

Half Yearly Financial Report 2017

Santander UK plc

PART OF THE BANCO SANTANDER GROUP

Important information for readers

Santander UK plc and its subsidiaries (collectively Santander UK or the Santander UK group) operate primarily in the UK, and are part of Banco Santander (comprising Banco Santander SA and its subsidiaries). Santander UK plc is regulated by the UK Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) and certain other companies within the Santander UK group are regulated by the FCA.

This Half Yearly Financial Report contains forward-looking statements that involve inherent risks and uncertainties. Actual results may differ materially from those contained in such forward-looking statements. See 'Forward-looking statements' in the Shareholder information section.

Santander UK plc

Half Yearly Financial Report 2017

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Introduction

The Company sets out in this report a fair review of its business and a description of its principal risks and uncertainties, including a balanced and comprehensive analysis of the development and performance of the business in the first half of the year and of its position at the end of the period.

Principal activities and business review

Santander UK plc (the Company) and its subsidiaries (collectively, Santander UK or the Santander UK group) is a major financial services provider, offering a wide range of personal financial products and services, and is a growing participant in the corporate banking market. The Company is authorised and regulated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).

Customer focused ring fencing model

We are progressing well with the implementation of a 'wide' ring-fence structure that will serve our retail, commercial and corporate customers. We believe this model provides greater certainty for our customers, while ensuring minimal disruption as we implement the changes required. This also maintains longer term flexibility for Santander UK, while lowering the overall programme implementation costs with the creation of the ring fence now involving the transfer of fewer customers.

The majority of our customer loans and assets as well as customer deposits and liabilities will remain within Santander UK plc, our principal ring-fenced bank. Prohibited activities which cannot be transacted within the ring-fence principally include our derivatives business with financial institutions and certain corporates, elements of our short term markets business and our branches in Jersey, Isle of Man and the US. Customers who cannot be served and services which are not permitted within a ring-fenced bank will be transferred to Banco Santander SA, or its London branch.

Customers who cannot be served and services which are not permitted within a ring-fenced bank will be transferred to Banco Santander SA, or its London branch. We intend to use a Part VII Ring-Fence Transfer Scheme to transfer the majority of the prohibited business of the Santander UK group to Banco Santander. We are on track to complete the implementation in advance of the legislative deadline of 1 January 2019, with implementation subject to regulatory and court approvals and various other authorisations.

Development and performance of our business in H117

Information on the development and performance of our business in H117 is set out in the 'Income statement review' section of the Financial review and information on our position at the end of the period is set out in the 'Balance sheet review' section of the Financial review.

Board appointments

We recently announced the appointment of two new Executive Directors. I would like to welcome Antonio Roman, Chief Financial Officer, and Javier San Felix, Head of Retail & Business Banking and Deputy CEO, to the Board of Santander UK.

2017 outlook

We expect solid UK economic growth in 2017. However, we see greater uncertainty in the outlook, with the concern that some downside risks could materialise later this year and into 2018. The labour market remains strong, but higher inflation, largely from the lower value of sterling, is now reducing households' real earnings. This is likely to result in lower consumer spending growth which, when combined with a potentially more challenging macro environment, adds a degree of caution to our outlook.

We have therefore deliberately controlled growth in certain business areas and in particular those with higher margins and the potential for higher risk. We believe that our proactive risk management policies and low risk appetite will deliver resilient performance going forward.

Our principal risks and uncertainties

Information on our principal risks and uncertainties is set out in the Risk review by type of risk. Except where noted, there has been no significant change to the description of these risks or key mitigating actions as set out in the 2016 Annual Report.

Key performance indicators

The directors of the Company's parent, Santander UK Group Holdings plc, manage the operations of the Santander UK Group Holdings plc group (which includes the Santander UK plc group) on a business division basis. Key performance indicators are not set, monitored or managed at the Santander UK plc group level. As a result, the Company's Directors believe that analysis using key performance indicators for the Company is not necessary or appropriate for an understanding of the development, performance or position of the Company. The development and performance of the business of the Santander UK plc group is set out in the 'Income statement review' section of the Financial review. The key performance indicators of the Santander UK Group Holdings plc group can be found on page 4 of its 2017 Half Yearly Financial Report, which does not form part of this report.

By Order of the Board

Nathan Bostock
Director
13 September 2017

Directors' responsibilities statement

The Directors confirm that to the best of their knowledge these Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union, and that the half-year management report herein includes a fair review of the information required by Disclosure and Transparency Rules 4.2.7R and 4.2.8R, namely:

- An indication of important events that have occurred during the six months ended 30 June 2017 and their impact on the Condensed Consolidated Interim Financial Statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year, and
- Material related party transactions in the six months ended 30 June 2017 and any material changes in the related party transactions described in the last Annual Report.

By Order of the Board

Nathan Bostock

Chief Executive Officer

13 September 2017

Financial review

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Income statement review

SUMMARISED CONSOLIDATED INCOME STATEMENT

| | Half year to 30 June 2017 | Half year to 30 June 2016 |
|---|------------------------------|------------------------------|
| | £m | £m |
| Net interest income | 1,922 | 1,773 |
| Non-interest income ⁽¹⁾ | 591 | 671 |
| Total operating income | 2,513 | 2,444 |
| Operating expenses before impairment losses, provisions and charges | (1,215) | (1,205) |
| Impairment losses on loans and advances | (48) | (63) |
| Provisions for other liabilities and charges | (186) | (97) |
| Total operating impairment losses, provisions and charges | (234) | (160) |
| Profit before tax | 1,064 | 1,079 |
| Tax on profit | (323) | (307) |
| Profit after tax for the period | 741 | 772 |
| Attributable to: | | |
| Equity holders of the parent | 730 | 756 |
| Non-controlling interests | 11 | 16 |

(1) Comprised of Net fee and commission income and Net trading and other income.

H117 compared to H116

Profit before tax was down 1%, with higher provisions for other liabilities and charges, offset by steady income growth, continued cost discipline, and good credit quality. By income statement line, the movements were:

- Net interest income was up 8%, driven by retail liability margin improvement and an accrued interest release, partially offset by continued SVR mortgage attrition and pressure on new lending margins. The SVR attrition was £2.5bn in H117, lower than the £3.4bn in H116. NIM was 1.53% in H117, compared to 1.48% in 2016.
- Non-interest income was down 12%, with mark-to-market movements on economic hedges and the absence of the gain on sale of Visa Europe Limited in H116. This was partially offset by growth in all customer business segments and the gain on sale of Vocalink Holdings Limited in H117.
- Operating expenses before impairment losses, provisions and charges were broadly stable. Operational efficiency continues to absorb higher investment costs in business growth and enhancements to our digital channels. Our costs were also well managed, despite inflationary pressures.
- Impairment losses on loans and advances decreased 24% to £48m, as a result of our prudent lending criteria and the ongoing resilience of the UK economy. Furthermore, mortgage releases were £21m in H117 compared to £58m in H116.
- Provisions for other liabilities and charges increased to £186m, driven by a Q117 £32m charge for PPI, a Q217 net charge of £37m for a specific PPI portfolio under review and £35m for other conduct matters.
- Tax on profit increased 5% to £323m, driven by higher conduct provisions that are disallowed for tax purposes. The effective tax rate increased to 30% from 28%.

PROFIT BEFORE TAX BY SEGMENT

This section contains a summary of our results, and commentary thereon, by income statement line item for each segment. The segmental information in this Half Yearly Financial Report reflects the reporting structure in place at the reporting date. For more, see Note 2 to the Condensed Consolidated Interim Financial Statements.

RETAIL BANKING

Retail Banking offers a wide range of products and financial services to individuals and small businesses through a network of branches and ATMs, as well as through telephony, digital and intermediary channels. Retail Banking serves business banking customers, small businesses with an annual turnover of up to £6.5m, and Santander Consumer Finance, predominantly a vehicle finance business. Its main products are residential mortgage loans, savings and current accounts, credit cards and personal loans as well as insurance policies.

Summarised income statement

| | Half year to 30 June 2017 £m | Half year to 30 June 2016 £m |
|---|------------------------------------|------------------------------------|
| Net interest income | 1,730 | 1,531 |
| Non-interest income | 314 | 283 |
| Total operating income | 2,044 | 1,814 |
| Operating expenses before impairment losses, provisions and charges | (919) | (922) |
| Impairment losses on loans and advances | (39) | (34) |
| Provisions for other liabilities and charges | (155) | (77) |
| Total operating impairment losses, provisions and charges | (194) | (111) |
| Profit before tax | 931 | 781 |

H117 compared to H116

Profit before tax increased by £150m to £931m in H117 (H116: £781m). By income statement line, the movements were:

- Net interest income increased 13%, with liability margin improvement offsetting continued SVR mortgage attrition and pressure on new lending margins.
- Non-interest income increased 11%, with higher current account and wealth management fees.
- Operating expenses before impairment losses, provisions and charges were flat with operational efficiencies, offsetting continued investment in business growth and digital enhancements.
- Impairment losses on loans and advances increased by £5m to £39m, with lower mortgage impairment releases of £21m in H117 compared to £58m in H116, which are starting to normalise from cyclically low levels.
- Provisions for other liabilities and charges increased to £155m, due to PPI charges in Q117 and Q217 and a charge for other conduct matters.

Balances

| | 30 June 2017 £bn | 31 December 2016 £bn |
|--|---------------------|-------------------------|
| Customer loans | 168.2 | 168.6 |
| - of which mortgages | 154.1 | 154.3 |
| - of which business banking ⁽¹⁾ | 2.0 | 2.3 |
| - of which consumer finance | 6.9 | 6.8 |
| - of which other unsecured lending | 5.2 | 5.2 |
| Risk-weighted assets (RWAs) | 43.9 | 43.6 |
| Customer deposits | 148.7 | 148.1 |
| - of which current accounts | 66.3 | 64.8 |
| - of which savings | 62.3 | 64.7 |
| - of which business banking accounts | 10.5 | 10.0 |
| - of which other retail products | 9.6 | 8.6 |

(1) Following a periodic review in Q117, a number of business banking customers were transferred to Commercial Banking, where their ongoing needs can be better served. The balance associated was £200m. Prior periods have not been amended.

30 June 2017 compared to 31 December 2016

- Mortgage lending balances decreased £0.2bn, reflecting management pricing actions in late 2016 that impacted new mortgage completions in H117. We retained c75% of mortgages reaching the end of their incentive period.
- Consumer finance and other unsecured lending balances were flat, in part as a result of controlled management actions in an increasingly competitive environment.
- Customer deposits were up £0.6bn, with ongoing demand for our current accounts and other retail products, partially offset by lower savings balances, which declined £2.4bn.
- Business banking deposits increased £0.5bn, as we continue to deepen relationships with our SME customers and focus on growing our lending capabilities.
- Retail Banking deposit spread narrowed, with a 30bps improvement to (0.27)% from (0.57)% in December 2016.

Business volumes⁽¹⁾

| | Half year to 30 June 2017 £bn | Half year to 30 June 2016 £bn |
|--------------------------------|-------------------------------------|-------------------------------------|
| Mortgage gross lending | 11.6 | 12.7 |
| Mortgage net lending | (0.2) | 0.6 |
| Business banking net lending | (0.3) | (0.1) |
| Consumer finance gross lending | 1.7 | 1.6 |
| Consumer finance net lending | 0.1 | 0.3 |

(1) Gross and net lending figures exclude any assets purchased or transferred in the period.

H117 compared to H116

- Lower mortgage gross lending at £11.6bn reflects management pricing actions in Q416 that impacted new mortgage completions in the first half of the year. In H117, we helped 10,900 first-time buyers (£1.8bn of gross lending) purchase their new home. Interest-only mortgage balances decreased £1.7bn to £50.6bn (2016: £52.3bn) while Buy-to-Let (BTL) mortgage balances increased £0.3bn to £6.9bn (2016: £6.6bn).

We continued to focus our BTL book on non-professional landlords, as this segment is closely aligned with residential mortgages and accounts for the majority of the volume in the BTL market. In H117, we completed 2,728 BTL mortgages, representing 4% of the value of our new business flow, at an average LTV of 62%.

- Consumer finance gross lending was £1.7bn with higher retail loans, partially offset by a decrease in the stock of new car registrations. We continue to benefit from our partnership with manufacturers and joint ventures, supported by prudent underwriting criteria within our traditional prime vehicle business.

Business development

- In the first half of the year, we introduced a new set of tools that aim to improve the customer experience across all channels. In January 2017, the new CRM tool was launched to enable our people to continue conversations with customers which may have started in another channel. It also utilises information from connected systems to facilitate new conversations. In addition, we updated the SmartBank app with voice commands capabilities. Furthermore, in March 2017, we simplified the process to open a current account online with instant decisions and document upload where required. Lastly, in June 2017, we launched a new service that allows customers to apply for a mortgage via video link to an advisor.
- Our digital customer base continued to grow in H117, gaining an average of 1,200 new active mobile users per day for a total of 2.4 million mobile customers, of which 1.6 million exclusively use our mobile app in their transactions with us. In the same period 47% of our mortgages were retained online, 34% of current account openings and 46% of credit card openings were made through digital channels.
- Our Cyber Resilience programme operates with a layered defence approach, continually evolving and adapting to cyber threats. Protecting our customers, systems and information is a top priority and a key area of focus. We have increased our resources and are leveraging connections with Banco Santander's Cyber Security Operations Centre.
- 11213 World customers increased, although at a slower rate, to 5.2 million. Whilst there has been an expected reduction in 11213 Current Account openings, following fee and interest rate changes in January 2016 and November 2016, the current account base continues to grow (up 43,000), reflecting the strength and stability of the franchise. We believe the 11213 Current Account and 11213 Lite Current Account continue to be outstanding propositions for many customers.
- We continue to make investments accessible to all our customers and have expanded our wealth management business by growing our Private Banking and Financial Planning advisory teams. From March 2017 through April 2017, we ran a media campaign that successfully raised awareness of our improved wealth management offering. As a result, over 8,600 customers registered on our new Investment Hub and over 18,000 customer appointments were scheduled with our Private Banking and Financial Planning advisory teams. In June 2017, we also launched the new World Elite Mastercard, offering our Select and Private Banking customers extensive travel and lifestyle benefits whilst also providing cashback on purchases.
- We plan to grow the Santander Business franchise with a relationship led approach and strong emphasis on increasing customer loyalty. In particular we see an opportunity to expand our lending capabilities by identifying innovative solutions that meet the needs of our SME customers.

COMMERCIAL BANKING

Commercial Banking offers a wide range of products and financial services provided by relationship teams that are based in a network of regional Corporate Business Centres (CBCs) and through telephony and digital channels. The management of our customers is organised across two relationship teams - the Regional Corporate Bank (RCB) that covers trading businesses with annual turnover from £6.5m to £500m and Specialist Sector Groups (SSG) that cover real estate, housing finance, education, healthcare, and hotels. Commercial Banking products and services include loans, bank accounts, deposits, treasury services, invoice discounting, cash transmission, trade finance and asset finance.

Summarised income statement

| | Half year to 30 June 2017 £m | Half year to 30 June 2016 £m |
|---|------------------------------------|------------------------------------|
| Net interest income | 198 | 203 |
| Non-interest income | 44 | 41 |
| Total operating income | 242 | 244 |
| Operating expenses before impairment losses, provisions and charges | (109) | (113) |
| Impairment losses on loans and advances | (3) | (11) |
| Provisions for other liabilities and charges | (29) | - |
| Total operating impairment losses, provisions and charges | (32) | (11) |
| Profit before tax | 101 | 120 |

H117 compared to H116

Profit before tax decreased by £19m to £101m in H117 (H116: £120m). By income statement line, the movements were:

- Net interest income decreased 2%, with continued asset margin pressures, partially offset by customer lending growth.
- Non-interest income increased 7% to £44m. Growth in asset restructuring fees, up 11%, international, up 13%, and digital and payment, up 10%, was partially offset by lower rates management fees.
- Operating expenses before impairment losses, provisions and charges decreased 4%, with continued focus on strong cost management and operational efficiency.
- Impairment losses on loans and advances were lower at £3m. Overall, the loan book continues to perform well and is supported by our prudent lending policy.
- Provisions for other liabilities and charges increased to £29m, mainly due to conduct provisions taken in Q217.

Balances

| | 30 June 2017 £bn | 31 December 2016 £bn |
|-------------------------------|---------------------|-------------------------|
| Customer loans ⁽¹⁾ | 19.6 | 19.4 |
| RWAs | 20.1 | 20.4 |
| Customer deposits | 18.1 | 17.2 |

(1) Following a periodic review in Q117, a number of business banking customers were transferred to Commercial Banking, where their ongoing needs can be better served. The balance associated was c£200m. Prior periods have not been amended.

30 June 2017 compared to 31 December 2016

- Customer loans were broadly flat at £19.6bn, with solid lending growth to trading business customers, offset by the continued active management of our CRE exposures amid economic uncertainty.
- RWAs were lower, driven by the reduction of our CRE exposures.
- We continue to attract deposit balances, through our strong customer relationships, supported by a comprehensive product range and competitive pricing.

Business volumes

| | Half year to 30 June 2017 | Half year to 30 June 2016 |
|--|------------------------------|------------------------------|
| New facilities (£bn) | 3.5 | 4.3 |
| Bank account openings (No.) | 1,621 | 1,314 |
| Online banking (Connect) active users ⁽¹⁾ (No.) | 28,843 | 26,100 |

(1) Online banking (Connect) active users include both business banking and Commercial Banking customers.

H117 compared to H116

- We continue to open bank accounts and extend new facilities, despite a competitive environment and economic uncertainty. Our Relationship Managers are building their portfolios by leveraging our comprehensive suite of products and services.
- There was a continuation in the pickup of our corporate banking platform 'Connect', with active users increasing 11% year on year.

Business development

- The focus of the Commercial Banking division is to expand its franchise by both growing the overall customer base, as well as deepening loyalty amongst our existing customers. We aim to increase loyalty by leveraging our international reach and proposition as well as continuing to develop our product capabilities to meet our customers' needs.
- Coverage of our commercial clients is organised by local relationship teams or by sectors. Our sector teams support our clients by using specialist knowledge of the individual business and its operating environment to recommend solutions. Furthermore, we have identified key strategic sectors and have partnered with leading trade bodies to deliver a customer led proposition that leverages our international presence and connectivity to access on-the-ground support overseas, connect to potential new business partners and enter global supply chains. Our partnerships also run a wide range of collaborative activity, including market reports, insight and events.
- We are working with Banco Santander SA and key strategic partners to develop trade initiatives that make it easier for clients to grow their business internationally. Our Spain-UK corridor has facilitated introductions to relationship directors by simplifying the process for cross-border account referrals. We have also launched a US-UK corridor and formalised an alliance with YES bank, India's fourth largest private sector bank, to support trade and offer our customers new business opportunities in the respective markets. These initiatives allow us to attract new clients and deepen existing relationships, as well as compliment some of our existing services, for example Santander Trade Club and Santander Passport.
- Breakthrough Growth Capital provides new funding and identifies key partnerships at milestones in the development of our clients' business. In the first six months of the year, we assisted 26 businesses in accessing £86m of facilities. Since inception, the Growth Capital team has completed 152 funding solutions for 108 companies, providing £438m of facilities, which will create over 6,360 jobs.
- Our innovative offering was recognised at the 2017 Business Moneyfacts Awards, winning a number of prestigious awards including: 'Business Bank of the Year' and the 'Best International Solutions Provider', both for the third consecutive year, to name a few. The industry recognition is a testament to Santander UK's commitment to become the bank of choice for UK companies and shows the strength of our overall value proposition for businesses, built on our relationship banking approach.

GLOBAL CORPORATE BANKING

Global Corporate Banking (GCB) services corporate clients with a turnover of £500m and above per annum and financial institutions. GCB clients require specially tailored solutions and value-added services due to their size, complexity and sophistication. We provide these clients with products to manage currency fluctuations, protect against interest rate risk, and arrange capital markets finance and specialist trade finance solutions, as well as providing support to the rest of Santander UK's business segments.

Summarised income statement

| | Half year to 30 June 2017 | Half year to 30 June 2016 |
|---|------------------------------|------------------------------|
| | £m | £m |
| Net interest income | 40 | 39 |
| Non-interest income | 206 | 184 |
| Total operating income | 246 | 223 |
| Operating expenses before impairment losses, provisions and charges | (145) | (141) |
| Impairment losses on loans and advances | (9) | (21) |
| Provisions for other liabilities and charges | - | - |
| Total operating provisions and charges | (9) | (21) |
| Profit before tax | 92 | 61 |

H117 compared to H116

Profit before tax increased by £31m to £92m in H117 (H116: £61m). By income statement line, the movements were:

- Net interest income was broadly flat at £40m, with ongoing demand for project and acquisition finance, transactional services and factoring products, offset by continued asset margin pressures. This also includes £10m income arising from favourable conditions in market rates.
- Non-interest income increased 12% to £206m, driven by security financing, derivative and cash sales, and market making activities.
- Operating expenses before impairment losses, provisions and charges increased 3% to £145m, with continued investment to improve our operating model.
- Impairment losses on loans and advances were lower at £9m, with continued good performance of the loan book.
- There were no provisions for other liabilities and charges in the period.

Balances

| | 30 June 2017 | 31 December 2016 |
|-------------------|--------------|------------------|
| | £bn | £bn |
| Customer loans | 6.5 | 5.7 |
| RWAs | 16.4 | 16.9 |
| Customer deposits | 4.4 | 4.1 |

30 June 2017 compared to 31 December 2016

- Customer loans increased to £6.5bn, driven by our refinancing and origination activities relating to project and acquisition finance and transactional services, as well as increased client drawdowns.
- RWAs were lower, driven by a decrease in counterparty credit and market risk that was partially offset by asset growth. RWAs attributable to customer loans were £8.0bn (2016: £7.5bn).
- Customer deposits were higher at £4.4bn, primarily driven by growth in cash management products.

Business development

- We continue to enhance our compliance and risk frameworks, with improvements to our internal process in compliance monitoring and financial crime management. We are also rolling out our client management service function to Commercial Banking, to simplify the client on-boarding process and improve the customer experience.
- In H117, we formed a mergers and acquisitions advisory team that will complement our existing product capabilities. The team is building a healthy pipeline of deals to support fee income growth. There was also solid momentum in business activity and increased demand from our Financial Institution Group clients for debt capital market services. Our ongoing focus is to maximise return on capital, by effectively leveraging our transactional banking products, FX and advisory services.

CORPORATE CENTRE

Corporate Centre predominantly consists of the non-core corporate and treasury legacy portfolios. Corporate Centre is also responsible for managing capital and funding, balance sheet composition, structure and strategic liquidity risk. The non-core corporate and treasury legacy portfolios are being run-down and/or managed for value.

Summarised income statement

| | Half year to 30 June 2017 | Half year to 30 June 2016 |
|---|------------------------------|------------------------------|
| | £m | £m |
| Net interest expense | (46) | - |
| Non-interest income | 27 | 163 |
| Total operating (expense)/income | (19) | 163 |
| Operating expenses before impairment losses, provisions and charges | (42) | (29) |
| Impairment releases on loans and advances | 3 | 3 |
| Provisions for other liabilities and charges | (2) | (20) |
| Total operating impairment releases, provisions and charges | 1 | (17) |
| (Loss)/profit before tax | (60) | 117 |

H117 compared to H116

Profit before tax decreased by £177m to a loss of £60m in H117 (H116: £117m profit). By income statement line, the movements were:

- Net interest expense of £46m, reflects changes in the commercial balance sheet profile, partially offset by a £39m release of accrued interest on a foreign tax liability that is no longer payable.

Due to the lower interest rate environment, we envisage that net interest income from the structural hedge will continue to decrease as a result of maturing positions being reinvested at lower prevailing rates. The majority of new mortgage flows are left un-hedged to provide stable returns. The average duration of our fixed term new mortgage flows is about 2.5 years, with a total structural hedge position of £80bn.
- Non-interest income was impacted by mark-to-market movement on economic hedges and the absence of the £119m gain on sale of Visa Europe Limited in H116, partially offset by the £48m gain on sale of Vocalink Holdings Limited in H117.
- Operating expenses before impairment losses, provisions and charges, predominantly represent £42m of regulatory compliance and project costs relating to Banking Reform.
- Impairment releases on loans and advances were flat, in line with the continued management of the non-core portfolio.
- Provisions for other liabilities and charges decreased to £2m, predominantly due to the absence of restructuring costs.

Balances

| | 30 June 2017 | 31 December 2016 |
|---------------------------|--------------|---------------------|
| | £bn | £bn |
| Non-core customer loans | 6.0 | 6.5 |
| - of which Social Housing | 5.1 | 5.4 |
| RWAs | 6.8 | 6.7 |
| Customer deposits | 3.2 | 3.0 |

30 June 2017 compared to 31 December 2016

- Non-core customer loans decreased £0.5bn, as we continue to implement our exit strategy from individual loans and leases in the non-core corporate and legacy portfolios.
- RWAs were broadly flat with higher counterparty credit risk, partially offset by a reduction in non-core customer loans and the Vocalink Holdings Limited shareholder sale. RWAs attributable to non-core customer loans amounted to £1.1bn (2016: £1.3bn).
- Customer deposits increased £0.2bn, as we continue to rebalance the deposit base tenor.

Balance sheet review

SUMMARISED CONDENSED CONSOLIDATED BALANCE SHEET

| | 30 June 2017 £m | 31 December 2016 £m |
|--|--------------------|------------------------|
| Assets | | |
| Cash and balances at central banks | 18,255 | 17,107 |
| Trading assets | 34,423 | 30,035 |
| Derivative financial instruments | 21,611 | 25,471 |
| Financial assets designated at fair value | 2,161 | 2,140 |
| Loans and advances to banks | 4,404 | 4,348 |
| Loans and advances to customers | 199,799 | 199,738 |
| Loans and receivables securities | 1,424 | 257 |
| Available-for-sale securities | 9,574 | 10,561 |
| Held-to-maturity investments | 6,613 | 6,648 |
| Macro hedge of interest rate risk | 914 | 1,098 |
| Interest in other entities | 66 | 61 |
| Property, plant and equipment | 1,508 | 1,491 |
| Retirement benefit assets | 500 | 398 |
| Tax, intangibles and other assets | 3,669 | 3,789 |
| Total assets | 304,921 | 303,142 |
| Liabilities | | |
| Deposits by banks | 11,890 | 9,769 |
| Deposits by customers | 181,189 | 177,172 |
| Trading liabilities | 21,490 | 15,560 |
| Derivative financial instruments | 18,488 | 23,103 |
| Financial liabilities designated at fair value | 2,976 | 2,440 |
| Debt securities in issue | 43,997 | 50,346 |
| Subordinated liabilities | 4,109 | 4,303 |
| Macro hedge of interest rate risk | 281 | 350 |
| Retirement benefit obligations | 220 | 262 |
| Tax, other liabilities and provisions | 3,400 | 3,753 |
| Total liabilities | 288,040 | 287,058 |
| Equity | | |
| Total shareholders' equity | 16,719 | 15,934 |
| Non-controlling interests | 162 | 150 |
| Total equity | 16,881 | 16,084 |
| Total liabilities and equity | 304,921 | 303,142 |

A more detailed consolidated balance sheet is contained in the Condensed Consolidated Interim Financial Statements.

30 June 2017 compared to 31 December 2016

Assets

Cash and balances at central banks

Cash and balances at central banks increased by 7% to £18,255m at 30 June 2017 (2016: £17,107m). The increase was mainly due to an increase in balances at central banks.

Trading assets

Trading assets increased by 15% to £34,423m at 30 June 2017 (2016: £30,035m). This is mainly attributable to higher levels of securities purchased under resale agreements and equities offset by decreased holdings of debt securities.

Derivative financial instruments - assets

Derivative assets decreased by 15% to £21,611m at 30 June 2017 (2016: £25,471m). The decrease was mainly due to volatility in the fair value of interest rate and cross currency derivative assets principally driven by movements in yield curves and foreign exchange rates.

Loans and advances to customers

Loans and advances to customers were broadly flat at £199,799m at 30 June 2017 (2016: £199,738m), mainly driven by an increase in loans to UK companies, partially offset by a decrease in residential mortgages.

Liabilities

Deposits by customers

Deposits by customers increased by 2% to £181,189m at 30 June 2017 (2016: £177,172m) as we focused on retaining and originating accounts held by more loyal customers, with continued net positive inflows to 11213 Current Account, everyday bank accounts as well as corporate accounts.

Trading liabilities

Trading liabilities increased by 38% to £21,490m at 30 June 2017 (2016: £15,560m) mainly as a result of an increase in securities purchased under resale agreements, as part of normal trading activity.

Derivative financial instruments - liabilities

Derivative liabilities decreased by 20% to £18,488m at 30 June 2017 (2016: £23,103m). The decrease was mainly due to volatility in the fair value of interest rate and cross currency derivative liabilities mainly driven by movements in yield curves and foreign exchange rates.

Debt securities in issue

Debt securities in issue decreased by 13% to £43,997m at 30 June 2017 (2016: £50,346m) driven by maturities across the covered bonds, securitisation and Medium Term Notes programmes, partially offset by issuances under the US-SEC registered debt shelf.

Equity

Total shareholders' equity

Total shareholders' equity increased by 5% to £16,719m at 30 June 2017 (2016: £15,934m). The increase was attributable to the issuance of AT1 capital, the profit for the period, actuarial gains on the defined benefit pension funds and the valuation of available for sale securities, partially offset by dividends approved, valuation of cash flow hedges and own credit adjustments.

Risk review

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Risk governance

As a financial services provider, managing risk is a core part of our day-to-day activities. To be able to manage our business effectively, it is critical that we understand and control risk in everything we do. We aim to use a prudent approach and advanced risk management techniques to help us deliver robust financial performance and build sustainable value for our stakeholders.

We aim to keep a predictable medium-low risk profile, consistent with our business model. This is key to achieving our strategic objectives.

30 June 2017 compared to 31 December 2016

There were no significant changes in our risk governance as described in the 2016 Annual Report.

Credit risk

Overview

Credit risk management

In H117, there were no significant changes in the way we manage credit risk as described in the 2016 Annual Report.

Credit risk review

In this section we analyse our credit risk profile and performance. We begin by discussing credit risk at a Santander UK group level and then cover Retail Banking separately from our other segments: Commercial Banking, Global Corporate Banking and Corporate Centre.

Key metric

- NPL ratio was 1.32% (2016: 1.50%)

SANTANDER UK GROUP LEVEL – CREDIT RISK REVIEW

Credit performance

| | Customer loans | NPLs ⁽¹⁾⁽²⁾ | NPL ratio | NPL coverage ⁽³⁾ | Gross write-offs ⁽⁴⁾ | Impairment loss allowances |
|---------------------------|----------------|------------------------|-----------|-----------------------------|---------------------------------|----------------------------|
| | £bn | £m | % | % | £m | £m |
| 30 June 2017 | | | | | | |
| Retail Banking: | 168.2 | 2,177 | 1.29 | 25 | 106 | 553 |
| - Residential mortgages | 154.1 | 1,936 | 1.26 | 13 | 11 | 251 |
| - Business banking | 2.0 | 121 | 6.05 | 48 | 13 | 58 |
| - Consumer finance | 6.9 | 33 | 0.48 | 239 | 21 | 79 |
| - Other unsecured lending | 5.2 | 87 | 1.67 | 190 | 61 | 165 |
| Commercial Banking | 19.6 | 358 | 1.83 | 57 | 12 | 204 |
| Global Corporate Banking | 6.5 | 80 | 1.23 | 81 | - | 65 |
| Corporate Centre | 6.0 | 26 | 0.43 | 162 | 17 | 42 |
| | 200.3 | 2,641 | 1.32 | 33 | 135 | 864 |
| 31 December 2016 | | | | | | |
| Retail Banking: | 168.6 | 2,340 | 1.39 | 25 ⁽⁵⁾ | 210 | 583 ⁽⁵⁾ |
| - Residential mortgages | 154.3 | 2,110 | 1.37 | 13 | 33 | 279 |
| - Business banking | 2.3 | 108 | 4.70 | 53 | 24 | 57 |
| - Consumer finance | 6.8 | 32 | 0.47 | 244 ⁽⁵⁾ | 30 | 78 ⁽⁵⁾ |
| - Other unsecured lending | 5.2 | 90 | 1.73 | 188 | 123 | 169 |
| Commercial Banking | 19.4 | 518 | 2.67 | 42 | 10 | 220 |
| Global Corporate Banking | 5.7 | 63 | 1.11 | 90 | - | 57 |
| Corporate Centre | 6.5 | 73 | 1.12 | 84 | 51 | 61 |
| | 200.2 | 2,994 | 1.50 | 31 ⁽⁵⁾ | 271 | 921 ⁽⁵⁾ |

(1) We define NPLs in the 'Credit risk management' section in the 2016 Annual Report.

(2) All NPLs continue accruing interest.

(3) Impairment loss allowances as a percentage of NPLs. Impairment loss allowances relate to early arrears and performing assets (i.e. the incurred but not observed provision) as well as NPLs, so the ratio can exceed 100%.

(4) 30 June 2017 reflects 6 months of gross write-offs and 31 December 2016 reflects 12 months of gross write-offs.

(5) In H117, we reclassified our provisions for residual value and voluntary termination from the consumer finance impairment loss allowance. To facilitate comparison with the current period, the 31 December 2016 consumer finance impairment loss allowance of £146m and NPL coverage ratio of 456% were amended to £78m and 244% respectively. This reclassification was also reflected in the Retail Banking and total impairment loss allowance and NPL coverage ratios.

At 30 June 2017 total corporate lending, comprising business banking, Commercial Banking and Global Corporate Banking, was £28.1bn (2016: £27.4bn). The NPL ratio for corporate lending was 1.99% (2016: 2.51%), the NPL coverage ratio was 58% (2016: 48%), gross write-offs were £25m (2016: £34m) and impairment loss allowances were £327m (2016: £334m).

30 June 2017 compared to 31 December 2016

The NPL ratio improved by 18bps to 1.32% (2016: 1.50%) and continued to perform well, supported by our prudent lending criteria and proactive management actions:

- The improvement in the Retail Banking NPL ratio to 1.29% (2016: 1.39%) was driven by the strong credit quality of our portfolio and the ongoing resilience of the UK economy. The loan loss rate remained low at 0.02% (2016: 0.01%).
- The NPL ratio for Commercial Banking decreased to 1.83% from 2.67% primarily due to the full repayment of three impaired loans and the write-off of some pre-2009 vintages. The loan loss rate in Commercial Banking improved to 0.10% (2016: 0.15%).
- In Global Corporate Banking, the NPL ratio of 1.23% (2016: 1.11%) was impacted by a single loan of £20m that moved to non-performance.
- The NPL ratio for the Corporate Centre decreased to 0.43% (2016: 1.12%), reflecting the ongoing sale and run-off of the non-core corporate and legacy portfolios.

For more on the credit performance of our key portfolios by business segment, see the 'Retail Banking – credit risk review' and 'Other segments – credit risk review' sections.

RETAIL BANKING – CREDIT RISK REVIEW

RESIDENTIAL MORTGAGES

Borrower profile

In this table, 'home movers' include both existing customers moving house and taking out a new mortgage with us, and customers who switch their mortgage to us when they move house. 'Remortgagers' are external customers who are remortgaging with us. We have not included internal remortgages, further advances and any flexible mortgage drawdowns in the new business figures.

| | Stock | | | | New business | | | |
|-------------------|--------------|-----|------------------|-----|---------------------------|-----|---------------------------|-----|
| | 30 June 2017 | | 31 December 2016 | | Half year to 30 June 2017 | | Half year to 30 June 2016 | |
| | £m | % | £m | % | £m | % | £m | % |
| First-time buyers | 28,812 | 19 | 29,143 | 19 | 1,840 | 17 | 1,970 | 16 |
| Home movers | 68,214 | 44 | 68,158 | 44 | 4,954 | 45 | 5,487 | 45 |
| Remortgagers | 50,190 | 33 | 50,325 | 33 | 3,673 | 34 | 3,361 | 28 |
| Buy-to-let | 6,923 | 4 | 6,648 | 4 | 447 | 4 | 1,268 | 11 |
| | 154,139 | 100 | 154,274 | 100 | 10,914 | 100 | 12,086 | 100 |

30 June 2017 compared to 31 December 2016

Mortgage lending balances decreased £135m, reflecting management pricing actions in late 2016 that impacted new mortgage completions in H117. We retained c. 75% of mortgages reaching the end of their incentive period.

We continued to focus our buy-to-let book on non-professional landlords, as this segment is closely aligned with residential mortgages and accounts for the majority of the volume in the buy-to-let market. In H117, we completed 2,728 buy-to-let mortgages, representing 4% of the value of our new business flow, at an average LTV of 62%.

In addition to the new business included in the table above, there were £11.6bn (H116: £9.1bn) of internal remortgages where we kept existing customers on new mortgages. We also provided £0.7bn (H116: £0.6bn) of further advances and flexible mortgage drawdowns.

Interest rate profile

The interest rate profile of our mortgage asset stock was:

| | 30 June 2017 | | 31 December 2016 | |
|------------------------------|--------------|-----|------------------|-----|
| | £m | % | £m | % |
| Fixed rate | 96,132 | 62 | 91,817 | 59 |
| Variable rate | 31,714 | 21 | 33,627 | 22 |
| Standard Variable Rate (SVR) | 26,293 | 17 | 28,830 | 19 |
| | 154,139 | 100 | 154,274 | 100 |

30 June 2017 compared to 31 December 2016

The SVR attrition of £2,537m in H117 was lower than the £3,464m in H116.

Geographical distribution

The Santander UK new business data in these tables cover H117 compared with FY16. The Council of Mortgage Lenders (CML) new business data for H117 covers the three months ended 31 March 2017. The percentages are calculated on a value-weighted basis.

| UK region | 30 June 2017 | | | | 31 December 2016 | | | |
|-----------------------------|--------------|----------------|----------------|-----|------------------|----------------|----------------|--|
| | Santander UK | | CML | | Santander UK | | CML | |
| | Stock % | New business % | New business % | % | Stock % | New business % | New business % | |
| London | 24 | 25 | 18 | 24 | 27 | 18 | 18 | |
| Midlands and East Anglia | 13 | 14 | 17 | 13 | 13 | 17 | 17 | |
| North | 15 | 12 | 17 | 15 | 12 | 17 | 17 | |
| Northern Ireland | 2 | 1 | 1 | 2 | 1 | 1 | 1 | |
| Scotland | 4 | 4 | 6 | 5 | 3 | 7 | 7 | |
| South East excluding London | 31 | 34 | 29 | 30 | 34 | 28 | 28 | |
| South West, Wales and other | 11 | 10 | 12 | 11 | 10 | 12 | 12 | |
| | 100 | 100 | 100 | 100 | 100 | 100 | 100 | |

30 June 2017 compared to 31 December 2016

The average loan size for new business was broadly in line with 2016, at £198,000 (FY16: £198,000) for the UK overall, £263,000 (FY16: £264,000) for the South East including London and £146,000 (2016: £144,000) for the rest of the UK. The loan-to-income multiple of mortgage lending in H117 also increased slightly to 3.18 (FY16: 3.16).

Loan-to-value analysis

This table shows the LTV distribution for new business and mortgage asset stock. We used our estimate of the property's value at the balance sheet date. We have included fees added to the loan in the calculation. If the product is on flexible terms, the calculation only includes the drawn loan amount, not undrawn limits.

| LTV | 30 June 2017 | | 31 December 2016 | |
|---|----------------|---------|------------------|---------|
| | New business % | Stock % | New business % | Stock % |
| Up to 50% | 18 | 46 | 17 | 46 |
| >50-75% | 43 | 41 | 43 | 41 |
| >75-85% | 19 | 8 | 23 | 8 |
| >85-100% | 20 | 4 | 17 | 4 |
| >100% | - | 1 | - | 1 |
| Simple average ⁽¹⁾ LTV (indexed) | 63 | 43 | 65 | 43 |

(1) Unweighted average of LTV of all accounts.

30 June 2017 compared to 31 December 2016

In H17 the proportion of lending with an LTV of over 85% increased to 20% (2016: 17%) mainly due to the lower proportion of buy-to-let new business typically written at lower LTVs. At 30 June 2017, the parts of the loans in negative equity which were effectively uncollateralised before taking account of impairment loss allowances reduced to £259m (2016: £285m).

Credit performance

| | 30 June 2017 £m | 31 December 2016 £m |
|--|--------------------|------------------------|
| Mortgage loans and advances to customers of which: | | |
| Performing ⁽¹⁾ | 154,139 | 154,274 |
| Early arrears: | | |
| - 31 to 60 days | 1,164 | 1,269 |
| - 61 to 90 days | 721 | 793 |
| | 443 | 476 |
| NPLs: ⁽²⁾⁽³⁾ | 1,936 | 2,110 |
| - By arrears | 1,464 | 1,578 |
| - By bankruptcy | 17 | 21 |
| - By maturity default | 296 | 316 |
| - By forbearance | 127 | 160 |
| - By properties in possession (PIPs) | 32 | 35 |

(1) Excludes mortgages where the customer did not pay for between 31 and 90 days, arrears, bankruptcy, maturity default, forbearance and PIPs NPLs. Includes £2,745m of mortgages (2016: £2,959m) where the customer did not pay for 30 days or less.

(2) We define NPLs in the 'Credit risk management' section of the 2016 Annual Report.

(3) All NPLs are in the UK and continue accruing interest.

Forbearance⁽¹⁾

The balances at 30 June 2017 and 31 December 2016, analysed by their payment status at the period-end and the forbearance we applied, were:

| | Capitalisation £m | Term extension £m | Interest-only £m | Total £m | Impairment loss allowances £m |
|-------------------------|----------------------|----------------------|---------------------|-------------|-------------------------------------|
| 30 June 2017 | | | | | |
| In arrears | 266 | 71 | 187 | 524 | 21 |
| Performing | 424 | 208 | 453 | 1,085 | 6 |
| | 690 | 279 | 640 | 1,609 | 27 |
| Proportion of portfolio | 0.4% | 0.2% | 0.4% | 1.0% | |
| 31 December 2016 | | | | | |
| In arrears | 293 | 78 | 226 | 597 | 24 |
| Performing | 466 | 222 | 481 | 1,169 | 7 |
| | 759 | 300 | 707 | 1,766 | 31 |
| Proportion of portfolio | 0.5% | 0.2% | 0.4% | 1.1% | |

(1) We base forbearance type on the first forbearance on the accounts. Tables only show accounts that were open at the period-end.

30 June 2017 compared to 31 December 2016

At 30 June 2017, the total stock of forbearance reduced by 9% as a result of a continued improvement in arrears performance and favourable market conditions.

Other changes in contract terms

At 30 June 2017, there were £4.8bn (2016: £5.1bn) of other mortgages on the balance sheet that we have modified since January 2008. We agreed these modifications in order to maintain a good relationship with the customer. The customers were not showing any signs of financial difficulty at the time, so did not classify these changes as forbearance.

We keep the performance and profile of the accounts under review. At 30 June 2017:

- The average LTV was 34% (2016: 35%) and 95% (2016: 94%) of accounts had made their last six months' contractual payments
- The proportion of accounts that were 90 days or more in arrears was 1.50% (2016: 1.57%).

PORTFOLIOS OF PARTICULAR INTEREST

For a description of the types of mortgage that have higher risk or stand out for different reasons, see the 'Credit risk' section of the Risk review of the 2016 Annual Report.

Portfolios of particular interest loans – credit performance

| | Total £m | Portfolio of particular interest ⁽¹⁾ | | | | | Other portfolio ⁽³⁾ £m |
|-------------------------|-------------|---|---|-------------------------------|-----------------|------------------|---|
| | | Interest-only £m | Part interest-only, part repayment £m | Flexible ⁽²⁾ £m | LTV >100% £m | Buy-to-let £m | |
| 30 June 2017 | | | | | | | |
| Mortgage portfolio | 154,139 | 40,174 | 14,160 | 15,851 | 1,690 | 6,923 | 92,834 |
| Performing | 151,039 | 38,771 | 13,734 | 15,504 | 1,500 | 6,891 | 91,820 |
| Early arrears: | | | | | | | |
| – 31 to 60 days | 721 | 320 | 96 | 56 | 26 | 8 | 295 |
| – 61 to 90 days | 443 | 202 | 59 | 41 | 20 | 6 | 177 |
| NPLs | 1,936 | 881 | 271 | 250 | 144 | 18 | 542 |
| NPL ratio | 1.26% | 2.19% | 1.91% | 1.58% | 8.52% | 0.26% | 0.58% |
| PIPs | 32 | 17 | 6 | 4 | 12 | 1 | 7 |
| 31 December 2016 | | | | | | | |
| Mortgage portfolio | 154,274 | 41,707 | 14,535 | 16,853 | 1,873 | 6,648 | 90,570 |
| Performing | 150,895 | 40,185 | 14,066 | 16,472 | 1,661 | 6,621 | 89,483 |
| Early arrears: | | | | | | | |
| – 31 to 60 days | 793 | 360 | 111 | 71 | 33 | 7 | 314 |
| – 61 to 90 days | 476 | 224 | 70 | 45 | 22 | 2 | 191 |
| NPLs | 2,110 | 938 | 288 | 265 | 157 | 18 | 582 |
| NPL ratio | 1.37% | 2.25% | 1.98% | 1.57% | 8.38% | 0.27% | 0.64% |
| PIPs | 35 | 15 | 7 | 4 | 13 | 1 | 9 |

(1) Where a loan falls into more than one category, we have included it in all the categories that apply. As a result, the sum of the mortgages in the segments of particular interest and the other portfolio does not agree to the total mortgage portfolio.

(2) Includes legacy Alliance & Leicester flexible loans that work in a more limited way than our current Flexi loan product.

(3) Includes other loans that are not in any segment of particular interest.

30 June 2017 compared to 31 December 2016

In H117, the value and proportion of interest-only loans together with part interest-only, part repayment loans reduced, reflecting our strategy to manage down the overall exposure to this lending profile. In addition the value and proportion of flexible mortgages also reduced as they are no longer offered on new mortgages.

Portfolios of particular interest loans – forbearance

The forbearance started in H117 was £161m (H116: £192m), which is in line with the overall reduction seen in flows into forbearance in H117. We keep the performance and profile of the accounts under review.

BUSINESS BANKING, CONSUMER FINANCE AND OTHER UNSECURED LENDING

In H117 business banking lending reduced slightly to £2.0bn (2016: £2.3bn), mainly due to the transfer of a number of business banking customers (associated balances of £0.2bn) to Commercial Banking, where their ongoing needs can be better served. This followed a periodic review in H117 and the year-end position has not been amended. The reduction contributed to an increase in the NPL ratio to 6.05% (2016: 4.70%).

Consumer finance and other unsecured lending balances were broadly flat at £6.9bn (2016: £6.8bn) and £5.2bn (2016: £5.2bn) respectively, in part as a result of controlled management actions in an increasingly competitive environment. The NPL ratios for consumer finance and other unsecured lending balances were 0.48% (2016: 0.47%) and 1.67% (2016: 1.73%) respectively. In H117, we reclassified our provisions for residual value and voluntary termination from the consumer finance impairment loss allowance. The 31 December 2016 consumer finance impairment loss allowance of £146m and NPL coverage ratio of 456% were amended to £78m and 244% respectively.

At 30 June 2017 forbearance across business banking, consumer finance and other unsecured lending increased by 6% to £179m (2016: £169m).

OTHER SEGMENTS – CREDIT RISK REVIEW

Other segments credit risk – committed exposures

Rating distribution

These tables show our credit risk exposure according to our internal rating scale (see 'Credit quality' in the 'Santander UK group level – credit risk review' section of the 2016 Annual Report) for each portfolio. On this scale, the higher the rating, the better the quality of the counterparty.

| | 9 (AAA to AA-) £m | 8 (A+ to A) £m | 7 (A- to BBB+) £m | 6 (BBB to BBB-) £m | 5 (BB+ to BB-) £m | 4 (B+ to B) £m | 1 to 3 (B- to D) £m | Other ⁽¹⁾ £m | Total £m |
|--------------------------|----------------------------|----------------------|----------------------------|-----------------------------|----------------------------|----------------------|---------------------------|----------------------------|-------------|
| 30 June 2017 | | | | | | | | | |
| Commercial Banking | 1,301 | 1,782 | 492 | 9,254 | 6,862 | 3,800 | 594 | 87 | 24,172 |
| Global Corporate Banking | 1,968 | 6,092 | 10,203 | 9,906 | 4,824 | 70 | 66 | - | 33,129 |
| Corporate Centre | 36,389 | 3,607 | 1,059 | 452 | 194 | 63 | 21 | 451 | 42,236 |
| 31 December 2016 | | | | | | | | | |
| Commercial Banking | 1,377 | 1,611 | 861 | 8,678 | 6,973 | 3,640 | 651 | 131 | 23,922 |
| Global Corporate Banking | 1,668 | 9,016 | 9,237 | 10,090 | 4,345 | 56 | 75 | 1 | 34,488 |
| Corporate Centre | 39,386 | 4,638 | 1,519 | 583 | 215 | 69 | 63 | 480 | 46,953 |

(1) Consists of smaller exposures mainly in the commercial mortgage portfolio. We use scorecards for them, instead of a rating model.

Geographical distribution

We classify geographical location according to country of risk – in other words, the country where each counterparty has its main business activity or assets unless there is a full risk transfer guarantee in place, in which case we use the guarantor's country of domicile instead. If our clients have operations in many countries, we use their country of incorporation.

| | UK £m | Peripheral eurozone £m | Rest of Europe £m | US £m | Rest of World £m | Total £m |
|--------------------------|----------|------------------------------|-------------------------|----------|------------------------|-------------|
| 30 June 2017 | | | | | | |
| Commercial Banking | 24,053 | 24 | 93 | 1 | 1 | 24,172 |
| Global Corporate Banking | 22,108 | 2,190 | 5,007 | 1,032 | 2,792 | 33,129 |
| Corporate Centre | 31,718 | 12 | 2,899 | 5,145 | 2,462 | 42,236 |
| 31 December 2016 | | | | | | |
| Commercial Banking | 23,782 | 18 | 65 | 57 | - | 23,922 |
| Global Corporate Banking | 22,407 | 2,374 | 4,254 | 1,248 | 4,205 | 34,488 |
| Corporate Centre | 36,173 | 5 | 3,105 | 4,933 | 2,737 | 46,953 |

Portfolio changes

30 June 2017 compared to 31 December 2016

Commercial Banking

In H117, our committed exposures increased, with increased demand from medium sized corporate customers partially offset by active management of Commercial Real Estate exposures amid economic uncertainty:

- Our SME and mid corporate exposures increased to £11.8bn (2016: £11.3bn) with growth seen across all portfolios.
- Our Commercial Real Estate portfolio decreased to £9.3bn (2016: £9.5bn) reflecting the impact of our proactive management of exposures to certain segments, as well as slower market activity.
- Our Social Housing portfolio remained stable at £3.1bn (2016: £3.1bn) as repayments offset new business and refinancing of longer-dated loans previously managed in Corporate Centre.

Global Corporate Banking

In H117, our committed exposures decreased, with growth in our Large Corporate portfolio more than offset by reductions in our Sovereign and Supranational and Financial Institutions portfolios:

- Sovereign and Supranational exposures decreased to £4.2bn (2016: £5.1bn) driven by reduced holdings in Japanese Government securities as part of normal liquid asset portfolio management and short-term markets trading activity. The portfolio profile stayed mainly short-term (up to one year), reflecting the purpose of the holdings. As in 2016, our rest of world exposures principally comprised of Japan.
- Large Corporate exposures increased to £22.0bn (2016: £21.5bn) driven by lending and origination activities relating to project and acquisition finance and transactional services, as well as new lending to a number of our trading corporate customers. At 30 June 2017, our direct lending committed exposure to oil and gas customers was £1.2bn (2016: £1.8bn) and to mining customers was £1.0bn (2016: £1.4bn). At 30 June 2017 credit quality remained broadly stable but reflected the downgrading of two customers with exposures of £0.6bn from rating band 8 to rating band 7. The portfolio profile stayed mainly short to medium-term (up to five years), reflecting the type of finance we typically provide to support our clients' needs.
- Exposures in our Financial Institutions portfolio decreased to £6.9bn (2016: £7.9bn) due to a reduction in counterparty credit risk.

Corporate Centre

In H117, committed exposures decreased to £42.2bn (2016: £47.0bn), driven by our Sovereign and Supranational portfolio. Exposures in our Sovereign and Supranational portfolio are mainly cash at central banks and highly-rated liquid assets we hold as part of normal liquid asset portfolio management. The decrease in the overall exposure to £30.0bn (2016: £34.5bn) was driven by a reduction in UK deposits.

Other segments – credit performance

We monitor exposures that show potentially higher risk characteristics using our Watchlist process (described in 'Risk monitoring' in the 'Credit risk management' section of the 2016 Annual Report). The table below shows the exposures we monitor, and those we classify as non-performing by portfolio at 30 June 2017 and 31 December 2016:

| | Committed exposure | | | | Total ⁽²⁾ £m | Observed impairment loss allowances £m |
|---|--------------------|------------------------------|-------------------------------|---|----------------------------|---|
| | Performing £m | Watchlist | | Non-performing exposure ⁽¹⁾ £m | | |
| | | Enhanced Monitoring £m | Proactive Management £m | | | |
| 30 June 2017 | | | | | | |
| Commercial Banking | 22,215 | 1,077 | 509 | 371 | 24,172 | 165 |
| Global Corporate Banking | 31,775 | 1,209 | 59 | 86 | 33,129 | 41 |
| Corporate Centre | 42,174 | 23 | 13 | 26 | 42,236 | 16 |
| Total observed impairment loss allowances | | | | | | 222 |
| Allowance for IBNO ⁽³⁾ | | | | | | 89 |
| Total impairment loss allowances | | | | | | 311 |
| 31 December 2016 | | | | | | |
| Commercial Banking | 21,810 | 1,192 | 380 | 540 | 23,922 | 183 |
| Global Corporate Banking | 33,486 | 861 | 72 | 69 | 34,488 | 33 |
| Corporate Centre | 46,687 | 184 | 9 | 73 | 46,953 | 31 |
| Total observed impairment loss allowances | | | | | | 247 |
| Allowance for IBNO ⁽³⁾ | | | | | | 91 |
| Total impairment loss allowances | | | | | | 338 |

(1) Non-performing exposure includes committed facilities and derivative exposures.

(2) Includes committed facilities and derivatives. We define 'Enhanced Monitoring' and 'Proactive Management' in the 'Risk monitoring' section of the 2016 Annual Report.

(3) Allowance for IBNO losses as described in Note 1 to the Consolidated Financial Statements of the 2016 Annual Report.

30 June 2017 compared to 31 December 2016

Commercial Banking

In our SME and mid corporate portfolio, exposures subject to enhanced monitoring reduced to £712m (2016: £892m), whilst exposures subject to proactive management increased to £425m (2016: £331m), primarily driven by the addition of a large trading customer. Non-performing exposures reduced to £286m (2016: £361m) due to successful exits on two larger cases.

In our Commercial Real Estate portfolio, exposures subject to enhanced monitoring increased to £257m (2016: £161m) primarily due to our prudent policy for facilities approaching maturity where refinancing is being finalised and exposures subject to proactive management increased to £84m (2016: £49m). Non-performing exposures reduced to £85m (2016: £179m) primarily driven by the full repayment of a loan of £50m that moved to non-performance in 2016. The portfolio remains well covered with an NPL coverage ratio of 63% and low write-offs of £7m.

In our Social Housing portfolio, exposures subject to enhanced monitoring reduced to £108m (2016: £139m).

Global Corporate Banking

In our Large Corporate portfolio, exposures subject to enhanced monitoring remained stable at £656m (2016: £659m). Exposures subject to proactive management decreased to £58m (2016: £70m). Non-performing exposures increased to £86m (2016: £69m) due to the movement of a single exposure to non-performing.

In our Financial Institutions portfolio, exposures subject to enhanced monitoring increased to £553m (2016: £202m) due to the redrawing of a secured loan transaction by an existing Watchlist customer. This loan is over-collateralised with high quality assets and is puttable on a quarterly basis.

Corporate Centre

In our Legacy Portfolios in run-off portfolio, non-performing exposures reduced to £26m (2016: £73m) driven by the sale of a shipping asset.

In our Social Housing portfolio, there were no exposures subject to enhanced monitoring (2016: £164m) due to the resolution of governance issues that had impacted two customers.

Other segments – forbearance

We only make forbearance arrangements for lending to customers.

| | Commercial Banking £m | Global Corporate Banking £m | Corporate Centre £m |
|------------------------------|-----------------------------|--------------------------------------|---------------------------|
| 30 June 2017 | | | |
| Stock ⁽¹⁾ | | | |
| – Term extension | 131 | 58 | - |
| – Interest-only | 145 | - | 17 |
| – Other payment rescheduling | 146 | 10 | 14 |
| | 422 | 68 | 31 |
| Of which: | | | |
| – Non-performing | 281 | 60 | 14 |
| – Performing | 141 | 8 | 17 |
| | 422 | 68 | 31 |
| Proportion of portfolio | 1.7% | 0.2% | 2.8% |
| 31 December 2016 | | | |
| Stock ⁽¹⁾ | | | |
| – Term extension | 168 | 11 | 1 |
| – Interest-only | 158 | - | 20 |
| – Other payment rescheduling | 208 | 10 | 16 |
| | 534 | 21 | 37 |
| Of which: | | | |
| – Non-performing | 344 | 10 | 15 |
| – Performing | 190 | 11 | 22 |
| | 534 | 21 | 37 |
| Proportion of portfolio | 2.2% | 0.1% | 2.7% |

(1) We base forbearance type on the first forbearance we applied. Tables only show accounts open at the period end.

30 June 2017 compared to 31 December 2016

Commercial Banking

At 30 June 2017, the cumulative forbearance stock reduced to £422m (2016: £534m). This decrease was mainly due to the successful resolution of NPL cases in the period and one performing case exiting forbearance according to defined criteria.

The accounts in forbearance as a percentage of the portfolio reduced to 1.7% (2016: 2.2%). At 30 June 2017, 78% (2016: 78%) of the cumulative forbearance stock had entered forbearance before default.

Global Corporate Banking

At 30 June 2017, there were three forborne cases totalling £68m (2016: two cases totalling £21m), of which £60m (2016: £10m) was classified as NPL. This increase in forbearance was driven from one deal that was classified as NPL in 2016.

Corporate Centre

At 30 June 2017 and 2016, we had only made forbearance arrangements for the Legacy Portfolios in run-off.

At 30 June 2017, the cumulative forbearance stock in our Legacy Portfolios in run-off decreased slightly to £31m (2016: £37m).

PORTFOLIOS OF PARTICULAR INTEREST

Commercial Real Estate

Commercial Real Estate – credit performance

The table below shows the main Commercial Real Estate credit performance metrics at 30 June 2017 and 31 December 2016:

| | Customer loans ⁽¹⁾ | NPLs ⁽²⁾ | NPL ratio | NPL coverage ⁽³⁾ | Gross write-offs | Impairment loss allowances |
|-------------------------|-------------------------------|---------------------|-------------|-----------------------------|------------------|-------------------------------|
| | £bn | £m | % | % | £m | £m |
| 30 June 2017 | 8.7 | 92 | 1.06 | 63 | 7 | 58 |
| 31 December 2016 | 9.0 | 180 | 2.00 | 32 | 1 | 58 |

(1) Comprises commercial real estate drawn loans in the business banking portfolio of our Retail Banking segment of £284m (2016: £365m) and in the Commercial Real Estate portfolio of our Commercial Banking segment of £8,457m (2016: £8,678m).

(2) All NPLs continue accruing interest.

(3) Impairment loss allowances as a percentage of NPLs. Impairment loss allowances relate to early arrears and performing assets (i.e. the IBNO provision) as well as NPLs, so the ratio can exceed 100%.

30 June 2017 compared to 31 December 2016

At 30 June 2017, our NPL ratio was 1.06% (2016: 2.00%) reflecting our conservative credit risk policy. The reduction in the ratio was driven by the full repayment of a £50m loan that had moved to non-performance in 2016, alongside other repayments and the write off of some smaller pre-2009 vintage cases. Commercial Real Estate loans written before 2009 totalled £468m (2016: £543m). The pre-2009 loans were written on market terms which, compared with more recent times and following a significant tightening in our lending criteria, included higher original LTVs, lower interest coverage and exposure to development risk.

Commercial Real Estate – LTV analysis

The tables below show LTVs (based on the drawn balance and our latest estimate of the property's current value) at 30 June 2017 and 31 December 2016:

| Loans and advances to customers | 30 June 2017 | | 31 December 2016 | |
|---------------------------------------|--------------|------------|------------------|------------|
| | £m | % | £m | % |
| <=70% | 7,702 | 88 | 7,886 | 88 |
| >70–100% | 89 | 1 | 194 | 2 |
| >100% i.e. negative equity | 41 | - | 88 | 1 |
| Standardised portfolio ⁽¹⁾ | 687 | 8 | 652 | 7 |
| Total with collateral | 8,519 | 97 | 8,820 | 98 |
| Development loans | 222 | 3 | 223 | 2 |
| | 8,741 | 100 | 9,043 | 100 |

(1) Consists of smaller value transactions, mainly commercial mortgages.

Commercial Real Estate – sector analysis

The table below shows the sector analysis of the portfolio at 30 June 2017 and 31 December 2016:

| Sector | 30 June 2017 | | 31 December 2016 | |
|---------------------------------------|--------------|------------|------------------|------------|
| | £m | % | £m | % |
| Office | 2,164 | 25 | 2,359 | 26 |
| Retail | 1,668 | 19 | 1,739 | 19 |
| Industrial | 1,276 | 15 | 1,274 | 14 |
| Residential | 1,012 | 11 | 1,016 | 11 |
| Mixed use | 1,196 | 14 | 1,184 | 13 |
| Student accommodation | 216 | 2 | 224 | 3 |
| Hotels and leisure | 353 | 4 | 389 | 5 |
| Other | 169 | 2 | 206 | 2 |
| Standardised portfolio ⁽¹⁾ | 687 | 8 | 652 | 7 |
| | 8,741 | 100 | 9,043 | 100 |

(1) Consists of smaller value transactions, mainly commercial mortgages.

30 June 2017 compared to 31 December 2016

The Commercial Real Estate portfolio of £8,741m (2016: £9,043m) is well diversified across sectors, with no significant regional or single name concentration, representing 31% (2016: 33%) of our total lending to corporates and 4% (2016: 4%) of total customer loans. At 30 June 2017, the LTV profile of the portfolio remained conservative with £7,702m (2016: £7,886m) of the non-standardised portfolio assets at or below 70% LTV. Loans with development risk were only 3% (2016: 2%) of the total Commercial Real Estate portfolio. Development lending is typically on a non-speculative basis with significant pre-lets in place and/or pre-sales in place.

In H117, no new business was written above 70% LTV (H116: nil), and 83% (H116: 96%) was written at or below 60% LTV. At 30 June 2017, the average LTV of the non-standardised portfolio, weighted by exposure, was 49% (2016: 50%). The weighted average LTV of new deals, which excludes the standardised portfolio, in H117 was 50% (2016: 48%). The average loan balance at 30 June 2017 remains at £4.8m (2016: £4.8m).

Commercial Real Estate – refinancing risk

For Commercial Real Estate loans approaching maturity, we look at the prospects of refinancing the loan on current market terms and applicable credit policy. Where this seems unlikely we put the case on our Watchlist. At 30 June 2017, Commercial Real Estate loans of £1,340m (2016: £1,408m) were due to mature within 12 months. Of these, £51m, i.e. 4% (2016: £161m, i.e. 11%), had an LTV ratio higher than is acceptable under our current credit policy. At 30 June 2017, all of this (2016: £149m) had been put on our Watchlist or recorded as NPL and had an impairment loss allowance of £24m (2016: £31m).

Market risk

Overview

Market risk management

In H117, there were no significant changes in the way we manage market risk as described in the 2016 Annual Report.

Market risk review

In this section we analyse our key trading and banking market risk metrics.

Key metrics

- NIM sensitivity to +50bps was £241m and to -50bps was £(114)m (2016: £240m and £(82)m)
- Economic Value of Equity (EVE) sensitivity to +50bps was £159m and to -50bps was £(270)m (2016: £54m and £(30)m)

TRADING MARKET RISK REVIEW

VaR

This table shows our Internal VaR for exposure to each of the main classes of risk at 30 June 2017 and 31 December 2016. The VaR figures show how much the fair values of all our tradeable instruments could have changed. Since trading instruments are recorded at fair value, these are also the amounts by which they could have increased or reduced our net income.

| Trading instruments | Period-end exposure | | Average exposure | | Highest exposure | | Lowest exposure | |
|--------------------------------------|---------------------|------------------------|--------------------|------------------------|--------------------|------------------------|--------------------|------------------------|
| | 30 June 2017 £m | 31 December 2016 £m | 30 June 2017 £m | 31 December 2016 £m | 30 June 2017 £m | 31 December 2016 £m | 30 June 2017 £m | 31 December 2016 £m |
| Interest rate risks ⁽¹⁾ | 3.4 | 2.9 | 2.3 | 2.5 | 3.4 | 3.6 | 1.8 | 1.7 |
| Equity risks ⁽²⁾ | 0.4 | 1.4 | 1.0 | 0.9 | 2.0 | 1.5 | 0.2 | 0.6 |
| Credit (spread) risks ⁽³⁾ | - | - | - | - | - | - | - | - |
| Foreign exchange risks | 0.2 | 1.5 | 0.6 | 1.4 | 1.6 | 2.2 | - | 0.1 |
| Correlation offsets ⁽⁴⁾ | (0.7) | (2.3) | (1.2) | (2.0) | - | - | - | - |
| Total correlated one-day VaR | 3.3 | 3.5 | 2.7 | 2.8 | 3.7 | 3.6 | 2.0 | 1.7 |

(1) This measures the effect of changes in interest rates and how volatile they are. The effects are on cash instruments, securities and derivatives. This includes swap spread risk (the difference between swap rates and government bond rates), basis risk (changes in interest rate tenor basis) and inflation risk (changes in inflation rates).

(2) This measures the effect of changes in equity prices, volatility and dividends on stock and derivatives.

(3) This measures the effect of changes in the credit spread of corporate bonds and credit derivatives.

(4) The highest and lowest exposures for each risk type did not necessarily happen on the same day as the highest and lowest total correlated one-day VaR. It is impossible to calculate a corresponding correlation offset effect, so we have not included it in the table.

BANKING MARKET RISK REVIEW

Interest rate risk

Yield curve risk

The table below shows how our base case income and valuation would be affected by a 50 basis point parallel shift (both upwards and downwards) applied instantaneously to the yield curve at 30 June 2017 and 31 December 2016.

| | 30 June 2017 | | 31 December 2016 | |
|-----------------|--------------|--------------|------------------|--------------|
| | +50bps £m | -50bps £m | +50bps £m | -50bps £m |
| NIM sensitivity | 241 | (114) | 240 | (82) |
| EVE sensitivity | 159 | (270) | 54 | (30) |

30 June 2017 compared to 31 December 2016

There was no significant change in the underlying risk position in H117. The movement in NIM and EVE sensitivities in H117 was largely due to changes in our underlying models used for risk measurement purposes. The models have been updated to better reflect the risks inherent in the current low interest rate environment, including the possibility of negative interest rates in the UK.

Liquidity risk

Overview

Liquidity risk management

In H117, there were no significant changes in the way we manage liquidity risk as described in the 2016 Annual Report.

Liquidity risk review

In this section we analyse our Liquidity Coverage Ratio (LCR) and our wholesale funding profile. We also provide details on asset encumbrance.

Key metrics

- LCR was 133% (2016: 139%)
- LCR eligible liquidity pool was £50.1bn (2016: £50.7bn) on a carrying value basis

LIQUIDITY RISK REVIEW

Liquidity Coverage Ratio and eligible liquidity pool

This table shows our LCR, and Liquidity Risk Appetite (LRA) reflecting the stress testing methodology in place at that time.

| | LCR | | LRA ⁽¹⁾ | |
|---|------------------------|----------------------------|------------------------|----------------------------|
| | 30 June 2017 £bn | 31 December 2016 £bn | 30 June 2017 £bn | 31 December 2016 £bn |
| Eligible liquidity pool (liquidity value) | 48.5 | 50.1 | 44.4 | 45.2 |
| Net stress outflows | (36.5) | (36.0) | (27.4) | (27.3) |
| Surplus | 12.0 | 14.1 | 17.0 | 17.9 |
| Eligible liquidity pool as a percentage of anticipated net cash flows | 133% | 139% | 162% | 166% |

(1) The LRA is a two-month Santander UK specific requirement.

At 30 June 2017, the value of the assets in our LCR eligible liquidity pool was £50.1bn (2016: £50.7bn) on a carrying value and £48.5bn (2016: £50.1bn) on a liquidity value.

30 June 2017 compared to 31 December 2016

Our LCR was 133% (2016: 139%), reflecting prudent liquidity planning, partially offset by the EU adoption of Regulatory Technical Standards for assessing additional collateral outflows on derivative contracts. Our LCR eligible liquidity pool significantly exceeded wholesale funding of less than one year, with a coverage ratio of 269% at 30 June 2017 (2016: 237%). Under our current interpretation, the NSFR stayed above 100% throughout H117 and FY16.

OUR FUNDING STRATEGY AND STRUCTURE

Deposit funding

Our Retail Banking and Commercial Banking activities are mostly funded by customer deposits. The rest is funded through wholesale markets.

Wholesale funding

Maturity profile of wholesale funding

This table shows our main sources of wholesale funding. It does not include securities financing repurchase and reverse repurchase agreements. The table is based on exchange rates at issue and scheduled repayments. It does not reflect the final contractual maturity of the funding.

| | <=1 month £bn | >1 and <=3 months £bn | >3 and <=6 months £bn | >6 and <=9 months £bn | >9 and <=12 months £bn | Sub-total <=1 year £bn | >1 and <=2 years £bn | >2 and <=5 years £bn | >5 years £bn | Total £bn |
|--|------------------|-----------------------------|-----------------------------|-----------------------------|------------------------------|------------------------------|----------------------------|----------------------------|-----------------|--------------|
| 30 June 2017 | | | | | | | | | | |
| Downstreamed from Santander UK Group Holdings plc to Santander UK plc⁽¹⁾ | | | | | | | | | | |
| Senior unsecured – public benchmark | - | - | - | - | - | - | - | 3.8 | 1.5 | 5.3 |
| – privately placed | - | - | - | - | - | - | - | - | 0.1 | 0.1 |
| Subordinated liabilities and equity (inc. AT1) | - | - | - | - | - | - | 0.5 | 1.1 | 1.5 | 3.1 |
| | - | - | - | - | - | - | 0.5 | 4.9 | 3.1 | 8.5 |
| Other Santander UK plc | | | | | | | | | | |
| Deposits by banks | - | 0.1 | 0.2 | - | - | 0.3 | - | - | - | 0.3 |
| Senior unsecured – public benchmark | - | 0.9 | - | 0.8 | - | 1.7 | 3.7 | 4.8 | 1.4 | 11.6 |
| – privately placed | - | 0.4 | 0.2 | 0.6 | - | 1.2 | 0.9 | 0.5 | 0.2 | 2.8 |
| Covered bonds | - | - | 1.5 | 0.9 | 0.9 | 3.3 | - | 7.8 | 3.3 | 14.4 |
| Securitisation and structured issuance ⁽²⁾ | 1.4 | - | 0.9 | - | 0.4 | 2.7 | 1.3 | 1.0 | - | 5.0 |
| Term Funding Scheme | - | - | - | - | - | - | - | 7.5 | - | 7.5 |
| Subordinated liabilities | - | - | - | 0.1 | - | 0.1 | 0.1 | - | 2.4 | 2.6 |
| | 1.4 | 1.4 | 2.8 | 2.4 | 1.3 | 9.3 | 6.0 | 21.6 | 7.3 | 44.2 |
| Other group entities | | | | | | | | | | |
| Deposits by banks | 0.7 | 0.4 | - | - | - | 1.1 | - | - | - | 1.1 |
| Certificates of deposit and commercial paper | 2.2 | 3.0 | 1.5 | 0.6 | 0.3 | 7.6 | - | - | - | 7.6 |
| Senior unsecured – privately placed | - | - | - | - | - | - | 0.1 | 0.5 | 0.4 | 1.0 |
| Securitisation and structured issuance ⁽³⁾ | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.6 | 0.7 | 0.3 | - | 1.6 |
| | 3.0 | 3.5 | 1.7 | 0.7 | 0.4 | 9.3 | 0.8 | 0.8 | 0.4 | 11.3 |
| Total at 30 June 2017 | 4.4 | 4.9 | 4.5 | 3.1 | 1.7 | 18.6 | 7.3 | 27.3 | 10.8 | 64.0 |
| Of which: – secured | 1.5 | 0.1 | 2.6 | 1.0 | 1.4 | 6.6 | 2.0 | 16.6 | 3.3 | 28.5 |
| – unsecured | 2.9 | 4.8 | 1.9 | 2.1 | 0.3 | 12.0 | 5.3 | 10.7 | 7.5 | 35.5 |
| Total at 31 December 2016 | | | | | | | | | | |
| | 6.5 | 4.6 | 3.4 | 3.8 | 3.1 | 21.4 | 7.0 | 24.0 | 12.8 | 65.2 |
| Of which: – secured | 2.1 | 0.6 | 2.1 | 1.6 | 2.5 | 8.9 | 4.0 | 11.7 | 4.7 | 29.3 |
| – unsecured | 4.4 | 4.0 | 1.3 | 2.2 | 0.6 | 12.5 | 3.0 | 12.3 | 8.1 | 35.9 |

(1) Currently all our senior debt issued out of Santander UK Group Holdings plc is downstreamed into Santander UK plc on an equivalent rankings basis (e.g. senior unsecured is downstreamed as senior unsecured, subordinated capital instruments are downstreamed as subordinated capital instruments, etc.). However, under the end-state MREL / TLAC regime, senior unsecured debt issued out of Santander UK Group Holdings plc will be downstreamed in a form that is subordinated to senior unsecured debt, but senior to subordinated capital instruments issued out of Santander UK plc.

(2) This includes funding from mortgage-backed securitisation vehicles where Santander UK plc is the asset originator.

(3) This includes funding from asset-backed securitisation vehicles where entities other than Santander UK plc are the asset originator.

Term issuance

In H117, our external term issuance (sterling equivalent) was:

| | Sterling £bn | US Dollar £bn | Euro £bn | Other £bn | Total H117 £bn | Total H116 £bn |
|--|-----------------|------------------|-------------|--------------|-------------------|-------------------|
| Downstreamed from Santander UK Group Holdings plc to Santander UK plc | | | | | | |
| Senior unsecured – public benchmark | - | 0.8 | 0.4 | - | 1.2 | 1.2 |
| – privately placed | - | - | - | 0.1 | 0.1 | - |
| Subordinated debt and equity (including AT1 issuance) | 0.5 | - | - | - | 0.5 | - |
| | 0.5 | 0.8 | 0.4 | 0.1 | 1.8 | 1.2 |
| Other Santander UK plc | | | | | | |
| Securitisations | - | - | - | - | - | 0.6 |
| Covered bonds | 1.0 | - | - | - | 1.0 | - |
| Term Funding Scheme | 3.0 | - | - | - | 3.0 | - |
| | 4.0 | - | - | - | 4.0 | 0.6 |
| Other group entities | | | | | | |
| Securitisations | - | - | - | - | - | 0.5 |
| Covered bonds | - | - | - | - | - | 0.8 |
| Senior unsecured – public benchmark | - | - | - | - | - | 1.4 |
| – privately placed | 0.1 | - | - | - | 0.1 | 1.0 |
| | 0.1 | - | - | - | 0.1 | 3.7 |
| Total gross issuances | 4.6 | 0.8 | 0.4 | 0.1 | 5.9 | 5.5 |

H117 presented a positive market environment for issuance despite the continuing backdrop of global geo-political tensions and other political issues causing intermittent volatility. Any concerns around events such as the French and UK elections and Brexit negotiations were quickly shrugged off by the market. Equities proved resilient and remained high, the Bank of England and the European Central Bank kept their broader monetary policy unchanged and we continued to see robust performance of credit markets across the capital structure. In April 2017 we took advantage of the strong market appetite for higher risk products and issued £500m of Perpetual Capital Securities to our immediate parent.

In H117, our total term funding was £5.9bn (H116: £5.5bn), of which £2.4bn (H116: £5.5bn) was medium-term issuance, and maturities were £6.3bn (H116: £5.5bn). We drew down a further £3.0bn from the Term Funding Scheme in the period, with a total drawdown outstanding of £7.5bn (2016: £4.5bn). At 30 June 2017 the total drawdowns of UK Treasury Bills under the Funding for Lending Scheme remained at £3.2bn (2016: £3.2bn). At 30 June 2017, 71% (2016: 67%) of wholesale funding had a maturity over one year, with an overall residual duration of 42 months (2016: 41 months).

Encumbrance

Encumbrance of customer loans and advances

We have issued prime retail mortgage-backed and other asset-backed securitised products to a diverse investor base through our mortgage-backed and other asset-backed funding programmes. For more on this, see Notes 11 and 19 to the Condensed Consolidated Interim Financial Statements.

We have raised funding with mortgage-backed notes, both issued to third parties and retained (the latter being central bank eligible collateral for funding purposes in other Bank of England facilities), and other asset-backed notes. We also have a covered bond programme. Under this, we issue securities to investors secured by a pool of residential mortgages.

30 June 2017 compared to 31 December 2016

Our level of encumbrance from external and internal issuance of securitisations and covered bonds decreased in H117 as planned. This reflected greater maturities than new issues in the period. We expect our overall level of encumbrance to continue to decrease in H217.

CREDIT RATINGS

Independent credit rating agencies review our creditworthiness. They base their work on a wide range of business and financial attributes. These include risk management, capital strength, earnings, funding, liquidity, accounting and governance.

| | Senior unsecured | Outlook | Short-term | Stand alone |
|---------------------|------------------|----------|------------|-------------|
| 30 June 2017 | | | | |
| Standard & Poor's | A | Negative | A-1 | bbb+ |
| Moody's | Aa3 | Negative | P-1 | a3 |
| Fitch | A | Stable | F-1 | baa1 |

30 June 2017 compared to 31 December 2016

Standard & Poor's affirmed our long and short-term ratings and maintained a negative outlook for various UK banks due to continued economic uncertainty. Fitch also affirmed our long-term credit rating, with the outlook changed to stable from positive, as a result of the weaker prospects for the banking sector following the results of the UK referendum on EU membership. There was no rating agency action by Moody's in H117.

Capital risk

Overview

Capital risk management

In H117, there were no significant changes in the way we manage capital risk as described in the 2016 Annual Report.

The scope of our capital adequacy

We set out below a brief update on emerging regulation.

Capital risk review

We then analyse our capital resources and key capital ratios.

Key metrics

- CET1 capital ratio was 12.1% (2016: 11.6%)
- Total capital resources were £ 17.1bn (2016: £16.2bn)

THE SCOPE OF OUR CAPITAL ADEQUACY

Regulatory supervision

30 June 2017 compared to 31 December 2016

In March 2017, the Bank of England confirmed Santander UK's non-binding Minimum Requirements for Eligible Liabilities (MREL). The indicative requirements (excluding any CET1 combined buffer requirements) equate to 6% of leverage exposures from 1 January 2019, 20.9% of RWAs from 1 January 2020 and 25.9% of RWAs from 1 January 2022.

These requirements are in line with our expectations, and may change at the end of the transitional period. We plan to meet the MREL largely through the issuance of senior unsecured debt from our holding company. This debt will then be downstreamed to the operating company in a compliant form. We have made good progress, with £5.6bn of senior unsecured debt issued from our holding company to date (H117: £1.3bn).

In June 2017, the FPC increased the UK countercyclical capital buffer from 0% to 0.5%, with binding effect from 27 June 2018. The FPC also expects to increase the buffer to 1% at its meeting in November 2017, with a 12 month implementation period absent any material change in the macroeconomic outlook.

CAPITAL RISK REVIEW

Capital resources

Key capital ratios

The tables below are consistent with our regulatory filings for 30 June 2017 and 31 December 2016. Our key capital ratios were:

| | 30 June 2017 | 31 December 2016 |
|----------------------|--------------|------------------|
| | % | % |
| CET1 capital ratio | 12.1 | 11.6 |
| AT1 | 2.3 | 1.8 |
| Grandfathered Tier 1 | 0.9 | 0.8 |
| Tier 2 | 4.3 | 4.3 |
| Total capital ratio | 19.6 | 18.5 |

The total subordination available to Santander UK plc bondholders was 19.6% (2016: 18.5%) of RWAs.

30 June 2017 compared to 31 December 2016

We complied with the PRA's capital adequacy rules throughout H117 and FY16.

The CET1 capital ratio of 12.1% (2016: 11.6%) improved by 50bps in H117, with stable profit and lower RWAs, which fell by £0.4bn to £87.2bn (2016: £87.6bn). The UK leverage ratio increased by 30bps to 4.4% (2016: 4.1%), with higher CET1 capital and the issuance of £500m of Perpetual Capital Securities that were priced in March 2017 with the transaction settling in April 2017.

Our total capital ratio increased to 19.6% at 30 June 2017 (2016: 18.5%), which also reflected the impact of higher CET1 capital and the Perpetual Capital Securities issuance. These were partially offset by the transitional reduction in the recognition of Tier 1 and Tier 2 capital instruments issued by Santander UK plc under the CRD IV Minority Interest rules, which are being phased in at 20% increments over a five year period.

Regulatory capital resources

The table below is consistent with our regulatory filings for 30 June 2017 and 31 December 2016. We manage our capital on a CRD IV basis. During H117 and FY16, we held capital over and above our regulatory requirements, and managed internal capital allocations and targets in accordance with our capital and risk management policies.

Analysis of regulatory capital

This table provides an analysis of our regulatory capital.

| | 30 June 2017 | 31 December 2016 |
|--|--------------|------------------|
| | £m | £m |
| CET1 capital before regulatory adjustments | 14,586 | 14,285 |
| Total regulatory adjustments to CET1 | (3,999) | (4,084) |
| CET1 capital | 10,587 | 10,201 |
| AT1 capital | 2,744 | 2,271 |
| Tier 1 capital | 13,331 | 12,472 |
| Tier 2 capital | 3,741 | 3,772 |
| Total regulatory capital | 17,072 | 16,244 |

Other key risks

Overview

Other key risks

In H117, there were no significant changes in the way we manage and monitor other key risks, as described in the 2016 Annual Report, except as set out below.

In this section, we discuss pension risk, conduct risk, operational risk and financial crime risk.

Key metrics

- Pension Deficit at Risk was £1,460m (2016: £1,688m)
- PPI provision was £405m (2016: £457m)
- Operational risk losses were £40m in H117 (H116: £40m)

PENSION RISK

30 June 2017 compared to 31 December 2016

Risk monitoring and measurement

The funding Deficit at Risk decreased to £1,460m (2016: £1,688m). In H117 the Scheme implemented additional equity hedging as a part of a review of the corporate trustee investment strategy.

At 30 June 2017, the interest rate hedging ratio on a funding basis was 55% (2016: 56%) and on an accounting basis was 70% (2016: 72%). The inflation rate hedging ratio of the Scheme on a funding basis was 61% (2016: 62%) and on an accounting basis was 93% (2016: 94%).

We continue to focus on achieving the right balance between risk and reward. In H117, overall asset returns were marginally positive. Our long-term objective is to reduce the risk of the Scheme and eliminate the deficit on a funding valuation basis.

Triennial funding valuation

The 31 March 2016 triennial funding valuation was concluded in early 2017. Santander UK plc has committed to continue to fund the Scheme at the current rate with the recovery plan extended for a further three years. In addition Santander UK plc has committed to make contingent contributions if the investment performance is lower than expected.

Accounting position

During H117, the accounting surplus of the Scheme and other funded arrangements increased to £319m (2016: £175m). In addition, there were unfunded defined benefit scheme liabilities of £39m at 30 June 2017 (2016: £39m). The improvement in the overall position was due to a decrease in liabilities caused mainly by a fall in implied inflation which reduced the value of future pension payments, together with ongoing deficit contributions and positive asset performance. This was partially offset by a fall in corporate bond yields, reducing the rate used to discount future pension obligations.

For more on our pension obligations, including the current asset allocation, see Note 16 to the Condensed Consolidated Interim Financial Statements.

CONDUCT RISK

30 June 2017 compared to 31 December 2016

In H117 we continued to build on progress made in 2016. This included:

- Assessing views and new policy areas set out in the FCA's Business Plan and Mission Statement and building these into our business planning, controls and oversight activities
- Improving our framework and guidance for how we support vulnerable customers, including ageing customers
- Enhancing management information to help us identify forward-looking risks earlier and analysing internal and external developments to capture lessons learnt
- Carrying out face to face training in addition to mandatory modules to aid colleagues on topical areas of conduct risk
- Creating a new conduct and compliance centre of excellence within our legal and regulatory division
- Refining and improving our product approval process.

On an ongoing basis, our conduct risk dashboards provide a granular view of how our products and services are performing for customers. They continue to help senior management oversee and measure conduct risk across the business and to take action where necessary.

Our business units continue to assess the potential customer, client and market impacts of structural reform as part of our ring-fencing programme.

PPI provisions

The remaining provision for PPI redress and related costs amounted to £405m (2016: £457m). In Q117, we made an additional provision of £32m relating to the final FCA rules and guidance published in March 2017. We also provided a net charge of £37m in Q217, following a review of claims handling procedures in relation to a specific PPI portfolio including the impact of a past business review.

In line with our assumptions, monthly utilisation increased from the 2016 average following the confirmation of a deadline for customer complaints. We will continue to monitor our provision levels in respect of recent claims experience.

Other conduct provisions

The remaining non-PPI related conduct provisions amounted to £51m including an additional provision of £35m in Q217, relating to the sale of interest rate derivatives. This charge follows an ongoing review regarding regulatory classification of certain customers eligible for redress.

For more on our provision for conduct remediation, including sensitivities, see Note 15 to the Condensed Consolidated Interim Financial Statements. We explain more about these sensitivities in 'Critical accounting policies and areas of significant management judgement' in Note 1 to the Consolidated Financial Statements in the 2016 Annual Report.

OPERATIONAL RISK

30 June 2017 compared to 31 December 2016

Operational losses

In H117 operational losses for reportable events with an impact greater than £10,000, and excluding conduct risk events, totalled £40m (H116: £40m). Losses relating to 'Execution, delivery, and process management' include historic systems functionality and process issues. Consistent with industry experience, we continued to see a high volume of low value events in the 'External fraud' category which primarily related to card and online payment fraud.

Operational Risk Transformation Programme

We have made a number of operational risk enhancements as part of a final year of investment to embed the programme into business as usual. Our focus in H217 is to demonstrate effective operational risk management to the regulators.

Cyber security

In H117, in common with other large UK financial institutions and other organisations, we continued to be subject to cyber-attacks but have suffered no significant events. We are continually improving our systems, processes, controls and staff training to reduce cyber risk and to help protect our customers, systems and information. Our Cyber Resilience Programme operates with a layered defence approach, continually evolving and adapting to cyber threats.

We have increased our resources and are leveraging connections with Banco Santander's Cyber Security Operations Centre. Together with our world-class data centres, this provides us with a solid foundation to enable our digital transformation and support future growth within an environment of improved cyber resilience and with a reduction in legacy technology issues. For more on this, see the case study on cyber security in the 'Risk review' section within the 2016 Annual Report.

Scams

We are very sympathetic to customers who are victims of fraud and welcome all initiatives by the industry and the media to help raise awareness of this important issue. We invest substantial resources to protect customers and in trying to prevent fraud. Our dedicated fraud experts work to identify, prevent and detect scams, warn and notify customers, and use robust technology in our customer protection systems. We continually invest in the fight to counter increasingly sophisticated scams, we run an ongoing customer education campaign and we offer tips and advice on our online security centre - www.santander.co.uk/securitycentre. Our efforts are successful in preventing the vast majority of fraud and protecting customers' money.

FINANCIAL CRIME RISK

30 June 2017 compared to 31 December 2016

In H117, we continued to implement our Financial Crime Transformation Programme and to address the requirements of new regulation, including the fourth money laundering directive. This was specifically around the following:

- **Governance:** we simplified governance by consolidating the financial crime forums for Commercial Banking and Global Corporate Banking. We also continued to raise the profile of financial crime through continued briefings to management and Board committees
- **Systems and controls:** we enhanced our payment screening to align it to the new EU Funds Transfer Regulation 2, and we introduced an Executive Committee sponsored programme to accelerate key control improvements across Commercial Banking and Global Corporate Banking
- **Policies:** we introduced new AML and sanctions policies and standards, reflecting new laws and regulations, and we began to implement the changes. We also launched an updated anti-bribery and corruption action plan
- **Training, culture and awareness:** we developed and approved an enhanced financial crime training strategy, with a strong focus on anti-financial crime culture, improved management information and anti-bribery and corruption. It contains modules to address the needs of high priority financial crime functions and specific business areas (anti-bribery and corruption, trade finance and sanctions compliance). We have also designed financial crime awareness events for implementation in early H217.
- **Operations:** we continued to enhance our intelligence and risk assessment capabilities including further investment in our Financial Intelligence Unit and improved country risk assessment. We also continued to improve our partnership with public authorities such as through the Joint Money Laundering Intelligence Task Force.
- **Resources:** we remain focused on ensuring we have the right number and quality of resources supporting our financial crime initiatives.

Financial statements

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Independent review report to Santander UK plc

Report on the Condensed Consolidated Interim Financial Statements

Our conclusion

We have reviewed Santander UK plc's condensed consolidated interim financial statements (the "interim financial statements") in the Half Yearly Financial Report of Santander UK plc for the 6 month period ended 30 June 2017. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements comprise:

- the consolidated balance sheet as at 30 June 2017;
- the consolidated income statement and consolidated statement of comprehensive income for the period then ended;
- the consolidated cash flow statement for the period then ended;
- the consolidated statement of changes in equity for the period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the Half Yearly Financial Report have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the Condensed Consolidated Interim Financial Statements and the review

Our responsibilities and those of the directors

The Half Yearly Financial Report, including the interim financial statements, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Half Yearly Financial Report in accordance with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial statements in the Half Yearly Financial Report based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What a review of the Condensed Consolidated Interim Financial Statements involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have read the other information contained in the Half Yearly Financial Report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial statements.

PricewaterhouseCoopers LLP

Chartered Accountants
London

13 September 2017

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT (unaudited)

For the half year to 30 June 2017 and the half year to 30 June 2016

| | Notes | Half year to 30 June 2017 £m | Half year to 30 June 2016 £m |
|---|-------|------------------------------------|------------------------------------|
| Interest and similar income | | 2,977 | 3,301 |
| Interest expense and similar charges | | (1,055) | (1,528) |
| Net interest income | | 1,922 | 1,773 |
| Fee and commission income | | 609 | 578 |
| Fee and commission expense | | (200) | (197) |
| Net fee and commission income | | 409 | 381 |
| Net trading and other income | 3 | 182 | 290 |
| Total operating income | | 2,513 | 2,444 |
| Operating expenses before impairment losses, provisions and charges | 4 | (1,215) | (1,205) |
| Impairment losses on loans and advances | 5 | (48) | (63) |
| Provisions for other liabilities and charges | 5 | (186) | (97) |
| Total operating impairment losses, provisions and charges | | (234) | (160) |
| Profit before tax | | 1,064 | 1,079 |
| Tax on profit | 6 | (323) | (307) |
| Profit after tax for the period | | 741 | 772 |
| Attributable to: | | | |
| Equity holders of the parent | | 730 | 756 |
| Non-controlling interests | | 11 | 16 |

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (unaudited)

For the half year to 30 June 2017 and the half year to 30 June 2016

| | Half year to 30 June 2017 £m | Half year to 30 June 2016 £m |
|--|------------------------------------|------------------------------------|
| Profit for the period | 741 | 772 |
| Other comprehensive income: | | |
| Other comprehensive income that may be reclassified to profit or loss subsequently: | | |
| Available-for-sale securities: | | |
| - Change in fair value | 72 | (3) |
| - Income statement transfers | (48) | (115) |
| - Taxation | (5) | 17 |
| | 19 | (101) |
| Cash flow hedges: | | |
| - Effective portion of changes in fair value | (48) | 3,761 |
| - Income statement transfers | (124) | (2,994) |
| - Taxation | 48 | (205) |
| | (124) | 562 |
| Currency translation on foreign operations | - | (3) |
| Net other comprehensive income that may be reclassified to profit or loss subsequently | (105) | 458 |
| Other comprehensive income that will not be reclassified to profit or loss subsequently: | | |
| Pension remeasurement | 79 | (489) |
| Taxation | (20) | 126 |
| | 59 | (363) |
| Own credit adjustment: | | |
| - Transfers | (23) | - |
| - Taxation | 6 | - |
| | (17) | - |
| Net other comprehensive income that will not be reclassified to profit or loss subsequently | 42 | (363) |
| Total other comprehensive income for the period net of tax | (63) | 95 |
| Total comprehensive income for the period | 678 | 867 |
| Attributable to: | | |
| Equity holders of the parent | 666 | 856 |
| Non-controlling interests | 12 | 11 |

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEET (unaudited)

At 30 June 2017 and 31 December 2016

| | Notes | 30 June 2017 £m | 31 December 2016 £m |
|--|-------|--------------------|------------------------|
| Assets | | | |
| Cash and balances at central banks | | 18,255 | 17,107 |
| Trading assets | 8 | 34,423 | 30,035 |
| Derivative financial instruments | 9 | 21,611 | 25,471 |
| Financial assets designated at fair value | | 2,161 | 2,140 |
| Loans and advances to banks | | 4,404 | 4,348 |
| Loans and advances to customers | 10 | 199,799 | 199,738 |
| Loans and receivables securities | | 1,424 | 257 |
| Available-for-sale securities | | 9,574 | 10,561 |
| Held-to-maturity investments | | 6,613 | 6,648 |
| Macro hedge of interest rate risk | | 914 | 1,098 |
| Interests in other entities | 12 | 66 | 61 |
| Intangible assets | | 2,334 | 2,316 |
| Property, plant and equipment | | 1,508 | 1,491 |
| Retirement benefit assets | 16 | 500 | 398 |
| Other assets | | 1,335 | 1,473 |
| Total assets | | 304,921 | 303,142 |
| Liabilities | | | |
| Deposits by banks | | 11,890 | 9,769 |
| Deposits by customers | | 181,189 | 177,172 |
| Trading liabilities | 13 | 21,490 | 15,560 |
| Derivative financial instruments | 9 | 18,488 | 23,103 |
| Financial liabilities designated at fair value | | 2,976 | 2,440 |
| Debt securities in issue | 14 | 43,997 | 50,346 |
| Subordinated liabilities | | 4,109 | 4,303 |
| Macro hedge of interest rate risk | | 281 | 350 |
| Other liabilities | | 2,590 | 2,871 |
| Provisions | 15 | 595 | 700 |
| Current tax liabilities | | 72 | 54 |
| Deferred tax liabilities | | 143 | 128 |
| Retirement benefit obligations | | 220 | 262 |
| Total liabilities | | 288,040 | 287,058 |
| Equity | | | |
| Share capital and other equity instruments | 18 | 5,400 | 4,904 |
| Share premium | | 5,620 | 5,620 |
| Retained earnings | | 5,280 | 4,886 |
| Other reserves | | 419 | 524 |
| Total shareholders' equity | | 16,719 | 15,934 |
| Non-controlling interests | | 162 | 150 |
| Total equity | | 16,881 | 16,084 |
| Total liabilities and equity | | 304,921 | 303,142 |

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

CONSOLIDATED CASH FLOW STATEMENT (unaudited)

For the half year to 30 June 2017 and the half year to 30 June 2016

| Notes | Half year to 30 June 2017 £m | Half year to 30 June 2016 £m |
|---|------------------------------------|------------------------------------|
| Cash flows from operating activities | | |
| Profit for the period | 741 | 772 |
| Adjustments for: | | |
| Non-cash items included in profit | 678 | (31) |
| Change in operating assets | (1,445) | (15,075) |
| Change in operating liabilities | 5,442 | 14,099 |
| Corporation taxes paid | (233) | (165) |
| Effects of exchange rate differences | (132) | 2,211 |
| Net cash flows from operating activities | 5,051 | 1,811 |
| Cash flows from investing activities | | |
| Purchase of property, plant and equipment and intangible assets | (217) | (128) |
| Proceeds from sale of property, plant and equipment and intangible assets | 24 | 44 |
| Purchase of available-for-sale securities | (419) | (1,664) |
| Proceeds from sale and redemption of available-for-sale securities | 1,186 | 1,634 |
| Net cash flows from investing activities | 574 | (114) |
| Cash flows from financing activities | | |
| Issue of ATI capital securities | 500 | - |
| Issuance costs of ATI capital securities | (4) | - |
| Issue of debt securities | 2,237 | 4,585 |
| Issuance costs of debt securities | (9) | (9) |
| Repayment of debt securities | (6,418) | (5,082) |
| Repurchase of other equity instruments | - | (7) |
| Dividends paid on ordinary shares | (276) | (102) |
| Dividends paid on other equity instruments | (80) | (73) |
| Net cash flows from financing activities | (4,050) | (688) |
| Change in cash and cash equivalents | 1,575 | 1,009 |
| Cash and cash equivalents at beginning of the period | 25,705 | 20,351 |
| Effects of exchange rate changes on cash and cash equivalents | (254) | 994 |
| Cash and cash equivalents at the end of the period | 27,026 | 22,354 |

Cash and cash equivalents consist of:

| | 30 June 2017 £m | 30 June 2016 £m |
|--|--------------------|--------------------|
| Cash and balances at central banks | 18,255 | 14,862 |
| Less: regulatory minimum cash balances | (380) | (344) |
| | 17,875 | 14,518 |
| Net trading other cash equivalents | 6,775 | 5,440 |
| Net non-trading other cash equivalents | 2,376 | 2,396 |
| Cash and cash equivalents | 27,026 | 22,354 |

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)

For the half year to 30 June 2017 and the half year to 30 June 2016

| | Notes | Share capital & other equity instruments £m | Share premium £m | Other reserves | | | Retained earnings £m | Total £m | Non- controlling interests £m | Total £m |
|--|-------|--|------------------------|------------------------------|----------------------------|-------------------------------|----------------------------|-------------|--|-------------|
| | | | | Available-for- sale £m | Cash flow hedging £m | Currency translation £m | | | | |
| 1 January 2017 | | 4,904 | 5,620 | 48 | 471 | 5 | 4,886 ⁽¹⁾ | 15,934 | 150 | 16,084 |
| Profit for the period | | - | - | - | - | - | 730 | 730 | 11 | 741 |
| Other comprehensive income, net of tax: | | | | | | | | | | |
| - Available-for-sale securities | | - | - | 19 | - | - | - | 19 | - | 19 |
| - Cash flow hedges | | - | - | - | (124) | - | - | (124) | - | (124) |
| - Pension remeasurement | 16 | - | - | - | - | - | 58 | 58 | 1 | 59 |
| - Own credit adjustment | | - | - | - | - | - | (17) | (17) | - | (17) |
| Total comprehensive income for the period | | - | - | 19 | (124) | - | 771 | 666 | 12 | 678 |
| Issue of ATI capital securities | 18 | 496 | - | - | - | - | - | 496 | - | 496 |
| Dividends on ordinary shares | 7 | - | - | - | - | - | (323) | (323) | - | (323) |
| Dividends on other equity instruments | 7 | - | - | - | - | - | (80) | (80) | - | (80) |
| Tax on other equity instruments | 18 | - | - | - | - | - | 26 | 26 | - | 26 |
| 30 June 2017 | | 5,400 | 5,620 | 67 | 347 | 5 | 5,280 | 16,719 | 162 | 16,881 |
| 1 January 2016 | | 4,911 | 5,620 | 52 | 254 | 8 | 4,679 | 15,524 | 135 | 15,659 |
| Profit for the period | | - | - | - | - | - | 756 | 756 | 16 | 772 |
| Other comprehensive income, net of tax: | | | | | | | | | | |
| - Available-for-sale securities | | - | - | (101) | - | - | - | (101) | - | (101) |
| - Cash flow hedges | | - | - | - | 562 | - | - | 562 | - | 562 |
| - Pension remeasurement | 16 | - | - | - | - | - | (358) | (358) | (5) | (363) |
| - Currency translation on foreign operations | | - | - | - | - | (3) | - | (3) | - | (3) |
| Total comprehensive income for the period | | - | - | (101) | 562 | (3) | 398 | 856 | 11 | 867 |
| Repurchase of other equity instruments | 18 | (7) | - | - | - | - | - | (7) | - | (7) |
| Dividends on ordinary shares | 7 | - | - | - | - | - | (317) | (317) | - | (317) |
| Dividends on other equity instruments | 7 | - | - | - | - | - | (73) | (73) | - | (73) |
| Tax on other equity instruments | 18 | - | - | - | - | - | 15 | 15 | - | 15 |
| 30 June 2016 | | 4,904 | 5,620 | (49) | 816 | 5 | 4,702 | 15,998 | 146 | 16,144 |

(1) The impact of the early adoption of IFRS 9 requirements for the presentation of gains and losses on such financial liabilities relating to own credit in other comprehensive income as described in Note 1, was £18m (net of tax).

1. ACCOUNTING POLICIES

Basis of preparation

The financial information in these Condensed Consolidated Interim Financial Statements does not constitute statutory accounts as defined in section 434 of the UK Companies Act 2006. Statutory accounts for the year ended 31 December 2016 have been delivered to the Registrar of Companies. The auditor's report on those accounts was unqualified, did not draw attention to any matters by way of emphasis and did not contain a statement under section 498(2) of the UK Companies Act 2006.

The Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Accounting Standard (IAS) 34 'Interim Financial Reporting', as issued by the International Accounting Standards Board (IASB) and adopted by the European Union, and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority (FCA). They do not include all the information and disclosures normally required for full annual financial statements and should be read in conjunction with the Consolidated Financial Statements of the Santander UK group for the year ended 31 December 2016 which were prepared in accordance with International Financial Reporting Standards as adopted by the European Union. Those Consolidated Financial Statements were also prepared in accordance with International Financial Reporting Standards as issued by the IASB including interpretations issued by the IFRS Interpretations Committee (IFRIC) of the IASB (together IFRS). The Santander UK group has also complied with its legal obligation to comply with International Financial Reporting Standards as adopted by the European Union as there are no applicable differences between the two frameworks for the periods presented.

In preparing the Condensed Consolidated Interim Financial Statements management makes judgements, estimates and assumptions which impact the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Because of the inherent uncertainty in making estimates, actual results reported in future periods may differ. Management continually evaluates the judgements, estimates and assumptions applied, including expectations of future events that are believed to be reasonable under the circumstances.

Except as noted below, the same accounting policies, presentation and methods of computation are followed in these Condensed Consolidated Interim Financial Statements as were applied in the presentation of the Santander UK group's 2016 Annual Report. Copies of the Santander UK group's 2016 Annual Report are available on the Santander UK group's website or upon request from Investor Relations, Santander UK plc, 2 Triton Square, Regent's Place, London NW1 3AN.

The Santander UK group designates certain financial liabilities at fair value through profit or loss where they contain embedded derivatives or where associated derivatives used to economically hedge the risk are held at fair value. Following the endorsement of IFRS 9 'Financial Instruments' by the EU in December 2016, the Santander UK group has elected to early apply from 1 January 2017 the requirements for the presentation of gains and losses on such financial liabilities relating to own credit in other comprehensive income without applying the other requirements in IFRS 9. The own credit component of the cumulative fair value adjustment on financial liabilities designated at fair value through profit or loss as at 1 January 2017 was £18m (net of tax) and is included in opening retained earnings. Comparatives have not been restated.

Except as noted below, there have been no other significant changes arising from new or revised standards and interpretations, and amendments thereto, which have been issued but which are not yet effective for the Santander UK group as were set out in the 2016 Annual Report.

Future accounting developments

IFRS 9 Financial Instruments – In the 2016 Annual Report, Santander UK provided detailed descriptions and explanations on how key IFRS 9 concepts will be implemented and included details of our proposed approaches for classification and measurement of financial assets and liabilities and hedge accounting and, in respect of the expected credit loss (ECL) methodology, proposed modelling techniques, judgements, and proposals for the incorporation of forward-looking information and the determination of a significant increase in credit risk.

Santander UK continues to make progress on developing and testing our ECL impairment models across the range of in-scope portfolios and formalising the governance framework to support the new operating model. A parallel-run will take place during H217 to provide assurances on the accuracy and completeness of the modelling process, whilst we implement the new operating model to ensure we can meet our range of disclosures relating to IFRS 9. We are also finalising the determination of the classification and measurement of financial assets. We expect to continue to apply IAS 39 hedge accounting until such time as further changes for macro hedge accounting rules are applicable.

It is not yet practicable to quantify the effect of IFRS 9 on these Condensed Consolidated Interim Financial Statements. Santander UK group expects to quantify the effect of IFRS 9 during H217 and by no later than the end of the year.

IFRS 15 Revenue from Contracts with Customers – In the 2016 Annual Report, Santander UK explained that revenue relating to lease contracts, insurance contracts and financial instruments is outside the scope of IFRS 15. In addition, a significant proportion of the recognition of Santander UK group's fee and commission income that is within the scope of the standard is not expected to change. Whilst the standard is not expected to have a significant impact on the Santander UK group's profitability, the impact of the standard is still being assessed. It is not yet practicable to quantify the effect of IFRS 15 on these Condensed Consolidated Interim Financial Statements.

Going concern

After making enquiries, the Directors have a reasonable expectation that the Santander UK group has adequate resources to continue in operational existence for at least twelve months from the date that the balance sheet is signed. Having reassessed the principal risks and uncertainties, the Directors consider it appropriate to adopt the 'going concern' basis of accounting in preparing the Condensed Consolidated Interim Financial Statements.

CRITICAL ACCOUNTING POLICIES AND AREAS OF SIGNIFICANT MANAGEMENT JUDGEMENT

The preparation of the Condensed Consolidated Interim Financial Statements requires management to make estimates and judgements that affect the reported amount of assets and liabilities at the date of the Condensed Consolidated Interim 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.

There have been no significant changes in the basis upon which estimates have been determined compared to that applied in the 2016 Annual Report.

2. SEGMENTS

The Santander UK group's business is managed and reported on the basis of the following segments: Retail Banking, Commercial Banking, Global Corporate Banking and Corporate Centre. The Santander UK 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. There has been no change to the descriptions of these segments and segmental accounting as set out in Note 2 to the Consolidated Financial Statements in the 2016 Annual Report.

| | Retail Banking £m | Commercial Banking £m | Global Corporate Banking £m | Corporate Centre £m | Total £m |
|---|-------------------------|-----------------------------|-----------------------------------|---------------------------|----------------|
| Half year to 30 June 2017 | | | | | |
| Net interest income/(expense) | 1,730 | 198 | 40 | (46) | 1,922 |
| Non-interest income ⁽¹⁾ | 314 | 44 | 206 | 27 | 591 |
| Total operating income/(expense) | 2,044 | 242 | 246 | (19) | 2,513 |
| Operating expenses before impairment losses, provisions and charges | (919) | (109) | (145) | (42) | (1,215) |
| Impairment (losses)/releases on loans and advances | (39) | (3) | (9) | 3 | (48) |
| Provisions for other liabilities and charges | (155) | (29) | - | (2) | (186) |
| Total operating impairment (losses)/releases, provisions and charges | (194) | (32) | (9) | 1 | (234) |
| Profit/(loss) before tax | 931 | 101 | 92 | (60) | 1,064 |
| Revenue from external customers | 2,272 | 318 | 279 | (356) | 2,513 |
| Inter-segment revenue | (228) | (76) | (33) | 337 | - |
| Total operating income | 2,044 | 242 | 246 | (19) | 2,513 |
| Total assets⁽²⁾ | 175,246 | 19,570 | 45,827 | 64,278 | 304,921 |
| Total liabilities | 150,394 | 18,074 | 39,234 | 80,338 | 288,040 |
| Half year to 30 June 2016 ⁽³⁾ | | | | | |
| Net interest income | 1,531 | 203 | 39 | - | 1,773 |
| Non-interest income ⁽¹⁾ | 283 | 41 | 184 | 163 | 671 |
| Total operating income | 1,814 | 244 | 223 | 163 | 2,444 |
| Operating expenses before impairment losses, provisions and charges | (922) | (113) | (141) | (29) | (1,205) |
| Impairment (losses)/releases on loans and advances | (34) | (11) | (21) | 3 | (63) |
| Provisions for other liabilities and charges | (77) | - | - | (20) | (97) |
| Total operating impairment losses, provisions and charges | (111) | (11) | (21) | (17) | (160) |
| Profit before tax | 781 | 120 | 61 | 117 | 1,079 |
| Revenue from external customers | 2,173 | 313 | 254 | (296) | 2,444 |
| Inter-segment revenue | (359) | (69) | (31) | 459 | - |
| Total operating income | 1,814 | 244 | 223 | 163 | 2,444 |
| 31 December 2016 | | | | | |
| Total assets⁽²⁾ | 175,731 | 19,381 | 39,777 | 68,253 | 303,142 |
| Total liabilities | 149,793 | 17,203 | 36,506 | 83,556 | 287,058 |

(1) Comprised of Net fee and commission income and Net trading and other income.

(2) Includes customer loans, net of impairment loss allowances.

(3) Restated on the same basis as described in Note 2 to the Consolidated Financial Statements in the 2016 Annual Report.

3. NET TRADING AND OTHER INCOME

| | Half year to 30 June 2017 £m | Half year to 30 June 2016 £m |
|------------------------------|------------------------------------|------------------------------------|
| Net trading and other income | 182 | 290 |

'Net trading and other income' includes the gain of £48m sterling equivalent in respect of the sale of the Vocalink shares. Santander UK was part of the consortium of banks that sold Vocalink Holdings Limited to Mastercard. Santander UK's stake in Vocalink Holdings Limited was 7.75%. Under the terms of the sale agreement, Santander UK will retain a shareholding of 0.775% for at least three years. In H116, 'Net trading and other income' included the gain of £119m sterling equivalent in respect of the sale of Visa shares.

In May 2016, as part of a liability management exercise, certain debt instruments were purchased pursuant to a tender offer. This had no significant impact on the income statement.

4. OPERATING EXPENSES BEFORE IMPAIRMENT LOSSES, PROVISIONS AND CHARGES

| | Half year to 30 June 2017 £m | Half year to 30 June 2016 £m |
|---|------------------------------------|------------------------------------|
| Staff costs | 566 | 545 |
| Other administration expenses | 493 | 522 |
| Depreciation, amortisation and impairment | 156 | 138 |
| | 1,215 | 1,205 |

5. IMPAIRMENT LOSSES AND PROVISIONS

| | Half year to 30 June 2017 £m | Half year to 30 June 2016 £m |
|---|------------------------------------|------------------------------------|
| Impairment losses on loans and advances to customers | 76 | 108 |
| Recoveries of loans and advances, net of collection costs (Note 10) | (28) | (45) |
| | 48 | 63 |
| Provisions for other liabilities and charges (Note 15) | 181 | 97 |
| Provisions for residual value and voluntary termination | 5 | - |
| | 186 | 97 |
| | 234 | 160 |

There were no impairment losses on loans and advances to banks, loans and receivables securities, available-for-sale securities and held-to-maturity investments.

6. TAXATION

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

| | Half year to 30 June 2017 £m | Half year to 30 June 2016 £m |
|--|------------------------------------|------------------------------------|
| Profit before tax | 1,064 | 1,079 |
| Tax calculated at a tax rate of 19.25% (H116: 20%) | 205 | 216 |
| Bank surcharge on profits | 77 | 77 |
| Net disallowable items and non-taxable income | 33 | 8 |
| Non-deductible UK Bank Levy | 18 | 17 |
| Effect of change in tax rate on deferred tax provision | - | (1) |
| Adjustment to prior period provisions | (10) | (10) |
| Tax charge | 323 | 307 |

Interim period corporation tax is accrued based on the estimated average annual effective corporation tax rate for the year of 30.4% (2016: 28.5%). The standard rate of UK corporation tax was 27.25% for banking entities and 19.25% for non-banking entities (2016: 28% for banking entities and 20% for non-banking entities) following the introduction of an 8% surcharge to be applied to banking companies from 1 January 2016. Taxation for other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions. The Finance (No.2) Act 2015, introduced reductions in the corporation tax rate from 20% to 19% in 2017 and 18% by 2020. Finance Act 2016, which was substantively enacted on 6 September 2016, introduced a further reduction in the standard rate of corporation tax rate to 17% from 2020. The effects of the changes in tax rates are included in the deferred tax balances at 30 June 2017 and 31 December 2016.

7. DIVIDENDS

a) Ordinary share capital

Dividends of £276m (H116: £102m) were paid on the Company's ordinary shares in issue during the period. An interim dividend of £323m was declared on 26 June 2017 on the Company's ordinary shares in issue.

b) Other equity instruments

| | Half year to 30 June 2017 £m | Half year to 30 June 2016 £m |
|---|------------------------------------|------------------------------------|
| £300m fixed/floating rate non-cumulative callable preference shares | 1 | 1 |
| £300m Step-up Callable Perpetual Reserve Capital Instruments | 17 | 17 |
| AT1 securities: | | |
| - £500m Perpetual Capital Securities | 7 | - |
| - £750m Perpetual Capital Securities | 28 | 28 |
| - £300m Perpetual Capital Securities | 11 | 12 |
| - £500m Perpetual Capital Securities | 16 | 15 |
| | 80 | 73 |

8. TRADING ASSETS

| | 30 June 2017 £m | 31 December 2016 £m |
|--|--------------------|------------------------|
| Loans and advances to banks | | |
| - securities purchased under resale agreements | 1,580 | 2,757 |
| - other ⁽¹⁾ | 4,502 | 4,721 |
| Loans and advances to customers | | |
| - securities purchased under resale agreements | 14,315 | 7,955 |
| - other ⁽¹⁾ | 1,768 | 2,368 |
| Debt securities | 4,507 | 6,248 |
| Equity securities | 7,751 | 5,986 |
| | 34,423 | 30,035 |

(1) Total 'other' comprises short-term loans of £1,279m (2016: £920m) and cash collateral of £4,991m (2016: £6,169m).

A significant portion of the debt and equity securities are held in our eligible liquidity pool. They comprise mainly of government bonds and quoted stocks.

9. DERIVATIVE FINANCIAL INSTRUMENTS

| | 30 June 2017 | | | 31 December 2016 | | |
|---|-----------------------|---------------|-------------------|-----------------------|---------------|-------------------|
| | Notional amount £m | Fair value | | Notional amount £m | Fair value | |
| | | Assets £m | Liabilities £m | | Assets £m | Liabilities £m |
| Derivatives held for trading | | | | | | |
| Exchange rate contracts | 146,818 | 2,983 | 4,955 | 165,521 | 3,664 | 6,022 |
| Interest rate contracts | 969,928 | 11,883 | 11,379 | 942,798 | 14,117 | 14,341 |
| Equity and credit contracts | 18,287 | 1,179 | 543 | 15,325 | 1,321 | 860 |
| Total derivatives held for trading | 1,135,033 | 16,045 | 16,877 | 1,123,644 | 19,102 | 21,223 |
| Derivatives held for hedging | | | | | | |
| Derivatives designated as fair value hedges: | | | | | | |
| Exchange rate contracts | 2,693 | 471 | - | 3,819 | 751 | - |
| Interest rate contracts | 57,882 | 1,321 | 1,499 | 70,849 | 1,578 | 1,790 |
| Equity derivative contracts | 81 | - | 3 | 74 | 4 | - |
| | 60,656 | 1,792 | 1,502 | 74,742 | 2,333 | 1,790 |
| Derivatives designated as cash flow hedges: | | | | | | |
| Exchange rate contracts | 23,894 | 3,639 | 8 | 23,786 | 3,907 | 8 |
| Interest rate contracts | 12,909 | 124 | 101 | 12,683 | 120 | 82 |
| Equity derivative contracts | 29 | 11 | - | 24 | 9 | - |
| | 36,832 | 3,774 | 109 | 36,493 | 4,036 | 90 |
| Total derivatives held for hedging | 97,488 | 5,566 | 1,611 | 111,235 | 6,369 | 1,880 |
| Total derivatives | 1,232,521 | 21,611 | 18,488 | 1,234,879 | 25,471 | 23,103 |

10. LOANS AND ADVANCES TO CUSTOMERS

| | 30 June 2017 £m | 31 December 2016 £m |
|--|--------------------|------------------------|
| Loans and advances to customers | 199,559 | 199,610 |
| Amounts due from fellow Banco Santander subsidiaries and joint ventures | 1,172 | 1,112 |
| Amounts due from Santander UK Group Holdings plc | 7 | 5 |
| Loans and advances to customers | 200,738 | 200,727 |
| Less: impairment loss allowances | (864) | (921) |
| Less: residual value and voluntary termination provisions ⁽¹⁾ | (75) | (68) |
| Net loans and advances to customers | 199,799 | 199,738 |

(1) In H117, we reclassified our provisions for residual value and voluntary termination classified within the Finance lease impairment loss allowances category. In order to facilitate comparison with the current period, prior year comparatives were amended.

Movement in impairment loss allowances:

| | Loans secured on residential property £m | Corporate loans £m | Finance leases £m | Other unsecured advances £m | Total £m |
|---|---|--------------------------|-------------------------|--------------------------------------|-------------|
| At 1 January 2017 | 279 | 382 | 45 | 215 | 921 |
| (Release)/charge to the income statement | (18) | 12 | 17 | 65 | 76 |
| Write-offs and other items ⁽²⁾ | (10) | (38) | (16) | (69) | (133) |
| At 30 June 2017 | 251 | 356 | 46 | 211 | 864 |
| At 1 January 2016 | 424 | 395 | 20 | 269 | 1,108 |
| (Release)/charge to the income statement | (54) | 35 | 3 | 124 | 108 |
| Write-offs and other items ⁽²⁾ | (16) | (15) | (15) | (115) | (161) |
| At 30 June 2016 | 354 | 415 | 8 | 278 | 1,055 |

(2) Mortgage write-offs exclude the effect of the unwind over time of the discounting in estimating losses, as described in the accounting policy 'Impairment of financial assets' in Note 1 to the Consolidated Financial Statements in the 2016 Annual Report. Mortgage write-offs including this effect were £11m (H116: £18m).

Recoveries of loans and advances, net of collection costs:

| | Loans secured on residential property £m | Corporate loans £m | Finance leases £m | Other unsecured advances £m | Total £m |
|---------------------|---|--------------------------|-------------------------|--------------------------------------|-------------|
| 30 June 2017 | 2 | 1 | 4 | 21 | 28 |
| 30 June 2016 | 2 | 2 | 1 | 40 | 45 |

11. SECURITISATIONS AND COVERED BONDS

a) Securitisations

The gross assets securitised at 30 June 2017 and 31 December 2016 under the structures described below were:

| | 30 June 2017 £m | 31 December 2016 £m |
|----------------------------------|--------------------|------------------------|
| Master Trust Structures: | | |
| - Holmes | 4,947 | 5,560 |
| - Fosse | 6,499 | 7,182 |
| - Langton | 4,595 | 5,211 |
| Other securitisation structures: | | |
| - Motor | 851 | 1,117 |
| - Auto ABS UK Loans | 1,112 | 1,260 |
| | 18,004 | 20,330 |

i) Master Trust Structures

Holmes

In H117, there were no issuances (H116: £1.2bn) from Holmes Master Issuer plc. Mortgage-backed notes totalling £0.7bn (H116: £2.9bn) equivalent were redeemed during the period.

Fosse

In H117 and H116 there were no issuances from Fosse Master Issuer plc. Mortgage-backed notes totalling £0.7bn (H116: £0.8bn) equivalent were redeemed during the period.

Langton

In H117 and H116 there were no issuances from any of the Langton issuing companies. No mortgage-backed notes (H116: £1.9bn) were redeemed during the period.

ii) Other securitisation structures

Motor

In H117 and H116 there were no issuances from the Motor securitisation structures. Asset-backed notes totalling £0.2bn (H116: £0.3bn) equivalent were redeemed during the period.

Auto ABS UK Loans

In H117, £0.5bn of asset-backed notes (H116: £0.5bn) were issued from Auto ABS UK Loans. Additionally, £0.7bn of asset-backed notes (H116: £0.4bn) were redeemed during the period.

b) Covered Bonds

In H117, there were issuances of £1.0bn (H116: £0.8bn) from the covered bond programme. Mortgage-backed notes totalling £1.8bn (H116: £nil) equivalent were redeemed during the period.

12. INTERESTS IN OTHER ENTITIES

The Santander UK group has interests in subsidiaries, associates, joint ventures and unconsolidated structured entities, as set out in Note 21 to the Consolidated Financial Statements in the 2016 Annual Report. The unconsolidated structured entities include Abbey National Capital Trust I and Abbey National Capital LP I, which are 100% owned finance subsidiaries (as defined in Regulation S-X under the US Securities Act 1933, as amended) of Santander UK plc. On 7 February 2000, Abbey National Capital Trust I issued US\$1bn of 8.963% Non-cumulative Trust Preferred Securities, which have been registered under the US Securities Act of 1933, as amended. Abbey National Capital Trust I serves solely as a passive vehicle holding the partnership preferred securities issued by Abbey National Capital LP I and each has passed all the rights relating to such partnership preferred securities to the holders of trust preferred securities issued by Abbey National Capital Trust I. All of the trust preferred securities and the partnership preferred securities have been fully and unconditionally guaranteed on a subordinated basis by Santander UK plc. The terms of the securities do not include any significant restrictions on the ability of Santander UK plc to obtain funds, by dividend or loan, from any subsidiary.

13. TRADING LIABILITIES

| | 30 June 2017 £m | 31 December 2016 £m |
|--|--------------------|------------------------|
| Deposits by banks: | | |
| - securities sold under repurchase agreements | 676 | 780 |
| - other ⁽¹⁾ | 2,969 | 3,420 |
| Deposits by customers: | | |
| - securities sold under repurchase agreements | 13,928 | 8,018 |
| - other ⁽¹⁾ | 407 | 541 |
| Short positions in securities and unsettled trades | 3,510 | 2,801 |
| | 21,490 | 15,560 |

(1) Comprises cash collateral of £3.371m (2016: £3.535m) and short-term deposits of £5m (2016: £426m).

14. DEBT SECURITIES IN ISSUE

| | 30 June 2017 £m | 31 December 2016 £m |
|---------------------------|--------------------|------------------------|
| Medium-term notes | 18,175 | 20,995 |
| Covered bond programme | 15,961 | 16,628 |
| Certificates of deposit | 4,401 | 5,217 |
| Securitisation programmes | 5,460 | 7,506 |
| | 43,997 | 50,346 |

15. PROVISIONS

| | Conduct remediation | | | Regulatory-related £m | Vacant property £m | Other £m | Total £m |
|--------------------------|---------------------|-----------------------------|----------------------|--------------------------|-----------------------|-------------|-------------|
| | PPI £m | Wealth and Investment £m | Other products £m | | | | |
| At 1 January 2017 | 457 | 22 | 14 | 96 | 47 | 64 | 700 |
| Additional provisions | 69 | - | 35 | 2 | 6 | 69 | 181 |
| Used during the period | (121) | (27) | (2) | (53) | (5) | (87) | (295) |
| Transfers | - | 9 | - | - | - | - | 9 |
| At 30 June 2017 | 405 | 4 | 47 | 45 | 48 | 46 | 595 |
| At 1 January 2016 | 465 | 146 | 26 | 93 | 68 | 72 | 870 |
| Additional provisions | - | - | - | 36 | 1 | 60 | 97 |
| Used during the period | (61) | (34) | (10) | (47) | (7) | (60) | (219) |
| At 30 June 2016 | 404 | 112 | 16 | 82 | 62 | 72 | 748 |

Conduct remediation

The table below sets out the key drivers of the Payment Protection Insurance (PPI) provision balance and forecast assumptions used in calculating the provision, as well as the sensitivity of the provision to changes in the assumptions.

| | Cumulative to 30 June 2017 | Future expected | Sensitivity analysis Increase/decrease in provision |
|--|----------------------------------|-----------------|---|
| Inbound complaints ⁽¹⁾ ('000) | 1,402 | 412 | 25 = £9m |
| Outbound contact ('000) | 406 | 342 | 25 = £15m |
| Response rate to outbound contact | 35% | 91% | 1% = £2.2m |
| Average uphold rate per claim ⁽²⁾ | 58% | 74% | 1% = £3.5m |
| Average redress per claim ⁽³⁾ | £1,657 | £643 | £100 = £54m |

(1) Excludes invalid claims where the complainant has not held a PPI policy.

(2) Claims include inbound and responses to outbound contact.

(3) The average redress per claim reduced from the cumulative average value at 30 June 2017 of £1,657 to a future expected average value of £643 due to the inclusion of Plevin cases in the provision, as well as a shift in the complaint mix to a greater proportion of storecards, which typically held lower average balances.

In November 2015, the FCA issued a Consultation Paper 15/39 (Rules and guidance on payment protection insurance complaints) which introduced the concept of unfair commission in relation to Plevin for customer redress plus a deadline by which customers would need to make their PPI complaints. On 2 August 2016, the FCA issued Consultation Paper 16/20 (Rules and Guidance on payment protection insurance complaints: Feedback on CP 15/39 and further consultation). The paper outlined the FCA's proposed approach to PPI in light of the 2014 decision of the Supreme Court in Plevin v Paragon Personal Finance Ltd (Plevin) and also recommended a two-year deadline period starting in June 2017, which was later than proposed in CP 15/39. The paper also included proposals in relation to how redress for Plevin-related claims should be calculated including consideration of how profit share arrangements should be reflected in commission levels. The final rules released on 2nd March 2017 in Policy Statement 17/3 (Payment Protection Insurance Complaints: Feedback on CP16/20 and final rules and guidance) confirmed that the two-year deadline period would start in August 2017. There is also now a requirement to proactively mail previously rejected complainants in scope of s140A of the Consumer Credit Act to explain they are eligible to complain again in light of Plevin. Lastly there are some clarifications to the profit share percentage calculations. These changes may impact on the future amounts expected to be paid.

30 June 2017 compared to 31 December 2016

The remaining provision for PPI redress and related costs amounted to £405m. In the first quarter of 2017, we made an additional provision of £32m relating to the final FCA rules and guidance published in Mar17. We also provided a net charge of £37m in the second quarter, following a review of claims handling procedures in relation to a specific PPI portfolio including the impact of a past business review. See Note 17.

In line with our assumptions, monthly utilisation increased from the 2016 average following the confirmation of a deadline for customer complaints. We will continue to monitor our provision levels in respect of recent claims experience.

The remaining non-PPI related conduct provisions amounted to £51m, including an additional provision of £35m in the second quarter, relating to the sale of interest rate derivatives. This charge follows an ongoing review regarding regulatory classification of certain customers eligible for redress.

16. RETIREMENT BENEFIT PLANS

The amounts recognised in the balance sheet were as follows:

| | 30 June 2017 £m | 31 December 2016 £m |
|---|--------------------|------------------------|
| Assets/(liabilities) | | |
| Funded defined benefit pension scheme – surplus | 500 | 398 |
| Funded defined benefit pension scheme – deficit | (181) | (223) |
| Unfunded defined benefit pension scheme | (39) | (39) |
| Total net assets | 280 | 136 |

a) Defined contribution pension plans

An expense of £27m (H116: £26m) was recognised for defined contribution plans in the period, and is included in staff costs classified within operating expenses in the Income Statement. None of this amount was recognised in respect of key management personnel for H117 and H116.

b) Defined benefit pension schemes

The total amount charged to the income statement, including any amounts classified as redundancy costs was £23m (H116: £11m).

Movements in the present value of defined benefit obligations and fair value of scheme assets were as follows:

| | 30 June 2017 | | 30 June 2016 | |
|--|---|--------------------------------|---|--------------------------------|
| | Present value of defined benefit obligations | Fair value of scheme assets | Present value of defined benefit obligations | Fair value of scheme assets |
| | £m | £m | £m | £m |
| Balance at 1 January | (11,082) | 11,218 | (9,004) | 9,450 |
| Income statement charge | (182) | 247 | (186) | 232 |
| Recognised in other comprehensive income | | | | |
| - Return on plan assets (excluding amounts included in net interest expense) | - | 85 | - | 1,055 |
| - Actuarial movements arising from experience adjustments | 11 | - | 28 | - |
| - Actuarial movements arising from changes in financial assumptions | (17) | - | (1,572) | - |
| Benefits paid | 191 | (191) | 130 | (130) |
| Balance at 30 June | (11,079) | 11,359 | (10,604) | 10,607 |

The net assets recognised in the balance sheet was determined as follows:

| | 30 June 2017 £m | 31 December 2016 £m |
|--|--------------------|------------------------|
| Present value of defined benefit obligations | (11,079) | (11,082) |
| Fair value of scheme assets | 11,359 | 11,218 |
| Net defined benefit assets | 280 | 136 |

Result of triennial valuation

The 31 March 2016 triennial funding valuation was concluded in early 2017. Santander UK plc has committed to continue to fund the Scheme at the current rate with the recovery plan extended for a further three years. In addition Santander UK plc has committed to make contingent contributions if the investment performance is lower than expected.

Actuarial assumptions

There have been no significant changes to the method for setting the principal actuarial assumptions used as set out in Note 34 to the Consolidated Financial Statements in the 2016 Annual Report.

17. CONTINGENT LIABILITIES AND COMMITMENTS

| | 30 June 2017 | 31 December 2016 |
|---|---------------|------------------|
| | £m | £m |
| Guarantees given to third parties | 1,435 | 1,859 |
| Formal standby facilities, credit lines and other commitments | 42,131 | 41,616 |
| | 43,566 | 43,475 |

There have been no significant changes to the contingent liabilities as set out in Note 35 to the Consolidated Financial Statements in the 2016 Annual Report, except as follows:

Guarantees given by Santander UK plc to its subsidiaries

Santander UK plc has fully and unconditionally guaranteed the unsubordinated liabilities of each of Abbey National Treasury Services plc and Cater Allen Limited, both of which are wholly owned subsidiaries of the Santander UK group, that have been or will be incurred before 31 December 2018.

Other legal actions and regulatory matters

Note 15 details our provisions including those in relation to PPI. In relation to a specific PPI portfolio of complaints, following a review of legal and regulatory responsibilities, including consultation with external professional advisers, it is not currently considered that the likelihood of Santander UK group incurring a liability is probable and as such no provision is held. There are a number of factual and legal issues to be resolved in relation to this portfolio which may impact the amount or timing of any liability. These issues create uncertainties which mean that it is not currently possible to make a reliable estimate of the financial effect, if any, that may arise.

18. SHARE CAPITAL AND OTHER EQUITY INSTRUMENTS

| | 30 June 2017 | 31 December 2016 |
|---|--------------|------------------|
| | £m | £m |
| Ordinary share capital | 3,105 | 3,105 |
| £300m fixed/floating rate non-cumulative callable preference shares | 14 | 14 |
| £300m Step-up Callable Perpetual Reserve Capital Instruments | 235 | 235 |
| AT1 securities: | | |
| - £500m Perpetual Capital Securities | 496 | - |
| - £750m Perpetual Capital Securities | 750 | 750 |
| - £300m Perpetual Capital Securities | 300 | 300 |
| - £500m Perpetual Capital Securities | 500 | 500 |
| | 5,400 | 4,904 |

£500m Perpetual Capital Securities

On 10 April 2017, the Company issued £500m Perpetual Capital Securities, all of which were subscribed by the Company's immediate parent, Santander UK Group Holdings plc. The securities are perpetual and pay a distribution rate on 24 March, June, September and December. At each distribution payment date, the Company can decide whether to pay the distribution rate, which is non-cumulative, in whole or in part. The distribution rate is 6.75% per annum until 24 June 2024; thereafter, the distribution rate resets every five years to a rate of 5.792% per annum above the then prevailing 5 year sterling mid swap rate. The Perpetual Capital Securities will be automatically written down should the Common Equity Tier 1 capital ratio of the Santander UK prudential consolidation group as defined in the PRA's rules fall below 7%. The Perpetual Capital Securities are redeemable at the option of the Company on 24 June 2024 or on any reset date thereafter. No such redemption may be made without the consent of the PRA.

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

Securitisations and covered bonds

As described in Note 16 to the Consolidated Financial Statements in the 2016 Annual Report, Santander UK plc and certain of its subsidiaries enter into securitisation transactions whereby portfolios of residential mortgage loans and other loans are purchased by or assigned to structured securitisation companies, and have been funded through the issue of mortgage-backed securities and other asset-backed securities. Holders of the securities are only entitled to obtain payments of principal and interest to the extent that the resources of the securitisation companies are sufficient to support such payments and the holders of the securities have agreed in writing not to seek recourse in any other form. At 30 June 2017, £1,450m (2016: £363m) of loans were so assigned by the Santander UK group.

Santander UK plc also has a covered bond programme, whereby securities are issued to investors and are secured by a pool of residential mortgages. At 30 June 2017, the pool of residential mortgages for the covered bond programme was £19,989m (2016: £20,263m).

At 30 June 2017, total notes issued externally from secured programmes (securitisations and covered bonds) decreased to £21,421m (2016: £24,134m), including gross issuance of £1,000m (H116: £1,147m) and redemptions of £3,538m (H116: £2,227m). At 30 June 2017, a total of £4,841m (2016: £4,998m) of notes issued under securitisation and covered bond programmes had also been retained internally, a proportion of which had been used as collateral for raising funds via third party bilateral secured funding transactions, which totalled £1,834m at 30 June 2017 (2016: £2,764m), or for creating collateral which could in the future be used for liquidity purposes.

20. FINANCIAL INSTRUMENTS

a) Measurement basis of financial assets and liabilities

The Santander UK group categorises assets and liabilities measured at fair value within the fair value hierarchy based on the inputs to the valuation techniques as described in Note 43(a) to the Consolidated Financial Statements in the 2016 Annual Report.

b) Fair values of financial instruments carried at amortised cost

The following table analyses the fair value of the financial instruments carried at amortised cost at 30 June 2017 and 31 December 2016. It does not include fair value information for financial assets and financial liabilities carried at amortised cost if the carrying amount is a reasonable approximation of fair value. Details of the valuation methodology of the financial assets and financial liabilities carried at amortised cost can be found in Note 43(c) to the Consolidated Financial Statements in the 2016 Annual Report.

| Balance sheet category | | 30 June 2017 | | 31 December 2016 | |
|----------------------------------|--|------------------|----------------------|------------------|----------------------|
| | | Fair value £m | Carrying value £m | Fair value £m | Carrying value £m |
| Assets | | | | | |
| Loans and advances to banks | | 4,351 | 4,404 | 4,215 | 4,348 |
| Loans and advances to customers | Advances secured on residential property | 157,009 | 154,295 | 157,961 | 154,448 |
| | Corporate loans | 31,281 | 31,302 | 31,590 | 31,596 |
| | Other advances | 14,204 | 14,202 | 13,685 | 13,694 |
| | | 202,494 | 199,799 | 203,236 | 199,738 |
| Loans and receivables securities | | 1,444 | 1,424 | 272 | 257 |
| Held-to-maturity investments | | 6,433 | 6,613 | 6,436 | 6,648 |
| Liabilities | | | | | |
| Deposits by banks | Securities sold under agreements to repurchase | 1,090 | 1,077 | 2,406 | 2,384 |
| | Other deposits | 10,827 | 10,813 | 7,392 | 7,385 |
| | | 11,917 | 11,890 | 9,798 | 9,769 |
| Deposits by customers | Current and demand accounts | 92,542 | 92,542 | 91,162 | 91,162 |
| | Savings accounts | 62,831 | 62,698 | 58,461 | 58,305 |
| | Time deposits | 25,481 | 25,447 | 27,260 | 27,203 |
| | Securities sold under agreements to repurchase | 572 | 502 | 582 | 502 |
| | | 181,426 | 181,189 | 177,465 | 177,172 |
| Debt securities in issue | Bonds and medium-term notes | 40,301 | 38,537 | 44,643 | 42,840 |
| | Securitisation programmes | 5,507 | 5,460 | 7,606 | 7,506 |
| | | 45,808 | 43,997 | 52,249 | 50,346 |
| Subordinated liabilities | | 4,491 | 4,109 | 4,562 | 4,303 |

c) Fair values of financial instruments measured at fair value on a recurring basis

The following tables summarise the fair values of the financial assets and liabilities accounted for at fair value at 30 June 2017 and 31 December 2016, analysed by their levels in the fair value hierarchy – Level 1, Level 2 and Level 3.

Transfers between levels of the fair value hierarchy

Transfers between levels of the fair value hierarchy are reported at the beginning of the period in which they occur.

During H117 there were no transfers of financial instruments between Levels 1, 2 and 3 in the fair value hierarchy. Transfers relating to 2016 are disclosed in Note 43(d) to the Consolidated Financial Statements in the 2016 Annual Report.

| Balance sheet category | | 30 June 2017 | | | | 31 December 2016 | | | | Valuation technique |
|--|---------------------------------|---------------|---------------|---------------|-------------|------------------|---------------|---------------|-------------|---------------------|
| | | Level 1 £m | Level 2 £m | Level 3 £m | Total £m | Level 1 £m | Level 2 £m | Level 3 £m | Total £m | |
| Assets | | | | | | | | | | |
| Trading assets | Loans and advances to banks | - | 6,082 | - | 6,082 | - | 7,478 | - | 7,478 | A |
| | Loans and advances to customers | 1,202 | 14,881 | - | 16,083 | 762 | 9,561 | - | 10,323 | A |
| | Debt securities | 4,507 | - | - | 4,507 | 6,248 | - | - | 6,248 | - |
| | Equity securities | 7,751 | - | - | 7,751 | 5,986 | - | - | 5,986 | - |
| Derivative assets | Exchange rate contracts | - | 7,072 | 21 | 7,093 | - | 8,300 | 22 | 8,322 | A |
| | Interest rate contracts | - | 13,313 | 15 | 13,328 | 1 | 15,795 | 19 | 15,815 | A & C |
| | Equity and credit contracts | - | 1,131 | 59 | 1,190 | - | 1,272 | 62 | 1,334 | B & D |
| Financial assets designated at fair value | Loans and advances to customers | - | 1,510 | 64 | 1,574 | - | 1,668 | 63 | 1,731 | A |
| | Debt securities | - | 399 | 188 | 587 | - | 208 | 201 | 409 | A & B |
| Available-for-sale securities | Equity securities | 19 | 9 | 41 | 69 | 17 | 63 | 32 | 112 | B |
| | Debt securities | 9,503 | 2 | - | 9,505 | 10,449 | - | - | 10,449 | C |
| Total assets at fair value | | 22,982 | 44,399 | 388 | 67,769 | 23,463 | 44,345 | 399 | 68,207 | |
| Liabilities | | | | | | | | | | |
| Trading liabilities | Deposits by banks | - | 3,645 | - | 3,645 | - | 4,200 | - | 4,200 | A |
| | Deposits by customers | - | 14,335 | - | 14,335 | - | 8,559 | - | 8,559 | A |
| | Short positions | 3,510 | - | - | 3,510 | 2,801 | - | - | 2,801 | - |
| Derivative liabilities | Exchange rate contracts | - | 4,943 | 20 | 4,963 | - | 6,009 | 21 | 6,030 | A |
| | Interest rate contracts | - | 12,972 | 7 | 12,979 | - | 16,202 | 11 | 16,213 | A & C |
| | Equity and credit contracts | 1 | 503 | 42 | 546 | 1 | 817 | 42 | 860 | B & D |
| Financial liabilities designated at fair value | Debt securities in issue | - | 2,161 | 6 | 2,167 | - | 1,908 | 6 | 1,914 | A |
| | Structured deposits | - | 809 | - | 809 | - | 526 | - | 526 | A |
| Total liabilities at fair value | | 3,511 | 39,368 | 75 | 42,954 | 2,802 | 38,221 | 80 | 41,103 | |

d) Valuation techniques

The main valuation techniques employed in internal models to measure the fair value of the financial instruments are disclosed in Note 43(e) to the Consolidated Financial Statements in the 2016 Annual Report. The Santander UK group did not make any material changes to the valuation techniques and internal models it used during H117.

e) Fair value adjustments

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

The Santander UK 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 Corporate Banking. The magnitude and types of fair value adjustment adopted by Global Corporate Banking are listed in the following table:

| | 30 June 2017 £m | 31 December 2016 £m |
|--|--------------------|------------------------|
| Risk-related: | | |
| - Bid-offer and trade specific adjustments | 42 | 37 |
| - Uncertainty | 43 | 49 |
| - Credit risk adjustment | 43 | 50 |
| - Funding fair value adjustment | 10 | 20 |
| | 138 | 156 |
| Model-related | | |
| Day One profit | 2 | 1 |
| | 1 | 4 |
| | 141 | 161 |

Risk-related adjustments

Risk-related adjustments are driven, in part, by the magnitude of the Santander UK group's market or credit risk exposure, and by external market factors, such as the size of market spreads. For further details, see the 'Risk-related adjustments' section in Note 43(f) to the Consolidated Financial Statements in the 2016 Annual Report.

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

Valuation techniques

There have been no significant changes to the valuation techniques set out in Note 43(i) to the Consolidated Financial Statements in the 2016 Annual Report.

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

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

| | Assets | | | | Liabilities | | |
|---|-------------|------------------------|--------------------|-------|-------------|------------------------|-------|
| | Derivatives | Fair value through P&L | Available-for-sale | Total | Derivatives | Fair value through P&L | Total |
| | £m | £m | £m | £m | £m | £m | £m |
| At 1 January 2017 | 103 | 264 | 32 | 399 | (74) | (6) | (80) |
| Total gains/(losses) recognised in profit/(loss): | | | | | | | |
| - Fair value movements | 6 | (9) | - | (3) | (7) | - | (7) |
| - Foreign exchange and other movements | (5) | - | - | (5) | 5 | - | 5 |
| Gains recognised in other comprehensive income | - | - | 9 | 9 | - | - | - |
| Sales | - | (3) | - | (3) | - | - | - |
| Settlements | (9) | - | - | (9) | 7 | - | 7 |
| At 30 June 2017 | 95 | 252 | 41 | 388 | (69) | (6) | (75) |
| Gains/(losses) recognised in profit/(loss) relating to assets and liabilities held at the end of the period | 1 | (9) | - | (8) | (2) | - | (2) |
| At 1 January 2016 | 188 | 267 | 100 | 555 | (105) | (5) | (110) |
| Total gains/(losses) recognised in profit/(loss): | | | | | | | |
| - Fair value movements | (2) | 36 | - | 34 | 8 | (1) | 7 |
| - Foreign exchange and other movements | 1 | - | - | 1 | - | (1) | (1) |
| Gains recognised in other comprehensive income | - | - | 19 | 19 | - | - | - |
| Additions | - | - | 25 | 25 | - | - | - |
| Sales | - | - | (119) | (119) | - | - | - |
| Settlements | (20) | (15) | - | (35) | 15 | - | 15 |
| At 30 June 2016 | 167 | 288 | 25 | 480 | (82) | (7) | (89) |
| Gains/(losses) recognised in profit/(loss) relating to assets and liabilities held at the end of the period | (1) | 36 | - | 35 | 8 | (2) | 6 |

Effect of changes in significant unobservable assumptions to reasonably possible alternatives (Level 3)

As discussed above, the fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data and, as such require the application of a degree of judgement. Changing one or more of the inputs to the valuation models to reasonably possible alternative assumptions would change the fair values significantly. There has been no significant change to the unobservable inputs and sensitivities used in Level 3 fair values as set out in Note 43(i) to the Consolidated Financial Statements in the 2016 Annual Report.

21. RELATED PARTY DISCLOSURES

The financial position and performance of the Santander UK group have not been materially affected in H117 by any related party transactions, or changes to related party transactions. In addition, transactions with pension schemes operated by the Santander UK group are described in Note 34 to the Consolidated Financial Statements in the 2016 Annual Report. These transactions were made in the ordinary course of business and substantially on the same terms as for comparable transactions with third party counterparties and within limits acceptable to the PRA. Such transactions do not involve more than the normal risk of collectability or present any unfavourable features.

22. EVENTS AFTER THE BALANCE SHEET DATE

There have been no significant events between 30 June 2017 and the date of approval of these financial statements which would require a change to or additional disclosure in the financial statements.

Shareholder information

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Forward-looking statements

The Company and its subsidiaries (together Santander UK) may from time to time make written or oral forward-looking statements. The Company makes written forward-looking statements in this Half Yearly Financial Report and may also make forward-looking statements in its periodic reports to the SEC on Forms 20-F and 6-K, in its offering circulars and prospectuses, in press releases and other written materials and in oral statements made by its officers, directors or employees to third parties. By their very nature, forward-looking statements are not statements of historical or current facts; they cannot be objectively verified, are speculative and involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. Santander UK 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 Santander UK or on its behalf. For more, see 'Forward-looking statements' in the Shareholder information section of the 2016 Annual Report. Please also refer to our latest filings with the SEC (including, without limitation, our Annual Report on Form 20-F for the year ended 31 December 2016) for a discussion of certain risk factors and forward-looking statements. Undue reliance should not be placed on forward-looking statements when making decisions with respect to any Santander UK member and/or its securities. Investors and others should take into account the inherent risks and uncertainties of forward-looking statements and should carefully consider the non-exhaustive list of important factors in the 2016 Annual Report. 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. Santander UK does not undertake any obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Selected financial data

SELECTED STATISTICAL INFORMATION

| | 30 June 2017 ⁽¹⁾ % | 31 December 2016 % |
|--|----------------------------------|-----------------------|
| Capital ratios: | | |
| CET1 capital ratio | 12.1 | 11.6 |
| Total capital ratio | 19.6 | 18.5 |
| Equity to assets ratio ⁽²⁾ | 4.61 | 4.60 |
| Ratio of earnings to fixed charges:⁽³⁾ | | |
| - Excluding interest on retail deposits | 382 | 292 |
| - Including interest on retail deposits | 201 | 166 |
| Profitability ratios: | | |
| Return on assets ⁽⁴⁾ | 0.48 | 0.44 |
| Return on ordinary shareholders' equity ⁽⁵⁾ | 10.3 | 9.3 |
| Dividend payout ratio ⁽⁶⁾ | n/a | 46 |

(1) As described in Note 1 to the Condensed Consolidated Interim Financial Statements, Santander UK elected to early apply the IFRS 9 requirement for the presentation of gains and losses on financial liabilities relating to own credit in other comprehensive income from 1 January 2017. The cumulative own credit adjustment component of the cumulative fair value adjustment on financial liabilities designated at fair value through profit or loss has been included in opening retained earnings. Comparatives have not been restated. We have not adopted the other requirements in IFRS 9.

(2) Average ordinary shareholders' equity divided by average total assets. Average balances are based on monthly data.

(3) For the purpose of calculating the ratios of earnings to fixed charges, earnings consist of profit from continuing operations before tax and before adjustment for non-controlling interests plus fixed charges. Fixed charges consist of interest expense, including the amortisation of discounts and premiums on debt securities in issue and related capitalised expenses and including or excluding interest on retail deposit as appropriate.

(4) Profit after tax divided by average total assets. Average balances are based on monthly data.

(5) Profit after tax divided by average ordinary shareholders' equity.

(6) Ordinary equity dividends approved divided by profit after tax attributable to equity holders of the parent.

Glossary

Our glossary of industry and other main terms is available on our website: www.santander.co.uk/uk/about-santander-uk/investor-relations-glossary.