

Risk Management

The Risk Management report contains audited financial information except for the discussion of Operational Risk on page 18 that, in accordance with the guidance in paragraph BC65 of IFRS 7, is unaudited.

Summary

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

Introduction - A description of the Group's Risk Governance Framework, including the three tiers of the Risk Governance structure. This can be found on pages 16 to 17;

Financial Risks and Risk Management - Group-wide disclosures about specific risks which do not originate in any single operating segment, such as operational risk and pension obligation risk, as well as Group-wide disclosures about market risk and credit risk are described on pages 17 to 20.

Liquidity risk - A description of the liquidity risks the Group faces, along with their management and activity in 2009 and 2008 can be found on page 20.

Discussion of Key Risks by Operating Segment - Detailed discussions about risk exposures, measurement information and management policies presented by operating segment can be found on pages 22 to 29:

- > **Risks in Retail Banking** - The risks in this segment are described on pages 22 to 26, comprising:
 - > **Credit risk**, including its management, an analysis of types and credit quality of retail lending and disclosures relating to provisioning, arrears and recoveries.
 - > **Market risk**, including its management.
- > **Risks in Corporate Banking** - The risks in this segment are described on pages 26 to 28, comprising:
 - > **Credit risk**, including its management and mitigation.
 - > **Market risk**, including its management.
- > **Risks in Private Banking** - The risks in this segment are described on page 28, comprising a description of credit risk and market risk in the entities which this segment incorporates.
- > **Risks in Group Infrastructure** - The risks in this segment are described on pages 28 to 29, comprising:
 - > **Credit risk**, including its management and mitigation.
 - > **Market risk**, including its management.

The Impact of the Current Credit Environment - Detailed disclosures can be found on pages 29 to 37, comprising description of the Group's exposures to certain classes of financial assets and off-balance sheet entities.

Introduction

Following Banco Santander, S.A.'s acquisition of Alliance & Leicester plc in October 2008, the key risks of Alliance & Leicester plc and Santander UK plc have been managed on a combined basis. For further information, please refer to the Risk Management Report of Santander UK plc's Consolidated Financial Statements.

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

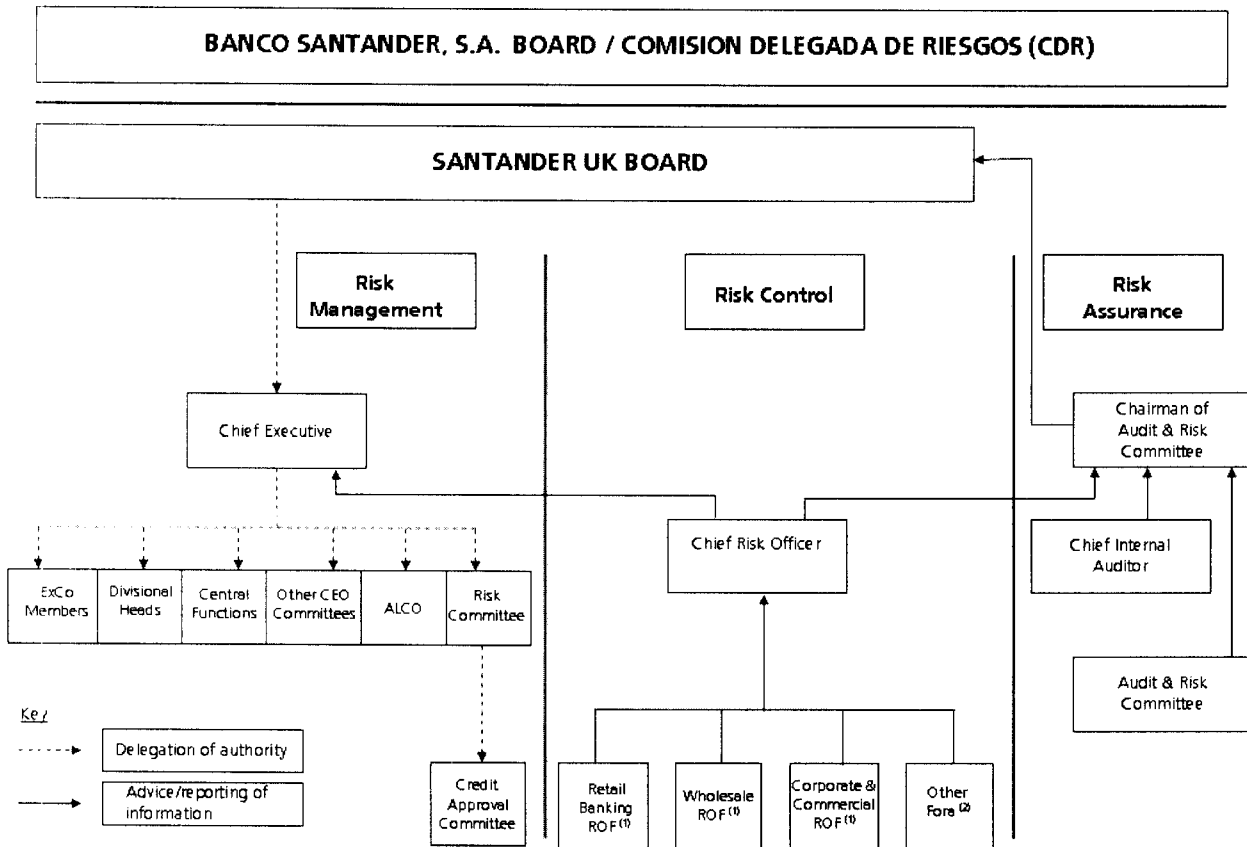
Understanding and controlling risk in a business is critical for the effective management of the business. Santander UK's Risk Framework ensures that risk is managed and controlled on behalf of shareholders, customers, depositors, employees and the Group's regulators. Effective and efficient risk governance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

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

Risk Management continued

Risk Governance Framework

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



(1) Risk Oversight Forum ('ROF').

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

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

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

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

First tier of risk governance in Santander UK

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

Risk Committee

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

Second tier of risk governance in Santander UK

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

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

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

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

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

Third tier of risk governance in Santander UK

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

Non-Executive Directors

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

Audit and Risk Committee

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

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

Internal Audit

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

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

Financial Risks and Risk Management

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

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

The Group-wide disclosures are followed by detailed discussions about risk exposures, measurement information and management policies presented by operating segment, being Retail Banking, Corporate Banking, Private Banking and Group Infrastructure.

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

Risk Management continued

Financial Instruments

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

Operational Risk – Group-wide (unaudited)

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

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

Managing operational risk (unaudited)

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

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

Key operational risk activity in 2009 (unaudited)

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

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

The Group continues to strengthen its point of sale compliance and control procedures to minimise risk and serve its customers. To this end, work continues to progress in implementing new systems which are already successfully operating in Banco Santander, S.A..

Internet frauds were greatly reduced throughout 2009 by developing and implementing improvements to fraud detection rates and introducing a Santander Group transactional model which increased the volume of cases that were intercepted.

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

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

Credit Risk – Group-wide

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

Significant concentrations of credit risk

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

- > the residential mortgage portfolio and unsecured personal lending businesses in Retail Banking;
- > secured lending and derivatives exposures to companies in Corporate Banking; and
- > the portfolio of assets in Group Infrastructure inconsistent with the Group's future strategy such as the Treasury asset portfolio.

Risk Management continued

Following Banco Santander, S.A.'s acquisition of Alliance & Leicester plc in October 2008, the liquidity risks of Alliance & Leicester plc and Santander UK plc have been managed on a combined basis. For further information, please refer to the Significant concentrations of credit risk section in the Risk Management Report of Santander UK plc's Consolidated Financial Statements.

Maximum exposure to credit risk

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

	2009 £m	2008 £m
Derivative financial instruments	1,095	2,876
Financial assets designated at fair value	50	63
Available-for-sale securities	11	1,658
Loan and receivable securities	9,828	14,250
Loans and advances to customers	46,758	51,402
Loans and advances to banks	325	1,239
Other	749	348
Third party exposures⁽¹⁾	58,816	71,836

(1) In addition, the Group is exposed to credit risk in respect of guarantees granted, loan commitments and stock borrowing and lending agreements. The estimated maximum exposure to credit risk is described in Note 33 to the Consolidated Financial Statements on page 92.

(2) Excludes loan to other members of the Santander UK and Santander groups

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

Analysis of provisions on loans and advances to customers

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

	2009 £m	2008 £m
Observed provision		
Advances secured on residential properties - UK	63	45
Corporate advances - UK	164	138
Finance leases - UK	1	4
Other secured advances - UK	-	1
Unsecured personal advances - UK	39	289
Total observed provisions	267	477
Incurred but not yet observed provision		
Advances secured on residential properties - UK	55	14
Corporate advances - UK	98	133
Finance leases - UK	1	1
Other secured advances - UK	-	-
Unsecured personal advances - UK	2	21
Total incurred but not yet observed provisions	156	169
Total provisions	423	646

Movements in provisions for impairment losses on loans and advances

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

	2009 £m	2008 £m
Provisions at 1 January	646	163
Amounts written off		
Advances secured on residential properties - UK	(16)	(9)
Corporate advances - UK	(96)	(17)
Finance leases - UK	(8)	-
Unsecured personal advances - UK	(290)	(98)
Total amounts written off	(410)	(124)
Disposal of business	(84)	-
Observed provisions charged against profit		
Advances secured on residential properties - UK	34	46
Corporate advances - UK	122	155
Finance leases - UK	5	-
Other secured advances - UK	(1)	-
Unsecured personal advances - UK	113	272
Total observed provisions charged against profit	273	473
Incurred but not yet observed provisions charged against profit	(2)	134
Total provisions charged against profit	271	607
Provisions at the end of the year	423	646

Risk Management continued

Basel II (unaudited)

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

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

The Group applied Basel II to its Internal Capital Adequacy Assessment Process (ICAAP) and to the risk and capital disclosures made to the market. The Group has applied Banco Santander, S.A.'s approach to risk management in its application of Basel II. Further information on the Group's capital position under Basel II is included in Note 44 to the Consolidated Financial Statements. The Pillar 3 disclosures for Santander UK, of which the Group is part, can be found in the Santander UK Consolidated Financial Statements.

Market risk – Group-wide

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

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

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

Pension obligation risk – Group-wide

The Group has statutory funding obligations as the sponsoring employer for a defined benefit staff pension scheme. The scheme is managed by independent trustees in accordance with legislation and trust deeds and rules, for the benefit of members. The Group accepts that it is exposed to pension obligation risk that could give rise to an unexpected increase in the Group's obligations to fund the scheme, either because of a loss of net asset value or because of changes in legislation or regulatory action. The principal risks to the net asset value of the scheme are an increase in the value of the liabilities arising from adverse changes in the longevity assumptions, increases in inflation or reductions in the discount rate used, and scheme assets being adversely affected by market movements. Further information on pensions can be found in "Critical Accounting Policies" within the Accounting Policies on page 66 and in Note 32 to the Consolidated Financial Statements.

Risk management

The Chief Financial Officer is responsible for managing the Group's exposure to pension obligation risk, in conjunction with the trustees. Further details of the funding arrangements for the pension schemes can be found on page 89.

Liquidity risk – Group wide

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

Following Banco Santander, S.A.'s acquisition of Alliance & Leicester plc in October 2008, the liquidity risks of the Group are managed on a combined basis with Santander UK plc. For further information, please refer to the liquidity risk discussion in the Risk Management Report in Santander UK plc's Consolidated Financial Statements.

The majority of funding is raised from retail deposits with the balance raised in wholesale markets. Alliance & Leicester plc now sources its wholesale funding from Santander UK plc.

Risk Management continued

Maturities of financial liabilities

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

At 31 December 2009	Group					Total £m
	Demand £m	Up to 3 Months £m	3-12 Months £m	1-5 Years £m	Over 5 Years £m	
Deposits by banks	16,155	12,069	3,171	12,519	9,257	53,171
Deposits by customers	27,547	12,507	2,684	720	1	43,459
Financial liabilities designated at fair value	-	16	29	38	-	83
Loan commitments	229	1,070	918	692	267	3,176
Debt securities in issue	-	476	2,179	3,202	4,274	10,131
Subordinated liabilities	-	29	40	212	1,458	1,739
	43,931	26,167	9,021	17,383	15,257	111,759
Derivative financial instruments	-	-	-	-	-	-
Total financial liabilities	43,931	26,167	9,021	17,383	15,257	111,759

At 31 December 2009	Company					Total £m
	Demand £m	Up to 3 Months £m	3-12 months £m	1-5 Years £m	Over 5 Years £m	
Deposits by banks	16,163	12,536	4,307	12,736	9,375	55,117
Deposits by customers	28,595	15,926	2,498	699	-	47,718
Financial liabilities designated at fair value	-	16	29	38	-	83
Loan commitments	229	1,070	905	310	267	2,781
Debt securities in issue	-	476	2,178	3,201	156	6,011
Subordinated liabilities	-	29	40	212	1,458	1,739
	44,987	30,053	9,957	17,196	11,256	113,449
Derivative financial instruments	-	-	-	-	-	-
Total financial liabilities	44,987	30,053	9,957	17,196	11,256	113,449

At 31 December 2008	Group					Total £m
	Demand £m	Up to 3 Months £m	3-12 Months £m	1-5 Years £m	Over 5 Years £m	
Deposits by banks	1,279	6,908	544	3,006	-	11,737
Deposits by customers	28,435	8,051	3,179	114	91	39,870
Financial liabilities designated at fair value	-	321	336	26	70	753
Loan commitments	-	28	302	836	792	1,958
Debt securities in issue	-	2,249	4,030	6,919	12,600	25,798
Subordinated liabilities	-	18	66	359	3,009	3,452
	29,714	17,575	8,457	11,260	16,562	83,568
Derivative financial instruments	-	243	262	240	119	864
Total financial liabilities	29,714	17,818	8,719	11,500	16,681	84,432

At 31 December 2008	Company					Total £m
	Demand £m	Up to 3 Months £m	3-12 Months £m	1-5 Years £m	Over 5 Years £m	
Deposits by banks	1,907	8,345	548	2,962	-	13,762
Deposits by customers	30,524	7,616	2,962	101	91	41,294
Loan commitments	-	14	259	621	137	1,031
Financial liabilities designated at fair value	-	321	336	26	70	753
Debt securities in issue	-	2,179	3,954	6,255	220	12,608
Subordinated liabilities	-	18	66	359	3,009	3,452
Funding for securitisations	-	72	79	684	12,753	13,588
	32,431	18,565	8,204	11,008	16,280	86,488
Derivative financial instruments	-	176	191	206	82	655
Total financial liabilities	32,431	18,741	8,395	11,214	16,362	87,143

As the above table is based on contractual maturities, no account is taken of call features related to subordinated liabilities. The repayment terms of the debt securities may be accelerated in line with the covenants contained within the individual loan agreements, as described in Note 29 to the Consolidated Financial Statements. In addition, no account is taken of the possible early repayment of the Group's mortgage-backed non-recourse finance which is redeemed by the Group as funds become available from redemptions of the residential mortgages. The Group has no control over the timing and amount of redemptions of residential mortgages.

Risk Management continued

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

Current market conditions

After a difficult start to the year, funding and liquidity conditions improved during 2009. This was the result of on-going liquidity support schemes through increased liquidity within the financial system; strengthened deposit protection insurance; and bank support through increased capital and guarantees. More recently, signs of macroeconomic recovery, although still fragile, have seen further improvements in debt markets. From the Group's perspective, short-term unsecured money-market funding has been continuously available. However, investor demand for unsecured and mortgage-backed issuance has been much reduced since 2007 and at significantly wider spreads. These markets have traditionally been important sources of funding. Funding issues also came to the fore in the banking sector more generally, resulting in the introduction of government-backed funding initiatives, including the UK Government Credit Guarantee Scheme.

During this time, the Group kept its main stress scenarios under review upon which the Santander UK Board's risk appetite is based, in light of market developments. At all times, the Group sought to maintain a buffer of securities that are eligible for discount in open market operations with the central banks to which the Group has access including highly rated central government debt. This buffer was at least sufficient to survive either an acute Group-specific stress during stressed market conditions, or a prolonged loss of unsecured wholesale funding during stressed market conditions. The underlying analysis of customer deposit behaviour under stressed conditions is aligned with the assumptions made in operational contingency planning.

The UK Government initiative announced in early October 2008, including the provision of liquidity and funding support and facilities to enable banks to raise new capital to strengthen their capital base, was welcomed by the Group. The Group did not use the UK Government recapitalisation scheme, nor does it expect to in the future. The Group believes that the current arrangements with the Bank of England, European Central Bank, Swiss National Bank and US Federal Reserve, as well as the UK Credit Guarantee Scheme that are available to the UK banking industry will help the banking sector to meet liquidity and funding needs.

Risk Management in Retail Banking

Credit risk in Retail Banking

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

Managing credit risk

The Santander UK Board has approved a set of risk appetite limits to cover credit risk, arising in Retail Banking. The management of Retail Banking credit risk is aligned with the processes and procedures used within Santander UK's Retail Banking and is managed on a Group basis. For further information, please refer to the Retail Banking section in the Risk Management Report of Santander UK plc's Consolidated Financial Statements.

Residential mortgages and secured lending

Retail Banking lends on many types of property but only after a credit risk assessment of the borrower, including affordability modelling, and an assessment of the property are undertaken. The systems used to manage and monitor the quality of the mortgage assets are reviewed in accordance with policy to ensure they perform as expected. Residential lending is subject to lending policy and lending authority levels, which are used to structure lending decisions to the same standard across the retail network, a process further improved by mortgage credit scoring, underwriter accreditation and regular compliance reviews.

Details concerning the prospective borrower and the mortgage are subject to a criteria-based decision-making process. Criteria for assessment include credit references, loan-to-value ratio, borrower status, and the mortgage credit score.

All loans provided by Retail Banking are secured on UK properties. All properties must be permanent in construction; mobile homes are not generally acceptable.

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

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

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Mortgage credit quality⁽¹⁾

	2009	2008
Loan-to-value analysis:		
New business		
< 75%	82%	62%
75% - 90%	18%	36%
> 90%	-	2%
	100%	100%
Average loan-to-value of new business (at inception)	60%	63%
Average loan-to-value of stock	51%	49%
Borrower profile:		
New business		
First-time buyers	16%	21%
Home movers	45%	48%
Remortgages	39%	31%
	100%	100%
Average earnings multiple (at inception)	2.8	3.1

(1) Excludes any fees added to the loan, and only includes the drawn loan amount, not drawdown limits. Includes prime mortgage lending and excludes buy to let

Loan-to-value analysis

The residential mortgage portfolio showed an increasing trend of payment arrears with the deterioration in economic conditions, which has stabilised in the second half of the year. Credit quality remains strong, with the expected bad rate of new business gradually reducing through the year. During 2009, LTV on new business completions declined during the first half of the year. However, this slightly increased during the second half of the year, with the fourth quarter of 2009 LTV at 65% (Q3 09: 61%, Q4 08: 60%). The indexed stock LTV increased to 51% from 2008 (Q3 09: 53%, Q4 08: 50%) due to net lending mix, and mitigated by rising house prices evidenced by portfolio revaluation towards the end of the year. Although, credit criteria continued to be tightened for higher risk segments, targeted policy relaxation and competitive pricing at higher LTV have begun to result in a slight uplift in new business average LTV in 2009.

- > Arrears more than 90 days past due have increased from 0.84% in December 2008 to 1.00% at the end of 2009. In the same period, industry arrears more than 90 days past due, as published by the UK Council of Mortgage Lenders have increased from 1.88% to 2.38%.
- > Completions in excess of 75% LTV have fallen from 38% in 2008 to 18% in 2009.

Mortgage arrears and repossessions

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

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

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

	Group ⁽¹⁾	CML ⁽²⁾ (unaudited)
	(Percentage of total mortgage loans by number)	
Mortgage arrears		
31 to 60 days in arrears:		
31 December 2008	0.76	-
31 December 2009	0.54	-
61 to 90 days in arrears:		
31 December 2008	0.37	-
31 December 2009	0.28	-
3 to 5 months in arrears:		
31 December 2008	0.47	1.01
31 December 2009	0.42	0.97
6 to 11 months in arrears:		
31 December 2008	0.26	0.62
31 December 2009	0.30	0.81
12 months or more in arrears:		
31 December 2008	0.10	0.25
31 December 2009	0.28	0.60

(1) Group data is not readily available for arrears less than 31 days

(2) Council of Mortgage Lenders data is not available for arrears less than 3 months

Risk Management continued

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

	Group	CML (unaudited)
	(Percentage of total mortgage loans by number)	
Properties in possession		
31 December 2008	0.03	0.21
31 December 2009	0.02	0.14

	Group
	£m
Carrying amount of assets obtained as collateral	
31 December 2008	16
31 December 2009	13

Restructured loans

Loans have been restructured or renegotiated by capitalising the arrears where customers in arrears have maintained an agreed monthly repayment for a period of five months. The value of capitalised arrears on loans that would have been impaired if the terms had not been renegotiated was less than £1m in both 2009 and 2008.

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

Unsecured personal loan arrears

	2009	2008
	£m	£m
Total unsecured personal loan arrears ^(1,2)	81	213
Total unsecured personal loan asset	2,294	3,534
Unsecured personal loan arrears as a % of asset	3.53	6.03

(1) Unsecured personal loans include current account customers.

(2) Unsecured personal loans are defined as the balances of accounts that are three or more months in arrears (> 4 instalments).

Provisions on loans and advances to customers

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

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

- > **Observed provision** - an observed provision is established for all past due loans after a specified period of repayment default where it is likely that some of the capital will not be repaid or recovered through enforcement of any applicable security. The length of the default period depends on the nature of the advance and is generally no more than three months. Once a loan misses a payment (breach of contractual terms) an assessment of the likelihood of collecting the principal and overdue payments is made. This assessment is generally made using statistical techniques developed on previous experience and on projections of current market conditions to the time the loss is expected to crystallise. These techniques estimate the propensity of loans to go to write-off and, as a separate exercise, the loss incurred on written off debt is monitored. For advances secured on residential property the propensity of loans to reach repossession is determined, with repossessed properties assessed on an individual basis through the use of external valuation, anticipated disposal costs and the current exposure.
- > **Incurred but not yet observed provision** - an incurred but not yet observed provision is made against loans which have not missed a payment but are known from past experience to have deteriorated since the initial decision to lend was made. Based on historical evidence, the number of accounts likely to default in the future, as a result of events present at the balance sheet date, are identified through use of statistical techniques. During 2008, these statistical techniques were expanded and enhanced. In particular, further detailed examination is now performed on the losses that emerge over a defined period of time after the reporting date called the emergence period. This period is determined to ensure that only those accounts which have credit deterioration at the reporting date are captured and excludes accounts which will suffer credit deterioration after the reporting period. The emergence period is two to three months for unsecured lending and 12 months for secured lending. The provision methodology outlined for observed provisions is then applied to accounts identified as impaired in the performing portfolios.

Risk Management continued

- > **Amounts written off** - unsecured loans are written off when all internal avenues of collecting the debt have failed and the debt is passed onto external collection agencies. On secured loans, the write-off takes place on ultimate realisation of collateral value, or from claiming on any mortgage indemnity guarantee or other insurance. All write-offs are on a case by case basis, taking account of the exposure at the date of write-off, after accounting for the value from any collateral or insurance held against the loan. The write-off policy is regularly reviewed.

Security is realised in accordance with the Group's internal debt management programme. Contact is made with customers with the aim to achieve a realistic and sustainable repayment arrangement. Litigation and/or enforcement of security is usually carried out only when the steps described above have been undertaken without success. As a result of the write-off policy, the provisions will be made significantly in advance of the related write-off on all products. The exception to this rule is the discovery of fraud, where the exposure is written off once full investigations have been completed and the probability of recovery is minimal. The time span between the discovery and write-off will be short and may not result in a provision being raised.

Retail Banking analysis of provisions on loans and advances to customers

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

	2009 £m
Observed provision	
Advances secured on residential properties - UK	63
Unsecured personal advances - UK	39
Total observed provisions	102
Incurred but not yet observed provision	
Advances secured on residential properties - UK	55
Unsecured personal advances - UK	2
Total incurred but not yet observed provisions	57
Total provisions	159

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

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

	2009 £m
Provisions at 1 January	298
Amounts written off	
Advances secured on residential properties - UK	(16)
Unsecured personal advances - UK	(192)
Total amounts written off	(208)
Disposal of business	(83)
Observed provisions charged against profit	
Advances secured on residential properties - UK	34
Other secured advances - UK	(1)
Unsecured personal advances - UK	87
Total observed provisions charged against profit	120
Incurred but not yet observed provisions charged against profit	32
Total provisions charged against profit	152
Provisions at the end of the year	159

Retail Banking recoveries

An analysis of the Retail Banking recoveries is presented below.

	2009 £m	2008 £m
Advances secured on residential properties - UK	-	1
Unsecured personal advances - UK	13	10
Total amount recovered	13	11

Risk Management continued

Retail Banking non-performing loans and advances⁽¹⁾

	2009 £m	2008 £m
Non-performing loans and advances that are impaired	178	186
Non-performing loans and advances that are not impaired	295	344
Total non-performing loans and advances ⁽²⁾	473	530
Non-performing loans and advances as a percentage of loans and advances to customers ⁽³⁾	1.18%	1.29%
Provision as a percentage of total non-performing loans and advances	48.97%	56.2%

(1) Loans and advances are classified as non-performing typically when the counterparty fails to make payments when contractually due for three months or longer.

(2) All non-performing loans are UK

(3) Loans and advances to customers exclude finance leases.

In 2009, non-performing loans and advances as a percentage of loans and advances to customers (excluding finance leases) was 1.18%. This reflects the impact of the deteriorating market environment on the performance of the unsecured personal loan and residential mortgage portfolio and a refinement in accounting estimates.

Interest income recognised on Retail Banking loans that are more than three months in arrears amounted to £20m (2008: £14m).

Market risk in Retail Banking

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

Risk Management in Corporate Banking

Credit risk in Corporate Banking

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

Managing credit risk

The Santander UK Board has approved a set of risk appetite limits to cover different types of risk, including credit risk, arising in Corporate Banking. Subsequent to its acquisition, the management of Corporate Banking credit risk was aligned with the processes and procedures used within Santander UK's Corporate Banking unit and is now managed on a Santander UK group basis. Santander UK's credit risk appetite is measured and controlled by a maximum Economic Capital value, which is defined as the maximum level of unexpected loss that Santander UK is willing to sustain over a one-year period. Within these limits, credit mandates and policies are approved to cover detailed industry, sector and product limits. All transactions falling within these mandates and policies are accommodated under credit limits approved by the appropriate credit authority. Specific approval is usually required by the Santander UK Credit Approvals Committee (a specific committee established under the authority of the Chief Executive) for any transaction that falls outside the mandates.

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

Credit risk on derivative instruments is calculated using the potential future mark-to-market exposure of the instruments at a 97.5% (95% prior to acquisition) statistical confidence level and adding this value to the current value. The resulting "loan equivalent" or credit risk is then included against credit limits, along with other non-derivative exposures. In addition, there is a policy framework to enable the collateralisation of derivative instruments including swaps. If collateral is deemed necessary to reduce credit risk, any unsecured risk threshold, and the nature of any collateral to be accepted, is determined by management's credit evaluation of the counterparty.

Risk Management continued

The following tables provide details of provisions, recoveries, arrears and non-performing loans for the Corporate Banking portfolio as at 31 December 2009.

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

	2009	2008
	£m	£m
Provisions at 1 January	275	29
Amounts written off		
Corporate advances	(96)	(17)
Finance leases	(8)	-
Total amounts written off	(104)	(17)
Observed provisions charged against profit		
Corporate advances	122	155
Finance leases	5	-
Total observed provisions charged against profit	127	155
Incurred but not yet observed provisions charged against profit	(34)	108
Total provisions charged against profit	93	263
Provisions at the end of the year	264	275

Corporate Banking recoveries

	2009	2008
	£m	£m
Secured	-	-
Unsecured	2	1
Total amount recovered	2	1

Corporate Banking arrears

	2009	2008
	£m	£m
Total Corporate lending arrears	410	89
Total Corporate lending assets	9,224	9,948
Corporate lending arrears as a % of asset	4.4%	0.89%

Corporate Banking non-performing loans and advances⁽¹⁾

	2009	2008
	£m	£m
Non-performing loans and advances that are impaired	173	343
Non-performing loans and advances that are not impaired	338	-
Total non-performing loans and advances ⁽²⁾	511	343
Non-performing loans and advances as a percentage of loans and advances to customers ⁽³⁾	5.54%	3.45%
Provision as a percentage of total non-performing loans and advances	51%	83%

(1) Loans and advances are classified as non-performing typically when the counterparty fails to make payments when contractually due for three months or longer.

(2) All non-performing loans are UK

(3) Loans and advances to customers exclude finance leases.

In 2009, non-performing loans and advances as a percentage of loans and advances to customers (excluding finance leases) increased to 5.54%. This reflects the impact of the continued deteriorating market condition on the performance of the corporate and real estate portfolio. In 2008, non-performing loans and advances as a percentage of loans and advances (excluding finance leases) to customers increased to 3.45% from 0.12% in 2007. This reflected the impact of deteriorating market condition on the performance of the corporate and real estate portfolio. Interest income recognised on impaired loans amounted to £1m (2008: £2m).

Credit risk mitigation**Collateralisation**

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

Restructured loans

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

Risk Management continued

Market risk in Corporate Banking

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

Risk Management in Private Banking

Credit risk in Private Banking

Alliance & Leicester International

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

Market risk in Private Banking

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

Managing market risk

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

Risk Management in Group Infrastructure

Group Infrastructure consists of the Treasury asset portfolio. Following Banco Santander, S.A.'s acquisition of Alliance & Leicester plc in October 2008, the credit risk and market risk of Alliance & Leicester plc and Santander UK plc have been managed on a combined basis. For further information, please refer to the "Risk Management in Group Infrastructure" discussion in the Risk Management Report of Santander UK plc's Consolidated Financial Statements.

Credit risk in Group Infrastructure

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

Managing credit risk

The Alliance & Leicester Group Risk department has been integrated into the Santander UK Wholesale Credit Risk department where responsibility for the credit control of assets held in the Treasury asset portfolio lies.

Market risk in Group Infrastructure

Market risk is the potential for loss of income or decrease in the value of net assets caused by movements in the levels and prices of financial instruments including interest rate and foreign currency risks. The Group's exposure to market risk is governed by a policy approved by the Santander UK Asset and Liability Management Committee (ALCO) and ratified by the Santander UK Risk Committee. The policy sets out the nature of risk which may be taken, and applicable maximum risk limits. The Group risk limits are allocated by the Santander UK ALCO to all business units.

Risk division monitors compliance with market risk limits and reports excesses to Santander UK ALCO or Risk Committee.

Risk Management continued

Managing market risk

The Santander UK ALCO is responsible for managing the Group's overall balance sheet position. The Santander UK Treasurer, Head of ALM is responsible for managing risks in accordance with the Santander UK ALCO's direction.

Impact of the Current Credit Environment

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

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

Details of the Group's investing and lending arrangements with respect to floating rate notes ('FRNs'), asset-backed securities ('ABS') including mortgage-backed securities ('MBS'), Collateralised Debt Obligations ('CDOs'), Collateralised Loan Obligations ('CLOs'), monoline insurers, off-balance sheet entities, other holdings for liquidity purposes and lending activities are set out below. Since the balance sheet date, exposure to banks in Greece has reduced to £5m.

Classification in the Consolidated Balance Sheet

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

Balance sheet line item	Note	Type of Financial Instrument analysed further					Sub-total	OECD Govt debts	Total
		FRN	ABS	CDO	CLO	Other			
		£m	£m	£m	£m	£m	£m	£m	£m
Financial assets designated at fair value – debt securities	13	-	-	50	-	-	50	-	50
Available for sale – debt securities	17	-	-	-	-	-	-	3	3
Loans and receivables securities	18	6,749	2,336	80	639	24	9,828	-	9,828
		6,749	2,336	130	639	24	9,878	3	9,881

Balance sheet line item	Note	Type of Financial Instrument analysed further					Sub-total	OECD Govt debts	Total
		FRN	ABS	CDO	CLO	Other			
		£m	£m	£m	£m	£m	£m	£m	£m
Financial assets designated at fair value – debt securities	13	-	63	-	-	-	63	-	63
Available for sale – debt securities	17	-	-	-	-	-	-	1,648	1,648
Loans and receivables securities	18	9,933	3,653	164	321	179	14,250	-	14,250
		9,933	3,716	164	321	179	14,313	1,648	15,961

Summary

2009	Nominal	Book value	Fair value	2009 movement		
				Income statement	Reserves	Other ⁽¹⁾
	£m	£m	£m	£m	£m	£m
Floating rate notes	6,855	6,749	6,659	(4)	(89)	(4)
Asset backed securities	2,533	2,336	2,069	(30)	(118)	(15)
Collateralised debt obligations	215	130	130	(11)	(4)	(3)
Collateralised loan obligations	703	639	606	(1)	(20)	-
Other investments	30	24	26	(1)	-	(4)
Total	10,336	9,878	9,490	(47)	(231)	(26)

(1) Other includes discounts and premiums, accrued interest and amortisation of mark-to-market losses.

2008	Nominal	Book value	Fair value	2008 movement		
				Income statement	Reserves	Other ⁽¹⁾
	£m	£m	£m	£m	£m	£m
Floating rate notes	10,132	9,933	9,456	(55)	(182)	38
Asset backed securities	4,001	3,716	3,218	(25)	(186)	(74)
Collateralised debt obligations	366	164	130	(72)	(15)	(115)
Collateralised loan obligations	352	321	247	(1)	(25)	(5)
Other investments	180	179	173	(12)	(6)	17
Total	15,031	14,313	13,224	(165)	(414)	(139)

(1) Other includes discounts and premiums, accrued interest and amortisation of mark-to-market losses.

Risk Management continued

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

2009	FRN £m	Other £m	Total £m
AAA	37	1,854	1,891
AA+	-	-	-
AA	1,712	385	2,097
A	3,771	248	4,019
BBB	546	153	699
Below BBB	593	191	784
Total	6,659	2,831	9,490

2008	FRN £m	Other £m	Total £m
AAA	-	3,326	3,326
AA	2,239	259	2,498
A	6,268	94	6,362
BBB	661	30	691
Below BBB	288	59	347
Total	9,456	3,768	13,224

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

Floating Rate Notes

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

2009	Nominal value		Book value £m	Fair value £m	Fair value as % of nominal	2009 movement		
	£m	%				Income statement £m	Reserves £m	Other £m
Country								
UK	603	9	586	571	95	-	(11)	(4)
Italy	653	9	650	650	100	-	(4)	-
Spain	1,502	22	1,483	1,466	98	-	(20)	-
Rest of Europe	2,461	36	2,428	2,391	97	-	(29)	-
US	677	10	647	629	93	(4)	(20)	-
Rest of the World	959	14	955	952	99	-	(5)	-
Total	6,855	100	6,749	6,659	97	(4)	(89)	(4)

2008	Nominal value		Book value £m	Fair value £m	Fair value as % of nominal	2008 movement		
	£m	%				Income statement £m	Reserves £m	Other £m
Country								
UK	942	9	913	877	93	(17)	(21)	9
Italy	1,101	11	1,099	1,073	97	-	(10)	8
Spain	2,338	23	2,308	2,221	95	-	(43)	13
Rest of Europe	3,393	33	3,305	3,164	93	(38)	(62)	12
US	994	10	948	825	83	-	(36)	(10)
Rest of the World	1,364	14	1,360	1,296	95	-	(10)	6
Total	10,132	100	9,933	9,456	93	(55)	(182)	38

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

2009	Nominal value		Book value £m	Fair value £m	Fair value as % of nominal	2009 movement		
	£m	%				Income statement £m	Reserves £m	Other £m
Credit rating								
AAA	37	1	37	37	100	-	-	-
AA	1,731	25	1,711	1,712	99	(1)	(19)	-
A	3,893	57	3,833	3,770	97	(2)	(51)	-
BBB	585	8	566	547	94	-	(16)	-
Below BBB	609	9	602	593	97	(1)	(3)	(4)
Total	6,855	100	6,749	6,659	97	(4)	(89)	(4)

Risk Management continued

2008

2008 movement

Credit rating	Nominal value		Book value £m	Fair value £m	Fair value as % of nominal	2008 movement		
	£m	%				Income statement £m	Reserves £m	Other £m
AA	2,350	23	2,333	2,239	95	-	(24)	7
A	6,703	66	6,596	6,268	94	-	(127)	20
BBB	735	7	712	661	90	-	(27)	4
Below BBB	344	4	292	288	84	(55)	(4)	7
Total	10,132	100	9,933	9,456	93	(55)	(182)	38

The FRNs held are principally issued by banks and other financial institutions. On average, the FRNs have 21 months to maturity (2008: 23 months).

Asset-Backed Securities

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

2009

2009 movement

Country	Nominal value		Book value £m	Fair value £m	Fair value as % of nominal	2009 movement		
	£m	%				Income statement £m	Reserves £m	Other £m
UK								
ABS	142	5	141	140	99	-	-	-
MBS	727	29	693	606	83	(7)	(28)	-
	869	34	834	746	86	(7)	(28)	-
US								
ABS	553	22	506	483	87	(8)	(37)	-
MBS	269	11	195	125	46	(8)	(29)	(9)
	822	33	701	608	74	(16)	(66)	(9)
Rest of Europe								
ABS	68	3	61	56	82	-	(2)	(6)
MBS	622	24	591	520	84	(6)	(20)	-
	690	27	652	576	83	(6)	(22)	(6)
Rest of the World								
MBS	152	6	149	139	91	(1)	(2)	-
Total	2,533	100	2,336	2,069	82	(30)	(118)	(15)

2008

2008 movement

Country	Nominal value		Book value £m	Fair value £m	Fair value as % of nominal	2008 movement		
	£m	%				Income statement £m	Reserves £m	Other £m
UK								
ABS	31	1	31	28	90	-	-	-
MBS	1,302	32	1,255	1,088	84	(11)	(29)	(7)
	1,333	33	1,286	1,116	84	(11)	(29)	(7)
US								
ABS	962	24	881	732	76	-	(56)	(25)
MBS	393	10	277	191	49	(11)	(61)	(44)
	1,355	34	1,158	923	68	(11)	(117)	(69)
Rest of Europe								
ABS	98	3	96	90	92	-	(3)	1
MBS	929	23	895	817	88	(3)	(34)	3
	1,027	26	991	907	88	(3)	(37)	4
Rest of the World								
ABS	36	1	36	34	94	-	-	-
MBS	250	6	245	238	95	-	(3)	(2)
	286	7	281	272	95	-	(3)	(2)
Total	4,001	100	3,716	3,218	80	(25)	(186)	(74)

Risk Management continued

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

2009	Nominal £m	Original credit enhancements £m	Original sub- prime exposure £m	2009				Original vintage	
				Pre-2005 %	2005 %	2006 %	2007 %	2008 %	2009 %
UK									
ABS	142	3	-	27	4	54	15	-	-
MBS	727	68	-	7	12	33	48	-	-
	869	71	-	10	11	36	43	-	-
US									
ABS	553	31	-	27	66	6	1	-	-
MBS	269	35	11	16	40	28	16	-	-
	822	66	11	23	58	13	6	-	-
Rest of Europe									
ABS	68	5	-	27	13	43	17	-	-
MBS	622	46	-	38	7	19	36	-	-
	690	51	-	37	8	21	34	-	-
Rest of the World									
MBS	152	6	-	34	3	3	60	-	-
	152	6	-	34	3	3	60	-	-
Total	2,533	194	11	23	25	23	29	-	-

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

2009	Nominal value		Book value £m	Fair value £m	Fair value as % of nominal %	2009 movement		
	£m	%				Income statement £m	Reserves £m	Other £m
Credit rating								
AAA								
ABS	574	23	536	509	89	(6)	(32)	-
MBS	1,359	53	1,296	1,159	85	(12)	(42)	-
	1,933	76	1,832	1,668	86	(18)	(74)	-
AA								
ABS	10	-	8	7	70	-	(1)	-
MBS	160	7	144	109	68	(3)	(10)	-
	170	7	152	116	68	(3)	(11)	-
A								
ABS	56	2	51	50	89	(1)	(3)	-
MBS	52	2	44	34	65	(1)	(6)	-
	108	4	95	84	78	(2)	(9)	-
BBB								
ABS	64	3	64	63	98	-	(1)	-
MBS	51	2	42	34	67	(1)	(6)	-
	115	5	106	97	84	(1)	(7)	-
Below BBB								
ABS	59	2	49	49	83	(1)	(2)	(6)
MBS	148	6	102	55	37	(5)	(15)	(9)
	207	8	151	104	50	(6)	(17)	(15)
Total	2,533	100	2,336	2,069	82	(30)	(118)	(15)

Risk Management continued

2008

Credit rating	Nominal value		Book value	Fair value	Fair value as % of nominal	2008 movement		
	£m	%				£m	£m	£m
						Income statement	Reserves	Other
AAA								
ABS	1,052	26	991	838	80	-	(56)	(5)
MBS	2,613	66	2,470	2,174	83	(13)	(102)	(28)
	3,665	92	3,461	3,012	82	(13)	(158)	(33)
AA								
ABS	18	-	15	12	67	-	-	(3)
MBS	105	3	85	62	59	-	(11)	(9)
	123	3	100	74	60	-	(11)	(12)
A								
ABS	83	2	67	59	71	-	(3)	(13)
MBS	38	1	29	18	47	-	(8)	(1)
	121	3	96	77	64	-	(11)	(14)
BBB								
ABS	17	-	12	12	71	-	-	(5)
MBS	33	1	22	12	36	-	(6)	(5)
	50	1	34	24	48	-	(6)	(10)
Below BBB								
MBS	42	1	25	31	74	(12)	-	(5)
Total	4,001	100	3,716	3,218	80	(25)	(186)	(74)

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

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

2009	Nominal £m	Original credit enhancements £m	Original sub- prime exposure £m	Original vintage				Original vintage	
				Pre-2005	2005	2006	2007	2008	2009
				%	%	%	%	%	%
AAA									
ABS	574	37	-	28	63	8	1	-	-
MBS	1,359	115	-	24	10	24	42	-	-
	1,933	152	-	25	26	19	30	-	-
AA									
ABS	10	1	-	26	37	37	-	-	-
MBS	160	15	6	10	15	24	51	-	-
	170	16	6	11	16	25	48	-	-
A									
ABS	56	1	-	-	-	100	-	-	-
MBS	52	3	-	41	32	-	27	-	-
	108	4	-	20	15	52	13	-	-
BBB									
ABS	64	-	-	54	-	11	35	-	-
MBS	51	4	-	49	40	11	-	-	-
	115	4	-	52	18	11	19	-	-
Below BBB									
ABS	59	-	-	-	27	47	26	-	-
MBS	148	18	6	9	27	41	23	-	-
	207	18	6	6	27	43	24	-	-
Total	2,533	194	12	23	25	23	29	-	-

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

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

Asset Type	Nominal £m	Original vintage				Original vintage	
		Pre-2005	2005	2006	2007	2008	2009
		%	%	%	%	%	%
Prime lending	2,303	24	23	23	30	-	-
ALT-A	224	34	40	17	9	-	-
Sub-prime	6	-	-	-	100	-	-
Total	2,533	24	24	23	29	-	-

Monoline Insurers

The Group has a £178m (2008: £214m) exposure to securitisations which are wrapped by monoline insurers. The principal risk exposures are recorded against the securitisations, with the monoline wraps being viewed as contingent exposures. The exposures to monoline insurers are classified as asset-backed securities in the balance sheet and are included in the tables above.

Risk Management continued

Collateralised Debt Obligations

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

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

Country	Nominal value		Book value	Fair value	Fair value as % of nominal	2008 movement			Original exposure to sub-prime	Original Credit enhancement
	£m	%				£m	£m	£m		
	£m	%	£m	£m	%	£m	£m	£m	%	%
UK	24	7	17	13	54	-	(6)	(1)	-	27
Rest of Europe	3	1	3	4	133	-	-	-	-	-
US	339	92	144	113	33	(72)	(9)	(114)	21	28
Total	366	100	164	130	36	(72)	(15)	(115)	19	27

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

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

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

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

Credit rating	Nominal value		Book value	Fair value	Fair value as % of nominal	2008 movement			Original exposure to sub-prime	Original credit enhancement
	£m	%				£m	£m	£m		
	£m	%	£m	£m	%	£m	£m	£m	%	%
AAA	147	40	91	75	51	-	(12)	(44)	1	34
AA	38	10	18	17	45	-	(1)	(19)	10	35
A	11	3	4	4	36	-	-	(7)	13	23
BBB	18	5	7	6	33	(1)	(2)	(8)	14	8
Below BBB	152	42	44	28	18	(71)	-	(37)	41	21
Total	366	100	164	130	36	(72)	(15)	(115)	19	27

Risk Management continued

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

2009	Nominal £m	Original credit enhancements £m	Original sub- prime exposure £m	2009				Original vintage	
				Pre-2005 %	2005 %	2006 %	2007 %	2008 %	2009 %
ABS CDO									
AAA	12	6	-	-	100	-	-	-	-
AA	12	3	2	100	-	-	-	-	-
A	1	-	-	100	-	-	-	-	-
BBB	5	1	2	100	-	-	-	-	-
Below BBB	20	5	10	-	95	5	-	-	-
	50	15	14	35	63	2	-	-	-
Synthetic CDO									
A	15	1	-	100	-	-	-	-	-
BBB	16	3	-	100	-	-	-	-	-
Below E3B	64	7	-	100	-	-	-	-	-
	95	11	-	100	-	-	-	-	-
Other CDO									
AAA	3	1	-	67	-	33	-	-	-
AA	51	7	1	39	-	11	50	-	-
A	1	-	-	-	100	-	-	-	-
BBB	2	-	-	50	50	-	-	-	-
Below BBB	13	-	-	31	-	69	-	-	-
	70	8	1	39	3	22	36	-	-
Total	215	34	15	64	17	8	11	-	-

Collateralised Loan Obligations

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

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

2008	Nominal value		Book value £m	Fair value £m	Fair value as % of nominal %	2008 movement		
	£m	%				Income statement £m	Reserves £m	Other £m
UK	115	33	108	94	82	(1)	(5)	(1)
Rest of Europe	47	13	41	30	64	-	(7)	1
US	190	54	172	123	65	-	(13)	(5)
Total	352	100	321	247	70	(1)	(25)	(5)

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

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

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

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

Risk Management continued

2008

Credit rating	Nominal value		Book value	Fair value	Fair value as %	2008 movement		
	£m	%	£m	£m	of nominal	Income statement	Reserves	Other
					%	£m	£m	£m
AAA	276	78	257	211	76	(1)	(12)	(6)
AA	42	12	36	23	55	-	(7)	1
A	30	9	26	13	43	-	(4)	-
BBB	4	1	2	-	-	-	(2)	-
Total	352	100	321	247	70	(1)	(25)	(5)

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

2009

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

Other investments

	Book value	Fair value	Book value	Fair value
	2009	2009	2008	2008
	£m	£m	£m	£m
Principal Protected Notes	24	26	34	28
Other	-	-	145	145
	24	26	179	173

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

Exposure to Off-Balance Sheet Entities sponsored by the Group

Secured Loan to Conduit

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

The assets of the Conduit vehicles consist of ABS (including Alt-A US residential mortgage-backed securities), CLOs and CDCs, and are consolidated in the respective tables above as at 31 December 2009. The underlying assets within the Conduit vehicles at 31 December 2008 analysed by asset type and credit rating were as follows:

Risk Management continued

As at 31 December 2008

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

Lending Activities

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