. Bid prices represent the price at which a long position could be sold and offer prices represent the price at which a short position could be bought back. Valuation models will typically generate mid market values. The bid-offer adjustment reflects the cost that would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the actual position.

The majority of the bid-offer adjustment relates to OTC derivative portfolios. For each portfolio, the major risk types are identified. These may include, inter alia, delta (the sensitivity to changes in the price of an underlying), vega (the sensitivity to changes in volatilities) and basis risk (the sensitivity to changes in the spread between two rates). For each risk type, the net portfolio risks are first classified into buckets, and then a bid-offer spread is applied to each risk bucket based upon the market bid-offer spread for the relevant hedging instrument.

The granularity of the risk bucketing is determined by reference to several factors, including the actual risk management practice undertaken by the Group, the granularity of risk bucketing within the risk reporting process, and the extent of correlation between risk buckets. Within a risk type, the bid-offer adjustment for each risk bucket may be aggregated without offset or limited netting may be applied to reflect correlation between buckets. There is no netting applied between risk types or between portfolios that are not managed together for risk management purposes. There is no netting across legal entities.

As bid-offer spreads vary by maturity and risk type to reflect different spreads in the market, for positions where there is no observable quote, a trade specific adjustment is further made. This is to reflect widened spreads in comparison to proxies due to reduced liquidity or observability. Trade specific adjustment can also made to incorporate liquidity triggers whereby wider spreads are applied to risks above pre-defined thresholds or on exotic products to ensure overall reserves match market close-out costs. These market close-out costs inherently incorporate risk decay and cross-effects which are unlikely to be adequately reflected in the static hedge based on vanilla instruments.

Notes to the Financial Statements continued

(ii) Uncertainty
Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective, with less market evidence available from which to determine general market practice. In these circumstances, there exists a range of possible values that the financial instrument or market parameter may assume and an adjustment may be necessary to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt rather more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model. Uncertainty adjustments are derived by considering the potential range of derivative portfolio valuation given the available market data. The objective of an uncertainty adjustment is to arrive at a fair value that is not overly prudent but rather reflects a level of prudence believed to be consistent with market pricing practice.

Uncertainty adjustments are applied to various types of exotic OTC derivative. For example, the mean reversion speed of interest rates may be an important component of an exotic derivative value and an uncertainty adjustment may be taken to reflect the range of possible values that market participants may assume for this parameter.

(iii) Credit risk adjustment
The Group adopts a credit risk adjustment (also frequently known as a 'credit valuation adjustment') against OTC derivative transactions to reflect within fair value the possibility that the counterparty may default, and the Group may not receive the full market value of the transactions. The Group calculates a separate credit risk adjustment for each Santander UK legal entity, and within each entity for each counterparty to which the entity has exposure. The Group attempts to mitigate credit risk to third parties by entering into netting and collateral arrangements. The net counterparty exposure (i.e. counterparty positions netted by offsetting transactions and both cash and securities collateral) is then assessed for counterparty creditworthiness. The Group has only a limited exposure to monolines, consisting of exposure to securitisations which are wrapped by monoline insurers. The principal risk exposures are recorded against the securitisations, with the monoline wraps being viewed as contingent exposures, as described in the Risk Management Report on page 94. The description below relates to the credit risk adjustment taken against counterparties other than monolines.

The Group calculates the credit risk adjustment by applying the probability of default of the counterparty to the expected positive exposure to the counterparty, and multiplying the result by the loss expected in the event of default (i.e. the loss given default or 'LGD'). The timing of the expected losses is reflected by using a discount factor. The calculation is performed over the life of the potential exposure i.e. the credit risk adjustment is measured as a lifetime expected loss.

The expected positive exposure is calculated at a portfolio level and is based on the underlying risks of the portfolio. The main drivers of the expected positive exposure are the size of the risk position with the counterparty along with the prevailing market environment. The probability of default assumptions are based upon analysis of historic default rates. The credit rating used for a particular counterparty is that determined by the Group's internal credit process. The LGD is calculated at the facility level and takes into account the counterparty characteristics. Credit ratings and LGD are updated by the credit team as new relevant information becomes available and at periodic reviews performed at least annually.

The Group also considers its own creditworthiness when determining the fair value of an instrument, including OTC derivative instruments and financial liabilities held at fair value through profit or loss if the Group believes market participants would take that into account when transacting the respective instrument. The approach to measuring the impact of the Group's credit risk on an instrument is done in the same manner as for third party credit risk. The impact of the Group's credit risk is considered when calculating the fair value of an instrument, even when credit risk is not readily observable such as in OTC derivatives. The Group has not realised any profit or loss on revaluing fair values of derivatives to reflect its own creditworthiness. If the Group had reflected such adjustments it would not have had a material impact on the valuations. Consequently, the Group does not derive the adjustment on a bilateral basis and has a zero adjustment against derivative liabilities, often referred to as a 'debit valuation adjustment'.

For certain types of exotic derivatives where the products are not currently supported by the standard methodology, the Group adopts an alternative methodology. Alternative methodologies used by the Group fall into two categories. One method maps transactions against the results for similar products which are accommodated by the standard methodology. Where such a mapping approach is not appropriate, a bespoke methodology is used, generally following the same principles as the standard methodology, reflecting the key characteristics of the instruments but in a manner that is computationally less intensive. The calculation is applied at a trade level, with more limited recognition of credit mitigants such as netting or collateral agreements than used in the standard methodology described previously.

The methodologies do not, in general, account for 'wrong-way risk'. Wrong-way risk arises where the underlying value of the derivative prior to any credit risk adjustment is related to the probability of default of the counterparty. A more detailed description of wrong-way risk is set out below.

The Group includes all third-party counterparties in the credit risk adjustment calculation and the Group does not net credit risk adjustments across Group entities. During 2010, there were no material changes made by the Group to the methodologies used to calculate the credit risk adjustment.

Notes to the Financial Statements continued

Wrong-way risk
Wrong-way risk is an aggravated form of concentration risk and arises when there is a strong correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction. Wrong-way risk can be seen in the following examples:

> when the counterparty is resident and/or incorporated in an emerging market and seeks to sell a non-domestic currency in exchange for its home currency;
> when the trade involves the purchase of an equity put option from a counterparty whose shares are the subject of the option;
> the purchase of credit protection from a counterparty who is closely associated with the reference entity of the credit default swap or total return swap; and
> the purchase of credit protection on an asset type which is highly concentrated in the exposure of the counterparty selling the credit protection.

Exposure to 'wrong way risk' is limited via internal governance processes and deal pricing. The Group considers that an appropriate adjustment to reflect wrong way risk is currently zero.

Model-related adjustments
These adjustments are primarily related to internal factors, such as the ability of the Group's models to incorporate all material market characteristics. A description of each adjustment type is given below:

(i) Model limitation
Models used for portfolio valuation purposes, particularly for exotic derivative products, may be based upon a simplifying set of assumptions that do not capture all material market characteristics or may be less reliable under certain market conditions. Additionally, markets evolve, and models that were adequate in the past may require development to capture all material market characteristics in current market conditions. In these circumstances, model limitation adjustments are adopted outside the core valuation model. The adjustment methodologies vary according to the nature of the model. The Quantitative Risk Group ('QRG'), an independent quantitative support function reporting into Risk Department, highlights the requirement for model limitation adjustments and develops the methodologies employed. Over time, as model development progresses, model limitations are addressed within the core revaluation models and a model limitation adjustment is no longer needed.

Day One profits adjustments
Day One profit adjustments are adopted where the fair value estimated by a valuation the model is based on one or more significant unobservable inputs, in accordance with IAS 39. Day One profits adjustments are amounts that have yet to be recognised in the income statement, which represent the difference between a transaction price (i.e. the fair value at initial recognition) and the amount that would have arisen had valuation models using unobservable inputs been used on initial recognition), less amounts subsequently recognised. Day One profits adjustments are calculated and reported on a portfolio basis. As at 31 December 2010 and 2009, the Day One profits adjustments were less than £1m.

f) Control framework

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

The factors that are considered in this regard include:

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

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

Notes to the Financial Statements continued

Internal valuation model review

Models provide a logical framework for the capture and processing of necessary valuation inputs. For fair values determined using a valuation model, the control framework may include, as applicable, independent development or validation of:

> The logic within valuation models;
> The inputs to those models;
> Any adjustments required outside the valuation models; and
> where possible, model outputs.

All internal valuation models are validated independently by QRG. A validation report is produced for each model-derived valuation that assesses the mathematical assumptions behind the model and the implementation of the model and its integration within the trading system. Where there is observable market data, the models calibrate to market. Where pricing data is unobservable then the input parameters are regularly reviewed by QRG.

The independent valuation process applies fair value adjustments in line with the Group's established documented policies. The results of the independent validation process are reported to, and considered monthly by Risk Fora. Each Risk Forum is composed of representatives from several independent support functions (Product Control, Market Risk, QRG and Finance) in addition to senior management and the front office. The members of each Risk Forum consider the appropriateness and adequacy of the fair value adjustments and the effectiveness of valuation models. Changes to the fair value adjustments methodologies are considered by the Risk Fora and signed off by the Head of Wholesale Risk. The Risk Fora are overseen by the Wholesale Risk Oversight Forum and Risk Committee.

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

During 2010 and 2009, there were no transfers between Level 1 and Level 2 financial instruments.

1. Trading Assets

Loans and advances to banks and loans and advances to customers - securities purchased under resale agreements

These instruments consist of securities purchased under resale agreements ('reverse repos') with both professional non-bank customers and bank counterparties as part of the Group's trading activities. The fair value of reverse repos is estimated by using the 'present value' method. Future cash flows are evaluated taking into consideration any derivative features of the reverse repos and are then discounted using the appropriate market rates for the applicable maturity and currency. Under these agreements, the Group receives collateral with a market value equal to, or in excess of, the principal amount loaned. The level of collateral held is monitored daily and if required, further calls are made to ensure the market values of collateral remains at least equal to the loan balance. As a result, there would be no adjustment, or an immaterial adjustment, to reflect the credit quality of the counterparty related to these agreements. As the inputs used in the valuation are based on observable market data, these reverse repos are classified within level 2 of the valuation hierarchy.

Loans and advances to banks and loans and advances to customers - other

These instruments consist of term deposits placed which are short-term in nature and are both utilised and managed as part of the funding requirements of the trading book. The fair value of loans and advances to banks and loans and advances to customers is estimated using the 'present value' method. Expected future cash flows are discounted using the interest rate curves of the applicable currencies. The interest rate curves are generally observable market data and reference yield curves derived from quoted interest rates in appropriate time bandings, which match the timings of the cashflows and maturities of the instruments. As the inputs used in the valuation are based on observable market data, these loans are classified within level 2 of the valuation hierarchy.

2. Derivative assets and liabilities

These instruments consist of exchange rate contracts, interest rate contracts, equity and credit contracts and equity derivatives. The models used in estimating the fair value of these derivatives do not contain a high level of subjectivity as the methodologies used in the models do not require significant judgement, and the inputs used in the models are observable market data such as plain vanilla interest rate swaps and option contracts. As the inputs used in the valuation are based on observable market data, these derivatives are classified within level 2 of the valuation hierarchy.

Certain derivatives which represent cross currency swaps, reversionary property interests, credit default swaps and options and forwards contain significant unobservable inputs or are traded less actively or traded in less-developed markets, and so are classified within level 3 of the valuation hierarchy. The valuation of such instruments is further discussed in the 'internal models based on information other than market data' section below.

Notes to the Financial Statements continued

3. Financial assets at FVTPL

Loans and advances to customers
These instruments consist of loans secured on residential property to housing associations. The fair value of these social housing loans is estimated using the 'present value' model based on an average benchmark spread. Observable market data include current market spreads for new accepted mandates and bids for comparable loans and are used to support or challenge the benchmark level. This provides a range of reasonably possible estimates of fair value. As the inputs used in the valuation are based on market observable data, these loans are classified within level 2 of the valuation hierarchy.

Certain loans and advances to customers which represent a portfolio of roll-up mortgages contain significant unobservable inputs and so are classified within level 3 of the valuation hierarchy. The valuation of such instruments is further discussed below.

Debt securities
These instruments consist of holdings of asset-backed securities. A significant portion of these securities are priced using the 'present value' models, based on observable market data e.g. LIBOR, credit spreads. Where there are quoted prices for these instruments, the model value is checked against the quoted prices for reference purposes, but is not used as the fair value as the market for these instruments are lacking in liquidity and depth. As the inputs used in the valuation are based on observable market data, these debt securities are classified within level 2 of the valuation hierarchy.

Certain debt securities which represent securities issued by Santander entities contain significant unobservable inputs, and so are classified within level 3 of the valuation hierarchy. The valuation of such instruments is further discussed below.

4. Trading liabilities

Deposits by banks and deposits by customers - securities sold under repurchase agreements
These instruments consist of securities sold under repurchase agreements ('repos') with both professional non-bank customers and bank counterparties as part of the Group's trading activities. The fair value of repos is estimated using the same technique as those reverse repos in trading assets discussed above. Under these agreements, the Group is required to provide and maintain collateral with a market value equal to, or in excess of, the principal amount borrowed. As a result, there would be no adjustment, or an immaterial adjustment, to reflect the credit quality of the Group related to these agreements. As the inputs used in the valuation are based on observable market data, these repos are classified within level 2 of the valuation hierarchy.

Deposits by banks and deposits by customers - other
These instruments consist of certain term and time deposits which tend to be short-term in nature and are both utilised and managed as part of the funding requirements of the trading book. These instruments are valued using the same techniques as those instruments in trading assets - loans and advances to banks and loans and advances to customers discussed above. As the inputs used in the valuation are based on observable market data, these deposits are classified within level 2 of the valuation hierarchy.

Debt securities in issue
These instruments consist of certificates of deposit and commercial paper issued by the Group and are valued using the 'present value' method. Expected future cash flows are discounted using the interest rate curves of the applicable currencies. The interest rate curves are generally observable market data and reference yield curves derived from quoted interest rates in appropriate time bandings, which match the timings of the cash flows and maturities of the instruments. As the inputs used in the valuation are based on observable market data, these certificates of deposit and commercial paper are classified within level 2 of the valuation hierarchy.

5. Financial liabilities at FVTPL

Debt securities in issue
These instruments include commercial paper, medium term notes and other bonds and are valued using the same techniques as those instruments in financial assets at FVTPL - debt securities discussed above. As the inputs used in the valuation are based on observable market data, these debt securities are classified within level 2 of the valuation hierarchy.

Certain debt securities in issue which represent the more exotic senior debt issuances, consisting of power reverse dual currency ('PRDC') notes contain significant unobservable inputs and so are classified within level 3 of the valuation hierarchy. The valuation of such instruments is further discussed below.

Notes to the Financial Statements continued

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

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

			Balance sheet value		Amount recognised in income/(expense)	
Balance sheet line item	Category	Financial instrument product type	2010 £m	2009 £m	2010 £m	2009 £m
1. Trading assets	Equity securities	Property unit trusts	**1**	7	**-**	(1)
2. Derivative assets	Exchange rate contracts	Cross-currency swaps	**61**	37	**42**	14
3. Derivative assets	Equity and credit contracts	Reversionary property interests	**67**	73	**(6)**	(4)
4. Derivative assets	Equity and credit contracts	Credit default swaps	**38**	-	**-**	-
5. Derivative assets	Equity contracts	Options and forwards	**242**	273	**(20)**	(5)
6. FVTPL	Loans and advances to customers	Roll-up mortgage portfolio	**50**	262	**5**	(36)
7. FVTPL	Debt securities	Asset-backed securities	**68**	1,169	**53**	62
8. Derivative liabilities	Equity contracts	Options and forwards	**(102)**	(260)	**99**	(82)
9. FVTPL	Debt securities in issue	Non-vanilla debt securities	**(137)**	(109)	**(42)**	(23)
Total net assets			**288**	1,452	**-**	-
Total income/(expense)			**-**	-	**131**	(75)

Valuation technique

1. Trading assets - Equity securities

These unit trusts are valued using net asset values, which are regular third party asset valuations, with an adjustment for the estimated discount to asset value inherent in current similar market prices, reflecting the specific asset characteristics and degree of leverage in each unit trust.

The Group is responsible for the valuations of the net assets and, in doing so, considers or relies in part on a report of a third party expert. The unobservable input for the valuation of these financial instruments is the discount to asset value. It is determined for each asset class and degree of leverage. At 31 December 2010, the adjustment was no longer significant.

2. Derivative assets - Exchange rate contracts

These cross currency swaps are used to hedge the foreign currency risks arising from the power reverse dual currency ('PRDC') notes issued by the Group, as described in Instrument 11 below. These derivatives are valued using a standard valuation model valuing each leg of the swap, with expected future cash flows less notional amount exchanged at maturity date discounted using an appropriate floating rate. The floating rate is adjusted by the relevant cross currency basis spread. Interest rates, foreign exchange rates, cross currency basis spread and long dated foreign exchange ('FX') volatility are used as inputs to determine fair value. Interest rates, foreign exchange rates are observable on the market. Cross currency spreads may be market observable or unobservable depending on the liquidity of the cross currency pair. As the Japanese Yen-US dollar cross currency pair related to the PRDC notes is liquid, the cross currency spreads (including long-dated cross currency spread) for these swaps are market observable.

The significant unobservable inputs for the valuation of these financial instruments are the long dated FX volatility and the correlation between the underlying assets. The correlation between the underlying assets is assumed to be zero, as there are no actively traded options from which correlations between the underlying assets could be implied. Furthermore, the zero correlation assumption implies that the sources of the long dated FX volatility are independent.

Long dated FX volatility

Long dated FX volatility is extrapolated from shorter-dated FX volatilities which are directly observable on the market. Short dated FX volatility is observable from the trading of FX options. As there is no active market for FX options with maturities greater than five years (long-dated FX options), long-dated FX volatility is not market observable. Furthermore, as historical prices are not relevant in determining the cost of hedging long-dated FX risk, long-dated FX volatility cannot be inferred from historical volatility. The Group extrapolates the long-dated FX volatility from the shorter-dated FX volatilities using Black's model.

FX volatility is modelled as the composition of the domestic interest rate, foreign interest rates and FX spot volatilities using standard Hull-White formulae. The Hull-White approach is used for estimating the future distribution of domestic and foreign zero-coupon rates, constructed from the relevant yield curves. Using short dated FX options, the FX spot volatility is calculated which is then extrapolated to derive the long dated FX volatility.

Notes to the Financial Statements continued

3. Derivative assets - Equity and credit contracts
These reversionary property derivatives are valued using a probability weighted set of the Halifax's UK House Price Index ('HPI') forward prices, which are assumed to be a reasonable representation of the increase in value of the Group's reversionary interest portfolio underlying the derivatives. The probability used reflects the likelihood of the home owner vacating the property and is calculated from mortality rates and acceleration rates which are a function of age and gender, obtained from the relevant mortality tables. Indexing is felt to be appropriate due to the size and geographical dispersion of the Group's reversionary interest portfolio. These are determined using HPI Spot Rates adjusted to reflect estimated forward growth. Launched in 1984, the Halifax's UK HPI is the UK's longest running monthly house price data series covering the whole country. The indices calculated are standardised and represent the price of a typically transacted house. Both national and regional HPI are published. The national HPI is published monthly. The regional HPI reflects the national HPI disaggregated into 12 UK regions and is published quarterly. Both indices are published on two bases, including and excluding seasonal adjustments in the housing market. The Group uses the non-seasonally adjusted ('NSA') national and regional HPI in its valuation model to avoid any subjective judgement in the adjustment process which is made by Halifax.

The inputs used to determine the value of the reversionary property derivatives are HPI spot, HPI forward growth and mortality rates. The principal pricing parameter is HPI forward growth.

HPI Spot Rate
The HPI spot rate used in the model is a weighted average of NSA regional HPI spot rates i.e. adjusted for difference in the actual regional composition of the property underlying the Group's reversionary interest portfolio and the composition of the published regional indices. The regional HPI spot rate (which is observable market data) is only published on specific quarterly dates. In between these dates, its value is estimated by applying the growth rate over the relevant time period inferred from the national HPI spot rates (which are observable market data and published monthly) to the most recently calculated weighted average regional HPI spot rate based on published regional indices.

An adjustment is also made to reflect the specific property risk i.e. possible deviation between the actual growth in the house prices underlying the Group's reversionary interest portfolio and their assumed index-linked growth, which is based on the regional HPI. This adjustment is based on the average historical deviation of price changes of the Group's actual property portfolio from that of the published indices over the time period since the last valuation date.

HPI Forward Growth Rate
Long-dated HPI forward growth rate is not directly observable in the market but is estimated from broker quotes and traded forward contracts. A specific spread is applied to the long-dated forward growth rate to reflect the uncertainty surrounding long dated data. This spread is calculated by analysing the historical volatility of the HPI, whilst incorporating mean reversion. An adjustment is made to reflect the specific property risk as for the HPI spot rate above.

Mortality Rate
Mortality rates are obtained from the PNMA00 and PNFA00 Continuous Mortality Investigation Tables published by the UK Institute and Faculty of Actuaries. These mortality rates are adjusted by acceleration rates to reflect the mortality profile of the holders of Group's reversionary property products underlying the derivatives.

4. Derivative assets - Equity and credit contracts
These derivative assets are credit default swaps held against certain bonds. The credit default swaps are valued using the credit spreads of the referenced bonds. These referenced bonds are valued with the assistance of valuations prepared by an independent, specialist valuation firm as a deep and liquid market does not exist.

In valuing the credit default swaps, the main inputs used to determine the underlying cost of credit are quoted risk premiums and the correlation between the quoted credit derivatives of various issuers. The assumptions relating to the correlation between the values of quoted and unquoted assets are based on historical correlations between the impact of adverse changes in market variables and the corresponding valuation of the associated unquoted assets. The measurement of the assets will vary depending on whether a more or less conservative scenario is selected. The other main input is the probability of default of the referenced bonds. The significant unobservable input for the valuation of these financial instruments is the probability of default.

Probability of default
The probability of default is assessed by considering the credit quality of the underlying referenced bonds. However, as no deep and liquid market exists for these assets the assessment of the probability of default is not directly observable and instead an estimate is calculated using the Standard Gausian Copula model.

5. Derivative assets – Equity and credit contracts
There are three types of derivatives within this category:

European options
These derivatives are valued using a modified Black-Scholes model where the HPI is log-normally distributed with the forward rates determined from the HPI forward growth.

Notes to the Financial Statements continued

Asian options
Asian (or average value) options are valued using a modified Black-Scholes model, with an amended strike price and volatility assumption to account for the average exercise period, through a closed form adjustment that reflects the strike price relative to the distribution of stock prices at each relevant date. This is also known as the Curran model.

Forward contracts
Forward contracts are valued using a standard forward pricing model.

The inputs used to determine the value of the above instruments are HPI spot rate, HPI forward growth rate and HPI volatility. The principal pricing parameter is HPI forward growth rate.

HPI Spot Rate
The HPI spot rate used is the NSA national HPI spot rate which is published monthly and directly observable in the market. This HPI rate used is different from the weighted average regional HPI spot rate used in the valuation of Instrument 3 above, as the underlying of these derivatives is the UK national HPI spot rate.

HPI Forward Growth Rate
The HPI forward growth rate used is unobservable and is the same as used in the valuation of Instrument 3 above.

HPI Volatility
Long-dated HPI volatility is not directly observable in the market but is estimated from the most recent traded values. An adjustment is applied to the long-dated HPI volatility rate to reflect the uncertainty surrounding long-dated data. This adjustment is based on the empirical standard deviation of historical volatility over a range of time horizons.

6. FVTPL – Loans and advances to customers
These loans and advances to customers represent roll-up mortgages, which are an equity release scheme under which a property owner takes out a loan secured against their home. The owner does not make any interest payments during their lifetime and the fixed interest payments are rolled up into the mortgage. The loan or mortgage (capital and rolled-up interest) is repaid upon the owner's vacation of the property and the value of the loan is only repaid from the value of the property. This is known as a 'no negative pledge'. The Group suffers a loss if the sale proceeds from the property are insufficient to repay the loan, as it is unable to pursue the homeowner's estate or beneficiaries for the shortfall.

The value of the mortgage 'rolls up' or accretes until the owner vacates the property. In order to value the roll-up mortgages, the Group uses a probability-weighted set of European option prices (puts) determined using the Black-Scholes model, in which the 'no negative pledges' are valued as short put options. The probability weighting applied is calculated from mortality rates and acceleration rates as a function of age and gender, taken from mortality tables.

The inputs used to determine the value of these instruments are HPI spot, HPI forward growth, HPI volatility, mortality rates and repayment rates. The principal pricing parameter is HPI forward growth. Discussion of the HPI spot rate, HPI forward growth rate and mortality rates for this financial instrument is the same as Instrument 3 above. Discussion of the HPI volatility is the same as for Instrument 4 above.

Repayment rates
The costs to the Group arising from early repayment by customers are estimated from prices of swaptions which reflect the costs associated with unwinding the swap hedges held by the Group against these roll-up mortgages in the event of early repayment. Early repayment most typically occurs following a fall in market interest rates. Prepayment rates were taken from the academic paper 'Pricing and Risk Capital in the Equity Release Market', presented to the Institute and Faculty of Actuaries in 2007.

7. FVTPL – Debt securities
These securities consist of residential mortgage-backed securities issued by Santander entities. In 2009, the portfolio also included other securities issued by Santander entities which were backed by small business and automotive loans and other collateralised debt obligations. These other securities were sold in 2010. Each instrument was valued with reference to the price from a consensus pricing service. This is then corroborated against the price from another consensus pricing service due to the lack of depth in the number of available market quotes. An average price is used where there is a more than insignificant difference between the two sources. The significant unobservable input is the adjustment to the credit spread embedded in the pricing consensus quotes.

8. Derivative liabilities - Equity contracts
These derivatives are the same as Instrument 5 with the exception that they have a negative fair value.

Notes to the Financial Statements continued

9. FVTPL - Debt securities in issue

These debt securities in issue are power reverse dual currency notes. These notes are financial structured products where an investor is seeking a better return and a borrower/issuer a lower rate by taking advantage of the interest rate differential between two countries. The note pays a foreign interest rate in the investor's domestic currency. The power component of the name denotes higher initial coupons and the fact that coupons rise as the domestic/foreign exchange rate depreciates. The power feature comes with a higher risk for the investor. Cash flows may have a digital cap feature where the rate gets locked once it reaches a certain threshold. Other add-on features are barriers such as knockouts and cancellation provisions for the issuer.

These debt securities in issue are valued using a three-factor Gaussian Model. The three factors used in the valuation are domestic interest rates, foreign interest rates and foreign exchange rates. The correlations between the factors are assumed to be zero within the valuation.

The Hull-White approach is used for estimating the future distribution of domestic and foreign zero-coupon rates, constructed from the relevant yield curves. A Geometric Brownian Motion model is used for estimating the future distribution of spot foreign exchange rates. The foreign exchange and interest rate volatilities are the most crucial pricing parameters; the model calibrates to the relevant swaption volatility surface.

The significant unobservable inputs for the valuation of these financial instruments are the long dated FX volatility and the correlation between the underlying assets and are the same as Instrument 2.

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**		
	Trading assets £m	**Derivatives £m**	**Fair value through P&L £m**	**Total £m**	**Derivatives £m**	**Fair value through P&L £m**	**Total £m**
At 1 January 2010	**7**	**383**	**1,431**	**1,821**	**(260)**	**(109)**	**(369)**
Total gains/(losses) recognised in profit/(loss):							
- Fair value movements	**-**	**16**	**58**	**74**	**99**	**(42)**	**57**
- Foreign exchange and other movements	**-**	**(16)**	**3**	**(13)**	**-**	**10**	**10**
Purchases	**-**	**38**	**-**	**38**	**-**	**-**	**-**
Sales	**(6)**	**-**	**(1,215)**	**(1,221)**	**-**	**-**	**-**
Settlements	**-**	**(13)**	**(159)**	**(172)**	**59**	**4**	**63**
At 31 December 2010	**1**	**408**	**118**	**527**	**(102)**	**(137)**	**(239)**
Total gains/(losses) recognised in profit/(loss) relating to those assets and liabilities held at the end of the year	**-**	**-**	**61**	**61**	**99**	**(32)**	**67**

	Assets				Liabilities		
	Trading assets £m	Derivatives £m	Fair value through P&L £m	Total £m	Derivatives £m	Fair value through P&L £m	Total £m
At 1 January 2009	37	310	4,365	4,712	(149)	(247)	(396)
Total gains/(losses) recognised in profit/(loss):							
- Fair value movements	(1)	5	26	30	(82)	(23)	(105)
- Foreign exchange and other movements	(3)	75	(122)	(50)	(38)	5	(33)
Sales	(26)	-	(90)	(116)	-	-	-
Settlements	-	(7)	(487)	(494)	9	156	165
Transfers out	-	-	(2,261)	(2,261)	-	-	-
At 31 December 2009	7	383	1,431	1,821	(260)	(109)	(369)
Total gains/(losses) recognised in profit/(loss) relating to those assets and liabilities held at the end of the year	(4)	80	(96)	(20)	(120)	(18)	(138)

Notes to the Financial Statements continued

Financial instrument assets and liabilities at 31 December 2010

Financial instrument assets valued using internal models based on information other than market data were 1% (2009: 2%) of total assets measured at fair value and 0.2% (2009: 1%) of total assets at 31 December 2010.

Trading assets decreased in 2010 principally due to assets being sold. Derivative assets increased in 2010 principally due to purchases of credit default swaps. Assets designated at fair value through profit or loss decreased in 2010 principally due to sales and maturities of securities issued by Santander entities which were backed by small business and automotive loans and other collateralised debt obligations.

Financial instrument liabilities valued using internal models based on information other than market data were 0.3% (2009: 0.5%) of total liabilities measured at fair value and 0.1% (2009: 0.1%) of total liabilities at 31 December 2010.

Derivative liabilities decreased in 2010 due to settlements and gains reflecting changes in credit spreads, the HPI index and foreign exchange rates. Liabilities designated at fair value through profit or loss decreased in 2010 principally due to maturities of debt securities in issue.

Gains and losses for the year ended 31 December 2010

Gains of £8m in respect of derivatives assets principally reflected changes in credit spreads and the HPI Index offset by unfavourable movements in foreign exchange rates. Gains of £58m in respect of assets designated at fair value through profit or loss principally reflected the smaller mark to market volatility on a reduced portfolio of asset-backed and mortgage-backed securities held during the year.

Gains of £91m in respect of derivatives liabilities principally reflected changes in credit spreads, the HPI Index and foreign exchange rates. Losses of £42m 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 year ended 31 December 2009

Losses of £4m in respect of trading assets valued using internal models based on information other than market data principally reflected the lack of market liquidity during the year.

Gains of £80m in respect of derivatives assets valued using internal models based on information other than market data principally reflected movements in foreign exchange rates.

Losses of £96m in respect of assets designated at fair value through profit or loss valued using internal models based on information other than market data principally reflected changes in foreign exchange rates partly offset by an increase in the value of the prime securities due to tightening of credit spreads of asset-backed and mortgage-backed securities.

Losses of £120m in respect of derivatives liabilities valued using internal models based on information other than market data principally reflected changes in credit spreads, the HPI index and foreign exchange rates.

Losses of £18m 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 changes in credit spreads, foreign exchange and interest rates. They are fully matched with derivatives.

Gains and losses on assets and liabilities classified as held for trading are presented in the income statement under “Net trading and other income”.

Fair value changes on long-term debt designated at fair value and related derivatives are presented in the income statement under ‘Changes in fair value of long-term debt issued and related derivatives’. The income statement line item ‘Net income/(expense) from other financial instruments designated at fair value’ captures fair value movements on all other financial instruments designated at fair value and related derivatives.

Notes to the Financial Statements continued

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

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 may have a significant risk of causing a material adjustment to the carrying amount.

The following tables show the potential income statement effects of using reasonably possible alternative assumptions. The potential effects do not take into effect any offsetting or hedged positions.

At 31 December 2010

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
1. Trading assets – Equity securities: – Property unit trusts	1	Estimated discount to asset value	10%	-	-
3. Derivative assets – Equity and credit contracts: – Reversionary property derivatives	67	HPI Forward growth rate	1%	10	(10)
		HPI Spot rate	10%	7	(7)
		Mortality rate	2 yrs	1	(1)
4. Derivative assets – Equity and credit contracts: – Credit default swaps	38	Probability of default	20%	12	(12)
5. Derivative assets – Equity and credit contracts: – Options and forwards	242	HPI Forward growth rate	1%	7	(7)
		HPI Spot rate	10%	4	(4)
		HPI Volatility	1%	1	(1)
6. FVTPL – Loans and advances to customers: – Roll-up mortgage portfolio	50	HPI Forward growth rate	1%	1	(1)
		HPI Spot rate	10%	-	-
		HPI Volatility	1%	-	-
		Mortality rate	2 yrs	-	-
7. FVTPL – Debt securities: – Asset-backed securities	68	Credit spread	3%	3	(3)
8. Derivative liabilities - Equity and credit contracts: – Options and forwards	(102)	HPI Forward growth rate	1%	4	(4)
		HPI Spot rate	10%	13	(17)
		HPI Volatility	1%	2	(2)

At 31 December 2009

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
1. Trading assets – Equity securities: – Property unit trusts	7	Estimated discount to asset value	10%	1	(1)
3. Derivative assets – Equity and credit contracts: – Reversionary property derivatives	73	HPI Forward growth rate	1%	11	(11)
		HPI Spot rate	10%	8	(8)
		Mortality rate	2 yrs	1	(1)
5. Derivative assets – Equity and credit contracts: – Options and forwards	273	HPI Forward growth rate	1%	3	(3)
		HPI Spot rate	10%	3	(2)
		HPI Volatility	1%	1	(1)
6. FVTPL – Loans and advances to customers: – Roll-up mortgage portfolio	262	HPI Forward growth rate	1%	28	(28)
		HPI Spot rate	10%	9	(11)
		HPI Volatility	1%	5	(5)
		Mortality rate	2 yrs	7	(6)
7. FVTPL – Debt securities: – Asset-backed securities	1,169	Credit spread	75 bps	15	(15)
8. Derivative liabilities - Equity and credit contracts: – Options and forwards	(260)	HPI Forward growth rate	1%	14	(14)
		HPI Spot rate	10%	32	(37)
		HPI Volatility	1%	2	(2)

No sensitivities are presented for the FVTPL - debt securities in issue (instrument 9) per page 109 and related exchange rate derivatives (instrument 2) per page 107 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.

When the fair value of a financial instrument is affected by more than one unobservable assumption, the above table reflects the most favourable or most unfavourable change from varying the assumptions individually.

Notes to the Financial Statements continued

45. Capital management and resources

Capital management and capital allocation

The Santander UK plc Board is responsible for capital management strategy and policy and ensuring that capital resources are appropriately monitored and controlled within regulatory and internal limits within the Santander UK group of companies ("Santander UK"). Authority for capital management flows to the Chief Executive Officer and from her to specific individuals who are members of Santander UK's Asset and Liability Management Committee ('ALCO').

ALCO adopts a centralised capital management approach that is driven by Santander UK's corporate purpose and strategy. This approach takes into account the regulatory and commercial environment in which Santander UK operates, Santander UK's risk appetite, the management strategy for each of Santander UK's material risks (including whether or not capital provides an appropriate risk mitigant) and the impact of appropriate adverse scenarios and stresses on Santander UK's capital requirements. This approach is reviewed annually as part of Santander UK's Internal Capital Adequacy Assessment Process ('ICAAP').

Santander UK manages its capital requirements, debt funding and liquidity on the basis of policies and plans reviewed regularly at ALCO and as part of the ICAAP process while debt funding and liquidity are also reviewed as part of the Internal Liquidity Adequacy Assessment ('ILAA') process. To support its capital and senior debt issuance programmes, the Company is rated on a stand alone basis.

On an ongoing basis and in accordance with the latest ICAAP review, Santander UK forecasts its regulatory and internal capital requirements based on the approved capital volumes allocated to business units as part of the corporate planning process and the need to have access to a capital buffer. Capital allocation decisions are made as part of planning based on the relative returns on capital using both economic and regulatory capital measures. Capital allocations are reviewed in response to changes in risk appetite and risk management strategy, changes to the commercial environment, changes in key economic indicators or when additional capital requests are received.

The combination of regulatory and economic capital ratios and limits, internal buffers and restrictions, together with the relevant costs of differing capital instruments and a consideration of various other capital management techniques are used to shape the most cost-effective structure to fulfil Santander UK's capital needs.

Capital adequacy

From 1 January 2008, the Group has managed its capital on a Basel II basis. Throughout 2010 and 2009, the Group held capital over and above its regulatory requirements, and managed internal capital allocations and targets in accordance with its capital and risk management policies.

Group Capital

	31 December 2010 £m	31 December 2009 £m
Tier 1 capital	**3,342**	3,483
Deductions from Tier 1 capital	**(55)**	(243)
Total Tier 1 capital	**3,287**	3,240
Total Capital Resources	**3,287**	3,240

Regulatory Capital Base

The Group's Tier 1 capital consists of shareholders' equity and audited profits for the years ended 31 December 2010 and 31 December 2009 after adjustment to comply with UK Financial Services Authority rules. The decrease in Tier 1 capital primarily represents the payment of a dividend during the year offset by the inclusion of audited profits for the year ended 31 December 2010. Deductions from Tier 1 relate to intangible assets recognised during the year and expected losses in excess of impairment loss allowances for portfolios on the IRB approach for measuring credit risk.

Risk Factors

An investment in Abbey National Treasury Services plc (the 'Company') and its subsidiaries (together, 'ANTS' or the 'Group') involves a number of risks, the material ones of which are set forth below.

The Group's results may be materially impacted by economic conditions in the UK

The Group's business activities are concentrated in the UK and on the offering of mortgage related products and services. As a consequence, the Group's business, financial condition and/or results of operations 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 subdued earnings growth, greater pressure on disposable income, rising unemployment, a decline in the availability of mortgage finance and the continued effect of global market volatility. In 2010, there was some improvement in UK property market conditions, but the number of loans approved for house purchase remains low relative to the experience of the past decade.

UK economic conditions and uncertainties may have an adverse effect on the quality of the Company's loan portfolio and may result in a rise in delinquency and default rates. There can be no assurance that the Company 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 the Company's provisions for loan losses and writeoffs/charge-offs could have a material adverse effect on the Company's business, financial condition and/or results of operations.

Although the UK economy has begun to show signs of recovery from the recession that followed in the wake of the financial crisis, the economic recovery remains fragile and consumer sentiment remains weak amid concerns of a possible "double-dip" recession precipitated by (amongst other things) the UK Government's emergency budget and the possibility of rising interest rates in the face of persistent inflation above the Bank of England's target rate of 2 per cent. The housing market correction in the UK combined with increasing unemployment continue to adversely affect the credit performance of real estate related exposures, including both residential mortgages and loans to the real estate sector by Corporate Banking, resulting in impairments of asset values by financial institutions, including the Company. These conditions may continue to affect consumer confidence levels and may cause further adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact the Company's provision for credit losses and write-offs/charge-offs.

UK Government measures to tackle the record levels of national debt, including taxation rises and the £81 billion of public spending cuts announced in the Government Spending Review in October 2010, are also likely to result in a slower recovery than other recent recessions. Political involvement in the regulatory environment and the major financial institutions in which the UK Government has a direct financial interest will continue. UK Government demands for financial institutions to increase lending to support the economic recovery will increase competition for deposits, potentially narrowing margins.

The combination of slow economic recovery, UK Government intervention and competition for deposits will maintain the pressure on the Company's retail business model. Credit quality may improve in some sectors as the economy returns to growth but could be adversely affected by any increase in unemployment. These negative conditions in the UK, together with any related significant reduction in the demand for the Group's products and services, could have a material adverse effect on the Company's business, financial condition and/or results of operations.

The Group's business, financial condition and/or results of operations may be negatively affected by conditions in global financial markets

The extreme volatility and disruption in global capital and credit markets over the past three years has led to severe dislocation of financial markets around the world, unprecedented reduced 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 Company'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 these 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. The continuing sovereign debt concerns and fiscal deterioration in relation to certain European countries 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 decreasing 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 Company, all of which could have a material adverse effect on the Group's business, financial condition and/or results of operations.

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), credit risk (wholesale), market risk, operational risk, securitisation risk, interest rate risk in the banking book, concentration risk, liquidity risk, reputational risk, strategic risk, pension obligation 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. While the Group employs a broad and diversified set of risk monitoring and risk mitigation techniques, such techniques, and the judgments 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 business, financial condition and/or results of operations. For example, failure to manage the credit risk (retail) associated with mortgage lending could result in the Company making mortgage loans outside of appropriate risk parameters and potentially resulting in higher levels of default or delinquency on the Company's mortgage loan assets.

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 judgments, 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 Company may fail to estimate accurately the impact of factors that it identifies. Any such failure may have a material adverse impact on the Company's business, financial condition and/or results of operations.

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, have led to market-wide liquidity problems and could lead to 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 business, financial condition and/or results of operations.

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

Liquidity risk is the risk that a bank will be unable to meet its obligations, including funding commitments, as they fall due. 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. From 2007 to 2009, the prime residential mortgage securitisation and covered bond markets experienced severe disruption as a result of a material reduction in investor demand for these securities. These markets, which are important sources of funding for the Group, have recovered to a reasonable extent in 2010 allowing new external issuances of securities. Global investor confidence however remains fragile.

Further 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. If capital 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. It is also possible that the Bank of England will raise interest rates in the near-term, thereby increasing the cost of the Group's funding. The persistence or worsening of these adverse market conditions, and the withdrawal 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, in part on retail 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 retail 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 retail deposit withdrawals in a short period of time, thereby reducing the Group's ability to access retail 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 business, financial condition and/or results of operations.

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 business, financial condition and/or results of operations

The Company is subject to capital adequacy requirements adopted by the Financial Services Authority (the "FSA") for a bank, 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 the Company and certain subsidiaries), expressed as a percentage. Any failure by the Company to maintain its ratios may result in administrative actions or sanctions which may affect the Company's ability to fulfil its obligations.

However, in response to the recent financial crisis, the FSA has imposed, and may continue to impose more stringent capital adequacy requirements, including increasing the minimum regulatory capital requirements imposed on the Group. For instance, the FSA has adopted a supervisory approach in relation to certain UK banks, including the Company, 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).

On 5 October 2009, the FSA published its new liquidity rules which significantly broadened the scope of the existing liquidity regime and are designed to enhance regulated firms' liquidity risk management practices. As part of these reforms, the FSA is also expected to implement gradually requirements for financial institutions to hold prescribed levels of 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.

Following its consultation paper issued in December 2009, the Basel Committee on Banking Supervision announced in September 2010 that it had reached agreement on a number of proposals to reform international capital adequacy and liquidity standards in order to increase resilience in the banking sector from financial and economic stresses (broadly referred to as Basel III). The changes brought about by 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 a retail bank, the Company'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.

These measures could have a material adverse effect on the Group's business, financial condition and/or results of operations. 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 the Group's profitability and ability to pay dividends, continue organic growth (including increased lending), or pursue acquisitions or other strategic opportunities (unless the Group were to restructure its balance sheet in order to reduce the capital charges incurred pursuant to the FSA 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 the Group'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 the Group, any member of the Group or to any of their respective debt securities could increase the Group's cost of funding and liquidity position and adversely affect its interest margins

Credit ratings affect the cost and other terms upon which the Group is able to obtain funding. Rating agencies regularly evaluate the Group and certain members of the Group, as well as their respective debt securities. Their ratings are based on a number of factors, including the financial strength of the Group or of the relevant member, as well as conditions affecting the financial services industry generally. There can be no assurance that the rating agencies will maintain the Group's or the relevant member's current ratings or outlook, especially in light of the difficulties in the financial services industry and the financial markets. Any reduction in those ratings and outlook could increase the cost of 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.

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 it would increase 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, including, 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, although there is increasing speculation that the Bank of England may have to increase interest rates in the near-term due to concerns over persistent inflation above the bank's target rate of 2 per cent.

Dramatic declines in housing markets over the past three 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 the Group). 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 the Group's borrowing costs, while decreasing values of global debt and equity markets have had an adverse effect on the value of the Group's portfolio of mortgage-backed securities and other asset-backed securities issued by Banco Santander, S.A. entities held for yield and liquidity purposes.

Any further increase in capital markets 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 capture new customer deposits.

The Company 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 the Group is undertaking measures to mitigate and control the effects of these conditions, there can be no assurances that such controls will insulate the Group from deteriorating market conditions.

Changes in foreign exchange rates affect the value of assets and liabilities denominated in foreign currencies, and such changes, and the degree of volatility with respect thereto, may affect earnings reported by the Group.

Market conditions have resulted, and could result in the future, 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 three years, financial markets have been subject to significant stress conditions 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, judgments 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 the Company is to grow the Group's operations and it may not be able to manage such growth effectively, which could have an adverse impact on its profitability

The Group allocates management and planning resources to develop strategic plans for organic growth, and to identify possible acquisitions and disposals and areas for restructuring the Group's businesses. The Group 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 the Group'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.

The Group may incur unanticipated losses related to its business combinations

The Group has made several recent business acquisitions, including the acquisition of Alliance & Leicester plc and the retail deposits, branch network and related employees of Bradford & Bingley. In October and November 2010, the Company 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 the Company already held 49.9%); and
- Santander PB UK (Holdings) Limited (of which the Company already held 51%) and its subsidiaries, (together, the "Reorganisation")

The Company will also acquire those parts of the banking business of the Royal Bank of Scotland Group which are carried out through its Royal Bank of Scotland branches in England and Wales and its NatWest branches in Scotland (the "RBS Acquisition") upon completion of the acquisition.

The Group's assessment of the businesses acquired under the Reorganisation 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 the Group 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 the Group's business, financial condition and/or results of operations.

The Group may fail to realise the anticipated benefits of its recent or proposed business combinations

The success of the Group's business combinations will depend, in part, on the Group's ability to realise the anticipated benefits from combining the businesses of Alliance & Leicester, those acquired under the Reorganisation and the assets to be acquired under the RBS Acquisition, with the Group'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 the Group and mean that the Group does not receive the full benefit anticipated from such acquisition. The Group's efforts to integrate these businesses are also likely to divert management attention and resources. If the Group takes longer than anticipated or is not able to integrate these businesses, the anticipated benefits of the Group's business combinations may not be realised fully or at all.

Goodwill impairments may be required in relation to certain of the Group's acquired businesses

The Group has made several recent business acquisitions (including the acquisition of Alliance & Leicester, and the retail deposits, branch network and related employees of Bradford & Bingley, and certain businesses under the Reorganisation), 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 the Company's valuation assumptions are required to be reassessed as a result of any deterioration in their underlying profitability, asset quality and other relevant matters. 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 the Company will not have to write down the value attributed to goodwill in the future, which would adversely affect the Group'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 Company 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 business, financial condition and/or results of operations. The increased 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 business, financial condition and/or results of operations.

In addition, if the Company's customer service levels were perceived by the market to be materially below those of its UK competitor financial institutions, the Company could lose existing and potential new 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 business, financial condition and/or results of operations.

Operational risks are inherent in the Group's business

Operational losses can result from fraud, criminal acts, errors by employees, 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 Company's suppliers or counterparties. Such operational losses could have a material adverse effect on the Company's business, financial condition and/or results of operations.

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

The Company'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 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 business, financial condition and/or results of operations, including control and operational risks, may be adversely affected. Likewise, if the Company fails to attract and appropriately train, motivate and retain qualified 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 (as the majority shareholder in the Company), or the reputation of affiliates operating under the "Santander" 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 business, financial condition and/or results of operations.

The Group's business is subject to substantial legislative, regulatory and governmental oversight

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 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. 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 any 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, the products and services offered or the value of assets as well as the Group's operations, and result in significant increases in operational costs. 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 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 a levy on banks. Although the Group works closely with its regulators and continually monitors the situation, future changes in 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. The resolution of a number of issues, including regulatory investigations and reviews (such as the review by the Office of Fair Trading of barriers to entry, expansion and exit in retail banking in the UK, the results of which were published on 4 November 2010) and court cases, affecting the UK financial services industry could have an adverse effect on the Group's business, financial condition and/or results of operations, or its relations with some of its customers and potential customers.

UK tax changes (including the new bank levy) could have a material adverse effect on the Group's business

HM Treasury will introduce a new and permanent bank levy via legislation in the Finance Bill 2011. The bank levy will be imposed on (amongst other entities) UK banking groups and subsidiaries, and therefore applies to the Group. The amount of the levy will be 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 will be applied to longer-term liabilities.

HM Treasury has emphasised that the 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. At present, it is expected that bank levy will raise £2.5 billion in each of 2011 and 2012, and £2.6 billion in each of 2013 and 2014.

The bank levy, and possible future changes in the taxation of banking groups in the UK, could have a material adverse effect on the Company's business, results of operations and/or financial condition, and the competitive position of UK banks, including the Company.

The Group is exposed to various forms of legal and regulatory risk, including the risk of misselling financial products, acting in breach of legal or regulatory principles or requirements and giving negligent advice, any of which could have a material adverse effect on its business, financial condition and/or results of operations or its relations with its customers

The Group is exposed to many forms of legal and regulatory risk, which may arise in a number of ways. Primarily:

- certain aspects of the Group'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 Financial Ombudsman Service, with what is fair and reasonable in the Ombudsman'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.
- the Group holds accounts for entities that might be or are subject to interest from various regulators, including the 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
- the Group may be liable for damages to third parties harmed by the conduct of its business.

In addition, the Group faces 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 the Group's reputation and/or its business, financial condition and/or results of operations.

The structure of the financial regulatory authorities in the UK and the UK regulatory framework that applies to members of the Group is the subject of reform and reorganisation

The UK Government announced proposals on 16 and 17 June 2010 to reform the institutional framework for UK financial regulation. Specifically, the UK Government intends to disband the FSA and reallocate its current responsibilities between three new regulatory authorities.

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

While it is not presently anticipated that the structural reorganisation of the regulatory authorities concerned will, itself, lead to substantive changes in the regulatory provisions and conduct of business rules and guidance which have been made or are being consulted on by the FSA, it is possible that future changes in the nature of, or policies for, prudential and conduct of business supervision, as performed by any successor authority 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 the Group.

Any or all of these factors could have a material adverse effect on the conduct of the business of the Company 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 new reforms to the mortgage lending market have been proposed which could require significant implementation costs or changes to the business strategy of relevant members of the Group and may create uncertainty in the application of relevant laws or regulation

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". The review involved a consultation concerning various potential reforms to the regulatory framework applicable to mortgage lenders and mortgage intermediaries, including in relation to mortgage firms' conduct of business, product distribution and advice, and their handling of arrears and repossessions.

Separately, HM Treasury announced on 26 March 2010 that it had decided to transfer the responsibility for the regulation of second charge residential mortgages, including existing loans, from the OFT to the FSA, and further to consider changes to the form of regulation proposed to protect consumers in the buy-to-let sector and to take action to protect borrowers when mortgage books are on-sold.

At this stage, it is not possible accurately to predict the nature and impact that these reforms (and any further reforms considered as part of the Mortgage Market Review) may have. However, it is possible that such reforms, if adopted, could lead to a period of uncertainty for the affected members of the Group, particularly as regards changes that may be required to the operational strategy and capital management of the relevant entity, and the supervisory approach taken by the FSA in relation to second charge mortgages, a portfolio of which the Group acquired as a result of its acquisition of Alliance & Leicester. In addition, a change of UK Government has occurred since these proposals were adopted and a new UK regulatory structure has been proposed. While there is, at present, nothing to suggest that these proposals will not be implemented, the change of UK Government and the proposed reforms to the regulatory supervisory structure could give rise to uncertainty for members of the Group as to whether or when the proposed reforms will take place.

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 business, financial condition and/or results of operations of the Group.

Potential intervention by the UK Financial Services Authority (or an overseas regulator) may occur, particularly in response to attempts by customers to seek redress from financial service institutions, including the Group, where it is alleged that particular products fail to meet the customers' reasonable expectations.

Customers of financial services institutions, including customers of the Group, 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 judgments by the FOS, it is possible that an adverse outcome in some matters could have a material adverse effect on the business, results of operations and/or financial condition of the Group arising from any penalties imposed or compensation awarded, together with the costs of defending such an action.

The Financial Services Act 2010 has provided for a new power for the FSA which enables the FSA to require authorised firms, including members of the Group, 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"), on which topic, in August 2010, the FSA published Policy Statement 10/12 entitled "The assessment and redress of Payment Protection Insurance complaints". This policy statement contains final FSA Rules which alter the basis on which FSA regulated firms (including the Company and certain members of the Group) 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 applied for judicial review of these new rules and it is currently uncertain as to whether this application will lead to further changes to the rules. The Company and certain members of the Group have sold and continue to sell PPI. At this point in time, the Company and the relevant members of the Group are assessing the likely impact of the revised FSA Rules on this subject. However, it is possible that these new rules may increase the costs associated with assessing PPI complaints and may lead to the Company and/or members of the Group paying out substantially higher amounts in compensation to customers who make such complaints. As a result, this may ultimately have an impact on the business, financial condition and/or results of operations of the Company and the Group.

The FSA may identify future industry-wide misselling or other issues that could affect the Group. 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 business, results of operations and/or financial condition of the Group.

Members of the Group 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 the Company and other members of the Group.

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 the Group may have a material adverse effect on its business, financial condition and/or results of operations. 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 in the future 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 the Group. For instance, the FSA produced a consultation paper on pre-funding the FSCS, which may affect the profitability of the Company (and other members of the Group required to contribute to the FSCS), although the UK Government has stated that pre-funding would not be introduced before 2012.

As a result of the structural reorganisation and reform of the UK financial regulatory authorities, it is proposed that the FSCS will become the responsibility of one of the successor regulatory authorities to the FSA. 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 the Group. In addition, it is possible that other jurisdictions where the Group operates could introduce similar compensation, contributory or reimbursement schemes. As a result of any such developments, the Group may incur additional costs and liabilities which may adversely affect its business, financial condition and/or results of operations.

The Banking Act may adversely affect the Group's business

The Banking Act came into force on 21 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 the Company, in a manner analogous to the situation that occurred at Northern Rock, adversely affecting the ability of the Company 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 the Company, such instrument or order (as the case may be) may (among other things): (i) result in a compulsory transfer of shares and/or other securities or property of the Company; and/or (ii) impact on the rights of the holders of shares or other securities in the Company, and/or result in the nullification or modification of the terms and conditions of such shares or securities; and/or (iii) result in the de-listing of the Company's shares and/or other securities. In addition, such an order may affect matters in respect of the Company and/or other aspects of the Company's shares or other securities which may negatively affect the ability of the Company 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 the Group 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 the Company 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, 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 systems (whether as a result of migrating any new business onto Partenon or otherwise), 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 business, financial condition and/or results of operations.

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 could have a material adverse effect on the Group's business, financial condition and/or results of operations.

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 business, financial condition and/or results of operations.

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 and/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 business, financial condition and/or results of operations.

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

The Group 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. The Group 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 the Group are service companies or may become insufficiently resourced, other companies within the Group 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 to 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 High Court decided in the 2010 case of *Bloom and others & Ors v The Pensions Regulator (Nortel, Re)* 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. The matter is not yet settled as it is understood that there will be an expedited appeal to the Court of Appeal and amendment to the existing legislation may be introduced.

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 the Group to restructure itself or to undertake certain corporate activities.

Changes in the size of the deficit in the defined benefit schemes operated by the Group, 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 the Group having to make increased contributions to reduce or satisfy the deficits which would divert resources from use in other areas of the Group's business and reduce the Company's capital resources. While a number of the above factors can be controlled by the Group, there are some over which it has no or limited control. Although the trustees of the defined benefit pension schemes are obliged to consult the Group before changing the pension schemes' investment strategy, the trustees have the final say.

Risks concerning enforcement of judgements made in the United States

Santander UK 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 Santander UK 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 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. 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.

Guarantees

GUARANTEE

THIS INSTRUMENT by way of deed poll is executed on 29 January, 2008 by ABBEY NATIONAL plc (registered in England No. 2294747) whose registered office is at Abbey National House, 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 Abbey National House, 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 (the '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 ANTS or any subsidiary of ANTS (as defined in section 736 of the Companies Act 1985 (the 'Act')) or any individual who is a connected person of ANTS within the meaning of section 346 of the Act) to whom an Obligation is from time to time owed;

'Obligation' means any obligation or liability, either primary or contingent, lawfully incurred by ANTS to any person on or before 31st July, 2012 (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) foreign exchange transactions to which ANTS is a party (including, without limitation of the generality of the foregoing, foreign exchange contracts, hedge settlement contracts, foreign exchange options, foreign exchange futures, and currency exchange or 'swap' agreements and cross-currency interest rate exchange or 'swap' agreements);

(vi) interest rate transactions to which ANTS is a party (including, without limitation to the generality of the foregoing, interest rate options, interest rate futures, forward rate agreements, interest rate exchange or 'swap' agreements and cross-currency interest rate exchange or 'swap' agreements);

and 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 31st July, 2012) together with all reasonable costs, commissions and other expenses incurred by any person in connection with the enforcement of this Guarantee and for the avoidance of doubt, 'Obligations' shall include 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 (including, without limitation to the generality of the foregoing, any such agreement relating to the obligations or liabilities of Abbey National Building Society) and references in this definition to 'ANTS' shall include persons whose obligations or liabilities have been so assumed by ANTS;

'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 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 of any Obligation, undertakes to pay, or procure the payment of, such Obligations in the currency in which the particular Obligation is denominated in the case of a payment 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 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 withholdings 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 weekdays 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 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 the Creditor shall be entitled to recover the value or amount thereof from the Guarantor as if such payment by ANTS had not been made.

10. This Guarantee shall remain in full force and effect irrespective of the validity, regularity, legality or enforceability against ANTS of, or of any defence or counter-claim whatsoever, available in relation to, any Obligations whether or not any action has been taken to enforce the same or any judgement obtained against ANTS or any other person, whether or not any time or indulgence has been granted to ANTS or any other person by or on behalf of any Creditor, whether or not there have been any dealings or transactions between ANTS or any other person and any of the Creditors, 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, 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 whether or not any circumstances have occurred which might otherwise constitute a legal or equitable discharge of or defence to a guarantor.
11. 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.
12. 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.
13. This Guarantee shall be governed by and construed in accordance with English law.

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

THE COMMON SEAL of)
ABBEY NATIONAL PLC)
was hereunto affixed)
in the presence of:)

Shaun Coles

Deputy Company Secretary

Directors' Responsibility Statement

We confirm to the best of our knowledge:

1. The financial statements, prepared in accordance with International Financial Reporting Standards, as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and

2. The management report, which is incorporated into the Directors' Report, includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face.

By Order of the Board

David Green
Director

17 March 2011