Santander UK plc

2021 Annual Report

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 the Banco Santander group (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 and the PRA.

This Annual 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 on page 238.

Santander UK Group Holdings plc is the immediate parent company of Santander UK plc. The two companies operate on the basis of a unified business strategy, albeit the principal business activities of the Santander UK Group Holdings plc group are carried on by Santander UK plc and its subsidiaries.

The Santander UK Group Holdings plc Corporate Governance and Risk Frameworks have been adopted by the Company and its subsidiaries to ensure consistency of application.

Strategic report

About this report

The Strategic Report outlines the key elements of the Annual Report and provides context for the related financial statements. It is also designed to help members of the company assess how the Directors have performed their duty under section 172 of the Companies Act 2006. The report highlights key financial and non-financial metrics which help to explain the business's performance over the past year. It also highlights the external environmental factors affecting the business along with Santander UK's position in the UK banking market.

At all times we try to treat our stakeholders fairly and meet our environmental responsibilities. Sustainability and our strategic direction are inseparable, and we continue to embed sustainability across our business. We have included information to demonstrate this within our Strategic Report and further information is also available in our ESG Supplement.

By Order of the Board.

William Vereker
Chair, 1 March 2022

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Santander UK at a glance

Our business model is focused on building customer loyalty

We provide high quality, seamless service across our branch, digital and telephony channels

14 million	**c18,000**	**450**
active UK customers	Full time equivalent employees	Branches
3rd	**5th**	
largest retail mortgage provider(1)	Largest commercial lender(1)	

We offer innovative products and services to help people and businesses prosper

We live our values of **Simple, Personal and Fair** through great behaviours and our people leaders

Reorganisation of our segments

Following a management review of our structure we have changed our segments in line with how we manage our business and these are outlined below. Our segmental structure is also consistent with how Banco Santander organises its operations across Europe. Prior periods in the segmental results have been restated accordingly.

Before these changes Consumer Finance was managed as part of Retail Banking.

Corporate & Investment Banking (CIB) is no longer a segment following the transfer of a significant part of its business under the Part VII banking business transfer scheme completed on 11 October 2021. The residual parts of CIB have been wound-down or transferred to other segments.

Retail Banking
Retail Banking consists of two business units, Homes and Everyday Banking. Homes provides prime UK mortgage lending to owner occupiers and buy-to-let landlords with small portfolios. Everyday Banking provides banking services and unsecured lending to individuals and small businesses as well as wealth management for high-net-worth clients.

Consumer Finance
Consumer Finance provides prime auto consumer financing for individuals, businesses, and automotive distribution networks.

Corporate & Commercial Banking (CCB)
CCB provides banking products and services to SMEs, mid-sized and larger corporates, typically with annual turnovers of between £2m and £500m, as well as to Local Authorities and Housing Associations.

Corporate Centre
Corporate Centre provides treasury services for asset and liability management of our balance sheet, as well as management of non-core and legacy portfolios.

A significant part of the Santander UK Group Holdings plc group

The Company and its subsidiaries represent almost all the business and operations of its immediate parent Santander UK Group Holdings plc, comprising approximately 99% of its immediate parent group's consolidated profit from continuing operations before tax for the year ended 31 December 2021 and approximately 99% of its consolidated net assets at 31 December 2021. More information on the Santander UK Group Holdings plc group, including the role of the Company as a ring-fenced bank, can be found in the Santander UK Group Holdings plc 2021 Annual Report, which does not form part of this report.

(1) Santander UK industry analysis of latest available bank and building society reports as at January 2022. Mortgage provider: UK mortgage stock, Retail Banking divisions. Commercial lender: UK commercial lending stock, Corporate and/or Commercial Banking divisions (excludes investment banking).

Market overview

Five major forces continue to shape the UK banking market

The five forces remain consistent themes however, we are conscious that there are other areas of transition which we face.

- **The transition to carbon neutrality** - Government policy and increased pressure on actions to become net zero by 2025 have gained impetus during 2021. COP 26 in Glasgow in November 2021 further raised the profile of the environmental agenda.
- **The transition to a world where we live with Covid-19 -** The successful vaccination programme in the UK has helped to alleviate the health crisis. This has led to the UK government's recent announcement of the plan to live with Covid-19.
- **The UK's transition away from the EU -** The UK's access to the EU's Single Market and Customs Union ended in January 2021. The UK now has greater autonomy to administer its own trade and customs agenda which could provide new opportunities for companies in the UK.
- **Transition away from a low rate and low inflation environment -** Rising inflation from pent up demand, supply chain disruptions and rising energy costs prompted the Bank of England to begin to raise interest rates. Further rate increases are expected in 2022 as the UK faces the highest inflation rate in 30 years.
- **The digital transition -** The pandemic has increased the availability and evolution of digital services. Blockchain and the use of cloud based and artificial intelligence technologies are becoming more commonplace and we expect them to become embedded in many aspects of daily life going forward.

Strong market competition

What we have seen

The UK banking sector remains very competitive. In particular the size of the mortgage market makes it attractive to lenders. Demand for housing remained robust and stamp duty waivers supported sales and a low rate environment supported remortgage activity. Deposits increased with the reduction in consumer spending seen in the last two years, particularly within the ring-fenced banks. In addition, funding costs were low for large mortgage lenders. As a result, mortgage rates decreased steadily through the first three quarters of 2021 as lenders competed for business. This trend stabilised as expectations for a rise in interest rates increased later in the year.

Our response and looking ahead

In line with the market, we reduced mortgage lending rates to maintain our market share. We modified our 1|2|3 Current Account proposition and other deposit products in light of the lower rate environment and competitor actions. We expect our net mortgage lending to be in line with market growth in 2022, as we focus on quality customer service, retention and our comprehensive proposition for first-time buyers.

Increased market disruption

What we have seen

There is a broad range of disruptive threats beyond traditional incumbents. Challenger banks have attracted a lot attention in the UK but remain relatively small. Digital banks continued to gain some traction, growing customer numbers, albeit from a small base. FinTechs see value in certain parts of financial services and are continuing to target specific customer segments. We have also seen global financial institutions enter the UK market including the launch of a UK digital bank by a a major US bank. As a result, the new entrants have taken a share of new personal current accounts and online savings deposits. There has been an expansion of unsecured credit into Buy Now Pay Later, consumer payments and lending has moved towards point of sale financing.

Our response and looking ahead

We continue to develop offerings to rival competitors and seek partnerships to develop new propositions. Banco Santander's PagoNxt offering incorporates simple and accessible digital payment solutions. This is a key area for growth alongside OpenBank, their 100% digital bank. We expect these to be rolled out across Europe in the future.

Changing customer behaviour and distribution

What we have seen

Although branches remained largely open during the Covid-19 pandemic, customer interactions continued to shift to digital and remote services. Younger customers value better digital tools, convenience, and a simpler purchasing process and banks have rapidly adapted accordingly. In mortgages, intermediary share of distribution continues to increase, whilst other products are now distributed largely through digital channels.

Our response and looking ahead

Customer engagement through contact centres and digital channels increased, with digital financial transactions up 17% over the year. We are mindful of the needs of our most vulnerable customers, responding with 'access to cash' solutions and providing mechanisms for help from a trusted third party. We continue to invest in ensuring access to financial services for our customers who are less confident using technology for managing their finances. We expect the shift to digital banking will persist post the pandemic. Around 93% of cards and unsecured lending products are now sold digitally. We continue to adapt our operating model to meet the changing needs of our customers and to increase remote banking capacity. Our multi-year transformation programme includes significant digital investment and reducing our physical footprint. We have redeployed trained branch staff to online chat and telephone services and we continue to move services online.

Demanding regulatory agenda

What we have seen

In 2021, the regulatory policy and change agenda continued to be intense. This was driven by preparations for the implementation of the Capital Requirements Regulation II, Environmental, Social and Governance (ESG) initiatives, LIBOR transition, the regulators' continued guidance on Covid-19 financial support measures, conduct initiatives such as the FCA's proposed Consumer Duty, and innovation and technological developments.

Our response and looking ahead
We are waiting for final Government reports on the UK's future regulatory framework and the Ring-fencing regime, as well as initial proposals from the PRA for implementing the Basel 3.1 package of capital framework reforms, and the FCA's final rules on the new Consumer Duty. We are engaging with the regulators, government, and industry trade associations on these and other policy initiatives, including a 2022 focus on the FCA's Consumer Duty, preventing fraud including Authorised Push Payment Fraud, Operational Resilience and Climate Risk Stress Testing.

Uncertain economic environment
What we have seen
The UK economy has faced a range of challenges in recent years from Brexit, the weakening global environment, and most significantly, the Covid-19 pandemic. Despite these headwinds, economic performance in 2021 was better than expected. This was largely due to the scale of government support measures implemented in 2020 and the success of the vaccination programme. This helped to alleviate the health crisis and allowed social restrictions to be lifted and economic activity to resume. Inflationary pressures began building in the second half of 2021 and the market consensus for bank rate shifted to a short term expectation for rate hikes, a marked change from a year before when the market expectation was for negative rates. In December 2021, Bank rate increased by 15bps to 0.25% and by a further 0.25% in February 2022. The market consensus is that Bank rate will rise further during 2022.

Our response and looking ahead
Although GDP has recovered in 2021, uncertainties remain for the UK economy. The ongoing effects of Covid-19, supply chain disruption, rising inflation and dislocation in the labour market are likely to have an impact on the sustainability of the recovery.

Our business model

Our purpose is to help people and businesses prosper

Our resources
People - Bringing the skills, expertise and drive to deliver enhanced customer loyalty and experience
Infrastructure - Branch and online presence, operating centres and innovative technology
Banco Santander family - Technology, shared management experience and brand benefits as part of well-diversified global bank
Financial - Strong capital, liquidity and a prudent approach to risk

Our competitive advantage
Leading scale challenger bank in the UK - Scale in our core banking businesses combined with an innovative mindset
Strong balance sheet - Focused on prime secured lending consistent strength under stress
International expertise for UK companies - 20 trade corridors to help UK companies expand into overseas markets

What we do
We provide financial products and services - Mortgages, consumer finance, unsecured loans, credit cards, banking and savings accounts, investment and insurance products for individuals and services for companies
How we do it
– Build strong customer relationships
– Offer a differentiated proposition
– Take a prudent approach to risk
– Do things The Santander Way

Our culture is built on doing things The Santander Way
Simple - Our products are easy to understand and we offer a service which is convenient, no matter when or how our customers want to engage with us.
Personal - We treat our customers as valued individuals, with a professional service they can trust. We support our colleagues to achieve their ambitions.
Fair - We are open, honest and treat others as we would like to be treated. We earn our investors a sustainable return and do our part to support our communities.

Our aim is to be the best open financial services platform by acting responsibly and earning the lasting loyalty of our people, customers, shareholders and communities

Our strategic priorities

Our strategic priorities focus on customer loyalty and experience, simplification, improved efficiency and sustainable growth, while aiming to be the best bank for all our stakeholders.

Our strategic priorities
1. Deliver growth through customer loyalty and outstanding customer experience
2. Simplify and digitise the business for improved efficiency and returns
3. Engage, motivate and develop a talented and diverse team
4. Be a responsible and sustainable business

Our performance and key performance indicators

The directors of the Company's immediate parent, Santander UK Group Holdings plc, manage the operations of the Santander UK Group Holdings plc group (which includes the Santander UK group) on a business division basis. Key performance indicators are not set, monitored or managed at the Santander UK 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, performance and position of the business of the Santander UK group is set out in the Financial review.

The key performance indicators of the Santander UK Group Holdings plc group can be found in its 2021 Annual Report, which does not form part of this report.

Risk management overview

Introduction
Key risk types are components of our overarching Risk Framework and are set out in detail in the Risk review. Each has its own defined framework, and we report on, and review its risk profile formally at the ERCC, BRC and Board. However, the risk profile status level is agreed at the underlying specialist risk control forums.

Within our Key risk types, there are top and emerging risk issues that require particular focus. We discuss our Top risks and Emerging risks in the next sections.

Top risks

Highlighted below are our Top risks in focus in 2021 and associated management actions. Many of these risks are likely to remain in focus in 2022, however some may become less so, such as Covid-19 first order risks, and Ring-Fencing.

Climate change
We are focused on ensuring that we appropriately consider and manage the risks associated with Climate Change. These include higher credit risk, reputational risk, operational risk and deteriorating macroeconomics (in the event of sustained damage to national infrastructure). We have continued to progress with our Climate Change Implementation plan, which includes integrating associated risks into our Risk Management Framework, formulating a risk appetite, and associated initiatives set out in more detail in relevant sections of the Risk review .

Financial crime (including Fraud)
We continue to enhance our financial crime risk management capabilities with material investment across data, systems and subject matter expertise. Financial Institutions remain under intense regulatory scrutiny, with expectations for effective systems and controls, reinforced through high profile regulatory enforcements. During 2021, we continued to cooperate with the FCA's civil regulatory investigation into Santander UK plc's financial crime systems, processes and controls focussed primarily on the period 2012-2017. See Note 31 to the Consolidated Financial Statements for detail. Covid-19 has provided an opportunity for fraudsters and in 2021, in line with the industry, we saw increased fraud attacks and scams aimed at customers. We continue to enhance our controls to address fraud attacks, as well as increased fraud messaging and scam education to help our customers.

IT risk
Technology is vital to our processes and operations, and in providing service to our customers. We proactively monitor technology platforms through automated alerts to detect events that could impact our operations, with any material events investigated to understand root causes and identify remedial actions. The importance of IT risk management and control has been emphasised by incidents during the year, including a significant systems outage in May and a duplicate payment in December.

These events also impacted our ability to meet the high standards of customer service we expect to deliver. As a result we initiated a wide reaching programme to address the root causes, which is expected to deliver risk improvement over a three year horizon, with progress closely tracked via risk governance.

Covid-19 first order risks
In 2021, our main focus continued to be on credit and operational risks, as these were the main impacts. Credit performance across our portfolios remained resilient, enabling us to release provisions across 2021. However, some risks remain, so we continue to position ourselves prudently. Our Operational risk focus remains on ensuring we are well resourced to support our customers and people, and operationally resilient, in terms of IT infrastructure, and business continuity.

Cyber risk management
Information and cyber security remains a top risk and a priority for the bank. In 2021, we experienced no notable data and cyber security incidents. However, externally we observed a large increase in ransomware attacks across all sectors and we expect this trend to continue. We continue to review and enhance our controls based on the latest intelligence. We also actively work with peers in the Cyber Defence Alliance to share threat intelligence expertise, and experiences, to help identify common cyber attack features and effective mitigation strategies.

People risk
In 2021, we continued to treat the wellbeing and safety of our colleagues as one of our top priorities. People risk is compounded by changes in operating models and execution of future strategies, which we recognise need to be managed carefully. Our overall wellbeing and inclusion strategy centres on supporting colleagues through transformation and change. In line with peers we are experiencing a competitive recruitment market. We are encouraging colleagues to return to office environments, whilst paying regard to prevailing government advice.

Conduct and regulatory
Risks remain elevated, reflecting the ongoing need for customer support, following the end of government support measures. We also face a challenging regulatory agenda with significant ongoing FCA and PRA interaction on a range of industry issues, as well as the ECB and Payments Services regulators.

These issues include the FCA's proposed Consumer duty, Covid-19 forbearance, SME collections and recoveries policies, operational resilience, thematic reviews, and regulatory models initiatives.

Managing complex change and capacity
We have a challenging change agenda including our continued aspirations for further transformation and growth. We have well-established change control processes, as well as a strong oversight framework and related risk-based prioritisation. This enables us to address operational and capacity challenges and facilitate timely project delivery.

Data management
We added Data management, including Data privacy, to our Top risks in 2021. This reflects its role in supporting our business plans and strategy, as well as the rising cyber threat landscape and the importance of controls over personal data. We have a central Data programme with clear deliverables that will improve our data management capabilities in line with our approved Data Strategy.

Brexit
We are maintaining a watching brief on external developments with respect to the Northern Ireland Protocol and the potential wider trade and economic risks that could evolve, should the UK Government trigger Article 16. Our earlier Brexit plans remain relevant in mitigating any potential risks.

Building and maintaining capital strength and Pension risk
We saw sustained resilience and improvement in our Regulatory Capital and Pension fund metrics throughout 2021. Detailed analysis is set out in the Risk review.

Third Party Risk Management
We are progressing with a programme of work to enhance our controls and governance arrangements. Regulatory requirements relating to the management of outsourced services continue to increase. We are on track to meet the 31 March 2022 industry deadline set by the PRA's Supervisory Statement, issued in March 2021.

Ring-Fencing
Ring-fencing was retained as a Top Risk in order to maintain our focus on ongoing governance and compliance, as we continue to assess the quality and maturity of controls.

Emerging risks

Highlighted below are our emerging risks in focus in 2021 and our associated management actions. Climate Change and Data Management both transitioned to Top Risks and are covered in that section of the report. All of these remaining risks will likely be in focus again in 2022, given that they are continuing to evolve.

Broader geopolitical and social risks, including invasion by Russia of Ukraine
During the course of the past two years, since the onset of the Covid-19 pandemic, a number of broader risks have evolved and may present future headwinds. These include, geopolitical tensions between regions across the world, global supply chain pressures (which have already fuelled inflationary pressures), stretched household finances, and emerging social unrest.

These factors are also likely to play into increased localised political risk, including in the UK. We are closely following these developments and the potential for any material impacts which may need to be taken into consideration in our future business plans.

Rapid technological change and customer behaviour
Our multi-year transformation programme, with a focus on investment in digitalisation and automation, is aimed at designing compelling propositions for targeted customer segments, reshaping customer interactions, and simplifying and digitising the business at scale for improved efficiency and returns.

However, we are cognisant of the Cyber, Cloud technology and Operational resilience risk implications of these developments, which we take account of in our development strategy. Our overall approach reflects the continued acceleration of existing strong trends towards customer digital adoption via mobile and online banking.

Intense Market Competition
Enhancing our digital proposition remains key in supporting our customers' needs, retaining and growing our customer loyalty base, and addressing the commercial challenges of a highly competitive mortgage market.

Surplus deposits in ring-fenced banks remain a key driver of market pricing, and are a contributory factor towards pressures on net interest margins. As well as the elevated competition between incumbent banks, new entrants backed by other large multi-national banks are also launching in the UK offering competitive incentives to compete in the growing digital market, as well as savings, lending and investment markets.

Demanding regulatory agenda
We remain vigilant in taking a customer-focused approach in developing strategy, products and policies that support fair customer outcomes and market integrity.

Like all UK banks we will continue to face a demanding and complex regulatory agenda in 2022 and beyond, focused on consumer outcomes, addressing consumer detriment, price regulation and vulnerability, competition, Climate Change and Consumer Duty. We also continue to engage regularly with the ECB on regulatory issues such as models development and implementation. These challenges, increase the level of operational risk, and also the costs of compliance and business model changes, with the potential to constrain our capacity to invest in transformation projects.

Extended Government involvement in banking and markets
Government policy interventions continue to broaden in the UK Banking Sector, with the potential to significantly impact future business plans, costs and revenues. We continue to focus on support for our customers as government lending and other Covid-19 support schemes, including furlough, have rolled-off. UK banks' policies and actions will remain under intense scrutiny by Regulators and the Government, during the evolving and challenging post pandemic period.

We are also assessing implications arising from the COP26 Climate Change Conference, including the need for financial institutions to disclose detailed plans and milestones to achieve net-zero targets.

Central Bank Digital Currencies (CBDC) and Crypto assets
We have responded to the Bank of England on its June 2021, paper, 'New Forms of Digital Money' (CBDC and stablecoins). Depending upon how these are implemented, there is a risk of a significant transfer of commercial bank deposits into these assets over time, increasing wholesale funding requirements and costs, and reducing the 'stickiness' of deposits in a stress.

There are also broader potential impacts on regulatory frameworks, and monetary and fiscal policy. We continue to monitor these developments as they evolve. We are also addressing the risk of crypto asset exposure, through our client onboarding policies and procedures, which are part of our Financial Crime Framework.

Disruption of UK macro-economic factors
As part of our business planning, budget forecasts and stress testing processes, we closely track and take account of the key factors that impact our business such as house prices, GDP, inflation, unemployment and interest rates. In 2021, the Bank of England commented that longer term structural shifts, such as the way we work, could impact the valuations of certain assets such as commercial real estate and residential property. The recent increases in housing demand and prices may also reflect these more persistent drivers, and may not fall back to pre-pandemic levels now that tax incentives have been removed.

We are also monitoring the potential for emerging inflation related risks to result in increased levels of debt and defaults. We consider this risk in our scenario ranges for our expected credit loss assessments. The Bank of England has notified an intention to consult on considering withdrawing explicit FPC guidance with regards to mortgage affordability stressing, although we note that the Loan to Income flow limit is expected to remain.

Task Force on Climate-related Financial Disclosures

We are implementing the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), and taking action to meet the expectations set by the PRA, BoE and FCA. This requires wide-ranging collaboration both within the bank and externally to develop the tools and methodologies needed. As such, we have adopted a unified approach across the Santander UK Group Holdings plc group and therefore present disclosures on that basis in the Santander UK Group Holdings plc group Annual Report.

Financial overview

Development and performance of our business in 2021

Information on the development and performance of our business in the year is set out in the 'Income statement review' section of the Financial review.

Our position at 31 December 2021

Information on our position at the end of the year is set out in the 'Balance sheet review' section of the Financial review.

Sustainability review

We strive to create value for all our stakeholders, by delivering on our commitment to be a more responsible bank. This section is designed to be read together with our Environmental, Social and Governance (ESG) Supplement.

Customers

Financial inclusion

Financial inclusion is an important element in our aspiration to become a digital bank with a human touch. It is a key part of our Sustainability and Responsible Banking strategy. We have made good progress in recent years and to enhance this further we developed a new overarching Financial Inclusion strategy in 2021 with three focus areas: Financial education and knowledge; an inclusive portfolio of products and services; and customer care. A key goal of the strategy is to help customers to become more financially resilient and support them with appropriate, fair and simple products and services. A new financial inclusion working group is responsible for coordinating our approach and enhancing collaboration across the bank.

Meeting our customers changing needs

In response to changing customer behaviour we aim to simplify our bank and utilise technology to better meet our customers' needs; ensuring we do this in an inclusive way whether it's virtually or face to face.

Supporting SMEs through economic recovery

Santander Breakthrough is our small and medium-sized business (SME) initiative providing tools and resources to help SMEs prosper. In 2021, we focused on supporting companies to re-focus their strategies post-pandemic, ongoing mentoring for women in business and helping under-represented businesses.

Shareholders

Part of a global bank

We are a subsidiary of Banco Santander SA and our ordinary shares are all held by Banco Santander group companies and are not listed. Our preference shares are listed on the London Stock Exchange and we also have other equity instruments in the form of AT1 securities.

Consistent shareholder returns

Our operations are consistently profitable and we have paid a dividend every year since 2008. Dividends are paid in line with our dividend policy following review and approval by the Santander UK Board. This ensures that our capital strength and resilience is maintained.

Investor engagement

Our Investor Relations team actively engages with institutional investors globally, working alongside our funding and capital teams for new issuances and building and maintaining relationships with fixed income investors and analysts.

People

Culture

Our culture, The Santander Way, encompasses our purpose, values, behaviours and ways of working. Our values – Simple, Personal, Fair – reflect how we work. We are tremendously proud of, and grateful to, our people for how they have risen to the challenges of the pandemic while demonstrating our culture and values.

Inclusion and belonging

Our commitment is to be a truly inclusive organisation, one that reflects our customer base and communities. Our Everyday Inclusion strategy prioritises the themes of intersectionality, respect, balanced representation, leadership, advocacy, allyship, transparency and accountability. The strategy focuses on how we attract, recruit, develop and retain the most talented and diverse people. More details on our work and progress towards our goal of belonging can be found in our annual Pay Gap report found on our website.

Wellbeing

The wellbeing and safety of our colleagues has remained at the centre of our response to the pandemic. Our comprehensive approach is divided into mental, physical, social and financial wellbeing and our internal Wellbeing Hub provides information on wellbeing topics and support options. Our approach has been recognised as industry leading through the Great Places to Work Excellence in Wellbeing accreditation.

Fair Pay & Transparency

We review our reward framework annually against the external market. We are proud to have been an accredited Real Living Wage employer since 2015. We assess salary reviews, and changes to reward policies, for any adverse impacts on a particular group. Salary ranges and Pay Progression arrangement are visible to all colleagues. We also published our ethnicity data in more detail this year.

Ways of Working

With 71% of colleagues working from home during the pandemic, we have a unique opportunity to review our working practices. Our future ways of working project is reviewing the needs of our workforce.

Our priorities going forward

Our cultural priorities in 2022 will continue to focus on being an inclusive and responsible organisation, growing the skills and capabilities needed for the future. We will also continue to embed the positive new ways of working that we have learned and adapted to in response to the pandemic. Our priority will be to engage our people on how it will enable great customer outcomes and continuously improve our culture.

Communities

Financial Education

We know that financial education and knowledge provides an important benefit to communities across the UK. As part of our new Financial Inclusion strategy, we have several initiatives and partnerships focused on raising confidence with numbers and money matters, especially with young people. These are key skills supporting financial inclusion and over time we plan to expand our current initiatives to a wider audience including parents and older people. So far, we have delivered financial education resources to over 500,000 young people. For more on our approach and initiatives, please see our ESG Supplement.

Santander Foundation

In 2021, the Santander Foundation launched its Financial and Digital Empowerment Fund. The Fund supports charities that work to empower people with digital confidence, knowledge and skills, allowing them to make better, more informed decisions about money and to access financial services.

Santander Universities

In 2021, we launched Union Black, a new programme to tackle racism in higher education. Over three years, the programme will offer a free online course to four million staff and students at universities in the UK. Developed in response to Universities UK's 'Tackling racial harassment in higher education' report, the course has been designed to inspire cultural change across the higher education sector.

Focus on Mental Health

We work with the mental health charity, Mind, to provide our colleagues with practical tools and guidance that allow them to more confidently manage difficult conversations with customers, as well as manage the potential impact these conversations can have on their own wellbeing.

Digital Inclusion for Older People

We continued our partnership with Age UK in 2021 with phase two of GoDigital, our digital awareness and skills initiative for older people. The initiative reached a further 10,646 older people during the year through digital awareness events, adding to the 21,716 people reached in 2020. One-to-one support was provided to 883 older people (2020: 462) through a network of 41 digital champions.

Award-Winning Strategic Partnership

For three years, we have been working together with Alzheimer's Society to become the UK's best dementia-friendly bank and have won five awards. Our Dementia Steering Group which aims to improve products and services through the lived experience and other experts, improved 16 Santander UK products and services. Internally, over 50% of colleagues have taken a Dementia Friendly e-learning module, increasing understanding of dementia and consequently supporting co-workers and customers affected by dementia. Employees have also raised over £2m since the start of our partnership. For more information please see our ESG supplement.

Climate and Ethics

Responsible lending

As part of the Banco Santander group, we comply with the Equator Principles as a way to factor social, ethical and environmental impacts into our risk analysis and decision making for financial transactions.

Our Reputational Risk and Environmental, Social and Climate Change (ESCC) Risk policies define how we create long-term value while managing those risks. Our policies cover Oil & Gas, Power Generation & Transmission, Mining & Metals and Soft Commodities. For example, financing is prohibited for project-related financing for Coal-fired power plants (CFPP) projects worldwide and we will only work with new clients with CFPPs to provide specific financing for renewable energy projects.

In line with Banco Santander's commitment, we will eliminate all exposure to thermal coal mining and stop providing financial services to power generation clients with over 10% revenue from thermal coal by 2030. We pay special attention to the ESCC risks of various activities and projects, including liquid natural gas facilities; deep-sea and ultra-deep-sea oilfields; nuclear power generation; solid and gaseous biomass; precious minerals and metals mining; and native tropical timber extraction.

We review all relationships and transactions with identified ESCC risks or reputational risks including human rights, to ensure they are within our risk appetite. Key decisions can be escalated to the Reputational Risk Forum and, if required, the Board.

Green finance

We changed how we track sustainable financing in 2021. A new internal guideline, the Banco Santander Sustainable Finance Classification System (SFCS) defines what investments can be considered green or social financing. Applying the SFCS we have identified the following as green financing: renewable energy and other green energy financing, mortgages on properties with A- or B- rated energy performance certificates and financing for green vehicles.

The SFCS uses harmonised definitions that provide consistency in tracking, reporting and managing sustainable finance at a Banco Santander level. The system was developed using best-in-class market frameworks, such as the EU Green Taxonomy, the ICMA Green/Social Bond Principles and LMA Green Loan Principles.

Anti-financial crime, anti-bribery and corruption

Our strategy seeks to deter, detect and disrupt financial crime. All colleagues receive mandatory fighting financial crime training, highlighting issues and risks across all types of financial crime. We also raise awareness through our anti-bribery and corruption day, which coincided with international anti-corruption day on 9 December. In 2021, we launched 36 enhanced training modules on financial crime topics, which were completed by 3,497 colleagues in high-risk roles.

Streamlined Energy and Carbon Reporting (SECR)

In 2021, we used 119,562,413 kWh of energy (2020: 123,152,495 kWh) and emitted 6,321 tCO_2e of greenhouse gas emissions (market-based emissions) (2020: 6,452 tCO_2e). This equates to 0.35 tCO_2e per employee (2020: 0.31 tCO_2e). The increase was due to a decreased workforce. We calculate our emissions using the UK government Department for Business, Energy and Industrial Strategy (BEIS) conversion factors. Our total Scope 1, 2 and 3 emissions were:

Scope 1 C02e	6074
Scope 2 CO2e - Location-based	18860
Scope 2 Co2e - Market-based	0
Scope 3 Co2e - business travel only	247

Excludes properties used by Santander Financial Services plc in Jersey and the Isle of Man.

More information can be found in our ESG Supplement.

Regarding energy efficiency improvements, in 2021 there were ongoing refurbishments at Triton Square with new LED lighting, FCU (fan coil unit) replacement, and HVAC upgrades. Uninterruptible Power Supply systems have been replaced at our Belfast and Bradford offices. Condensing boiler control strategies have also been updated following a range of boiler upgrades between 2019 and 2021.

Stakeholder voice in the boardroom (Section 172)

The Directors are committed to fulfilling their responsibilities under Section 172 of the Companies Act 2006 (s172), ensuring they take into account the likely impact of any decision in the long-term, as well as the interests of our stakeholders. This report aims to describing how we have met these responsibilities during 2021, with an example included to bring it to life. Further examples can be found in the Santander UK Group Holdings plc 2021 Annual Report. A more comprehensive report is set out in the consolidated strategic report of the Company's holding company, Santander UK Group Holdings plc. This summary extracts highlights for ease of reference.

The Board has identified four key stakeholder groups whose interests and needs it regularly considers because they are key both to achieving Santander UK's Purpose of Helping People and Businesses Prosper and to delivering our strategic priority of becoming a Sustainable and Responsible Bank. These stakeholders are our customers, people, shareholders and communities. Although not a 'stakeholder' as such, we also spend time considering Santander UK's response to climate change.

We engage with our stakeholders in a variety of ways in order to understand their needs, priorities and concerns. Although Covid-19 has limited our ability to meet face to face, during 2021 we have continued this engagement as far as possible online and face to face when allowed and safe to do so. The Board recognises that our stakeholders' interests are not always aligned, and sometimes we need to make difficult choices. However, we believe that our stakeholders' interests are linked to a great extent and ensuring that we deliver for one will often positively impact others' interests. For example, providing excellent products and customer service:

- ensures value for our customers because we are meeting or exceeding their needs.
- drives value for our investors because the company should be more profitable as a result.
- ensures that the communities where we operate are getting the support they need from us.
- provides job satisfaction for our people. It also provides financial reward because our people's bonuses are linked to the delivery of good customer service.
- meets the regulators' requirements to treat customers fairly and protect their interests.
- supports the environment where we are able to provide excellent environmentally friendly products which our customers need.
- supports the long-term success of the company.

Transforming Santander UK to deliver long-term success for all our stakeholders
2021 was the third year of our multi-year plan to transform Santander UK for the benefit of all our stakeholders in the long-term. Our Transform for Success Programme is aimed at making Santander UK a more simple, efficient and digitised business which will allow it to focus and deliver on its core purpose of Helping People and Businesses Prosper.

The Board has continued to oversee the delivery of the Transforming for Success Programme. We recognise that transforming a business is a challenging time, with many competing priorities on our people. If not managed carefully, these competing priorities can put at risk the success of the programme or destabilise the continued delivery of high-quality service to our customers. Successful delivery of the transformation falls, to a great extent, on the heads of the same people who are responsible for the day-to-day running of the business. The Board has therefore received at least quarterly updates on progress. During these reviews, we scrutinise delivery plans and seek to understand the stretch that our people are under and the impact on the business and its stakeholders, in order to safeguard the business for today and in the long term. In Q1 2021 we encouraged management to re-assess the prioritisation of projects that sit within the Transforming for Success programme as well as the hiring of new members of senior management and technical specialists to help spread the load. In response, management moved delivery deadlines of some projects back and successfully completed key new hires. This has helped to ensure the safety of the business and the well-being of our people.

Non-financial information statement

This section is produced to comply with Sections 414CA and 414CB of the Companies Act 2006. The information listed is incorporated by cross-reference. Additional non-financial information can be found in our 2021 ESG Supplement and our Sustainability pages in the Annual Report.

Reporting requirement	Policies and standards	Information necessary to understand our business and its impact
Environmental matters	Environmental Policy	Emerging risks, page 6 TCFD, page 7 Sustainability: Climate and Ethics, page 10 Streamlined Energy and Carbon Reporting (SECR), page 10
Employees	People Policies Whistleblowing Policy Ethical Code of Conduct Policy	Sustainability: People, Fair Pay & Transparency, page 9 Chair's report on Corporate Governance: Board Audit Committee: whistleblowing, page 27 Directors' report: Ethical Code of Conduct, page 40
Human rights	Human Rights Policy	Sustainability: Climate and Ethics, page 10
Social matters	Social Ethical Policy	Sustainability: Communities, page 9 Climate and Ethics , page 10
Anti-corruption and anti-bribery	Anti-Bribery & Corruption Policy Ethical Code of Conduct Policy	Sustainability: Climate and Ethics, Anti-financial crime, anti-bribery and corruption, page 10 Directors' report: Ethical Code of Conduct, page 40
Principal risks and impact of business activity		Risk review, page 42
Description of business model		Business model, page 4
Non-financial key performance indicators		Our Performance and KPIs, page 5

Financial review

Critical factors affecting results

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

Estimates and judgements that are considered important to the portrayal of our financial condition including, where applicable, quantification of the effects of reasonably possible ranges of such estimates are set out in 'Critical Judgements and Accounting Estimates' in Note 1 to the Consolidated Financial Statements.

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Income statement review

SUMMARISED CONSOLIDATED INCOME STATEMENT

	2021 £m	2020[2] £m
Net interest income	**3,949**	3,388
Non-interest income[1]	**550**	464
Total operating income	**4,499**	3,852
Operating expenses before credit impairment write-backs/losses, provisions and charges	**(2,510)**	(2,390)
Credit impairment write-backs/ (losses)	**233**	(638)
Provisions for other liabilities and charges	**(377)**	(264)
Total operating credit impairment write-backs/losses, provisions and charges	**(144)**	(902)
Profit from continuing operations before tax	**1,845**	560
Tax on profit from continuing operations	**(492)**	(121)
Profit from continuing operations after tax	**1,353**	439
Profit/(loss) from discontinued operations after tax	**31**	32
Profit after tax	**1,384**	471
Attributable to:		
Equity holders of the parent	**1,365**	452
Non- controlling interests	**19**	19
Profit after tax	**1,384**	471

(1) Comprises 'Net fee and commission income' and 'Other operating income'.
(2) Adjusted to reflect the presentation of discontinued operations as set out in Note 43 to the Consolidated Financial Statements.

A more detailed Consolidated Income Statement is contained in the Consolidated Financial Statements.

2021 compared to 2020

Profit from continuing operations before tax was up 229% to £1,845m due to the factors outlined below. By income statement line item, the movements were:

- Net interest income was up 17%, with repricing actions on the 1|2|3 Current Account and other deposits offsetting 2020 base rate cuts and back book mortgage margin pressure, including £1.9bn net attrition on SVR and Follow on Rate products (2020: £1.8bn).
- Non-interest income was up 19%, with the gain on sale of our UK head office in Q2 2021 partially offset by significantly lower banking and transaction fees in our retail business largely due to the implementation of regulatory changes to overdrafts.

- Operating expenses before credit impairment write-backs/losses, provisions and charges up 5% largely related to the transformation programme including the closure of 111 branches and 40% reduction in head office space.
- Credit impairment write-backs of £233m were largely due to net releases related to the improved economic outlook and Covid-19 PMAs. In 2020 we made a significant charge for Covid-19 related PMAs. New to arrears flows and Stage 3 defaults remain low as all portfolios continue to perform resiliently. Notable changes in ECL are outlined in the Credit risk section of the Risk review.
- Provisions for other liabilities and charges increased 43% to £377m, largely related to the transformation programme.
- Tax on profit from continuing operations increased to £492m driven by a higher profit. The effective tax rate of 26.7% (2020: 21.6%) was higher as the proportion of profits subject to the bank surcharge increased.

Profit from discontinued operations after tax of £31m) relates to the Corporate & Investment Banking business. In 2021 this comprised the profit before tax of the discontinued operations of £43m (2020: £45m) and a tax charge of £12m (2020: £13m).

PROFIT BEFORE TAX BY SEGMENT

Continuing operations

The segmental information in this Annual Report reflects the reporting structure in place at the reporting date in accordance with the segmental information in Note 2 to the Consolidated Financial Statements.

2021	Retail Banking[2] £m	Consumer Finance[2] £m	Corporate & Commercial Banking £m	Corporate Centre £m	Total £m
Net interest income/(expense)	**3,356**	**233**	**401**	**(41)**	**3,949**
Non-interest income[1]	**205**	**178**	**109**	**58**	**550**
Total operating income	**3,561**	**411**	**510**	**17**	**4,499**
Operating expenses before credit impairment write-backs, provisions and charges	**(1,701)**	**(163)**	**(365)**	**(281)**	**(2,510)**
Credit impairment write-backs	**98**	**33**	**91**	**11**	**233**
Provisions for other liabilities and charges	**(185)**	**4**	**(34)**	**(162)**	**(377)**
Total operating credit impairment write-backs, provisions and charges	**(87)**	**37**	**57**	**(151)**	**(144)**
Profit from continuing operations before tax	**1,773**	**285**	**202**	**(415)**	**1,845**

2020[3]					
Net interest income/(expense)	2,753	264	363	8	3,388
Non-interest income[1]	245	127	94	(2)	464
Total operating income/(expense)	2,998	391	457	6	3,852
Operating expenses before credit impairment losses, provisions and charges	(1,792)	(166)	(324)	(108)	(2,390)
Credit impairment losses	(264)	(44)	(294)	(36)	(638)
Provisions for other liabilities and charges	(157)	(8)	(6)	(93)	(264)
Total operating credit impairment losses, provisions and charges	(421)	(52)	(300)	(129)	(902)
Profit from continuing operations before tax	785	173	(167)	(231)	560

(1) Comprises 'Net fee and commission income' and 'Other operating income'.
(2) The segmental basis of presentation has changed following a management review of our structure. Segmental income statements and customer balances for 2020 have been restated to reflect the resegmentation of the Retail Banking segment into the Retail Banking and Consumer Finance segments. See Note 2 to the Consolidated Financial Statements.
(3) Adjusted to reflect the presentation of discontinued operations as set out in Note 43 to the Consolidated Financial Statements.

2021 compared to 2020

- For Retail Banking, profit increased due to growth in mortgage lending, higher mortgage early redemption charges, improved margin reflecting interest rate changes on the 1|2|3 Current Account and lower funding costs as well as credit impairment write-backs.
- For Consumer Finance, profit increased reflecting an increase in the residual value of cars, lower funding costs and credit impairment write-backs, partially offset by the impact of the sale of our PSA shareholding.
- For Corporate & Commercial Banking, profit increased due to lower customer deposit rates, higher fee income and credit impairment write-backs.
- For Corporate Centre, loss increased due to higher transformation programme spending.

Balance sheet review

SUMMARISED CONSOLIDATED BALANCE SHEET

	2021 £m	2020 £m
Assets		
Cash and balances at central banks	**48,139**	41,250
Financial assets at fair value through profit or loss	**1,866**	3,614
Financial assets at amortised cost	**224,452**	231,194
Financial assets at fair value through other comprehensive income	**5,851**	8,950
Interest in other entities	**201**	172
Property, plant and equipment	**1,548**	1,734
Retirement benefit assets	**1,572**	495
Tax, intangibles and other assets	**3,469**	4,923
Total assets	**287,098**	292,332
Liabilities		
Financial liabilities at fair value through profit or loss	**1,580**	3,018
Financial liabilities at amortised cost	**266,247**	270,063
Retirement benefit obligations	**37**	403
Tax, other liabilities and provisions	**3,132**	2,912
Total liabilities	**270,996**	276,396
Equity		
Total shareholders' equity	**16,102**	15,774
Non-controlling interests	**—**	162
Total equity	**16,102**	15,936
Total liabilities and equity	**287,098**	292,332

A more detailed Consolidated Balance Sheet is contained in the Consolidated Financial Statements.

2021 compared to 2020

Assets

Cash and balances at central banks

Cash and balances at central banks increased by 17% to £48,139m at 31 December 2021 (2020: £41,250m). This was driven by cash inflows generated from an increase in our drawdown of TFSME, the sale and maturity of sovereign debt securities held in our liquid asset portfolio, lower net reverse repurchase agreements and a reduction in corporate lending (outside the Government's Coronavirus loan schemes) and non-mortgage related retail lending partially offset by net cash outflows from the issue, maturity and buyback of debt securities and an increase in mortgage lending.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss decreased by 48% to £1,866m at 31 December 2021 (2020: £3,614m), mainly due to a £2.4bn decrease in exchange rate and interest rate derivative contracts held for hedging.

Financial assets at amortised cost

Financial assets at amortised cost decreased by 3% to £224,452m at 31 December 2021 (2020: £231,194m), largely driven by a £6.9bn decrease in reverse repurchase agreements driven by normal business activities, a reduction in corporate lending (outside the Government's Coronavirus loan schemes), non-mortgage related retail lending and the maturity of UK Government Gilts partially offset by an increase in mortgage lending.

Financial assets at fair value through other comprehensive income

Financial assets at fair value through other comprehensive income decreased by 35% to £5,851m at 31 December 2021 (2020: £8,950m) mainly due to a decrease in Japanese government bonds and other bonds.

Property, plant and equipment

Property, plant and equipment decreased by 11% to £1,548m at 31 December 2021 (2020: £1,734m) reflecting freehold and leasehold property sales including the sale of our London head office.

Retirement benefit assets

Retirement benefit assets increased by 218% to £1,572m at 31 December 2021 (2020: £495m). This was mainly due to actuarial gains in the year driven by an increase in the discount rate and positive returns on assets partially offset by actuarial losses due to higher inflation.

Tax, intangibles and other assets

Tax, intangibles and other assets decreased by 30% to £3,469m at 31 December 2021 (2020: £4,923m), mainly due to hedge adjustments resulting from an increase in the 5-year GBP SONIA rate over the year.

Liabilities

Financial liabilities at amortised cost

Financial liabilities at amortised cost decreased by 1% to £266,247m at 31 December 2021 (2020: £270,063m). This was mainly due to maturities and buybacks across a range of debt securities partially offset by new issuances of £10.0bn, a decrease in non-trading repurchase agreements as part of normal business activities of £4.1bn, and a reduction in customer time deposits and other customer deposits partially offset by a £14.0bn increase in TFSME related time deposits by banks, increases in current, demand and savings accounts and decreased cash collateral.

Retirement benefit obligations

Retirement benefit obligations decreased by 91% to £37m at 31 December 2021 (2020: £403m). This was due to actuarial gains over the year driven by an increase in the discount rate and positive returns on assets partially offset by actuarial losses due to higher inflation. In 2021, all remaining sections in deficit in the defined benefit scheme moved into surplus, leaving only the unfunded pension and post-retirement medical benefit arrangements.

Equity

Total shareholders' equity

Total shareholders' equity increased by 2% to £16,102m at 31 December 2021 (2020: £15,774m). This increase was principally due to retained profits for the period, pension remeasurement partially offset by the net redemption of other equity instruments, decreases in the fair value of cash flow hedges, and dividends paid including the payment of an additional ordinary dividend (on top of the ordinary dividend based on 50% of retained profits for the year) reflecting the capital allocated to the Corporate & Investment Banking business and PSA shareholding transferred.

CUSTOMER BALANCES

Consolidated

	2021 £bn	2020 £bn
Customer loans	**207.3**	207.0
Other assets	**79.8**	85.3
Total assets	**287.1**	292.3
Customer deposits	**186.2**	185.7
Total wholesale funding	**65.2**	63.1
Other liabilities	**19.6**	27.5
Total liabilities	**271.0**	276.3
Shareholders' equity	**16.1**	15.8
Non-controlling interest	**—**	0.2
Total liabilities and equity	**287.1**	292.3

Further analyses of credit risk on customer loans, and on our funding strategy, are included in the Credit risk and Liquidity risk sections of the Risk review.

2021 compared to 2020

- Customer loans increased £0.3bn, with £7.5bn net mortgage lending (£33.6bn of gross lending) largely offset by £6.0bn of asset sales and transfer of the CIB segment, a significant part of which was moved to SLB under a Part VII banking business transfer scheme, which completed on 11 October 2021. The residual parts of CIB were wound down or transferred to other segments during 2021.
- Customer deposits increased £0.5bn, with growth in Retail Banking, CCB and Corporate Centre partially offset by the transfer of CIB. 1|2|3 Current Account balances grew to £58bn (2020: £57bn) despite repricing actions taken during 2020 and 2021.
- Other assets and other liabilities fell, primarily reflecting our approach to liquidity management during 2021.

Customer loans by segment

	2021 £bn	2020 £bn
Retail Banking	**183.0**	175.4
Consumer Finance	**5.0**	8.0
CCB [1]	**17.0**	17.6
Corporate Centre [2]	**2.3**	3.2
CIB	**—**	2.8
Total	**207.3**	207.0

(1) CCB customer loans includes £4.4bn of CRE loans (2020: £5.0bn).
(2) Corporate centre customer loans includes Social Housing lending of £2.2bn (2020: £3.0bn).

Customer deposits by segment

	2021 £bn	2020 £bn
Retail Banking	**157.0**	152.2
CCB customer	**25.6**	25.0
Corporate centre	**3.6**	2.0
CIB	**—**	6.5
Total	**186.2**	185.7

Retail Banking customer loans and customer deposits by portfolio

	2021 £bn	2020 £bn
Mortgages	**174.7**	166.7
Business banking	**3.5**	3.9
Other unsecured lending	**4.8**	4.8
Retail Banking customer loans	**183.0**	175.4
Current accounts	**80.7**	75.6
Savings	**57.8**	57.4
Business banking accounts	**13.1**	13.4
Other retail products	**5.4**	5.8
Retail Banking customer deposits	**157.0**	152.2

Corporate loans by segment

	2021 £bn	2020 £bn
Retail Banking (primarily BBLS through Business Banking)	**3.5**	3.9
CCB	**17.0**	17.6
Corporate Centre (primarily Social Housing)	**2.3**	3.2
CIB	**—**	2.8
Total	**22.8**	27.5

Cash flows

SUMMARISED CONSOLIDATED CASH FLOW STATEMENT

	2021 £m	2020 £m
Net cash flows from operating activities	**10,846**	18,823
Net cash flows from investing activities	**3,077**	6,636
Net cash flows from financing activities	**(10,753)**	(6,773)
Change in cash and cash equivalents	**3,170**	18,686

A more detailed Consolidated Cash Flow Statement is contained in the Consolidated Financial Statements.

The major activities and transactions that affected cash flows in 2021 and 2020 were as follows:

In 2021, the net cash inflows from operating activities of £10,545m resulted from net cash inflows generated from profits in the year and higher customer deposits, partially offset by a decrease in repurchase agreements. The net cash inflows from investing activities of £3,077m mainly reflected the net disposal of certain asset backed securities as part of normal liquid asset portfolio management. The net cash outflows from financing activities mainly reflected net cash outflows relating to debt securities in issue. These resulted in cash and cash equivalents increasing by £2,869m in the year.

In 2020, the net cash inflows from operating activities of £19,025m resulted from net cash inflows generated from profits in the year and higher customer deposits, offset by additional retail and corporate lending. The net cash inflows from investing activities of £6,636m mainly reflected the net disposal of certain asset backed securities as part of normal liquid asset portfolio management. The net cash outflows from financing activities mainly reflected net cash outflows relating to debt securities in issue. These resulted in cash and cash equivalents increasing by £18,888m in the year.

Cash flow requirements
For details of our cash flow requirements over the next 12 months and in the longer term and how we plan to meet them, see the Liquidity risk section of the Risk review.

Material cash requirements
Our material commitments under commercial contracts at 31 December 2021 were as follows:

- For cash flows and maturities relating to Derivatives, Deposits by customers, Deposits by banks, Debt securities in issue, Subordinated liabilities and Lease obligations, see Note 40 to the Consolidated Financial Statements. The maturities of financial liabilities and off-balance sheet commitments table analyses the maturities of the cash flows based on the remaining period to the contractual maturity date at the balance sheet date. In practice, the behavioural profiles of many liabilities show more stability and longer maturity than their contractual maturity. This is especially true of many types of retail and corporate deposits that, while they may be repayable on demand or at short notice, have shown good stability even in times of stress. For further details, see the Liquidity risk section of the Risk review.
- For details of cash flows and maturities relating to Retirement benefit obligations including employer contributions and funding see Note 30 to the Consolidated Financial Statements.
- Purchase obligations: We have entered into outsourcing contracts where, in some cases, there is no minimum specified spending requirement. In these cases, anticipated spending volumes have been included in purchase obligations. Total purchase obligations, all of which are due within 1 year, totalled £447m.

Capital and funding

	2021 £bn	2020 £bn
Capital		
CET1 capital	**10.8**	11.1
Total qualifying regulatory capital	**14.8**	15.2
CET1 capital ratio	**16.1%**	15.4%
Total capital ratio	**21.9%**	21.2%
Risk-weighted assets	**67.1**	71.9
Funding		
Total wholesale funding and AT1	**67.4**	65.3
– of which with a residual maturity of less than one year	**10.2**	21.1

Liquidity

	2021 £bn	2020 £bn
Santander UK Domestic Liquidity Sub Group (RFB DoLSub)		
Liquidity Coverage Ratio (LCR)	**166%**	150%
LCR eligible liquidity pool	**51.4**	51.5

Further analysis of capital, funding and liquidity is included in the Capital risk and Liquidity risk sections of the Risk review.

2021 compared to 2020

- CET1 capital ratio increased 70 basis points to 16.1%, 590bps above the MDA threshold, largely due to lower RWAs and retained profit.
- Total capital ratio increased by c70bps to 21.9%, with lower RWA and retained profits offsetting the reduction in AT1 securities in issue and the increased effect from January 2021 of the CRD IV Grandfathering Cap rules that reduce the recognition of grandfathered capital instruments issued by Santander UK plc.
- We drew further on TFSME in Q4 2021, with £31.9bn outstanding at the year-end. We repaid all TFS outstanding. We issued £2.8bn of MREL eligible senior unsecured securities. Wholesale funding costs improved in 2021 with buy backs and maturities being refinanced at lower cost.
- The RFB DoLSub LCR of 166% increased (2020: 150%) and remains significantly above regulatory requirements.
- We paid £1,346m interim ordinary share dividends related to 2021 profit and an assessment of capital surpluses (2020: £103m). Dividends were paid in line with our dividend policy following review and approval by the Santander UK Board.
- Our structural hedge position remained broadly stable at circa £103bn, with an average duration of circa 2.6 years.
- RWA reduced circa £6bn following a sale of our PSA shareholding to PSA Financial Services Spain, the transfer of Corporate & Investment Banking to the London branch of Banco Santander SA, the sale of our London head office and the sale of a £0.6bn retail mortgage portfolio. These sales and transfers reduced customer loans by £6.0bn.

Alternative Performance Measures (APMs)

In addition to the financial information prepared under IFRS, this Annual Financial Report contains non-IFRS financial measures that constitute APMs, as defined in European Securities and Markets Authority (ESMA) guidelines. The financial measures contained in this Annual Financial Report that qualify as APMs have been calculated using the financial information of the Santander UK group but are not defined or detailed in the applicable financial information framework or under IFRS.

We use these APMs when planning, monitoring and evaluating our performance. We consider these APMs to be useful metrics for management and investors to facilitate operating performance comparisons from period to period. Whilst we believe that these APMs are useful in evaluating our business, this information should be considered as supplemental in nature and is not meant as a substitute for IFRS measures.

A description of the Santander UK group's APMs and their calculation, is set out below.

APM	Description and calculation
Non-interest income	Net fee and commission income plus Other operating income.
Stage 3 ratio	The sum of Stage 3 drawn and Stage 3 undrawn assets divided by the sum of total drawn assets and Stage 3 undrawn assets.

Governance

Our governance

The UK Corporate Governance Code 2018 (the Code) sets out the framework for premium listed companies in the UK. Although the Company does not have premium listed shares on the London Stock Exchange, and does not need to comply with the Code, the Board has chosen to voluntarily adopt those principles of the Code that are considered appropriate for the Company.

This Governance section details how the Company has applied and complied with the principles and provisions of the Code. Any principles and provisions of the Code that are not complied with are detailed in the Directors' Report. The Board confirms that we complied with all of the provisions set out in the Code for the period under review, unless otherwise detailed in the Directors' Report.

How our governance supports the delivery of our strategy

All Directors are collectively responsible for the success of the Company. The Non-Executive Directors exercise objective judgement in respect of Board decisions, and scrutinise and challenge management. They also have various responsibilities concerning the integrity of financial information, internal controls and risk management.

The Board is responsible for setting our strategy and policies, overseeing risk and corporate governance, and monitoring progress towards meeting our objectives and annual plans. It is accountable to our shareholder for the proper conduct of the business and our long-term success, and seeks to represent the interests of all stakeholders.

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Board of Directors

1 William Vereker

Chair

Appointed 1 November 2020 (Chair)
Previously Independent Non-Executive Director from 1 October 2020.

Skills and experience

William is an experienced and well-respected Banker, previously having served as Global Head of Investment Banking for UBS (2013 – 2018), and prior to that holding a number of leadership roles at Nomura, Lehman Brothers and Morgan Stanley. From 2018 to 2019 he served as the Prime Minister's Business Envoy. He was a Vice Chairman at JP Morgan until October 2020. William has been a member of the Nomination Committee since 1 October 2020.

Other principal appointments

Chair of Santander UK Group Holdings plc*. Member of the UK Investment Council. Member and Special Advisor of Delancey Credit and Income Fund GP – Investment Committee. Chairman of Gonville & Caius Development Advisory Group.

Board Committee memberships

Board Nomination Committee

2 Lisa Fretwell

Independent Non-Executive Director

Appointed 1 January 2022

Skills and experience

Lisa has 25 years' experience within the financial services, technology, retail, and manufacturing industries in both business and consulting roles. She holds a first-class honours degree in Chemical engineering from the University of Birmingham and an MBA from Cranfield Business School. She was awarded Business Leader of the Year by Women in Credit in 2020. Lisa joined Santander from Experian, where she was Managing Director of Experian UK's Data Business from 2019 - 2021. Prior to this, Lisa held various senior roles at Cisco for over 10 years, including Vice President of Software and Operations and Managing Director of Consulting Services and Internet Business Solutions. Lisa also held roles at Capgemini and Procter & Gamble before joining Cisco.

Other principal appointments

Independent Non-Executive Director of Santander UK Group Holdings plc*.

Board Committee memberships

Board Audit Committee
Board Risk Committee
Board Responsible Banking Committee

3 Annemarie Durbin

Independent Non-Executive Director, Employee Designated Director, Senior Ring-Fencing Director

Appointed 13 January 2016

Skills and experience

Annemarie has 30 years' international retail, commercial, corporate and institutional banking experience culminating in membership of Standard Chartered's Group Executive Committee where she was Group Company Secretary.

Annemarie is an executive coach and mentor.

Other principal appointments

Chair of Cater Allen Limited*. Non-Executive Director and Chair of Remuneration Committee of Persimmon Plc.

Board Committee memberships

Board Nomination Committee
Board Remuneration Committee
Board Responsible Banking Committee
Board Risk Committee
Board Audit Committee

4 Ed Giera

Independent Non-Executive Director, Senior Independent Director

Ed was appointed Independent Non-Executive Director on 19 August 2015 and Senior Independent Non-Executive Director on 7 April 2021.

Skills and experience

Ed's executive career was with JP Morgan Securities, the investment banking affiliate of JP Morgan Chase & Co. where he held positions as Global Head of Pension Advisory, Head of Capital Markets for the EMEA region, and other senior roles. Ed is currently a Partner and Manager of Boscobel Place Capital LLC, a private investment partnership focused on the global financial services sector, and Principal of EJ Giera LLC, providing corporate finance advisory and fiduciary services. Ed was formerly a Non-Executive Director at Pension Corporation Group Limited, a holding company for the Pension Insurance Corporation, where he chaired the Board Audit & Risk Committee. He has also served as a Non-Executive Director for ICBC Standard Bank plc; for the Renshaw Bay Real Estate Fund and Renshaw Bay Structured Finance Opportunity Fund, respectively; and for NovaTech LLC.

Other principal appointments

Independent Non-Executive Director of Santander UK Group Holdings plc*. Non-Executive Director of Rothesay Life Plc.

Board Committee memberships

Board Audit Committee
Board Nomination Committee
Board Responsible Banking Committee
Board Risk Committee
Board Remuneration Committee

5 Chris Jones

Independent Non-Executive Director, Whistleblowers' Champion

Appointed 30 March 2015

Skills and experience

Chris was a partner at PwC from 1989 to 2014 and was a Senior Audit Partner specialising in the audit of banks and other financial services companies. He also led PwC's EMEA Financial Services practice. He is a past president of the Association of Corporate Treasurers and a former Chairman of the Advisory Board of the Association of Corporate Treasurers.

Other principal appointments

Independent Non-Executive Director of Santander UK Group Holdings plc*. Audit and Risk Committee member of the Wellcome Trust. Independent Non-Executive Director of Legal & General Investment Management (Holdings) Limited.

Board Committee memberships

Board Audit Committee
Board Remuneration Committee
Board Responsible Banking Committee
Board Risk Committee
Whistleblowers' Champion

* Part of the Banco Santander group.

Board of Directors continued

6 Mark Lewis

Independent Non-Executive Director
Appointed 16 December 2020

Skills and experience
Mark brings a track record of digital transformation and growth across multiple consumer businesses and sectors. Most recently he was CEO of Moneysupermarket Group plc, operating regulated marketplaces across financial services, travel and home services and helping UK households save over £7bn from their bills.

Prior to this, Mark sat on the John Lewis Management Board as Retail Director, responsible for sales and operations across 48 UK department stores and online channels serving 37 countries. He previously served as Managing Director of eBay UK and CEO of Collect+.

Other principal appointments
Mark is a Trustee of The Photographers Gallery.

Board Committee memberships
Board Remuneration Committee
Board Responsible Banking Committee
Board Risk Committee

7 Antonio Simões

Banco Santander Nominated Non-Executive Director
Appointed 30 April 2021

Skills and experience
Antonio is currently CEO of Spain and Head of Europe for Banco Santander. He joined the Banco Santander group in September 2020 as regional head of Europe with managerial responsibility and oversight of the bank's businesses in Europe with reporting lines from the country heads of Spain, UK, Portugal and Poland. He joined Banco Santander group from HSBC where, for 13 years, he led a number of businesses, both in London and Hong Kong. Most recently he was CEO, Global Private Banking and before that Antonio was CEO for the UK and continental Europe. Before joining HSBC, he was a partner at McKinsey & Company in their London office and also at Goldman Sachs.

Other principal appointments
Non-Executive Director of Santander UK Group Holdings plc*. Trustee for the Prince's Trust International. Director of PagoNxT SL (Spain)*.

* Part of the Banco Santander group.

8 Pamela Walkden

Banco Santander Nominated Non-Executive Director
Appointed 1 October 2021

Skills and experience
Pamela has served in a number of senior management positions predominantly at Standard Chartered Bank, including as Group Head of Human Resources, Chief Risk Officer, Group Treasurer, Group Head of Asset and Liability Management and Regional Markets, Group Head of Internal Audit, Group Head of Corporate Affairs and Group Manager of Investor Relations.

In addition, she served as an independent member of the UK Prudential Regulation Authority (PRA) Regulatory Reform Panel and as a member of the European Banking Authority Stakeholder Group.

Other principal appointments
Non-Executive Director of Santander UK Group Holdings plc* since 1 October 2021. Independent Non-Executive Director and Chair of the Audit Committee in Banco Santander SA. Member of the Advisory Board at JD Haspel Limited.

Board Committee memberships
Board Risk Committee
Board Nomination Committee

9 Dirk Marzluf

Banco Santander Nominated Non-Executive Director
Appointed 7 May 2019

Skills and experience
Dirk joined Banco Santander as Group Head of Technology and Operations in September 2018. He joined Banco Santander from AXA Group, where he served as Group Chief Information Officer, leading the insurance group's technology and information security transformation, and overseeing its overall project portfolio and acting as co-sponsor of its digital strategy. His global technology leadership roles include previous work at Accenture, Daimler Chrysler and Winterthur Group.

As Banco Santander Group Head of Technology and Operations, Dirk leads the information technology and operations function and its strategic development.

Other principal appointments
Chairman of Santander Global Operations SA* and Santander Global Technology SL.* Director of Ebury Partners Limited.

10 The Rt Hon. the Baroness Morgan of Cotes

Independent Non-Executive Director
Appointed 10 August 2021

Skills and experience
Nicky Morgan is a former MP, Cabinet Minister and Chair of the House of Commons Treasury Committee and is now a member of the House of the Lords. She is a qualified solicitor by background and before being elected to Parliament spent 16 years with City law firms, focused on mergers and acquisitions and advisory work. Nicky possesses significant experience as a senior leader of high-profile large organisations, responsible for setting and overseeing implementation of strategy and communicating the organisation's narrative and capabilities. She brings a wealth of experience from both a public and private perspective of the financial services sector, communications & media.

Other principal appointments
Non-Executive Director of Financial Services Compensation Scheme, Careers & Enterprise Company and Great Central Railway plc. Chair of the Association of British Insurers.

Board Committee memberships
Board Audit Committee
Board Responsible Banking Committee
Board Risk Committee

Board of Directors continued

11 Nathan Bostock

Executive Director,
Chief Executive Officer

Nathan was appointed Executive Director on 19 August 2014 and Chief Executive Officer on 29 September 2014

Skills and experience

Nathan joined Santander UK from The Royal Bank of Scotland plc (RBS), where he was an Executive Director and Group Finance Director. He previously held the post of Group Chief Risk Officer, having joined RBS in 2009. Nathan served on the Board of Abbey National plc (now Santander UK plc) as an Executive Director, from 2005 until 2009. He joined Abbey National plc in 2001, holding a number of senior positions including Chief Financial Officer and Executive Director of Finance, Markets and Human Resources.

Prior to joining RBS (now NatWest) he spent seven years with Chase Manhattan Bank, having previously qualified as a Chartered Accountant at Coopers & Lybrand (now PwC).

Other principal appointments

Chief Executive Officer of Santander UK Group Holdings plc*. Member of the Financial Services Trade and Investment Board.

12 Madhukar (Duke) Dayal

Executive Director,
Chief Financial Officer

Appointed 16 September 2019

Skills and experience

Duke has extensive financial services experience in a wide range of areas. Before joining Santander UK, he worked for Santander US* in Boston as CFO of Santander Holdings* (April 2016 – July 2019) and President and CEO of Santander Bank NA* (September 2017 – July 2019).

Prior to joining Santander, Duke was with BNP Paribas for six years, where he served as Chief Financial Officer for BNP Paribas USA Holdings, BancWest and Bank of the West in San Francisco. Before that he helped lead a private equity start-up for JP Morgan Chase & Co, Brysam Global Partners. Prior to that, he spent eight years with Citi in a variety of business and finance roles in New York, California, South Korea and Brussels.

Duke also served as a member of the Executive Committee on the Board of Trustees for the Institute of International Banking in New York, as a Board member of the Federal Home Loan Bank of Pittsburgh and is on the Board of Governors for Nottingham Trent University.

Other principal appointments

Chief Financial Officer of Santander UK Group Holdings plc*.

13 Mike Regnier

Incoming Executive Director,
Chief Executive Officer

Mike will stand for election as Executive Director and Chief Executive Officer at the Company's AGM on 1 April 2022.

Skills and experience

Mike will be joining Santander UK from Yorkshire Building Society (YBS), where he was a Board member since 2014 and Chief Executive since 2017. He previously held the posts of Chief Commercial Officer and Chief Customer Officer.

Mike began his career in strategic management consulting with a focus on Retail and Retail Financial Services. After management positions at Asda, he joined the banking sector and held a number of senior positions at Lloyds Banking Group, including Personal Current Accounts and Credit Cards Director, and Products and Marketing Director for TSB.

Mike has served as a Board Director of Visa UK, and Chairman of the merchant acquirer LTSB Cardnet. He was also Chair of the Building Societies Association from 2019 – 2021. Mike holds an MEng in Engineering, Economics & Management from Oxford, together with an MBA from INSEAD.

* Part of the Banco Santander group.

For full bios visit:
www.santander.co.uk/uk/about-santander

Chair's report on corporate governance

My report describes the roles, responsibilities and activities of the Board and its Committees.

"

The Board has been focused on succession planning and delivering on our transformation programme for the benefit of our customers.

William Vereker
Chair
1 March 2022

Our governance

Maintaining high standards of corporate governance are an essential element to ensure the long-term sustainable success of the Company.

In addition to the UK Corporate Governance Code 2018 (the Code) (the standard against which we measure ourselves), we also have internal governance practices and rules which are set out in a number of our key documents, principally:

- The UK Group Framework, which defines clearly our responsibilities and relationship with Banco Santander SA, our ultimate shareholder, taking account of our fiduciary and regulatory responsibilities. This gives us the autonomy to discharge our responsibilities in the UK in line with best practice as an independent board while giving Banco Santander SA the oversight it needs. Clarity of roles and responsibilities is key to ensuring proper accountability for decisions and outcomes.
- The Corporate Governance Framework, which is designed to assist the Board of Directors in discharging their responsibilities and ensuring an appropriate scheme of delegation throughout the Santander UK group.

The Board's schedule and activities are planned to make sure that Directors have regard to the matters necessary to promote the success of the Company, including the broader implications of their decisions for all the Company's stakeholders including its shareholder. Details of how the Board has achieved this are set out in the 'Stakeholder voice in the boardroom' (Section 172 statement) in the Strategic report. Our statement of compliance with the Code can be found in the Directors' report.

Ring-fencing governance

The substantive business of the Santander UK group is conducted by Santander UK plc, our principal ring-fenced bank (RFB). Ring-fenced banks operate within governance rules defined and overseen by the PRA who have granted Santander UK plc certain ring-fencing governance rule modifications, subject to various safeguards. This allows for certain overlaps of the Board and senior management of Santander UK Group Holdings plc and Santander UK plc, recognising our ownership structure and chosen ring-fencing business model.

The key ring-fencing safeguards include:

- The requirement to have at least three ring-fenced bank Independent Non-Executive Directors (INEDs), of whom none are employees or directors of any other member of the ring-fenced bank's group other than a ring-fenced affiliate (referred to as Double INEDs (DINEDs)); and one of whom is designated senior ring-fencing director (SRD) responsible for making sure that processes to identify and manage any conflicts of interest between the RFB and other members of the RFB's group are operating effectively.
- The DINEDs and SRD have certain veto rights designed to protect the interests of the RFB.
- The requirement for an approved person who is part of the RFB risk management function and who is not a director of, employed by, or has any responsibilities for any other member of the RFB group other than a ring-fenced affiliate (RFB Risk Officer). The RFB Risk Officer has certain specific responsibilities in relation to identifying conflict matters.
- the Board and Committees of the two companies continue to be run substantially simultaneously to ensure efficiency and effectiveness whilst guaranteeing the independence and autonomy of RFB are appropriately protected. Under PRA rule modifications, the RFB Board and Board Committees must hold separate meetings at least twice a year to consider matters specific to the ring-fenced bank. The separate Board and Board Committee meetings of the RFB took place in July and December 2021.

Board activities
Read more on **p28**

Committee membership and attendance
Read more on **p36**

Chair's report on corporate governance continued

At 31 December 2021, the four DINEDs of Santander UK plc were Garrett Curran, Annemarie Durbin, Mark Lewis and Nicky Morgan. In addition, Annemarie Durbin acts as the SRD of Santander UK plc.

In addition, the Board Committees of the RFB must comprise at least one DINED member (or two DINED members for the Board Audit Committee and the Board Risk Committee). Santander UK Group Holdings plc continues to benefit from the knowledge, skills and experience of the DINEDs, where appropriate, in the simultaneous Board and Committee meetings of both companies.

Board membership

At 31 December 2021, the Board of Santander UK Group Holdings plc consisted of the Chair (independent on appointment), two INEDs, two Group appointed Non-Executive Directors (GNEDs) and two Executive Directors (EDs). The Santander UK plc Board, at 31 December 2021, consisted of the Chair, six INEDs, two EDs and three GNEDs. The Board composition does not comply with the Code because our shareholder requires a maximum of 50% of the Board, including the Chair, to be independent.

Through the Board Nomination Committee, we make sure we have the right mix of individuals on the Board, giving an appropriate balance of knowledge, skills, experience and perspectives. Our aim of ensuring orderly succession for Board positions is supported by continuous and proactive processes. We take into account our strategic priorities and the main trends and factors affecting the sustainability and success of the business. We oversee and regularly review the development of a diverse pipeline for succession.

Changes to Board membership are set out in the Directors' report. During the year, Antonio Simoes Nicky Morgan and Pamela Walkden joined the Board as NEDs. In addition, we appointed Mike Regnier as CEO and Lisa Fretwell as an INED with these appointments taking effect in early 2022. All these appointees have valuable skills and experience of financial services, digital, strategy, development and execution and transformation. On behalf of the Board, I would like to thank Susan Allen, Garrett Curran, Genevieve Shore, Tony Prestedge, Ana Botin and Bruce Carnegie-Brown who stepped down during 2021 for their invaluable service to the Board and the Company.

All aspects of diversity form part of our Board succession planning process. In 2021 we set an aspirational target of having a minimum 33% and overall aim of 50% female representation on the Board by 2030 and at least one member from an ethnic minority by 2022. At 31 December 2021 we achieved 25% female representation and at least one member from an ethnic minority, with the level of female representation increasing to 33% on 1 January 2022 with the appointment of Lisa Fretwell.

Director inductions and training

The Company Secretary supports the Chair in designing individual inductions for NEDs, which include site visits and cover topics like strategy, balance sheet and capital, key risks and current issues including the legal and regulatory landscape. The delivery of our tailored NED induction programme for our new appointments continued through 2021, appropriately adapted in light of the pandemic to include a number of virtual site visits and interactions.

Lisa Fretwell, Antonio Simoes and Pamela Walkden and Nicky Morgan are benefiting from tailored induction programmes phased over a period of 12 months, which includes meeting with senior management, mentoring and site visits to branches, where appropriate and in a Covid-19 safe way.

Throughout 2021, we continued to deliver workshops for the Board to further develop their knowledge and understanding of key business issues including financial crime (including back book remediation), strategy, recovery and resolution, climate change, operational resilience, culture, responsible banking and mortgages.

Views of the workforce at the Board

Annemarie Durbin is the designated NED responsible for ensuring that the views of the workforce are made known to the Board.

During 2021, as well as extensive reporting on people issues to the Board (including the impacts of the pandemic on colleagues), Annemarie participated in focus groups, management forums and development workshops. She also had regular meetings with the Head of Culture, Inclusion and Experience to discuss matters like the employee voice and engagement survey results.

Board Committees

The Board delegates certain responsibilities to Board Committees to help discharge its duties. The Committees play an essential role in supporting the Board, giving focused oversight of key areas and aspects of the business. The role and responsibilities of the Board and Board Committees are set out in formal Terms of Reference. These are reviewed at least annually as part of the Corporate Governance Framework review.

Except for the Board Nomination and Board Risk Committees which have one GNED, all Committees are composed of INEDs only.

Additionally, the Board Committees of Santander UK plc met twice during the year, independently from the Board Committees of Santander UK Group Holdings plc.

Further details of the roles and responsibilities of the Board Committees are found below and should be read in conjunction with the Chair's reports of each of the Board Committees as set out in the Santander UK Group Holdings plc Annual Report.

Board Nomination Committee

Succession planning

The Committee leads a formal, rigorous and transparent process for the identification, nomination and recommendation of candidates for appointments to the Board and senior management. Part of the process is ensuring that there are succession plans in place for both Board and key management positions encompassing internal and external candidates and that there is a skills and diversity matrix which takes account of the future strategic direction of the Company and its needs. This matrix is also used to track the Board's strengths and identify any gaps in its desired collective skills profile.

While appointments are based on the merit of the individual candidates and objective criteria they also aim to promote diversity, in its broadest sense, to complement and strengthen the overall Board and its Committees' skills, knowledge and experience. Any appointment also takes account of all legal and regulatory requirements.

Chair's report on corporate governance continued

Board effectiveness

As explained in last year's report, the external evaluation of the Board was delayed by a year to 2021. This was to allow new Board members such as myself to transition and for new Board processes to be established and tested, giving more meaningful observations for the ongoing operational effectiveness of the Board and its Committees. The evaluation was facilitated by Boardroom Review Limited (BRL) who have no other connection to Santander or any individual Directors, and commenced in October 2021.

Dr Tracy Long of BRL both interviewed and attended each of the Board and Board Committee meetings to inform her report. The results were shared with me and each Committee Chair and then considered by the Board as a whole at its meeting in January 2022. The review concluded that while the Board and its Committees were operating effectively, there were a number of areas in which performance could be improved. The report categorised these areas as (i) Board Leadership and Governance; (ii) the work of the Board: Strategy; and (iii) the work of the Board: Risk, Control and People.

In each of these areas, there were several challenges for the Board and recommendations as to the factors to consider. A number of the challenges and recommendations applied to one or more of the Board's Committees as well as the Board itself and it was therefore felt appropriate to agree the challenges and actions to address them at the Board.

Diversity, inclusion and engagement with stakeholders

In 2021 we set an aspirational target of having a minimum of 33% and overall aim of 50% female representation on the Board by 2030 and at least one member from an ethnic minority by 2022.At 31 December 2021, 27% of Executive Committee members were female and 26% of Executive Committee members' direct reports were female. In February 2019, the Board confirmed our ambition to increase representation of Asian, Black and other Minority Ethnic colleagues in senior roles (excluding Board members) to 14% (+/-2%) by 2025.

Board appointments are made on merit by assessing candidates against measurable objective criteria. We recognise that a diverse and inclusive Board should result in a broad strategic perspective. Therefore, we strive to maintain a Board in which a diverse range of skills, knowledge and experiences are combined in an environment which values the input of every director and due regard will be given to this when identifying and selecting candidates for Board appointments. The Board Diversity and Inclusion Policy is available at www.aboutsantander.co.uk.

Annual review of Director interests, fees and conflicts of interest

In 2021, the Committee continued to review the time commitment and Directors' potential conflicts of interest to ensure that any such conflicts are managed appropriately and in compliance with CRD IV and ring-fencing requirements. External appointments must be agreed with the Chairman and disclosed to the Board, before appointment, with an indication of time involved. No significant external appointments were undertaken by any Directors. The Company's Articles of Association contain provisions that allow the Board to consider and, if it sees fit, to authorise situational conflicts.

Board Remuneration Committee

Details of the structure of our remuneration arrangements and the activities of the Remuneration Committee in the year are provided in the Remuneration Committee Chair's Report, Remuneration Policy and Implementation Reports.

Board Audit Committee

All Committee members, including the Chair, are INEDs. The members of the RFB Committee in 2021 were Chris Jones, Ed Giera, Annemarie Durbin, Genevieve Shore (until 31 June 2021), Garrett Curran (until 31 December 2021) and Nicky Morgan (from 10 August 2021). Lisa Fretwell joined the Committee with effect from January 2022.

The use of assumptions or estimates and the application of management judgement are an essential part of financial reporting. During the year, credit provisioning was the main consideration for financial issues/ judgements. We considered the appropriateness of assumptions (particularly considering Covid-19), customer remediation, litigation and regulatory provisions and pension related obligations.

The overall approach to address these issues was to:

- Note that applying management judgements on IFRS 9 ECL provisioning was highly challenging given the unusual and unique circumstances because of Covid-19.
- Scrutinise the level and adequacy of customer remediation, litigation and other regulatory provisions and challenge the reasonableness of management's assumptions throughout the year.
- In relation to pensions, review the approach to and outcome of principal assumptions, including illiquid assets valuation.
- Review the outcome of management's assessment of any potential impairment of goodwill and noted the decrease in 'headroom' arising from a higher capital allocation to our Retail Banking business which was partially offset by higher profitability.

To ensure the activities, quality and experience of the Internal Audit Function is appropriate for the business, the Committee:

- Approves the annual plan and receives regular updates against that plan.
- Receives regular updates on operational effectiveness, appropriateness of skills, experience and resources.
- Feedback on interactions with management and our external auditors.
- Conducts a review (every five years), evaluating conformance with the standards of the Chartered Institute of Internal Auditors, along with performance and effectiveness relative to industry peers. The next review is due by 2023.

The Committee continued to develop and oversee the interaction with PwC who were appointed as auditors in 2016. Laura Needham was lead audit engagement partner from March 2021. The independence of PwC was considered and monitored throughout the year and the Committee satisfied itself that PwC had met the independence requirements. The effectiveness of the auditors is evaluated once the year end process is completed by means of a questionnaire and review by the Committee.

Chair's report on corporate governance continued

We have a robust policy on non-audit services provided by our External Auditors. Non-audit services were under continuous review throughout 2021 to determine that they were permitted by reference to their nature, assessing potential threats and safeguards to auditor independence as well as the overall ratio of audit to non-audit fees. All assignments require advance approval, either by the Chair (or in his absence his alternate), under delegated authority for amounts under £250,000 plus VAT or, if larger, by the Committee. This process is in addition to the requirement for all non-audit fees to be approved by the Banco Santander Audit Committee.

Following a formalised assessment, the Committee satisfied itself as to the rigour and quality of PwC's audit process.

The Committee continues to oversee whistleblowing arrangements, effectiveness of underlying procedures and review the Santander UK's annual whistleblowing report prior to submission to the Board. It also receives a report from the Disclosure Committee on whether the Annual Report is fair, balanced, and understandable and whether it provides the information necessary for readers to assess Santander UK's financial position and performance, business model and strategy.

Board Risk Committee

The Committee undertook a thorough assessment of the Company's emerging and top risks, including financial, operational, and compliance controls. Our top risks and emerging risks are discussed in the Risk Review section of this report. The process for identifying, evaluating, and managing the Company's emerging and top risks is integrated into the overall risk governance framework. Regularly, the Committee reviews and discusses a consolidated enterprise-wide risk report to ensure that they are satisfied with the overall risk profile, risk accountabilities, and mitigating measures.

Board activities

The Chair, with the CEO and Company Secretary, supported by the Directors and senior management, make sure that the Board has an appropriate schedule. This is focused on the opportunities to drive growth and profitability of the business, transformation to support the future success of the business, business performance and risk management, customer experience and outcomes. It includes the Company's digital strategy, ensuring the Company is run in a responsible and sustainable way in the interests of its stakeholders, and ensuring that the Company's culture is aligned with its purpose, values and strategy.

The Board ensures regular contact with management and colleagues through a number of means. These include inviting relevant business and function heads to present to the Board or its Committees on latest developments; permitting observers as part of individual senior managers' development plans; scheduling regular meetings for Committee Chairs to meet with relevant senior managers; site visits by one or more NEDs, and topical or technical workshops. Senior leaders are also available to the NEDs for advice and support throughout the year.

The Board regularly monitors progress against the strategic priorities and performance targets of the business, and during 2021, once again held a separate Board Strategy day as its processes returned to more normal ways of working. Presentations at this meeting included a review of the overall strategy, progress against the 3-year business plan set in 2019 (covering 2020 – 2023), economic outlook, scenario analysis and potential financial impact. Having reviewed the strategic context, the Board discussed opportunities for growth (organic and inorganic) across each business division with a focus on initiatives to enhance customer experience and outcomes. Each opportunity was assessed having regard to its incremental contribution to profit relative to capital and resource needs and inherent risks. The Board remained focused on the execution of strategy and responding to the challenges the business faced due to Covid-19, working closely with the government on the implementation of their support programmes.

From June 2021, Board meetings were held as hybrid meetings with an increasing number of directors physically present. The Board received deep dives on a number of areas complemented with external speaker workshops to consider important topics in depth and engage with key stakeholders.

To ensure the most effective use of the time at Board meetings, in addition to the delegation of certain responsibilities to the Board Committees, the Chair holds informal discussions with Board members. The INEDs also met on several occasions without management and once without the Chair to assess his performance.

Further details of the Board activities in 2021 are set out on the following page.

Chair's report on corporate governance continued

Summary of Board activities in 2021

The Board aims to consider the views of all impacted stakeholders, whilst acting in the best interests of the Company and its members as a whole, as set out in the Section 172 statement ('Stakeholder voice in the Boardroom') in the Strategic report. Activities in 2021 included:

Theme	Action taken by the Board and outcomes
Strategy including One Europe and Banco Santander	– Following on from the Board Strategy Day, considered and challenged management's proposals to drive growth in our Retail Banking business and progress our digital journey. – Reviewed our customer segment strategy, experience and sentiment, including a deep dive on our Net Promoter Score (NPS) including key driver analysis, interrelationship between variables and initiatives to improve the NPS trend. – Revalidated the Corporate & Commercial Banking Business Strategy and opportunities for growth following the transfer of the Corporate & Investment Banking business to the Banco Santander London Branch. – Reviewed and challenged our marketing and brand strategy with a view to developing a coherent brand narrative aligned with our ambition to be a 'digital bank with a human touch'. – Considered specific M&A market opportunities to accelerate growth. – Progressed implementation of the One Europe operating model to drive synergies and collaboration across Europe including establishing centres of excellence for Financial Crime and Payments. – Reviewed initiatives to leverage resources and capability across the Europe region and the Banco Santander group, including a common payments platform, banking application (OneApp) and global cards business.
Business, Customer and Transformation	– Reviewed, challenged and approved the 3-year business plan (2022-2024) and the annual Budget, including cost efficiencies and associated risk assessments. – Reviewed, challenged and remained apprised of the performance of the business divisions and functions, strategic business opportunities, developments with customer experience and the Company's transformation programme. – Received regular updates on progress to reduce operating expenses in line with the One Europe cost reduction ambition – Received regular updates on the competitive landscape, the UK economy and banking sector including changes resulting from Government initiatives, regulatory change requirements or in response to Covid-19. – Considered Financial Crime, including approval of risk appetite and oversight of programmes to accelerate controls enhancement and regulatory engagement, as well as back book remediation. – Received regular updates on IT infrastructure and systems including remediation activity to mitigate the risk of IT network outages following the May 2021 outage incident, as well as the duplicate payments issue in December 2021. – Reviewed and approved the response to implementing the High Cost of Credit Review and changes to current accounts.
Regulation, Balance Sheet and Capital	– Reviewed, challenged and approved the ICAAP, ILAAP, adequacy and effectiveness of stress-testing and capital management, AT1 Payments and ordinary and preference share dividend payments in line with PRA guidance. – Considered and approved a mortgage RWA optimisation transaction. – Submitted to the Bank of England results to the annual cyclical and solvency stress test submissions. – Submitted a self-assessment of resolvability to the PRA in line with the BoE Resolvability Assessment Framework. – Received regular updates on capital planning. – Considered asset and liability management activities and was apprised of regulatory developments.
Risk and control	– Received regular enterprise-wide risk updates from the CRO, together with updates on specific risks, such as third-party outsourcing, IT, data management, financial crime, fraud, climate change and inflation. The Board closely monitored overall operational risk given the ongoing execution of the extensive transformation agenda. – Approved/adopted changes to the Risk Framework as part of the annual review, including the introduction of a new minimum standard to ensure each business area and risk type considers risks posed by climate change. – Received annual reports on whistleblowing and cyber security, considering the effectiveness of such arrangements. – Reviewed and began refining of the Operational Resilience programme to comply with PRA and FCA final rules. – Approved the submission to the BoE results from the Biennial Exploratory Scenario Stress Test for Climate Change.
People and Culture	– Received updates on issues including talent management & succession planning, gender pay, and diversity & inclusion. – Received updates on culture, considering our long-term strategic direction and cultural priorities following employee feedback and assessment findings from the Banking Standards Board. – Considered succession planning across all key control and support functions. – Reviewed the model for our future ways of working. – A number of Board members also participated in a workshop delivered to the Board Responsible Banking Committee to define our culture ambition and strategy with a view to simplify and streamline culture priorities, our values and behaviours and enhance its relevance for our people.
Governance and Responsible Banking	– Approved the appointment of new NEDs and the Company Secretary. – Reviewed, challenged and approved the Annual Report. – Received regular verbal updates of Board Committee activity from their respective Committee Chairs. – Approved a revised Banco Santander Subsidiary Governance Model for subsidiaries, and certain Corporate Frameworks. – Approved policies including a new Board level Conflicts of Interest Policy, Board Diversity & Inclusion Policy, Policy for the Suitability, Selection and Succession of Board members and Policy on Regulatory Documents on the recommendation of the Board Nomination Committee. – A number of Board members also participated in a workshop delivered to the Board Responsible Banking Committee to define what responsible banking means to the Company; our areas of focus; and set targets to measure our progress.

Remuneration policy report

Basis of preparation

This report has been prepared on behalf of the Board by the Board Remuneration Committee. We comply with the statutory reporting obligations for large private companies. Furthermore, we follow the UK Corporate Governance Code 2018 (the Code) where appropriate in order to practice best standards of corporate governance, and other listed disclosure requirements to the extent considered appropriate.

Accordingly, several voluntary disclosures relating to remuneration are presented in this report.

Remuneration policy for Executive Directors (EDs)

Our remuneration policy, which applies to EDs, is outlined below. Remuneration is structured in two elements: fixed and variable pay. Fixed pay is set at market competitive levels appropriate for the role. Variable pay rewards the delivery of internal financial targets, key strategic priorities and individual performance, subject to risk adjustment.

Remuneration policy applicable to Executive Directors in the year

Fixed pay	Principle and description	Policy
Base salary	– To attract and retain EDs of sufficient calibre and with the skills to deliver our strategy, taking into account the demands and complexity of the role.	– Base salaries are normally reviewed annually. In reviewing base salaries the Committee considers a number of factors, including: – The skills required and responsibilities of the role alongside the market value of those attributes; – The requirement for base salaries to be set at a level to avoid inappropriate risk taking; – Base salary increases across the colleague population; and – Prevailing market and economic conditions.
Pension arrangements	– To provide a discrete element of the package to contribute towards retirement.	– All EDs receive a cash allowance in lieu of pension, in line with the average level of pension provision available to the broader workforce, currently 9% of salary.
Other benefits	– To offer a competitive package and to support employee wellbeing.	– Including but not limited to: private medical insurance for EDs and their dependants, life assurance, health screening, and relocation allowances where relevant. – Access to Santander UK's all-employee share schemes on the same terms as all UK employees.

Variable pay	Principle and description	Policy
Variable pay plans	– The Variable Pay Plan aims to motivate EDs to achieve and exceed annual internal targets within Santander UK's Risk Appetite and in alignment with our business strategy and values. – Multi-year deferral, further performance testing and delivery in Banco Santander SA shares aligns EDs' interests to the long-term interests of Santander UK. – Part of the award is deferred according to the requirements of the PRA Rulebook (Remuneration Part). – The long-term Transformation Incentive Plan recognises the collective achievement of key financial and non-financial internal targets associated with the bank's ongoing transformation.	– Bonus awards under the Variable Pay Plan are discretionary and determined by reference to performance against a scorecard of financial and non-financial goals, as well as individual performance. – 40% of any bonus awarded is paid upfront after the performance year ends, and delivered at least half in shares or share-linked instruments. – 60% of the bonus awarded is deferred and delivered in equal tranches over years three to seven, with each tranche delivered at least half in shares or share-linked instruments. – For EDs, the first three of five deferred award tranches are subject to further performance testing, which may reduce the level of payout, but not increase it. – The Transformation Incentive is based on performance assessed over a three year period with further deferral into cash and share based awards in line with regulatory requirements. – Share based awards are subject to a minimum twelve-month retention period following vesting. – Malus and clawback provisions apply to variable pay for up to ten years following the grant of an award. – The structure of variable pay awards means EDs acquire a meaningful shareholding in Banco Santander SA which may extend for a significant period post-employment. In addition, the CEO is subject to a Shareholding Policy, which ensures alignment with the long-term interests of Banco Santander shareholders. The requirement under the policy is set at two times the incumbent's net salary upon appointment. A formal post-employment shareholding requirement is not in place.

Remuneration policy report continued

Our remuneration policy continues to meet regulatory requirements. Santander UK applies a 2:1 variable to fixed pay cap in line with approvals granted to Banco Santander SA by its shareholders. For control function staff, a lower ratio of 1:1 is applied, apart from in exceptional circumstances.

Executive remuneration policies and principles

Our core values of Simple, Personal and Fair drive our remuneration policy. We focus on delivering a reward framework that is easily understood, tailored to individual roles, competitive and fair.

The key drivers of our Remuneration Policy

Alignment to culture

- To design policies aligned to the long-term success of the business which support the delivery of our strategy and reinforce our values.
- To base variable pay on a balanced scorecard of quantitative and qualitative metrics which reflect our strategic priorities across Customers, Shareholders, People and Sustainability. This ensures that our day-to-day activities align with Santander UK's over-arching strategy and our aim of being the best bank.

Simplicity

- To ensure our approach to remuneration is transparent and easily understood.
- To operate clear structures to support each colleague to link their contribution to the success of the organisation.

Risk

- To apply a consistent approach to reward for all our employees which upholds our prudent approach to Risk Appetite set as part of a Santander UK-wide framework. Risk adjustment occurs at individual and bonus pool level.
- To provide a package that is balanced between fixed and variable pay, and short-term and long-term horizons, which aligns to our strategy whilst promoting prudent risk management.
- To ensure remuneration is compliant with applicable regulations and legislation.

Fairness

- To take into account an assessment of the EDs' performance against objectives set at the start of the year covering a range of financial, non-financial, quantitative and qualitative criteria.
- To set robust and stretching internal targets and reward exceptional performance.
- To attract, retain and motivate employees of the highest calibre by providing total remuneration which reflects individual and Company performance, is competitive, reflects the responsibilities of the role and drives the organisation's growth and transformation.
- To consider wider employee pay when determining pay of our Executives.

Clarity

- The Committee reviews remuneration reporting on an annual basis against principles of best practice and developments in corporate governance, including the Code. Our reporting is designed to be transparent to promote effective stakeholder engagement, whilst reflective of our structure.

Predictability

- The Committee annually reviews the variable pay opportunity for individuals and the basis of the pool calculation. Due to commercial sensitivity, these are not disclosed as per the provisions of the Code. Directors' remuneration is within the variable pay cap as approved by Banco Santander SA shareholders and set out above.

Executive Director pension alignment

In 2018, following developments in corporate governance and best practice, the Committee took the decision to reduce pension allowances for new EDs to 9% of salary, in line with the wider workforce average.

In 2019, the Committee decided to extend this approach to existing EDs, namely the CEO, on a phased basis and from 1 January 2021 this is aligned with the current workforce average.

On recruitment

When appointing a new ED, base salary is set at a market competitive level appropriate for the role, taking into consideration a range of factors including role scope and responsibilities, internal and external peer groups, relevant experience, and affordability.

Unless determined otherwise, any new ED will receive a pension allowance in line with the wider workforce average, currently 9% of salary. Benefits available will typically be aligned to the wider employee population.

Other elements of remuneration will be established in line with the Remuneration Policy, as set out in the EDs' remuneration structure table in this report.

Relocation support and international mobility benefits may also be given. Where provided, relocation assistance will normally be a capped amount for a limited time. For an overseas appointment, the Committee will have discretion to offer benefits and pension provisions which reflect their home country market practice and align to relevant legislation.

Buy-out awards

Compensation may be provided to EDs recruited externally for the forfeiture of any award on leaving their previous employer. The Committee retains discretion to make such compensation as deemed appropriate to secure the relevant ED's employment and will ensure any such payments align with both the long-term interests of Santander UK and the prevailing regulatory framework.

Such payments will be in line with the awards foregone as a result of leaving the previous employer taking into account value, form of awards, vesting dates and the extent to which performance conditions applied to the original awards.

Service agreements

The key terms and conditions of employment are set out in individual service agreements. These agreements include a notice period of six months from both the ED and the Company.

The agreement reserves a right for the Company to terminate employment immediately with a payment in lieu equal to the ED's fixed pay for the notice period. In the event of termination for gross misconduct, neither notice nor payment in lieu of notice is required.

Remuneration policy report continued

Termination payments
The impact on remuneration of variable pay and/or any termination payment for an ED leaving the Company reflects the terms of the service agreements, relevant scheme rules, regulatory requirements and the Committee's policy relevant to the reason for leaving.

Outstanding variable pay awards will generally lapse on termination, other than where an individual is considered a 'good leaver'. Where an ED is a good leaver, eligibility to variable pay awards will normally subsist until the relevant scheduled payment dates.

The Committee determines whether an ED is a good leaver. Usual good leaver circumstances include but are not limited to: injury, ill-health, disability, redundancy, retirement and death. The Committee may, at its discretion, determine an ED a good leaver in any other circumstances.

A framework is in place to guide the Committee to determine the discretionary circumstances when good leaver status is appropriate. Other than a payment in the event of redundancy, there are generally no other payments upon termination of employment for EDs.

In the event of a change in control, any outstanding variable pay awards will be treated in line with the relevant scheme rules, taking into account the applicable regulatory requirements.

Risk and Performance adjustment
We continue to ensure that the regulatory requirements in respect of risk and performance adjustment are met for our colleagues. All variable remuneration is subject to adjustment for current and future risks through our Additional Risk Adjustment Standard which is linked to our Board approved Risk Appetite.

The Standard provides both a formula-based assessment against Santander UK's Risk Appetite and an additional qualitative risk event assessment that can reduce the bonus pool or individual awards to nil at the Committee's discretion. Given commercial sensitivity, the Committee does not provide annual detail on the application of discretion as required by the Code.

Our Individual Remuneration Adjustment Standard provides a framework for the process, governance and standards relevant for decisions in relation to individual performance adjustments following an incident, including the application of malus and clawback.

Performance adjustments may include, but are not limited to:

- Reducing an award for the current year;
- Reducing the amount of any unvested deferred variable remuneration;
- Requiring an award which has not yet been paid to be forfeited; and
- Requiring repayment on demand (on a net basis) of any cash and share awards received at any time for a period of up to ten years following the date of award.

The Committee has full discretion to prevent vesting of all or part of an amount of deferred remuneration and/or to freeze an award during an ongoing investigation in a number of circumstances, including:

- Colleague misbehaviour, misconduct or material error;
- Material downturn in the performance of Santander UK or a relevant business unit; and
- Santander UK or a relevant business unit suffering a material failure of risk management.

When determining variable pay awards for individuals performing roles across Santander UK plc and Santander UK Group Holdings plc, the Santander UK Group Holdings plc Board Remuneration Committee will apply any necessary discretion based on factors related to UK group entities outside of Santander UK plc. This discretion is subject to validation by the Santander UK plc Board Remuneration Committee.

The Committee seeks input from the Chair of the Board, Chair of the Board Risk Committee, Chair of the Board Audit Committee, Chief Risk Officer, Chief Legal and Regulatory Officer, Chief HR Officer and Chief Internal Auditor when determining whether any performance or risk adjustments are required.

Policy for all employees
Our performance, reward and benefits approach across the Company supports and drives our business strategy, rewards strong performance and reinforces our values within the approved risk management framework. The general principles of the Remuneration Policy broadly apply across all colleagues where appropriate, and are designed to facilitate recruitment, motivation and retention whilst driving performance.

The composition of remuneration packages for EDs is aligned with the broader colleague population, comprising salary, pensions and benefits and eligibility for discretionary variable pay dependent on role and responsibility. The level of pension allowance for all current EDs is aligned with the current average employer contribution for the wider workforce.

The Committee annually approves the operation of variable reward schemes for all our colleagues to ensure they reward appropriate behaviour and do not incentivise activities which are outside risk appetite.

Remuneration implementation report

Introduction

This section of the report outlines how our Remuneration Policy was implemented for 2021.

Variable Pay Plan

To incentivise and reward EDs for achieving superior and sustained performance, our Directors participate in an annual variable incentive plan. A balance of financial and non-financial performance metrics are selected annually by the Committee and are aligned with our strategy as measured over the financial year. Multi-year deferral, further performance testing and delivery in Banco Santander SA shares ensure that EDs' interests are aligned to the long-term interests of the business.

Both upfront and deferred awards are made at least half in shares or share-linked instruments. The deferred element is delivered over seven years, with the first three deferred tranches of awards subject to further performance testing against long-term metrics which can reduce but not increase the overall level of awards. Awards delivered in shares or share-linked instruments are subject to an additional one-year retention period from the point of delivery.

The 2021 Variable Pay Plan pool was determined based on a range of metrics using a balanced scorecard approach as follows:

Quantitative assessment

A quantitative assessment is undertaken against a balanced scorecard of financial and non-financial metrics that are key to Santander UK's 2021 strategy. Performance metrics are reviewed annually to ensure continued alignment with strategy and, for 2021 a simplified scorecard comprised:

- Customers (Net Promoter Score)
- Shareholders
  - Risk (Cost of credit)
  - Capital (Contribution to Banco Santander group capital)
  - Profitability (RoTE)
- Sustainability (Financial empowerment)
- People (Employee Engagement).

A profit underpin applies which requires Profit after Tax to remain positive in order to pay any award, with a reduced pool should profit reduce substantially from the prior year.

Qualitative assessment

A qualitative assessment adds context to the quantitative assessment and ensures a balanced view of performance is taken. Performance is assessed across metrics including sustainability of capital, conduct risk and contribution to Banco Santander group's Responsible Banking commitments.

Banco Santander Group Multiplier

The Committee has the discretion to adjust the pool upwards or downwards to reflect overall Banco Santander performance if appropriate.

Regional Adjustment

A Regional Adjustment was introduced in 2021. The Committee has the discretion to adjust the pool upwards or downwards to reflect the UK's contribution to performance of the Banco Santander group's European Region (comprising Spain, Portugal, Poland and the UK).

Exceptional Adjustment

Intended to cover unexpected factors or additional internal targets not covered by the quantitative or qualitative assessments. This may also include adjustments not covered in the qualitative assessments, including major risk events. No exceptional adjustments were applied to the 2021 variable awards for EDs.

UK-focused risk adjustment

Linked to Santander UK's Risk Appetite, this provides both a formula-based assessment against Risk Appetite and an additional qualitative risk event assessment overlay, including consideration of other risk appetite limit breaches such as reputational risk and financial crime risk. This can result in a downward risk adjustment of up to 100% of the bonus pool or individual awards at the discretion of the Committee.

The Committee reviews and approves remuneration governance and frameworks on an annual basis to ensure continued compliance with the relevant regulatory rules, including for ring-fencing.

Individual assessment

The allocation of the pool is based on an individual's performance, taking into account a range of factors including behaviours, conduct and risk.

Deferred long-term awards

The payment of the first three deferred tranches of the 2021 awards (36% of the total award), payable in 2025, 2026 and 2027, is conditional on the achievement of long-term objectives measured over the three-year period 2022 to 2024.

The performance measures for 2021 awards are EPS, relative TSR and compliance with the fully-loaded CET1 capital ratio. Following performance assessment, the level of awards will be adjusted accordingly.

The measures can reduce but not increase the overall value of the deferred awards. The payment of the final two deferred tranches (24% of the total award), payable in 2028 and 2029 is subject only to continued employment and ex-post risk adjustment.

Transformation Incentive Plan

This is a one-off long-term incentive plan which is designed to recognise the achievement of financial targets and an enhanced customer experience, whilst maintaining appropriate conduct controls and risk management, over the course of our transformation period.

Awards under the plan were based on performance in 2020 and granted in 2021 and performance will be assessed over the period 1 January 2021 to 31 December 2023. Awards were granted half in cash and half in share based awards (linked to the Banco Santander SA share price) and will vest in accordance with regulatory requirements.

Remuneration implementation report continued

2021 Business Performance and Impact on Remuneration

In the context of financial recovery following the impact of the pandemic, we have delivered a strong financial performance in a competitive environment. Our balance sheet remains strong and resilient, and progress has been made to reduce expenses through the transformation programme. Our people have responded rapidly and positively to the challenges posed by the pandemic, to support our customers and meet their changing needs. In addition, we continue to deliver on our strategy to become a more sustainable and responsible bank.

It is in this context that the Committee made remuneration decisions in respect of the 2021 performance period. Bonus awards were enhanced in comparison to preceding years, reflecting improved financial performance. The Committee confirms that the remuneration policy operated as intended, demonstrating pay for performance alignment.

Context for decision making

The Committee ensures that broader remuneration policies and practices for employees across the Santander UK group are taken into account when setting policy for executive remuneration. The Committee reviews remuneration trends across the Santander UK group including the outcome of any pay negotiations with our recognised trade unions and considers the relationship between executive remuneration and that of other Santander UK group employees, as well as remuneration in the wider UK market when making decisions on executive pay.

The Committee oversees broader workforce remuneration policies and practices, the implementation of remuneration and related employment policies across Santander UK and the salary and variable pay awards for all Material Risk Takers. It also approves the design of any material performance-related pay plans.

As part of the monitoring of pay, the following is considered:

- Santander UK's engagement with its recognised trade unions on pay and benefits matters for all colleagues;
- Annual pay reviews for the general employee population;
- Santander UK group-wide pension and other benefit provisions;
- The design of and overall spend on variable incentive arrangements; and
- An assessment of conduct across the business.

The Committee is focused on ensuring that colleagues are not subject to undue pressures or inappropriately incentivised. This is monitored using existing employee engagement indicators including engagement surveys.

The Committee always considers the broader stakeholder environment when setting policy or reaching decisions on executive pay.

Executive Directors' remuneration (audited)

Total remuneration of each ED for the years ended 31 December 2021 and 2020.

	Nathan Bostock [3]		Susan Allen [6]		Duke Dayal [4,5]		Tony Prestedge [7]	
	2021	2020	**2021**	2020	**2021**	2020	**2021**	2020
	£000	£000	**£000**	£000	**£000**	£000	**£000**	£000
Salary and fees	**1,680**	1,680	**289**	800	**958**	922	**544**	36
Taxable benefits [1]	**45**	44	**48**	2	**523**	487	**1**	—
Pension	**151**	370	**26**	72	**86**	83	**49**	3
Total fixed pay	**1,876**	2,094	**363**	874	**1,567**	1,492	**594**	39
Bonus (paid and deferred) [2]	**2,913**	—	**—**	668	**2,283**	726	**—**	64
Total variable pay	**2,913**	—	**—**	668	**2,283**	726	**—**	64
Total remuneration	**4,789**	2,094	**363**	1,542	**3,850**	2,218	**594**	103

(1) Taxable benefits for the EDs comprise a range of benefits including private health care, life and critical illness cover and health insurance . Included in the 2020 and 2021 benefits figure for Duke Dayal is a relocation allowance of £500,000.

(2) The bonus values shown represent the total annual variable pay award made in respect of the relevant year. As set out in this report, awards are deferred in line with regulatory requirement. The Variable Pay Plan awards made in respect of 2020 were delivered wholly in shares.

(3) The pension contribution received by Nathan Bostock was reduced from 35% to 22% of salary from 1 January 2020, and to 9% of salary from 1 January 2021.

(4) An additional one-off award was delivered to Duke Dayal in recognition of his contribution to regulatory projects during his service with Santander Holdings USA prior to joining the Company, and subject to Santander UK plc corporate and individual performance conditions during 2021. The value of the award is £294,532, and is included in the bonus value for 2021.

(5) The 2020 values shown for Duke Dayal represent an allocation of 97% of his remuneration for his time spent as a Director of the Company in that year. The remaining 3% was allocated to Santander Financial Services plc.

(6) Susan Allen stepped down from the Board of Santander UK plc on 28 April 2021, prior to leaving the Company on 31 October 2021. The remuneration figures above reflect remuneration received while a Board Director. In the period to 31 October 2021, she received £838,141 in respect of salary, pension and benefits. In relation to her departure, she received a redundancy payment of £346,154 and a contribution of £3,900 towards legal costs. No further payments are due.

(7) Tony Prestedge was appointed as an ED on 16 December 2020. He stepped down on 28 July 2021 from the Board of Santander UK plc. The remuneration figures above reflect the remuneration received while a Board Director. They do not include a buy-out of deferred performance related payments in respect of his previous employment, of which £242,605 was delivered in 2020 and £67,899 in 2021, net of any adjustments. No further payments are due. In relation to his departure, he received a contribution of £6,000 towards legal costs.

Relative importance of spend on pay

	2021	2020	Change
	£m	£m	%
Profit from continuing operations before tax	**1,845**	560	229
Total employee costs	**1,183**	1,123	5

Remuneration implementation report continued

Stakeholder views

During 2021, Santander UK continued to engage with key stakeholders on remuneration related matters including its main regulators the PRA and FCA.

Regular engagement takes place with our shareholder to ensure there is alignment with remuneration constructs across the wider Banco Santander group while meeting all regulatory requirements and expectations. The outcome of these discussions drives our bonus pool construct.

In addition to her role as RFB Committee Chair, Annemarie Durbin performs the designated NED role, with responsibility to further enhance the employee voice in the boardroom on matters associated with organisational culture. This is set out in further detail in the Chair's report on Corporate Governance.

Employee opinion surveys are undertaken annually on employee engagement, and discussion takes place with union representatives during the annual pay review cycle and on relevant employee reward matters on a more frequent basis. The Committee receives updates on these discussions during the year.

More frequent colleague pulse surveys were conducted throughout 2021, with the launch of Your Say enabling colleagues to share thoughts and ideas more frequently and anonymously all year round. Alongside other virtual listening forums, this gives a more frequent gauge of employee sentiment.

CEO pay ratio

Santander UK is committed to delivering fair pay which attracts, retains and motivates colleagues of the highest calibre across all grades. In line with this commitment, the Committee has oversight of compensation across the organisation, including pay ratios, and considers this when determining reward outcomes. For the third year we are voluntarily disclosing the ratio of the CEO's total remuneration to that of UK colleagues.

The CEO's pay mix is weighted more heavily towards variable pay to incentivise the achievement of stretching internal targets and long-term value creation. This can lead to greater variability in total remuneration. In contrast, the typical pay mix of our less senior colleagues places more emphasis on fixed pay, to ensure earnings offer security and certainty, and to meet our commitment to colleague financial wellbeing.

Changes in the ratio are therefore influenced by the differences in remuneration structure, rather than an increase in pay disparity. Although the ratio in 2021 increased from 64:1 to 127:1, this reflects the fact that the 2020 ratio itself was significantly reduced because the CEO did not receive a bonus for 2020 and the available bonus pool was allocated towards less senior colleagues.

The 2021 ratio is aligned to the 2019 equivalent (129:1). In assessing the pay ratio, the Committee is confident that the Company's policy on remuneration is fair and consistent with our all-employee pay policies .

Advice and support provided to the Committee

As permitted by its Terms of Reference, the Committee has engaged the advice and support of Deloitte LLP (Deloitte) as independent remuneration consultants at the expense of the Company. Total fees (excluding VAT) for advice and support provided to the Committee in 2021 were £199,050 (2020: £143,600). Deloitte was first appointed as Adviser to the Committee following a formal tender process conducted in 2015, and the Committee reviews Deloitte's independence and effectiveness annually. Deloitte is a founding member of the Remuneration Consultants Group and voluntarily operates under the Code of Conduct in relation to executive remuneration consulting in the UK.

The Committee is satisfied that the Deloitte engagement partner and team that provides remuneration advice to the Committee do not have connections with Santander UK that may impair their independence, following review in 2021.

In 2021, Deloitte also provided unrelated tax, advisory, risk, assurance and consulting services to Santander UK.

By Committee invitation, the Chair, CEO and designated representatives from business functions attend meetings as appropriate to advise on HR, Risk, Legal and Regulatory matters in support of the Committee's work. Attendees included the Chief HR Officer, Performance & Reward Director, CLRO, CRO and Company Secretary.

CEO pay ratio

	Methodology [1]	25th percentile	Median	75th percentile
2021 CEO pay ratio	**Option A**	**183:1**	**127:1**	**71:1**
2020 CEO pay ratio [4]	Option A	88:1	64:1	37:1
2019 CEO pay ratio	Option A	178:1	129:1	76:1

2021 CEO pay ratio	CEO remuneration [3] £	25th percentile [2] £	Median [2] £	75th percentile [2] £
Total salary £	1,680,000	21,126	29,047	46,824
Total remuneration £	4,789,480	26,138	37,808	67,422

(1) Employee pay is calculated based on the 'Option A' methodology. We have chosen Option A as it gives the most reliable and accurate result by calculating a comparable single figure for each employee.

(2) Employee pay data is based on full time equivalent pay for Santander UK plc employees. This excludes a small number of employees in the rest of the Santander UK group. Including those employees results in a ratio consistent with the above. For each employee, total remuneration is calculated based on fixed pay accrued during the 2021 financial year, and variable pay is either based on actual bonuses in respect of the 2021 year (where these are available) or modelled target bonuses where actuals are not yet available.

(3) The CEO's total remuneration is aligned to that disclosed in the Executive Directors' remuneration table on the previous page.

(4) The 2020 ratios are re-stated above. These were originally calculated based on fixed pay accrued within the 2020 year, in addition to target bonuses for eligible colleagues. The 2020 ratios have now been recalculated using 2020 fixed pay and bonuses paid in 2021 in respect of 2020 for all employees. There was no change to the previously published ratios.

Remuneration implementation report continued

Chair and Non-Executive Director remuneration

The Chair's fee is reviewed and approved by the Committee. The fees paid to NEDs are reviewed and approved by the CEO and the Chair. Fees are reviewed annually taking into account the market rate and time commitment for the role. The Chair is paid an all-inclusive base fee. NEDs are paid a base fee, with a supplement for serving on or chairing a Board Committee.

All NEDs and the Chair serve under letters of appointment and either party can terminate on three months' written notice, except in the case of the Chair where twelve months' written notice is required.

Neither the Chair nor the NEDs have the right to compensation on the early termination of their appointment beyond payments in lieu of notice at the option of Santander UK. In addition, neither the Chair nor the NEDs are eligible for pension scheme membership or incentive arrangements

Chair and Board Committee member fees

	1 January 2021 £000	1 January 2020 £000
Chair (inclusive of membership fee)	**675**	675
Board member	**95**	95
Additional responsibilities		
Senior Independent Director	**45**	35
Chair of Board Risk Committee	**65**	65
Chair of Board Audit Committee	**60**	60
Chair of Board Responsible Banking Committee	**60**	60
Chair of Board Remuneration Committee	**60**	60
Membership of Board Risk Committee	**30**	30
Membership of Board Audit Committee	**25**	25
Membership of Board Responsible Banking Committee	**25**	25
Membership of Board Remuneration Committee	**25**	25
Senior Ringfencing Director	**8**	—
Designated NED to represent views of the workforce	**8**	—

1. Note a review of fees took place in late 2020, with changes being effective from 1 January 2021 .

Non-Executive Directors	2021 £000	2020 £000	2021 £000	2020 £000	2021 £000	2020 £000	2021 £000	2020 £000
Chair								
William Vereker [1]	**675**	120	**—**	—	**2**	1	**677**	121
Shriti Vadera	**—**	563	**—**	—	**—**	47	**—**	610
Independent Non-Executive Directors								
Garrett Curran [7]	**197**	203	**3**	1	**—**	—	**200**	204
Annemarie Durbin [8]	**265**	229	**—**	—	**—**	—	**265**	229
Ed Giera	**287**	214	**—**	—	**—**	—	**287**	214
Chris Jones	**235**	214	**4**	—	**—**	—	**239**	214
Genevieve Shore [9]	**100**	200	**2**	3		—	**102**	203
Scott Wheway	**—**	165	**—**	2	**—**	—	**—**	167
Mark Lewis [10]	**183**	8	**4**	—	**—**	—	**187**	8
Nicky Morgan [11]	**83**	—	**4**	—	**—**	—	**87**	—
Banco Santander nominated Non-Executive Directors [6]								
Ana Botin [2]	**—**	—	**—**	—	**—**	—	**—**	—
Bruce Carnegie-Brown [3]	**—**	—	**—**	—	**—**	—	**—**	—
Antonio Simoes [4]	**—**	—	**—**	—	**—**	—	**—**	—
Pamela Walkden [5]	**31**	—	**—**	—	**—**	—	**31**	—
Dirk Marzluf	**—**	—	**—**	—	**—**	—	**—**	—
Gerry Byrne	**—**	—	**—**	—	**—**	—	**—**	—

(1) William Vereker joined on 1 October 2020 and was appointed Board Chair on 1 November 2020. His taxable benefit relates to private health care.
(2) Ana Botin stepped down on 30 April 2021.
(3) Bruce Carnegie-Brown stepped down on 30 September 2021.
(4) Antonio Simoes was appointed on 30 April 2021.
(5) Pamela Walkden was appointed on 1 October 2021. Fees received are in respect of services from that date.
(6) With exception of Pamela Walkden, none of the Banco Santander nominated Non-Executive Directors received any fees or expenses.
(7) Garrett Curran stepped down on 31 December 2021.
(8) Annemarie Durbin's fees include £15,000 in relation to her services as Chair of Cater Allen Ltd.
(9) Genevieve Shore stepped down on 30 June 2021. Fees received are in respect of services to that date.
(10) Mark Lewis was appointed on 16 December 2020. Fees received are in respect of services from that date.
(11) Nicky Morgan was appointed on 10 August 2021. Fees received are in respect of services from that date.

Board and Committee membership and attendance

The Directors' attendance for the Board and Board Committee meetings held in the year is set out below. Meetings for the Board and Board Committees are held concurrently with Santander UK Group Holdings plc, with items of business specific to each company identified and recorded as appropriate, reflecting the decisions taken by the Board of the relevant entity. Board Director attendance for Santander UK Group Holdings plc is set out in the 'Board and Committee membership and attendance' section of its Annual Report.

		Board		Audit Committee		Risk Committee		Remuneration Committee		Responsible Banking Committee		Nomination Committee	
		Scheduled meetings attended	Ad hoc meetings attended	Scheduled meetings attended	Ad hoc meetings attended	Scheduled meetings attended	Ad hoc meetings attended	Scheduled meetings attended	Ad hoc meetings attended	Scheduled meetings attended	Ad hoc meetings attended	Scheduled meetings attended	Ad hoc meetings attended
Chair	William Vereker	8/8	2/2	-	-	-	-	-	-	-	-	7/7	5/5
Independent Non-Executive Directors	Annemarie Durbin	8/8	2/2	9/9	-	9/9	1/1	6/6	4/4	5/5	-	7/7	5/5
	Chris Jones	8/8	2/2	9/9	-	9/9	1/1	6/6	4/4	5/5	-	-	-
	Ed Giera	8/8	2/2	9/9	-	9/9	1/1	6/6	4/4	5/5	-	7/7	5/5
	Garrett Curran	8/8	2/2	8/9	-	9/9	1/1	-	-	5/5	-	-	-
	Mark Lewis	8/8	2/2	-	-	9/9	1/1	6/6	4/4	5/5	-	-	-
	Nicky Morgan [1]	2/3	2/2	3/3	-	3/3	-	-	-	2/2	-	-	-
	Genevieve Shore [2]	*4/4*	-	*4/4*	-	*4/4*	*0/1*	*3/3*	-	*2/3*	-	-	-
Banco Santander nominated Non-Executive Directors	Dirk Marzluf	8/8	2/2	-	-	-	-	-	-	-	-	-	-
	Antonio Simoes [3]	5/5	2/2	-	-	-	-	-	-	-	-	-	-
	Pamela Walkden [4]	2/2	2/2	-	-	2/2	-	-	-	-	-	2/2	1/1
	Ana Botin [5]	*2/3*	-	-	-	-	-	-	-	-	-	-	-
	Bruce Carnegie-Brown [6]	*6/6*	-	-	-	-	-	-	-	-	-	*5/5*	*4/4*
Executive Directors	Nathan Bostock	8/8	2/2	-	-	-	-	-	-	-	-	-	-
	Duke Dayal	8/8	1/1	-	-	-	-	-	-	-	-	-	-
	Susan Allen [7]	*3/3*	-	-	-	-	-	-	-	-	-	-	-
	Tony Prestedge [8]	*4/5*	-	-	-	-	-	-	-	-	-	-	-

1 Nicky Morgan joined on 10 August 2021
2 Genevieve Shore resigned on 30 June 2021
3 Antonio Simoes joined on 30 April 2021
4 Pamela Walkden joined on 1 October 2021
5 Ana Botin resigned on 30 April 2021
6 Bruce Carnegie-Brown resigned on 30 September 2021
7 Susan Allen resigned on 28 April 2021
8 Tony Prestedge resigned on 28 July 2021

Directors' report

Introduction

The Directors submit their report together with the financial statements for the year ended 31 December 2021. The information in the Directors' Report is unaudited, except where marked.

Corporate structure, Subsidiaries and Branches

Santander UK plc is a subsidiary of Banco Santander SA, a Spanish retail and commercial bank with a market share in ten core countries in Europe and the Americas.

Santander UK was formed from two former building societies, Abbey National and Alliance & Leicester, together with the branch network and savings business of Bradford & Bingley, and has operated under a single brand since 2010.

The ordinary shares of the Company are unlisted and are all held

by Santander UK Group Holdings plc, which is a wholly owned subsidiary of Banco Santander SA.

The Company's preference shares are listed on the London Stock Exchange.

Both the Company and Santander UK Group Holdings plc have other equity instruments in the form of AT1 securities listed on various securities exchange markets, including the London Stock Exchange and Euronext Dublin.

In addition, the Company and Santander UK Group Holdings plc are subject to US Securities Exchange Act reporting requirements as they have debt securities registered in the United States.

The Santander UK group consists of a parent company, Santander UK plc, incorporated in England and Wales, and a number of directly and indirectly held subsidiaries and associates. The Company directly or indirectly holds 100% of the issued ordinary share capital of its principal subsidiaries. All companies operate principally in their country of incorporation or registration.

As a result of ring-fencing implementation in 2018, and requirements set out in the Financial Services (Banking Reform) Act 2013, Santander UK plc and its subsidiaries comprise of only entities whose business is permitted under the Act as a ring-fenced bank. For more information, see Note 19.

Result and dividends

For details of the results for the year, see the Income Statement in the Consolidated Financial Statements. For more on the dividends, see Note 10.

Details of Santander UK's activities and business performance in 2021, together with an indication of future outlook, are set out in the Strategic report and the Financial review.

Events after the balance sheet date

There have been no material post balance sheet events, except as set out in Note 45.

Directors

Further information including biographical details of the current Directors are outlined in the Board of Directors section. Details of their emoluments and interests in shares are set out in the Directors' Remuneration implementation report. Changes to the composition of the Board can be found in the Board of Directors section with more details in the Chair's report on Corporate Governance.

Appointment and retirement of Directors

All Directors are appointed and retired in accordance with the Company's Articles of Association, the UK Companies Act 2006 and the UK Group Framework.

The following appointments took place in 2021: Nicky Morgan, Antonio Simoes and Pamela Walkden. In 2021, the Board also resolved to appoint Mike Regnier and Lisa Fretwell as Directors, both of whom join the Company in 2022. The following resignations took place in 2021: Susan Allen, Ana Botin, Garrett Curran, Bruce Carnegie-Brown, Tony Prestedge and Genevieve Shore.

Further details are set out in the governance section.

The Articles of Association require each Director to retire every year at the Annual General Meeting and any Director may offer themselves for re-election by members.

Directors' indemnities

Directors' and Officers' liability insurance cover was in place throughout 2021, in addition to a deed of indemnity to provide cover to the Directors for liabilities to the maximum extent permitted by law. These remain in force for the duration of the Directors' period of office from the date of appointment until such time as any limitation periods for bringing claims against the Directors have expired. The Directors of the Company, including former Directors who resigned in the year, benefit from these deeds of indemnity.

They constitute qualifying third party indemnity provisions for the purposes of the Companies Act 2006. Deeds for existing Directors are available for inspection at the Company's registered office.

The Company has also granted an indemnity which constitutes 'qualifying third party indemnity provisions' to the Directors of its subsidiary and affiliated companies, including former Directors who resigned in the year and since the year-end. Qualifying pension scheme indemnities were also granted to the Trustees of the Santander UK group's pension schemes.

Employees

We continue to ensure that Santander UK's remuneration policies are consistent with its strategic objectives and are designed with its long-term success in mind. In doing so, we aim to attract and retain the most talented and committed people.

Communication

Santander UK aims to involve and inform employees on matters that affect them. The intranet is a focal point for communications and the 'AskHR' website connects employees to all the information they need about working for Santander UK. We also use face-to-face communication, such as team meetings and roadshows for updates.

Santander UK regularly considers employees' opinions and asks for their views on a range of issues through regular engagement and surveys.

Employee Designated Non-Executive Director

Annemarie Durbin is the Santander UK Employee Designated NED representing the views of employees in the Boardroom. Further details are set out in the 'Stakeholder voice in the boardroom (Section 172)' section of the Strategic report.

Director's report continued

Consultation
Santander UK has a successful history of working in partnership with its recognised trade unions, Advance and the Communication Workers Union (CWU), who collectively negotiate on behalf of approximately 99.5% of our UK workforce. Both trade unions are affiliated to the Trades Union Congress. We consult Advance and the CWU on significant proposals including those relating to change across the business at both national and local levels.

Employee share ownership
Santander UK continues to operate two all-employee, HMRC-approved share schemes: a Save-As-You-Earn (Sharesave) Scheme and a Share Incentive Plan (SIP). Those employees who are designated as Material Risk Takers receive part of their annual bonus awards in Banco Santander SA shares. Details of the plans and the related costs and obligations can be found in the Notes.

Disability
Santander UK is committed to equality of employment, access and quality of service for disabled people and complies with the UK Equality Act 2010 throughout its business operations. Santander UK has processes in place to help train, develop, retain and promote employees with disabilities. We are a Disability Confident Employer achieving the 'Leader' level. We are committed to giving full and fair consideration to employment applications by disabled people, having regard to their particular aptitudes and abilities, and for continuing the employment of employees who have become disabled by arranging appropriate training and making reasonable adjustment in the workplace.

Engagement with stakeholders and employees
Santander UK recognises the importance of fostering relationships with its principal stakeholders and that this is key to the long-term success of our business. We understand the importance to act fairly and responsibly between members of the Company. For more, see the S172 section in the Strategic report.

Streamlined Energy and Carbon Reporting (SECR)
For details on our energy use, carbon emissions and efficiency measures implemented in 2021, including scope 1, 2 and 3 data, see the SECR section, under Climate and Ethics in the Sustainability Review in the Strategic Report.

Political contributions
In 2021 and 2020, no contributions were made for political purposes and no political expenditure was incurred by the Company.

Share capital
Details about the structure of the Company's capital can be found in Note 32.

For details of employee share schemes and how rights are exercisable, see Note 37.

The powers of the Directors in relation to share capital are set out in the Company's Articles of Association as determined by the Companies Act 2006.

Financial instruments
The financial risk management objectives and policies of Santander UK and the policy for hedging, along with details of Santander UK's exposure to credit risk, market risk and liquidity risk are set out in the Risk review.

Research and development
Santander UK has a comprehensive product approval process and policy. New products, campaigns and business initiatives are reviewed by Santander UK's Proposition Approval Forum.

Supervision and regulation
The Company is authorised by the PRA and regulated by the FCA and the PRA (dual regulated). Some of its subsidiaries and joint venture companies are also authorised by both the FCA and the PRA (dual regulated) or the PRA or the FCA (solo regulated).

While Santander UK operates primarily in the UK, it is also subject to the laws and regulations of the other jurisdictions in which it operates, such as the rules of the Securities and Exchange Commission (the SEC) for its debt securities listed in the US.

Internal controls
Risk management and internal controls
The Board and its Committees are responsible for reviewing and ensuring the effectiveness of management's system of risk management and internal controls.

We have carried out a robust assessment of the principal and emerging risks facing Santander UK including those that would threaten its business model, future performance, solvency or liquidity. Details of our principal risks, our procedures to identify emerging risks, and an explanation of how these are being managed or mitigated are set out in the Risk review. A summary of our Top and Emerging Risks is also set out in the Strategic report. For more details, see the Risk review and the Strategic report.

Management's report on internal control over financial reporting
Internal control over financial reporting is a component of an overall system of internal control. Santander UK's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting, and the preparation and fair presentation of financial statements for external purposes in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Santander UK's internal control over financial reporting includes:

- Policies and procedures that relate to the maintenance of records that fairly and accurately reflect transactions and dispositions of assets
- Controls providing reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with IFRS, and that receipts and expenditures are being made only as authorised by management
- Controls providing reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use or disposition of assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or because the degree of compliance with policies or procedures may deteriorate.

Director's report continued

Management is responsible for establishing and maintaining adequate internal control over the financial reporting of Santander UK. Management assessed the effectiveness of Santander UK's internal control over financial reporting at 31 December 2021 based on the criteria established in the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) in May 2013.

As a registrant under the US Securities Exchange Act of 1934, Santander UK plc's management is responsible for establishing and maintaining an adequate system of internal control over financial reporting in order to ensure the accuracy and reliability of Santander UK plc's Financial Statements and the Form 20-F submitted to the SEC.

In line with COSO and SEC requirements, those controls recognised as Sarbanes-Oxley applicable are subject to annual testing and certification by management including an attestation by the CEO and the CFO that the controls are operating effectively and that the internal control over financial reporting can be relied on.

All Sarbanes-Oxley control weaknesses identified are captured, assessed and included within the year end assessment of the reliability of the Internal Control environment. These weaknesses are reported on an ongoing basis to the Board Audit Committee to ensure continuous improvements to the control environment are achieved.

Based on this assessment, management concluded, as at31 December 2021, that Santander UK's internal control over financial reporting was effective.

Disclosure controls and procedures over financial reporting

Santander UK's management has evaluated, with the participation of its CEO and CFO, the effectiveness of its disclosure controls at 31 December 2021. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error, and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Based upon this evaluation, the CEO and the CFO have concluded that, at 31 December 2021 Santander UK's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by Santander UK in the reports that it files and submits under the US Securities Exchange Act of 1934 is recorded, processed, summarised and reported within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to Santander UK's management, including the CEO and CFO, as appropriate, to allow timely decisions regarding disclosure.

Changes in internal control over financial reporting

The internal control environment over financial reporting has been enhanced with 100% of key controls independently tested for both design and operational effectiveness within the period (in prior periods independent testing has been focused on the higher inherent risk areas).

Statements of Compliance

The UK Corporate Governance Code 2018

Santander UK has opted to comply with the Code wherever applicable in order to achieve best standards of corporate governance.

The Code applied to the financial year ended 31 December 2021. The Board confirms that it applied the principles and complied with those provisions of the Code throughout the year, except as follows:

- Provision 11: The Company does not comply with the requirement for at least half the Board, excluding the Chair, to be NEDs whom the Board considers to be independent for the full year, but was compliant for periods of the year when Director appointments or resignations altered the Board composition so at least half of the Board were considered to be independent NEDs. For details, see Board membership in the Chair's Report on Corporate Governance.
- Provision 17: The Company does not comply with the requirement for the Board Nomination Committee membership to comprise a majority of INEDs, following the appointment of Pamela Walkden on 1 October 2021. Whilst Pamela Walkden is not an INED, her credentials and experience were felt to be invaluable to the Board Nomination Committee. We have assessed the implications and believe that the approach we follow is appropriate for our size and ownership structure. Pamela Walkden replaced Bruce Carnegie-Brown who was also a GNED.
- Provision 36: The Remuneration Committee has not developed a policy for post-employment shareholding requirements. However, the structure of variable pay for EDs and other senior executives ensures that they acquire a meaningful shareholding in Banco Santander SA which is held over a period of up to eight years and which extends for a significant period post employment. For details, see the Remuneration Policy Report
- Provisions 40 and 41: When determining executive remuneration policy and practices, the Remuneration Committee addresses the factors of clarity, simplicity, risk, predictability, proportionality, and alignment to culture, and in particular how our policy and practices align to Santander UK's core values of Simple, Personal and Fair. Due to commercial sensitivity, whilst we have chosen to provide details of our pay arrangements beyond the requirements for an entity with our ownership structure, we have chosen not to provide all of the disclosures required by Provision 41. The details not provided relate to (1) the extent to which discretion has been applied to remuneration outcomes and the reasons why and (2) a description, with examples, of how the remuneration committee has addressed the factors in Provision 40 (specifically predictability as we do not provide the range of possible values of rewards to individual directors). Specific engagement does not take place with the workforce to explain how executive remuneration aligns with wider company pay policy. However, an explanation is publicly available for employees in the Directors' Remuneration Report and the RFB Committee Chair, who also has the responsibility for the role of the Santander UK plc Employee Designated NED, holds a number of online engagement events which provides opportunities for employees to share their views and ask questions on this subject. Details of the structure of our remuneration arrangements and key considerations of the Committee in the year are included in the Remuneration Policy and Implementation Reports. The Code is publicly available on the Financial Reporting Council website at www.frc.org.uk.

UK Finance Code for Financial Reporting Disclosure

Santander UK's financial statements for the year ended 31 December 2021 have been prepared in compliance with the principles of the UK Finance Code for Financial Reporting Disclosure.

Director's report continued

Going concern

The going concern of Santander UK is reliant on preserving a sufficient level of capital and adequately funding the balance sheet. In making their going concern assessment in connection with preparing the financial statements, the Directors considered a wide range of information similar to that considered as part of their assessment of longer-term viability including Santander UK's long-term business and strategic plans, forecasts and projections, estimated capital, funding and liquidity requirements, contingent liabilities and the reasonably possible changes in trading performance arising from potential economic, market and product developments. The Directors' assessment included consideration of the ongoing impacts of the Covid-19 pandemic.

Having assessed this information and the principal risks and uncertainties, the Directors are satisfied that the Santander UK group has adequate resources to continue operations for a period of at least twelve months from the date of this report and therefore consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

Viability

In accordance with Provision 31 of the UK Corporate Governance Code 2018, the Directors must make a statement in this Annual Report regarding the viability of Santander UK, including an explanation of how they assessed the prospects of Santander UK and the period of time for which they have made the assessment, including why they consider that period to be appropriate.

Considerations

In making their assessment, the Directors considered a wide range of information including Santander UK's:

- Long-term business and strategic plans
- Risk profile and risk management practices, including the processes by which risks are identified and mitigated, as well as updates on climate risk and progress towards integrating associated risks into Santander UK's Risk Framework
- Top and emerging risks. Notable among these are risks which the Directors believe could cause Santander UK's future financial performance or financial condition to differ materially from current expectations or could adversely impact Santander UK's ability to meet regulatory requirements
- Forecasts and projections, estimated capital, funding and liquidity requirements
- Viability under specific internal and regulatory stress scenarios explained further below, including scenarios which might affect operational resiliency and
- Contingent liabilities and the reasonably possible changes in trading performance arising from potential economic, market and product developments.

The Directors' assessment also takes account of the ongoing implications of the Covid-19 pandemic including potential impacts on Santander UK's performance and capital, funding and liquidity requirements.

For capital, funding and liquidity purposes, Santander UK operates on a standalone basis and is subject to regular and rigorous monitoring by external parties. In addition, for capital purposes, the Company operates as part of the ring-fenced bank sub group Capital Support Deed. For funding and liquidity purposes, the Company operates as part of the Domestic Liquidity sub-group.

Assessment

The viability of Santander UK is reliant on preserving a sufficient level of capital and adequately funding the balance sheet.

Santander UK's business activities and financial position, together with the factors likely to affect its future development and performance, are set out in the Financial review. Santander UK's objectives, policies and processes for managing the financial risks to which it is exposed are described in the Risk review.

Threats to the achievement of Santander UK's plans, are controlled and managed in line with Santander UK's Risk Framework and within the risk appetite approved by the Board. The risk profile, including an assessment of top and emerging risks, is reported regularly to the Board Risk Committee and the Board. Risks are selected on the basis of their ability to impact viability over the time frame of the assessment but most risks extend beyond this period.

Stress testing

Santander UK participates in regulatory stress tests usually carried out annually by the Bank of England as well as being part of the biennial stress testing of Banco Santander carried out by the European Banking Authority (EBA).

Internal stress testing encompasses a series of extreme but plausible scenarios, (which include potential impacts arising from the Covid-19 pandemic), covering a wide range of outcomes, risk factors, time horizons and market conditions.

We also conduct reverse stress testing, in which we identify and assess scenarios that could cause Santander UK's business model to become unviable. Santander UK participates in regulatory stress testing usually carried out annually by the Bank of England as well as being part of the biennial stress testing of Banco Santander carried out by the EBA. In 2021, Santander UK also participated in the BoE Climate Biennial Exploratory Scenario.

The Directors review the outputs of stress testing as part of the approval processes for the ICAAP, the ILAAP, our Risk Appetite and regulatory stress tests.

Time horizon

While a five-year plan is prepared for regulatory purposes and our stress testing encompasses scenarios some of which also extend out to that time period, using a longer time horizon increases uncertainty.

After taking account of Santander UK's current position and principal risks and uncertainties, the Directors consider that a period of three years from the balance sheet date is the most appropriate time frame from which a reasonable assessment of viability can be made.

This period is consistent with the period covered by Santander UK's three-year plan, and is representative of the time horizon to consider the impact of anticipated regulatory changes within the financial services industry.

Statement

Based on their assessment of longer-term viability, the Directors have a reasonable expectation that Santander UK will be able to continue in operation and meet its liabilities as they fall due over the next three years.

Ethical Code of Conduct

Santander UK is committed to ensuring we hold ourselves to high ethical standards. This means adhering to laws and regulations and also conducting business in a responsible way, and treating all stakeholders with fairness and respect. These principles are reflected in Santander UK's Ethical Code of Conduct, which sets the standards expected of all employees and forms part of the terms and conditions of employment.

Maintaining high standards of professional and personal conduct helps Santander identify, manage and respond to risks, creates a positive, collaborative working environment and it ensures positive customer interactions and outcomes.

Director's report continued

Among the requirements set out in the Ethical Code of Conduct we expect employees to:

- Act with integrity in all their business actions and relationships on behalf of Santander UK
- Not use their authority or position for personal gain
- Speak up and report risks
- Conduct business relationships in a transparent manner

There are numerous policies which support employees to meet these expectations and to ensure Santander UK remains a Simple, Personal and Fair bank for its colleagues, customers, shareholders and the communities it serves.

The Ethical Code of Conduct applies to all employees including permanent and temporary employees as well as EDs and NEDs. The SEC requires companies to disclose whether they have a code of ethics that applies to the CEO and senior financial officers which promotes honest and ethical conduct, full, fair, accurate, timely and understandable disclosures, compliance with applicable governmental laws, rules and regulations, prompt internal reporting of violations, and accountability for adherence to such a code of ethics.

The Santander UK group meets these requirements through its Ethical Code of Conduct and supporting policies, including but not limited to the Anti-Bribery and Corruption Policy, the Whistleblowing Policy, the FCA's Principles for Businesses, and the FCA's Statements of Principle and Code of Practice for Approved Persons, with which the CEO and senior financial officers must comply.

These include requirements to manage conflicts of interest appropriately and to disclose any information the FCA may request. Copies of these documents are available to anyone, free of charge, on application to Santander UK plc, 2 Triton Square, Regent's Place, London NW1 3AN.

Statement of Directors' responsibilities

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Santander UK group and Company financial statements in accordance with UK-adopted international accounting standards (IAS). In preparing the Santander UK group and Company financial statements, the Directors have also elected to comply with International Financial Reporting Standards issued by the International Accounting Standards Board (IFRSs as issued by the IASB).

Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Santander UK group and the Company and of the profit or loss of the Santander UK group and the Company for that period. In preparing the financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently
- State whether applicable UK-adopted IAS and IFRSs as issued by the IASB have been followed, subject to any material departures disclosed and explained in the financial statements
- Make judgements and accounting estimates that are reasonable and prudent, and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Santander UK group and the Company will continue in business.

The Directors are responsible for safeguarding the assets of the Santander UK group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are also responsible for keeping adequate accounting records that are sufficient to show and explain the Santander UK group's and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Santander UK group and the Company, and enable them to ensure that the financial statements comply with the Companies Act 2006.

The Directors are responsible for the maintenance and integrity of Santander UK's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Directors are responsible for presenting and marking up the consolidated financial statements in compliance with the requirements set out in the Delegated Regulation 2019/815 on European Single Electronic Format.

Having taken into account all the matters considered by the Board and brought to its attention during the year, the Directors are satisfied that the Annual Report taken as a whole is fair, balanced and understandable, and provides the information necessary to assess Santander UK's position and performance, business model and strategy.

Directors' confirmations

Each of the Directors whose names and functions are listed in the Board of Directors section and the Chair's report on Corporate Governance confirms that, to the best of their knowledge:

- The Santander UK group and Company financial statements, which have been prepared in accordance with UK-adopted IAS and IFRSs as issued by the IASB, give a true and fair view of the assets, liabilities and financial position of the Santander UK group and the Company, and of the profit of the Santander UK group, and
- The management report, which is incorporated into the Directors' report, includes a fair review of the development and performance of the business and the position of the Santander UK group and the Company, together with a description of the principal risks and uncertainties they face.

Disclosure of information to Auditors

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

- So far as the Director is aware, there is no relevant audit information of which Santander UK's auditor is unaware
- The Director has taken all steps that they ought to have taken as a Director to make himself or herself aware of any relevant audit information and to establish that Santander UK's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the UK Companies Act 2006.

Auditor

PricewaterhouseCoopers LLP will continue in the office of auditor. A resolution to reappoint them will be proposed at the Company's forthcoming Annual General Meeting.

By Order of the Board

John Mills
Company Secretary

1 March 2022

2 Triton Square,
Regent's Place,
London NW1 3AN

Risk review

The Risk review consists of unaudited financial information unless otherwise stated. The audited financial information is an integral part of our Consolidated Financial Statements.

We aim to continually enhance our disclosures and their usefulness to readers in the light of developing market practice and areas of focus. As a result, our disclosures go beyond the minimum required by accounting standards and other regulatory requirements.

We support the recommendations and guidance made by the Taskforce on Disclosures about ECL (DECL Taskforce) and have adopted its recommendations where it is practical to do so. The DECL Taskforce was formed in 2017 by the FCA, FRC and PRA with a remit to help encourage high-quality ECL-related disclosures following adoption of IFRS 9.

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Risk governance

INTRODUCTION

Santander UK Group Holdings plc is the immediate parent company of Santander UK plc. The two companies operate on the basis of a unified business strategy with some overlap in membership, albeit the principal business activities of the Santander UK Group Holdings plc group are carried out by Santander UK plc and its subsidiaries. The Santander UK Group Holdings plc Risk Frameworks have been adopted by the Company and its subsidiaries to ensure consistent application.

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, withstand stresses, such as the impacts of the Covid-19 pandemic, 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.

Detailed discussions of the impact of Covid-19 on specific risk types are set out in the relevant sections of this Risk review.

RISK FRAMEWORK

How we define risk

Risk is any uncertainty about us being able to achieve our business objectives. It covers both financial and non-financial risks (NFRs). NFR is a broad term usually defined by exclusion, i.e. any risks other than the traditional financial risks of Credit, Market, Liquidity, Capital and Pension, and Strategic and business risk. Risk can be split into a set of risk types, each of which could affect our results and our financial resources. Enterprise wide risk is the aggregate view of all the risk types described below:

Risk types	Description
Credit	The risk of financial loss due to the default or credit quality deterioration of a customer or counterparty to which we have provided credit, or for whom we have assumed a financial obligation.
Market	**Non-traded market risk** – the risk of loss of income, economic or market value due to changes to interest rates in the non-trading book or to changes in other market risk factors (e.g. credit spread and inflation risk), where such changes would affect our net worth through a change to revenues, assets, liabilities and off-balance sheet exposures in the non-trading book. **Traded market risk** – the risk of changes in market factors that affect the value of positions in the trading book.
Liquidity	The risk that we do not have sufficient liquid financial resources available to meet our obligations as they fall due, or we can only secure such resources at excessive cost.
Capital	The risk that we do not have an adequate amount or quality of capital to meet our internal business objectives, regulatory requirements and market expectations.
Pension	The risk caused by our statutory contractual or other liabilities with respect to a pension scheme (whether set up for our employees or those of a related company or otherwise). It also refers to the risk that we will need to make payments or other contributions with respect to a pension scheme due to a moral obligation or for some other reason.
Operational risk & resilience	The risk of loss due to inadequate or failed internal processes, people and systems, or external events. We give a particular focus to the following risks which we mitigate through our management of Operational risk & resilience: **Cyber** – Cyber risk refers to threats in cyberspace, using the internet, mobile or digital technologies. Cyberspace refers to the information technologies used to store, modify and communicate information. It includes internet, information systems, mobile devices and digital technologies that support business, infrastructure and services. **Fraud** – The risk associated with an attempted or successful fraud being committed against us, a customer or a third party. We define fraud as seeking to obtain a financial benefit by the use of deception or dishonesty with the intention to deprive or disadvantage us, our customers or other parties. **IT** – IT risk is any event related to the use of technology that supports business processes that may result in the unavailability or failure in systems or processing errors causing an impact to our customers or operations. **People** – People risk include all risks related to employees and third parties working for us, covering resource management, health & safety and employee relations. **Third party** – The risk that may arise when we use third-party suppliers to provide us with goods, services or activities. In 2021, we retitled our governing framework from 'Operational Risk Framework' to 'Operational Risk & Resilience Framework'. This was to reflect the importance of operational resilience and the intrinsically close link between the managing of operational risk and the operational resilience of the organisation.
Conduct and regulatory	**Conduct risk** – the risk that our decisions and behaviours lead to a detriment or poor outcome for our customers. It also refers to the risk that we fail to maintain high standards of market behaviour and integrity. **Regulatory risk** – the risk of financial or reputational loss, or imposition or conditions on regulatory permission, as a result of failing to comply with applicable codes, regulator's rules, guidance and regulatory expectations.

Risk types	Description
Other risk types	**Financial crime risk** – the risk that we are used to further financial crime, including money laundering, sanctions evasion, terrorist financing, facilitation of tax evasion, bribery and corruption. Failure to meet our legal and regulatory obligations could result in criminal or civil penalties against Santander UK or individuals, as well as affecting our customers and the communities we serve. **Legal risk** – the risk of an impact arising from legal deficiencies in contracts; failure to protect assets; failure to manage legal disputes appropriately; failure to assess or implement the requirements of a change of law; or failure to comply with law or regulation or to discharge duties or responsibilities created by law or regulation. **Strategic and business risk** – the risk of significant loss or underperformance against planned objectives; damage arising from strategic decisions or their poor implementation that impact the long-term interests of our key stakeholders or from an inability to adapt to external developments. **Reputational risk** – the risk of damage to the way our reputation and brand are perceived by the public, clients, government, colleagues, investors or any other interested party. **Model risk** – the risk that the predictions of our models may be inaccurate, causing us to make sub-optimal decisions, or that a model may be used inappropriately.

Top and emerging risks

Several of our risk types also have top risks associated with them. We regularly review the top risks that could impact our business, customers and shareholders, and they are monitored at each meeting of the ERCC and BRC. The top risks we actively monitored over 2021 are set out in the relevant section of this Risk review and summarised in the 'Top risks' section of the 'Risk management overview' in the Strategic report. Our top risks included risks arising from Climate change, Financial crime, IT, Covid-19, Operational risks, Conduct and regulation, Brexit, Regulatory Capital, pension risk, and Ring-Fencing.

We also regularly review emerging risks that could impact our business, customers and shareholders, including regular review and discussion at the ERCC and BRC. The identification of emerging risks is co-ordinated by the Risk Division. A key part of the process is continual scanning of the external environment, focusing on emerging risk drivers such as broader geo-political, environmental and social risks, technology change, customer behaviour, market competition, regulation, government, digital assets and disruption of UK macro-economic factors. Emerging risks actively monitored over 2021 are set out in the relevant section of this Risk review and summarised in the 'Emerging risks' section of the 'Risk management overview' in the Strategic report.

In 2021, we did not add any new emerging risks to our monitor, although we transitioned Data management and Climate change to top risks. We also continued to monitor previously identified emerging risks including changing customer behaviour, rapid technological change, IBOR transition and inflation risk, which became more prominent in the year.

Key elements

Our Risk Framework sets out how we manage and control risk. In 2021, we enhanced some of the standards to provide more details and clarity on the relationship between, and roles of, Banco Santander SA and Santander UK, climate related risk drivers whether physical or transition-led, and the development of risk methodologies and quantitative models.

How we approach risk – our culture and principles

The complexity and importance of the financial services industry demands a strong risk culture. We have extensive systems, controls and safeguards in place to manage and control the risks we face, but it is also crucial that everyone takes personal responsibility for managing risk. Our risk culture plays a key role in our aim to be the best bank for our customers, shareholders, people and communities by acting responsibly. It is vital that everyone in our business understands this. To achieve this, our people have a strong, shared understanding of what risk is, and what their role is in helping to control it. We express this in our Risk Culture Statement:

Risk Culture Statement
Santander UK will only take risks that it understands and will always remain prudent in identifying, assessing, managing and reporting all risks. We proactively encourage our people to take personal responsibility for doing the right thing and to challenge without fear. We ensure decisions and actions take account of the best interests of all our stakeholders and are in line with The Santander Way.

The Board reviews and approves our Risk Culture Statement every year. Senior executives are responsible for promoting our risk culture from the top. They drive cultural change and increased accountability across the business. We reinforce our Risk Culture Statement and embed our risk culture in all our business units through our Risk Framework, Risk Certifications and other initiatives. This includes highlighting that:

- It is everyone's personal responsibility to play their part in managing risk
- We must Identify, Assess, Manage and Report risk quickly and accurately
- We make risk part of how we assess our people's performance and how we recruit, develop and reward them
- Our internal control system is essential to ensure we manage and control risk in line with our principles, standards, Risk Appetite and policies.

We use Risk Certifications to confirm how we manage and control risks in line with our Risk Framework and within our Risk Appetite. As an example, every year, each member of our Executive Committee confirms that they have managed risk effectively in line with the Risk Framework in the part of the business for which they are responsible. Their certification lists any exceptions and the agreed actions to be taken to correct them. This is a tangible sign of the personal responsibility that is such a key part of our risk culture.

Our risk culture programme – I AM Risk

The Covid-19 pandemic created additional risks in our business. At the same time, we continued with significant transformation programme activities, while dealing with a highly competitive financial services sector and a challenging political and regulatory environment. At times of change, it is important that we make the decisions that help us achieve our goals while supporting and protecting our colleagues and customers. I AM Risk continues to play a key part in our aim to be the best bank for our people, customers, shareholders and communities. Our I AM Risk approach aims to make sure our people:

- **Identify** risks and opportunities
- **Assess** their probability and impact
- **Manage** the risks and suggest alternatives
- **Report**, challenge, review, learn and 'speak up'.

I AM Risk is how we make risk management part of everyone's life as a Santander UK employee from how we recruit them and manage their performance to how we develop and reward them. It is also how we encourage people to take personal responsibility for risk to speak up and to come up with ideas. We use I AM Risk in our risk certifications, policies, frameworks and governance, and risk-related communications. We also include it in reward arrangements and in mandatory training. To support general awareness, our learning websites include videos and factsheets.

As part of I AM Risk, we include mandatory risk objectives for all our people in our performance management processes – from our Executive Committee to branch staff. The Executive Committee leads our culture initiatives under the CEO's sponsorship. In our most recent employment engagement survey, 93% of employees recognised their personal responsibility for the risks they face in their day-to-day work. This demonstrates how we have embedded risk management in our culture.

In June 2021, we launched our new recognition platform for Santander UK staff, including, for the first time, the ability to specifically recognise colleagues for demonstrating strong risk culture behaviours, with the use of a bespoke 'I AM Risk' tag.

I AM Risk in Action - Our Covid-19 Response

Our I AM Risk ethos was demonstrated through our response to Covid-19. Since the start of the Covid-19 pandemic, we have all had to adjust to new ways of working, but the common risks remain, irrespective of our working environment. We now review the increased risks of remote and hybrid working as part of business-as-usual and the mandatory training material we launched in 2020 to support our colleagues in their new ways of working was refreshed to help them to continue to protect our customers and themselves, regardless of their specific working location. As 2021 progressed, we supported our colleagues in branches and those gradually returning to offices, to comply with the relevant government guidelines.

I AM Risk Week 2021

In November 2021, we once again joined colleagues from across the Banco Santander group to celebrate our risk culture, with an emphasis on our personal responsibility and accountability for managing risk, to speak up, reminders of how to manage our common risks and why good conduct and compliance matter. During this time, we encouraged our colleagues to use our I AM Risk resources to:

- Attend global risk related webinars focused notably on Financial Crime, Fraud, Reputational, Social and Climate Change risks and Speak Up.
- Recognise a colleague for good risk behaviour
- Use the Santander Speak Up toolkit, which provides helpful information and guidance to build confidence in speaking up.

Our risk governance structure

We are committed to the highest standards of corporate governance in every part of our business, including risk management. For details of our governance, including the Board and its Committees, see the 'Governance' section of this Annual Report. The Board delegates certain responsibilities to Board Level Committees as needed and where appropriate. Our risk governance structure strengthens our ability to identify, assess, manage and report risks, as follows:

- **Committees:** A number of Board and Executive committees are responsible for specific parts of our Risk Framework
- **Key senior management roles:** A number of senior roles have specific responsibilities for risk management
- **Risk organisational structure:** We have the 'three lines of defence' model built into the way we run our business.

Committees

The Board and Board Level Committee responsibilities for risk are:

Board Level Committee	Main risk responsibilities
The Board	– Has overall responsibility for business execution and for managing risk
	– Reviews and approves the Risk Framework and Risk Appetite
Board Risk Committee (BRC)	– Assesses the Risk Framework and recommends it to the Board for approval
	– Advises the Board on our overall Risk Appetite, tolerance and strategy
	– Oversees our exposure to risk and our strategy and advises the Board on both
	– Reviews the effectiveness of our risk management systems and internal controls
	– Receives regular updates on financial crime compliance measures and risks including money laundering, bribery and corruption and sanctions compliance and monitors KPIs to measure progress to return to approved Board risk appetite and sustain returns to Board risk appetite
Board Responsible Banking Committee	– Responsible for culture and operational risk from conduct, compliance, competition & legal matters
	– Reviews reports from the CLRO on the adequacy and effectiveness of the compliance function
	– Ensures that adequate and effective control processes are in place to identify and manage reputational risks
	– Oversees our Corporate Social Responsibility programme and how it impacts on employees, communities, the environment including sustainability and climate change, reputation, brand and market positioning
Board Audit Committee	– Monitors and reviews the financial statements integrity, and any formal announcements on financial performance
	– Reviews the adequacy and effectiveness of the internal financial controls and whistleblowing arrangements
	– Monitors and reviews the effectiveness of the internal audit function
	– Oversees the independence and performance of our auditors
Board Remuneration Committee	– Oversees implementation of remuneration policies, ensuring they promote sound and effective risk management

The Executive Level Committee responsibilities for risk are:

Executive Level Committee	Main risk responsibilities
Executive Committee	– Reviews business plans in line with our Risk Framework and Risk Appetite before they are sent to the Board to approve
	– Receives updates on key risk issues managed by CEO-level committees and monitors the actions taken
Senior Management Committee	– Focuses on the responsibilities of the Executive Committee Senior Management Function holders and how they are discharged
	– Reviews updates on key risk issues, customer, reputational and conduct matters
Executive Risk Control Committee (ERCC)	– Reviews Risk Appetite proposals before they are sent to the Board Risk Committee and the Board to approve
	– Ensures that we comply with our Risk Framework, Risk Appetite and risk policies
	– Reviews and monitors our risk exposures and approves any corrective steps we need to take
Asset and Liability Committee (ALCO)	– Reviews liquidity risk appetite (LRA) proposals
	– Ensures we measure and control structural balance sheet risks, including capital, funding and liquidity, in line with the policies, strategies and plans set by the Board
	– Reviews and monitors key asset and liability management activities to ensure we keep our exposures within our Risk Appetite
Pensions Committee	– Reviews pension risk appetite proposals
	– Approves actuarial valuations and reviews the impact they may have on our contributions, capital and funding
	– Consults with the pension scheme trustees on the scheme's investment strategy
Capital Committee	– Puts in place reporting systems and risk control processes to make sure capital risks are managed within our Risk Framework
	– Reviews capital adequacy and capital plans, including the ICAAP, before they are sent to the Board to approve
Incident Accountability Committee	– Considers, calibrates, challenges and agrees any appropriate individual remuneration adjustments
	– Presents recommendations to the Board Remuneration Committee
Credit Approval Committee	– Approves corporate and wholesale credit transactions which exceed levels delegated to lower level forums or individuals
Investment Approval Committee	– Approves equity type investment transactions which exceed levels delegated to lower level approval forums or individuals
Financial Crime Committee	– Ensures due reporting, consideration, oversight and informed decision making regarding compliance by the Company and its subsidiaries with financial crime laws and regulations, and best industry practice aligned to the Company's stated risk appetite

Key senior management roles
Senior roles with specific responsibilities for risk management are:

Role	Main risk responsibilities
Chief Executive Officer	The Board delegates responsibility for our business activities and managing risk on a day-to-day basis to the CEO. The CEO proposes our strategy and business plan, puts them into practice and manages the risks involved. The CEO must also ensure we have a suitable system of controls to manage risks and report to the Board on it.
Chief Risk Officer (CRO)	Oversees and challenges risk activities, and ensures lending decisions are made within our Risk Appetite. Accountable for control and oversight of credit, market, liquidity, capital, pension, strategic & business, operational, model risk and risks associated with climate change.
Chief Legal and Regulatory Officer (CLRO)	Accountable for the control and oversight of legal, conduct and regulatory, reputational and financial crime risk, and is responsible for reporting on these risks to the CRO, to provide the CRO with a holistic enterprise wide view of all risks.
Chief Financial Officer	Responsible for developing strategy, leadership and management of the CFO Division. In supporting our corporate goals within our risk appetite, the CFO is responsible for managing interest rate, liquidity, pension and capital risks. The CFO aims to maximise the return on Regulatory and Economic Capital, ensuring transactions create value with the right risk-based profile.
Chief Internal Auditor (CIA)	Designs and uses an audit system that identifies key risks and evaluates controls. The CIA also develops an audit plan to assess existing risks that involve producing audit, assurance and monitoring reports.
Money Laundering Reporting Officer (MLRO)	Responsible to the CLRO for control and oversight of financial crime risk but has regulatory responsibility to report on this risk type to Executive and Board Committees and the FCA.

Risk organisational structure
We use the 'three lines of defence' model to manage risk. This model is widely used in the banking industry and has a clear set of principles to put in place a cohesive operating model across an organisation. It does this by separating risk management, risk control and risk assurance. The reporting lines to the Board with respect to risk are as follows:

Line 1: Business Units and Business Support Units identify, assess and manage the risks which originate and exist in their area, within our Risk Appetite.
Line 2: Risk Control Units are independent monitoring and control functions. They are under the executive responsibility of the CEO, but responsible to the CRO or the CLRO for overseeing the first line of defence. They make sure Business Units and Business Support Units manage risks effectively and within our Risk Appetite. The Risk Control Units are: Financial Crime; Conduct & Compliance, responsible for controlling reputational and conduct & regulatory risks; Legal; and Risk, responsible for controlling credit, market, liquidity, capital, pension, strategic and business, operational and model risks.
Line 3: Internal Audit is an independent corporate function. It gives assurance on the design and effectiveness of our risk management and control processes.

Internal control system

Our Risk Framework is an overarching view of our internal control system that helps us manage risk across the business. It sets out at a high level the principles, standards, roles and responsibilities, and governance for internal control. Our Risk Framework covers the categories below:

Category	Description
Risk Frameworks	Set out how we should manage and control risk across the business (overall framework), our risk types (risk type frameworks) and our risk activities (risk activity frameworks).
Risk Management Responsibilities	Set out the Line 1 risk management responsibilities for Business Units and Business Support Units.
Strategic Commercial Plans	Plans produced by business areas, at least annually, which describe the forecasted objectives, volumes and risk profile of new and existing business, within the limits defined in our Risk Appetite.
Risk Appetite	See our Risk Appetite section that follows.
Delegated Authorities/Mandates	Define who can do what under the authority delegated to the CEO by the Board.
Risk Certifications	Business Units, Business Support Units or Risk Control Units set out how they have managed and/or controlled risks in line with our risk frameworks and within our Risk Appetite. They are completed at least once a year and explain action to be taken. This helps ensure people can be held personally accountable.

RISK APPETITE

How we control the risks we are prepared to take

When our Board sets our strategic objectives, it is important that we are clear about the risks we are prepared to take to achieve them. We express this through our Risk Appetite Statement, which defines the amount and kind of risk we are willing to take. Our Risk Appetite and strategy are closely linked, and our strategy must be achievable within the limits set out in our Risk Appetite.

The principles of our Risk Appetite

Our Risk Appetite Statement lists ten principles that we use to set our Risk Appetite.

- We always aim to have enough financial resources to continue to do business in adverse but plausible stressed economic and business conditions, as well as to survive a very severe stress that would deplete our capital reserves
- We should be able to predict how our income and losses might vary – that is, how volatile they are. That applies to all our risks and lines of business
- Our earnings and dividend payments should be stable, and in line with the return we aim to achieve
- We are an autonomous business, so we always aim to have strong capital and liquidity resources
- The way we fund our business should be based on diverse funding sources and duration. This helps us avoid relying too much on wholesale markets
- We set controls on large concentrations of risk, like single customers or specific industries
- There are some key risks we take, but for which we do not actively seek any reward, like operational, conduct and regulatory, financial crime, legal and reputational risk. We take a risk-averse approach to these risks
- We comply with all regulations – and aim to exceed the standards they set
- Our pay and bonus schemes should support these principles and our risk culture
- We always aim to earn the trust of our people, customers, shareholders and communities.

How we describe the limits in our Risk Appetite

Our Risk Appetite sets out detailed limits across all types of risk, using metrics and qualitative statements.

Metrics

We use metrics to set limits across most risk types including a set of metrics focused on losses, capital, liquidity and concentration. We set:

- Limits for losses for our most important risks, including credit, market, operational and conduct risk
- Capital limits, reflecting both the capital that regulators expect us to hold (regulatory capital) and our own internal measure economic capital (EC)
- Liquidity limits according to a range of plausible stress scenarios for our business
- Concentration limits, to determine the maximum concentration level that we are willing to accept.

These limits apply in normal business conditions, but also when we might be experiencing a far more difficult economic environment. We refer to conditions like this as being under stress. For more on EC and stress scenarios, see the next page.

Qualitative statements

For some types of risk we also use qualitative statements that describe in words the appetite we want to set. For example, in operational risk, we use them to describe our risk-averse appetite for cyber risk. We also use them to prohibit or restrict exposure to certain sectors, types of customer and activities.

How we set our Risk Appetite, and stay within it

We control our Risk Appetite through our Risk Appetite Framework. Our Board approves and oversees our Risk Appetite Statement every year. This ensures it is consistent with our strategy and reflects changes in the markets and economic environment in which we operate. Our ERCC is responsible for ensuring that our risk profile (the level of risk we are prepared to accept) is consistent with our Risk Appetite Statement. To do this they monitor our performance against our Risk Appetite, business plans and budgets each month.

We also use stress testing to review how our business plan performs against our Risk Appetite Statement. This shows us if we would stay within our Risk Appetite under stress conditions. It also helps us to identify any adverse trends or inconsistencies.

We embed our Risk Appetite by setting more detailed risk limits for each business unit and key portfolios. These are set in a way so that if we stay within each detailed limit, we will stay within our overall Risk Appetite. When we use qualitative statements to describe our appetite for a risk, we link them to lower-level key risk indicators, so that we can monitor and report our performance against them.

STRESS TESTING

Stress testing helps us understand how different events and economic conditions could affect our business plan, earnings and risk profile. This helps us plan and manage our business.

Scenarios for stress testing
To see how we might cope with difficult conditions, we regularly develop challenging scenarios that we might face. We consult a broad range of internal stakeholders, including Board members, when we design and choose our most important scenarios. The scenarios cover a wide range of outcomes, risk factors, time horizons and market conditions. They are designed to test:

- The impact of shocks affecting the economy as a whole or the markets we operate in
- Key potential vulnerabilities of our business model, and the processes and systems which support it
- Potential impacts on specific risk types.

We describe each scenario using a narrative setting out how events might unfold, as well as a market and/or economic context. For example, the key economic factors we reflect in our ICAAP scenarios include house prices, interest rates, unemployment levels and the size of the UK economy. We also explore sensitivities around several macro variables where there may be concerns or levels of uncertainty. In 2021, we also completed the Bank of England's (BoE) Climate Biennial Exploratory Scenario (CBES). The purpose of this exercise was to investigate a range of risks that may not be directly linked to prevailing economic and financial conditions and helps us to prepare for possible future shocks. The CBES tested the resilience of the UK financial system to the physical and transition risks associated with three different climate pathways. The key climate factors included physical risks due to higher global temperatures, and transition risks as a consequence of the structural changes needed to transition towards a low-carbon economy.

How we use stress testing
We use stress testing to estimate the effect of these scenarios on our business and financial performance, including:

- Our business plan, and its assessment against our Risk Appetite
- Our capital strength, through our ICAAP
- Our liquidity position, through our ILAAP
- Our long term impacts of climate change, through the CBES
- Impacts on other risk types.

We use a wide range of models, approaches and assumptions. These help us interpret the links between factors in markets and the economy, and our financial performance. For example, one model looks at how changes to key macroeconomic variables like unemployment rates might affect the number of customers who might fall into arrears on their mortgage or other loans.

Our stress testing models are subject to a formal review, independent validation and approval process. We highlight the key weaknesses and related model assumptions in the approval process for each stress test. In some cases, we overlay expert judgement onto the results of our models. Where this is material to the outcome of the stress test, the approving governance committee reviews it. We take a multi-layered approach to stress testing to capture risks at various levels. This ranges from sensitivity analysis of a single factor to a portfolio, to wider exercises that cover all risks across our entire business. We use stress test outputs to design plans that aim to mitigate damaging effects.

We also conduct reverse stress tests. These are tests in which we identify and assess scenarios that are most likely to cause our business model to fail.

Board oversight of stress testing
The ERCC approves the design of the scenarios in our ICAAP and ILAAP. The Board Risk Committee approves the stress testing framework. The Board reviews stress test outputs as part of the approval processes for the ICAAP, ILAAP, Recovery and Resolution, our Risk Appetite and regulatory stress tests, including CBES.

Regulatory stress tests
We take part in a number of external stress testing exercises. These can include stress tests of the UK banking system conducted by the PRA and the BoE. We also contribute to stress tests of Banco Santander SA conducted by the European Banking Authority (EBA).

For more on capital and liquidity stress testing, see the 'Capital risk' and 'Liquidity risk' sections.

HOW RISK IS DISTRIBUTED ACROSS OUR BUSINESS

Economic capital
As well as assessing how much regulatory capital we need to hold, we use an internal EC model to measure our risk. We use EC to get a consistent measure across different risk types. EC also takes account of how concentrated our portfolios are, and how much diversification there is between our various businesses and risk types. As a consequence, we can use EC for a range of risk management activities. For example, we can use it to help us compare requirements in our ICAAP or to get a risk-adjusted comparison of income from different activities.

Regulatory capital – risk-weighted assets
We hold regulatory capital against our credit, market and operational risks. In 2021, the largest category continued to be credit risk in Retail Banking, which accounted for more than half of our risk-weighted assets. This reflects our business strategy and balance sheet.

TASKFORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (TCFD)

We are implementing the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), and taking action to meet the expectations set by the PRA, BoE and FCA. This requires wide-ranging collaboration both within the bank and externally to develop the tools and methodologies needed. As such, we have adopted a unified approach across the Santander UK Group Holdings plc group and therefore present disclosures on that basis in the Santander UK Group Holdings plc group Annual Report.

Credit risk

Overview

Credit risk is the risk of financial loss due to the default or credit quality deterioration of a customer or counterparty to which we provided credit, or for whom we have assumed a financial obligation.

We set out how our exposures arise and our approach to credit risk across the credit risk lifecycle. We discuss our ECL approach and the key inputs to our ECL model. We also summarise various Covid-19 support measures provided to our customers and their impact on ECL. We then analyse our key metrics, credit performance and forbearance, and highlight how Covid-19 affected them where relevant.

Key metrics

Stage 3 ratio remained stable at 1.45% (2020: 1.45%).

Loss allowances decreased to £865m (2020: £1,377m).

Average LTV of 64% (2020: 64%) on new mortgage lending.

CREDIT RISK MANAGEMENT

Exposures (audited)
Exposures to credit risk arise in our business segments from:

Retail Banking	Consumer Finance	Corporate & Commercial Banking	Corporate Centre
In Homes, – We provide residential mortgages for customers with good credit quality (prime lending). – We provide these mostly for owner-occupied homes, with some buy-to-let mortgages provided to non-professional landlords. In Everyday Banking, – We provide unsecured lending to individuals, including personal loans, credit cards and account overdrafts. – We provide banking services to businesses with a turnover of up to £6.5m per annum and relatively simple borrowing needs. We offer overdrafts, credit cards and business loans.	– We provide financing for cars, vans, motorbikes and caravans through Santander Consumer (UK) plc (SCUK). – Through our joint ventures, Hyundai Capital UK Ltd and Volvo Car Financial Services UK Limited, we provide retail point of sale customer finance and wholesale finance facilities (stock finance).	– Loans, bank accounts, treasury services, invoice discounting, cash transmission, trade finance and asset finance. – We provide these to SMEs and mid-sized corporates with an annual turnover of up to £500m, Commercial Real Estate and Social Housing associations.	– Asset and liability management of our balance sheet, as well as our non-core and legacy portfolios being run down. – Exposures include financial institutions, sovereign and other international organisation assets, and structured products, chosen for diversification and liquidity.

The segmental basis of presentation in this Annual Report has changed following a management review of our structure, and comparative amounts have been restated to be consistent with the new presentation. Previously, Consumer Finance was managed as part of Retail Banking. See Note 2 for more information.

Santander UK transferred a significant part of the CIB business to the London branch of Banco Santander SA under a Part VII banking business transfer scheme which completed on 11 October 2021. For more information, see Note 43.

Prior to the transfer, CIB provided loans, bank accounts, treasury services and markets activities, trade finance, receivables discounting and cash transmission to large corporates and financial institutions, under approved ring-fenced bank exceptions policy.

Our approach to credit risk

We manage our portfolios across the credit risk lifecycle, from drawing up our risk strategy, plans, budgets and limits to make sure the actual risk profile of our exposures stays in line with our business plans and within our Risk Appetite. We further tailor the way we manage risk across the lifecycle to the type of product and regularly review our approach and refine it when we need to.

1. Risk strategy and planning (audited)
All relevant areas of the business work together to create our business plans. We aim to balance our strategy, goals, and financial and technical resources with our Risk Appetite. To do this, we focus on economic and market conditions and forecasts, regulations, conduct matters, profitability, returns and market share.

2. Assessment and origination (audited)
Managing credit risk begins with lending responsibly. That means only lending to customers who are committed to paying us back and can afford to, even if their circumstances change. We undertake a thorough risk assessment to make sure a customer can meet their obligations before we approve a loan.

We take proportionate steps to assess whether a customer will be able to repay the money borrowed. We do this by a series of initial affordability and credit risk assessments. We access each customer's credit profile and signs of how reliable they are at repaying credit. When a customer applies, we assess the data they provide, plus data from credit reference agencies (for Retail Banking and Consumer Finance) and performance on their other Santander accounts (if they have any) against our Credit Policy.

Retail Banking
In Homes, for secured loans, we assess affordability by reviewing the customer's income and spending, their other credit commitments, and what would happen if interest rates went up. Many of our decisions are automated as we use data available to us. We tailor the process and how we assess the application based on the product. More complex transactions often need greater manual assessment. This means we have to rely more on our credit underwriters' skill and experience in making the decision.

In Everyday Banking, similar to Homes, many of our decisions are automated as we use data available to us. We tailor the process and how we assess the application based on the product. For unsecured personal loans and credit cards, we assess affordability by reviewing the customer's income and spending, their other credit commitments and stress accommodation costs on a proportionate basis.

For business banking services, we use a combination of internal, credit reference agency and application data in our credit assessments. Credit scoring combined with policy rules give us confidence that businesses are creditworthy and can afford their repayments.

Credit risk mitigation
The types of credit risk mitigation, including collateral, across each of our portfolios is:

Portfolio	Description
Residential mortgages	Collateral is in the form of a first legal charge over the property. Before we grant a mortgage, the property is valued either by a surveyor or using automated valuation methodologies where our confidence in the accuracy of this method is high.
Unsecured lending	There is no collateral or security tied to the loan that can be used to mitigate any potential loss if the customer does not pay us back.
Business banking services	Business banking lending is unsecured. When lending to incorporated businesses, we typically obtain personal guarantees from each director but we do not treat these as collateral.

Consumer Finance
In Consumer Finance, similar to Retail Banking, many of our decisions are automated as we use data available to us. We tailor the process and how we assess the application based on the product. Residual value risk is one of our top risks. We use leading independent vehicle valuation companies to assess the future value of the asset before the start of the agreement.

Credit risk mitigation
The type of credit risk mitigation, including collateral, is:

Portfolio	Description
Consumer (auto) finance	Collateral is in the form of legal ownership of the vehicle for most consumer (auto) finance loans, with the customer being the registered keeper. Only a very small proportion of the business is underwritten as a personal loan. In these cases, there is no collateral or security tied to the loan. We use a leading vehicle valuation company to assess the LTV at the proposal stage to ensure that the value of the vehicle being lent against is appropriate.

Corporate & Commercial Banking
Our risk assessment assigns each customer a credit rating according to the internal rating threshold, using our internal rating scale (see 'Credit quality' in 'Santander UK group level – credit risk review' section). To do this, we look at the customer's financial history and trends in the economy, backed up by the expert judgement of a risk analyst. We review our internal ratings on a dynamic basis and at least once a year for those clients that are rated. We also assess the underlying risk of the transaction, taking account of any mitigating factors (see the tables below) and how it fits with our risk policies, limits and Risk Appetite.

Responsible lending, including climate change and the transition to a low carbon economy

We lend to a wide range of sectors and industries, including those that are intrinsic or of strategic importance to the economy of the UK. As part of lending responsibly, we observe the Equator Principles as a way to factor social, ethical and environmental impacts into our risk analysis and decision making for financial transactions. Our Reputational Risk and Environmental, Social and Climate Change (ESCC) Risk policies define how we create long-term value while managing those risks. Our policies cover Oil & Gas, Power Generation & Transmission, Mining & Metals and Soft Commodities. For example, financing is prohibited for project-related financing for Coal Fired Power Plants (CFPPs) projects worldwide and we will only work with new clients with CFPPs to provide specific financing for renewable energy projects. In line with the Banco Santander commitment, we will eliminate all exposure to thermal coal mining and stop providing financial services to power generation clients with over 10% revenue from thermal coal by 2030. We pay special attention to the ESCC risks of various activities and projects, including liquid natural gas facilities; deep-sea and ultra-deep-sea oilfields; nuclear power generation; solid and gaseous biomass; precious minerals and metals mining; and native tropical timber extraction. We review all relationships and transactions with identified ESCC risks or reputational risks including human rights, to ensure they are within our risk appetite. Key decisions can be escalated to the Reputational Risk Forum and, if required, the Board.

Credit risk mitigation

The types of credit risk mitigation, including collateral, across each of our portfolios are as follows. In addition, from time to time at a portfolio level we execute significant risk transfer transactions, which typically reduce RWAs.

Portfolio	Description
SME and mid corporate	Includes secured and unsecured lending. We can take mortgage debentures or a first charge on commercial property as collateral. Before agreeing the loan, we get an independent professional valuation which assesses the property. Loan agreements typically allow us to obtain revaluations during the term of the loan. We can also take guarantees, but we do not treat them as collateral unless they are supported by a tangible asset which is charged to us. We also lend against assets (like vehicles and equipment) and invoices for some customers. We value assets before we lend. For invoices, we review the customers' ledgers regularly and lend against debtors who meet agreed criteria. We consider the UK Government guarantee supporting losses on amounts lent under its Coronavirus Loan Schemes as collateral (80% for CBILS, CLBILS and RLS, and 100% for BBLS).
Commercial Real Estate	We take a first legal charge on commercial property as collateral. The loan is subject to strict criteria, including the property condition, age and location, tenant quality, lease terms and length, and the sponsor's experience and creditworthiness. Before agreeing the loan, we visit the property and get an independent professional valuation which assesses the property, the tenant and future demand. Loan agreements typically allow us to obtain revaluations during the term of the loan.
Social Housing	We take a first legal charge on portfolios of residential real estate owned and let by UK Housing Associations as collateral, in most cases. We revalue this every three to five years (in line with industry practice), using the standard methods for property used for Social Housing.

Corporate Centre

We follow the same assessment and origination process in Corporate Centre as that in Corporate & Commercial Banking.

Credit risk mitigation

The types of credit risk mitigation, including collateral, across each of our portfolios are as follows. In addition, from time to time at a portfolio level we execute significant risk transfer transactions, which typically reduce RWAs.

Portfolio	Description
Sovereign and Supranational	In line with market practice, there is no collateral against these assets.
Structured Products	These are our High Quality Liquid Assets (HQLA) and Legacy Treasury asset portfolios. These assets are primarily ABS and covered bonds, which benefit from senior positions in the creditor hierarchy. Their credit rating reflects the over-collateralisation in the structure, and the assets that underpin their cash flows and repayment schedules.
Social Housing	We manage the risk on this portfolio in the same way as for the Social Housing portfolio in Corporate & Commercial Banking.
Financial Institutions	We use standard legal agreements to reduce credit risk via netting and collateralisation on derivatives, repos and reverse repos, and stock borrowing/lending. We also reduce risk by clearing trades through central counterparties (CCPs) where possible.
Legacy Portfolios in run off	We often hold collateral through a first legal charge over the underlying asset or cash. We get independent third-party valuations on fixed charge security in line with industry guidelines.

Corporate & Investment Banking

Prior to the transfer in Q4 2021, we followed the same assessment and origination process in Corporate & Investment Banking as that in Corporate & Commercial Banking and Corporate Centre. In addition, in Corporate & Investment Banking, a specialist analyst usually reviewed a transaction at the start and over its life.

Credit risk mitigation

The types of credit risk mitigation, including collateral, across each of our portfolios were as follows.

Portfolio	Description
Large Corporates	Most of these corporate loans and products were unsecured. We also had a structured finance portfolio, where we typically held legal charges over assets we financed. We monitored borrowers in line with expected performance and applicable covenants, so we detected any financial distress early.
Financial Institutions	Financial Institutions exposures were minimal and were managed in the same way as Large Corporates.

3. Monitoring (audited)

We measure and monitor changes in our credit risk profile on a regular and systematic basis against our budgets, limits and benchmarks.

Credit concentrations

A core part of our monitoring and management is a focus on credit concentrations, such as the proportion of our lending that goes to specific borrowers, groups or industries. We set and monitor concentration limits in line with our Risk Appetite and review them on a regular basis.

- Geographical concentrations: We set exposure limits to countries and geographies, with reference to the country limits set by Banco Santander and our own Risk Appetite. For more geographical information, see 'Country risk exposures'.
- Industry concentrations**:** We also set exposure limits by industry sector. We set these limits based on the industry outlook, our strategic aims and desired level of concentration, and relevant limits set by Banco Santander. We analyse committed exposures in the 'Credit risk review' section that follows.

Retail Banking

In Homes, we use IT systems and data available to us to monitor accounts. The main parts are:
- Behavioural scoring: we use statistical models that help predict whether a customer will have problems repaying, based on how they use their accounts
- Credit reference agencies: we often use data from agencies on how the borrower is handling credit from other lenders in our behaviour scoring models
- Other Santander accounts: each month, we also look at how the customer uses their other accounts with us, so we can identify problems early.

Our day-to-day retail credit risk monitoring relies on a mix of product, customer and portfolio performance measures as described above. However, changes in the wider UK macro-economy also impact our Homes portfolio. To reflect this, since 2017 we have used a Retail Risk Playbook tolerance framework to enhance our day-to-day risk monitoring. This is a formal, structured framework that sets out the macroeconomic variables that are most relevant to retail portfolio performance. We monitor these variables against the related forecasts in our business plans. If the economy deviates materially from our forecasts, we formally review and reconsider our retail risk management policy and strategy. This framework will stay in place for as long as we consider it necessary.

Covid-19 has and will continue to affect the macro-economic environment and we have responded to this using the Retail Risk Playbook tolerance framework and management judgements to ensure that portfolio quality remains within Risk Appetite.

Our monitoring can also mean we change our minds about whether a product is still right for a customer. If we find evidence that a customer is in financial difficulties, we contact them about arrears management including forbearance, which we explain in more detail below.

For secured lending, our monitoring also takes account of changes in property prices. We estimate the property's value every three months. In most cases, we use statistical models based on recent sales prices and valuations in that local area. Use of this model is subject to Model Risk Governance. Where a lack of data means the model's valuation is not available, we use the original surveyor valuation with a House Price Index (HPI) adjustment as appropriate.

In Everyday Banking, similar to Homes, we use IT systems and data available to us to monitor accounts, and we use the Retail Risk Playbook tolerance framework (except for business banking services) and management judgements to ensure that portfolio quality remains within Risk Appetite. For unsecured personal lending like credit cards and overdrafts, monitoring might lead us to raise or lower credit limits. For business banking services, we review revolving credit facilities each year to ensure the facilities remain appropriate for the customer's financial circumstances.

Consumer Finance

In Consumer Finance, similar to Retail Banking, we use IT systems and data available to us to monitor accounts, and we use the Retail Risk Playbook tolerance framework and management judgements to ensure that portfolio quality remains within Risk Appetite. We also check the Residual Value of our portfolio each month, using triggers set to identify any material change in trends.

Corporate & Commercial Banking and Corporate Centre

We regularly monitor and report our credit risk by portfolio, segment, industry, location and customer. We monitor detailed analyses of our credit exposures and risk trends each month. We also report our larger exposures and risks to the Board Risk Committee each month.

Our Watchlist

We also use a Watchlist for exposures subject to annual reviews to help identify potential problem debt early. Just because a customer is on our Watchlist does not mean they have defaulted. It just means that something has happened that has increased the probability of default, such as they breach a covenant or lose a major contract.

We classify Watchlist cases as:
- Enhanced monitoring: for less urgent cases. If they are significant, we monitor them more often and where appropriate may consider more collateral.
- Proactive management: for more urgent or serious cases. We may take steps to restructure debt including extending the term, taking more collateral, agreeing a lower credit limit, or seeking repayment of the loan through refinancing or other means.

We assess cases on the Watchlist for impairment as explained in the 'Significant Increase in Credit Risk (SICR)' section. When a customer is included in enhanced monitoring, we do not consider that it has suffered a SICR for ECL purposes, so it remains in Stage 1 for purposes of our loss allowance calculations. When a customer is included in proactive management, we consider that it has suffered a SICR. This means we transfer it to Stage 2 and subject it to a lifetime ECL assessment to calculate the new loss allowance. We take into account any forbearance we offer. This includes whether any extra security or guarantees are available, the likelihood of more equity and the potential to enhance value through asset management.

In Corporate & Commercial Banking, as part of our client review process, for 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.

In Corporate & Commercial Banking, there are also exposures that are not subject to annual reviews, which are primarily high volume and low value cases. They are managed using early warning indicators, which are supported by teams of expert analysts. Early warning indicators include the use of data from credit reference agencies.

In Corporate Centre, we typically monitor the credit quality of our exposures daily. We use both internal and third-party data to detect any potential credit deterioration.

Corporate & Investment Banking

Prior to the transfer in Q4 2021, we followed the same monitoring process in Corporate & Investment Banking as that in Corporate & Commercial Banking and Corporate Centre. In addition, we also monitored the credit quality of our exposures daily. We used both internal and third-party data to detect any potential credit deterioration.

4. Arrears management (audited)

Retail Banking and Consumer Finance

We have several strategies to manage arrears that we can use as early as the day after a missed payment. We assess the problems a customer is having, so we can offer them the right help to bring their account up to date as soon as possible. The strategy we use depends on the risk and the customer's circumstances.

Corporate & Commercial Banking and Corporate Centre

We identify problem debt by close monitoring, supported by our Watchlist process for all exposures subject to annual reviews. When there is a problem, our Relationship Directors are the first to act, supported by the relevant credit risk expert. We aim to identify warning signs early by monitoring customers' financial and trading data, checking to make sure they are not breaching any covenants, and by having regular dialogue with them. Our Restructuring & Recoveries team are engaged as needed on Watchlist cases and we may hand over more serious cases to them.

For the exposures not subject to annual review, we have several strategies for managing arrears that can be used as early as the day of the missed payment. We assess the problems a customer is having, so we can offer them the right help to bring their account up to date as soon as possible.

If a case becomes more urgent or needs specialist attention, and if it transfers to Stage 3, we transfer it to our Restructuring & Recoveries team. We aim to act before a customer defaults, to prevent it, if possible. The strategy we use depends on the type of customer, their circumstances and the level of risk. We use restructuring and rehabilitation tools to try to help our customers find their own way out of financial difficulty and agree on a plan that works for both of us.

Corporate & Investment Banking

Prior to the transfer in Q4 2021, we managed arrears in Corporate & Investment Banking in the same way as that in Corporate & Commercial Banking and Corporate Centre.

For more, see the Forbearance section.

5. Debt recovery (audited)

Sometimes, even when we have taken all reasonable and responsible steps to manage arrears, they are not effective. If this happens, we have to end our agreement with the customer and try to recover the whole debt, or as much of it as we can.

Retail Banking

In Homes, to recover what we are owed, we may use a debt collection agency, sell the debt, or take the customer to court. For retail mortgage loans we may consider legal action including repossession of the property as a last resort or, if necessary, to protect the property from damage or third-party claims. We make sure our estimated losses from repossessed properties are realistic by getting two independent valuations on each property, as well as the estimated cost of selling it. These form the basis of our loss allowances calculations. Where we do enforce the possession of a property we do not take ownership. We make use of external agents to realise the value and settle the debt. Any surplus funds are returned to the borrower or are otherwise dealt with in line with insolvency regulations.

In Everyday Banking, to recover what we are owed, we may use a debt collection agency, sell the debt, or take the customer to court, similar to our approach in Homes.

Consumer Finance

To recover what we are owed, we may use a debt collection agency, sell the debt, or take the customer to court, similar to our approach in Retail Banking. We may consider taking steps to re-possess of the vehicles we have financed.

Corporate & Commercial Banking and Corporate Centre

Where we look for an exit, we aim to do this, if we can, by agreeing with the borrower that they will sell some or all their assets on a voluntary basis or agreeing to give them time to refinance their debt with another lender. Where we cannot find a way forward or reach a consensual arrangement, we consider recovery options. This can be through an insolvency proceeding, enforcing over any collateral or selling debt on the secondary market. We may also consider other legal action available to recover what we are owed from debtors and guarantors. If there is a shortfall, we write it off against loss allowances we hold. In certain very rare instances, we may act as mortgagee in possession of assets held as collateral against non-performing commercial lending. In such cases, we carry the assets on our balance sheet and classify them in line with our accounting policies.

Corporate & Investment Banking

Prior to the transfer in Q4 2021, we followed the same debt recovery process in Corporate & Investment Banking as that in Corporate & Commercial Banking and Corporate Centre.

Loan modifications (audited)

We sometimes change the terms of a loan when a customer gets into financial difficulty (this is known as forbearance), or for other commercial reasons.

Forbearance

When a customer gets into financial difficulties, we can change the terms of their loan, either temporarily or permanently. We do this to help customers through temporary periods of difficulty so they can get back on to sustainable terms and fully pay off the loan over its lifetime, with support if needed. We try to do this before the customer defaults. Whatever we offer, we assess it to make sure the customer can afford the repayments. Forbearance improves our customer relationships and our credit risk profile. We review our approach regularly to make sure it is still effective. In a few cases, we can help a customer in this way more than once. This can happen if the plan to repay their debt doesn't work and we have to draw up another one. When this happens more than once in a year, or more than three times in five years, we call it multiple forbearance. We only use foreclosure or repossession as a last resort.

We may offer the following types of forbearance, but only if our assessments show the customer can meet the revised payments:

Action	Description
Term extension	We can extend the term of the loan, making each monthly payment smaller. For retail customers, where applicable they must also meet our policies for maximum loan term and age when they finish repaying. Customers with interest-only mortgages have to make arrangements to repay the principal at the end of the mortgage. For corporate customers, we expect the customer to be able to pay the interest in the short-term and have a realistic chance of repaying the full balance in the long-term at a minimum. We may offer term extensions if the customer is up to date with their payments but showing signs of financial difficulties. We may also offer this option if the loan is about to mature and near-term refinancing is not possible on market terms.
Interest-only	For retail customers, interest-only is only offered as a short-term standard collections arrangement since March 2015. We now record any related shortfall in monthly payments as arrears and report them to the credit reference agencies. As a result, we do not classify interest-only arrangements agreed since March 2015 as forbearance. We continue to manage and report all interest-only arrangements offered before then as forbearance. For corporate customers, we can agree to let a customer pay only the interest on the loan for a short time – usually less than a year. We only agree to this if we believe their financial problems are temporary and they are going to recover. After the interest-only period, we expect the customer to go back to making full payments of interest and capital once they are in a stronger financial position.
Other payment rescheduling, including capitalisation	For retail customers, we offer two main types, which are often combined with term extensions and, in the past, interest-only concessions: – If the customer cannot afford to increase their monthly payment enough to pay off their arrears in a reasonable time but has been making their monthly payments (usually for at least six months), then we can add the arrears to the mortgage balance. – We can also add to the mortgage balance at the time of forbearance, unpaid property charges which are due to a landlord and which we pay on behalf of the customer to avoid the lease being forfeited. For corporate customers, we may agree to lower or stop their payments until they have had time to recover. We may: – Reschedule payments to better match the customer's cash flow – for example if the business is seasonal – Provide a temporary increase in facilities to cover peak demand ahead of the customer's trading improving. We might do this by adding their arrears to their loan balance (we call this arrears capitalisation) or drawing from an overdraft. We may also offer other types of forbearance, including providing new facilities, interest rate concessions, seasonal profiling and interest roll-up. In rare cases, we agree to forgive or reduce part of the debt.

When we agree to forbearance, we consider that the account has suffered a Significant Increase in Credit Risk (SICR), as we explain later on. We review our loss allowance for it and report the account as forborne. For retail accounts, if an account is in Stage 1 (a 12-month ECL) when we agree forbearance, we transfer it to Stage 2 (a lifetime ECL). For all accounts, if an account is already in Stage 2 when we agree forbearance, we keep it in Stage 2 unless the forbearance arrangement involves an account that is deemed unlikely to pay (defined through a number of events listed in our Classification Policy), the forgiveness of fees and interest or debt, or is being granted multiple forbearances which would put the case into Stage 3 (a lifetime ECL). If an account is already in Stage 3 when we agree forbearance, we keep it in Stage 3. We monitor the performance of all forborne loans. A loan moves from a lifetime ECL to a 12-month ECL once the criteria to exit forbearance have been met, as set out below.

Exit from forbearance or cure

For an account in Stage 3 to exit forbearance, all the following conditions must be met:

– The account has been classed as Stage 3 for at least one year since the end of the latest forbearance strategy
– The account is not deemed unlikely to pay
– The account is no longer in arrears, and the customer has no other material debts with us which are more than 90 days in arrears.

If all the conditions are met, the account is re-classed as Stage 2 forbearance until the Stage 2 forbearance exit conditions set out below are also met.

For an account in Stage 2 to exit forbearance, all the following conditions must be met:

– The account has been classed as Stage 2 for at least two years since the end of the latest forbearance strategy
– The account has been performing, i.e. the customer is no longer in financial difficulty
– Meaningful capital and interest repayments have been made for at least 50% of the two year period
– The account is no longer in arrears, and the customer has no other material debts with us which are more than 30 days in arrears.

Other forms of debt management and modifications

When a customer is not showing signs of financial difficulties, we can also change the terms of their loan. We do this to help them manage their financial liabilities.

In addition, from March 2020 to March 2021, we provided mortgage customers with payment holidays in line with UK Government and FCA guidance. Similar payment holidays were also granted in respect of consumer (auto) finance, personal loans, credit cards, business and corporate loans. For more on this, see 'Covid-19 Support measures'. The granting of a payment holiday on its own was not considered to be a SICR event or a default under regulatory definitions or forbearance. For customers who needed further financial support after the payment holiday period, we offered them help in line with our policies.

Retail Banking

In Homes, apart from forbearance, we have sometimes changed the contract terms to keep a good relationship with a customer. We do not classify insolvency solutions for any unsecured retail customers as forbearance. This is in line with industry guidelines on the treatment of customers in insolvency or bankruptcy.

In Everyday Banking, we do not classify insolvency solutions for any unsecured retail customers as forbearance. This is in line with industry guidelines on the treatment of customers in insolvency or bankruptcy.

Consumer Finance

We do not classify insolvency solutions for any unsecured retail customers as forbearance. This is in line with industry guidelines on the treatment of customers in insolvency or bankruptcy.

Corporate & Commercial Banking and Corporate Centre
When customers are in financial difficulty, we can also manage debt in other ways, depending on the facts of the specific case:

Action	Description
Waiving or changing covenants	If a borrower breaks a covenant, we can either waive it or change it, taking their latest and future financial position into account. We may also add a condition on the use of any surplus cash (after operating costs) to pay down their debt to us.
Asking for more collateral or guarantees	If a borrower has unencumbered assets, we may accept new or extra collateral in return for revised financing terms. We may also take a guarantee from other companies in the same group and/or major shareholders. We only do this where we believe the guarantor will be able to meet their commitment.
Asking for more equity	Where a borrower can no longer pay the interest on their debt, we may accept fresh equity capital from new or existing investors to change the capital structure in return for better terms on the existing debt.

Corporate & Investment Banking
Prior to the transfer in Q4 2021, we managed debt in Corporate & Investment Banking in the same way as that in Corporate & Commercial Banking and Corporate Centre.

Risk measurement and control

We measure and control credit risk at all stages across the credit risk lifecycle. We have a range of tools, processes and approaches.

Retail Banking and Consumer Finance
These businesses involve managing large numbers of accounts, so they produce a huge amount of data. This allows us to take a more analytical and data intense approach to measuring risk. This is reflected in the wide range of statistical models we use across the credit risk lifecycle. We use:
- **Risk strategy and planning:** econometric models
- **Assessment and origination:** application scorecards, and attrition, pricing, loss allowance and capital models
- **Monitoring:** behavioural scorecards and profitability models
- **Arrears management:** models to estimate the proportion of cases that will result in possession (known as roll rates)
- **Debt recovery:** recovery models.

We assess and review our loss allowances regularly and have them independently reviewed. We look at a number of factors, including the cash flow available to service debt. We also use an agency to value any collateral – mainly mortgages.

Corporate & Commercial Banking and Corporate Centre
We measure the credit risk on treasury products by adding their potential future exposure to market movements over their lives to their fair value. Then we add it to any other exposure and measure the total against our credit limits for each client. We assess our loss allowances regularly by looking at a number of factors, including the cash flow available to service debt and the value of collateral based on third-party professional valuations.

Corporate & Investment Banking
Prior to the transfer in Q4 2021, we measured and controlled credit risk in the same way as Corporate & Commercial Banking and Corporate Centre.

Key metrics (audited)
We use a number of key metrics to measure and control credit risk, as follows:

Metric	Description
Expected Credit Loss (ECL)	ECL tells us what credit risk is likely to cost us either over the next 12 months on qualifying exposures, or defaults over the lifetime of the exposure where there is evidence of a SICR since origination. We explain how we calculate ECL below.
Stages 1, 2 and 3	We assess each facility's credit risk profile to determine which stage to allocate them to, and we monitor where there is a SICR and transfers between the Stages including monitoring of coverage ratios for each stage. We explain how we allocate a facility to Stage 1, 2 or 3 below.
Stage 3 ratio	The Stage 3 ratio is the sum of Stage 3 drawn and Stage 3 undrawn assets divided by the sum of total drawn assets and Stage 3 undrawn assets. The Stage 3 ratio is the main indicator of credit quality performance.
Expected Loss (EL)	EL is based on the regulatory capital rules of CRD IV and gives us another view of credit risk. It is the product of the probability of default, exposure at default and loss given default. We calculate each factor in accordance with CRD IV and include direct and indirect costs. We base them on our risk models and our assessment of each customer's credit quality. There are differences between regulatory EL and IFRS 9 ECL, which we set out below. The rest of our Risk review, impairments, losses and loss allowances refer to calculations in accordance with IFRS, unless we specifically say they relate to CRD IV. For our IFRS accounting policy on impairment, see Note 1 to the Consolidated Financial Statements.

We also assess risks from other perspectives, such as geography, business area, product and process to identify areas we need to focus on. We also use stress testing to establish vulnerabilities to economic deterioration. Our business segments tailor their approach to credit risk to their own customers, as we explain later on.

Recognising ECL (audited)
The ECL approach estimates the credit losses arising from defaults in the next 12 months on qualifying exposures, or defaults over the lifetime of the exposure where there is evidence of a SICR since the origination date. The ECL approach takes into account forward-looking data, including a range of possible outcomes, which should be unbiased and probability-weighted in order to reflect the risk of a loss being incurred even when it is considered unlikely.

Critical judgements and accounting estimates applied in calculating ECL (audited)
IFRS 9 recognises that critical management judgements and accounting estimates are an essential part of calculating ECL. Specifically, where the historical data that we use in our models does not reflect current or future expected conditions, or the data we have does not cover a sufficient period or is not robust enough. We consider the critical accounting estimates in calculating ECL to be:

- Forward-looking multiple economic scenarios; and
- Probability weights applied to multiple economic scenarios.

We consider the critical management judgements in calculating ECL to be:

- Definition of default;
- Significant Increase in Credit Risk (SICR) thresholds;
- Post Model Adjustments (PMAs);
- Internal credit risk rating for corporate borrowers; and
- Individually assessed corporate Stage 3 exposures.

See sections below for more on each of these key judgements and estimates.

Multiple economic scenarios and probability weights (audited)
For all our portfolios, except CIB, we use five forward-looking economic scenarios. For 2021, they consist of a central base case, one upside scenario and three downside scenarios. We use five scenarios to reflect a wide range of possible outcomes for the UK economy.

(i) For all our portfolios, except CIB
Our forecasting approach
We derive our scenarios in part by using a set of parameters in GDP fan charts published by the Office for Budget Responsibility (OBR). To avoid major changes to the scenarios due to changes in the OBR fan charts, we place more weight on the long-run outlook of the fan charts rather than relying solely on each individual release as this can create large swings in the scenarios which may not be appropriate. We use the OBR fan charts to calculate our GDP paths for each scenario. For 2021 this applied to the Upside 1, Downside 1 and Downside 2 scenarios. These fan charts reflect the probability distribution of a deviation from the OBR's central forecast to illustrate the uncertainty regarding the outcome of a variable, in this case GDP.

We use the 0.6 fan chart path for our Upside 1 scenario and the 0.3 path for Downside 1. For Downside 2 we use a blend of the Downside 1 scenario and the base case rather than the 2008/09 recession, which is used under BAU. This is because the fall in GDP in the base case is markedly higher than the one seen in 2008/09, due to the lockdown restrictions imposed due to Covid-19. To ensure that Downside 2 is kept consistent with any changes to the OBR fan charts, we calculate the Downside 2 GDP by taking the percentage difference between Downside 2 and Downside 1 GDP in the original forecast and applying this difference to the new Downside 1.

Once we have established the GDP paths for each scenario, we run them through the Oxford Global Economic Model (OGEM) to derive the other macroeconomic variables, such as unemployment and house prices. These variables are the product of the GDP growth paths we have forecast and the output of the OGEM for these growth paths. We then impose a Bank Rate profile for each scenario using expert judgement. We determine the Bank of England Bank Rate (Bank Rate) by using the base case Bank Rate profile and adjusting this for each of the four other scenarios. To do this, we firstly consider what each of the scenarios is trying to achieve.

For the upside scenario, which has a higher growth path and rising productivity growth, we allow for a managed tightening of the monetary stance, so we assume small increases in Bank Rate. In contrast, for Downside 2 the scenario shows monetary policy forced into a reactive stance to contain CPI inflation at a time of weakening output growth, so we assume the Bank of England would raise rates in this scenario to bring inflation back to its target rate. The rising Bank Rate profiles are based on forward guidance from the Bank of England, where increases are assumed to be gradual and incremental. For the Downside 1 scenario, this is aligned to the base case forecast for the majority of the 5 year forecast as inflation is similar to that of the base case, and for Downside 3, this shows a negative interest rate profile which the Bank of England follows to try and boost growth with inflation remaining low. In this way, our scenarios reflect a range of possible outcomes that the Bank of England may follow for different growth paths.

Our use of five scenarios is designed to reflect different possible outcomes to the base case forecast highlighting the upside and downside risks associated with the central scenario. The downside risks for the UK economy include further waves of Covid-19 leading to restrictions on economic activity, a further and sharper downturn in global growth, a substantial increase in inflation which raises the cost of living, a continuation of the very low productivity growth seen in the UK, and a move to a more protectionist agenda for trade. The upside risks are more muted at present and include a stronger recovery in global growth, coupled with a move to more open trade and further trade agreements with other countries.

We update the baseline in our economic scenarios at least twice a year in line with our annual budgeting and three-year planning processes, or sooner if there is a material change in current or expected economic conditions. For instance, in 2021 the base case has been updated every quarter. We refresh all our economic scenarios each quarter to reflect the latest data and OBR fan charts if these have changed, which are then reviewed and approved by the Credit Risk Provisions Forum (CRPF). The CRPF also assesses the probability weights at least once a quarter.

We do not use consensus forecasts as inputs to our models, but we do compare the outputs of our models against consensus views for the base case, to make sure that we understand any significant differences and address them where needed. At the end of 2021, there were no significant differences between our base case forecasts and the consensus views.

In 2021, we were also able to do further peer benchmarking analysis of the economic scenarios using the data the PRA provided, which for Q4 2021 included the mean weighted analysis for a selection of economic variables, including GDP, unemployment rate and HPI. This meant that we could compare our weighted scenarios against the average of our peers to understand what differences there may be. The conclusion of this analysis demonstrated that our economic scenarios were in line with our peers, although on a weighted basis house price inflation reflected a more conservative view.

In 2021, we also considered any likely impact from climate change risk on our forecasting approach and concluded that no adjustment to the multiple economic scenarios for climate change risk was required. This is because climate change effects are generally regarded to be relevant over a longer timeframe than our forecast period of five years.

Key changes to our forecasting approach in 2021

In 2021, there were no specific changes to our forecasting approach. The OBR have not published fan charts since March 2020. However, in order to ensure that the error bands remain reasonable, they have been cross-checked against other forecasters views on downside and upside scenarios to make sure they remain a reasonable proxy and we are considering using our own fan chart error bands going forward to mitigate this issue.

Base case

For our base case, the forecasts are based on the following assumptions: that there are no further lockdowns due to rising Covid-19 infections; that the majority of overseas travel restrictions have been removed; that supply constraints continue into 2022; that in Q4 further self-imposed social distancing restrictions are re-enacted to deal with increased infection rates slowing growth further; and that GDP 2019 levels are returned to in H1 2022. It is normal practice to review the scenarios and associated weights every quarter to ensure they appropriately reflect the current economic circumstances, and we will continue to follow that approach particularly as the advice the UK Government issues is subject to change in this fluid environment.

Base case key macroeconomic assumptions
– **House price growth:** The stamp duty holiday ceased at the end of September 2021. However, there has not appeared to be a marked slowdown in house price growth, although it was expected to fall back further in Q4 2021 as more normal demand patterns for housing emerge. With unemployment continuing to remain low, conditions for buying still favourable, albeit with mortgage rates increasing in line with Bank Rate hikes, and with the supply side remaining weak this will help keep house prices from falling. On this basis we were projecting an increase of 5% by the end of 2021, although this will vary across the UK regions with London seeing much smaller rises.
– **GDP:** The outlook assumes the recovery peaked in Q2 2021 with slowing quarterly growth rates thereafter. Growth in 2021 and 2022 will be hampered by the changes to the trading conditions brought about by the UK's exit from the EU and with supply constraints continuing to dominate, raising prices which along with the jump in prices for gas and oil result in inflation peaking in H1 2022. Growth continues in 2022, but with rates starting to return to pre-Covid levels as catch-up consumption begins to dissipate and the economy moves towards average growth rates. Key to growth is ensuring rising prices remain under control and that the cost of living spike remains that.
– **Unemployment rate:** Unemployment was expected to peak in Q4 2021 at 4.7% as the UK Government's job support schemes come to an end. However, with the majority of UK businesses wanting to retain staff for when trading conditions return to more 'normal' patterns, unemployment continues to fall back over the forecast period. Given the reduced size of the UK workforce, unemployment by the end of the forecast period is only slightly higher than pre-pandemic.
– **Bank Rate:** For the Bank Rate forecast, the base case had Bank Rate at 25bps at the end of 2021, in line with the increase in rates implemented by the Monetary Policy Committee (MPC) on 16 December 2021. In 2022 it assumes two further rate hikes of 25bps, each to end 2022 at 75bps. These further increases are designed to bring CPI inflation back towards target in 2023 given a peak of circa 6% in H1 2022. The base case remains flat from beginning of 2023 over the rest of the forecast period as inflation starts to drop back with rates now at pre-pandemic levels. The Bank of England look to bed in these new rates and to understand its effects on businesses.

In the medium-term, the projections assume that current demographic and productivity trends will continue, causing a reduction in the UK's growth potential. For instance, it is likely that the reduction in the UK workforce continues and that this will have a knock on impact for the economy, particularly if there are shortages of skilled workers in particular sectors. This is reflected in an average annual growth expectation of 1.6%, the OBR's latest estimate of the UK's long run average growth rate. CPI inflation is forecast to be significantly above the 2% target rate in the initial forecast period but then fall to target by the end. With higher levels of savings, consumers use a proportion of these to help support household spending power through 2022.

In summary, the base case assumes that the outlook improves as the successful vaccination programme continues, which ends the need for further national lockdowns.

Key changes to our base case in 2021

The key changes to our base case assumptions in 2021 were: (i) stronger GDP growth in 2021 and weaker expansion in 2022 to reflect the faster recovery followed by a return to slower, pre-pandemic growth rates; (ii) the unemployment rate, whilst lower than expected given the government furlough scheme, rises a little and peaks in Q4 2021. Thereafter it falls back very gradually over the forecast horizon; (iii) there is much faster house price growth in 2021 as the ending of the stamp duty holiday only has a limited effect on reducing demand and supply remains constrained; and (iv) the Bank Rate profile increases to 75bps by 2022 and thereafter is held flat at its pre-pandemic level of 0.75%. This had the effect of increasing the weighted average of the Bank Rate across the five scenarios to 1.25%.

Other scenarios

Based on this revised base case, we have reviewed our suite of scenarios to ensure that they capture the wide range of potential outcomes for the UK economy. These include (i) a significant rise in Covid-19 cases and further lockdown measures being imposed as variants continue to appear; (ii) a slower recovery that is more akin to the 'U' shape of past recessions; (iii) higher inflation; (iv) labour market frictions due to skills mismatches and a shrinking workforce as some discouraged workers leave altogether (for example EU workers returning to their native countries and older UK born workers retiring early); and (v) the global economy bouncing back more strongly than expected.

In order to reflect these potential outcomes, we decided to continue to use the base case and four additional scenarios, which management considers to provide a range wide enough to reflect all of the above potential outcomes. However, as the risks remain skewed to the downside, to reflect these outcomes sufficiently, we concluded that only one upside scenario would be needed to reflect the upside risks to the base case. As with the base case, the scenarios are forecast over a five-year period and then mean revert over the next three years to the OBR's latest estimate of the UK's long run average growth rate.

The four scenarios are as follows:

One upside scenario

Our modest upside scenario remains appropriate based on vaccines and boosters continuing to be distributed quickly and effectively to the population, which in turn creates a more resilient workforce. It also assumes a faster global recovery and the UK continuing to agree to trade agreements with a number of countries outside the EU. It is also based on productivity growth recovering. HPI for Upside 1 is less positive than for the base case and is based on the HPI equations built into the Oxford Global Economic Model (OGEM) and the particular GDP profile used, whereas our base case reflects our planning view which allows for flexibility to align what is currently seen in the market to the outlook of the economic variable forecast.

Three downside scenarios

Downside 1 assumes further local/regional restrictions were implemented as we moved through 2021 and into 2022 than in the base case as a means of controlling increases in infection rates, which in turn impact economic growth as vaccines are not as effective in combating new variants as hoped. The scenario also reflects a fall in demand for housing leading to downward price corrections over the next five years with a peak to trough of negative 5%. It assumes trade agreements with other countries being negotiated over the forecast period, but fewer than in the base case.

Downside 2 reflects a severe downturn with a longer recovery needed (U shape) capturing even more conservatism and lack of confidence in terms of spending by consumers with higher levels of unemployment. For businesses, it reflects a slower return to profitability and more insolvencies as vaccines are unable to keep infection rates from new variants under control. Companies also struggle to adapt to the new trading conditions with the EU, which create supply bottlenecks and push up manufacturing costs that businesses can no longer absorb, forcing them to pass this burden onto consumers. With business confidence weak and investment contracting, a reduction in investor appetite for UK assets causes a sharp depreciation in sterling which pushes up imported inflation and causes the MPC to raise rates significantly. It also assumes that the incidence of major risk events, for example those caused by climate change, continue to occur exposing risks to countries' fiscal position and the means to respond to such events which results in growth taking far longer to recover.

There is a substantial rise in interest rates of up to 3%, which results in a large increase in debt-service costs to households and a rapid undermining of demand in the housing market. House values fall sharply and the combination of rising interest rates and unemployment with falling house prices results in a rising profile of credit impairment losses.

Downside 3 features a double dip in economic activity (W shape) lasting three quarters, with higher unemployment and a sharper fall in house prices compared to the four other scenarios. The fall in GDP of circa 7% between Q4 2020 and Q2 2022 is less than half the fall of circa 22% in H1 2020, as this assumes businesses have contingency plans to be able to stay open whilst practising social distancing. The peak in the unemployment rate is similar to that seen in the early 1980s recession peaking at 11.9% in 2022 and remaining in double digits until early 2023, before falling back very gradually. The long-term effects of high unemployment result in a permanent hit to potential output, as persistent and elevated uncertainty leads to more job losses and corporate bankruptcies. Sharp falls in house prices (circa 27%) combined with persistently higher unemployment have particularly adverse consequences for credit impairment charges.

Key changes to our alternative scenarios in 2021

The key changes to our alternative scenarios in 2021 related to changes to the base case, historical data for each variable, and the OGEM. We also rolled forward the GDP path in Downside 3 but kept the overall shape of the profile the same. We did not make any other methodological changes to the scenarios. The combination of these different inputs will mean differences across the variables for each of the alternative scenarios when we update them each quarter. As such, it is not possible to pin-point a specific reason for each change as we do not run the inputs in isolation. However, we compare the variables between each quarter and review any large changes to ensure they are not erroneous.

The table below sets out our macroeconomic assumptions for each of the five scenarios at 31 December 2021:

		Upside 1 %	Base case %	Downside 1 %	Downside 2 %	Downside 3 %
GDP[1]	2020 (actual)	(9.7)	(9.7)	(9.7)	(9.7)	(9.7)
	2021	7.0	6.9	6.8	6.2	5.6
	2022	4.8	4.6	4.1	(0.7)	(7.5)
	2023	2.2	1.7	0.9	0.5	3.1
	2024	1.9	1.5	0.5	1.6	1.5
	2025	2.1	1.6	0.5	1.7	1.5
Bank Rate[1]	2020 (actual)	0.10	0.10	0.10	0.10	0.10
	2021	0.25	0.25	0.25	0.25	0.25
	2022	0.75	0.75	0.75	1.00	(0.50)
	2023	0.75	0.75	0.75	2.00	0.00
	2024	1.25	0.75	1.00	3.00	0.00
	2025	1.75	0.75	1.00	2.75	0.00
HPI[1]	2020 (actual)	6.9	6.9	6.9	6.9	6.9
	2021	5.4	5.0	5.4	5.4	(2.5)
	2022	(0.8)	2.0	(1.8)	(8.3)	(19.6)
	2023	(2.0)	2.0	(4.6)	(13.1)	(9.3)
	2024	1.0	2.0	(3.1)	(4.8)	2.4
	2025	3.8	2.0	(0.7)	4.3	3.3
Unemployment[1]	2020 (actual)	5.2	5.2	5.2	5.2	5.2
	2021	4.4	4.7	4.4	4.4	6.8
	2022	4.4	4.5	4.8	6.9	11.4
	2023	4.2	4.4	5.0	6.9	8.7
	2024	3.9	4.3	5.1	6.4	8.0
	2025	3.7	4.3	5.4	6.1	7.4

The table below sets out our macroeconomic assumptions for each of the five scenarios at 31 December 2020:

		Upside 1 %	Base case %	Downside 1 %	Downside 2 %	Downside 3 %
GDP[1]	2020	(10.5)	(11.5)	(10.5)	(11.1)	(11.5)
	2021	4.8	4.5	4.0	(0.8)	(8.0)
	2022	4.9	6.1	3.6	3.2	3.1
	2023	3.0	2.2	1.5	2.7	1.5
	2024	2.0	1.5	0.4	1.5	1.5
Bank Rate[1]	2020	0.10	0.10	0.10	0.10	0.10
	2021	0.25	0.10	0.10	0.75	(0.50)
	2022	0.75	0.10	0.10	1.75	0.00
	2023	1.25	0.10	0.10	3.00	0.00
	2024	1.75	0.25	0.25	2.75	0.00
HPI[1]	2020	3.7	3.5	3.7	3.7	3.5
	2021	(4.6)	(2.0)	(5.4)	(11.3)	(19.7)
	2022	(4.1)	1.5	(6.6)	(14.5)	(8.2)
	2023	2.4	2.0	(1.8)	(3.8)	1.3
	2024	5.5	2.0	0.5	4.9	3.1
Unemployment[1]	2020	6.3	6.8	6.3	6.3	6.8
	2021	6.1	7.5	6.5	8.5	11.4
	2022	5.3	6.2	6.1	7.9	8.7
	2023	4.4	5.6	5.7	6.9	8.0
	2024	4.1	5.5	5.8	6.5	7.4

(1) GDP is the calendar year annual growth rate, HPI is Q4 annual growth rate and all other data points are at 31 December in the year indicated.

Our macroeconomic assumptions and their evolution throughout the forecast period

Our macroeconomic assumptions and their evolution throughout the forecast period for 2021 and 2020 were:

2021		Upside 1 %	Base case %	Downside 1 %	Downside 2 %	Downside 3 %
House price growth	5-year average increase/decrease	**1.30**	**2.00**	**(1.78)**	**(3.27)**	**(6.00)**
	Peak/(trough) at [1]	**(3.07)**	**0.00**	**(9.87)**	**(24.03)**	**(32.12)**
GDP	5-year average increase/decrease	**2.33**	**1.89**	**0.93**	**0.49**	**(0.58)**
	Cumulative growth/(fall) to peak/(trough) [2]	**12.19**	**9.83**	**4.75**	**2.48**	**(2.85)**
Unemployment rate	5-year end period	**3.60**	**4.30**	**5.65**	**5.95**	**6.80**
	Peak/(trough) at [1]	**4.45**	**4.70**	**5.65**	**7.27**	**11.90**
Bank of England bank rate	5-year end period	**2.00**	**0.75**	**1.00**	**2.25**	**0.25**
	Peak/(trough) at [1]	**2.00**	**0.75**	**1.00**	**3.00**	**(0.50)**

2020		Upside 1 %	Base case %	Downside 1 %	Downside 2 %	Downside 3 %
House price growth	5-year average increase/decrease	0.49	1.38	(2.01)	(4.54)	(4.44)
	Peak/(trough) at [1]	2.45	7.11	(9.65)	(20.72)	(20.32)
GDP	5-year average increase/decrease	0.75	0.39	(0.38)	(0.98)	(2.82)
	Cumulative growth/(fall) to peak/(trough) [2]	3.82	1.96	(1.88)	(4.80)	(13.33)
Unemployment rate	5-year end period	4.14	5.50	5.84	6.52	7.40
	Peak/(trough) at [1]	6.28	7.90	6.51	8.78	11.90
Bank of England bank rate	5-year end period	1.75	0.25	0.25	2.75	0.00
	Peak/(trough) at [1]	1.75	0.25	0.25	3.00	(0.50)

(1) For GDP and house price growth it is the peak to trough change within the 5 year period; for the unemployment rate it is the peak; and for Bank Rate it is the peak or trough.
(2) This is the cumulative growth for the 5 year period.

Scenario weights

Given the change to the base case in Q4 2021, we undertook a full review of the probability weights applied to all the scenarios. The setting of probability weights needs to consider both the probability of the economic scenarios occurring while ensuring that the scenarios capture the non-linear distribution of losses across a reasonable range. To support the initial assessment of how likely a scenario is to occur, we typically undertake a Monte Carlo analysis which would ascertain the likelihood of a five-year average GDP forecast growth rate occurring based on the long run historically observed average. Creating a standard distribution bell curve around this long run average allows us to estimate the probability of a given GDP scenario occurring and therefore assign a probability weight to that scenario. However, a key challenge with this approach in a stressed environment like the one seen in 2020 is that extreme GDP forecasts occur.

Due to the extreme falls in growth, in 2020 we changed the time period that we looked at for the Monte Carlo analysis to 2007-2012 in order to capture the very low period of growth, similar to those seen in 2020. However, this time period is no longer appropriate as the economy recovers resulting in large upswings in growth. As such, we have assessed various periods of growth, similar to the action we took in 2020, and the most relevant period would be to include the entire data set given that the number of growth periods since 1948 far outweighs the downswings. In this case, the base case sits at the 10th percentile with such a growth rate occurring, historically, nearly half the time (43%) implying that a weight of between 40-50% remains appropriate. Under the longer period, the Downside 3 scenario now sits in the 50th percentile since the number of significant quarterly growth periods is increasing as we move through 2021. However, this still suggests that a low weight remains appropriate.

We also need to consider the UK economic and political environment when applying weights. Although the economic recovery has started, it is clear that the roadmap will need to be altered in order to deal with any increasing infection rates caused by new variants, particularly as they are appearing regularly and vaccines may need to evolve further to deal with potential resistance to them. As such, we remain of the view that the risks are still biased to the downside and include: emergence of further variants that are resistant to existing vaccines leading to further lockdowns - at present the Omicron variant is an example of where uncertainty is affecting the UK economy via self-imposed restrictions as well as those mandated by the UK Government; a substantial increase in inflation; continuing weak investment; a larger negative impact from the EU trade deal than assumed; and the increasing possibility of a second Scottish referendum which may bring disruption to any recovery in the latter years of the forecast. As such, it remains appropriate to reflect this with a 50% weight for the downside scenarios.

The scenario weights we applied for 2021 and 2020 were:

Scenario weights	Upside 1 %	Base case %	Downside 1 %	Downside 2 %	Downside 3 %
2021	**5**	**45**	**25**	**20**	**5**

Scenario weights	Upside 1 %	Base case %	Downside 1 %	Downside 2 %	Downside 3 %
2020	5	45	15	25	10

(ii) For our CIB portfolios (prior to the transfer in Q4 2021)

Our forecasting approach

The scenario we applied for CIB was an overlay calculation which was used for the overlay in provisions estimation, due to Covid-19. The Long Run scenario was based on a long run (rather than point in time) view and was prepared in the context of a long-term stable outlook where the structural deterioration is materialised to quantify the overlay to account for the macroeconomic worsening. This was to avoid excessive volatility and considered appropriate due to the size of the portfolio. No weights were applied.

Our macroeconomic assumptions and their evolution throughout the forecast period

Our macroeconomic assumptions and their evolution throughout the forecast period for our CIB portfolio at 31 December 2020 were:

GDP assumption		%
2020	Long Run global growth scenario [1]	1.3

(1) The Long Run scenario is the average annual global growth rate over the 5 year period 2020 to 2024.

Definition of default (Credit impaired) (audited)

We define a financial instrument as in default (i.e. credit impaired) for purposes of calculating ECL if it is more than three months past due, or if we have data to make us doubt the customer can keep up with their payments i.e. they are unlikely to pay. The data we have on customers varies across our business segments. It typically includes where:

Retail Banking and Consumer Finance
– They have been reported bankrupt or insolvent. This excludes accounts which are up to date and are not defaulted
– Their loan term has ended, but they still owe us money more than three months later
– They have had forbearance while in default, but have not caught up with the payments they had missed before that, or they have had multiple forbearance
– We have suspended their fees and interest because they are in financial difficulties
– We have repossessed the property
Corporate & Commercial Banking and Corporate Centre
– They have had a winding up notice issued, or something happens that is likely to trigger insolvency – such as another lender calls in a loan
– Something happens that makes them less likely to be able to pay us – such as they lose an important client or contract
– They have regularly missed or delayed payments, even though they have not gone over the three-month limit for default
– Their loan is unlikely to be refinanced or repaid in full on maturity
– Their loan has an excessive LTV that is unlikely to be resolved, such as by a change in planning policy, pay-downs, or increase in market value

Where we use the advanced internal ratings-based basis for a portfolio in our capital calculations, we use the same default definitions for ECL purposes. The CRPF reviews and approves the definition of default at least annually.

The Board Audit Committee reviews and challenges the appropriateness of the definition each year, or more often if we change it.

Between March 2020 and March 2021, we offered customers the option to take a payment holiday for up to 6 months where the customer had self certified they had been financially impacted by Covid-19. The granting of a payment holiday on its own was not considered to be a SICR, nor was it considered to be a default under regulatory definitions. Customers requiring longer-term financial support after the 6 month period, such as term extension or interest-only conversion, are treated in accordance with our normal SICR and default definitions.

Prior to the transfer in Q4 2021, we used the same definition of default in Corporate & Investment Banking as that used in Corporate & Commercial Banking and Corporate Centre.

Significant Increase in Credit Risk (SICR) (audited)

Loans which have suffered a SICR since origination are subject to a lifetime ECL assessment which extends to a maximum of the contractual term of the loan, or the behavioural term for a revolving facility. Loans which have not experienced a SICR are subject to 12-month ECL. We assess the credit risk profile of each facility to determine which of three stages to allocate them to:

- **Stage 1:** when there has been no SICR since initial recognition. We apply a loss allowance equal to a 12-month ECL i.e. the proportion of lifetime expected losses that relate to that default event expected in the next 12 months
- **Stage 2:** when there has been a SICR since initial recognition, but no credit impairment has materialised. We apply a loss allowance equal to the lifetime ECL i.e. lifetime expected loss resulting from all possible defaults throughout the residual life of a facility
- **Stage 3:** when the exposure is considered credit impaired. We apply a loss allowance equal to the lifetime ECL. Objective evidence of credit impairment is required. For more, see the section 'Definition of default (Credit impaired)' above.

We use a range of quantitative, qualitative and backstop criteria to identify exposures that have experienced a SICR. The Credit Risk Provisions Forum (CRPF) reviews and approves our SICR thresholds periodically. The Board Audit Committee reviews and challenges the appropriateness of them each year, or more often if we change them.

Quantitative criteria

We use quantitative criteria to identify where an exposure has increased in credit risk. The criteria we apply are based on whether any increase in the lifetime PD since the recognition date exceeds a set threshold both in relative and absolute terms. We base the value anticipated from the initial recognition on a similar set of assumptions and data to the ones we used at the reporting date, adjusted to reflect the account surviving to that date. The comparison uses either an annualised lifetime PD, where the lifetime PD is divided by the forecast period, or the absolute change in lifetime PD since initial recognition. For each portfolio, the quantitative criteria we used for 2021 were:

Retail Banking				Consumer Finance [2]	Corporate & Commercial Banking	Corporate Centre
Homes	Everyday Banking [1]					
	Personal loans	Credit cards	Overdrafts			
30bps	30bps	340bps	260bps	300bps	30bps	Internal rating method

(1) For larger business banking customers we apply the same criteria that we use for Corporate & Commercial Banking.
(2) Consumer Finance use the comparison of lifetime PDs to determine Stage allocation, unlike other products which first turn the lifetime PD into an average yearly PD (annualised) and then do the comparison.

The criteria above are absolute (rather than relative) increases in lifetime PD since initial recognition. These are all absolute values. We also applied a relative threshold of 100% (doubling the PD) across all portfolios.

In 2021, there were no changes to the way that we measure SICR. The granting of a payment holiday on its own was not considered to be a SICR event.

Prior to the transfer in Q4 2021, we used the Internal rating method in Corporate & Investment Banking.

Qualitative criteria

We also use qualitative criteria to identify where an exposure has increased in credit risk, independent of any changes in PD. For each portfolio, the criteria we used for 2021 and 2020 were:

Retail Banking				Consumer Finance	Corporate & Commercial Banking	Corporate Centre
Homes	Everyday Banking[1]					
	Personal loans	Credit cards	Overdrafts			
- In forbearance - Default in last 24m - 30 Days past due (DPD) in last 12m - Bankrupt - £100+ arrears	- In Collections - Default in last 12m - £50+ arrears	- In forbearance - Default in last 12m - In Collections - £100+ arrears - Behaviour score indicators	- Fees suspended - Default in last 12m - Debit dormant >35 days - Any excess in month	- In forbearance - Deceased or Insolvent - Court 'Return of goods' order or Police watchlist - Agreement terminated - Payment holiday - Cash Collection	- In forbearance - Default in last 12m - Watchlist: proactive management - Default at proxy origination	- Watchlist: proactive management

(1) For larger business banking customers we apply the same criteria that we use for Corporate & Commercial Banking.

In addition, due to Covid-19 we introduced temporary Post Model Adjustments (PMAs) since Q2 2020 to Stage allocation based on collective assessments of portfolios in Retail Banking and Consumer Finance, and client level in corporate lending (Corporate & Commercial Banking and Corporate & Investment Banking segments) based on sector and client credit quality. See the section 'Post Model Adjustments (PMAs)' below for more on this.

Prior to the transfer in Q4 2021, we used Watchlist: proactive management in Corporate & Investment Banking.

Backstop criteria

As a backstop, we classify all exposures more than 30 or 90 DPD in at least Stage 2 or in Stage 3, respectively. This means that we do not rebut the backstop presumptions in IFRS 9 (i.e. credit risk has significantly increased if contractual payments are more than 30 DPD) relating to either a SICR or default.

Improvement in credit risk or cure

In some cases, instruments with a lifetime ECL (in Stage 2 or 3) may be transferred back to 12-month ECL (Stage 1). Financial assets in Stage 3 can only be transferred to Stage 2 or Stage 1 when they are no longer considered to be credit impaired, as defined above. Financial assets in Stage 2 can only be transferred to Stage 1 when they are no longer considered to have experienced a SICR. Where we identified a SICR using quantitative criteria, the instruments automatically transfer back to Stage 1 when the original PD-based transfer criteria are no longer met. Where we identified a SICR using qualitative criteria, the issues that led to the transfer must be cured before the instruments can be reclassified to Stage 1. For a loan in forbearance to cure, it must meet the exit conditions set out in the earlier section 'Forbearance'.

Post Model Adjustments (PMAs) (audited)

We use a range of methods to identify whether we need a PMA. These include regular review of model monitoring tools, period-to-period movement and trend analysis, comparison against forecasts, and input from expert teams who monitor and manage key portfolio risks. We only recognise a PMA if the ECL is over £1m. We keep PMAs in place until we no longer need them. This will typically be when they are built into our core credit model or the conditions that impacted the historical data no longer exist.

The Risk Provisions & Forecasting team calculates PMAs to ensure they are incremental to the core credit model and to ensure the calculation is performed in a consistent and controlled manner. We apply standard end-user computing controls to material and long-standing PMAs i.e. those expected to be in place for more than six months. Our Independent Validations Team may also review significant PMAs at their discretion. The CRPF approves all new PMAs. It delegates authority to approve temporary PMAs not expected to last beyond a quarter-end to the CFO. The Consolidated Reporting team reviews all new PMAs to ensure they comply with IFRS 9. We record all PMAs on a central log maintained by the Consolidated Reporting team which documents the justification, IFRS 9 compliance assessment, expected life, recalibration frequency, calculation methodology and value of each PMA. The CRPF reviews and approves the log each quarter.

2021	Modelled ECL £m	Individually assessed £m	PMAs £m	Total ECL £m
Retail Banking	**264**	**1**	**123**	**388**
– Homes	**119**	**1**	**70**	**190**
– Everyday Banking	**145**	**—**	**53**	**198**
Consumer Finance	**51**	**—**	**1**	**52**
Corporate & Commercial Banking	**106**	**100**	**217**	**423**
Corporate Centre	**2**	**—**	**—**	**2**
Total	**423**	**101**	**341**	**865**

2020	£m	£m	£m	£m
Retail Banking	472	3	113	588
– Homes	220	3	57	280
– Everyday Banking	252	—	56	308
Consumer Finance	110	—	8	118
Corporate & Commercial Banking	195	157	251	603
Corporate & Investment Banking	26	—	7	33
Corporate Centre	—	—	35	35
Total	803	160	414	1,377

2021 compared to 2020

PMAs reduced from £414m to £341m though the proportion of PMAs to total ECL increased from 30% to 39%. The change in proportion was mainly due to reduction in total ECL driven by favourable macroeconomic forecast and improved credit quality on assets compared to 2020.

The PMAs that we applied at 31 December 2021 and 31 December 2020 were:

PMAs	2021 £m	2020 £m
Non Covid-19 PMAs		
Long-term indeterminate arrears	**14**	29
12+ months in arrears	**29**	34
Cladding risk	**15**	—
Mortgages affordability	**18**	—
UPL loss floor	**21**	31
Other PMA	**8**	30
Total non Covid-19 PMAs	**105**	124
Covid-19 PMAs		
Corporate lending to segments affected by Covid-19	**176**	193
Payment holidays	**—**	27
Corporate single large exposure	**23**	35
Model underestimation	**28**	20
SME debt burden	**9**	—
Other Covid-19 PMAs	**—**	15
Total Covid-19 PMAs	**236**	290

- **Long-term indeterminate arrears:** To mitigate the risk of model underestimation, we fully provide for accounts in arrears which have neither repaid (cured) or been written-off after a period of 2 years for unsecured portfolios or 5 years for secured portfolios. For our secured portfolios, we use expected security valuations at the point of repossession to estimate the adjustment. At 31 December 2021 and 31 December 2020, we only needed to make an adjustment for mortgages. As a result of regulatory suspension of repossession in response to the Covid-19 pandemic, management has assumed up to a 2 year delay in repossessions when calculating the ECL uplift for this PMA. This is to make sure LTVs are appropriately stressed by the economic scenarios. Over the medium term, as we continue to address long term arrears in the portfolio, we expect the need for this PMA will diminish. This PMA increased our ECL by £14m. Had management assumed no delay in repossessions or a 3 year delay, the PMA could have been within a range of £11m to £15m.
- **12+ months in arrears:** To mitigate the risk of underestimating ECL, mortgage accounts which are more than 12 months past due are fully provided for after deducting a historically observed self-cure rate. As a result of regulatory suspension of repossession in response to the Covid-19 pandemic, management has assumed up to a 2 year delay in repossessions when calculating the ECL uplift for this PMA. This is to make sure LTVs are appropriately stressed by the economic scenarios. Over the medium term, as we continue to address long term arrears in the portfolio, we expect the need for this PMA will diminish. This PMA increased our ECL by £29m. Had management assumed no delay in repossessions or a 3 year delay, the PMA could have been within a range of £21m to £32m.
- **Cladding risk:** This PMA reduces the valuation of flats deemed to be at high-risk, where both fire safety and cladding rectification was highly probable, by 20%, and reduces medium risk flats, where just cladding rectification was deemed to be likely, valuation by 10%. The PMA increased our ECL by £15m, which reflects the reduction in valuation on these flats.
- **Mortgage affordability:** This PMA addresses the risk that the current PD model for mortgages is likely to underestimate a 'cost of living crisis' whereby real disposable income is stretched with increasing living costs and debt burden as interest rates begin to rise. The PMA identifies a population of customers most likely to be under inflationary pressures, increases their PDs and moves them to Stage 2. At 31 December 2021 these accounts made up a significant amount of the total mortgage Stage 2 population as £4.2bn mortgages were moved from Stage 1 into Stage 2 as a result. The PMA increased our ECL by £18m. Had management applied different sensitivities to the PD uplifts, the ECL impact could have been between £14m and £27m.
- **UPL loss floor:** This PMA addresses the perceived macroeconomic insensitivity within the UPL IFRS 9 models, where historical analysis of losses shows a much larger correlation to the International Labour Organisation (ILO) unemployment forecast than the model gives. The PMA then uplifts the lifetime losses expected in each of the five macroeconomic scenarios within the IFRS 9 model to meet the expected losses the historical analysis predicts. The PMA increased our ECL by £21m. If management had only increased PDs, the PMA could have been £16m.

- **Corporate lending to segments affected by Covid-19:** In 2020, following internal sector and counterparty assessments, we transferred loans for some corporate and SME sectors and clients who have been severely impacted because of Covid-19 from Stage 1 into Stage 2. This included exposures in a sector where trading had been highly impacted by Covid-19 including Hotels, Hospitality, Retail, Leisure and Care Homes sectors, and where the client has been assessed as most likely to require financial support based on their current financial circumstances. In addition, we have transferred some Stage 2 corporate and SME loans to Stage 3 based on a similar analysis of sector and client credit quality taking into consideration any concessions given to clients since the start of the pandemic as an indicator of those loans most likely to meet our default definition. We use our models to calculate the incremental ECL required from transferring loans between stages and apply stress factors to the client PD ratings based on our historical experience. Over the medium term, as our actual data on the performance of these customers grows, we expect the need for this PMA will diminish. This PMA increased our ECL by £176m. Had management assumed the lowest observed PD stress factors to all Stage 1 to Stage 2 transferred loans or transferred none of the Stage 2 exposures in highly impacted sectors to Stage 3, the PMA would reduce to £23m. Had management assumed the highest observed PD stress factor to all Stage 1 to Stage 2 transferred loans and transferred all high risk Stage 2 exposures in highly impacted sectors to Stage 3, the PMA would increase to £287m.
- **Payment holidays:** In 2020, we transferred a proportion of Stage 1 loans into Stage 2 where our discussions with retail customers on a Covid-19 payment holiday established they are in longer-term financial difficulties. This was done on a collective basis through a customer contact exercise and customer data profiling. As completed payment holiday customers reached 12 months of successful repayments, we released the unutilised ECL.
- **Corporate single large exposure:** In 2020, to mitigate against the risk of a single large corporate exposure with an ECL requirement of greater than £10m defaulting, which has not been covered by the existing model estimate or the corporate and SME PMA above, we applied a PMA for the risk of a company which unexpectedly defaults. This PMA has been calculated based on incurring three average historically observed single name large losses in our Corporate & Commercial business segment (and Corporate & Investment Banking business segment before the transfer in Q4 2021). We will continue to assess this risk over the medium term based on actual experience and we will refine the estimate based on changes in our portfolio credit quality and loan size mix. This PMA increased our ECL by £23m. Had management assumed only one average loss was incurred the PMA would decrease to £12m. The PMA would increase to £35m assuming three average losses were incurred.
- **Model underestimation:** This PMA addresses potential underestimation risk of ECL models identified by our model monitoring and back-testing from lower PDs given the extreme scenarios of low level of macroeconomic stress and timing effects of government support schemes on emergence of defaults. This PMA increased our ECL by £28m. Had management only corrected for the perceived underestimation in the Base case and Upside 1 scenarios on mortgages and used the historic uplift factor on overdrafts, the PMA could have been £12m. Had management applied the same uplift on the Downside 2 scenario as the Base case, Upside 1 and Downside 1 scenarios, the PMA could have been £29m.
- **SME debt burden:** We introduced a SME debt burden PMA in H1 2021 to take account of the potential debt burden risk of unsecured lending to our SME customers who also took a BBL. This does not incorporate the credit risk on BBLs, as these are government guaranteed but instead considers the possible impact on repayment of other lending with us. This PMA increased our ECL by £9m. Had management used the modelled lifetime losses for all dragged accounts, the PMA could have been £3m. Had management used a 50% coverage on all accounts, the PMA could have been £15m.

Climate change

In addition, in 2021 we assessed the risks to asset valuations in the customer loan book from both transitional and physical risks associated with climate change. At 31 December 2021, we did not consider it appropriate to recognise a climate change risk related PMA for the following reasons:

- The behavioural life of the loan book is less than five years. Any material transitional risks are generally regarded to be relevant over a longer timeframe than five years and as such, the risk predominantly relates to assets yet to be written;
- There has been no observed default event occurred to our knowledge because of climate change, as such, it is not possible to identify a SICR or default event for any part of the existing loan book;
- The absolute exposure to fossil fuel industries is not deemed to be material. On an individually assessed basis, clients in these industries are highly rated and their markets remain highly liquid;
- In Consumer Finance, residual value risk is already set at the more cautious end of the acceptable range to capture the inherent risk of diesel obsolescence and measurement uncertainty of electric vehicles; and
- The proportion of mortgage loans subject to flood and subsidence risk is not deemed to be material. The terms of our mortgage lending also require homeowners to buy suitable insurance which transfers the majority of the risk to asset valuations to third party insurers.

Internal credit risk rating for corporate borrowers (audited)

We assign each corporate borrower an internal credit rating based on our internal rating scale. To do this, we look at the customer's financial history and trends in the economy including reflecting the impacts of the Covid-19 pandemic – backed up by the expert judgement of a risk analyst. We review our internal ratings on a dynamic basis and at least once a year. The internal risk rating is used to determine the Probability of Default for a client.

Individually assessed corporate Stage 3 exposures (audited)

We assess the ECL requirement for large single name corporate exposures on an individual basis when they meet our definition of default and are transferred into Stage 3. This assessment takes into consideration the latest specific information about the counterparty to determine a probability weighted ECL based on a best, worst and mid case outcome. For those loans that were in default (i.e. Stage 3), the ECL was £100m at 31 December 2021 (2020: £157m). Had management assumed the best or worst outcome in terms of loss estimates, the ECL could have been within a range of £38m to £155m.

Sensitivity of ECL allowance (audited)

The ECL allowance is sensitive to the methods, assumptions and estimates underlying its calculation. For example, management could have applied different probability weights to the economic scenarios and, depending on the weights chosen, this could have a material effect on the ECL allowance. In addition, the ECL allowance for residential mortgages, in particular, is significantly affected by the HPI assumptions which determine the valuation of collateral used in the calculations.

Had management used different assumptions on probability weights and HPI, a larger or smaller ECL charge would have resulted that could have had a material impact on the Santander UK group's reported ECL allowance and profit before tax. Sensitivities to these assumptions are set out below.

Scenario sensitivity

The amounts shown in the following tables illustrate the ECL allowances that would have arisen had management applied a 100% weight to each economic scenario. The allowances were calculated using a stage allocation appropriate to each economic scenario presented and differs from the probability-weighted stage allocation used to determine the ECL allowance shown above. For exposures subject to individual assessment, the distribution of ECL which could reasonably be expected has also been considered, assuming no change in the number of cases subject to individual assessment, and within the context of a potential best to worst case outcome. All exposures disclosed in 'Credit quality' in 'Santander UK group level - Credit risk review' are included in the following tables.

As described above, prior to the transfer in Q4 2021 our CIB segment used a single forward-looking economic scenario. However, three scenarios were still used in the model, with a PMA held to increase provisions to the level required in the single scenario. In order to present a consolidated view in a single table and show variation from the forward-looking component, the three scenarios were presented in the table with the overlay value added to each scenario. As all other segments use five scenarios, interpolation is also required. Data from the CIB Upside scenario is presented in the Upside 1 Column, the Downside scenario is in the Downside 3 column, the Base case is in the Base case column and values in Downside 1 and Downside 2 are interpolated from the Base case and Downside scenarios.

2021	Weighted £m	Upside 1 £m	Base case £m	Downside 1 £m	Downside 2 £m	Downside 3 £m
Exposure	**313,347**	**313,347**	**313,347**	**313,347**	**313,347**	**313,347**
Retail Banking	**212,395**	**212,395**	**212,395**	**212,395**	**212,395**	**212,395**
– Homes	**190,663**	**190,663**	**190,663**	**190,663**	**190,663**	**190,663**
– Everyday Banking	**21,732**	**21,732**	**21,732**	**21,732**	**21,732**	**21,732**
Consumer Finance	**5,298**	**5,298**	**5,298**	**5,298**	**5,298**	**5,298**
Corporate & Commercial Banking	**24,691**	**24,691**	**24,691**	**24,691**	**24,691**	**24,691**
Corporate Centre	**70,963**	**70,963**	**70,963**	**70,963**	**70,963**	**70,963**
ECL	**865**	**740**	**738**	**849**	**1,123**	**1,288**
Retail Banking	**388**	**307**	**286**	**375**	**510**	**662**
– Homes	**190**	**134**	**125**	**177**	**283**	**437**
– Everyday Banking	**198**	**173**	**161**	**198**	**227**	**225**
Consumer Finance	**52**	**50**	**51**	**51**	**53**	**54**
Corporate & Commercial Banking	**423**	**381**	**399**	**421**	**558**	**570**
Corporate Centre	**2**	**2**	**2**	**2**	**2**	**2**
	%	%	%	%	%	%
Proportion of assets in Stage 2	**5.2**	**4.9**	**4.9**	**5.1**	**6.2**	**7.0**
Retail Banking	**5.5**	**5.2**	**5.2**	**5.4**	**6.6**	**7.7**
– Homes	**5.8**	**5.5**	**5.5**	**5.7**	**6.9**	**8.2**
– Everyday Banking	**2.6**	**2.3**	**2.1**	**3.0**	**3.5**	**3.0**
Consumer Finance	**3.8**	**3.8**	**3.8**	**3.8**	**3.8**	**3.8**
Corporate & Commercial Banking	**17.8**	**16.3**	**16.2**	**16.9**	**20.8**	**20.9**
Corporate Centre	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**

2020	Weighted £m	Upside 1 £m	Base case £m	Downside 1 £m	Downside 2 £m	Downside 3 £m
Exposure	322,745	322,745	322,745	322,745	322,745	322,745
Retail Banking	201,990	201,990	201,990	201,990	201,990	201,990
– Homes	180,006	180,006	180,006	180,006	180,006	180,006
– Everyday Banking	21,984	21,984	21,984	21,984	21,984	21,984
Consumer Finance	8,261	8,261	8,261	8,261	8,261	8,261
Corporate & Commercial Banking	24,503	24,503	24,503	24,503	24,503	24,503
Corporate & Investment Banking	11,646	11,646	11,646	11,646	11,646	11,646
Corporate Centre	76,345	76,345	76,345	76,345	76,345	76,345
ECL	1,377	1,129	1,222	1,300	1,612	1,802
Retail Banking	588	495	470	544	730	740
– Homes	280	212	207	253	389	415
– Everyday Banking	308	283	263	291	341	325
Consumer Finance	118	115	117	116	119	123
Corporate & Commercial Banking	603	485	575	567	671	824
Corporate & Investment Banking	33	5	26	40	53	66
Corporate Centre	35	29	34	33	39	49
	%	%	%	%	%	%
Proportion of assets in Stage 2	5.3	4.6	4.7	4.6	6.6	6.8
Retail Banking	5.4	4.5	4.6	4.7	7.2	7.2
– Homes	5.7	4.8	4.9	4.9	7.7	7.5
– Everyday Banking	2.8	2.4	2.1	2.6	3.3	4.9
Consumer Finance	4.6	4.6	4.6	4.6	4.6	4.8
Corporate & Commercial Banking	22.4	20.1	20.8	20.2	24.5	28.6
Corporate & Investment Banking	1.7	1.7	1.7	1.7	1.7	1.7
Corporate Centre	—	—	—	—	—	—

Changes to Stage 3 instruments are part of the sensitivity analysis but we do not disclose the proportion of assets in Stage 3, because their values do not move due to changes in macroeconomic assumptions, i.e. they are either in default or not in default at the reporting date.

We have incorporated our post model adjustments into the sensitivity analysis.

2021 compared to 2020
During 2021 credit performance across all sectors was strong, driving down ECL provisions and Stage 2 balances as PDs and LGDs reduced. Customers who took payment holidays returned to making full payments with much less arrears arising on this population than anticipated, allowing for a release of ECL provisions as the payment holiday PMAs unwound. At the same time macroeconomic forecasts improved, with GDP paths revised upwards and a much lower unemployment rate forecast in the Downside 2 scenario, though this was partially offset by increasing Base Rate forecasts. This further reduced PDs and LGDs and moved accounts below the SICR thresholds, curing them out of Stage 2. However, this effect was fully offset by the introduction of a number of new PMAs, one of which moved £4.2bn of mortgage asset into Stage 2 and increased their PDs to account for the added inflationary risks in the portfolio.

Scenario weights sensitivity
In December 2021, management shifted 5% weights from the Base case scenario to Downside 1 scenario to capture uncertain risk in relation to inflation, which increased ECL by £4m. If management had moved the weights from the Base case scenario to Downside 3 scenario, ECL would have increased by £22m.

HPI sensitivity
Given the relative size of our residential mortgage portfolio, management considers that changes in HPI assumptions underpinning the calculation of the ECL allowance for residential mortgages would have the most significant impact on the ECL allowance. The table below shows the ECL impact on profit before tax of applying an immediate and permanent house price increase/decrease to our unweighted base case economic scenario, and assumes no changes to the staging allocation of exposures.

	Increase/decrease in house prices			
	+20%	+10%	-10%	-20%
Increase/(decrease) in profit before tax	£m	£m	£m	£m
2021	**64**	**40**	**(69)**	**(197)**
2020	63	38	(66)	(183)

2021 compared to 2020
The HPI ECL sensitivity remains similar to 2020. The expected impact from a drop in the HPI index by 10% and 20% is £69m and £197m respectively. The strong growth of the housing market in 2021 significantly improved the LTV profile of the portfolio, which offset the potential losses from new business.

Measuring ECL (audited)
For accounts not in default at the reporting date, we estimate a monthly ECL for each exposure and for each month over the forecast period. The lifetime ECL is the sum of the monthly ECLs over the forecast period, while the 12-month ECL is limited to the first 12 months. We calculate each monthly ECL as the discounted value for the relevant forecast month of the product of the following factors:

Factor	Description
Survival rate (SR)	The probability that the exposure has not closed or defaulted since the reporting date.
Probability of default (PD)	The likelihood of a borrower defaulting in the following month, assuming it has not closed or defaulted since the reporting date. For each month in the forecast period, we estimate the monthly PD from a range of factors. These include the current risk grade for the exposure, which becomes less relevant further into the forecast period, as well as the expected evolution of the account risk with maturity and factors for changing economics. We support this with historical data analysis.
Exposure at default (EAD)	The amount we expect to be owed if a default event was to occur. We determine EAD for each month of the forecast period by the expected payment profile, which varies by product type. For amortising products, we base it on the borrower's contractual repayments over the forecast period. We adjust this for any expected overpayments on Stage 1 accounts that the borrower may make and for any arrears we expect if the account was to default. For revolving products, or amortising products with an off-balance sheet element, we determine EAD using the balance at default and the contractual exposure limit. We vary these assumptions by product type and base them on analysis of recent default data.
Loss given default (LGD)	Our expected loss if a default event were to occur. We express it as a percentage and calculate it based on factors that we have observed to affect the likelihood and/or value of any subsequent write-offs, which vary according to whether the product is secured or unsecured. If the product is secured, we take into account collateral values as well as the historical discounts to market/book values due to forced sales type.

We use the original effective interest rate as the discount rate. For accounts in default, we use the EAD as the reporting date balance. We also calculate an LGD to reflect the default status of the account, considering the current DPD and loan to value. PD and SR are not required for accounts in default.

Forecast period
We base the forecast period for amortising facilities on the remaining contract term. For revolving facilities, we use an analytical approach based on the behavioural, rather than contractual, characteristics of the facility type. In some cases, we shorten the period to simplify the calculation. If we do this, we apply a post model adjustment to reflect our view of the full lifetime ECL.

Forward-looking information
Our assessments of a SICR and the calculation of ECL both incorporate forward-looking data. We perform historical analysis and identify the key economic variables that impact credit risk and ECL for each portfolio. These can include the house price growth, GDP, unemployment rate and Bank of England bank rate. Where applicable, we incorporate these economic variables and their associated impacts into our models.

Economic forecasts have the most impact on the measurement of ECL for residential mortgages and, to a lesser extent, corporate loans. This is due to the long behavioural lives and large sizes of these portfolios. Economic forecasts have less impact on the measurement of ECL for our other portfolios. This is due to the shorter behavioural lives and smaller sizes of these portfolios.

Grouping of instruments for losses measured on a collective basis
We measure ECL at the individual financial instrument level. However, where we have used internal capital or similar models as the basis for our ECL models, this typically results in a large number of relatively small homogenous groups. We typically group instruments where they share risk characteristics using one or more statistical models and assess them for impairment collectively.

We use this approach for:

- all our Retail Banking and Consumer Finance portfolios
- SME customers in Corporate & Commercial Banking
- Legacy Portfolios in run-off in Corporate Centre.

We calculate separate collective provisions for instruments in Stages 1, 2 and 3 where the instrument is not individually assessed.

As described above, prior to the transfer in Q4 2021 for our CIB portfolios (whether we assess them for impairment individually or collectively) we used one forward-looking economic scenario for forecasting in 2020. For all our other portfolios (whether we assess them for impairment individually or collectively) we use five forward-looking economic scenarios.

Governance around ECL impairment allowances (audited)
Our Risk Methodology team developed our ECL impairment models (except for the external models we use, such as OGEM which we described earlier in 'Our forecasting approach'), and our Independent Validations team independently reviews all material models. As model owners, our Risk Provisioning & Forecasting team run the models to calculate our ECL impairment allowances each month. The models are sensitive to changes in credit conditions and reflect various management judgements that give rise to measurement uncertainty in our reportable ECL as set out above. The following committees and forums review the provision drivers and ensure that the management judgements we apply remain appropriate:

- **Model Risk Control Forum** (MRCF) reviews and approves new models and required model changes. It also reviews the use of OGEM as a reliable model on which to base our other forecast macroeconomic variables. It is used across all stress testing and planning so it is subject to model risk criteria. MRCF will delegate responsibility of approvals to Model Risk Management Forum (MRMF) for changes of low risk materiality or less complex changes.
- **ALCO** reviews and approves the base case used in the economic scenarios we use to calculate forward-looking scenarios.
- **CRPF** reviews and approves the economic scenarios and probability weights we use to calculate forward-looking scenarios. It also reviews management judgements and approves ECL impairment allowances.
- **Board Audit Committee** reviews and challenges the appropriateness of the estimates and judgements made by management.

For more on the governance around specific elements of the ECL impairment allowances, including the frequency of, and thresholds for, reviews, including by these committees and forums, see the detailed sections above.

How we assess the performance of our ECL estimation process
We assess the reasonableness of our ECL provisions and the results of our Staging analysis using a range of methods. These include:

- **Benchmarking:** we compare our coverage levels with our peers.
- **Stand-back testing:** we monitor the level of our coverage against actual write-offs.
- **Back-testing:** we compare key drivers periodically as part of model monitoring practices.
- **Monitoring trends:** we track ECL and Staged assets over time and against our internal budgets and forecasts, with triggers set accordingly.

Covid-19 support measures
The Covid-19 pandemic had a major impact on the UK and global economies in 2020 and continued to impact in 2021. The UK Government's fiscal interventions helped our customers to mitigate some of the adverse financial effects.

Since March 2020, we have provided mortgage customers with payment holiday terms in line with UK Government's and FCA's guidance. Similar payment holidays have also been granted in respect of consumer (auto) finance, personal loans, credit cards, business and corporate loans. Applications for these payment holidays closed on 31 March 2021.

We participated in the UK Government's Coronavirus Loan Schemes, of which the applications were closed on 31 March 2021:

- CBILS,
- BBLS, and
- CLBILS.

We are participating in the Recovery Loan Scheme (RLS) which launched on 6 April 2021 and we are making Pay As You Grow scheme (PAYG) options available to borrowers of BBLS loans.

The UK Government guarantees amounts lent under these schemes, although the guarantee is limited to 80% in the case of the CBILS, the CLBILS and the RLS. As a result, ECL is not applied to the BBLS but a 20% weighting is applied to the ECL for the CBILS, the CLBILS and the RLS. The UK Government also pays interest on behalf of customers for the first 12 months under the CBILS and the BBLS, plus any lender-levied charges under the CBILS.

Loans for customers who were provided with payment holidays were considered to have the contract terms modified. The granting of a payment holiday on its own was not considered to be a SICR event, nor was it considered a default under regulatory definitions. Neither were they considered to have been granted forbearance for risk management purposes. For customers who have needed further financial support after the payment holiday period, we help them by offering assistance in line with our policies. See the section 'Significant Increase in Credit Risk (SICR)' above for more on this.

As explained above on the interaction between payment holidays and SICR, the majority of customers affected have not been moved to Stage 2 for a lifetime ECL assessment unless they had triggered other SICR criteria. Such payment holidays also did not cause accounts to become past due and therefore did not automatically trigger a Stage 2 or Stage 3 lifetime ECL assessment.

For quantitative information, see 'Covid-19 support schemes' section in 'Santander UK Group level - credit risk review'.

SANTANDER UK GROUP LEVEL – CREDIT RISK REVIEW

Our maximum and net exposure to credit risk (audited)

The tables below show the main differences between our maximum and net exposure to credit risk. They show the effects of collateral, netting, and risk transfer to mitigate our exposure. The tables only show the financial assets that credit risk affects and to which the impairment requirements in IFRS 9 are applied.

For balance sheet assets, the maximum exposure to credit risk is the carrying value after impairment loss allowances. Off-balance sheet exposures are mortgage offers, guarantees, formal standby facilities, credit lines and other commitments. For off-balance sheet guarantees, the maximum exposure is the maximum amount that we would have to pay if the guarantees were called on. For formal standby facilities, credit lines and other commitments that are irrevocable over the life of the facility, the maximum exposure is the total amount of the commitment.

	Maximum exposure						Collateral[1]			
	Balance sheet asset			Off-balance sheet						
2021	Gross amounts £bn	Loss allowance £bn	Net amounts £bn	Gross amounts £bn	Loss allowance £bn	Net amounts £bn	Cash £bn	Non-cash £bn	Netting[2] £bn	Net exposure £bn
Cash and balances at central banks	**48.1**	**—**	**48.1**	**—**	**—**	**—**	**—**	**—**	**—**	**48.1**
Financial assets at amortised cost:										
– Loans and advances to customers:[3]										
– Loans secured on residential properties[4]	**174.7**	**(0.2)**	**174.5**	**16.0**	**—**	**16.0**	**—**	**(177.8)**	**—**	**12.7**
– Corporate loans	**19.3**	**(0.4)**	**18.9**	**7.6**	**—**	**7.6**	**(0.1)**	**(16.8)**	**—**	**9.6**
– Finance leases	**3.9**	**(0.1)**	**3.8**	**0.3**	**—**	**0.3**	**—**	**(4.7)**	**—**	**(0.6)**
– Accrued interest and other adjustments	**0.5**	**—**	**0.5**	**—**	**—**	**—**	**—**	**—**	**—**	**0.5**
– Other unsecured loans	**9.4**	**(0.2)**	**9.2**	**13.4**	**—**	**13.4**	**—**	**—**	**—**	**22.6**
– Amounts due from fellow Banco Santander group subsidiaries and joint ventures	**3.2**	**—**	**3.2**	**—**	**—**	**—**	**—**	**—**	**—**	**3.2**
Total loans and advances to customers	**211.0**	**(0.9)**	**210.1**	**37.3**	**—**	**37.3**	**(0.1)**	**(199.3)**	**—**	**48.0**
– Loans and advances to banks	**1.2**	**—**	**1.2**	**0.4**	**—**	**0.4**	**—**	**—**	**—**	**1.6**
– Reverse repurchase agreements – non trading	**12.7**	**—**	**12.7**	**—**	**—**	**—**	**—**	**(12.2)**	**(0.4)**	**0.1**
– Other financial assets at amortised cost	**0.5**	**—**	**0.5**	**—**	**—**	**—**	**—**	**—**	**—**	**0.5**
Total financial assets at amortised cost	**225.4**	**(0.9)**	**224.5**	**37.7**	**—**	**37.7**	**(0.1)**	**(211.5)**	**(0.4)**	**50.2**
Financial assets at fair value at FVOCI:										
– Loans and advances to customers	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
– Debt securities	**5.9**	**—**	**5.9**	**—**	**—**	**—**	**—**	**—**	**—**	**5.9**
Total financial assets at FVOCI	**5.9**	**—**	**5.9**	**—**	**—**	**—**	**—**	**—**	**—**	**5.9**
Total	**279.4**	**(0.9)**	**278.5**	**37.7**	**—**	**37.7**	**(0.1)**	**(211.5)**	**(0.4)**	**104.2**

2020										
Cash and balances at central banks	41.3	—	41.3	—	—	—	—	—	—	41.3
Financial assets at amortised cost:										
– Loans and advances to customers:[3]										
– Loans secured on residential properties[4]	166.7	(0.3)	166.4	13.3	—	13.3	—	(170.0)	—	9.7
– Corporate loans	23.6	(0.6)	23.0	15.4	(0.1)	15.3	(0.1)	(20.4)	—	17.8
– Finance leases	6.6	(0.1)	6.5	0.2	—	0.2	(0.1)	(5.8)	—	0.8
– Accrued interest and other adjustments	0.9	—	0.9	—	—	—	—	—	—	0.9
– Other unsecured loans	9.9	(0.3)	9.6	13.3	—	13.3	—	—	—	22.9
– Amounts due from fellow Banco Santander group subsidiaries and joint ventures	2.4	—	2.4	—	—	—	—	—	—	2.4
Total loans and advances to customers	210.1	(1.3)	208.8	42.2	(0.1)	42.1	(0.2)	(196.2)	—	54.5
– Loans and advances to banks	1.7	—	1.7	1.0	—	1.0	—	—	—	2.7
– Reverse repurchase agreements – non trading	19.6	—	19.6	—	—	—	—	(19.5)	(0.1)	—
– Other financial assets at amortised cost	1.2	—	1.2	—	—	—	—	—	—	1.2
Total financial assets at amortised cost	232.6	(1.3)	231.3	43.2	(0.1)	43.1	(0.2)	(215.7)	(0.1)	58.4
Financial assets at FVOCI:										
– Loans and advances to customers	—	—	—	—	—	—	—	—	—	—
– Debt securities	9.0	—	9.0	—	—	—	—	—	—	9.0
Total financial assets at FVOCI	9.0	—	9.0	—	—	—	—	—	—	9.0
Total	282.9	(1.3)	281.6	43.2	(0.1)	43.1	(0.2)	(215.7)	(0.1)	108.7

(1) The forms of collateral we take to reduce credit risk include: residential and commercial property; other physical assets, including motor vehicles; liquid securities, including those transferred under reverse repurchase agreements; cash, including cash used as collateral for derivative transactions; and receivables. Charges on residential property are most of the collateral we take.

(2) We can reduce credit risk exposures by applying netting. We do this mainly for derivative and repurchase transactions with financial institutions. For derivatives and securities finance transactions, we use standard master netting agreements. They allow us to set off our credit risk exposure to a counterparty against our obligations to the counterparty in relation to transactions under the master netting agreement in the event of default. This gives us a lower net credit exposure. They may also reduce settlement exposure. For more on this, see 'Credit risk mitigation' in the 'Credit risk - Credit risk management' section.

(3) Balances include interest we have charged to the customer's account and accrued interest that we have not charged to the account yet.

(4) The collateral value we have shown against advances secured on residential property is limited to the balance of each associated individual loan. It does not include the impact of over–collateralisation (where the collateral has a higher value than the loan balance) and includes collateral we would receive on draw down of certain off–balance sheet commitments.

The tables below show the main differences between our maximum and net exposure to credit risk on the financial assets that credit risk affects and to which the impairment requirements in IFRS 9 are not applied.

2021	Balance sheet asset gross amount £bn	Collateral[1] Cash £bn	Collateral[1] Non-cash £bn	Netting[2] £bn	Net exposure £bn
Financial assets at FVTPL:					
– Derivative financial instruments	**1.7**	**—**	**(0.7)**	**(0.8)**	**0.2**
– Other financial assets at FVTPL	**0.2**	**—**	**—**	**—**	**0.2**
Total	**1.9**	**—**	**(0.7)**	**(0.8)**	**0.4**

2020					
Financial assets at FVTPL:					
– Derivative financial instruments	3.4	—	(1.8)	(0.8)	0.8
– Other financial assets at FVTPL	0.2	—	—	—	0.2
Total	3.6	—	(1.8)	(0.8)	1.0

(1) The forms of collateral we take to reduce credit risk include: liquid securities, including those transferred under reverse repurchase agreements; cash, including cash used as collateral for derivative transactions; and receivables.

(2) We can reduce credit risk exposures by applying netting. We do this mainly for derivative and repurchase transactions with financial institutions. For derivatives and securities finance transactions, we use standard master netting agreements. They allow us to set off our credit risk exposure to a counterparty against our obligations to the counterparty in relation to transactions under the master netting agreement in the event of default. This gives us a lower net credit exposure. They may also reduce settlement exposure. For more on this, see 'Credit risk mitigation' in the 'Credit risk – Credit risk management' section.

Single credit rating scale

In the table below, we have used a single rating scale to ensure we are consistent across all our credit risk portfolios in how we report the risk of default. It has eight grades for non–defaulted exposures, from 9 (lowest risk) to 2 (highest risk). We define each grade by an upper and lower PD value and we scale the grades so that the default risk increases by a factor of ten every time the grade number drops by two steps. For example, grade 9 has an average PD of 0.010%, and grade 7 has an average PD of 0.100%. We give defaulted exposures a grade 1 and a PD value of 100%. In the final column of the table we show the approximate equivalent credit rating grade used by Standard & Poor's Ratings Services (S&P).

Santander UK risk grade	PD range Mid %	PD range Lower %	PD range Upper %	S&P equivalent
9	0.010	0.000	0.021	AAA to AA+
8	0.032	0.021	0.066	AA to AA-
7	0.100	0.066	0.208	A+ to BBB
6	0.316	0.208	0.658	BBB- to BB
5	1.000	0.658	2.081	BB-
4	3.162	2.081	6.581	B+ to B
3	10.000	6.581	20.811	B-
2	31.623	20.811	99.999	CCC to C
1 (Default)	100.000	100.000	100.000	D

The PDs in the table above are based on Economic Capital (EC) PD mappings which are calculated based on the average probability of default over an economic cycle. This is different to the IFRS 9 PDs which are calculated at a point in time using forward looking economic scenarios. Where possible, the EC PD values are largely aligned to the regulatory capital models however any regulatory floors are removed and PDs are defined at every possible rating rather than categorised into rating buckets.

Rating distribution (audited)

The tables below show the credit rating of our financial assets to which the impairment requirements in IFRS 9 apply. PMAs are incorporated in the balances. For more on the credit rating profiles of key portfolios, see the credit risk review section for each business segment.

	Santander UK risk grade									
	9	8	7	6	5	4	3 to 1	Other[1]	Loss allowance	Total
2021	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Exposures										
On balance sheet										
Cash and balances at central banks	48.1	—	—	—	—	—	—	—	—	48.1
– Stage 1	48.1	—	—	—	—	—	—	—	—	48.1
Financial assets at amortised cost:										
– Loans and advances to customers[2]	9.0	32.5	84.5	48.0	12.8	10.2	6.0	8.0	(0.9)	210.1
– Stage 1	9.0	31.7	83.1	44.9	10.0	5.0	0.6	7.4	(0.1)	191.6
– Stage 2	—	0.8	1.4	3.1	2.8	5.2	2.8	0.3	(0.4)	16.0
– Stage 3	—	—	—	—	—	—	2.6	0.3	(0.4)	2.5
Of which mortgages:	9.0	29.7	79.3	42.5	6.4	4.7	3.1	—	(0.2)	174.5
– Stage 1	9.0	29.5	78.0	39.6	4.1	1.6	—	—	—	161.8
– Stage 2	—	0.2	1.3	2.9	2.3	3.1	1.3	—	(0.1)	11.0
– Stage 3	—	—	—	—	—	—	1.8	—	(0.1)	1.7
– Loans and advances to banks	0.2	0.2	0.8	—	—	—	—	—	—	1.2
– Stage 1	0.2	0.2	0.8	—	—	—	—	—	—	1.2
– Reverse repo agreements – non trading	9.7	0.1	1.1	0.6	—	—	—	1.2	—	12.7
– Stage 1	9.7	0.1	1.1	0.6	—	—	—	1.2	—	12.7
– Other financial assets at amortised cost	0.5	—	—	—	—	—	—	—	—	0.5
– Stage 1	0.5	—	—	—	—	—	—	—	—	0.5
Total financial assets at amortised cost	19.4	32.8	86.4	48.6	12.8	10.2	6.0	9.2	(0.9)	224.5
Financial assets at FVOCI:	3.6	2.1	0.2	—	—	—	—	—	—	5.9
– Stage 1	3.6	2.1	0.2	—	—	—	—	—	—	5.9
Total on balance sheet	71.1	34.9	86.6	48.6	12.8	10.2	6.0	9.2	(0.9)	278.5
Total off–balance sheet	0.1	7.2	7.0	6.8	4.5	1.3	0.5	10.3	—	37.7
– Stage 1	0.1	6.9	6.7	6.6	4.3	1.0	0.2	10.3	—	36.1
– Stage 2	—	0.3	0.3	0.2	0.2	0.3	0.2	—	—	1.5
– Stage 3	—	—	—	—	—	—	0.1	—	—	0.1
Total exposures	71.2	42.1	93.6	55.4	17.3	11.5	6.5	19.5	(0.9)	316.2
ECL										
On balance sheet										
Cash and balances at central banks	—	—	—	—	—	—	—	—		—
– Stage 1	—	—	—	—	—	—	—	—		—
Financial assets at amortised cost:										
– Loans and advances to customers[2]	—	—	—	—	0.2	0.1	0.6	—		0.9
– Stage 1	—	—	—	—	0.1	—	—	—		0.1
– Stage 2	—	—	—	—	0.1	0.1	0.2	—		0.4
– Stage 3	—	—	—	—	—	—	0.4	—		0.4
Of which mortgages:	—	—	—	—	—	0.1	0.1	—		0.2
– Stage 1	—	—	—	—	—	—	—	—		—
– Stage 2	—	—	—	—	—	0.1	—	—		0.1
– Stage 3	—	—	—	—	—	—	0.1	—		0.1
– Loans and advances to banks	—	—	—	—	—	—	—	—		—
– Stage 1	—	—	—	—	—	—	—	—		—
– Reverse repo agreements – non trading	—	—	—	—	—	—	—	—		—
– Stage 1	—	—	—	—	—	—	—	—		—
– Other financial assets at amortised cost	—	—	—	—	—	—	—	—		—
– Stage 1	—	—	—	—	—	—	—	—		—
Total financial assets at amortised cost	—	—	—	—	0.2	0.1	0.6	—		0.9
Financial assets at FVOCI:	—	—	—	—	—	—	—	—		—
– Stage 1	—	—	—	—	—	—	—	—		—
Total on balance sheet	—	—	—	—	0.2	0.1	0.6	—		0.9
Total off–balance sheet	—	—	—	—	—	—	—	—		—
– Stage 1	—	—	—	—	—	—	—	—		—
– Stage 2	—	—	—	—	—	—	—	—		—
– Stage 3	—	—	—	—	—	—	—	—		—
Total ECL	—	—	—	—	0.2	0.1	0.6	—		0.9

2021	Santander UK risk grade 9 %	8 %	7 %	6 %	5 %	4 %	3 to 1 %	Other[1] %	Total %
Coverage ratio									
On balance sheet									
Cash and balances at central banks	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Financial assets at amortised cost:									
– Loans and advances to customers[2]	—	—	—	—	1.6	1.0	10.0	—	0.4
– Stage 1	—	—	—	—	1.0	—	—	—	0.1
– Stage 2	—	—	—	—	3.6	1.9	7.1	—	2.5
– Stage 3	—	—	—	—	—	—	15.4	—	16.0
Of which mortgages:	—	—	—	—	—	2.1	3.2	—	0.1
– Stage 1	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	3.2	—	—	0.9
– Stage 3	—	—	—	—	—	—	5.6	—	5.9
– Loans and advances to banks	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Reverse repo agreements – non trading	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Other financial assets at amortised cost	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Total financial assets at amortised cost	—	—	—	—	1.6	1.0	10.0	—	0.4
Financial assets at FVOCI:	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Total on balance sheet	—	—	—	—	1.6	1.0	10.0	—	0.3
Total off–balance sheet	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	—	—	—	—
– Stage 3	—	—	—	—	—	—	—	—	—
Total coverage ratio	—	—	—	—	1.2	0.9	9.2	—	0.3

2020	Santander UK risk grade 9 £bn	8 £bn	7 £bn	6 £bn	5 £bn	4 £bn	3 to 1 £bn	Other[1] £bn	Loss allowance £bn	Total £bn
Exposures										
On balance sheet										
Cash and balances at central banks	41.3	—	—	—	—	—	—	—	—	41.3
– Stage 1	41.3	—	—	—	—	—	—	—	—	41.3
Financial assets at amortised cost:										
– Loans and advances to customers[2]	8.0	27.7	74.4	44.1	13.5	27.0	8.2	7.2	(1.3)	208.8
– Stage 1	8.0	27.6	74.0	42.6	10.8	19.0	1.1	7.0	(0.2)	189.9
– Stage 2	—	0.1	0.4	1.5	2.7	8.0	4.2	0.2	(0.5)	16.6
– Stage 3	—	—	—	—	—	—	2.9	—	(0.6)	2.3
Of which mortgages:	7.9	24.3	68.0	36.8	5.6	19.6	4.5	—	(0.3)	166.4
– Stage 1	7.9	24.3	67.7	35.5	3.9	14.7	0.6	—	—	154.6
– Stage 2	—	—	0.3	1.3	1.7	4.9	2.1	—	(0.2)	10.1
– Stage 3	—	—	—	—	—	—	1.8	—	(0.1)	1.7
– Loans and advances to banks	0.1	0.1	0.4	—	—	—	—	1.1	—	1.7
– Stage 1	0.1	0.1	0.4	—	—	—	—	1.1	—	1.7
– Reverse repo agreements – non trading	12.2	3.3	1.5	2.4	—	—	—	0.2	—	19.6
– Stage 1	12.2	3.3	1.5	2.4	—	—	—	0.2	—	19.6
– Other financial assets at amortised cost	1.2	—	—	—	—	—	—	—	—	1.2
– Stage 1	1.2	—	—	—	—	—	—	—	—	1.2
Total financial assets at amortised cost	21.5	31.1	76.3	46.5	13.5	27.0	8.2	8.5	(1.3)	231.3
Financial assets at FVOCI:	5.3	3.4	0.2	0.1	—	—	—	—	—	9.0
– Stage 1	5.3	3.4	0.2	0.1	—	—	—	—	—	9.0
Total on balance sheet	68.1	34.5	76.5	46.6	13.5	27.0	8.2	8.5	(1.3)	281.6
Total off–balance sheet	0.4	8.8	9.5	8.8	5.1	1.6	0.5	8.5	(0.1)	43.1
– Stage 1	0.4	8.8	9.5	8.6	4.7	1.1	0.2	8.5	—	41.8
– Stage 2	—	—	—	0.2	0.4	0.5	0.2	—	(0.1)	1.2
– Stage 3	—	—	—	—	—	—	0.1	—	—	0.1
Total exposures	68.5	43.3	86.0	55.4	18.6	28.6	8.7	17.0	(1.4)	324.7

	Santander UK risk grade								
	9	8	7	6	5	4	3 to 1	Other[1]	Total
2020	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
ECL									
On balance sheet									
Cash and balances at central banks	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Financial assets at amortised cost:									
– Loans and advances to customers[2]	—	—	—	0.1	0.1	0.2	0.9	—	1.3
– Stage 1	—	—	—	0.1	—	—	0.1	—	0.2
– Stage 2	—	—	—	—	0.1	0.2	0.2	—	0.5
– Stage 3	—	—	—	—	—	—	0.6	—	0.6
Of which mortgages:	—	—	—	—	—	0.1	0.2	—	0.3
– Stage 1	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	0.1	0.1	—	0.2
– Stage 3	—	—	—	—	—	—	0.1	—	0.1
– Loans and advances to banks	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Reverse repo agreements – non trading	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Other financial assets at amortised cost	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Total financial assets at amortised cost	—	—	—	0.1	0.1	0.2	0.9	—	1.3
Financial assets at FVOCI:	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Total on balance sheet	—	—	—	0.1	0.1	0.2	0.9	—	1.3
Total off–balance sheet	—	—	—	—	—	—	0.1	—	0.1
– Stage 1	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	—	0.1	—	0.1
– Stage 3	—	—	—	—	—	—	—	—	—
Total ECL	—	—	—	0.1	0.1	0.2	1.0	—	1.4
2020	%	%	%	%	%	%	%	%	%
Coverage ratio									
On balance sheet									
Cash and balances at central banks	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Financial assets at amortised cost:									
– Loans and advances to customers[2]	—	—	—	0.2	0.7	0.7	11.0	—	0.4
– Stage 1	—	—	—	0.2	—	—	9.1	—	0.1
– Stage 2	—	—	—	—	3.7	2.5	4.8	—	3.0
– Stage 3	—	—	—	—	—	—	20.7	—	26.1
Of which mortgages:	—	—	—	—	—	0.5	4.4	—	0.2
– Stage 1	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	2.0	4.8	—	2.0
– Stage 3	—	—	—	—	—	—	5.6	—	5.9
– Loans and advances to banks	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Reverse repo agreements – non trading	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
– Other financial assets at amortised cost	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Total financial assets at amortised cost	—	—	—	0.2	0.7	0.7	11.0	—	0.6
Financial assets at FVOCI:	—	—	—	—	—	—	—	—	—
– Stage 1	—	—	—	—	—	—	—	—	—
Total on balance sheet	—	—	—	0.2	0.7	0.7	11.0	—	0.5
Total off–balance sheet	—	—	—	—	—	—	20.0	—	0.2
– Stage 1	—	—	—	—	—	—	—	—	—
– Stage 2	—	—	—	—	—	—	50.0	—	8.3
– Stage 3	—	—	—	—	—	—	—	—	—
Total coverage ratio	—	—	—	0.2	0.5	0.7	11.5	—	0.4

(1) Includes cash at hand and smaller cases mainly in the consumer (auto) finance and commercial mortgages portfolios, as well as loans written as part of the UK Government Covid-19 support schemes for micro-SMEs. We use scorecards for these items, rather than rating models.
(2) Includes interest we have charged to the customer's account and accrued interest we have not charged to the account yet.

Credit performance (audited)

2021	Customer Loans Total £bn	Stage 1 £bn	Stage 2 £bn	Stage 3 £bn	Gross write-offs £m	Loan Loss Allowances £m
Retail Banking	**183.0**	**169.2**	**11.7**	**2.1**	**108**	**388**
– Homes	**174.7**	**161.8**	**11.1**	**1.8**	**5**	**190**
– Everyday Banking[1]	**8.3**	**7.4**	**0.6**	**0.3**	**103**	**198**
Consumer Finance	**5.0**	**4.8**	**0.2**	**—**	**25**	**52**
Corporate & Commercial Banking	**17.0**	**11.8**	**4.4**	**0.8**	**58**	**423**
Corporate Centre	**2.3**	**2.1**	**0.2**	**—**	**—**	**2**
	207.3	**187.9**	**16.5**	**2.9**	**191**	**865**
Undrawn Balances	**37.7**	**36.1**	**1.5**	**0.1**		
Stage 1, Stage 2 and Stage 3[2] ratios %		**90.65**	**7.93**	**1.45**		

2020	£bn	£bn	£bn	£bn	£m	£m
Retail Banking	175.4	162.6	10.9	1.9	155	588
– Homes	166.7	154.6	10.3	1.8	14	280
– Everyday Banking[1]	8.7	8.0	0.6	0.1	141	308
Consumer Finance	8.0	7.6	0.4	—	25	118
Corporate & Commercial Banking	17.6	11.1	5.5	1.0	51	603
Corporate & Investment Banking	2.8	2.6	0.2	—	22	33
Corporate Centre	3.2	3.2	—	—	—	35
	207.0	187.1	17.0	2.9	253	1,377
Undrawn Balances	43.2	41.8	1.3	0.1		
Stage 1, Stage 2 and Stage 3[2] ratios %		90.34	8.26	1.45		

(1) Everyday Banking includes BBLS lending through Business Banking.
(2) Stage 3 ratio = (Stage3 drawn + Stage 3 undrawn assets)/(total drawn assets + Stage 3 undrawn assets).

For more on the credit performance of our key portfolios by business segment, see the credit risk review section for each business segment.

2021 compared to 2020

The notable changes in 2021 which impacted credit impairment were:

- Economic scenarios and weights: net release of £170m. The update to economic scenarios and weights used to calculate ECL reflected lower unemployment and a strong housing market against a back-drop of low arrears and defaults.
- Covid-19 related PMAs: net release of £53m. The release for Covid-19 related PMAs largely related to payment holidays and corporate lending to sectors affected by Covid-19. These improved as customers completed 12 months of repayments since the end of the payment holiday or corporate client ratings were reviewed and upgraded.

Covid-19 support schemes

Payment holidays

We granted Covid-19 related payment holidays to more than 350,000 customers as part of our support for those affected by Covid-19. These schemes have now ended, and most customers returned to normal scheduled repayments when due.

Government lending schemes

We granted around £5bn of lending under government support schemes, mostly through the BBLS. Retail Banking customer loans includes Business Banking lending which is predominantly BBLS with a 100% government guarantee.

Credit quality (audited)

Total on-balance sheet exposures at 31 December 2021 comprised £207.3bn of customer loans, loans and advances to banks of £1.2bn, £13.2bn of sovereign assets measured at amortised cost, £5.9bn of assets measured at FVOCI, and £48.1bn of cash and balances at central banks.

2021	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Exposures				
On-balance sheet				
Retail Banking	169,255	11,646	2,122	183,023
– Homes	161,845	11,071	1,796	174,712
– Everyday Banking	7,410	575	326	8,311
Consumer Finance	4,760	200	24	4,984
Corporate & Commercial Banking	11,812	4,395	790	16,997
Corporate Centre	70,427	207	—	70,634
Total on-balance sheet	256,254	16,448	2,936	275,638
Off-balance sheet				
Retail Banking[1]	29,123	204	45	29,372
– Homes[1]	15,851	81	19	15,951
– Everyday Banking	13,272	123	26	13,421
Consumer Finance	314	—	—	314
Corporate & Commercial Banking	6,392	1,266	36	7,694
Corporate Centre	283	46	—	329
Total off-balance sheet[2]	36,112	1,516	81	37,709
Total exposures	292,366	17,964	3,017	313,347
ECL				
On-balance sheet				
Retail Banking	52	178	137	367
– Homes	8	88	89	185
– Everyday Banking	44	90	48	182
Consumer Finance	18	17	17	52
Corporate & Commercial Banking	43	119	245	407
Corporate Centre	2	—	—	2
Total on-balance sheet	115	314	399	828
Off-balance sheet				
Retail Banking	12	8	1	21
– Homes	5	—	—	5
– Everyday Banking	7	8	1	16
Consumer Finance	—	—	—	—
Corporate & Commercial Banking	5	8	3	16
Total off-balance sheet	17	16	4	37
Total ECL	132	330	403	865
Coverage ratio[3]	%	%	%	%
On-balance sheet				
Retail Banking	—	1.5	6.5	0.2
– Homes	—	0.8	5.0	0.1
– Everyday Banking	0.6	15.7	14.7	2.2
Consumer Finance	0.4	8.5	70.8	1.0
Corporate & Commercial Banking	0.4	2.7	31.0	2.4
Corporate Centre	—	—	—	—
Total on-balance sheet	—	1.9	13.6	0.3
Off-balance sheet				
Retail Banking	—	3.9	2.2	0.1
– Homes	—	—	—	—
– Everyday Banking	0.1	6.5	3.8	0.1
Consumer Finance	—	—	—	—
Corporate & Commercial Banking	0.1	0.6	8.3	0.2
Total off-balance sheet	—	1.1	4.9	0.1
Total coverage	—	1.8	13.4	0.3

(1) Off-balance sheet exposures include£10.6bn of residential mortgage offers in the pipeline.
(2) Off-balance sheet amounts consist of contingent liabilities and commitments. For more, see Note 31 to the Consolidated Financial Statements.
(3) ECL as a percentage of the related exposure.

Total on-balance sheet exposures at 31 December 2020 comprised £207.0bn of customer loans, loans and advances to banks of £1.7bn, £20.8bn of sovereign assets measured at amortised cost, £9.0bn of assets measured at FVOCI, and £41.3bn of cash and balances at central banks.

2020	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Exposures				
On-balance sheet				
Retail Banking	162,541	10,962	1,877	175,380
– Homes	154,586	10,345	1,799	166,730
– Everyday Banking	7,955	617	78	8,650
Consumer Finance	7,587	379	58	8,024
Corporate & Commercial Banking	11,167	5,498	961	17,626
Corporate & Investment Banking	2,587	198	—	2,785
Corporate Centre	75,743	27	—	75,770
Total on-balance sheet	259,625	17,064	2,896	279,585
Off-balance sheet				
Retail Banking[1]	26,313	256	41	26,610
– Homes[1]	13,180	82	14	13,276
– Everyday Banking	13,133	174	27	13,334
Consumer Finance	237	—	—	237
Corporate & Commercial Banking	6,050	768	59	6,877
Corporate & Investment Banking	8,630	231	—	8,861
Corporate Centre	558	17	—	575
Total off-balance sheet[2]	41,788	1,272	100	43,160
Total exposures	301,413	18,336	2,996	322,745
ECL				
On-balance sheet				
Retail Banking	56	313	181	550
– Homes	15	130	132	277
– Everyday Banking	41	183	49	273
Consumer Finance	44	37	37	118
Corporate & Commercial Banking	46	189	342	577
Corporate & Investment Banking	5	17	—	22
Corporate Centre	35	—	—	35
Total on-balance sheet	186	556	560	1,302
Off-balance sheet				
Retail Banking	18	19	1	38
– Homes	2	1	—	3
– Everyday Banking	16	18	1	35
Consumer Finance	—	—	—	—
Corporate & Commercial Banking	8	10	8	26
Corporate & Investment Banking	4	7	—	11
Total off-balance sheet	30	36	9	75
Total ECL	216	592	569	1,377
	%	%	%	%
Coverage ratio[3]				
On-balance sheet				
Retail Banking	—	2.9	9.6	0.3
– Homes	—	1.3	7.3	0.2
– Everyday Banking	0.5	29.7	62.8	3.2
Consumer Finance	0.6	9.8	63.8	1.5
Corporate & Commercial Banking	0.4	3.4	35.6	3.3
Corporate & Investment Banking	0.2	8.6	—	0.8
Corporate Centre	—	—	—	—
Total on-balance sheet	0.1	3.3	19.3	0.5
Off-balance sheet				
Retail Banking	0.1	7.4	2.4	0.1
– Homes	—	1.2	—	—
– Everyday Banking	0.1	10.3	3.7	0.3
Consumer Finance	—	0.0	—	—
Corporate & Commercial Banking	0.1	1.3	13.6	0.4
Corporate & Investment Banking	—	3.0	—	0.1
Total off-balance sheet	0.1	2.8	9.0	0.2
Total coverage	0.1	3.2	19.0	0.4

(1) Off-balance sheet exposures include £7.7bn of residential mortgage offers in the pipeline.
(2) Off-balance sheet amounts consist of contingent liabilities and commitments. For more, see Note 31 to the Consolidated Financial Statements.
(3) ECL as a percentage of the related exposure.

2021 compared to 2020

Key movements in exposures and ECL in the period by stage were:

- The reduction in Stage 1 exposures was mainly driven by the sale of our shareholding in PSA and transfer of CIB to SLB and a reduction in non-customer liquid assets (led by financial assets at fair value through OCI) as part of the normal course of the business. This was offset by an increase in exposures in residential mortgages. The reduction in ECL was mainly due to an improved macroeconomic outlook, and transactions relating to PSA and CIB as explained above.
- Stage 2 exposures reduced slightly due to a favourable macroeconomic outlook, improvement in arrears and other credit risk indicators. This also reduced accounts meeting the qualitative criteria for Stage 2 and lowered the probability of defaults, thus curing them out of Stage 2. The reduction in ECL was mainly from improved macroeconomic outlook and the unwind of Covid-19 related PMAs.
- Stage 3 exposures remained broadly flat, with a small reduction in undrawn exposures. There was a reduction in ECL mainly due to the improved macroeconomic outlook, fewer accounts entering default, single name accounts curing and write-off utilisation.

Stage 2 analysis (audited)

The following table analyses our Stage 2 exposures and ECL by the reason the exposure is classified as Stage 2.

	Retail Banking			Consumer Finance			Corporate & Commercial Banking			Corporate & Investment Banking			Corporate Centre			Total		
	Exposure	ECL	Coverage	Exposure	ECL	Coverage	Exposure	ECL	Coverage	Exposure	ECL	Coverage	Exposure	ECL	Coverage	Exposure	ECL	Coverage
2021	£m	£m	%	£m	£m	%	£m	£m	%	£m	£m	%	£m	£m	%	£m	£m	%
PD deterioration	**5,644**	**125**	**2.2**	**42**	**6**	**14.3**	**1,522**	**20**	**1.3**	**—**	**—**	**—**	**214**	**—**	**—**	**7,422**	**151**	**2.0**
Forbearance	**664**	**4**	**0.6**	**11**	**2**	**18.2**	**272**	**8**	**2.9**	**—**	**—**	**—**	**—**	**—**	**—**	**947**	**14**	**1.5**
Other	**556**	**5**	**0.9**	**130**	**4**	**3.1**	**445**	**19**	**4.3**	**—**	**—**	**—**	**—**	**—**	**—**	**1,131**	**28**	**2.5**
30 DPD	**745**	**33**	**4.4**	**17**	**5**	**29.4**	**313**	**2**	**0.6**	**—**	**—**	**—**	**39**	**—**	**—**	**1,114**	**40**	**3.6**
Payment holiday	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Mortgage affordability	**4,241**	**19**	**0.4**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**4,241**	**19**	**0.4**
High risk corporate	**—**	**—**	**—**	**—**	**—**	**—**	**3,109**	**78**	**2.5**	**—**	**—**	**—**	**—**	**—**	**—**	**3,109**	**78**	**2.5**
	11,850	**186**	**1.6**	**200**	**17**	**8.5**	**5,661**	**127**	**2.2**	**—**	**—**	**—**	**253**	**—**	**—**	**17,964**	**330**	**1.8**
2020																		
PD deterioration	7,752	247	3.2	88	13	14.8	2,128	39	1.8	—	—	—	32	—	—	10,000	299	3.0
Forbearance	612	3	0.5	—	—	—	151	6	4.0	—	—	—	4	—	—	767	9	1.2
Other	1,155	10	0.9	249	11	4.4	612	66	10.8	429	24	5.6	5	—	—	2,450	111	4.5
30 DPD	870	46	5.3	27	12	44.4	250	5	2.0	—	—	—	3	—	—	1,150	63	5.5
Payment holiday	829	26	3.1	15	1	6.7	—	—	—	—	—	—	—	—	—	844	27	3.2
Mortgage affordability	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
High risk corporate	—	—	—	—	—	—	3,125	83	2.7	—	—	—	—	—	—	3,125	83	2.7
	11,218	332	3.0	379	37	9.8	6,266	199	3.2	429	24	5.6	44	—	—	18,336	592	3.2

Where balances satisfy more than one of the criteria above for determining a SCIR, we have assigned the corresponding gross carrying amount and ECL in order of the categories presented.

The following table analyses our Stage 2 exposures and the related ECL by whether or not they are in a cure period at the balance sheet date.

	2021			2020		
	Exposure	ECL	Coverage	Exposure	ECL	Coverage
	£m	£m	%	£m	£m	%
Stage 2 not in cure period	**13,302**	**286**	**2.2**	16,992	554	3.3
Stage 2 in cure period (for transfer to Stage 1)	**4,662**	**44**	**0.9**	1,344	38	2.8
	17,964	**330**	**1.8**	18,336	592	3.2

2021 compared to 2020

Credit performance was strong during 2021. Arrears and other internal and external credit risk indicators improved. These reduced accounts hitting the qualitative criteria for Stage 2, lowered PDs, and moved accounts below the SICR thresholds, thus curing them out of Stage 2. The macroeconomic outlook also contributed to this, where GDP paths were revised upwards, further decreasing PDs and allowing accounts to exit out of Stage 2. Though this was partially offset by increasing Base Rate forecasts. Credit performance was further helped by the unwinding of the payment holiday PMA, as payment holiday accounts performed much better than expected when returning to full payments. Management took action to hold back some of the ECL releases as uncertainty about future performance remains, including the introduction of PMAs around the government backed BBLs, PMAs to deal with cladding risk and perceived model underestimation, and the most notable PMA moving £4.2bn of mortgage from Stage 1 to Stage 2 to deal with the potential upcoming inflationary pressures that these customers will face. Without these PMAs the Stage 2 population would have dramatically improved since December 2020.

Coverage lowered in 2021 due to the above mentioned factors affecting ECL.

The accounts in a cure period at 31 December 2021 reduced compared to 31 December 2020, as the payment holiday PMA unwound, allowing those accounts to move to Stage 2.

We do not have any cure period criteria for exiting Stage 3 at 31 December 2021.

Reconciliation of exposures, loss allowance and net carrying amounts (audited)

The table below shows the relationships between disclosures in this Credit risk review section which refer to drawn exposures and the associated ECL, and the total assets as presented in the Consolidated Balance Sheet.

	On-balance sheet			Off-balance sheet	
	Exposures	Loss allowance	Net carrying amount	Exposures	Loss allowance
2021	£m	£m	£m	£m	£m
Retail Banking[1]	**183,023**	**367**	**182,656**	**29,372**	**21**
– Homes[1]	**174,712**	**185**	**174,527**	**15,951**	**5**
– Everyday Banking[2]	**8,311**	**182**	**8,129**	**13,421**	**16**
Consumer Finance	**4,984**	**52**	**4,932**	**314**	**—**
Corporate & Commercial Banking	**16,997**	**407**	**16,590**	**7,694**	**16**
Corporate Centre	**70,634**	**2**	**70,632**	**329**	**—**
Total exposures presented in Credit Quality tables	**275,638**	**828**	**274,810**	**37,709**	**37**
Other items[3]			**3,632**		
Adjusted net carrying amount			**278,442**		
Assets classified at FVTPL			**1,866**		
Non-financial assets			**6,790**		
Total assets per the Consolidated Balance Sheet			**287,098**		

2020					
Retail Banking[1]	175,380	550	174,830	26,610	38
– Homes[1]	166,730	277	166,453	13,276	3
– Everyday Banking[2]	8,650	273	8,377	13,334	35
Consumer Finance	8,024	118	7,906	237	—
Corporate & Commercial Banking	17,626	577	17,049	6,877	26
Corporate & Investment Banking	2,785	22	2,763	8,861	11
Corporate Centre	75,770	35	75,735	575	—
Total exposures presented in Credit Quality tables	279,585	1,302	278,283	43,160	75
Other items[3]			3,111		
Adjusted net carrying amount			281,394		
Assets classified at FVTPL			3,614		
Non-financial assets			7,324		
Total assets per the Consolidated Balance Sheet			292,332		

(1) Off-balance sheet exposures include offers in the pipeline and undrawn flexible mortgages products.
(2) Off-balance sheet exposures include credit cards.
(3) These assets mainly relate to loans as part of a joint venture agreement and the accrued interest on them. They carry low credit risk and therefore have an immaterial ECL.

Movement in total exposures and the corresponding ECL (audited)

The following table shows changes in total on and off-balance sheet exposures, subject to ECL assessment, and the corresponding ECL, in the period. The table presents total gross carrying amounts and ECLs at a Santander UK group level. We present segmental views in the sections below.

	Stage 1		Stage 2		Stage 3		Total	
	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	**301,413**	**216**	**18,336**	**592**	**2,996**	**569**	**322,745**	**1,377**
Transfers from Stage 1 to Stage 2[3]	(6,805)	(9)	6,805	9	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	5,883	167	(5,883)	(167)	—	—	—	—
Transfers to Stage 3[3]	(571)	(3)	(532)	(20)	1,103	23	—	—
Transfers from Stage 3[3]	14	2	456	62	(470)	(64)	—	—
Transfers of financial instruments	(1,479)	157	846	(116)	633	(41)	—	—
Net ECL remeasurement on stage transfer[4]	—	(133)	—	26	—	64	—	(43)
Change in economic scenarios[2]	—	(7)	—	(151)	—	(12)	—	(170)
Changes to model	—	—	—	—	—	—	—	—
New lending and assets purchased[5]	50,862	31	936	26	25	19	51,823	76
Redemptions, repayments and assets sold[7]	(63,658)	(70)	(3,442)	(67)	(519)	(68)	(67,619)	(205)
Changes in risk parameters and other movements[6]	5,228	(62)	1,288	20	179	63	6,695	21
Assets written off[7]	—	—	—	—	(297)	(191)	(297)	(191)
At 31 December 2021	**292,366**	**132**	**17,964**	**330**	**3,017**	**403**	**313,347**	**865**
Net movement in the period	(9,047)	(84)	(372)	(262)	21	(166)	(9,398)	(512)

ECL charge/(release) to the Income Statement		(84)		(262)		25		(321)
Less: Discount unwind		—		—		(11)		(11)
Less: Recoveries net of collection costs		—		—		88		88
ECL charge/(release) to the Income Statement from continued operations		(84)		(262)		102		(244)
Discontinued operations ECL adjustment		11		—		—		11
Total ECL charge/(release) to the Income Statement		(73)		(262)		102		(233)

At 1 January 2020	295,436	147	12,351	348	2,368	368	310,155	863
Transfers from Stage 1 to Stage 2[3]	(9,815)	(47)	9,815	47	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	3,178	110	(3,178)	(110)	—	—	—	—
Transfers to Stage 3[3]	(385)	(8)	(1,126)	(61)	1,511	69	—	—
Transfers from Stage 3[3]	12	2	326	21	(338)	(23)	—	—
Transfers of financial instruments	(7,010)	57	5,837	(103)	1,173	46	—	—
Net remeasurement of ECL on stage transfer[4]	—	(101)	—	239	—	241	—	379
Change in economic scenarios[2]	—	15	—	139	—	10	—	164
Changes to model	—	—	—	—	—	25	—	25
New lending and assets purchased[5]	55,546	40	1,371	64	104	52	57,021	156
Redemptions, repayments and assets sold[7]	(50,698)	(30)	(2,295)	(42)	(441)	(18)	(53,434)	(90)
Changes in risk parameters and other movements[6]	8,141	88	1,072	(53)	185	98	9,398	133
Assets written off[7]	(2)	—	—	—	(393)	(253)	(395)	(253)
At 31 December 2020	301,413	216	18,336	592	2,996	569	322,745	1,377
Net movement in the period	5,977	69	5,985	244	628	201	12,590	514

ECL charge/(release) to the Income Statement		69		244		454		767
Less: Discount unwind		—		—		(14)		(14)
Less: Recoveries net of collection costs		—		—		(108)		(108)
ECL charge/(release) to the Income Statement from continued operations		69		244		332		645
Discontinued operations ECL adjustment		—		—		(7)		(7)
Total ECL charge/(release) to the Income Statement		69		244		325		638

(1) Exposures that have attracted an ECL, and as reported in the Credit Quality table above.
(2) Changes to assumptions in the period. Isolates the impact on ECL from changes to the economic variables for each scenario, the scenarios themselves, and the probability weights from all other movements. Also includes the impact of quarterly revaluation of collateral. The impact of changes in economics on exposure Stage allocations are shown in Transfers of financial instruments.
(3) Total impact of facilities that moved Stage(s) in the period. This means, for example, that where risk parameter changes (model inputs) or model changes (methodology) result in a facility moving Stage, the full impact is reflected here (rather than in Other). Stage flow analysis only applies to facilities that existed at both the start and end of the period. Transfers between Stages are based on opening balances and ECL at the start of the period.
(4) Relates to the revaluation of ECL following the transfer of an exposure from one Stage to another.
(5) Exposures and ECL of facilities that did not exist at the start of the period but did at the end. Amounts in Stage 2 and 3 represent assets which deteriorated in the period after origination in Stage 1.
(6) Residual movements on existing facilities that did not change Stage in the period, and which were not acquired in the period. Includes the net increase or decrease in the period of cash at central banks, the impact of changes in risk parameters in the period, unwind of discount rates and increases in ECL requirements of accounts which ultimately were written off in the period.
(7) Exposures and ECL for facilities that existed at the start of the period but not at the end.

COUNTRY RISK EXPOSURES (AUDITED)

We manage our country risk exposure under our global limits framework. Within this framework we set our Risk Appetite for each country, taking into account factors that may affect its risk profile. These can include political events, macroeconomics and the nature of the risk. We actively manage exposures if we think we need to. We consider Banco Santander SA related risk separately.

The tables below show our total exposures, which are the total of balance sheet and off–balance sheet values. We calculate balance sheet values in accordance with IFRS (i.e. after netting allowed under IAS 32) except for credit provisions which we add back. Off–balance sheet values are undrawn facilities and letters of credit. We classify location by country of risk – the country where each client has its main business or assets. That is unless there is a full risk transfer guarantee in place, in which case we use the guarantor's country of domicile. If a client has operations in many countries, we use their country of incorporation. The tables below exclude balances with other Banco Santander group members. We show them separately in the 'Balances with other Banco Santander group members' section.

	2021						2020					
		Financial institutions						Financial institutions				
	Governments	Banks[1]	Other	Retail	Corporate	Total[2]	Governments	Banks[1]	Other	Retail	Corporate	Total[2]
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Eurozone												
Ireland	**—**	**—**	**5.3**	**—**	**—**	**5.3**	—	—	6.0	—	0.1	6.1
Italy	**—**	**—**	**—**	**—**	**—**	**—**	—	—	—	—	—	—
Spain	**—**	**—**	**—**	**—**	**0.1**	**0.1**	—	—	—	—	0.1	0.1
France	**0.1**	**0.3**	**0.2**	**—**	**—**	**0.6**	0.1	0.5	0.2	—	—	0.8
Germany	**—**	**0.4**	**—**	**—**	**—**	**0.4**	—	0.7	0.1	—	0.1	0.9
Luxembourg	**—**	**—**	**0.1**	**—**	**—**	**0.1**	—	0.1	1.3	—	0.1	1.5
Other[3]	**0.3**	**0.8**	**—**	**—**	**—**	**1.1**	0.4	1.1	—	—	0.4	1.9
	0.4	**1.5**	**5.6**	**—**	**0.1**	**7.6**	0.5	2.4	7.6	—	0.8	11.3
Other countries												
UK	**47.9**	**2.0**	**9.3**	**215.1**	**28.7**	**303.0**	42.0	2.8	14.8	206.1	40.4	306.1
US	**0.5**	**0.8**	**—**	**—**	**—**	**1.3**	0.8	0.9	0.1	—	0.3	2.1
Japan	**1.0**	**0.2**	**—**	**—**	**—**	**1.2**	2.4	1.0	—	—	—	3.4
Switzerland	**—**	**—**	**—**	**—**	**—**	**—**	—	—	—	—	—	—
Denmark	**—**	**—**	**—**	**—**	**—**	**—**	—	—	—	—	—	—
Other	**0.3**	**0.2**	**0.1**	**—**	**0.1**	**0.7**	0.3	0.5	0.1	—	0.7	1.6
	49.7	**3.2**	**9.4**	**215.1**	**28.8**	**306.2**	45.5	5.2	15.0	206.1	41.4	313.2
Total	**50.1**	**4.7**	**15.0**	**215.1**	**28.9**	**313.8**	46.0	7.6	22.6	206.1	42.2	324.5

(1) Excludes balances with central banks.
(2) Excludes cash at hand, interests in other entities, intangible assets, property, plant and equipment, tax assets, retirement benefit assets and other assets. Loans are included gross of credit provisions.
(3) Includes The Netherlands of£0.2bn (2020: £0.6bn), Belgium of £0.7bn (2020: £0.9bn).

Balances with other Banco Santander group members (audited)

We deal with other Banco Santander group members in the ordinary course of business. We do this where we have a particular business advantage or expertise and where they can offer us commercial opportunities. These transactions also arise where we support the activities of, or with, larger multinational corporate clients and financial institutions which may deal with other Banco Santander group members. We also dealt with Banco Santander SA as part of implementing our ring–fencing plans. We conduct these activities on the same terms as for similar transactions with third parties, and in a way that manages the credit risk within limits acceptable to the Board and the PRA.

At 31 December 2021 and 31 December 2020, we had gross balances with other Banco Santander group members as follows:

	2021				2020			
	Financial institutions				Financial institutions			
	Banks	Other	Corporate	Total	Banks	Other	Corporate	Total
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Assets								
Spain	**0.8**	**—**	**—**	**0.8**	1.6	—	—	1.6
UK	**—**	**3.3**	**—**	**3.3**	—	2.4	—	2.4
	0.8	**3.3**	**—**	**4.1**	1.6	2.4	—	4.0
Liabilities								
Spain	**1.2**	**0.1**	**—**	**1.3**	2.2	0.1	—	2.3
UK	**—**	**12.1**	**—**	**12.1**	—	11.5	—	11.5
Uruguay	**0.1**	**—**	**—**	**0.1**	0.1	—	—	0.1
	1.3	**12.2**	**—**	**13.5**	2.3	11.6	—	13.9

RETAIL BANKING – CREDIT RISK REVIEW

We set out below the overall credit profile for Retail Banking. We provide further detailed credit risk analysis in separate sections for:

- Homes, our largest portfolio in 'Retail Banking: Homes - credit risk review', and
- Everyday Banking portfolio in 'Retail Banking: Everyday Banking - credit risk review' .

Movement in total exposures and the corresponding ECL (audited)
The following table shows changes in total on and off-balance sheet exposures subject to ECL assessment, and the corresponding ECL, for Retail Banking in the period. The footnotes to the Santander UK group level analysis on page 79 are also applicable to this table.

	Stage 1		Stage 2		Stage 3		Total	
	Exposures [1]	ECL	Exposures [1]	ECL	Exposures [1]	ECL	Exposures [1]	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	**188,854**	**74**	**11,218**	**332**	**1,918**	**182**	**201,990**	**588**
Transfers from Stage 1 to Stage 2[3]	(5,653)	(4)	5,653	4	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	4,200	101	(4,200)	(101)	—	—	—	—
Transfers to Stage 3[3]	(526)	(2)	(488)	(16)	1,014	18	—	—
Transfers from Stage 3[3]	9	1	364	21	(373)	(22)	—	—
Transfers of financial instruments	(1,970)	96	1,329	(92)	641	(4)	—	—
Net ECL remeasurement on stage transfer[4]	—	(95)	—	48	—	33	—	(14)
Change in economic scenarios[2]	—	(6)	—	(86)	—	(12)	—	(104)
Changes to model	—	—	—	—	—	—	—	—
New lending and assets purchased[5]	35,442	19	417	14	9	4	35,868	37
Redemptions, repayments and assets sold [7]	(28,094)	(14)	(1,537)	(22)	(361)	(21)	(29,992)	(57)
Changes in risk parameters and other movements[6]	4,146	(10)	423	(7)	89	64	4,658	47
Assets written off[7]	—	—	—	(1)	(129)	(108)	(129)	(109)
At 31 December 2021	**198,378**	**64**	**11,850**	**186**	**2,167**	**138**	**212,395**	**388**
Net movement in the period	9,524	(10)	632	(146)	249	(44)	10,405	(200)

Charge/(release) to the Income Statement		(10)		(145)		64		(91)
Less: Discount unwind		—		—		(7)		(7)
Less: Recoveries net of collection costs		—		—		—		—
Total ECL charge/(release) to the Income Statement		(10)		(145)		57		(98)

At 1 January 2020	186,088	59	8,872	232	1,859	170	196,819	461
Transfers from Stage 1 to Stage 2[3]	(5,087)	(7)	5,087	7	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	2,168	82	(2,168)	(82)	—	—	—	—
Transfers to Stage 3[3]	(272)	(4)	(520)	(22)	792	26	—	—
Transfers from Stage 3[3]	8	1	323	20	(331)	(21)	—	—
Transfers of financial instruments:	(3,183)	72	2,722	(77)	461	5	—	—
Net ECL remeasurement on stage transfer[4]	—	(78)	—	144	—	42	—	108
Change in economic scenarios[2]	—	7	—	81	—	10	—	98
Changes to model	—	—	—	—	—	25	—	25
New lending and assets purchased[5]	31,499	15	345	30	6	4	31,850	49
Redemptions, repayments and assets sold[7]	(26,727)	(12)	(1,031)	(25)	(314)	(20)	(28,072)	(57)
Changes in risk parameters and other movements[6]	1,177	11	310	(53)	109	101	1,596	59
Assets written off[7]	—	—	—	—	(203)	(155)	(203)	(155)
At 31 December 2020	188,854	74	11,218	332	1,918	182	201,990	588
Net movement in the period	2,766	15	2,346	100	59	12	5,171	127

Charge/(release) to the Income Statement		15		100		167		282
Less: Discount unwind		—		—		(7)		(7)
Less: Recoveries net of collection costs		—		—		(11)		(11)
Total ECL charge/(release) to the Income Statement		15		100		149		264

RETAIL BANKING: HOMES – CREDIT RISK REVIEW

We offer mortgages to people who want to buy a property and offer additional borrowing (known as further advances) to existing mortgage customers. The property must be in the UK.

2021 compared to 2020
A historically stable credit environment supported our customers and helped to reduce credit risk. Unemployment, which tracked at historically low levels in 2021, is one of the most important factors in defaults on mortgages. Whilst the UK housing market continues to show resilience, we maintain a cautious outlook in light of continued economic uncertainty due to the Covid-19 pandemic. Net mortgage growth in 2021 was £8.0bn (2020: £1.4bn).

Borrower profile (audited)
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 new customers who are taking a new mortgage with us.

	Stock				New business			
	2021		2020		2021		2020	
	£m	%	£m	%	£m	%	£m	%
Home movers	**74,657**	**42**	71,008	42	**13,537**	**43**	10,116	41
Remortgagers	**50,645**	**29**	50,934	31	**8,031**	**25**	6,861	27
First-time buyers	**34,517**	**20**	33,180	20	**6,206**	**19**	5,354	21
Buy-to-let	**14,893**	**9**	11,608	7	**4,239**	**13**	2,622	11
	174,712	**100**	166,730	100	**32,013**	**100**	24,953	100

As well as the new business in the table above, there were £29.8bn (2020: £31.6bn) of remortgages where we moved existing customers with maturing products onto new mortgages. We also provided £1.4bn (2020: £1.2bn) of further advances and flexible mortgage drawdowns.

2021 compared to 2020
in 2021 mortgage asset stock increased. The borrower profile of stock altered slightly, as the reduction in remortgage asset was replaced by an increase in house purchases across both residential and BTL mortgages. Our new business profiles displayed similar trends, reflecting market conditions and in particular a strong demand for purchase activity for both residential and BTL mortgages, driven by the temporarily reduced rates of Stamp Duty Land Tax effective during the period. In 2021, we helped first-time buyers purchase their new home with £6.2bn of gross lending (2020: £5.4bn).

Interest rate profile (audited)
The interest rate profile of our mortgage asset stock was:

	2021		2020	
	£m	%	£m	%
Fixed rate	**147,147**	**84**	133,231	80
Variable rate	**17,010**	**10**	20,986	13
Standard Variable Rate (SVR)	**7,836**	**4**	10,627	6
Follow on Rate (FoR)	**2,719**	**2**	1,886	1
	174,712	**100**	166,730	100

2021 compared to 2020
In 2021, we continued to see customers refinance from variable rate and SVR to fixed rate products influenced by low mortgage rates and the competitive mortgage market. Within fixed rate products, we saw an increase in the proportion of 5 year fixed rate mortgages in 2021.

Geographical distribution (audited)
The geographical distribution of our mortgage asset stock was:

	Stock		New business	
	2021	2020	2021	2020
Region	£bn	£bn	£bn	£bn
London	**44.6**	41.8	**8.3**	6.1
Midlands and East Anglia	**23.8**	22.5	**4.7**	3.7
North	**23.1**	22.6	**3.8**	3.3
Northern Ireland	**3.0**	3.1	**0.3**	0.2
Scotland	**6.6**	6.7	**1.0**	0.8
South East excluding London	**55.5**	52.5	**10.5**	8.3
South West, Wales and other	**18.1**	17.5	**3.4**	2.6
	174.7	166.7	**32.0**	25.0

Average loan size for new business	£'000	£'000
South East including London	**306**	284
Rest of the UK	**175**	166
UK as a whole	**234**	218

2021 compared to 2020
The portfolio's geographical distribution continued to represent a broad footprint across the UK, with a concentration around London and the South East. The loan-to-income multiple of mortgage lending in the period, based on average earnings of new business at inception, was 3.35 (2020: 3.29).

Larger loans (audited)
The mortgage asset stock of larger loans was:

	South East including London		UK	
	2021	2020	**2021**	2020
Individual mortgage loan size	£m	£m	£m	£m
<£0.25m	**44,431**	44,790	**103,657**	103,785
£0.25m to £0.50m	**38,749**	35,487	**51,699**	46,914
£0.50m to £1.0m	**13,820**	11,942	**15,972**	13,763
£1.0m to £2.0m	**2,823**	1,875	**3,053**	2,024
>£2.0m	**318**	236	**331**	244
	100,141	94,330	**174,712**	166,730

At 31 December 2021, there were 131 (2020: 98) individual mortgages over £2m. In 2021, there were 52 (2020: 38) new mortgages over £2m.

Loan-to-value analysis (audited)
This table shows the LTV distribution for the gross carrying amount and the related ECL of our total mortgage portfolio and Stage 3 mortgages, as well as the LTV distribution for new business. We also show the collateral value and simple average LTV for our mortgage stock, Stage 3 stock and new business. We use our estimate of the property value at the balance sheet date. We include fees that have been added to the loan in the LTV calculation. For flexible products, we only include the drawn amount, not undrawn limits.

	2021					2020				
	Stock		Stage 3		New	Stock		Stage 3		New
	Total	ECL	Total	ECL	Business	Total	ECL	Total	ECL	Business
LTV	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Up to 50%	**78,911**	**25**	**942**	**9**	**4,997**	73,489	28	858	11	4,180
>50-75%	**77,781**	**62**	**614**	**28**	**15,831**	68,324	89	633	36	10,088
>75-85%	**13,866**	**26**	**106**	**12**	**6,896**	18,113	41	125	19	5,858
>85-100%	**3,626**	**26**	**69**	**14**	**4,239**	6,070	44	93	22	4,781
>100%	**528**	**51**	**65**	**26**	**50**	734	78	90	44	46
	174,712	**190**	**1,796**	**89**	**32,013**	166,730	280	1,799	132	24,953
Collateral value of residential properties [1]	**174,637**		**1,784**		**32,012**	166,623		1,783		24,953
	%		%		%	%		%		%
Simple Average[2] LTV (indexed)	**41**		**38**		**64**	42		41		64

(1) Collateral value shown is limited to the balance of each related loan. Excludes the impact of over-collateralisation, where the collateral is higher than the loan. Includes collateral against loans in negative equity of £455m (2020: £629m).
(2) Total of all LTV% divided by the total of all accounts.

At 31 December 2021, the parts of loans in negative equity which were effectively uncollateralised before deducting loss allowances was £75m (2020: £107m). In 2021, the simple average LTV of mortgage total new lending in London was 60% (2020: 60%).

2021 compared to 2020
There were no significant changes in the quality of our collateral in 2021. Despite the economic pressures from the Covid-19 pandemic, simple average LTV remained broadly flat over the period. We continue to monitor the LTV profile of new lending and take action as needed to ensure the LTV mix of completions is appropriate.

Credit performance (audited)

	2021	2020
	£m	£m
Mortgage loans and advances to customers of which:	**174,712**	166,730
– Stage 1	**161,845**	154,586
– Stage 2	**11,071**	10,345
– Stage 3	**1,796**	1,799
Loss allowances[1]	**190**	280
	%	%
Stage 1 ratio[2]	**92.64**	92.72
Stage 2 ratio[2]	**6.34**	6.20
Stage 3 ratio[3]	**1.04**	1.09

(1) The ECL allowance is for both on and off–balance sheet exposures.
(2) Stage 1/Stage 2 exposures as a percentage of customer loans.
(3) The sum of Stage 3 drawn and Stage 3 undrawn assets divided by the sum of total drawn assets and Stage 3 undrawn assets.

Movement in total exposures and the corresponding ECL (audited)

The following table shows changes in total on and off-balance sheet exposures subject to ECL assessment, and the corresponding ECL, for residential mortgages in the period. The footnotes to the Santander UK group level analysis on page 79 are also applicable to this table.

	Stage 1		Stage 2		Stage 3		Total	
	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	**167,766**	**17**	**10,427**	**131**	**1,813**	**132**	**180,006**	**280**
Transfers from Stage 1 to Stage 2[3]	(5,439)	(2)	5,439	2	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	3,782	21	(3,782)	(21)	—	—	—	—
Transfers to Stage 3[3]	(242)	(2)	(451)	(4)	693	6	—	—
Transfers from Stage 3[3]	3	—	353	15	(356)	(15)	—	—
Transfers of financial instruments	(1,896)	17	1,559	(8)	337	(9)	—	—
Net ECL remeasurement on stage transfer[4]	—	(19)	—	10	—	9	—	—
Change in economic scenarios[2]	—	(1)	—	(67)	—	(12)	—	(80)
Changes to model	—	—	—	—	—	—	—	—
New lending and assets purchased[5]	33,292	6	332	2	1	—	33,625	8
Redemptions, repayments and assets sold[7]	(25,072)	(3)	(1,436)	(6)	(331)	(16)	(26,839)	(25)
Changes in risk parameters and other movements[6]	3,606	(4)	270	26	11	(10)	3,887	12
Assets written off[7]	—	—	—	—	(16)	(5)	(16)	(5)
At 31 December 2021	**177,696**	**13**	**11,152**	**88**	**1,815**	**89**	**190,663**	**190**
Net movement in the period	9,930	(4)	725	(43)	2	(43)	10,657	(90)
Charge/(release) to the Income Statement		(3)		(43)		(38)		(84)
Less: Discount unwind		—		—		(2)		(2)
Less: Recoveries net of collection costs		—		—		(1)		(1)
Total ECL charge/(release) to the Income Statement		(3)		(43)		(41)		(87)

At 1 January 2020	168,830	14	8,224	101	1,734	103	178,788	218
Transfers from Stage 1 to Stage 2[3]	(4,686)	(2)	4,686	2	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	1,911	17	(1,911)	(17)	—	—	—	—
Transfers to Stage 3[3]	(229)	(3)	(491)	(11)	720	14	—	—
Transfers from Stage 3[3]	4	—	311	15	(315)	(15)	—	—
Transfers of financial instruments	(3,000)	12	2,595	(11)	405	(1)	—	—
Net ECL remeasurement on stage transfer[4]	—	(15)	—	49	—	17	—	51
Change in economic scenarios[2]	—	7	—	13	—	10	—	30
Changes to model	—	—	—	—	—	25	—	25
New lending and assets purchased[5]	26,102	4	237	5	1	—	26,340	9
Redemptions, repayments and assets sold[7]	(23,707)	(4)	(899)	(7)	(297)	(15)	(24,903)	(26)
Changes in risk parameters and other movements[6]	(459)	(1)	270	(19)	24	7	(165)	(13)
Assets written off[7]	—	—	—	—	(54)	(14)	(54)	(14)
At 31 December 2020	167,766	17	10,427	131	1,813	132	180,006	280
Net movement in the period	(1,064)	3	2,203	30	79	29	1,218	62
Charge/(release) to the Income Statement		3		29		43		75
Less: Discount unwind		—		—		(2)		(2)
Less: Recoveries net of collection costs		—		—		(1)		(1)
Total ECL charge/(release) to the Income Statement		3		29		40		72

Loan modifications

Forbearance[1]

The following table (audited) sets out the financial assets that were forborne while they had a loss allowance measured at lifetime ECL.

	2021 £m	2020 £m
Financial assets modified in the period:		
– Amortised cost before modification	**422**	305
– Net modification loss	**9**	7
Financial assets modified since initial recognition:		
– Gross carrying amount of financial assets for which the loss allowance changed to 12 months ECL in the period	**152**	114

The balances at 31 December 2021 and 31 December 2020, analysed by their staging at the period-end and the forbearance we applied, were:

2021	Capitalisation £m	Term extension £m	Interest-only £m	Concessionary interest rate £m	Total[2] £m	Loss allowances £m
Stage 2	**387**	**444**	**273**	**4**	**1,108**	**12**
Stage 3	**217**	**74**	**73**	**111**	**475**	**26**
	604	**518**	**346**	**115**	**1,583**	**38**
Proportion of portfolio	**0.3%**	**0.3%**	**0.2%**	**0.1%**	**0.9%**	

2020						
Stage 2	409	393	310	—	1,112	13
Stage 3	219	83	86	28	416	29
	628	476	396	28	1,528	42
Proportion of portfolio	0.4%	0.3%	0.2%	—%	0.9%	

(1) We base forbearance type on the first forbearance on the accounts.
(2) The total is audited.

2021 compared to 2020

In 2021, forbearance activity remained stable. The proportion of the mortgage portfolio in forbearance remained flat at 0.9% (2020: 0.9%).

- At 31 December 2021, the proportion of accounts in forbearance for more than six months that had made their last six months' contractual payments increased to 85% (2020: 81%).
- The weighted average LTV of all accounts in forbearance was 32% (2020: 34%) compared to the weighted average portfolio LTV of 35% (2020: 38%).
- At 31 December 2021, the carrying value of mortgages classified as multiple forbearance increased slightly to £148m (2020: £143m).

Other loan modifications

Since March 2020, we have provided mortgage customers with payment holiday terms in line with UK Government and FCA guidance. The following table provides information on such loan modifications. For more on this, see 'Covid-19 Support schemes' in 'Santander UK group level - Credit risk review'.

	2021 £m	2020 £m
Financial assets modified in the period:		
– Amortised cost before modification	**647**	36,326
– Net modification loss	**—**	—
Financial assets modified since initial recognition:		
– Gross carrying amount of financial assets for which the loss allowance changed to 12 months ECL in the period	**8**	99

At 31 December 2021, there were £2.3bn (2020: £2.6bn) of other mortgages on the balance sheet that we had modified since January 2008. At 31 December 2021:

- The average LTV was 27% (2020: 30%), and 95% (2020: 96%) of accounts had made their last six months' contractual payments.
- The proportion of accounts that were 90 days or more in arrears was 2.62% (2020: 1.50%).

RETAIL BANKING: HOMES – PORTFOLIOS OF PARTICULAR INTEREST

Introduction

We are mainly a residential prime lender and we do not originate sub-prime or second charge mortgages. Despite that, some types of mortgages have higher risks and others stand out for different reasons. These are:

Product	Description
Interest-only loans and part interest-only, part repayment loans	With an interest-only mortgage, the customer pays interest every month but the principal balance may remain outstanding until the end of the mortgage term. Some mortgages have a part that is interest-only, with the rest being a normal repayment mortgage. Customers with part interest-only, part repayment mortgages still have to pay back a lump sum at the end of their mortgage for the interest-only part. This means there is a higher credit risk on these loans as we depend on the customers to pay back a lump sum. We design new account LTV maximums to mitigate this credit risk. We also make sure the customer has a plausible repayment plan before we lend to them and remains on track for the life of the loan. Since 2009, we have reduced the risk from new interest-only mortgages by lowering the maximum LTV. For the majority of applicants a maximum LTV of 50% applies. For high net worth customers (gross annual income > £250k) this maximum LTV for an interest-only mortgage can be up to 75%. When a customer plans to repay their mortgage by selling the property, we require a minimum equity buffer of £250k. Customers with interest-only mortgages have to make arrangements to repay the principal at the end of the mortgage. We have a strategy to make sure that we tell these customers that they have to do this. We send them messages with their annual mortgage statements, and we run contact campaigns to encourage them to tell us how they plan to repay. We undertake these contact campaigns periodically throughout the customers' interest-only mortgage term and increase the frequency of contact as customers approach term maturity. If customers know they will not be able to repay their mortgage in full when it ends, or if their mortgage has already passed the date when it should have ended, we talk to them. If we think it is in the customer's interests and they can afford it, we look at other ways of managing it. That can mean turning the mortgage into a standard repayment one and extending it. Or, if the customer is waiting for their means of repaying it, such as an investment plan or bonds, to mature, an extension may be permitted.
Flexible loans	Flexible mortgages allow customers to pay more or less than their usual amount each month, or even to take 'payment holidays' when they pay nothing at all. Customers do not have to take or draw down the whole loan all at once – so if they took out a mortgage big enough to allow them to build a home extension after three years, they do not have to start paying interest on that extra money until they are ready to spend it. There are conditions on when and how much customers can draw down: – There are often limits on how much can be drawn down in any month – The customer cannot be in payment arrears – The customer cannot have insolvency problems, such as a county court judgement, bankruptcy, an individual voluntary arrangement, an administration order or a debt relief order. A customer can ask us to increase their credit limit, but that means we will go through our full standard credit approval process. We can also lower the customer's credit limit at any time, so it never goes above 90% of the property's current market value. We no longer offer flexible loan products for new mortgages. This is an area of interest in order to identify customers who might be using these facilities to self-forbear, such as regularly drawing down small amounts. If there is any sign that the credit risk has significantly increased, we reflect this in our provision calculations.
Loans with an LTV >100%	Where the mortgage balance is more than the property is now worth, we cannot recover the full value of the loan by repossessing and selling the property. This means there is a higher credit risk on these loans. In some cases, property prices have fallen, so mortgages we gave in the past with lower LTVs now have LTVs greater than 100%. We monitor existing accounts with LTVs >100% as part of our assessment of ongoing portfolio performance. We design new account LTV maximums to mitigate an increase in the volume of accounts with an LTV >100%.
Buy-to-Let (BTL) loans	In recent years, we have refined our BTL proposition to appeal to a wider catchment, and we have improved our systems to cater for this segment with a focus on non-professional landlords. We have prudent lending criteria, and specific policies for BTL. We only lend to a maximum 75% LTV. The first applicant must earn a minimum income of £25,000 per year, and we require evidence of income in all cases. We also use a BTL affordability rate as part of our assessment about whether to lend. This means that the rental income must cover the monthly mortgage interest payments by a prescribed amount when calculated using a stressed interest rate. We regularly review the prescribed amount and adjust it as needed.

In 2020 and 2021 we provided customers with payment holiday terms in line with the UK Government's Covid-19 guidance. For more on this, see 'Covid-19 Support schemes' in 'Santander UK group level - Credit risk review'.

Climate change

The value of property collateral for mortgages might be affected by physical impacts related to the frequency and scale of extreme weather events, such as flood and subsidence risk or changing environmental performance standards for property. In 2021 we reviewed the proportion of mortgage loans subject to flood and subsidence risk and concluded that the risk was not material. The terms of our mortgage lending require homeowners to buy suitable insurance which transfers the majority of the risk to asset valuations to third party insurers.

Credit performance (audited)

		Portfolio of particular interest[1]					
2021	Total £m	Interest-only £m	Part interest-only, part repayment [2] [3] £m	Flexible[3] £m	LTV >100% £m	Buy-to-let £m	Other portfolio £m
Mortgage portfolio	**174,712**	**40,654**	**13,638**	**8,549**	**528**	**14,893**	**116,767**
– Stage 1	**161,845**	**36,212**	**12,391**	**7,509**	**354**	**14,363**	**109,878**
– Stage 2	**11,071**	**3,626**	**1,020**	**796**	**109**	**489**	**6,188**
– Stage 3	**1,796**	**816**	**227**	**244**	**65**	**41**	**701**
Stage 3 ratio[4]	**1.04%**	**2.03%**	**1.66%**	**3.06%**	**12.34%**	**0.27%**	**0.60%**
PIPs	**2**	**1**	**1**	**—**	**1**	**—**	**—**
Simple average LTV (indexed)	**41%**	**44%**	**43%**	**23%**	**116%**	**59%**	**41%**

2020							
Mortgage portfolio	166,730	38,441	13,234	9,953	734	11,608	110,854
– Stage 1	154,586	33,330	11,860	8,731	423	11,180	105,514
– Stage 2	10,345	4,228	1,126	989	221	393	4,728
– Stage 3	1,799	883	248	233	90	35	612
Stage 3 ratio[4]	1.09%	2.31%	1.88%	2.48%	12.30%	0.30%	0.55%
PIPs	10	5	2	1	4	—	2
Simple average LTV (indexed)	42%	44%	44%	26%	117%	59%	43%

(1) Where a loan falls into more than one category, we include 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) Mortgage balance includes both the interest-only part of £10,106m (2020: £9,847m) and the non-interest-only part of the loan.
(3) Includes legacy Alliance & Leicester flexible loans that work in a more limited way than our current Flexi loan product.
(4) The sum of Stage 3 drawn and Stage 3 undrawn assets divided by the sum of total drawn assets and Stage 3 undrawn assets.

2021 compared to 2020

- In 2021, the combined total proportion of interest-only loans, part interest-only, part repayment loans and flexible loans reduced, reflecting our strategy to manage down our proportional exposure to these lending profiles.
- BTL mortgage balances increased £3.3bn to £14.9bn (2020: £11.6bn) driven by continued focus in growing this portfolio. In 2021, the simple average LTV of mortgage total new BTL lending was 68% (2020: 65%).

Interest-only sub analysis

Full interest-only new business in the period

	2021 £m	2020 £m
Full interest-only loans	**6,339**	4,267

Full interest-only maturity profile

2021	Term expired £m	Within 2 years £m	Between 2-5 years £m	Between 5-15 years £m	Greater than 15 years £m	Total £m
Full interest-only portfolio	**392**	**1,892**	**3,795**	**19,633**	**14,942**	**40,654**
– of which value weighted average LTV (indexed) is >75%	**13**	**106**	**112**	**1,015**	**1,355**	**2,601**

2020						
Full interest-only portfolio	374	1,726	3,697	20,318	12,326	38,441
– of which value weighted average LTV (indexed) is >75%	13	131	154	1,397	1,017	2,712

2021 compared to 2020

For full interest-only mortgages, of the total £392m that was term expired at 31 December 2021, 83% continued to pay the interest due under the expired contract terms. Interest-only mortgages that matured in 2021 totalled £797m, of which: £331m was subsequently repaid, £6m was refinanced under normal credit terms, £217m was refinanced under forbearance arrangements and £243m remained unpaid and was classified as term expired at 31 December 2021.

At 31 December 2021, there were 61,750 (2020: 69,713) flexible mortgage customers, with undrawn facilities of £4,627m (2020: £5,621m). The portfolio's value weighted LTV (indexed) was 24% (2020: 26%).

Forbearance[1] (audited)

The balances at 31 December 2021 and 31 December 2020 were:

2021	Interest-only[2] £m	Flexible £m	LTV >100% £m	Buy-to-Let £m
Total	**419**	**35**	**13**	**11**
– Stage 2	**280**	**24**	**3**	**8**
– Stage 3	**139**	**11**	**10**	**3**
2020				
Total	285	48	10	9
– Stage 2	184	34	3	6
– Stage 3	101	14	7	3

(1) Where a loan falls into more than one category, we have included it in all the categories that apply.
(2) Comprises full interest-only loans and part interest-only, part repayment loans.

2021 compared to 2020

Levels of forbearance undertaken on accounts on Interest-only increased during 2021, driven by two factors. Firstly, maturing or past maturity customers impacted or potentially impacted by Covid-19 opted to take a one year deferral of repaying their capital. This was offered in line with FCA guidance to support maturing Interest-only customers who may be impacted by Covid-19. These guidelines were in place between November 2020 and October 2021. Secondly, Interest-only vulnerable customers who are in financial difficulties elected to take a product specifically offered to support them in this situation.

RETAIL BANKING : EVERYDAY BANKING – CREDIT RISK REVIEW

Movement in total exposures and the corresponding ECL (audited)

The following table shows changes in total on and off-balance sheet exposures subject to ECL assessment, and the corresponding ECL, for Everyday Banking in the period. The footnotes to the Santander UK group level analysis on page 79 are also applicable to this table.

	Stage 1		Stage 2		Stage 3		Total	
	Exposures [1]	ECL	Exposures [1]	ECL	Exposures [1]	ECL	Exposures [1]	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	**21,089**	**57**	**791**	**201**	**105**	**50**	**21,985**	**308**
Transfers from Stage 1 to Stage 2[3]	(214)	(2)	214	2	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	418	81	(418)	(81)	—	—	—	—
Transfers to Stage 3[3]	(284)	(1)	(36)	(10)	320	11	—	—
Transfers from Stage 3[3]	5	1	11	5	(16)	(6)	—	—
Transfers of financial instruments	(75)	79	(229)	(84)	304	5	—	—
Net ECL remeasurement on stage transfer[4]	—	(78)	—	39	—	23	—	(16)
Change in economic scenarios[2]	—	(4)	—	(19)	—	—	—	(23)
Changes to model	—	—	—	—	—	—	—	—
New lending and assets purchased[5]	2,150	13	84	12	9	4	2,243	29
Redemptions, repayments and assets sold [7]	(3,023)	(11)	(101)	(16)	(29)	(5)	(3,153)	(32)
Changes in risk parameters and other movements[6]	541	(6)	153	(34)	77	74	771	34
Assets written off[7]	—	1	—	(1)	(114)	(102)	(114)	(102)
At 31 December 2021	**20,682**	**51**	**698**	**98**	**352**	**49**	**21,732**	**198**
Net movement in the period	(407)	(6)	(93)	(103)	247	(1)	(253)	(110)

Charge/(release) to the Income Statement		(7)		(102)		101		(8)
Less: Discount unwind		—		—		(4)		(4)
Less: Recoveries net of collection costs		—		—		(51)		(51)
Total ECL charge/(release) to the Income Statement		(7)		(102)		46		(63)

At 1 January 2020	17,258	46	648	130	125	67	18,031	243
Transfers from Stage 1 to Stage 2[3]	(402)	(5)	402	5	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	257	65	(257)	(65)	—	—	—	—
Transfers to Stage 3[3]	(42)	(1)	(29)	(11)	71	12	—	—
Transfers from Stage 3[3]	4	1	11	5	(15)	(6)	—	—
Transfers of financial instruments:	(183)	60	127	(66)	56	6	—	—
Net ECL remeasurement on stage transfer[4]	—	(63)	—	95	—	25	—	57
Change in economic scenarios[2]	—	—	—	68	—	—	—	68
Changes to model	—	—	—	—	—	—	—	—
New lending and assets purchased[5]	5,398	11	107	25	5	4	5,510	40
Redemptions, repayments and assets sold[7]	(3,020)	(8)	(130)	(19)	(19)	(5)	(3,169)	(32)
Changes in risk parameters and other movements[6]	1,636	12	39	(33)	87	94	1,762	73
Assets written off[7]	—	(1)	—	1	(149)	(141)	(149)	(141)
At 31 December 2020	21,089	57	791	201	105	50	21,985	308
Net movement in the period	3,831	11	143	71	(20)	(17)	3,954	65

Charge/(release) to the Income Statement		12		70		124		206
Less: Discount unwind		—		—		(4)		(4)
Less: Recoveries net of collection costs		—		—		(52)		(52)
Total ECL charge/(release) to the Income Statement		12		70		68		150

Credit performance (audited)

2021	Business banking £m	Other unsecured: Personal loans £m	Other unsecured: Credit cards £m	Other unsecured: Overdrafts £m	Other unsecured: Total other unsecured £m	Total £m
Loans and advances to customers of which:	**3,532**	**2,000**	**2,341**	**438**	**4,779**	**8,311**
– Stage 1	**3,076**	**1,910**	**2,125**	**299**	**4,334**	**7,410**
– Stage 2	**201**	**73**	**181**	**120**	**374**	**575**
– Stage 3	**255**	**17**	**35**	**19**	**71**	**326**
Loss allowances[1]	**22**	**47**	**89**	**40**	**176**	**198**
Stage 3 undrawn exposures	**—**				**26**	**26**
Stage 3 ratio[2]	**7.20%**				**2.03%**	**4.23%**
Gross write-offs	**6**				**97**	**103**

2020						
Loans and advances to customers of which:	3,855	2,038	2,349	408	4,795	8,650
– Stage 1	3,845	1,881	1,975	253	4,109	7,954
– Stage 2	6	139	335	138	612	618
– Stage 3	4	18	39	17	74	78
Loss allowances[1]	9	80	158	61	299	308
Stage 3 undrawn exposures	—				27	27
Stage 3 ratio[2]	0.10%				2.09%	1.24%
Gross write-offs	12				129	141

(1) The ECL allowance is for both on and off–balance sheet exposures
(2) The sum of Stage 3 drawn and Stage 3 undrawn assets divided by the sum of total drawn assets and Stage 3 undrawn assets.

2021 compared to 2020

Business banking balances reduced mainly due to customers repaying their Bounce back loans (BBLs). Stage 2 and Stage 3 assets grew in 2021 and they were mainly BBLs accounts. However, they had no impact on ECL since BBLs are100% government guaranteed. The increase in ECL was mainly to take into account the additional debt burden on customers taking BBLs.

The credit risk profile for other unsecured loans was stable in 2021, with an improvement in Stage 2 assets from a favourable macroeconomic outlook and lower risk indicators observed in this population. The reduction in ECL levels was reflective of the improved macroeconomics and fewer accounts being triggered into Stage 2.

Loan modifications

Forbearance

The following table (audited) sets out the financial assets that were forborne while they had a loss allowance measured at lifetime ECL.

2021	Business banking £m	Credit cards £m	Overdrafts £m	Total £m
Financial assets modified in the period:				
– Amortised cost before modification	**—**	**13**	**9**	**22**
– Net modification gain	**—**	**5**	**4**	**9**
Financial assets modified since initial recognition:				
– Gross carrying amount of financial assets for which the loss allowance changed to 12m ECL in the period	**—**	**4**	**2**	**6**

2020				
Financial assets modified in the period:				
– Amortised cost before modification	—	18	8	26
– Net modification gain	—	8	4	12
Financial assets modified since initial recognition:				
– Gross carrying amount of financial assets for which the loss allowance changed to 12m ECL in the period	—	2	2	4

The balances (audited) at 31 December 2021 and 31 December 2020 were:

		Other unsecured				
2021	Business banking £m	Personal loans £m	Credit cards £m	Overdrafts £m	Total other unsecured £m	Total £m
Total	**2**	**1**	**38**	**15**	**54**	**56**
– Stage 2	**—**	**—**	**7**	**3**	**10**	**10**
– Stage 3	**2**	**1**	**31**	**12**	**44**	**46**
2020						
Total	4	—	43	16	59	63
– Stage 2	—	—	10	5	15	15
– Stage 3	4	—	33	11	44	48

Other loan modifications

Since March 2020, we have provided business banking and other unsecured lending customers with payment holiday terms. The following table provides information on such loan modifications. For more on this, see 'Covid-19 Support measures' in 'Santander UK group level - Credit risk review'.

2021	Business banking £m	Other unsecured £m	Total £m
Financial assets modified in the period:			
– Amortised cost before modification	**—**	**9**	**9**
– Net modification gain	**—**	**—**	**—**
Financial assets modified since initial recognition:			
– Gross carrying amount of financial assets for which the loss allowance changed to 12m ECL in the period	**—**	**1**	**1**
2020			
Financial assets modified in the period:			
– Amortised cost before modification	—	300	300
– Net modification gain	—	—	—
Financial assets modified since initial recognition:			
– Gross carrying amount of financial assets for which the loss allowance changed to 12m ECL in the period	—	6	6

CONSUMER FINANCE – CREDIT RISK REVIEW

Movement in total exposures and the corresponding ECL (audited)

The following table shows changes in total on and off-balance sheet exposures subject to ECL assessment, and the corresponding ECL, for Consumer Finance in the period. The footnotes to the Santander UK group level analysis on page 79 are also applicable to this table.

	Stage 1		Stage 2		Stage 3		Total	
	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	**7,824**	**44**	**379**	**37**	**58**	**37**	**8,261**	**118**
Transfers from Stage 1 to Stage 2[3]	(98)	(1)	98	1	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	105	6	(105)	(6)	—	—	—	—
Transfers to Stage 3[3]	(8)	—	(8)	(2)	16	2	—	—
Transfers from Stage 3[3]	5	—	3	2	(8)	(2)	—	—
Transfers of financial instruments	4	5	(12)	(5)	8	—	—	—
Net ECL remeasurement on stage transfer[4]	—	—	—	—	—	—	—	—
Change in economic scenarios[2]	—	—	—	(2)	—	—	—	(2)
Changes to model	—	—	—	—	—	—	—	—
New lending and assets purchased[5]	2,212	6	70	4	3	2	2,285	12
Redemptions, repayments and assets sold[7]	(4,063)	(19)	(142)	(6)	(19)	(3)	(4,224)	(28)
Changes in risk parameters and other movements[6]	(903)	(18)	(95)	(12)	11	6	(987)	(24)
Assets written off[7]	—	—	—	1	(37)	(25)	(37)	(24)
At 31 December 2021	**5,074**	**18**	**200**	**17**	**24**	**17**	**5,298**	**52**
Net movement in the period	(2,750)	(26)	(179)	(20)	(34)	(20)	(2,963)	(66)

Charge/(release) to the Income Statement		(26)		(21)		5		(42)
Less: Discount unwind		—		—		—		—
Less: Recoveries net of collection costs		—		—		9		9
Total ECL charge/(release) to the Income Statement		(26)		(21)		14		(33)

At 1 January 2020	7,315	29	604	28	42	31	7,961	88
Transfers from Stage 1 to Stage 2[3]	(154)	(1)	154	1	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	375	4	(375)	(4)	—	—	—	—
Transfers to Stage 3[3]	(33)	(3)	(20)	(5)	53	8	—	—
Transfers from Stage 3[3]	—	—	1	1	(1)	(1)	—	—
Transfers of financial instruments:	188	—	(240)	(7)	52	7	—	—
Net ECL remeasurement on stage transfer[4]	—	—	—	—	—	—	—	—
Change in economic scenarios[2]	—	—	—	—	—	—	—	—
Changes to model	—	—	—	—	—	—	—	—
New lending and assets purchased[5]	3,486	14	134	6	4	2	3,624	22
Redemptions, repayments and assets sold[7]	(2,136)	(4)	(151)	3	(5)	29	(2,292)	28
Changes in risk parameters and other movements[6]	(1,027)	5	32	8	(10)	(8)	(1,005)	5
Assets written off[7]	(2)	—	—	(1)	(25)	(24)	(27)	(25)
At 31 December 2020	7,824	44	379	37	58	37	8,261	118
Net movement in the period	509	15	(225)	9	16	6	300	30

Charge/(release) to the Income Statement		15		10		30		55
Less: Discount unwind		—		—		6		6
Less: Recoveries net of collection costs		—		—		(17)		(17)
Total ECL charge/(release) to the Income Statement		15		10		19		44

Credit performance (audited)

	2021 £m	2020 £m
Loans and advances to customers of which:	**4,984**	8,024
– Stage 1	**4,760**	7,587
– Stage 2	**200**	379
– Stage 3	**24**	58
Loss allowances[1]	**52**	118
Stage 3 undrawn exposures	**—**	—
Stage 3 ratio[2]	**0.49%**	0.72%
Gross write offs	**25**	25

(1) The ECL allowance is for both on and off–balance sheet exposures.
(2) The sum of Stage 3 drawn and Stage 3 undrawn assets divided by the sum of total drawn assets and Stage 3 undrawn assets.

2021 compared to 2020

We maintained our prudent underwriting criteria throughout the period. The product mix showed a material decrease in wholesale finance facilities (stock finance) 2021of £0.4bn due to low availability of new cars and a transfer of wholesale portfolio to a new joint venture with Volvo Car Financial Services Ltd. The retail car finance market saw challenges in 2021 mainly due to a one month closure at dealerships as a result of Covid-19. It was also impacted by an ongoing global semiconductor shortage which acted as a limiting factor on the supply of new vehicles. We monitor residual values on all types of vehicles, including diesel, petrol, hybrid and electric.

At 31 December 2021, total loan balance decreased by £3,040m (38%) compared to 31 December 2020, mainly due to the sale of PSA Finance UK Limited, where £3.2bn of assets were derecognised. For more details, see Note 34. Gross lending new business in 2021 was £2,383m (2020: £3,074m). Wholesale loans (stock finance) to car dealerships were approximately 7% of the loan book, unchanged since 31 December 2020. The average Consumer (auto) finance loan size was £16,182 (2020: £15,918).

The risk profile remained stable in terms of our credit scoring acceptance policies. The overall risk performance was good with a majority of customers paying.

Climate change

The residual value of automotive vehicles might be impacted by diesel obsolescence and the transition to electric vehicles. In 2021, we also considered any movement in ECL provision due to climate change risk and concluded that it was not material. This was because residual value risk was already set at the more cautious end of the acceptable range to capture the inherent risk of diesel obsolescence and measurement uncertainty of electric vehicles.

Loan modifications

Forbearance

The balances (audited) at 31 December 2021 and 31 December 2020 were:

	2021 £m	2020 £m
Total	**—**	9
– Stage 2	**—**	4
– Stage 3	**—**	5

Other loan modifications

Since March 2020, we have provided Consumer Finance customers with payment holiday terms. The following table provides information on such loan modifications. For more on this, see 'Covid-19 Support measures' in 'Santander UK group level - Credit risk review'.

	2021 £m	2020 £m
Financial assets modified in the period:		
– Amortised cost before modification	**54**	403
– Net modification loss	**—**	6
Financial assets modified since initial recognition:		
– Gross carrying amount of financial assets for which the ECL allowance changed to 12-month measurement in the period	**226**	403

CORPORATE & COMMERCIAL BANKING – CREDIT RISK REVIEW

Movement in total exposures and the corresponding ECL (audited)
The following tables show changes in total on and off-balance sheet exposures and ECL in the period. The footnotes to the Santander UK group level table on page 79 also apply to these tables.

	Stage 1		Stage 2		Stage 3		Total	
	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	**17,217**	**54**	**6,266**	**199**	**1,020**	**350**	**24,503**	**603**
Transfers from Stage 1 to Stage 2[3]	(914)	(4)	914	4	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	1,579	60	(1,579)	(60)	—	—	—	—
Transfers to Stage 3[3]	(38)	—	(37)	(3)	75	3	—	—
Transfers from Stage 3[3]	1	—	88	40	(89)	(40)	—	—
Transfers of financial instruments	**628**	**56**	**(614)**	**(19)**	**(14)**	**(37)**	**—**	**—**
Net ECL remeasurement on stage transfer[4]	—	(39)	—	(22)	—	31	—	(30)
Change in economic scenarios[2]	—	(2)	—	(62)	—	(1)	—	(65)
Changes to model	—	—	—	—	—	—	—	—
New lending and assets purchased[5]	12,783	5	448	8	12	13	13,243	26
Redemptions, repayments and assets sold[7]	(15,067)	(9)	(1,330)	(17)	(140)	(43)	(16,537)	(69)
Changes in risk parameters and other movements[6]	2,642	(16)	891	40	55	(7)	3,588	17
Assets written off[7]	—	—	—	—	(106)	(59)	(106)	(59)
At 31 December 2021	**18,203**	**49**	**5,661**	**127**	**827**	**247**	**24,691**	**423**
Net movement in the period	986	(5)	(605)	(72)	(193)	(103)	188	(180)

ECL charge/(release) to the Income Statement		(5)		(72)		(44)		(121)
Less: Discount unwind		—		—		(4)		(4)
Less: Recoveries net of collection costs		—		—		34		34
Total ECL charge/(release) to the Income Statement		(5)		(72)		(14)		(91)

	Stage 1		Stage 2		Stage 3		Total	
	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	21,281	53	2,385	51	452	158	24,118	262
Transfers from Stage 1 to Stage 2[3]	(4,443)	(37)	4,443	37	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	528	20	(528)	(20)	—	—	—	—
Transfers to Stage 3[3]	(78)	(1)	(543)	(21)	621	22	—	—
Transfers from Stage 3[3]	4	1	1	—	(5)	(1)	—	—
Transfers of financial instruments	(3,989)	(17)	3,373	(4)	616	21	—	—
Net ECL remeasurement on stage transfer[4]	—	(18)	—	92	—	198	—	272
Change in economic scenarios[2]	—	7	—	44	—	—	—	51
Changes to model	—	—	—	—	—	—	—	—
New lending and assets purchased[5]	7,984	10	805	28	94	44	8,883	82
Redemptions, repayments and assets sold[7]	(6,487)	(13)	(818)	(18)	(118)	(25)	(7,423)	(56)
Changes in risk parameters and other movements[6]	(1,572)	32	521	6	97	5	(954)	43
Assets written off[7]	—	—	—	—	(121)	(51)	(121)	(51)
At 31 December 2020	17,217	54	6,266	199	1,020	350	24,503	603
Net movement in the period	(4,064)	1	3,881	148	568	192	385	341

ECL charge/(release) to the Income Statement		1		148		243		392
Less: Discount unwind		—		—		(5)		(5)
Less: Recoveries net of collection costs		—		—		(93)		(93)
Total ECL charge/(release) to the Income Statement		1		148		145		294

Committed exposures

Credit risk arises on both on- and off–balance sheet transactions, e.g. guarantees. Therefore, committed exposures are typically higher than asset balances. However, committed exposures can be smaller than the asset balances due to netting.

Rating distribution (audited)

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) for each portfolio. On this scale, the higher the rating, the better the quality of the counterparty.

	Santander UK risk grade								
	9	8	7	6	5	4	3 to 1	Other[1]	Total
2021	£m	£m	£m	£m	£m	£m	£m	£m	£m
SME and mid corporate	—	592	954	3,060	3,166	3,559	2,465	733	14,529
Commercial Real Estate	—	—	55	21	2,172	2,064	181	4	4,497
Social Housing	52	2,985	2,471	—	—	1	—	—	5,509
	52	3,577	3,480	3,081	5,338	5,624	2,646	737	24,535
Of which:									
Stage 1	52	2,890	3,168	2,750	4,796	3,388	309	577	17,930
Stage 2	—	687	312	331	542	2,236	1,511	160	5,779
Stage 3	—	—	—	—	—	—	826	—	826
2020									
SME and mid corporate	—	468	1,288	2,640	2,820	3,518	2,790	922	14,446
Commercial Real Estate	—	—	65	214	696	3,684	484	9	5,152
Social Housing	112	2,631	2,334	—	—	2	—	3	5,082
	112	3,099	3,687	2,854	3,516	7,204	3,274	934	24,680
Of which:									
Stage 1	112	3,060	3,626	2,589	2,776	4,027	454	749	17,393
Stage 2	—	39	61	265	740	3,177	1,800	185	6,267
Stage 3	—	—	—	—	—	—	1,020	—	1,020

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

2021 compared to 2020

In Corporate & Commercial Banking, committed exposure reduced marginally by 0.6%, with lending in Social Housing offset by redemptions in the Commercial Real Estate (CRE) portfolio. Our CRE portfolio decreased by 13% as we continue to manage our exposure in line with proactive risk management policies. Social Housing exposure increased by 8% as we refinance lending from the Corporate Centre to the core book. The rating distribution has improved in both the CRE and SME and mid Corporate portfolios following a recovery in the credit quality of a number of names initially downgraded as a result of Covid-19.

Geographical distribution (audited)

We typically classify geographical location according to the counterparty's country of domicile unless a full risk transfer guarantee is in place, in which case we use the guarantor's country of domicile instead.

	2021					2020				
	UK	Europe	US	Rest of World	Total	UK	Europe	US	Rest of World	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
SME and mid corporate	14,486	43	—	—	14,529	14,399	47	—	—	14,446
Commercial Real Estate	4,497	—	—	—	4,497	5,151	—	—	1	5,152
Social Housing	5,509	—	—	—	5,509	5,082	—	—	—	5,082
	24,492	43	—	—	24,535	24,632	47	—	1	24,680

Credit risk mitigation (audited)

2021	Gross exposure Stage 3 £m	Collateral Stage 3 £m	Net exposure Stage 3 £m
SME and mid corporate	**723**	**354**	**369**
Commercial Real Estate	**103**	**85**	**18**
	826	**439**	**387**
2020			
SME and mid corporate	853	286	567
Commercial Real Estate	167	105	62
	1,020	391	629

Credit performance (audited)

We monitor exposures that show potentially higher risk characteristics using our Watchlist process. The table below shows the exposures we monitor, and those we classify as Stage 3 by portfolio at 31 December 2021 and 31 December 2020.

	Committed exposure					
		Watchlist				
2021	Fully performing £m	Enhanced monitoring £m	Proactive management £m	Stage 3 £m	Total[1] £m	Loss allowances £m
SME and mid corporate	**11,131**	**531**	**2,144**	**723**	**14,529**	**378**
Commercial Real Estate	**3,989**	**193**	**212**	**103**	**4,497**	**43**
Social Housing	**5,344**	**—**	**165**	**—**	**5,509**	**2**
	20,464	**724**	**2,521**	**826**	**24,535**	**423**
2020						
SME and mid corporate	10,844	340	2,409	853	14,446	478
Commercial Real Estate	4,191	233	561	167	5,152	125
Social Housing	5,009	—	73	—	5,082	—
	20,044	573	3,043	1,020	24,680	603

(1) Includes committed facilities and derivatives.

2021 compared to 2020

In Corporate & Commercial Banking, exposures subject to enhanced monitoring increased by 26%. This was mainly in SME and mid Corporate. Accommodation and food service activities have been particularly heavily impacted by Covid-19 related restrictions despite the measures taken by the government to support industries through the pandemic. Exposures subject to proactive monitoring however decreased by 17% across both the SME and mid Corporate portfolio and the CRE portfolio. This followed the upgrading of a number of names initially downgraded as a result of Covid-19 uncertainty but which have since stabilised.

Loan loss allowances decreased by £180m (30%). This reflects the improved economic assumptions and scenario weightings applied within the IFRS 9 model due to the improved economic outlook. Also stage reclassifications for some corporate loans as they emerged from lockdown saw provision releases as well as the release of some Covid-19 related PMAs.

Loan modifications

Forbearance

The following table (audited)sets out the financial assets that were forborne while they had a loss allowance measured at lifetime ECL.

	2021	2020
	£m	£m
Financial assets modified in the period:		
– Amortised cost before modification	**243**	201
– Net modification gain/ (loss)	**(5)**	(5)
Financial assets modified since initial recognition:		
– Gross carrying amount of financial assets for which the loss allowance changed to 12-month ECL in the period	**29**	40

We only make forbearance arrangements for lending to customers. The balances (audited) at 31 December 2021 and 31 December 2020, analysed by their staging at the period–end and the forbearance we applied, were:

	2021	2020
	£m	£m
Stock[1]		
– Term extension	**150**	141
– Interest-only	**239**	175
– Other payment rescheduling	**204**	180
	593	496
Of which:		
– Stage 1	**20**	13
– Stage 2	**303**	179
– Stage 3	**270**	304
	593	496
Proportion of portfolio	**2.4%**	2.0%

(1) We base forbearance type on the first forbearance we applied. Tables only show accounts open at the period-end. Amounts are drawn balances and include off balance sheet balances.

2021 compared to 2020

In 2020, in line with guidance from the EBA and PRA, concessions required primarily as a result of Covid-19 were not recorded as forbearance. This categorisation dispensation ended in March 2021, after which concessions granted to borrowers exhibiting signs of financial difficulty are reported as forbearance. This was the driver for the increase in forbearance balances in 2021.

PORTFOLIOS OF PARTICULAR INTEREST

Introduction

Some types of lending have higher risk and others stand out for other reasons. We give more detail below on two areas of particular interest.

Portfolio	Description
Commercial Real Estate	This is lending to experienced, professional landlords mainly secured by tenanted UK property in the office, retail, industrial and residential sub-sectors. The CRE market experienced a challenging environment in the immediate years after the last financial crisis and has previously seen regular cyclical downturns. For those reasons, this is a portfolio of particular interest. We manage and report our Commercial Real Estate portfolio in Corporate & Commercial Banking.
Social Housing	This is lending and treasury services for UK housing association groups secured by tenanted UK residential property. Borrowers are mainly charitable entities and registered with the appropriate regulator for the part of the UK in which they operate. The Social Housing sector in the UK is critical in ensuring the supply of affordable housing across the country. Housing associations play a prominent role in addressing the UK's shortage of housing across all tenures. The sector benefits from a zero–loss default history aided by its regulated nature. This is a portfolio of particular interest as we hold a significant position in the market. We see continued investment in this sector as a direct way to support the UK and, indirectly, the wider community initiatives undertaken by our customers. We manage and report our Social Housing portfolio in Corporate & Commercial Banking, except for older loans that do not fit our current business strategy, which we manage and report in Corporate Centre. We provide detailed disclosures of our Social Housing portfolios in the sections above. We provide a summary of our total Social Housing portfolio below, to give a Santander UK–wide view.

In 2020 and 2021 we provided customers with payment holiday terms in line with the UK Government's Covid-19 guidance. For more on this, see 'Covid-19 Support schemes' in 'Santander UK group level - Credit risk review'.

Climate change

The global economy is still heavily dependent on fossil fuel energy sources such as coal, natural gas and oil, which significantly contribute to climate change. Energy transmission requires building and maintaining appropriate wholesale networks that can affect the natural environment. We remain committed to reallocating financial flows from fossil fuel consumption, including for electricity generation, to cleaner alternatives as set out in our Environmental, Social and Climate Change Policy.

In order to track and measure how our current lending activities contribute towards the reliance of fossil fuels, in 2021 we analysed our portfolio to identify fossil fuel exposures. We classified lending as a fossil fuel exposure if the counterparty engaged in any of the following activities:

- Oil & Gas: production and treatment including refining, transportation, storage and wholesale distribution
- Mining & Extraction: any coal mining or extraction activities
- Power Generation: clients for who coal-fired generation represents more than 10% of revenues on a consolidated basis.

At 31 December 2021, we had limited exposure to such counterparties, with these activities making up less than 0.1% of our Corporate and Commercial Banking lending portfolio. On an individually assessed basis, clients in these industries were highly rated and their markets remained highly liquid. We will continue to monitor, disclose and reduce lending which contributes to ongoing fossil fuel use.

Commercial Real Estate

Credit performance

The table below shows the main CRE credit performance metrics at 31 December 2021 and 31 December 2020.

	Customer loans[1]	Stage 3[2]	Stage 3 Ratio[3]	Gross write-offs	Total loss allowance
	£m	£m	%	£m	£m
2021	**4,158**	**103**	**2.48**	**25**	**43**
2020	4,689	165	3.60	13	125

(1) CRE drawn loans in the CRE portfolio of our Corporate & Commercial Banking segment of £4,158m(2020: £4,689m).
(2) We define Stage 3 in the 'Credit risk management' section.
(3) The sum of Stage 3 drawn and Stage 3 undrawn assets divided by the sum of total drawn assets and Stage 3 undrawn assets.

LTV analysis

The table below shows the LTV distribution for our CRE total stock and Stage 3 stock (based on the drawn balance and our latest estimate of the property's current value) of the portfolio at 31 December 2021 and 31 December 2020.

	2021				2020			
	Stock		Stage 3		Stock		Stage 3	
LTV	Total £m	ECL £m	Total £m	ECL £m	Total £m	ECL £m	Total £m	ECL £m
Up to 50%	**2,739**	**19**	**44**	**9**	3,043	53	43	13
>50-70%	**1,101**	**20**	**50**	**15**	1,342	59	109	42
>70-100%	**38**	**2**	**7**	**1**	49	6	7	3
> 100%	**10**	**1**	**2**	**1**	8	4	6	4
Other portfolio[1]	**270**	**1**	**—**	**—**	230	3	—	—
Total with collateral	**4,158**	**43**	**103**	**26**	4,672	125	165	62
Development loans	**—**	**—**	**—**	**—**	17	—	—	—
	4,158	**43**	**103**	**26**	4,689	125	165	62

(1) Smaller value transactions, mainly commercial mortgages.

Sector analysis

Sector	2021 £m	2021 %	2020 £m	2020 %
Office	**1,106**	**27**	1,491	32
Retail	**631**	**15**	853	18
Industrial	**530**	**13**	680	15
Residential	**589**	**14**	766	16
Mixed use	**605**	**14**	358	8
Student accommodation	**109**	**3**	62	1
Hotels and leisure	**253**	**6**	181	4
Other	**65**	**2**	51	1
Small value transactions portfolio[1]	**270**	**6**	247	5
	4,158	**100**	4,689	100

(1) Mainly commercial mortgages.

The CRE portfolio is well diversified across sectors, with no significant regional or single name concentration. Falling capital and rental yields along with Covid-19 related rent collection challenges have exacerbated structural issues in sub-sectors such as Retail. However, at 31 December 2021, the LTV profile of the portfolio remained conservative with £3,840m and 99% (2020: £4,385m and 99%) at or below 70% LTV following planned deleveraging of the portfolio. Almost three quarters of the CRE portfolio have an LTV below 50%.

Refinancing risk

At 31 December 2021, CRE loans of £1,213m (2020: £1,337m) were due to mature within 12 months. Of these, £11m or 0.9% (2020: £9m or 0.7%) had an LTV ratio higher than is acceptable under our current credit policy, £5m of which were reported as Stage 3 (2020: £9m).

2021 compared to 2020

In our CRE portfolio, drawn customer loans decreased by £531m, as we focus on risk-weighted returns to manage our exposure in line with proactive risk management policies. In 2021, we maintained a prudent lending approach, with 100% new business (2020: 100%) written at or below 60% LTV. The weighted average LTV on the CRE portfolio was 43% (2020: 45%).

Drawn facilities subject to enhanced monitoring decreased by 16% to £190m (2020: £225m). Drawn facilities subject to proactive management decreased by 59% to £212m (2020: £522m). This followed the improvement in credit quality of a number of names initially downgraded as a result of Covid-19 but which have since stabilised. Stage 3 exposures increased to £103m (2020: £165m).

Social Housing

We manage and report our Social Housing portfolio in Corporate & Commercial Banking, except for older Social Housing loans that do not fit our current business strategy, which we manage and report in Corporate Centre. We provide detailed disclosures of our Social Housing portfolios in the sections above. At 31 December 2021 and 31 December 2020, our total Social Housing exposure was:

	2021 On-balance sheet £m	2021 Total exposure £m	2021 Total loss allowances £m	2020 On-balance sheet £m	2020 Total exposure £m	2020 Total loss allowances £m
Corporate & Commercial Banking	**2,929**	**5,509**	**2**	2,770	5,082	—
Corporate Centre	**2,162**	**2,858**	**1**	3,043	3,817	—
	5,091	**8,367**	**3**	5,813	8,899	—

CORPORATE CENTRE – CREDIT RISK REVIEW

Movement in total exposures and the corresponding ECL (audited)
The following tables show changes in total on and off-balance sheet exposures and ECL in the period. The footnotes to the Santander UK group level table on page 79 also apply to these tables.

	Stage 1		Stage 2		Stage 3		Total	
	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	**76,301**	**35**	**44**	**—**	**—**	**—**	**76,345**	**35**
Transfers from Stage 1 to Stage 2[3]	**(141)**	**—**	**141**	**—**	**—**	**—**	**—**	**—**
Transfers from Stage 2 to Stage 1[3]	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Transfers to Stage 3[3]	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Transfers from Stage 3[3]	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Transfers of financial instruments	**(141)**	**—**	**141**	**—**	**—**	**—**	**—**	**—**
Net ECL remeasurement on stage transfer[4]	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Change in economic scenarios[2]	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Changes to model	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
New lending and assets purchased[5]	**425**	**1**	**2**	**—**	**—**	**—**	**427**	**1**
Redemptions, repayments and assets sold[7]	**(5,327)**	**(17)**	**(27)**	**—**	**—**	**—**	**(5,354)**	**(17)**
Changes in risk parameters and other movements[6]	**(548)**	**(17)**	**93**	**—**	**—**	**—**	**(455)**	**(17)**
Assets written off[7]	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
At 31 December 2021	**70,710**	**2**	**253**	**—**	**—**	**—**	**70,963**	**2**
Net movement in the period	**(5,591)**	**(33)**	**209**	**—**	**—**	**—**	**(5,382)**	**(33)**

ECL charge/(release) to the Income Statement		**(33)**		**—**		**—**		**(33)**
Less: Discount unwind		**—**		**—**		**—**		**—**
Less: Recoveries net of collection costs		**—**		**—**		**22**		**22**
Total ECL charge/(release) to the Income Statement		**(33)**		**—**		**22**		**(11)**

	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	67,779	1	94	1	—	—	67,873	2
Transfers from Stage 1 to Stage 2[3]	(87)	(2)	87	2	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	106	4	(106)	(4)	—	—	—	—
Transfers to Stage 3[3]	(2)	—	(3)	(1)	5	1	—	—
Transfers from Stage 3[3]	1	1	1	—	(2)	(1)	—	—
Transfers of financial instruments	18	3	(21)	(3)	3	—	—	—
Net ECL remeasurement on stage transfer[4]	—	(3)	—	3	—	1	—	1
Change in economic scenarios[2]	—	—	—	6	—	—	—	6
Changes to model	—	—	—	—	—	—	—	—
New lending and assets purchased[5]	11,457	1	45	—	1	—	11,503	1
Redemptions, repayments and assets sold[7]	(10,342)	(1)	(9)	(1)	(3)	(1)	(10,354)	(3)
Changes in risk parameters and other movements[6]	7,389	34	(65)	(6)	1	—	7,325	28
Assets written off[7]	—	—	—	—	(2)	—	(2)	—
At 31 December 2020	76,301	35	44	—	—	—	76,345	35
Net movement in the period	8,522	34	(50)	(1)	—	—	8,472	33

ECL charge/(release) to the Income Statement		34		(1)		—		33
Less: Discount unwind		—		—		—		—
Less: Recoveries net of collection costs		—		—		4		4
Total ECL charge/(release) to the Income Statement		34		(1)		4		37

Committed exposures

Credit risk arises on both on- and off–balance sheet transactions, e.g. guarantees. Therefore, committed exposures are typically higher than asset balances. However, committed exposures can be smaller than the asset balances due to netting. We show Sovereigns and Supranationals net of short positions and reverse repurchase agreement exposures in Large Corporate net of repurchase agreement liabilities, including OTC derivatives. The derivative and other treasury product exposures (classified as 'Financial Institutions') are also typically lower than the asset balances, because we show our overall risk exposure which takes into account our procedures to mitigate credit risk. The balances on our balance sheet only reflect the more restrictive netting permitted by IAS 32.

Rating distribution (audited)

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) for each portfolio. On this scale, the higher the rating, the better the quality of the counterparty.

	Santander UK risk grade								
2021	9 £m	8 £m	7 £m	6 £m	5 £m	4 £m	3 to 1 £m	Other[1] £m	Total £m
Sovereign and Supranational	**55,061**	**1,051**	**—**	**—**	**—**	**—**	**—**	**—**	**56,112**
Structured Products	**573**	**1,064**	**197**	**41**	**—**	**—**	**—**	**—**	**1,875**
Social Housing	**—**	**1,290**	**1,568**	**—**	**—**	**—**	**—**	**—**	**2,858**
Financial Institutions	**479**	**533**	**345**	**7**	**—**	**—**	**—**	**—**	**1,364**
Legacy Portfolios in run-off[2]	**—**	**—**	**—**	**6**	**—**	**—**	**—**	**44**	**50**
Derivatives	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
	56,113	**3,938**	**2,110**	**54**	**—**	**—**	**—**	**44**	**62,259**
Of which:									
Stage 1	**56,113**	**3,731**	**2,066**	**54**	**—**	**—**	**—**	**38**	**62,002**
Stage 2	**—**	**207**	**44**	**—**	**—**	**—**	**—**	**4**	**255**
Stage 3	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**2**	**2**

2020									
Sovereign and Supranational	48,579	2,383	—	—	—	—	—	—	50,962
Structured Products	1,168	1,044	229	41	—	—	—	—	2,482
Social Housing	2	2,001	1,814	—	—	—	—	—	3,817
Financial Institutions	497	200	9	6	—	—	—	—	712
Legacy Portfolios in run-off[2]	—	—	—	—	—	—	—	156	156
Derivatives	—	—	—	—	—	—	—	—	—
	50,246	5,628	2,052	47	—	—	—	156	58,129
Of which:									
Stage 1	50,246	5,583	2,052	47	—	—	—	156	58,084
Stage 2	—	45	—	—	—	—	—	—	45
Stage 3	—	—	—	—	—	—	—	—	—

(1) Smaller exposures mainly in the commercial mortgage portfolio. We use scorecards for them, instead of a rating model.
(2) Commercial mortgages and residual structured and asset finance loans (shipping, aviation and structured finance).

2021 compared to 2020

In Corporate Centre, committed exposures decreased by 7% mainly driven by UK Sovereign and Supranational exposures as part of normal liquid asset portfolio management, which increased by 10%. The portfolio profile remained short-term, reflecting the purpose of the holdings. Social Housing exposures reduced by 25% as we refinance lending from the Corporate Centre to the core book and Legacy Portfolios in run-off reduced by 68% driven by deals not refinancing at maturity.

Geographical distribution (audited)

We typically classify geographical location according to the counterparty's country of domicile unless a full risk transfer guarantee is in place, in which case we use the guarantor's country of domicile instead.

	2021					2020				
	UK £m	Europe £m	US £m	Rest of World £m	Total £m	UK £m	Europe £m	US £m	Rest of World £m	Total £m
Sovereign and Supranational	**52,297**	**950**	**469**	**2,396**	**56,112**	44,624	1,516	849	3,973	50,962
Structured Products	**1,219**	**656**	**—**	**—**	**1,875**	1,683	799	—	—	2,482
Social Housing	**2,858**	**—**	**—**	**—**	**2,858**	3,817	—	—	—	3,817
Financial Institutions	**504**	**565**	**81**	**214**	**1,364**	301	365	6	40	712
Legacy Portfolios in run-off	**50**	**—**	**—**	**—**	**50**	59	—	—	97	156
Derivatives	**—**	**—**	**—**	**—**	**—**	—	—	—	—	—
	56,928	**2,171**	**550**	**2,610**	**62,259**	50,484	2,680	855	4,110	58,129

Credit risk mitigation (audited)

2021	Gross exposure Stage 3 £m	Collateral Stage 3 £m	Net exposure Stage 3 £m
Legacy Portfolios in run–off	2	—	2
	2	—	2
2020			
Legacy Portfolios in run–off			
	—	—	—

Credit performance (audited)

We monitor exposures that show potentially higher risk characteristics using our Watchlist process. The table below shows the exposures we monitor, and those we classify as Stage 3 by portfolio at 31 December 2021 and 31 December 2020.

	Committed exposure					
		Watchlist				
2021	Fully performing £m	Enhanced monitoring £m	Proactive management £m	Stage 3 £m	Total[1] £m	Loss allowances £m
Sovereign and Supranational	56,112	—	—	—	56,112	—
Structured Products	1,875	—	—	—	1,875	—
Social Housing	2,858	—	—	—	2,858	1
Financial Institutions	1,364	—	—	—	1,364	—
Legacy Portfolios in run-off	48	—	—	2	50	1
Derivatives	—	—	—	—	—	—
	62,257	—	—	2	62,259	2
2020						
Sovereign and Supranational	50,962	—	—	—	50,962	—
Structured Products	2,482	—	—	—	2,482	35
Social Housing	3,748	69	—	—	3,817	—
Financial Institutions	712	—	—	—	712	—
Legacy Portfolios in run-off	156	—	—	—	156	—
Derivatives	—	—	—	—	—	—
	58,060	69	—	—	58,129	35

(1) Includes committed facilities and derivatives.

2021 compared to 2020

In Corporate Centre, exposures were all fully performing at 31 December 2021. The exposure that was subject to enhanced monitoring in 2020 was upgraded to fully performing following completion of a restructure.

Loan loss allowances decreased by £33m (94%). This reflects the improved economic assumptions and scenario weightings applied within the IFRS 9 model due to the improved economic outlook as well as the release of some Covid-19 related PMAs.

Loan modifications (audited)

There were no loan modifications made in 2021 and 2020.

CORPORATE & INVESTMENT BANKING – 2020 CREDIT RISK REVIEW

This section sets out the credit risk profile for the CIB business at 31 December 2020, as published in the 2020 Annual Report. For the 2021 financial performance and cash flow information relating to CIB prior to its transfer to SLB in 2021, see Note 43.

Movement in total exposures and the corresponding ECL (audited)
The following tables show changes in total on and off-balance sheet exposures and ECL in the period. The footnotes to the Santander UK group level table on page 79 also apply to this table.

	Stage 1		Stage 2		Stage 3		Total	
	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL	Exposures[1]	ECL
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2020	12,972	4	397	37	15	9	13,384	50
Transfers from Stage 1 to Stage 2[3]	(43)	—	43	—	—	—	—	—
Transfers from Stage 2 to Stage 1[3]	—	—	—	—	—	—	—	—
Transfers to Stage 3[3]	—	—	(40)	(13)	40	13	—	—
Transfers from Stage 3[3]	—	—	—	—	—	—	—	—
Transfers of financial instruments	(43)	—	3	(13)	40	13	—	—
Net ECL remeasurement on stage transfer[4]	—	—	—	—	—	—	—	—
Change in economic scenarios[2]	—	—	—	8	—	—	—	8
Changes to model	—	—	—	—	—	—	—	—
New lending and assets purchased[5]	1,119	1	43	—	—	—	1,162	1
Redemptions, repayments and assets sold[7]	(5,005)	(1)	(287)	(1)	(1)	—	(5,293)	(2)
Changes in risk parameters and other movements[6]	2,174	5	273	(7)	(12)	—	2,435	(2)
Assets written off[7]	—	—	—	—	(42)	(22)	(42)	(22)
At 31 December 2020	11,217	9	429	24	—	—	11,646	33
Net movement in the period	(1,755)	5	32	(13)	(15)	(9)	(1,738)	(17)

ECL charge/(release) to the Income Statement	5	(13)	13	5
Less: Discount unwind	—	—	—	—
Less: Recoveries net of collection costs	—	—	2	2
Total ECL charge/(release) to the Income Statement	5	(13)	15	7

Committed exposures

Credit risk arises on both on- and off–balance sheet transactions, e.g. guarantees. Therefore, committed exposures are typically higher than asset balances. However, committed exposures can be smaller than the asset balances due to netting. The derivative and other treasury product exposures (classified as 'Financial Institutions') are also typically lower than the asset balances, because we show our overall risk exposure which takes into account our procedures to mitigate credit risk. The balances on our balance sheet only reflect the more restrictive netting permitted by IAS 32.

Rating distribution (audited)
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) for each portfolio. On this scale, the higher the rating, the better the quality of the counterparty.

	Santander UK risk grade								
	9	8	7	6	5	4	3 to 1	Other	Total
2020	£m	£m	£m	£m	£m	£m	£m	£m	£m
Large Corporate	174	1,802	3,267	3,882	1,523	157	81	—	10,886
Financial Institutions	367	443	622	23	6	—	—	—	1,461
	541	2,245	3,889	3,905	1,529	157	81	—	12,347

Geographical distribution (audited)
We typically classify geographical location according to the counterparty's country of domicile unless a full risk transfer guarantee is in place, in which case we use the guarantor's country of domicile instead.

	2020				
	UK	Europe	US	Rest of World	Total
	£m	£m	£m	£m	£m
Large Corporate	9,814	1,052	—	20	10,886
Financial Institutions	642	435	130	254	1,461
	10,456	1,487	130	274	12,347

Credit risk mitigation (audited)

2020	Gross exposure Stage 3 £m	Collateral Stage 3 £m	Net exposure Stage 3 £m
Large Corporate	—	—	—
	—	—	—

Credit performance (audited)

We monitor exposures that show potentially higher risk characteristics using our Watchlist process. The table below shows the exposures we monitor, and those we classify as Stage 3 by portfolio at 31 December 2020.

	Committed exposure					
	Watchlist					
2020	Fully performing £m	Enhanced monitoring £m	Proactive management £m	Stage 3 £m	Total[1] £m	Loss allowances £m
Large Corporate	9,374	252	1,260	—	10,886	33
Financial Institutions	1,461	—	—	—	1,461	—
	10,835	252	1,260	—	12,347	33

(1) Includes committed facilities and derivatives.

Loan modifications

Forbearance

The following table (audited) sets out the financial assets that were forborne while they had a loss allowance measured at lifetime ECL.

	2020 £m
Financial assets modified in the period:	
– Amortised cost before modification	23
– Net modification gain/ (loss)	1
Financial assets modified since initial recognition:	
– Gross carrying amount of financial assets for which the loss allowance changed to 12-month ECL in the period	—

We only make forbearance arrangements for lending to customers. The balances (audited) at 31 December 2020, analysed by their staging at the period–end and the forbearance we applied, were:

	2020 £m
Stock[1]	
– Term extension	23
– Interest-only	—
– Other payment rescheduling	—
	23
Of which:	
– Stage 1	—
– Stage 2	23
– Stage 3	—
	23
Proportion of portfolio	0.2%

(1) We base forbearance type on the first forbearance we applied. Tables only show accounts open at the period-end. Amounts are drawn balances and include off balance sheet balances.

Market risk

Overview

Market risk comprises non-traded market risk and traded market risk.

Non-traded market risk is the risk of loss of income, economic or market value due to changes to interest rates in the non-trading book or to changes in other market risk factors (e.g. credit spread and inflation risk), where such changes would affect our net worth through an adjustment to revenues, assets, liabilities and off-balance sheet exposures in the non-trading book.

Traded market risk is the risk of changes in market factors that affect the value of the positions in the trading book.

In this section, we set out which of our assets and liabilities are exposed to non-traded and traded market risk. Then we explain how we manage these risks and discuss our key market risk metrics. We also provide an update on the process of replacing LIBOR and other Interbank Offered Rates.

Key metrics

Net Interest Margin (NIM) sensitivity to +25bps was £89m and to -25bps was £(94)m (2020: £116m and £(23)m)

Economic Value of Equity (EVE) sensitivity to +25bps was £89m and to -25bps was £(125)m (2020: £190m and £(369)m)

BALANCE SHEET ALLOCATION BY MARKET RISK CLASSIFICATION (AUDITED)

We manage our assets and liabilities exposed to market risk as either non-traded or traded market risk. We classify all our assets and liabilities exposed to market risk as non-traded market risk, except for certain derivatives that we manage on a trading intent basis. For accounting purposes, we classify all derivatives as held for trading unless they are designated as being in a hedging relationship. The derivatives that we manage on a trading intent basis are a small proportion of the derivatives that we classify as held for trading for accounting purposes. For more, see Note 11 to the Consolidated Financial Statements.

NON-TRADED MARKET RISK

OUR KEY NON-TRADED MARKET RISKS (AUDITED)

Non-traded market risk mainly comes from providing banking products and services to our customers, as well as our structural balance sheet exposures. It arises in all our business segments.

In Retail Banking, Consumer Finance and Corporate & Commercial Banking, it is a by-product of us writing customer business and we transfer most of these risks to Corporate Centre to manage. The only types of non-traded market risk that we keep in Retail Banking, Consumer Finance and Corporate & Commercial Banking are short-term mismatches due to forecasting variances in prepayment and launch risk. This is where customers repay their loans earlier than their expected maturity date or do not take the expected volume of new products.

Before the transfer in Q4 2021, in Corporate & Investment Banking, it arose from lending to corporates, which we also transferred to Corporate Centre to manage. Corporate Centre also manages our structural balance sheet exposures, such as foreign exchange and Income Statement volatility risk.

Our key non-traded market risks are:

Key risks	Description
Interest rate risk	**Yield curve risk:** comes from timing mismatches in repricing fixed and variable rate assets, liabilities and off-balance sheet instruments. It also comes from investing non-rate sensitive liabilities in interest-earning assets. We mainly measure yield curve risk with NIM and EVE sensitivities, which are measures commonly used in the financial services industry. We also use other risk measures, such as Value at Risk (VaR) which is a statistical measure based on a historical simulation of events, and stress testing. Our NIM and EVE sensitivities cover all the material yield curve risk in our banking book balance sheet. **Basis risk:** comes from pricing assets using a different rate index to the liabilities that fund them. We are exposed to basis risks associated with Bank of England bank rate, reserve rate linked assets we deposit with central banks, the Sterling Overnight Index Average (SONIA) rate, and LIBOR rates of different terms. LIBOR for Sterling, Swiss Francs and Japanese Yen were replaced with Risk Free Rates at the end of 2021. We will have some legacy positions using synthetic LIBOR in 2022, but there should be no basis risk incurred on re-hedging these positions. We are also very advanced with the transition of our loan and derivative portfolios. As the transition progresses, we continue to monitor our basis risk positions.
Spread risk	Spread risk arises when the value of assets or liabilities which are accounted for at fair value (either through Other Comprehensive Income or through Profit and Loss) are affected by changes in the spread. We measure these spreads as the difference between the discount rate we use to value the asset or liability, and an underlying interest rate curve. Spread risks can be split into Swap Spread (where the instrument has been issued by a Sovereign counterparty) and Credit Spread (where the instrument has been issued by for example a corporate or bank counterparty). It mainly arises in the bond portfolios we hold for liquidity purposes. We measure spread risk with sensitivities, stress tests and VaR measures.
Foreign exchange risk	Our banking businesses operate mainly in sterling markets, so we do not create significant foreign exchange exposures. The only exception to this is money we raise in foreign currencies. For more on this, see 'Wholesale funding' in the 'Liquidity risk' section.
Income statement volatility risk	We measure most of the assets and liabilities in our banking book balance sheet at amortised cost. We sometimes manage their risk profile by using derivatives. As all derivatives are accounted for at fair value, the mismatch in their accounting treatment can lead to volatility in our Income Statement. This happens even if the derivative is an economic hedge of the asset or liability.

NON-TRADED MARKET RISK MANAGEMENT

Risk appetite

Our framework for dealing with market risk is part of our overall Risk Framework. Our Structural and Market Risk framework sets out our high-level arrangements and standards to manage, control and oversee non-traded market risk. Our Risk Appetite sets the controls, risk limits and key risk metrics for non-traded market risk. We articulate risk appetite by the income and value sensitivity limits we set in our Risk Appetite, at both Santander UK and Banco Santander group levels.

Risk measurement

For non-traded market risk, we mainly measure our exposures with NIM and EVE sensitivity analysis. We support this with VaR risk measures and stress testing. We also monitor our interest rate repricing gap.

NIM and EVE sensitivities

The calculations for NIM and EVE sensitivities involve many assumptions, including expected customer behaviour (such as early repayment of loans) and how interest rates may move. These assumptions are a key part of our overall control framework, so we update and review them regularly.

Our NIM and EVE sensitivities include the interest rate risk from all our banking book positions. Our banking book positions generate almost all our reported net interest income.

NIM sensitivity
– NIM sensitivity is an income-based measure we use to forecast the changes to interest income and interest expense in different scenarios. It gives us a combined impact on net interest income over a given period – usually 12 or 36 months.
– We calculate NIM sensitivity by simulating the NIM using two yield curves. The difference between the two NIM totals is the NIM sensitivity.
– Our main model assumptions are that: – The balance sheet is dynamic. This means that it includes the run-off of current assets and liabilities as well as retained and new business – We use a behavioural balance sheet rather than a contractual one. This means that we adjust balances for their behavioural or assumed profile. We do this with most retail products whose behavioural maturity is different to the contractual maturity. This is usually because customers are exercising the option to withdraw or prepay early, or there is no contractual maturity.

EVE sensitivity
– We calculate EVE sensitivity as the change in the net present value of all the interest rate sensitive items in the banking book balance sheet for a defined set of instantaneous parallel and non-parallel shifts in the yield curve.
– We use a static balance sheet. This means that all balance sheet items run-off according to their contractual, behavioural or assumed run-off behaviour (whichever is appropriate), and there is no retained or new business.

The limitations of sensitivities

We use sensitivities to measure the impact of standard, instantaneous, parallel shifts in relevant yield curves. The advantage of using standard parallel shifts is they generally give us a constant measure of the size of our market risk exposure, with a simple and consistent stress. This compares to specific scenarios like 'flat rates'. The magnitude of flat rates depends on the shape of the current curve and the shift required to reach the flat rate scenario.

We also run non-parallel stress tests, to calculate the impact of some plausible non-parallel scenarios, and over various time periods for income stresses, usually one or three years.

VaR (audited)

VaR
– VaR indicates the losses that we might suffer because of unfavourable changes in the markets under normal (non-stressed) market conditions.
– We run a historical simulation using historical daily price moves, at a 99% confidence level for example, to find how much we might lose – the VaR.
– For any given day's position, we expect to suffer losses greater than the VaR estimate 1% of the time – once every 100 trading days, or two to three times a year.
– This gives us a consistent way of assessing risk for all relevant market risk factors in our portfolios.

The limitations of VaR

VaR is a useful and important market standard measure of risk, but it does have some limitations. These include:

- VaR assumes what happened in the past is a reliable way to predict what will happen in the future. This may not always be the case
- VaR is based on positions at the end of the business day so it doesn't include intra-day positions
- VaR does not predict how big the loss could be on the 1% of trading days that it is greater than the VaR
- Using a time horizon of one day means VaR does not tell us everything about exposures that we cannot liquidate or hedge within a day, or products with infrequent pricing.

Back-testing – comparing VaR estimates with reality

To check that the way we estimate VaR is reasonable, we back-test our VaR by comparing it against both actual and hypothetical profits and losses, using a one-day time horizon. Back-testing allows us to identify exceptions – times when the predictions were out of line with what happened. We can then look for trends in these exceptions, which can help us decide whether we need to recalibrate our VaR model.

Other ways of measuring risk
As well as using sensitivities and stress tests, we can measure non-traded market risk using net notional positions. This can give us a simple view of our exposure, although we generally need to combine it with other risk measures to cover all aspects of a risk profile, such as projected changes over time.

Other metrics we can use include Earnings at Risk (EaR). Although VaR can be useful as it captures changes in economic values, as we describe above, VaR will not reflect the actual Income Statement impact of most of our banking book positions. This is because we account for them at amortised cost rather than fair value. EaR is like VaR but captures changes in income rather than value. We use this approach for example to generate a one-year EaR measure to assess Basis risk.

Stress testing
Stress testing is an essential part of our risk management. It helps us to measure and evaluate the potential impact on portfolio values of more extreme, although plausible, events or market moves. We express limits as on how much we could lose in a stress event, and this restricts how much risk we take.

Stress testing scenarios
Simple stress tests (like parallel shifts in relevant curves) give us clear measures of risk control and a consistent starting point for setting limits. More complex, multi-factor and multi-time period stress tests can give us information about specific potential events. They can also test outcomes that we might not capture through parallel stresses or VaR-type measures because of data or model limitations. We can also use stress tests to estimate losses in extreme market events beyond the confidence level used in VaR models.

We can adapt our stress tests to reflect current concerns such as climate change risk, the Covid-19 pandemic and other macroeconomic events or changing market conditions quicker than we can with other risk measures, like VaR. We can include both individual business area stresses and Santander UK-wide scenarios. We can produce stress tests using either income or value measures. They cover one or more categories of exposures on an accruals basis or at fair value. We use expert judgement to define appropriate hypothetical stress tests and any adjusting assumptions based on the balance sheet, management actions and customer behaviour.

How we use stress testing
We discuss stress testing results at senior management committees. They affect Corporate Centre's decisions by highlighting possible risks in the banking book and the effectiveness of remedial actions we could take. We compare stress test results with stress limits and triggers set by our internal committees, or against metrics set by the PRA. If the results are over our limits or triggers, we take remedial actions and follow an escalation process.

Risk mitigation (audited)
We mitigate Income Statement volatility mainly through hedge accounting. We monitor any hedge accounting ineffectiveness that might lead to Income Statement volatility with a VaR measure and trigger, reported monthly. For our accounting policies for derivatives and hedge accounting, see Note 1 to the Consolidated Financial Statements.

We typically hedge the interest rate risk of the securities we hold for liquidity and investment purposes with interest rate swaps, retaining spread exposures. These retained exposures are the key drivers of the VaR and stress tests we use to assess the risk of the portfolio.

We hedge our foreign currency funding positions back to sterling, so our foreign exchange positions tend to be residual exposures that remain after hedging. These positions could be, for example, to 'spot' foreign exchange rates or to cross currency basis. We monitor foreign exchange risk against absolute net exposures and VaR-based limits and triggers.

For more on this, see 'Funding strategy' and 'Term issuance' in the 'Liquidity risk' section.

Risk monitoring and reporting (audited)
We monitor the non-traded market risks of the securities we hold for liquidity and investment purposes using sensitivities, VaR and stress tests. We report them against limits and triggers to senior management daily and to ALCO and ERCC each month. The VaR we report captures all key sources of volatility (including interest rate and spread risks) to fully reflect the potential volatility.

NON-TRADED 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 25 basis points (bps) and a 50 bps parallel shift (both up and down) applied instantaneously to the yield curve at 31 December 2021 and 31 December 2020. Sensitivity to parallel shifts represents the amount of risk in a way that we think is both simple and scalable. From 2021, we have typically focused on a 25bps stress for non-traded market risk controls that reflects a more plausible yield curve stress in the current low rate environment. We continue to monitor sensitivities to other parallel and non-parallel shifts as well as scenarios. Sensitivities to a 50bps shift are also provided this year as a bridge to previous year's disclosures.

	2021				2020			
	+25bps	-25bps	+50bps	-50bps	+25bps	-25bps	+50bps	-50bps
	£m	£m	£m	£m	£m	£m	£m	£m
NIM sensitivity (audited)	**89**	**(94)**	**167**	**(205)**	**116**	(23)	225	(15)
EVE sensitivity	**89**	**(125)**	**148**	**(301)**	**190**	(369)	367	(585)

Basis risk

We report basis risk using the EaR approach.

	2021	2020
	£m	£m
Basis risk EaR	**2**	8

Interest rate repricing gap

The table below shows the interest rate repricing gap of our balance sheet by repricing buckets.

2021	3 months	1 year	3 years	5 years	>5years	Not sensitive	Total
	£m	£m	£m	£m	£m	£m	£m
Assets	**111,211**	**45,979**	**77,726**	**44,418**	**7,191**	**16,930**	**303,455**
Liabilities	**190,649**	**17,328**	**25,735**	**16,108**	**28,733**	**25,551**	**304,104**
Off-balance sheet	**27,369**	**(18,508)**	**(19,842)**	**3,447**	**8,183**	**—**	**649**
Net gap	**(52,069)**	**10,143**	**32,149**	**31,757**	**(13,359)**	**(8,621)**	**—**
2020							
Assets	121,812	47,975	71,729	37,114	7,944	16,513	303,087
Liabilities	191,178	22,836	21,013	16,322	27,385	25,551	304,285
Off-balance sheet	25,788	(11,081)	(17,322)	(1,794)	5,607	—	1,198
Net gap	(43,578)	14,058	33,394	18,998	(13,834)	(9,038)	—

Spread risk

The table below shows the risk metrics covering the portfolios of securities we hold for liquidity and investment purposes.

	2021	2020
	£m	£m
VaR	**4**	7
Worst three month stressed loss	**56**	93

2021 compared to 2020

We regularly review our risk models and metrics including underlying modelling assumptions to ensure they continue to reflect the risks inherent in the prevailing rate environment and incorporate regulatory expectations. The adverse movement in NIM sensitivities in 2021 was largely driven by changes in modelling assumptions used for risk measurement purposes. These were partially offset by less margin compression risk following a steepening in the yield curve. These assumption changes also contributed to the movement in sensitivities in 2021 and this was offset to a larger extent by the higher curve and lower margin compression risk over the longer time horizon considered under the EVE metric.

The basis risk EaR decreased in 2021 due to reduced underlying net basis position, following the move to risk-free rates as part of our IBOR transition programme.

TRADED MARKET RISK

OUR KEY TRADED MARKET RISKS (AUDITED)

Our traded market risks come from providing financial services to our customers. Our exposures are affected by market movements in interest rates, credit spreads, and foreign exchange rates. Traded market risk can reduce our net income.

We only have a very small amount of traded market risk. This is from permitted products sold to permitted customers. We hedge risks from client trades. Our books are as close to back-to-back as possible. Market risk is hedged with Banco Santander SA or CCPs. This is required by Banking Reform legislation.

We have two trading desks. The Link Desk transacts derivatives with our corporate clients that are permitted under the ring-fencing regime. The Retail Structured Products desk (RSP) sells investments to retail investors, through our UK branches and other channels. The Link Desk is exposed to the credit quality of our clients. We adjust valuations for this with the Credit Valuation Adjustment (CVA), which feeds our valuations and hence income and expenses. The low market risk in our trading business means that CVA is the main driver of income movements, along with similar factors – Debt Valuation Adjustment (DVA) driven by our own credit, and Liquidity Valuation Adjustment (LVA) driven by the market price of liquidity. These valuation adjustments are collectively referred to as XVAs.

We calculate market risk capital using standard rules.

TRADED MARKET RISK MANAGEMENT

Risk appetite
Market risk is managed within our overall Risk Framework. Our market risk framework sets our high level arrangements and standards for managing and controlling traded market risk. Our Risk Appetite for traded market risk is low. We only need to report a qualitative measure to the Board.

Risk measurement
We have a range of ways of measuring traded market risk, including stress testing (explained in the Non-traded market risk management section above) and detailed sensitivity measures.

Stress testing
This is an essential part of our risk management. It helps us measure and evaluate the possible results of extreme, although plausible, events and market moves. We set limits on what we could lose in a stress event. This restricts how much risk we take.

Stress testing scenarios
We calculate the impact of 100 scenarios on our trading books every month. The scenarios we create may be inspired by past events, like the global financial crisis and the Covid-19 pandemic. They may include ways that unusual market conditions could happen. They include interest rates, equity prices and exchange rates. Most are reported against limits, and so could lead to our front office being asked to reduce risk. Our scenarios are not all calibrated to the same severity; some may be for a much longer holding period or a completely artificial and unrealistic scenario. We therefore do not limit all of them in the same way.

How we use stress testing
We use limits to manage how much we can lose in a crisis. This limits the risk we take. We make sure that plausible losses are below the Risk Appetite set by the Board. We report to senior management regularly at the Market & Structural Risk Control Forum.

Risk mitigation (audited)
We manage and control traded market risk within clear limits. There are specific levels that need escalation or action. This means we limit the impact of negative market movements. We keep the areas that create traded market risk separate from areas which control and oversee risk.

Risk monitoring and reporting (audited)
We maintain a complete set of written policies, procedures, and processes. These make sure we identify, assess, manage, and report traded market risk.

TRADED MARKET RISK REVIEW

2021 compared to 2020
In 2021, there were no significant changes to our traded market risk exposures. Our exposure to traded market risk is small, and arises from permitted transactions under the ring-fencing regime, offset by permitted market risk hedges.

The Internal VaR for exposure to traded market risk in 2021 was less than £1m (2020: less than £1m).

Liquidity risk

Overview

Liquidity risk is the risk that we do not have sufficient liquid financial resources available to meet our obligations when they fall due, or we can only secure such resources at excessive cost.

In this section, we describe our sources and uses of liquidity and how we manage liquidity risk. We also analyse our key liquidity metrics, including our LCRs and our eligible liquidity pools.

We then explain our funding strategy and structure and we analyse our wholesale funding. Finally, we analyse how we have encumbered some of our assets to support our funding activities.

Key metrics

RFB DoLSub LCR of 166% (2020: 150%)

Wholesale funding with maturity <1 year £10.2bn (2020: £21.1bn)

RFB DoLSub LCR eligible liquidity pool of £51.4bn (2020: £51.5bn)

OUR KEY LIQUIDITY RISKS (AUDITED)

Through our LRA framework, we manage our funding or structural contingent and market liquidity risks wherever they arise. This can be in retail and corporate deposit outflows, wholesale secured and unsecured liquidity outflows and off-balance sheet activities. Other risks our framework covers include funding concentrations, intra-day cash flows, intra-group commitments and support, franchise retention and cross currency risk.

Our main sources of liquidity

Customer deposits finance most of our customer lending. Although these funds are mostly callable, in practice they give us a stable and predictable core of funding. This is due to the nature of retail accounts and the breadth of our retail customer relationships.

We have a strong wholesale funding investor base, diversified across product types and geographies. Through the wholesale markets, we have active relationships in many sectors including banks, other financial institutions, corporates and investment funds. We access the wholesale funding markets through the issuance of capital, senior unsecured debt, covered bonds, structured notes and short-term funding. We also access these markets through securitisations of certain assets of Santander UK plc and our operating subsidiaries. For more on our programmes, see Notes 14, 22 and 26 in the Consolidated Financial Statements.

We generate funding on the strength of our own balance sheet, our own profitability and our own network of investors. In addition, we have access to UK Government funding schemes. We comply with rules set by the PRA, other regulators, and Banco Santander standards. While we manage, consolidate and monitor liquidity risk centrally, we also manage and monitor it in the business area it comes from.

Our main uses of liquidity

Our main uses of liquidity are to fund our lending in Retail Banking, Consumer Finance and Corporate & Commercial Banking, to pay interest and dividends, and to repay debt. Our ability to pay dividends depends on various factors. These include our regulatory capital needs, the level of our distributable reserves, and our financial performance. We also use liquidity to pay for business combinations.

LIQUIDITY RISK MANAGEMENT

Introduction

We manage liquidity risk on a consolidated basis in our CFO division, which is our centralised function for managing funding, liquidity and capital. We created our governance, oversight and control frameworks, and our LRA, on the same consolidated basis.

Under the PRA's liquidity rules, Santander UK plc and its subsidiary Cater Allen Limited form the RFB Domestic Liquidity Sub-group (the RFB DoLSub), which allows the entities to collectively meet regulatory requirements for the purpose of managing liquidity risk. Each member of the RFB DoLSub will support the other by transferring surplus liquidity in times of stress.

Risk appetite

Our LRA statement is based on the principles of liquidity management we use to manage our balance sheet. It also supports our need to meet or exceed the rules of our regulators. In line with our liquidity management principles, we avoid an over-reliance on funding from a single product, customer or counterparty. We also maintain enough unencumbered customer assets to support current and future funding and collateral requirements and maintain enough capacity to monetise liquid assets and other counterbalancing capacity within an appropriate timeframe.

Our LRA is proposed to the Risk division and the Board, which is then approved under advice from the Board Risk Committee. Our LRA, in the context of our overall Risk Appetite, is reviewed and approved by the Board each year, or more often if needed.

Risk measurement

We use a number of metrics to manage liquidity risk. These include metrics that show the difference between cash and collateral inflows and outflows in different periods. They also include structural metrics, such as our level of encumbered assets.

Ongoing business management

Within our framework of prudent funding and liquidity management, we manage our activities to our liquidity risk appetite. We have clear responsibilities for short-term funding, medium-term funding, encumbrance, collateral and liquid asset management. This ensures we manage liquidity risks as part of our daily operations, strategy and planning.

Our liquidity management framework is split between short-term and strategic activities. Our short-term activities focus on intra-day collateral; management and maintaining liquid assets to cover unexpected demands on cash in a stress scenario, such as large and unexpected deposit withdrawals by customers and loss of wholesale funding. Our strategic activities focus on ensuring we are not over reliant on any one source for funding and that we avoid excessive concentrations in the maturity of our funding.

We regularly test the liquidity of our eligible liquidity pool, in line with PRA and Basel rules. We do this by realising some of the assets through repurchase or outright sale to the market. We make sure that over any 12-month period we realise a significant part of our eligible liquidity pool. As well as our eligible liquidity pool, we always hold a portfolio of unencumbered liquid assets. Our LRA and PRA requirements determine the size and composition of this portfolio. These assets give us a source of contingent liquidity, as we can realise some of them in a time of stress to create liquidity through repurchase or outright sale to the market.

Stress testing

We have a liquidity stress testing framework in place which is central to our LRA measurement and monitoring. It includes three severe but plausible stress test scenarios. To fit with our risk appetite, the liquidity outflows that come from these stress tests must be fully covered with high-quality liquid assets, other liquid assets and management actions sanctioned at the right level of governance. A funding plan disruption stress scenario also forms part of our LRA monitoring.

Our Risk division runs a range of stress tests. Our LRA stress test is a combination of three tests that cover idiosyncratic, market-wide and combined scenarios.

Our other tests consider scenarios such as a global economic slowdown that results in reduced confidence in the banking industry, a slowdown in one of the major economies or a deterioration in the availability of liquidity. These are considered on both an acute and protracted basis. We also run severe combined stress tests which look at both a deep and prolonged UK recession that results in a reduction in wholesale funding availability and a simultaneous idiosyncratic shock that would lead to retail and commercial outflows. We run a Covid-19 pandemic stress, in which no UK government support is assumed and like the combined stress includes a reduction in wholesale funding and retail and corporate outflows.

We also conduct sensitivity analysis and reverse stress testing for instant liquidity shocks by each key liquidity risk. We do this to understand the impacts they would have on our LRA and our regulatory liquidity metrics.

We monitor our LCR to ensure we continue to meet the requirements. We also monitor the Net Stable Funding Ratio (NSFR), which was implemented on 1 January 2022. We exceed the requirements for both LCR and NSFR.

Risk mitigation (audited)

The Board aims to make our balance sheet resilient at all times and for it to be perceived as such by stakeholders. This preserves our short and long-term viability. The Board recognises that as we are involved in maturity transformation, we cannot hold enough liquidity to cover all possible stress scenarios. The Board requires us to hold enough liquidity to make sure we will survive three plausible but severe stress scenarios (our LRA stress). We do this by maintaining a prudent balance sheet structure and approved liquid resources.

Recovery & Resolution framework

The CFO is the accountable SMF for recovery and resolution and the related work is managed by the CFO division. They are overseen by the Board Audit Committee and the Board.

We review and refresh our recovery plan each year. It sets out the risks, the indicators we use to monitor these risks, and the actions that are available to mitigate a capital, liquidity or combined stress event. We are confident that we have sufficient credible and executable options to respond to a wide variety of stresses, be they market-wide or idiosyncratic, in a timely and effective manner. Recovery indicators are both qualitative and quantitative and are embedded into risk frameworks. We monitor recovery capacity, headroom to recovery triggers and recovery indicators regularly. If necessary, we would invoke recovery early to mitigate the effects of a stress and restore our financial position and balance sheet strength.

Santander UK's first self-assessment of its resolvability was submitted to the PRA in October 2021. More details will be set out in the public disclosure due in June 2022.

Risk monitoring and reporting (audited)

We monitor liquidity risk daily, weekly and monthly. We do this through different committees and levels of management, including ALCO and the Board Risk Committee.

LIQUIDITY RISK REVIEW

Liquidity Coverage Ratio

This table shows our LCR and LRA at 31 December 2021 and 31 December 2020. The LRA data reflect the stress testing methodology in place at that time.

	RFB DoLSub LCR[1]		RFB LRA[2]	
	2021	2020	**2021**	2020
	£bn	£bn	**£bn**	£bn
Eligible liquidity pool (liquidity value)[3]	**51.3**	51.2	**52.5**	47.2
Net stress outflows	**(30.9)**	(34.1)	**(30.4)**	(34.4)
Surplus	**20.4**	17.1	**22.1**	12.8
Eligible liquidity pool as a percentage of anticipated net cash flows	**166%**	150%	**173%**	137%

(1) The RFB LCR was 168% (2020:152%).
(2) The LRA is calculated for the Santander UK plc group (the RFB Group) and is a three-month Santander UK specific requirement.
(3) The liquidity value is calculated as applying an applicable haircut to the carrying value.

LCR eligible liquidity pool

This table shows the carrying value of our eligible liquidity pool assets at 31 December 2021 and 31 December 2020. It also shows the weighted average carrying value in the year.

	Carrying value						RFB DoLSub Weighted average carrying value in the year	
	2021			2020			**2021**	2020
	Level 1	**Level 2**	**Total**	Level 1	Level 2	Total	**Total**	Total
	£bn	**£bn**	**£bn**	£bn	£bn	£bn	**£bn**	£bn
Cash and balances at central banks	**45.9**	**—**	**45.9**	39.4	—	39.4	**40.6**	26.8
Government bonds	**4.2**	**—**	**4.2**	8.9	0.1	9.0	**7.0**	15.5
Supranational bonds and multilateral development banks	**0.2**	**—**	**0.2**	1.5	—	1.5	**0.3**	2.9
Covered bonds	**0.8**	**—**	**0.8**	1.0	—	1.0	**1.1**	1.2
Asset-backed securities	**—**	**0.3**	**0.3**	—	0.6	0.6	**0.4**	0.6
Equities	**—**	**—**	**—**	—	—	—	**—**	—
	51.1	**0.3**	**51.4**	50.8	0.7	51.5	**49.4**	47.0

Currency analysis

This table shows the carrying value of our eligible liquidity pool by major currencies at 31 December 2021 and 31 December 2020. The composition of the pool is consistent with the currency profile of our net liquidity outflows.

	US Dollar	Euro	Sterling	Other	RFB DoLSub Total
	£bn	£bn	£bn	£bn	£bn
2021	**0.8**	**0.4**	**50.2**	**—**	**51.4**
2020	2.0	1.2	48.1	0.2	51.5

2021 compared to 2020

The RFB DoLSub LCR of 166% increased from 150% and remains significantly above regulatory requirements. We also monitor the Net Stable Funding Ratio (NSFR), which has been implemented on 1 January 2022 and we exceed the requirements. At 31 December 2021, the RFB DolSub NSFR was 136%.

We remain in a strong liquidity position and the impacts of the Covid-19 pandemic did not trigger a liquidity stress.

We hold sufficient liquid resources and have adequate governance and controls in place to manage the liquidity risks arising from its business and strategy.

FUNDING RISK MANAGEMENT

Funding strategy

Our funding strategy continues to be based on maintaining a conservatively structured balance sheet and diverse sources of funding to meet the needs of our business strategy and plans. The CFO Division maintains a funding plan and ensures it is compliant with the LRA and regulatory liquidity and capital requirements.

Most of our funding comes from customer deposits. We source the rest from a mix of secured and unsecured funding in the wholesale markets. Overall, this means that we do not rely too heavily on wholesale funds. We manage funding requirements by targeting a specific Liquidity Coverage Ratio, we ensure maturities are prefunded and capital/Minimum Requirements for Eligible Liabilities (MREl) requirements are prioritised. We also have checks and controls to limit our asset encumbrance from our secured funding operations.

As part of maintaining a diverse funding base, we raise funding in a number of currencies, including EUR and USD, and convert it into sterling through currency swaps to fund our commercial assets which are largely sterling denominated.

Our base of stable retail and corporate deposits is a key funding source for us. We leverage our large and diverse customer base to offer products that give us a long-term sustainable source of funding. We do this by focusing on building long-term relationships. Over 85% of our total core retail customer liabilities are covered by the Financial Services Compensation Scheme (the FSCS).

Behavioural maturities

The contractual maturity of our balance sheet assets and liabilities highlights the maturity transformation that underpins the role of banks to lend long term, but to fund themselves mainly with shorter-term liabilities, like customer deposits. We do this by diversifying our funding operations across a wide customer base, both in numbers and by type of depositor. In practice, the behavioural profiles of many liabilities show more stability and longer maturity than their contractual maturity. This is especially true of many types of retail and corporate deposits that, while they may be repayable on demand or at short notice, have shown good stability even in times of stress. We model behaviour profiles using our experience of customer behaviour. We use this data to determine the funds transfer pricing interest rates at which we reward and charge our business units for sources and uses of funds. We apply this rate until a customer changes to a different product or service offered by us or by one of our competitors.

We continue to maintain the quality of our retail, commercial and wholesale deposits. We aim to deepen our customer relationships across all customer segments. We do this to lengthen the contractual and behavioural profile of our liability base.

Deposit funding

We mainly fund our Retail Banking, Consumer Finance and Corporate & Commercial Banking activities by customer deposits. We fund the rest through wholesale markets.

Wholesale funding

Composition of wholesale funding

We are active in the wholesale markets and we have direct access to both money market and long-term investors through our funding programmes. This makes our wholesale funding well diversified by product, maturity, geography and currency. This includes currencies available across a range of channels from money markets, repo markets, senior unsecured, secured, medium-term and capital. For details of our main programmes, see the Funding Information section of our website www.santander.co.uk/uk/about-santander-uk/investor-relations/funding-information.

Santander UK plc is our main operating company issuer of senior unsecured debt, structured notes, short-term funding and covered bonds.

Our immediate parent Santander UK Group Holdings plc is the issuer of capital and MREL/Total Loss Absorbing Capacity (TLAC) eligible senior unsecured debt. Under CRR II, G-SIBs have been subject to the MREL standard. As part of this, UK resolution entities that are G-SIBs or are part of a G-SIB, including our immediate parent Santander UK Group Holdings plc, are required to meet the MREL minimum requirements, implemented through the Bank of England Statement of Policy on MREL in the UK. From 1 January 2020, the MREL requirement is the higher of (i) two times the Pillar 1 capital requirements and one times their Pillar 2A add-ons; (ii) 6% of CRR leverage exposures or (iii) two times the minimum leverage ratio requirement. The MREL requirements has been fully implemented from 1 January 2022 and G-SIBs is required to meet the higher of (i) two times the sum of Pillar 1 capital requirements and their Pillar 2A add-ons; (ii) 6.75% of CRR leverage exposures or (iii) two times the minimum leverage ratio requirement.

The Company is subject to internal MREL as it meets the requirements of a material subsidiary of our ultimate parent Banco Santander SA.

We also access the wholesale markets through securitisations of certain assets of our operating subsidiaries. In addition, we have access to UK Government funding schemes. Eligible collateral for these schemes includes all collateral that is eligible in the Bank of England's Discount Window Facility. We ensure that enough collateral is placed and available at the Discount Window.

Issuance model and resolution

Banco Santander is a multiple point of entry resolution group. This means that should it fail, it would be split up into parts. Healthy parts might be sold or be kept as a residual group without their distressed sister companies. The resolution or recapitalisation of the distressed parts might be effected via 'bail in' of bonds that had been issued to the market by a regional intermediate holding company.

Santander UK is a single point of entry resolution group. This means that resolution would work downwards from the group's holding company i.e. Santander UK Group Holdings plc. Losses in subsidiaries would first be transferred up to Santander UK Group Holdings plc. If the holding company is bankrupt as a result, the group is deemed to be failing or likely to fail, it will be put into resolution. The 'bail in' tool is applied to the holding company, with the equity being written off and bonds written off or converted into equity as needed to recapitalise the group. Those bondholders would become the new owners, and the group would stay together.

Santander UK Group Holdings plc is the immediate holding company of Santander UK plc but does not guarantee its debts or other obligations. This structure is a Bank of England recommended configuration which aims to ensure the activities of the operating company are not disrupted as the Santander UK group goes through resolution, thereby maintaining continuity of services for customers.

FUNDING RISK REVIEW

Our funding strategy continues to be based on maintaining a conservatively structured balance sheet and diverse sources of funding to meet the needs of our business strategy and plans. The CFO Division maintains a funding plan and ensures it is compliant with the LRA and regulatory liquidity and capital requirements.

2021 compared to 2020

- Together with our immediate parent, Santander UK Group Holdings plc, our overall funding strategy remains to develop and sustain a diversified funding base. We also need to fulfil regulatory requirements as well as support our credit ratings.
- In 2021, we utilised central bank liquidity schemes to provide core funding to Santander UK plc. Wholesale markets were open and utilised by our peers but our large capacity and relative cost of the TFSME meant this was the cornerstone of 2021 funding for Santander. We have spoken to over 220 investors across all asset classes since the start of the Covid-19 pandemic, ensuring we retain relationships and can easily resume wholesale funding as required going forward.
- Maturities in 2021 were £19.2bn (2020: £16.5bn). At 31 December 2021, 85% (2020: 68%) of wholesale funding had a maturity of greater than one year, with an overall residual duration of 47 months (2020: 38 months).
- Our level of encumbrance from external and internal issuance of securitisations and covered bonds fell in 2021.

Reconciliation of wholesale funding to the balance sheet (audited)
This table reconciles our wholesale funding to our balance sheet at 31 December 2021 and 31 December 2020..

		Balance sheet line item						
2021	Funding analysis £bn	Deposits by banks[3] £bn	Deposits by customers[1] £bn	Repurchase agreements - non trading £bn	Financial liabilities designated at fair value £bn	Debt securities in issue £bn	Subordinated liabilities £bn	Other equity instruments[2] £bn
Deposits by banks	**0.2**	**0.2**	**—**	**—**	**—**	**—**	**—**	**—**
Certificates of deposit and commercial paper	**5.1**	**—**	**—**	**—**	**—**	**5.1**	**—**	**—**
Senior unsecured – public benchmark	**12.3**	**—**	**5.8**	**—**	**—**	**6.5**	**—**	**—**
– privately placed	**0.6**	**—**	**0.1**	**—**	**0.5**	**—**	**—**	**—**
Covered bonds	**12.5**	**—**	**—**	**—**	**—**	**12.5**	**—**	**—**
Securitisation and structured issuance	**0.7**	**—**	**—**	**—**	**—**	**0.7**	**—**	**—**
Term Funding Scheme	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
TFSME	**31.9**	**31.9**	**—**	**—**	**—**	**—**	**—**	**—**
Subordinated liabilities and equity	**4.1**	**—**	**—**	**—**	**—**	**—**	**1.9**	**2.2**
Total wholesale funding	**67.4**	**32.1**	**5.9**	**—**	**0.5**	**24.8**	**1.9**	**2.2**
Repos	**11.7**	**—**	**—**	**11.7**	**—**	**—**	**—**	**—**
Foreign exchange and hedge accounting	**1.1**	**—**	**0.1**	**—**	**—**	**0.7**	**0.3**	**—**
Other	**2.1**	**1.8**	**—**	**—**	**0.3**	**—**	**—**	**—**
Balance sheet total	**82.3**	**33.9**	**6.0**	**11.7**	**0.8**	**25.5**	**2.2**	**2.2**
2020								
Deposits by banks	—	—	—	—	—	—	—	—
Certificates of deposit and commercial paper	5.7	—	—	—	—	5.7	—	—
Senior unsecured – public benchmark	15.4	—	7.8	—	—	7.6		—
– privately placed	1.1	—	0.1	—	0.9	0.1	—	—
Covered bonds	17.9	—	—	—	—	17.9	—	—
Securitisation and structured issuance	2.8	—	—	—	0.5	2.3	—	—
Term Funding Scheme	6.3	6.3	—	—	—	—	—	—
TFSME	11.7	11.7	—	—	—	—	—	—
Subordinated liabilities and equity	4.4	—	—	—	—	—	2.2	2.2
Total wholesale funding	65.3	18.0	7.9	—	1.4	33.6	2.2	2.2
Repos	15.8	—	—	15.8	—	—	—	—
Foreign exchange and hedge accounting	2.5	—	0.2	—	—	2.0	0.3	—
Other	3.0	3.0	—	—	—	—	—	—
Balance sheet total	86.6	21.0	8.1	15.8	1.4	35.6	2.5	2.2

(1) This is included in our balance sheet total of £192,926m (2020: £195,135m).
(2) Consists of £nil (2020: £nil) fixed/floating rate non-cumulative callable preference shares, £235m (2020: £235m) Step-up Callable Perpetual Reserve Capital Instruments and £1,956m (2020: £1,956m) Perpetual Capital Securities. See Notes 33 and 34 to the Consolidated Financial Statements.
(3) Other consists of items in the course of transmission and other deposits, excluding the TFS. See Note 24 to the Consolidated Financial Statements.

Maturity profile of wholesale funding (audited)

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

2021	≤ 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
Downstreamed from Santander UK Group Holdings plc to Santander UK plc[1]										
Senior unsecured – public benchmark	**0.8**	**—**	**0.4**	**—**	**—**	**1.2**	**3.0**	**4.0**	**1.8**	**10.0**
– privately placed	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**0.1**	**0.1**
Subordinated liabilities and equity (incl. AT1)	**—**	**—**	**0.8**	**—**	**—**	**0.8**	**—**	**1.6**	**0.3**	**2.7**
	0.8	**—**	**1.2**	**—**	**—**	**2.0**	**3.0**	**5.6**	**2.2**	**12.8**
Other Santander UK plc										
Deposits by banks	**0.2**	**—**	**—**	**—**	**—**	**0.2**	**—**	**—**	**—**	**0.2**
Certificates of deposit and commercial paper	**1.3**	**3.0**	**0.7**	**0.1**	**—**	**5.1**	**—**	**—**	**—**	**5.1**
Senior unsecured – public benchmark	**0.6**	**—**	**—**	**—**	**—**	**0.6**	**0.3**	**1.1**	**0.3**	**2.3**
– privately placed	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**0.3**	**0.2**	**0.5**
Covered bonds	**—**	**—**	**0.8**	**—**	**0.9**	**1.7**	**1.9**	**5.6**	**3.3**	**12.5**
Securitisation & structured issuance[2]	**0.2**	**—**	**0.1**	**0.1**	**—**	**0.4**	**0.2**	**0.1**	**—**	**0.7**
Term Funding Scheme (TFS)	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
TFSME	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**28.0**	**3.9**	**31.9**
Subordinated liabilities	**—**	**0.2**	**—**	**—**	**—**	**0.2**	**0.5**	**—**	**0.7**	**1.4**
	2.3	**3.2**	**1.6**	**0.2**	**0.9**	**8.2**	**2.9**	**35.1**	**8.4**	**54.6**
Other group entities										
Securitisation & structured issuance[3]	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Total at 31 December 2021	**3.1**	**3.2**	**2.8**	**0.2**	**0.9**	**10.2**	**5.9**	**40.7**	**10.6**	**67.4**
Of which:										
– Secured	**0.2**	**—**	**0.9**	**0.1**	**0.9**	**2.1**	**2.1**	**33.7**	**7.2**	**45.1**
– Unsecured	**2.9**	**3.2**	**1.9**	**0.1**	**—**	**8.1**	**3.8**	**7.0**	**3.4**	**22.3**
	3.1	**3.2**	**2.8**	**0.2**	**0.9**	**10.2**	**5.9**	**40.7**	**10.6**	**67.4**
2020										
Total at 31 December 2020	2.2	5.6	8.0	4.1	1.2	21.1	7.9	28.2	8.1	65.3
Of which:										
– Secured	0.4	1.6	5.2	3.0	0.2	10.4	5.3	18.6	4.4	38.7
– Unsecured	1.8	4.0	2.8	1.1	1.0	10.7	2.6	9.6	3.7	26.6

(1) 95% of senior unsecured debt issued from Santander UK Group Holdings plc has been downstreamed to Santander UK plc as 'secondary non-preferential debt' in line with the guidelines from the Bank of England for Internal MREL.
(2) Includes funding from mortgage-backed securitisation vehicles where Santander UK plc is the asset originator.
(3) Includes funding from asset-backed securitisation vehicles where entities other than Santander UK plc are the asset originator.

Currency composition of wholesale funds (audited)
This table shows our wholesale funding by major currency at 31 December 2021 and 31 December 2020.

	2021				2020			
	Sterling	US Dollar	Euro	Other	Sterling	US Dollar	Euro	Other
	%	%	%	%	%	%	%	%
Downstreamed from Santander UK Group Holdings plc to Santander UK plc								
Senior unsecured – public benchmark	**9**	**59**	**32**	**—**	10	62	28	—
– privately placed	**—**	**—**	**—**	**100**	—	—	—	100
Subordinated liabilities and equity (incl. AT1)	**73**	**27**	**—**	**—**	73	27	—	—
	22	**52**	**25**	**1**	24	53	22	1
Other Santander UK plc								
Deposits by banks	**32**	**68**	**—**	**—**	—	—	—	—
Certificates of deposit and commercial paper	**45**	**53**	**2**	**—**	51	44	4	1
Senior unsecured – public benchmark	**14**	**46**	**40**	**—**	10	73	17	—
– privately placed	**92**	**—**	**6**	**2**	41	37	10	12
Covered bonds	**44**	**8**	**48**	**—**	48	5	46	1
Securitisation & structured issuance	**74**	**26**	**—**	**—**	77	23	—	—
Term Funding Scheme	**—**	**—**	**—**	**—**	100	—	—	—
TFSME	**100**	**—**	**—**	**—**	100	—	—	—
Subordinated liabilities	**57**	**43**	**—**	**—**	63	37	—	—
	77	**10**	**13**	**—**	63	18	19	—
Other group entities								
Securitisation & structured issuance	**—**	**—**	**—**	**—**	100	—	—	—
Total	**66**	**18**	**15**	**1**	57	24	19	—

Term issuance (audited)
In 2021, our external term issuance (sterling equivalent) was:

	Sterling	US Dollar	Euro	Other	Total 2021	Total 2020
	£bn	£bn	£bn	£bn	£bn	£bn
Downstreamed from Santander UK Group Holdings plc to Santander UK plc						
Senior unsecured – public benchmark	**—**	**2.2**	**0.6**	**—**	**2.8**	1.4
Subordinated debt and equity (inc. AT1)	**0.2**	**—**	**—**	**—**	**0.2**	—
	0.2	**2.2**	**0.6**	**—**	**3.0**	1.4
Other Santander UK plc						
Securitisations and other secured funding	**—**	**—**	**—**	**—**	**—**	—
Covered bonds	**—**	**—**	**—**	**—**	**—**	3.0
Senior unsecured – public benchmark	**—**	**—**	**—**	**—**	**—**	1.0
– privately placed	**0.1**	**—**	**—**	**—**	**0.1**	—
TFSME	**20.2**	**—**	**—**	**—**	**20.2**	11.7
	20.3	**—**	**—**	**—**	**20.3**	15.7
Other group entities						
Securitisations	**—**	**—**	**—**	**—**	**—**	—
Total gross issuances	**20.5**	**2.2**	**0.6**	**—**	**23.3**	17.1

Encumbrance

We have encumbered an asset if we have pledged or transferred it as collateral against an existing liability. This means it is no longer available to secure funding, meet our collateral needs or be sold to reduce future funding needs. Being able to pledge or transfer assets as collateral is an integral part of a financial institution's operations. The main ways we encumber assets are that we:

- Enter into securitisation, covered bonds, and repurchase agreements (including central bank programmes) to access medium and long-term funding
- Enter into short-term funding transactions. These include repurchase agreements and stock borrowing transactions as part of our operational liquidity management
- Pledge collateral as part of participating in payment and settlement systems
- Post collateral as part of derivatives activity.

We monitor our mix of secured and unsecured funding sources in our funding plan. We aim to use our available collateral efficiently to raise secured funding and to meet our other collateralised obligations.

Our biggest source of encumbrance is where we use our mortgage portfolio to raise funds through Bank of England facilities, securitisation, covered bonds or other structured borrowing. We control our levels of encumbrance from these by setting a minimum level of unencumbered assets that must be available after we factor in our future funding plans, whether we can use our assets for our future collateral needs, the impact of a possible stress and our current level of encumbrance.

Assets classified as readily available for encumbrance include cash and securities we hold in our eligible liquidity pool. They also include other unencumbered assets that give us a source of contingent liquidity. We do not rely on these extra unencumbered assets in our LRA, but we might use some of them in a time of stress. We can create liquidity by using them as collateral for secured funding or through outright sale.

Loans and advances to customers are only classified as readily available for encumbrance if they are already in a form we can use to raise funding without any other actions on our part. This includes excess collateral that is already in a secured funding structure. It also includes collateral that is pre-positioned at central banks and is available for use in secured funding.

All other loans and advances are classified as not readily available for encumbrance, however, they may still be suitable for use in secured funding structures.

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.

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. We also have a covered bond programme, under which we issue securities to investors secured by a pool of residential mortgages.

For more on how we have issued notes from our secured programmes externally and also retained them, and what we have used them for, see Notes 14 and 26 to the Consolidated Financial Statements.

On-balance sheet encumbered and unencumbered assets (audited)

	Encumbered with counterparties other than central banks					Unencumbered assets not pre-positioned with central banks				
2021	Covered bonds £m	Securitis-ations £m	Other £m	Total £m	Assets positioned at central banks[3] £m	Readily available £m	Other available assets £m	Cannot be encumbered £m	Total £m	Total assets £m
Cash and balances at central banks[1][2]	—	—	1,580	1,580	918	45,641	—	—	46,559	48,139
Financial assets at FVTPL:										
– Derivative financial instruments	—	—	—	—	—	—	—	1,681	1,681	1,681
– Other financial assets at FVTPL	—	—	—	—	—	—	—	185	185	185
Financial assets at amortised cost:										
– Loans and advances to customers	15,713	3,720	100	19,533	80,624	74,890	18,893	16,154	190,561	210,094
– Loans and advances to banks	—	—	478	478	—	—	—	691	691	1,169
– Repurchase agreements – non trading	—	—	—	—	—	—	—	12,683	12,683	12,683
– Other financial assets at amortised cost	—	—	—	—	—	506	—	—	506	506
Financial assets at FVOCI	—	—	4,363	4,363	—	1,488	—	—	1,488	5,851
Interests in other entities	—	—	—	—	—	—	—	201	201	201
Intangible assets	—	—	—	—	—	—	—	1,545	1,545	1,545
Property, plant and equipment	—	—	—	—	—	—	1,548	—	1,548	1,548
Current tax assets	—	—	—	—	—	—	—	347	347	347
Retirement benefit assets	—	—	—	—	—	—	—	1,572	1,572	1,572
Other assets	—	—	—	—	—	—	—	1,577	1,577	1,577
Total assets	15,713	3,720	6,521	25,954	81,542	122,525	20,441	36,636	261,144	287,098
2020										
Cash and balances at central banks[1][2]	—	—	985	985	854	39,411	—	—	40,265	41,250
Financial assets at FVTPL:				—						
– Derivative financial instruments	—	—	—	—	—	—	—	3,406	3,406	3,406
– Other financial assets at FVTPL	—	—	—	—	—	—	—	208	208	208
Financial assets at amortised cost:				—						
– Loans and advances to customers	23,669	7,469	184	31,322	61,292	74,758	19,801	21,577	177,428	208,750
– Loans and advances to banks	—	—	804	804	—	—	—	878	878	1,682
– Repurchase agreements – non trading	—	—	—	—	—	—	—	19,599	19,599	19,599
– Other financial assets at amortised cost	—	—	648	648	—	515	—	—	515	1,163
Financial assets at FVOCI	—	—	5,581	5,581	—	3,369	—	—	3,369	8,950
Interests in other entities	—	—	—	—	—	—	—	172	172	172
Intangible assets	—	—	—	—	—	—	—	1,646	1,646	1,646
Property, plant and equipment	—	—	—	—	—	—	1,734	—	1,734	1,734
Current tax assets	—	—	—	—	—	—	—	264	264	264
Retirement benefit assets	—	—	—	—	—	—	—	495	495	495
Other assets	—	—	—	—	—	—	—	3,013	3,013	3,013
Total assets	23,669	7,469	8,202	39,340	62,146	118,053	21,535	51,258	252,992	292,332

(1) Encumbered cash and balances at central banks include minimum cash balances we have to hold at central banks for regulatory purposes.
(2) Readily realisable cash and balances at central banks are amounts held at central banks as part of our liquidity management activities.
(3) Comprises pre-positioned assets and encumbered assets.

Capital risk

Overview

Capital risk is the risk that we do not have an adequate amount or quality of capital to meet our internal business objectives, regulatory requirements and market expectations.

In this section, we set out how we are regulated. We explain how we manage capital on a standalone basis as a subsidiary in the Banco Santander group. We then analyse our capital resources and key capital ratios including our RWAs.

Key metrics

CET1 capital ratio of 16.1% (2020: 15.4%)

Total qualifying regulatory capital of £14.8bn (2020: £15.2bn)

THE SCOPE OF OUR CAPITAL ADEQUACY

Regulatory supervision

For capital purposes, we are subject to prudential supervision by the PRA, as a UK banking group, and by the European Central Bank (ECB) as part of the Banco Santander group. The ECB supervises Banco Santander as part of the Single Supervisory Mechanism (SSM). Although we are part of the Banco Santander group, we do not have a guarantee from our ultimate parent Banco Santander SA and we operate as a standalone subsidiary. As we are part of the UK sub-group that is regulated by the PRA, we have to meet the PRA capital requirements on a standalone basis. We also have to show the PRA that we can withstand capital stress tests without the support of our parent. Reinforcing our corporate governance framework, the PRA exercises oversight through its rules and regulations on the Board and senior management appointments. Santander UK Group Holdings plc is the holding company of Santander UK plc and is the head of the Santander UK group for regulatory capital and leverage purposes. Santander UK plc is the head of the ring-fenced bank sub-group and is subject to regulatory capital and leverage rules in relation to that sub-group.

Our basis of consolidation for our capital disclosures is substantially the same as for our Consolidated Financial Statements.

CAPITAL RISK MANAGEMENT

The Board is responsible for capital management strategy and policy and ensuring that we monitor and control our capital resources within regulatory and internal limits. We manage our funding and maintain capital adequacy on a standalone basis. We operate within the capital risk framework and appetite approved by our Board. This reflects the business environment we operate in, our strategy for each material risk and the potential impact of any adverse scenarios or stresses on our capital position.

Management of capital requirements (audited)

Our capital risk appetite aims to maintain capital levels appropriate to the level of stress applied, and the expected regulatory response. In:

- An adverse economic stress, which we might expect to occur once in 20 years, the firm should remain profitable and exceed all regulatory capital minimums at all times.
- A very severe economic stress, which we might expect to occur once in 100 years, and which has been designed to test any specific weaknesses of a firm's business model, the firm should meet all regulatory capital minimums at all times. This is subject to the use of regulatory buffers designed to absorb losses in such a stress.

Management of capital resources (audited)

We use a mix of regulatory and EC ratios and limits, internal buffers and restrictions to manage our capital resources. We also take account of the costs of differing capital instruments and capital management techniques. We also use these to shape the best structure for our capital needs. We decide how to allocate our capital resources as part of our strategic planning process. We base this in part on the relative returns on capital using both EC and regulatory capital measures. We plan for severe stresses and we set out what action we would take if an extremely severe stress threatened our viability and solvency. This could include not paying dividends, selling assets, reducing our business and issuing more capital.

Risk measurement

We apply Banco Santander's approach to capital measurement and risk management for CRD IV. Santander UK plc is classified as a significant subsidiary of Banco Santander SA. For more on the CRD IV risk measurement of our exposures, see Banco Santander's Pillar 3 report. For more on our capital, see our Additional Capital and Risk Management Disclosures on www.aboutsantander.co.uk.

Key metrics

The main metrics we use to measure capital risk are CET1 capital ratio and total capital ratio. We continue to be in excess of overall capital requirements, minimum leverage requirements and minimum requirements for own funds and eligible liabilities (MREL).

Stress testing

Each year we create a capital plan, as part of our ICAAP. We share our ICAAP with the PRA. The PRA then tells us how much capital (Pillar 2A), and of what quality, it thinks we should hold on top of our Pillar 1 requirements and buffer levels. We also develop a series of economic scenarios to stress test our capital needs and confirm that we have enough regulatory capital to meet our projected and stressed capital needs and to meet our obligations as they fall due. We augment our regulatory minimum capital with internal buffers. We hold buffers to ensure we have enough time to take action against unexpected movements.

Risk mitigation

We have designed our capital risk framework, policies and procedures to ensure that we operate within our Risk Appetite. We manage capital transferability between our subsidiaries in line with our business strategy, our risk and capital management policies, and UK laws and regulations. There are no legal restrictions on us moving capital resources promptly, or repaying liabilities, between the Company and its subsidiaries except for distributions between Santander UK entities in the ring-fenced bank sub-group and Santander UK entities that are not members of the ring-fenced bank sub-group, where the PRA is required to assess the impact of proposed distribution prior to payment. For details on our Recovery framework in the event of a capital stress, see the risk mitigation section in the 'Liquidity risk' section.

At 31 December 2021, Santander UK plc (RFB), Cater Allen Limited and certain other non-regulated subsidiaries within the RFB were party to the RFB Sub-Group Capital Support Deed dated 13 November 2018. These parties were permitted by the PRA to form a core UK group as defined in the PRA Rulebook. Exposures of each of the regulated entities to other members of the core UK group were exempt from large exposure limits that would otherwise apply and intra-group exposures risk-weighted at 0% on a solo as well as consolidated basis. The purpose of the 2018 Deed was to facilitate the prompt transfer of available capital resources from, or repayment of liabilities by, the non-regulated parties to any of the regulated parties in the RFB Sub-Group in the event that one of the regulated parties breached or was at risk of breaching its capital resources or risk concentrations requirements.

A new RFB Sub-Group Capital Support Deed was entered into on 17 December 2021 and effective from 1 January 2022. This reflected the latest version of associated regulation and addition of two RFB subsidiaries including Santander ISA Managers Limited, an entity regulated by the FCA. The parties to the 2021 Deed were granted a new permission by the PRA to operate the RFB core UK group from 1 January 2022 to 31 December 2024, following expiry of the previous permission on 31 December 2021. Where applicable this also provides for intra-group exposures to be excluded from leverage exposure on a solo as well as consolidated basis.

Risk monitoring and reporting

We monitor and report regularly against our capital plan. We do this to identify any change in our business performance that might affect our capital. Each month, we also review the economic assumptions we use to create and stress test our capital plan. We do this to identify any potential reduction in our capital.

CAPITAL RISK REVIEW

Meeting evolving capital requirements

We target a CET1 management buffer of sufficient size to absorb volatility in CET1 deductions, capital supply and capital demand whilst remaining above the regulatory CET1 requirement. Distribution restrictions would be expected to be applied if we were unable to meet both our minimum requirement, which consists of the Pillar 1 minimum plus Pillar 2A, the CRD IV buffers consisting of the Capital Conservation Buffer (CCB), the Countercyclical Capital Buffer (CCyB), and the Other Systemically Important Institutions Buffer (O-SII).

Impact of IFRS 9 on regulatory capital

Our ECL methodology takes account of forward-looking data and covers a range of possible economic outcomes, and consequently provision movements may result in increased pro-cyclicality of risk-based capital and leverage ratios. However, the impact is currently mitigated by our surplus of IRB model regulatory expected losses over provisions for exposures using the IRB approach. For such exposures (which include residential mortgages) the adverse impact on CET1 capital of provision increases from reserve movements is offset by the related reduction of the negative CET1 capital adjustment for regulatory expected loss amounts. Furthermore, the UK CRR transitional rules for the capital impact of IFRS 9 mean that adverse CET1 effects from increases in ECL-based provisions from the level of such provisions at 1 January 2018 are partly reduced until the end of 2024.

We reflect projections of ECL provisions in our capital position forecasting under base case and stress scenarios for ICAAP and capital management purposes. We also consider the dynamics of ECL in how we assess, monitor and manage capital risk. A period of economic instability, such as that seen in early 2020 due to the impacts of the Covid-19 pandemic, could significantly impact our results and our financial assets. It could also impact the amount of capital we have to hold. We take into account the volatility of ECL in our capital planning strategy.

MREL recapitalisation

To date, we have down streamed £9.7bn of senior unsecured bonds from Santander UK Group Holdings plc as Internal MREL compliant, secondary non-preferential debt to Santander UK plc as the ring-fenced bank.

Key capital ratios

	2021 %	2020 %
CET1 capital ratio	**16.1**	15.4
AT1	**2.9**	2.7
Grandfathered Tier 1	**0.2**	0.4
Tier 2	**2.7**	2.7
Total capital ratio	**21.9**	21.2

The total subordination available to Santander UK plc bondholders was 21.9% (2020: 21.2%) of RWAs.

Return on assets - profit after tax divided by average total assets was 0.48% (2020: 0.16%).

2021 compared to 2020

CET1 capital ratio increased 70bps to 16.1%, largely due to lower RWAs and retained profit.

CET1 capital ratio includes a benefit of circa 20bps from the change in treatment of software assets outlined in the EBA technical standard on the prudential treatment of software assets. The PRA have outlined in Policy Statement PS17/21 on the implementation of Basel Standards that this treatment will fall away at the start of 2022 and software assets will instead be fully deducted from CET1 capital from that date.

Total capital ratio increased by 70bps to 21.9%, with lower RWA and retained profits offsetting the reduction in capital securities in issue and the increased effect from January 2021 of the CRD IV Grandfathering Cap rules that reduce the recognition of grandfathered capital instruments issued by Santander UK plc.

Regulatory capital resources (audited)

This table shows our qualifying regulatory capital:

	2021 £m	2020 £m
CET1 capital	**10,820**	11,057
AT1 capital	**2,119**	2,281
Tier 1 capital	**12,939**	13,338
Tier 2 capital	**1,816**	1,909
Total regulatory capital[1]	**14,755**	15,247

(1) Capital resources include a transitional IFRS 9 benefit at 31 December 2021 of £21m(2020: £73m).

AT1 capital

These are preference shares and innovative/hybrid Tier 1 securities. None of the instruments we issued before 1 January 2014 fully meet the CRD IV AT1 capital rules, which apply from that date. The instruments contribution to Tier 1 capital has been phased out by CRD IV rules as at the end of 2021. The £750m Fixed Rate Reset Perpetual AT1 Capital Securities (net of issuance costs), the £800m Perpetual Capital Securities and the £500m Perpetual Capital Securities we issued since then fully meet the CRD IV AT1 capital rules.

Tier 2 capital

These are fully CRD IV eligible Tier 2 instruments and grandfathered Tier 2 instruments whose recognition as capital has been phased out under CRD IV as at the end of 2021.

Risk-weighted assets

The tables below are consistent with our regulatory filings for 31 December 2021 and 31 December 2020.

	2021 £bn	2020 £bn
Total RWAs	**67.1**	71.9

Pension risk

Overview

Pension risk is the risk caused by our statutory contractual or other liabilities with respect to a pension scheme (whether set up for our employees or those of a related company or otherwise). It also refers to the risk that we will need to make payments or other contributions with respect to a pension scheme due to some other reason.

In this section, we explain how we manage and mitigate pension risk, including our investment and hedging strategies.

Key metrics

Funding Deficit at Risk was £1,190m (2020: £1,280m)

Funded defined benefit pension scheme accounting surplus was £1,572m (2020: £134m)

OUR KEY PENSION RISKS

Sources of risk

Pension risk is one of our key financial risks. Santander UK plc is the sponsor of the Santander (UK) Group Pension Scheme (the Scheme), a defined benefit scheme. Our risk is that over the long-term the Scheme's assets are not enough to meet its liabilities as they fall due. If this happens, we could have to (or choose to) make extra contributions. We might also need to hold more capital to reflect this risk.

The key pension risk factors the Scheme is exposed to are:

Key risks	Description
Interest rate risk	The risk that a decrease in (long-term) interest rates causes an increase in the value of the Scheme's liabilities that are not matched by an increase in the value of its assets.
Inflation risk	Annual pension increases are directly linked to RPI or CPI. The risk is that an increase in inflation causes an increase in the value of the Scheme's liabilities that are not matched by an increase in the value of its assets.
Longevity risk	The Scheme's liabilities are in respect of current and past employees and are expected to stretch beyond 2080 due to the long-term nature of the obligation. Therefore, the value of the Scheme's liabilities is also impacted by changes to the life expectancy of Scheme members over time.
Investment risk	The risk that the return on the Scheme's assets is insufficient to meet the liabilities.

The risk metrics and regulatory capital can be sensitive to changes in the assumptions of these key risk factors.

For more on our defined benefit schemes, see Note 30 to the Consolidated Financial Statements. This includes a sensitivity analysis of our key actuarial assumptions.

Defined contribution schemes

We also have defined contribution schemes for some of our employees. The benefits received at retirement will mainly depend on the contributions made (by both the employees and us) and the performance of the investments which are typically chosen by employees. These schemes carry far less market risk for us, although we are still exposed to operational and reputational risks. To manage these risks, we monitor the administration performance of the provider and the performance of the investment funds and the costs met by members. We ensure our employees are given enough information about their investment choices.

For more on our defined contribution schemes, see Note 30 to the Consolidated Financial Statements.

The impact of our defined benefit schemes on capital

We take account of the impact of pension risk on our capital as part of our planning and stress testing process, considering measures such as the impact on CET1 and Pillar 2A, and also where relevant the impact on the related measures such as the leverage ratio. This includes our ICAAPs, PRA stress tests and our quarterly assessment of capital requirements. We also consider the impact of any changes proposed to the Scheme or its investment strategy.

Our defined benefit pension schemes affect capital in two ways:

- We treat an IAS 19 deficit as a liability on our balance sheet. We recognise movements in a deficit through Other Comprehensive Income and so this reduces our shareholders' equity and CET1 capital. Deficit movements on the balance sheet are mainly due to re-measurements, including actuarial losses. We treat an IAS 19 surplus as an asset on our balance sheet. This increases shareholders' equity. However, it is deducted for the purposes of determining CET1 capital. An IAS 19 surplus or deficit on our balance sheet is partially offset by a deferred tax liability or asset, respectively. These may be recognised for calculating CET1 capital depending on our overall deferred tax position at that time.
- The PRA takes pension risk into account in the Pillar 2A capital assessment through the annual ICAAP exercise. The Pillar 2A requirement forms part of our overall regulatory minimum requirement for CET1 capital, Tier 1 capital and total capital. We perform a quarterly assessment internally. For more on our minimum regulatory requirements, see the 'Capital risk' section.

PENSION RISK MANAGEMENT

Scheme governance

The Scheme operates under a trust deed. Santander (UK) Group Pension Scheme Trustees Limited (the Trustee), is a wholly owned subsidiary of the Santander UK group. The Trustee ensures that the Scheme is run properly, and that members' benefits are secure. It delegates investment decisions within ranges determined in the Statement of Investment Principles to the board of Santander (CF Trustee) Limited (the CF Trustee). The CF Trustee is responsible for reviewing, agreeing and implementing investment strategies, with our input as and when needed. Every month, we discuss pension-related matters at our Pensions Committee and Pension Risk Forum. For example, our Pensions Committee reviews the Scheme's investment strategies and approves actuarial valuations. The Pension Risk Forum is a Risk division management forum that monitors our pension risk within approved risk appetite and policies. We work with the Trustee to ensure that the Scheme is adequately funded but our responsibilities are clearly segregated from the Trustee's.

Risk appetite

Our risk appetite is a key consideration in all decisions and risk management activities related to the Scheme. Our pension risk appetite is reviewed by our Pensions Committee at least once a year. It is then sent to the Board for approval. We measure pension risk on both a technical provisions (funding) basis and an accounting (IAS 19) basis. We manage pension risk on both the accounting and the funding basis. Both bases are inputs into our capital calculations.

Risk measurement

Our key risk metrics include:

Key risk metrics	Description
Funding Deficit at Risk	We use a VaR and a forward-looking stress testing framework to model the Scheme's assets and liabilities to show the potential deterioration in the current funding position. This ensures we adequately capture the risks, diversification benefits and liability matching characteristics of the obligations and investments of the Scheme. We use a time period of 1 year and a 95% confidence interval in our VaR model.
Required Return	This estimates the return required from the Scheme's assets each year to reach a pre-defined funding target by a fixed date in the future.
Pensions Volatility	We use a VaR and a forward-looking stress testing framework to model the volatility in the pension-related capital deduction. We use a time period of 1 year and a 95% confidence interval in our VaR model.

The Scheme invests in certain assets whose values are not based on market observable data, such as investments in private equity funds and property. See Note 30 to the Consolidated Financial Statements for more details. The risks of these assets are included in the metrics described above. The absence of readily observable market data can make the calibration of models to reflect the risks of these assets more challenging. As a result, data from a range of sources is sought to inform their risk profile, and the resulting assumptions used in the risk models are reviewed in detail by subject matter experts.

We perform stress tests for regulators, including for ICAAPs and PRA stress tests. The stress testing framework allows us to also consider how macroeconomic events could impact the Scheme's assets and liabilities. For more on our stress testing, see the 'Risk governance' section.

Climate change scenario analysis testing was developed in 2021, creating the capacity to simulate risk exposures in a climate stress over an extended time horizon. This capacity will be built upon in 2022, where monitoring of exposures to climate risk will be embedded into periodic reporting.

Risk mitigation

The key tools we use to maintain the above key risk metrics within appetite are:

Key tools	Description
Investment strategies	The Trustee developed the following investment objectives to reflect their principal duty to act in the best interests of the Scheme beneficiaries: – To maintain a diversified portfolio of assets of appropriate suitability, quality, security, liquidity and profitability which will generate income and capital growth to meet, together with new contributions from members and the employers, the cost of current and future benefits which the Scheme provides, as set out in the rules of the Scheme – To limit the risk that the assets fail to meet the liabilities – To invest in a manner appropriate to the nature and duration of the expected future retirement benefit payments under the Scheme – To minimise the long-term costs of the Scheme by maximising asset returns net of fees and expenses whilst reflecting the objectives above. The investment strategy is regularly reviewed. The impact of the investment strategy on Funding Deficit at Risk is considered. This assessment includes the changing impact of different forward-looking stress tests as the asset allocation evolves over time, as the profile of the Scheme evolves on the journey to lower dependence on Santander UK. Fund managers are also reviewed annually to ensure the investments remain appropriate for the Scheme.
Hedging strategies	The Trustee has a hedging strategy to reduce key market risks, mainly interest rate and inflation risk. This includes investing in suitable fixed income and inflation-linked assets and entering into interest rate and inflation hedges. The CF Trustee also hedges some of the Scheme's equity and currency risk. This is achieved by using equity put options, equity collars and other derivatives that provide downside protection. Currency hedging is used to reduce risks from investing in assets denominated in currencies other than sterling. The hedging of interest rate and inflation risk in particular reduce the Funding Deficit at Risk. As the Scheme matures, the Trustee also actively manages longevity risk through transactions such as buy-ins and longevity swaps. See 'Pension risk review' section below for more detail.
Environmental, social and governance (ESG)	The Trustee has a long-term investment horizon. It believes that an appropriate assessment of factors such as sustainable growth, environmental and climate change impacts, as well as other social and governance considerations, will help to better achieve the objectives set and improve outcomes for members and beneficiaries through enhanced long-term returns and management of arising risks in respect of the Scheme's assets. The Trustee also believes that investors who are responsible owners, and who engage, support better outcomes for the companies they invest in and ultimately enhance their investments by using their rights as shareholders influencing more sustainable corporate strategies, performance, risk management, capital structure, tax transparency and corporate governance, including culture, diversity and remuneration, potential conflicts of interest and social and environmental impact. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings. The Trustee will also monitor its supply chain for modern slavery risk.

We look at the impact on our risk metrics when determining the appropriateness of the investment and hedging strategies. We also use the impact on our risk metrics to propose changes to optimise these strategies.

Risk monitoring and reporting

We monitor pension risk each month and report on it at Pension Risk Forum, ERCC, Pensions Committee and, where thresholds are exceeded (or likely to be), to the Board Risk Committee and the Board in line with our pension risk appetite. We discuss any remedial action with the Trustee. For all key risk metrics, we determine tolerance levels for deterioration based on our risk appetite. We use different triggers to indicate our position relative to those risks and report all key risk metrics against these triggers to Pensions Committee and Pension Risk Forum each month. We consider actions to reduce risk to an acceptable level where the position looks likely to exceed the red trigger level.

In addition, we monitor the performance of third parties who support the valuation of the Scheme's assets and liabilities. The models they use are reviewed and validated by our internal model validation team and approved by the model risk committee. Every year, we carry out a full analysis of the assumptions we use which is considered by the Board Audit Committee and Pensions Committee. We ensure that we carry out consistency checks for all liability calculations supplied by third parties. We obtain audited asset values from the appointed investment manager. Independent audits are then carried out on behalf of the custodian. We also apply our own checks to make sure that the asset values provided are consistent with expectations.

PENSION RISK REVIEW

2021 compared to 2020

Interest and inflation hedging increased in 2021 as part of the long-term goal to reduce the risk of the Santander (UK) Group Pension Scheme (the Scheme). During 2021, the Scheme transacted a £5bn longevity swap that covers the majority of pensioners in the Scheme. The swap protects against the risk of the liabilities increasing because life expectancy increases by more than expected in the future. The swap was structured with a UK-regulated intermediary between the Scheme and the reinsurance provider. The value of the swap was £(8)m at 31 December 2021.

Risk monitoring and measurement

Our main focus is to ensure the Scheme achieves the right balance between risk and reward whilst minimising the impact on our capital and financial position. At 31 December 2021, the Funding Deficit at Risk decreased to £1,190m (2020: £1,280m), mainly due to interest rate and inflation hedging, partly offset by mark-to-market increases in the value of return seeking assets. Our long-term objective is to reduce the risk of the Scheme and eliminate the deficit on the funding basis. On the funding basis, the interest rate hedging ratio was 93% (2020: 81%) and the inflation hedging ratio was 94% (2020: 79%) at 31 December 2021.

We also monitor the potential impact from variations in the IAS 19 position on CET1 capital. The negative impact on CET1 capital decreased in 2021. For more on the impact of our defined benefit schemes on capital, see the 'Capital risk' section.

Accounting position

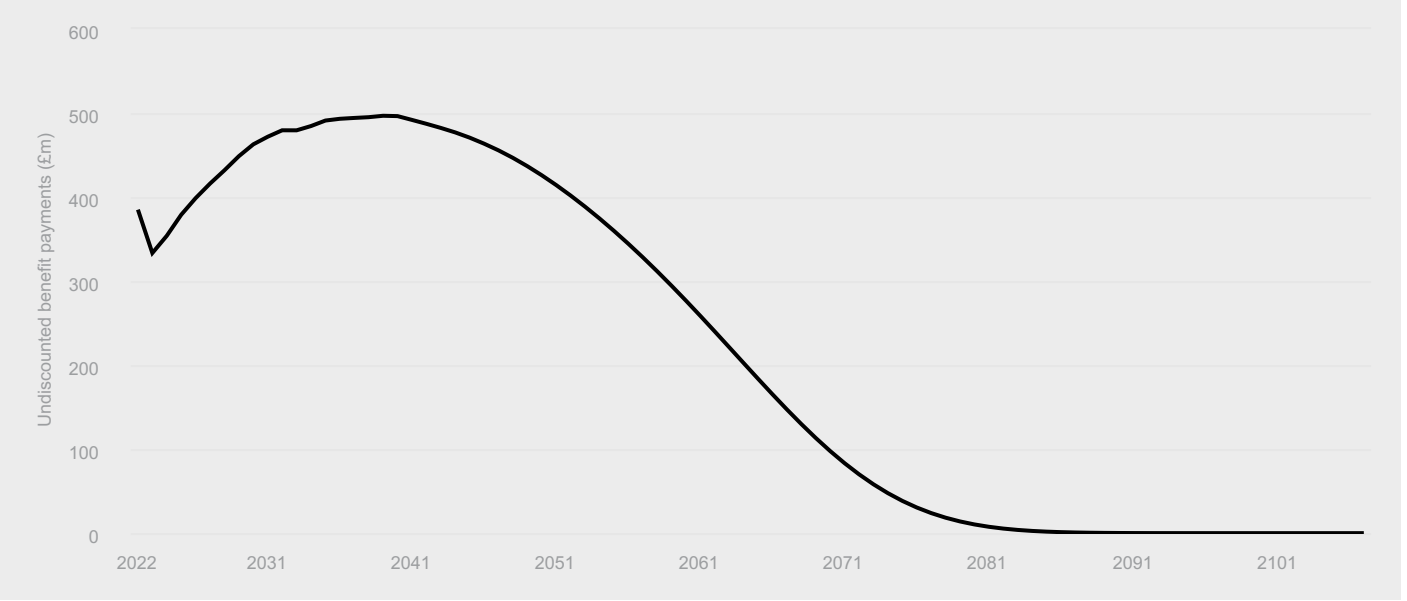
The accounting position improved over 2021. The Scheme sections in surplus had an aggregate surplus of £1,572m at 31 December 2021 (2020: £495m) while there were no sections in deficit (2020: £361m). The overall funded position was a £1,572m surplus (2020: £134m surplus). There were also unfunded liabilities of £37m at 31 December 2021 (2020: £42m). The improvement in the overall position was mainly driven by an increase in the discount rate and increases in the value of growth assets over the period.

There remains considerable market uncertainty and while the actions highlighted above mitigate some of the impact of market movements in yields, our position could change materially over a short period.

For more on our pension schemes, including the current asset allocation and our accounting assumptions, see Note 30 to the Consolidated Financial Statements.

Maturity profile of undiscounted benefit payments

The Scheme's obligation to make benefit payments extends over the long-term. This is expected to stretch beyond 2080. The graph below shows the maturity profile of the undiscounted benefit payments expected to be paid from the Scheme over its life at 31 December 2021:



Operational risk & resilience

Overview

Operational risk is the risk of loss due to inadequate or failed internal processes, people and systems, or external events. In 2021, we retitled our governing framework from 'Operational Risk Framework' to 'Operational Risk & Resilience Framework'. This was to reflect the importance of operational resilience and the intrinsically close link between the managing of operational risk and the operational resilience of the organisation.

In this section, we explain how we manage operational risk, with a focus on our top operational risks. These top operational risks may change each year depending on the relative movement in importance among all operational risks. In 2021, these consisted of Cyber, Fraud, IT, People and Third Party.

We also describe our operational risk event losses and developments in the year, and give some insight into how we fought fraud and scam.

Key metrics

Operational risk losses (over £10,000, and excluding PPI) increased by 39% compared to 2020

OUR KEY OPERATIONAL RISKS

Operational risk is inherent in our business. As a result, we aim to manage it down to as low a level as possible, rather than eliminate it entirely. Operational risk events can have a financial impact and can also affect our business objectives, customer service and regulatory obligations. These events can include product mis-selling, fraud, process failures, system downtime and damage to assets or external events.

Our top operational risks are:

Key risks	Description
Cyber	We rely extensively on the use of technology to support our customers and to run our business. This includes internal platforms, such as our core banking systems, mortgage platforms, telecommunications, remote working and finance systems, and customer-facing platforms such as our mobile app and online banking websites. The use of technology and the internet have changed the way we live and work, and the Covid-19 pandemic has further evidenced the reliance on technology. While technology allows us to develop and improve the way we serve our customers, it is critically important that we protect our customers' information and provide them with a secure environment in which to deal with us, especially when the threat from cyber criminals is so prevalent and more sophisticated than ever. Failure to protect the information assets of Santander UK and its customers against theft, damage or destruction from cyber-attacks could cause operational disruption, unauthorised access, loss or misuse of personal or confidential or proprietary information, breach of regulations, negative customer outcomes, financial loss or reputational damage. Even small periods of disruption that deny access to our services can erode our customers' trust in us. This applies not only to our own systems but also to those of our third-party providers and counterparties in the market. The value of the data itself, especially the personal details of customers and employees, has increased considerably and is a core focus of cyber criminals along with systems, such as payments and ATM networks, that enable the monetisation of cyber-attacks and breaches. It is therefore critical that we are resilient to cyber-attacks and can quickly recover from those events should they occur.
Fraud	Fraud can be committed by first parties (our customers), second parties (people known to our customers or us), third parties (people unknown to our customers or us), and internally by our staff. We are responding to the wider fraud ecosystem threats with a holistic review of our detection controls, an enhanced focus on preventative methodology and a review of our organisational model. We are committed to protecting ourselves and our customers from fraud and to mitigating our fraud risk in an ever-evolving external fraud environment.
IT	As noted in Cyber above, technology is vital to our processes and operations, and in providing service to our customers. IT risk arises from any event related to the use of technology supporting business processes, where the event may result in the unavailability or failure of systems or in processing errors that impact our customers or operations. This includes hardware or software failures, or issues caused by change.
People	People risks include all risks related to employees and third parties working for us, covering resource management, health, safety and wellbeing and employee relations. These have collectively increased in significance to become a top risk for the bank driven primarily by the Covid-19 pandemic and the new ways of working that have evolved during the pandemic. The majority of non-branch employees have continued to work from home since restrictions have been lifted and we are encouraging colleagues to gradually return to the office for part of the week. Ergonomic risk remains a key People risk for those not permanently site based who are working from home and / or office locations at the current time. In addition, as the bank transforms itself, the significant level of organisational change may cause disruption for employees. As we develop our working practices and adapt to changing circumstances, people impacts and risks continue to be key considerations.
Third party	We rely extensively on third parties, both within the Banco Santander group and outside of it, for a range of services and goods. These include outsourced services, such as IT infrastructure including increasing use of the Cloud, software development and banking operations. Regulations require us to classify other legal entities in the Banco Santander group as external suppliers, so we manage them as third parties. Third party risk is a key operational risk for us due to increased outsourcing in 2021 and our strategic intent to increase the use of the Cloud. Many suppliers are also shared across the sector and this could increase risk due to complexity and capacity issues at the third parties. The failure of a supplier may cause operational disruption, breach of data security or regulations, negative customer impact, financial loss or reputational damage.

We are also exposed to tax risk which, even though it is a lower risk for us, is still a high-profile risk and may include legacy items. We define tax risk as the risk that we fail to comply with domestic and international tax regulations because we misinterpret legislation, regulations or guidance, or we report to the tax authorities inaccurately or late. This could lead to financial penalties, additional tax charges or reputational damage. Santander UK adopted the Code of Practice on Taxation for Banks in 2010. For more on this, see our Taxation Strategy at www.santander.co.uk/about-santander/investor-relations/taxation-strategy.

In March 2021, UK regulators issued policy and supervisory statements outlining the requirements for operational resilience to be complied with by 2025. Our operational resilience programme is working towards a primary deadline of 31 March 2022 for consolidation of the operational resilience self-assessment. To achieve this objective, we must have: 1) Identified our Important Business Services (IBS); 2) Mapped underlying assets which support these IBS; 3) Set Impact Tolerances to identify the point at which intolerable harm is caused to customers, us, or the market in the event of an outage; 4) Commenced scenario testing of our ability to recover within the agreed Impact Tolerances; 5) Identified and documented resilience vulnerabilities and action plans to remediate them; and 6) Consolidated a resilience self-assessment to be provided to the regulators on request. The Board are actively engaged in this work and will be required to approve the self-assessment. Through our participation in industry collaboration groups and with support from UK Finance we continue to validate the consistency of our approach against our peers whilst, in parallel, contributing to industry best practice. In order to sustain our operational resilience capabilities, both a new target operating model and focused investment will enable us to operate through disruption.

To support the transition to a low carbon economy and minimise the environmental impact of our energy use, we are committed to continual improvement in the energy performance of our property operations. We maintain ISO 50001 energy management systems in all head office buildings, and we set annual energy reduction targets to drive improvement in energy performance. Our Operational Risk & Resilience Framework requires that all business units consider the impact of risks related to climate change in their risk management processes.

OPERATIONAL RISK MANAGEMENT

Risk appetite

We set our operational risk appetite at a Santander UK group level and we express it through measures approved by the Board. These include risk statements and metrics set against our main non-financial risk loss event types. We cascade our appetite across our business areas by setting out clear lower level triggers, qualitative parameters and quantitative thresholds. We monitor our risk profile and performance against the risk appetite under several principal risk areas, and we have processes to enable us to identify, manage and escalate risks and events. Our governance requires us to mitigate or accept all identified risks.

Coverage across the seven CRD IV loss event types is comprehensive and aligns to the principal risk areas approved by ERCC. As a result, we have specific embedded monitoring and measurement of our operational risks, including our top operational risk types which are as follows:

- **Cyber:** We have a comprehensive set of Risk Appetite statements and metrics agreed by the Board, which allow us to measure our cyber risk. We have defined statements and metrics with key subject matter experts in our Cyber and IT teams, and we incorporate Banco Santander group principles and standards, regulatory requirements and industry best practice, where applicable.
- **Fraud:** Revised fraud Risk Appetite statements were approved by the Board in 2021. New and more comprehensive metrics to allow us to measure performance against risk appetite are being produced as part of our Fraud Transformation program.
- **IT:** We have a set of Risk Appetite statements and metrics that have been agreed by the Board, measuring the risk, performance and control of technology. These statements and metrics incorporate Banco Santander group principles and standards. Specific actions are raised to address key risks and escalated as required.
- **People:** We have people-related Risk Appetite statements and metrics agreed by the Board. These were broadened and refreshed in 2021 to enhance how we measure our people risk, including the well-being of our employees, and to inform employee relations and engagement. We employ subject matter experts in our HR function to help us to monitor and manage our people risk. Formal actions are required to address and mitigate any measures which are reported out of tolerance. We communicate, action, and escalate, as needed, any material issues to the Board.
- **Third party:** We have a comprehensive set of Risk Appetite statements and metrics agreed by the Board, which allow us to measure our third party risk. We have defined statements and metrics with key subject matter experts in our Third Party Risk Management and Procurement teams. We incorporate Banco Santander group principles and standards, regulatory requirements and industry best practice, where applicable.

Risk measurement and mitigation

The key components of the operational risk toolset we use to measure and mitigate risk are:

Operational risk toolset	Description
Operational risk and control assessments	Our business units identify and assess their operational risks to ensure they manage and control them within our operational risk appetite. They also ensure that we prioritise any actions needed. Every area has to identify their risks, assess their controls for adequacy and then accept the risk or formulate a plan to address any deficiencies. We also use operational risk assessments and project risk rating tools as essential elements of our change risk management.
Risk scenario analysis	We perform this across business units. It involves a top down assessment of our most significant operational risks. We have a set of scenarios that we review and update each year. The analysis gives us insight into rare but high impact events. It also allows us to better understand the potential impacts and to address any issues.
Key indicators	Key indicators and their tolerance levels give us an objective view of the degree of risk exposure or the strength of a control at any point in time. They also show trends over time and give us early warning of potential increasing risk exposures. Of primary importance are business-wide risk appetite indicators which measure our adherence to our defined risk appetite statements.
Operational risk losses	Our operational risk loss appetite sets the level of total operational risk loss (expected and unexpected) in any given year (on a 12-month rolling basis) that we consider to be acceptable. We track actual losses against our appetite, and we escalate as needed.
Operational risk event management	Operational risk events occur when our controls do not operate as we planned and this leads to customer impact, financial loss, regulatory impacts and/or damage to our reputation. We have processes to capture and analyse loss events. We use data from these processes to identify and correct any control weaknesses. We also use root cause analysis to identify emerging themes, to prevent or reduce the impacts of recurrence and to support risk and control assessments, scenario analysis and risk reporting.
Risk based insurance	Where appropriate, we use insurance to complement other risk mitigation measures.

We mitigate our key operational risks in the following ways:

Key risks	Risk mitigation
Cyber	Protecting our customers, systems and data remains a top priority for us. Online security and data breach stories, along with many reports of scams and online fraud, continue to feature in the press. All organisations, including banks, are in an ongoing race to keep ahead of criminals who are becoming ever more sophisticated and destructive in their approach. Criminals persist in attempts to deny our customers access to our digital channels, target online services and data, or steal online credentials and appropriate funds by various methods, including social engineering. We continue to enhance our resilience to cyber disruption as our Security and Information Technology teams continually identify, assess and monitor cyber security risks. We assess Cyber control maturity and associated risks each quarter using Banco Santander's Holistic Cyber Risk Framework. We measure the maturity of our controls in terms of their design and operating effectiveness and when combined with our cyber threat intelligence, we use it to define and prioritise our programmes of mitigation. We have processes and tools to capture and analyse events from our security systems that drive escalation processes as needed. We operate a layered defence approach to cyber risk which we test and assess continually to ensure that it addresses the prevailing threats. Our comprehensive approach to validating our controls includes tests designed to replicate real-world cyber-attacks with test findings driving our ongoing improvement plans. Security is a business risk, rather than a technological risk. Therefore, keeping our systems secure is a bank-wide responsibility and we continue to enhance our training programmes for employees to support this. We have Board-level expertise and supervision in cyber security matters to ensure robust monitoring and challenge. We also have targeted training for Board members and senior management and other employees who may be singled out by criminals, such as those facilitating payments. Continuous cyber security training ensures that everyone understands the threats we face, and that we all have the expertise to spot emails from criminals and attacks on our systems. We continue to work with other banks as members of the Cyber Defence Alliance, where we share intelligence on cyber threats and effective strategies to counter them. We campaign to raise awareness and give customers the knowledge they need to avoid becoming victims of fraud. We use robust technology processes, and training to protect our customers, and we continually invest our efforts to counter scams and fraud. As part of this, we run customer education campaigns, and we offer advice through our online security centre. We are highly vigilant at all times. We have a cyber insurance policy to provide us with comprehensive cover to respond and recover losses and damages arising from security or system failures and any impact of a data breach. Analysis of our security posture drives an ongoing discussion about cyber risks across the business. This includes individual business areas who must include cyber risk when they make business continuity decisions. We also use maturity assessments and both internal and external threat analyses. Our cyber security experts assess our overall security posture and make recommendations to both management and risk fora on a monthly basis, with onward reporting to the Executive Committee, ERCC, BRC and Board at least twice a year.
Fraud	Protecting our customers from fraud remains a key priority for us. Given the current UK fraud environment, we see the ever-present threat of increasing fraud attack. We have seen significant shifts towards social engineering fraud, where traditional controls (such as strong identification protocols) are less effective. We operate layered security controls combining prevention and detection controls, to best mitigate risks. The current fraud environment is incredibly challenging, and as such our current Fraud Transformation program contains several projects that are designed to enable us to reduce the risk impacts to us and our customers. We are committed to taking a more preventative approach to mitigate these risks. To help support customers, over the past five years we have created a series of fraud education and media campaigns, many of which focus on drawing public attention to our most common fraud types, such as online fraud avoidance lessons, purchase scams, investment fraud, and money mules. Two of these campaigns have won industry awards in the last 12 months.
IT	We proactively monitor technology platforms and applications through automated alerts to detect events that may impact their performance or availability. Any material event is investigated to understand the root cause and to identify remedial actions to ensure that the event is not repeated. We escalate these events as required through the Santander Early Escalation Notification (SEEN) Process, and we review them each quarter to identify any trends we need to remediate. We assess IT risk each year as part of the Risk and Control Self-Assessment (RCSA) process where risks are identified and assessed by the business units and are then subject to a review and challenge process from the relevant SMEs. This risk posture is then reviewed monthly to understand if there have been any events that would require an update to the risk profile.
People	We mitigate the People risks associated with remote working using virtual meeting tools and keeping-in-touch schemes. We also provide regular communications and other support. We are encouraging colleagues to gradually return to the office for part of the week and we are mitigating ergonomic risks through Occupational Health Service support and assessments for individuals where appropriate. Our Wellbeing Hub continues to offer support to employees and people managers on targeted support interventions to tackle longer-term impacts on psychological wellbeing due to the Covid-19 pandemic. We use operational risk indicators to track and monitor all people related measures. All significant people-related change initiatives must have Operational Risk Assessments conducted. We also have processes to capture and assess people-related events.
Third party	We identify and assess the inherent risk profile of each of our third party arrangements before onboarding and then continue to measure this throughout the relationship. The assessed level of inherent risk drives the level of governance we put in place to manage the arrangement – the higher the inherent risk profile, the greater the governance. We also identify and measure key third party risks, and the related control environment, within our operational risk and control assessments, as part of business as usual activities and related change initiatives. We have processes to capture and assess related events, as well as operational risk indicators to measure the ongoing third party risk profile of the business. We place emphasis on a carefully controlled and managed Third Party Supplier Risk Framework and are enhancing our operating model in this area in order to manage this risk. We aim to ensure that those with whom we do business meet our risk and control standards across the life of our relationship with them: **On-boarding:** We ensure that all third-party suppliers meet our needs in terms of capacity and supply before entering into any agreement with them to mitigate the risks inherent to the process, function or activity they may provide. We also make sure that each third-party provider meets minimum conditions we require in legal, compliance, financial crime and technical terms and analyse their short and medium term economic viability. **In-service management:** We monitor and manage our ongoing supplier relationships to ensure our standards and contracted service performance continue to be met and undertake Service Review Meetings to ensure adequate supervision of the third-party services. **Off-boarding and exit management:** Where we decide to exit a third-party arrangement, we aim to exit without undue disruption or adverse impact on their compliance with the regulatory framework and without detriment to the continuity and quality of services provided to customers.

Risk monitoring and reporting

Reporting is a key part of how we manage risk. It ensures we identify, escalate and manage issues on a timely basis. We can identify exposures through our operational risk and control assessments, risk scenario analysis, key indicators, operational risk assessments and incidents and events. We report exposures for each business unit through regular risk and control reports. These include details of risk exposures and how we plan to mitigate them. We prioritise and highlight events that have a material impact on our customers, reputation or finance by reporting them to key executives and committees.

We use The Standardised Approach (TSA) for Pillar 1 operational risk capital needs. We use an internal model aligned to the CRD IV advanced measurement approach to assess our Pillar 2 capital needs.

We have a crisis management framework that covers all levels of the business. This includes the Board, Executive Committee, senior management and business and support functions. Our framework identifies possible trigger events and sets out how we will manage a crisis or major incident and we test it at least annually. If an event occurs, we have business continuity plans in place to recover as quickly as possible and we undertake post incident reviews to ensure any learnings are taken forward.

Cyber

We base our monitoring and reporting on the metrics and operational dashboards in our cyber security and IT functions. Our Cyber Threat Unit and experts carry out analysis in the Santander Global Security Operations Centre in Madrid. We use a wide range of key risk indicators, threat intelligence reports and results from security testing to identify improvements to our cyber defences. Our operational teams, with input from Risk, review these trends and steer management activity where required.

We also formally track our cyber and technological risks against our risk appetite through a monthly risk control forum. Part of the forum's remit is to identify changes in risk posture and to inform senior risk committees of any significant changes. Issues such as technological obsolescence and the challenges in keeping our technologies protected from known vulnerabilities are examples of where a metric-driven approach to reporting through our risk management frameworks has led to proactive mitigation of risk.

Fraud

We base our monitoring and reporting on the overall fraud performance metrics (case types, volumes, operational losses). Fraud performance is tracked through a monthly risk control forum, which is part of a revised fraud governance structure which has been created over the last 12 months. In a fast-paced environment, it is essential we see shifts in criminal behaviour quickly, and our fraud strategy team react swiftly to attacks and changes of fraud methodology through detailed reviews of fraud cases and typologies, and by monitoring trends and data. The current fraud methodologies which cause most concern are those where our systems and processes are not sufficient to prevent the fraud. The Fraud Transformation in the Digital Accelerator projects will deliver technical changes to mitigate these ever-changing threats.

IT

In common with cyber risk, we base our monitoring of IT risk on the metrics and dashboards produced by the Technology teams. These are reviewed in the monthly risk control forum where changes to the risks profile are discussed. These metrics cover IT incidents and technological obsolescence as well as top IT risks for the different business units. In addition updates on significant changes and programmes and their impact on the risk profile are reviewed.

People

We formally track our People risk profile against our risk appetite through our monthly HR & People Risk and Control Forum and other risk governance fora. We use key risk indicators to support our monitoring activity and we report them to this Forum. We escalate any significant risks, or changes in the risk profile, to the relevant senior risk committees and the Board where appropriate. We report a monthly view of People risk in terms of sickness absence, wellbeing and attrition. We use the results of regular wellbeing surveys to help drive our areas of People focus.

Third party

We formally track our Third party risk profile against our risk appetite through our monthly Third Party Risk and Supplier Forum and other risk governance fora. We use key risk indicators to support our monitoring activity and we report them to this Forum. We escalate any significant risks, or changes in the risk profile, to the relevant senior risk committees and the Board where appropriate.

OPERATIONAL RISK REVIEW

2021 compared to 2020

Operational risk event losses

The table below shows our operational losses in 2021 and 2020 for reportable events with an impact over £10,000, excluding conduct risk events (which we discuss separately in the 'Conduct and regulatory risk' section), by CRD IV loss event types. We manage some of these risks using frameworks for other risk types, including regulatory and financial crime risk even though we report them here.

	2021		2020	
	Value %	Volume %	Value %	Volume %
Internal fraud	—	—	1	—
External fraud	30	89	58	89
Employment practices and workplace safety	—	2	1	1
Clients, products, and business practices	41	—	34	3
Business disruption and systems failures	14	1	1	—
Execution, delivery, and process management	15	8	5	7
	100	100	100	100

Operational risk losses increased during 2021 partly due to an 8% increase in fraud losses, in line with the general trends across the industry. This was driven by a 46% increase in fraud cases, including Authorised Push Payment fraud. In addition, the rise in losses also reflects the IT remediation costs following the outage in May 2021 and provisions relating to operational incidents and conduct related issues.

People

We continue to treat the wellbeing and safety of our colleagues as one of our top priorities. People risk is compounded by changes in operating models and the execution of future strategies, which we recognise need to be managed carefully. We will continue to adapt and allow for these factors, along with the potential impact on productivity with our overall wellbeing and inclusion strategy centred around supporting colleagues through change and transformation. As we adapt to new ways of working, we will continue to focus targeted support interventions to tackle longer-term impacts on psychological wellbeing promoted by the Covid-19 pandemic. In line with our peers, we are beginning to see an increase in levels of attrition reflecting a more buoyant employment market with cyber, digital and IT SMEs being in demand. We are encouraging colleagues to return to central office environments, whilst paying regard to prevailing government advice. In addition, we managed the potential risk associated with the flu season by again offering flu vaccinations to all our colleagues during Q4 2021.

Cyber

Information and cyber security remain a top risk and a priority. We experienced no notable information and cyber security incidents in 2021. Externally, we have observed a large increase in ransomware attacks across all sectors driven by supply chain tools compromises and we expect this trend to continue. As a result, we are continuing to review and enhance our controls based on the latest intelligence. We also actively work with peers in the Cyber Defence Alliance to share threat intelligence, expertise, and experience to help identify common features of cyber-attacks and effective mitigation strategies.

We also continue to invest to maintain the right skills and resources to manage information and cyber security risk effectively across all our lines of defence.

Systems outage

We experienced a systems outage on 15 May 2021, following a routine software update. The outage impacted a number of services, including online and mobile banking, cards and ATM services, along with branches and contact centres. Customer servicing technologies were fully recovered by 23:30 on 15 May 2021 and contact centre technologies were re-enabled by 01:00 on 16 May 2021. During the outage, customers were able to obtain cash over our branch counters and through other banks' ATMs. They were also able to obtain cashback within their limits and use their credit cards, with Visa and Mastercard credit cards remaining available throughout the incident.

Duplicate payment issue

On 25 December 2021 a system scheduling issue cased the duplication of £130m of payments. These have largely been recovered with non-material amounts outstanding. Our people worked hard across the holiday period to ensure that nobody was left out of pocket, but it confirmed that improving our IT infrastructure is a key aspect of our ongoing transformation programme and one that we will remain utterly focused on.

Fraud

Fraud against our customers and the bank remains a top risk and a priority. Fraud levels across all banks in the UK increased significantly in 2021, with fraudsters using different techniques to take advantage of customers through a range of fraud attacks and scams. In line with industry, the most prevalent fraud type we face is Authorised Push Payment (APP) fraud, which accounted for approximately 30% of our total fraud losses for 2021. In response to this, we have increased our fraud messaging and scam education to assist our customers, are designing new fraud prevention tools and have continued to build on existing controls to address fraud attacks.

We continue to strengthen our own capabilities in terms of fraud prevention, being the first bank to deploy dynamic 'scam warnings' in our online banking payment process, to prevent customers falling victim to purchase and investment scams. These enhance the fraud prevention controls for high risk digital payments and mean the customer is presented with a number of questions and warnings in their payment journey, tailored to their specific circumstances. We continue to manage cases of APP Fraud under the Contingent Reimbursement Model (CRM) Code, which is overseen by the Lending Standards Board.

We play an active role in the collaboration work on fraud management with our industry partners, through UK Finance and our membership of Stop Scams UK. We have an ongoing programme of customer awareness campaigns, which cover the most common fraud and scam types encountered by our customers, including remote access fraud, investment scams, safe account scams and cold calls. We have continued to run virtual fraud awareness sessions to provide information to our customers and communities on how they can protect themselves from fraud and scams. In July 2021, we ran a media relations campaign, Push Off Politely, to raise awareness of how to handle suspicious phone calls with a very simple message to hang up the phone. In November 2021, the national press published a piece on our Break the Spell team. This demonstrated the work some of our colleagues are delivering to tackle social engineering and protect our customers from fraud.

IBOR transition

We are on track to meet industry and regulatory deadlines. We are continuing with the transformation of key systems and processes to deal with the new risk-free rates. Some challenges remain, in particular for products with cross-currency dimensions, different responses across jurisdictions will need multi-stage transitions. We still await regulator's guidelines regarding 'Tough Legacy', where a transition path cannot be agreed with the customer. For quantitative information, see Note 42 to the Consolidated Financial Statements.

IT

The importance of IT has been reiterated by a few outages to customer services in the year. As a result, we have initiated a wide programme to address the root causes and further reduce key risks within our IT estate. The programme is expected to deliver risk reduction over a three year horizon and progress is closely monitored though our comprehensive risk governance.

Data management

In 2021 we continued to monitor data management risk through the enhanced governance structures and processes put in place by our Chief Data Officer. A Data Programme has been established with clear deliverables defined that will improve our ability to manage data and to improve our data management capabilities in line with our approved Data Strategy.

Operational resilience

In March 2021 the Bank of England, PRA and FCA issued policy and supervisory statements outlining operational resilience requirements. The UK regulators expect financial services institutions under the scope of the regulation to assume disruptive operational incidents will occur, and to be able to show that they can withstand, absorb, recover and manage these in a way which considers the needs of all affected parties. All firms are to implement enhancements to address identified resilience gaps by 2025.

Our operational resilience programme is on track to meet the regulators' primary deadline of 31 March 2022 to prepare and consolidate the first operational resilience self-assessment. To achieve this objective, during 2021 we have: 1) identified our Important Business Services (IBS); 2) mapped underlying assets which support these IBS; 3) set impact tolerances to identify the point at which intolerable harm is caused to customers, the firm, or the market in the event of an outage; 4) scenario tested our ability to recover within the agreed impact tolerances; 5) identified and documented resilience vulnerabilities; and we are 6) developing action plans to remediate vulnerabilities; and 7) consolidating a resilience self-assessment to be provided to the regulators on request.

The Board are actively engaged in the operational resilience journey and will approve the self-assessment in Q1 2022. Through our participation in industry collaboration groups, and with support from UK Finance, we continue to validate the consistency of our approach against our peers while contributing to industry best practice in parallel. To sustain our operational resilience capabilities, both a new target operating model and focused investment will enable us to deliver operations through disruptions.

We continue to improve our operational resilience through our management of incidents including root cause analysis. Our combined Operational Risk & Resilience Framework and its supporting tools are now focused around the bank's IBS, having stress tested our ability to remain within Impact Tolerances and maintain the IBS under severe but plausible scenarios. Any operational resilience vulnerabilities identified will be escalated to the Board and proactively actioned. In addition to regulatory compliance, this will achieve business and operational benefits designed to embed operational resilience in our Digital Transformation programme as well as day-to-day activities.

Third parties

We continue to rely extensively on third parties, both within the Banco Santander group and outside of it, for a range of services and goods. These include outsourced services, such as IT infrastructure including increasing use of the Cloud, software development and banking operations. Regulatory requirements relating to the management of our outsourced services continue to increase, with the PRA publishing their Supervisory Statement on Outsourcing and Third Party Risk Management in March 2021. These require us to use certain internal governance arrangements, including sound risk management, whenever we outsource functions. These also complement the above-mentioned requirements and expectations on operational resilience, including the management of third parties relating to our Important Business Services. We are progressing with a programme of work to review and enhance our governance arrangements ahead of the 31 March 2022 implementation deadline.

Climate related risks

In order to address the requirements in the Supervisory Statement issued in March 2019, which describes the PRA expectations for banks to manage the financial risks of climate related risks, we produced a 2021 Implementation plan. As part of this plan, we undertook three main activities. We considered climate change in our Operational Risk Scenario Programme and in our Risk & Control Assessments. We conducted a physical climate change risk assessment of our head offices, branches and data centres.

Conduct and regulatory risk

Overview

We manage the conduct and non-financial regulatory risk types in one framework. We do this to reflect their similarities.

Conduct risk is the risk that our decisions and behaviours lead to a detriment or poor outcome for our customers. It also refers to the risk that we fail to maintain high standards of market behaviour and integrity.

Regulatory risk is the risk of financial or reputational loss, or imposition of or conditions on regulatory permission, as a result of failing to comply with applicable codes, regulator's rules, guidance and regulatory expectations.

We are committed to ensuring conduct strategy is embedded in our business and that the fair treatment of our customers is at the heart of what we do.

In this section, we explain how we manage conduct and regulatory risk and highlight new processes we implemented in response to Covid-19. We also describe our main conduct and regulatory provisions, and give some insight into our work to protect vulnerable consumers via our Customer Support feature in 2021.

Key metrics

Customer remediation provision was £44m (2020: £69m)

Litigation and other regulatory provision was £166m (2020: £198m)

OUR KEY CONDUCT AND REGULATORY RISKS

Our purpose is to help customers and businesses prosper. To achieve this, we are committed to making sure that our strategy, proposition and initiative approval process, and systems, operations and controls are well designed and delivered.

We see our key exposure to conduct and regulatory risk through:

- the risk of errors in our product design, sales practices, post-sale servicing, operational processes, complaint handling, and
- failure to supervise, monitor and control the activities of our employees.

All of these may result in the risk that we do not meet our customers' needs, align to the expectations of our regulators or deliver the expected outcomes or observe required standards of market behaviour.

Our Conduct and Regulatory Framework is built on the following underlying types of risk:

Key risks	Description
Regulatory	The risk that we fail to adhere to relevant laws, regulations and codes which could have serious financial, reputational and customer impacts. This includes the risk that we may be adversely impacted by changes and related uncertainty around UK and international regulations. We categorise regulatory risk into financial and non-financial risk. This is aligned to our main regulators who are the PRA and FCA but also includes other regulators and authorities such as the CMA, Payment Systems Regulator, Lending Standards Board, Financial Ombudsman Service and Information Commissioner's Office. As well as being subject to UK regulation, as part of the Banco Santander group, we are impacted indirectly through regulation by the Banco de España (the Bank of Spain) and, at a corporate level, by the ECB through the SSM. We also fall within the scope of US regulation, including the Dodd-Frank Wall Street Reform and Consumer Protection Act. We must also adhere to the rules and guidance of other regulators and voluntary codes in the UK.
Product	The risk that we offer products and services that do not result in the right outcomes for our customers.
Sales	The risk that we sell products and services to our customers without giving them enough information to make an informed decision or we do not provide correct advice.
After-sale and servicing	The risk that failures of our operations, processes, servicing activity, IT or controls result in poor outcomes for our customers. This includes the risks that: – We do not give appropriate after-sale communications to customers, making it difficult for them to contact us, or we fail to take account of a customer's vulnerability – We do not have robust systems and controls to detect and prevent fraud or errors in the customer experience.
Culture	The risk that we do not maintain a culture that encourages the right behaviours and puts the customer at the heart of what we do.
Competition	The risk of financial harm, criminal liability, customer harm or reputational damage that we may incur because we fail to comply with relevant competition law or being involved in any competition law investigation or proceedings.
Controls	The risk that we do not supervise and monitor our employees effectively or do not have robust systems and controls in place to prevent and detect misconduct.

CONDUCT AND REGULATORY RISK MANAGEMENT

Risk appetite

We aim to comply with all regulatory requirements, and we have no appetite to make decisions or operate in a way that leads to unfair outcomes for our customers or negatively impacts the market. Our Board approves our risk appetite on an annual basis, or more often if needed, and we cascade it to our business units through our risk framework and policies. We also have lower level risk tolerance thresholds that are agreed at least annually. Our material conduct and regulatory risk exposures are subject to, and reported against, our conduct and regulatory risk appetite statements, as well as lower level triggers and thresholds for action.

Risk measurement

Due to the close links between our conduct, regulatory and operational risk frameworks, our tools to identify, assess, manage and report operational risks also apply where such exposures and risks have a conduct and/or regulatory risk impact. We continue to monitor the position in relation to Covid-19, with particular focus on customers rolling off support schemes and payment holidays, to ensure that appropriate outcomes are provided and regulatory expectations are met.

We support our conduct and regulatory risk framework and policies with tools that aim to identify and assess new and emerging conduct risks. These include:

Key tools	Description
Strategy and business planning	Our Strategy and Corporate Development team help align our overall corporate strategy, financial plans, risk appetite and operational capabilities through our annual process to set our strategy. We derive our business unit plans from our overall corporate strategy and they contain a view of conduct and regulatory risk with our other key risk types.
Sales quality assurance	We subject retail sales and processes to internal quality assurance and, as needed, external monitoring to ensure their quality.
Operational risk and control assessments	Our business and business support units assess our operational risks, systems and controls to give us a consolidated risk view across all our business areas. We complete the assessments through a central tool to evaluate and manage our residual risk exposures.
Scenario testing and horizon scanning	We consider conduct and regulatory risk in our scenario testing. This reviews possible root causes and assumptions to determine the likelihood and size of the impact, and actions to enhance our controls where required.
Conduct risk reporting	We use dashboards to give us an end-to-end view of our conduct risks across our business. This allows us to apply a lens to manage conduct risk and understand if it is in line with our risk appetite.
Compliance monitoring	We carry out an annual conduct and regulatory risk assurance programme approved by the Board and tracked through the year.

Risk mitigation

Our conduct and regulatory risk framework and policies set out the principles, standards, roles and responsibilities and governance for conduct and regulatory risk, such as:

Policies	Description
Product approval	Our product approval process aims to minimise our conduct, legal, regulatory or reputational risks in the design, marketing, sales and service of new products and services. We assess all our products and services within a formal framework to ensure they meet the needs and expectations of our customers, are within our risk appetite and agreed metrics, and to ensure that processes and controls are in place.
Suitable advice for customers	We give guidance to advisers and staff on the key principles, requirements and ethical behaviours they must follow. This ensures our customers are sufficiently informed when they make a buying decision. In our Retail Banking and Consumer Finance divisions, the main products we cover are current accounts, mortgages, investments, savings and protection. In our Corporate & Commercial Banking division, we cover current accounts, deposits, business loans, invoice and structure finance, working capital and trade finance.
Training and competence	In line with the expectations of our regulators, we train our staff and require them to maintain an appropriate level of competence (in line with their role and responsibilities) to ensure customers achieve fair outcomes. We invest in all our people to ensure that we achieve our mandatory risk objectives and that everyone acknowledges their personal responsibility to manage risk through our I AM Risk approach. We place a specific focus on: – **Vulnerability:** We ensure our colleagues are trained to help customers who may be vulnerable (see below). – **Financial abuse:** We work closely with other members of UK Finance, as part of the Financial Abuse Working Party, with a shared vision to help victims regain control of their finances. Through this collaboration we have adopted a Financial Abuse Code of Practice as part of our overall vulnerable customer strategy. We have specific training material for colleagues to raise awareness and improve understanding around the devastating impacts of financial abuse and how we can help. Due to the very complex nature of situations involving financial abuse, we also have a dedicated Specialist Support Team that offers guidance to colleagues dealing with customers who are victims and need tailored solutions to help them regain control of their finances. – **Covid-19:** We designed and delivered tailored training across key areas of the business to support customers affected by Covid-19. We have increased our resource and enhanced our tools to deal with high levels of customer contact.
Treating vulnerable customers fairly	Some customers may be impacted financially or personally as a result of their circumstances. Our Vulnerable Customer Policy gives business areas a clear and consistent understanding of what vulnerability can mean and the types of situations when customers may need more support. Our guidelines focus on identifying vulnerable customers, and the support we can give to help them avoid financial difficulty. We work with key charities, authorities, trade associations and other specialists to develop our understanding of vulnerability. In addition to mandatory training, we train our customer-facing colleagues using real customer scenarios to highlight different vulnerable situations. This enables our colleagues to deal with a wide range of sensitive issues. We also have an online Vulnerable Customer Support Tool for our colleagues to give them more guidance and support. Our colleagues have access to our Specialist Support Team who can give specific help and guidance for the most complex vulnerable customer situations. We consider vulnerability in every initiative. Adapting our technology to the needs of customers with physical disabilities is a key part of our design and testing stages and we work closely with the Digital Accessibility Centre. We have also developed our training approach through a series of real-life customer stories available to colleagues to access anytime to develop their skills. Our objective throughout the Covid-19 pandemic continues to be to provide support and solutions for customers who find themselves facing financial difficulty, based on individual customer circumstances, with the aim of rehabilitating customers back into a healthy financial position. Our Financial Support model has evolved to ensure that we help customers who are facing temporary but severe financial difficulty, as well as customers who face financial difficulty for a longer time.

Risk monitoring and reporting

We consider conduct and regulatory risk as part of the governance around all our business decisions. We have specific fora and committees such as the Conduct and Compliance Forum, and business specific risk management fora to make decisions on conduct and regulatory risk matters and we report to the ERCC and BRBC. The data we report to senior management and Committees gives them a clear view of current and potential emerging conduct and regulatory risks and issues. Our risk and control fora support management to control risks in their business units. Reporting includes conduct risk dashboards, with metrics across common areas. These include policy breaches logged, mystery shopping, quality assurance and complaints, and commentary on trends and root causes. This approach enables us to take effective action. Our Legal and Regulatory Division also reports directly to the Board on legal, conduct and regulatory, reputational and financial crime risks, and to escalate issues or any breach of our risk appetite.

CONDUCT AND REGULATORY RISK REVIEW

2021 compared to 2020

In 2021, we continued to build on our progress in 2020 and remained vigilant in taking a customer-focused approach in developing strategy, products and policies that support fair customer outcomes and market integrity, in particular in the context of government driven Covid-19 initiatives. These were deployed at pace, with systems and controls in place to support our staff working from home, whilst continuing to provide critical customer services. As part of this, we:

- Assessed the FCA's 2021/22 Business Plan. Key priorities are aligned with 2020, in ensuring consumer credit markets work well, making payments safe and accessible, enabling effective consumer investment decisions and delivering fair value in a digital age, in particular in a post pandemic landscape. We addressed them in our controls, product processes and frameworks, which we will continue to adapt in line with the evolution of a digital economy
- Continued support for customers rolling off Covid-19 support schemes and payment holidays with focus on forbearance measures, as per the FCA's further 'Guidance on Fair Treatment of Vulnerable Customers' and its finalised 'Mortgages and Coronavirus: Tailored Support Guidance'
- Implemented processes to support customers including creating the Financial Support Centre of Excellence and SME support to ensure we continue to drive fair and consistent outcomes, whilst managing the increased inflow of customers impacted by Covid-19, with further investment in people and technology
- Focused on collections and further financial support, including Pay As You Grow options for BBLS customers following the closure of new applications to the UK Government's BBLS, CBILS and CLBILS schemes on 31 March 2021, while supporting the Government's Recovery Loan Scheme for corporate customers
- Took steps to maintain appropriate monitoring and surveillance capability for our market and customer facing staff working from home due to Covid-19
- Continued to manage technological change and increased digitalisation in line with regulatory initiatives
- Delivered change to meet the evolving regulatory landscape, including changes brought about by Payment Systems Regulator (PSR): Confirmation of Payee for Corporate Banking, Debt Respite Scheme, Open Banking and PSD2, and the FCA Consumer Protection Agenda
- Prior to the end of 2021, we - along with our customers and counterparties – successfully agreed the transition to alternative reference rates for the vast majority of our post-2021 LIBOR agreements. As such, the focus has now shifted to finalising the transition of those agreements still referencing the continuing USD LIBOR tenors, and to managing down the small 'tough legacy' position
- Following PRA sector-wide feedback on Hybrid model applications, banks have revised timings and the revised Hybrid plan has been presented to the PRA with regular ExCo and PRA review points
- Continued to consult with HM Treasury on the Future UK Regulatory Framework, along with the industry and peers on how regulatory rulemaking powers will be distributed post-Brexit, and the mechanisms for improving accountability and scrutiny of the rule-makers, and
- are committed to protecting the personal data we collect and use, and respecting the data protection rights of our customers, our people and others associated with us. Our data protection policy and processes reflect current data protection laws and regulations, and all employees, businesses, and third-party suppliers are required to comply with them. Annual data protection training is mandatory for all employees. We tell our customers, our people and others associated with us how we process their personal data by giving them a data protection statement. We regularly update our data protection policy and processes, and they cover how we collect, handle, store, share, use and dispose of personal data. They also set robust controls for suppliers. The Data Protection Officer (DPO) oversees compliance with data protection laws and reports to the highest management level.

Following the implementation of the Contingent Reimbursement Model, a voluntary code of practice to deal with authorised push payment fraud, we continue to engage with the industry and authorities, giving input and support to further develop the code's framework. Like all UK banks, we continue to see a demanding regulatory agenda focused on consumer outcomes, addressing customer detriment, price regulation and vulnerability, while currently consulting on the measures proposed under Consumer Duty regulation. Conduct risks will likely continue to rise in the near- and medium-term as banks deal with a large volume of personal and business borrowers who continue to be impacted by the Covid-19 pandemic.

For an update on key movements in our financial crime risk profile, see the 'Financial crime risk review' section.

Accounting position

For more on our provisions, see Note 29 to the Consolidated Financial Statements. For more on our contingent liabilities, see Note 31 to the Consolidated Financial Statements.

Other key risks

Overview

In this section, we describe how we manage our other key risks and discuss developments in the year. Our other key risks are:

- **Financial crime risk:** the risk that we are used to further financial crime, including money laundering, sanctions evasion, terrorist financing, facilitation of tax evasion, bribery and corruption.
- **Legal risk:** the risk of loss arising from legal deficiencies in contracts; failure to protect assets; failure to manage legal disputes appropriately; failure to assess or implement the requirements of a change of law; or failure to comply with law or regulation or to discharge duties or responsibilities created by law or regulation.
- **Strategic and business risk:** the risk of significant loss or underperformance against planned objectives; damage arising from strategic decisions or their poor implementation that impact the long-term interests of our key stakeholders, or from an inability to adapt to external developments.
- **Reputational risk:** the risk of damage to the way our reputation and brand are perceived by the public, clients, government, colleagues, investors, or any other interested party.
- **Model risk:** the risk that the prediction of our models may be inaccurate, causing us to make sub-optimal decisions, or that a model may be used inappropriately.

FINANCIAL CRIME RISK

OUR KEY FINANCIAL CRIME RISKS

We recognise that financial crime and associated illegal activity damages the customers and communities we serve. Criminals use the financial system to launder the profits of illegal activity such as human trafficking and to fund terrorism. Financial crime is therefore a high priority risk for us and we remain committed in our efforts to counter it by maintaining the highest ethical standards and conducting business in accordance with regulatory and legal requirements. We have adopted a bank wide anti-financial crime strategy (AFC) that sets out the principles of 'Deter, Detect and Disrupt' and invested in training our colleagues in how to identify and prevent financial crime.

We believe that having a comprehensive and effective financial crime risk management framework is a business imperative and a positive investment that protects us from legal, regulatory and reputational risks. This includes implementing policies, procedures, and maintaining effective systems and controls to prevent and detect financial crime. We may be adversely affected if we fail to effectively mitigate the risk that third parties or our employees facilitate, or that our products and services are used to facilitate financial crime. We adopt a risk-based approach in line with UK and international laws and standards, and we work with government, law enforcement and the private sector to help meet our commitments and to inform our AFC strategy.

Our key financial crime risks are:

Key risks	Description
Money laundering	We are used by criminals to transform the proceeds of crime into seemingly legitimate money or other assets.
Terrorist financing	We are used by terrorists to deposit, distribute or collect funds that are used to fund their activity.
Sanctions	We do not identify payments, customers or entities that are subject to economic or financial sanctions.
Bribery and corruption	We fail to put in place effective controls to prevent or detect bribery and corruption.
Facilitation of tax evasion	We fail to put in place effective systems and controls to prevent the facilitation of tax evasion.

FINANCIAL CRIME RISK MANAGEMENT

Risk appetite

Financial crime risk appetite is the level of financial crime risk we are prepared to accept in carrying out our activities. This is approved at Board level and shared across the business, with limits specified to control exposures and activities that have material risk implications for us and the communities we are part of. Our customers and shareholders will be impacted if we do not mitigate the risk that we are being used to facilitate financial crime. We seek to comply with applicable UK and international sanctions laws and other regulations and make sure our risk appetite adapts to external events. We have minimal tolerance for residual financial crime risk, bribery and corruption risk, facilitation of tax evasion risk and zero tolerance for non-compliance with sanctions laws and regulations. We require employees and third parties acting on our behalf to act with integrity, due diligence and care. We have no appetite for non-compliance with financial crime laws or regulations by employees or persons acting for or on our behalf.

Risk measurement

We measure our exposure to financial crime risk regularly. Our AFC strategy and frameworks set the strategic direction for risk management by defining standards, objectives and responsibilities for all areas of the business. It supports senior management in effective risk management and developing a strong risk culture. We screen and risk rate all our customers and monitor activity to identify potential suspicious behaviour. We complete ad-hoc reviews based on key trigger events. Our Financial Intelligence Unit assesses specific types of threat, drawing on data from law enforcement and public authorities.

Risk mitigation

We take a proactive approach to mitigating financial crime risk. Our financial crime risk frameworks are supported by policies and standards which explain the requirements for mitigating money laundering, terrorist financing, sanctions compliance risks, bribery and corruption, and facilitation of tax evasion risks. We update these regularly to ensure they reflect new requirements and industry best practice. We support our colleagues to make sure they can make the right decisions at the right time. We raise awareness and provide role-specific training to build knowledge of emerging risks.

Key elements of our financial crime risk mitigation approach are that we:

- Undertake customer due diligence measures for new and existing customers, which include understanding their activities and banking needs
- Conduct risk assessments of customers, products, businesses, sectors and geographic risks to tailor our mitigation efforts
- Ensure all our staff complete mandatory financial crime training and, where required, role-based specialist training
- Deploy new systems to better capture, analyse and act on data to mitigate financial crime risks
- Partner with public authorities, the Home Office and the wider financial services industry to pool expertise and data. We are also involved in partnerships such as the Joint Money Laundering Intelligence Taskforce (JMLIT) which supports public-private collaboration to tackle financial crime.

Risk monitoring and reporting

We use key risk indicators to monitor our exposure to financial crime risks, and we report all issues in a timely manner. We work closely with subject matter experts across the business on all risk management and monitoring activities alongside more effective communication of policy changes. Regulators around the world continue to emphasise the importance of effective risk culture, personal accountability and the adoption and enforcement of risk-based requirements and adequate internal reporting processes and procedures. We continue to develop and enhance our financial crime operating and governance model to ensure that our control environment evolves at pace, keeping up with new or amended laws, regulations or industry guidance.

We adhere to a strong governance and reporting schedule to our ERCC and Financial Crime Committee, including analysis of the risks on the horizon, key risk indicators and a directional indication of the risk profile. Throughout 2021, management continued to update the risk committees on management and mitigation of financial crime risks including our activities to understand and address emerging challenges. We enhanced our financial crime risk indicators for effective risk reporting to senior management. We also regularly report to the Board Risk Committee on financial crime risk, the impact on the business and the actions we are taking to mitigate the risk.

FINANCIAL CRIME RISK REVIEW

2021 compared to 2020

Financial institutions (FIs) remain under intense regulatory scrutiny to demonstrate the steps they are taking to prevent and detect financial crime. Legal and regulatory expectations regarding the need for FIs to maintain effective financial crime systems and controls, including adapting these to identify and respond to new and emerging threats, have been reinforced through a number of high-profile regulatory enforcements, such as the conclusion of the first criminal prosecution of a Financial Services firm in the UK for breaches of the UK Money Laundering Regulations. During 2021, we continued to cooperate with the FCA's civil regulatory investigation into our financial crime systems, processes and controls focused primarily on the period from 2012 to 2017. See Note 31 to the Consolidated Financial Statements for detail.

The financial crime landscape continues to be complex, with evolving regulatory and legal requirements, geo-political factors and changing criminal methods influencing the risks we face. Rapid deployment of government relief measures to support individuals and businesses during the pandemic, have increased the risk of financial crime. Developments around virtual and digital currencies have continued, with the industry's financial crime risk assessment and management frameworks in their early stages. Changes to sanctions regimes continue to add complexity. We continue to monitor external developments and respond to their impacts upon our financial crime controls and have increased our resources to do so.

Senior management and the Board engagement in the management of financial crime risk has remained high, proportionate with one of our top risks. We continue to enhance our financial crime risk management capabilities with material investment across data, systems and subject matter expertise, and back book remediation. Key areas of focus include:

- Reviewing and updating our financial crime policies and standards in response to changes in laws, regulations and regulatory expectations, to ensure we reflect all current external obligations; as well as providing detailed guidance on new and emerging risk areas to assist business areas;
- Assessing, adapting, and responding to new and emerging financial crime threats and typologies;
- Assessing lessons and read across from regulatory enforcements and Dear CEO letters, identifying actions required to adapt our control framework and taking steps to deliver these;
- Continued delivery of our multi-year Financial Crime Transformation and Customer Remediation Programme, modernising the technology and data estate, better connecting operations and controls, and automating client due diligence processes, as well as systematically reviewing and updating our existing client records in line with due diligence requirements;
- The maturation of the dedicated Financial Crime operations, increasing in capacity and capability, uplifting specialist role competencies through the Anti-Financial Crime (AFC) Training Academy, enhancing the skill sets, knowledge and qualifications of key staff; and
- Investing in additional specialist resources for our second line of defence financial crime compliance function, as the function continues to develop.

We take a proactive approach to engagement with the FCA, our industry colleagues and HM Government, including through our participation in the Economic Crime Reform Program. This external engagement helps inform our internal policies and forward-looking strategies. We continued to play a proactive role in supporting the Government Economic Crime Action Plan, as a member of the Economic Crime Strategic Board and also inputting into reviews of legislation and other government policy initiatives relating to economic crime and beyond. We also continue to participate in external partnerships of a more operational nature, such as the Joint Money Laundering Intelligence Task Force and the Public Partnership Threat Group as well working with Non-Profit Organisations on specific topics including anti-corruption, human trafficking, and anti-slavery.

LEGAL RISK

Legal risk includes the legal consequences of operational risk, such as breach of contract, and operational risk with legal origins, such as a legally defective contract. We manage legal risk as a standalone risk type to reflect the continued pace and breadth of regulatory change across financial services.

We define legal risk as losses or impacts arising from legal deficiencies in contracts or failure to:

- Take appropriate measures to protect assets
- Manage legal disputes appropriately
- Assess, implement or comply with law or regulation
- Discharge duties or responsibilities created by law or regulation.

Legal risk management	Description
Risk appetite	We should aim to make decisions and operate in a way that does not lead to legal risk. We apply robust controls to manage these risks and we have a low tolerance for residual legal risk.
Risk measurement	Due to the close links between our legal and operational risk frameworks, our tools to identify, assess, manage and report operational risks also apply where such exposures have a legal risk impact.
Risk mitigation	The Legal teams provide specialist advice and support to all business units to ensure we effectively manage legal risk. They help to implement a strong legal risk culture throughout our business using guidelines, templates, policies and procedures and specific support on a product, service, transaction or arrangement basis and decide whether legal advice should be sourced internally or externally.
Risk monitoring and reporting	An internal legal risk reporting framework is in place to provide visibility of the Santander UK-wide legal risk profile. We provide regular updates of our key legal risks, issues or breaches, to senior management and the Board through our Legal & Regulatory Division. This is in addition to reports issued by the business.

2021 compared to 2020

Our legal risk profile remained heightened but broadly stable in 2021, reflecting the high number and value of legal risks that continue to be managed.

We delivered the compliance frameworks for future business in relation to Brexit and continued to monitor the evolution of the post-Brexit regulatory environment throughout 2021. The Breathing Space regulations were successfully implemented in accordance with legislative timescales. Legal risks related to LIBOR cessation abated through 2021, as our work in this area progressed. At the end of 2021, we had transitioned, terminated or disposed of most of our GBP LIBOR contracts, with substantially all the residual positions moving to synthetic LIBOR pursuant to the Critical Benchmarks (References and Administrators' Liability) Act 2021. We continue to take steps to transition the remaining GBP LIBOR contracts and prepare for the cessation of USD LIBOR from 30 June 2023. For more details, see Note 42 to the Consolidated Financial Statements. We have considered the implications of the Pension Schemes Act 2021 and the National Security and Investment Act 2021 for our business and taken steps to enable compliance with their requirements.

Nevertheless, legal risks continued to emerge and develop throughout 2021. The Schrems-II decision in 2021 rendered invalid the use of the Privacy Shield for transfer of personal data to the US making transfers relying on the Privacy Shield unlawful. Work continues to align all outsourcing and material contracts to ensure EBA compliance together with PRA/FCA prescribed requirements on operational resiliency and continuity. With respect to EBA compliance there is a risk that not all contracts will have been amended by 31 March 2022. There is an increased focus on the legal risks related to climate change and we expect to continue to build on our initial review of those risks in 2022. Litigated PPI claim volumes continued to increase and pre-action letters also continued to be received which suggest that this trend will continue into 2022. The publication of the FCA consultation on a proposed Consumer Duty has the potential to materially shift and broaden the duty of care banks already have in the provision of services.

The oversight of external spend was further enhanced in 2021 with the implementation of an automated legal spend tool. This has enabled additional oversight and challenge of all legal spend across the bank.

STRATEGIC AND BUSINESS RISK

Strategic and business risk could impact our long-term success if it caused our business model to become out of date, ineffective, or inconsistent with our goals. This could arise if we:

- Fail to identify threats in our environment, arising from the economy, regulation, competitors and/or changes in technology and customer expectations
- Misjudge our capabilities, or ability to implement our strategy
- Pursue initiatives or acquisitions that do not fit with our business model or miss to capitalise on opportunities we could benefit from.

Strategic and business risk management	Description
Risk appetite	We have a low to moderate appetite for strategic and business risk. This limits the risks we are prepared to take to achieve our strategic objectives and is aligned to our balanced, customer-centric business model.
Risk measurement	Our Board and senior management regularly review potential risks in our operations and plans to ensure we stay within risk appetite.
Risk mitigation	We manage strategic and business risk by having a clear and consistent strategy that takes account of external factors and our own capabilities. We have an effective planning process which ensures we refine, strengthen, and adapt our strategy to reflect changes in the environment and other key risks and opportunities.
Risk monitoring and reporting	We closely track our business environment, including long-term trends that might affect us in the future. As part of this, we report a range of indicators.

2021 compared to 2020

Our business environment is always changing, and this affects how we do business. The effects of Covid-19 persisted in early part of 2021, though the outlook started to improve as restrictions eased and businesses opened. Throughout the Covid-19 pandemic, our top priority has been to support the welfare of our people, our customers and our communities. As the economy opened up, we worked with our customers and provided the support that they needed at that time such as mortgages and recovery loans. We have continued to enhance our online services to ensure our customers have access to their accounts and services as per their convenience while continuing to provide important services face to face, especially for our vulnerable customers. As UK's leading full-service challenger bank, with a resilient balance sheet and track record of consistent profitability, we believe we are well placed to delivery on our strategic priorities as we push our way forward through the Covid-19 pandemic.

Competitive pressures have continued in 2021, driven largely by established players. Technology-led entrants have received a boost as a result of the Covid-19 pandemic and continued to make progress, threatening to disrupt the market in the longer term. We expect these trends to continue in 2022. However, we believe our customer-focused business model and strategy, alongside our adaptable and innovative approach, will support our continued success.

Key to our strategy is being a sustainable and responsible business. We are committed to playing our part in helping the UK transition to net zero economy. Banco Santander group have committed to eliminate all exposure to thermal coal mining and no longer provide financial services to power generation clients with more than 10% of their revenue coming from thermal coal by 2030. Our Corporate & Commercial Bank supported companies involved in delivering sustainable energy solutions and social housing by providing £1.6bn of facilities.

Overall, we remain focused on supporting customer needs, building customer loyalty, improving efficiency and transforming the business for success, while continuing to progress with our agenda to tackle climate change.

REPUTATIONAL RISK

Potential reputational risks can arise from many factors, both internal and external. We seek to manage our reputation proactively, underpinned by our aim to be a responsible bank, and through our reputational risk framework. This enables us to adopt an active approach to managing and where possible preventing and mitigating reputational risks in a broad range of areas, including corporate governance, supplier management and the treatment and behaviour of our customers. We also consider external factors such as the macro environment and the overall performance of the sector.

Reputational risk is not static; today's decisions may be judged by different standards tomorrow. We build this into our risk culture, evaluation and sanction procedures.

Reputational risk management	Description
Risk appetite	We have a low appetite for reputational risk, which is agreed by the Board at least each year. We express it in terms of the risk measures set out below.
Risk measurement	We assess our exposure to reputational risk daily. We base this on expert judgement and analysis of social, print, and broadcast media, and the views of political and market commentators. We also commission independent third parties to analyse our activities and those of our UK peers to identify significant reputational events, or a prolonged decline in our reputation and any sector level or thematic issues that may impact our wider business. We also measure the perception of Santander UK amongst key stakeholder groups through regular interactions and perform annual reviews of staff sentiment.
Risk mitigation	Our business units consider reputational risk as part of their operational risk and control assessments. We also consider it as part of our new product assessments. Our Corporate Communications and Responsible Banking, Legal and Regulatory Affairs and Marketing team helps our business units to mitigate the risk and agree action plans as needed. They do this as part of their role to monitor, build and protect our reputation and brand.
Risk monitoring and reporting	We monitor and report reputational risks and issues on a timely basis. Our Reputational Risk Forum reviews, monitors and escalates to Board level key decisions on reputational risks. It also has regular and ad-hoc meetings to discuss the risks we face. We escalate them to the ERCC and Board Responsible Banking Committee, as needed. Our Corporate Communications and Responsible Banking, Legal and Regulatory Affairs and Marketing teams also reports regularly to our Executive Committee on Corporate Social Responsibility, Sustainability and Public Affairs policies. They do this from an environment, community and sector point of view.

Our Reputational Risk and Environmental, Social and Climate Change (ESCC) Risk policies define how we create long-term value while managing those risks. Our policies cover Oil & Gas, Power Generation & Transmission, Mining & Metals and Soft Commodities. For example, financing is prohibited for project-related financing for Coal-fired power plants (CFPP) projects worldwide and we will only work with new clients with CFPPs to provide specific financing for renewable energy projects.

2021 compared to 2020

In 2021, our key reputational risks continued to lie in our response to the Covid-19 pandemic. To manage this, we regularly and proactively shared information with key external stakeholders on the numerous actions we took to support customers, colleagues and communities over the course of the year. Particular areas of external focus included our participation in the UK Government's Coronavirus Loan Schemes for businesses, our support for customers facing financial difficulties and our ability to provide daily services from the branch network, contact centres and our online platforms.

We also worked to minimise the reputational impact of operational resilience issues, including the significant system outage we experienced in May 2021, through timely, clear and transparent communication with customers and stakeholders.

Our Reputational Risk Forum continued to meet regularly to discuss our emerging and material risks, bringing together senior representatives from across the business, alongside the use of our formal Reputational Risk Register. This ensured that reputational risk is a leading consideration with the ERCC and the Board Responsible Banking Committee. This maintains the visibility and discussion of reputational risk issues at Board level.

MODEL RISK

Models typically analyse data to look for relationships, formulating a methodology with a set of assumptions and parameters. Generally, we consider a model to be any method that relies on assumptions to produce estimates of uncertain outcomes. Our key model risks arise from weaknesses and limitations in our models, or the incorrect use of a model. They include risks stemming from model data, systems, development, performance and governance. The most material models we use help us calculate our regulatory capital and credit losses, and perform stress tests. Increased regulatory standards influence how we manage and control model risk.

Model risk management	Description
Risk appetite	We express our model risk appetite through risk assessments of our key risk models. The Board is asked to agree this at least annually.
Risk measurement	We consider both the percentage of models that have been independently assessed, and the outcome of those reviews, in how we measure model risk. All models have several assumptions and in general the more limitations we have for those assumptions, the higher the levels of uncertainty and therefore model risk.
Risk mitigation	We mitigate model risk through controls over how we use models throughout their life. We maintain a central model inventory that includes data on owners, uses and model limitations. We assess how important each model is to our business, and we track and resolve actions from independent reviews. We also maintain a clear approval path for new models and changes to existing models.
Risk monitoring and reporting	We report model risks and issues using management and control forums. We escalate issues to the ERCC when needed, or if our risk appetite is breached or showing adverse trends that could lead to future issues.

2021 compared to 2020

We maintain a risk-based approach to management and control. For example, we focus our model monitoring and independent model reviews on our more material models, such as those for credit losses or those with specific regulatory standards defined.

We have started to assess in more detail the impacts of Covid-19 on our models. This is now possible given that we have nearly two years of data available. For the most part models continue to perform in line with expectations, with more minor adjustments required in those areas where models are looking at a shorter time horizon.

A significant portion of 2021 development and implementation time was geared towards regulatory models focusing on capital adequacy. These models have been updated to ensure compliance with regulatory technical standards published by various banking regulators. This trend will continue over the next 2 years in line with supervisory plans and expectations.

The methodology teams also worked on new models for IFRS 9 reporting, with a focus on residential real estate and commercial lending. The new models are designed to be easier to run and improve the overall control environment. They will also enable us to eliminate some long-standing post model adjustments required to account for limitations in prior models.

Changes to models resulting from the cessation of LIBOR completed in line with plans. All model updates were governed in line with the complexity of change and the materiality of underlying models. This meant changes to models in all areas of the bank, for example traded market risk, non-traded market risk, credit risk and pension risk.

During 2021 there was also a focus on models used to help support the Bank of England climate change stress test. These were new types of models with much lengthier forecast horizons. There is an expectation of further work in this area over the coming years.

We have updated our toolsets to help manage and control model risk, implementing a good quality piece of software that supports the end-to-end model risk lifecycle. The new tool provides a register for all models and their uses, new automated reporting capabilities and governance workflow. The tool is already accessed by over 100 users across Santander UK and has full traceability to support any internal or external audits.

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Independent auditors' report to the members of Santander UK plc

Report on the audit of the financial statements

Opinion

In our opinion, Santander UK plc's group financial statements and company financial statements (the "financial statements"):

- give a true and fair view of the state of the group's and of the company's affairs as at 31 December 2021 and of the group's and company's profit and the group's and company's cash flows for the year then ended;
- have been properly prepared in accordance with UK-adopted international accounting standards; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report, which comprise: the Consolidated and Company Balance Sheets as at 31 December 2021; the Consolidated Income Statement and Consolidated Statement of Comprehensive Income; Consolidated and Company Cash Flow Statements; Consolidated and Company Statements of Changes in Equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Board Audit Committee.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 1 to the financial statements, the group, in addition to applying UK-adopted international accounting standards, has also applied international financial reporting standards (IFRSs) as issued by the International Accounting Standards Board (IASB).

In our opinion, the group financial statements have been properly prepared in accordance with IFRSs as issued by the IASB.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided.

Other than those disclosed in note 7 to the financial statements, we have provided no non-audit services to the company or its controlled undertakings in the period under audit.

Our audit approach

Context

This is the first year that it has been my responsibility to form this opinion on behalf of PricewaterhouseCoopers LLP (PwC). PwC was first appointed on 31 March 2016 in relation to that year's audit. In addition to forming this opinion, in this report we have also provided information on how we approached the audit, how it changed from the previous year and details of the significant discussions that we had with the Board Audit Committee (BAC). We approached our audit by determining what would be considered to be material to the users of the financial statements. Given the continued impact of Covid-19, substantially all of our interactions were undertaken virtually, including those between the engagement team, Board members and management. Similarly, substantially all of our audit testing was performed remotely.

Overview

Audit scope

- The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment, the financial significance of components and other qualitative factors (including history of misstatement through fraud or error).
- We performed audit procedures over components considered to be financially significant in the context of the group (full scope audit) or in the context of individual primary statement account balances (audit of specific account balances).
- As set out in Note 2 to the financial statements, the group changed its operating segments in 2021, following the transfer of the Corporate and Investment Banking and a change in the reporting structure for Retail Banking. The new segments are Retail Banking, Consumer Finance, Corporate & Commercial Banking and Corporate Centre. We structured our audit procedures in line with the operating segments.
- Our audit plan was discussed with the BAC in June 2021 and updates were provided to the Committee at later stages of the audit. We executed the planned approach and concluded based on the results of our testing ensuring that sufficient audit evidence had been obtained to support our opinion. We discussed our approach and the results of our audit with the BAC. We also discussed the key audit matters with the BAC at the conclusion of the audit.

Key audit matters

- Expected credit loss allowance for loans and advances to customers (group and parent)
- Valuation of defined benefit pension surplus (group and parent)
- Impairment assessment of goodwill (group and parent)
- Legal and regulatory matters (group and parent)

Materiality
- Overall group materiality: £59 million (2020: £57 million) based on 3% of adjusted profit before tax (2020: 5% of the adjusted average profit before tax for the last three years).
- Overall company materiality: £50 million (2020: £50 million) based on 4% of adjusted profit before tax (2020: 5% of the adjusted average profit before tax for the last three years).
- Performance materiality: £44 million (2020: £43 million) (group) and £37 million (2020: £38 million) (company).

The scope of our audit
As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

Key audit matters
Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

This is not a complete list of all risks identified by our audit.

We have added the valuation of illiquid pension assets to the key audit matter which covers the defined benefit pension surplus (group). The impact of COVID-19 (group and parent), which was a key audit matter last year, is no longer included as a key audit matter because we deem our consideration of this matter to be adequately captured by our other key audit matters and not to represent an area of increased audit attention in its own right. Otherwise, the key audit matters below are consistent with last year.

Key audit matter	How our audit addressed the key audit matter
Expected credit loss allowance for loans and advances to customers (group and parent)	
Refer to the Board Audit Committee Chair's report, note 1 (Accounting Policies and Critical Accounting Estimates) and note 13 (Loans and Advances to customers). Impairment allowances represent management's best estimate of expected credit loss (ECL) within each portfolio at the balance sheet date. The identification and the determination of allowances is inherently judgemental. The significant risks relate to residential mortgage loans within Retail Banking and the corporate loans within Corporate & Commercial Banking. Under IFRS 9 management is required to determine ECLs that are expected to occur based on possible default events over a 12 month period or the remaining life of the asset, depending on the categorisation of the individual asset. This categorisation is determined by an assessment of whether there has been a significant increase in credit risk (SICR) of the borrower since loan origination. It is also necessary to consider the impact of different future macroeconomic conditions in the determination of ECLs. Management uses a number of models and post model adjustments (PMAs) to achieve compliance with the requirements of IFRS 9. The determination of ECLs is complex and a number of significant judgements are involved in the estimation process. The COVID-19 pandemic and the UK leaving the EU has impacted many individuals and businesses and their ability to operate normally. There continues to be significant uncertainty regarding the path to recovery and the impact on the ability of borrowers to repay. In response, management introduced two significant PMAs in 2020 which remain in place for 2021 year end: – A PMA related to SICR to move certain corporate loans from Stage 1 to Stage 2; and – A PMA to identify a proportion of corporate loans that are unlikely to repay and should be moved from Stage 2 to Stage 3; Given that further economic uncertainty exists, particularly in relation to high inflation, management introduced the following significant PMA in 2021: – A PMA to recognise the affordability pressures on mortgage customers. We consider the following judgements and assumptions used in the determination of the modelled ECL for the residential mortgage and corporate loan portfolios to be significant: – The determination of forward looking macroeconomic scenarios and the probability weights applied to ECLs associated with each scenario; – The determination of internal credit ratings in corporate loan portfolios due to the uncertainty over the future performance of corporate borrowers in the current environment; and – The completeness and appropriateness of PMAs to address data and model limitations. In the corporate loan portfolios, individual impairment assessments are performed for credit impaired loans and advances which are categorised as Stage 3. Judgement is required to estimate the level of any allowance. Our focus was on the principal judgements applied by management in estimating impairment allowances such as the valuation of collateral, forecast cash flows and the reasonableness of the probability weighting of expected likely outcomes.	**Testing of key management controls** We understood and evaluated the design of the key controls over the determination of ECLs and tested their operating effectiveness. These controls included: – Model performance monitoring controls, including testing model estimates against actual outcomes; – The Credit Risk Provisions Forum's review and approval of significant judgements, estimates and the assessment of ECL modelled outputs. – Review and approval of periodically assessed risk ratings for individual corporate borrowers; and – Review and approval of the key judgements used to calculate ECLs on individually assessed corporate loans including the valuation of collateral and probability weighting of likely outcomes. We noted no significant exceptions in the design or operating effectiveness of the above controls. In addition, we performed the substantive procedures described below. **Forward looking economic scenarios and scenario probability weightings** We used our economics and credit risk modelling experts to critically assess the reasonableness of the multiple economic scenarios and scenario probability weightings adopted by management. We considered external economic data and consensus forecasts and whether management's forecasts appropriately reflected the possible economic consequences of the pandemic, the UK leaving the EU and high inflation, and different possible paths that the pandemic could take. As part of our testing of the scenario probability weightings, we considered the inferred GDP 'time to recovery' for each scenario based on historical distribution and made a comparison to other external consensus forecasts. We observed that generally the group assigns a slightly lower weighting to a slower recovery than the historical distribution would imply. We concluded that this is broadly consistent with external forecasts and reflects the unique nature of the current economic crisis. Management made updates to the scenario weightings in response to the improving UK economic outlook as a result of the successful vaccination programmes and the lifting of social restrictions. However the weighting applied continues to recognise the uncertainties posed by new COVID variants, the impact of the UK leaving the EU and high inflation. We found that the change to scenario weights appropriately captured the economic uncertainty created by these three factors. Similarly, we challenged the use of a very severe COVID-19 stress scenario, which reflects a prolonged shock to UK GDP, resulting in a permanent hit to potential output. We found the selection of this scenario appropriate in the context of the range of scenarios selected and the probability weightings assigned to this scenario. Overall, we concluded that management's scenarios and associated weights were reasonable.

Key audit matter	How our audit addressed the key audit matter
	Internal credit ratings for corporate borrowers For a sample of loan ratings. We obtained management's internal credit rating assessments and, supported by our credit expert's independent analysis, tested whether the ratings were in accordance with the bank's ratings framework, including whether the assessment took account of the impacts of the current economic circumstances. **Post model adjustments (PMAs)** We considered whether management had identified PMAs where risks were not captured in the modelled loss allowances, and whether appropriate methodologies were applied in their calculation. This included PMAs in place to address modelling and operational limitations highlighted by the economic conditions caused by the pandemic, the UK leaving the EU and high inflation. **Corporate PMAs** Corporate loan PMAs were used to address the risk that corporate default indicators were not sufficiently captured on a timely basis by the internal risk ratings or the model, and therefore stage 2 and 3 loans may be understated. The PMAs seek to identify customers and sectors at higher risk and transfer these loans to stage 2 or 3. We critically assessed management's PMA methodologies and sector analysis used by management in the calculations. We used our economics and restructuring experts to provide input on sector risks. Where customers were transferred into stage 2, management applied a downward rating adjustment to better align ratings and ECL coverage with the existing Stage 2 portfolio. We tested this by assessing the rating changes typically seen when customers are moved into stage 2, recalculating coverage ratios in the PMA population and existing Stage 2 book, and sensitising the impact of credit risk downgrades to ensure the magnitude of downgrade applied by management was appropriate. We also tested the accuracy of calculations for the ECL impact of these changes. For the customers transferred into stage 3, we challenged whether the methodology was appropriate for determining which customers have defaulted but not yet been identified. We developed independent alternative methodologies, and assessed the impact on ECL. We tested the accuracy of management's calculation of both PMAs. **Retail PMAs** We critically assessed management's PMA methodologies including the key judgements and assumptions used in the PMAs for the Retail portfolios. In particular, we challenged the appropriateness of PMAs: – Used to address data limitations in the mortgages model and estimate the provision for accounts that are interest only, Buy-to-Let or in long-term arrears. – Introduced to assess the impact of affordability pressures on mortgage customers. We also challenged the completeness of PMAs, specifically management's decision to not introduce a PMA to address the affordability pressures for customers in the unsecured portfolios We tested the accuracy of management's calculation of the PMAs. Overall, we were satisfied with the PMAs included in the estimate of ECL. **Individually assessed cases** For a sample of credit impaired loans, we evaluated the specific circumstances of the borrower, including the latest developments, scenarios and weightings assigned for measuring the impairment provision, and whether key judgements were appropriate. We re-performed management's impairment calculations and tested key inputs. We tested the valuation of collateral held and challenged management on subjective estimates and assumptions. Where applicable, we engaged our real estate experts to critically assess the collateral valuation. We also compared gains and losses realised when a loan is sold or exited to the existing provision. Based on the procedures performed and the evidence obtained, we found management's judgements used in the determination of the ECLs to be reasonable.

Key audit matter	How our audit addressed the key audit matter
Valuation of defined benefit pension surplus (group and parent)	
Refer to the Board Audit Committee Chair's report, note 1 (Accounting Policies and Critical Accounting Estimates), note 30 (Retirement Benefit Plans). The group defined benefit pension scheme is in a net surplus position as at 31 December 2021. **Defined benefit obligations:** The valuation of the defined benefit obligations of the Santander (UK) Group Pension Scheme (the 'Scheme') is dependent on a number of assumptions, including the discount rate, price inflation and life expectancy. Small changes in these assumptions can have a material impact on the valuation due to the size and the duration of the pension obligations. Management performs a review of the valuation methodology and assumptions each year with the assistance of external experts. During 2021, management moved to using section specific discount and inflation rates in order to better reflect the duration and profile of each section of the scheme. Additionally, mortality rates were updated to reflect the latest data for life expectancy. The valuation of the defined benefit obligations is complex and judgemental and therefore represents a key audit matter. **Illiquid pension assets:** The scheme assets consist of certain assets which are more difficult to value because they are illiquid. These illiquid assets are unquoted equities, unquoted corporate bonds and other assets not quoted in active markets, as well as investments in property, infrastructure and hedge funds. The valuation of these assets relies on unobservable data as they do not have a readily available quoted price in an active market. Directly held property is valued using a bespoke valuation method taking both the nature of the properties and the tenancy schedules as inputs to derive the fair value. Unquoted equities, unquoted corporate bonds and other assets not quoted in active markets, as well as investments in property, infrastructure and hedge funds are illiquid. Each fund is valued by the respective investment manager on either a Bid or Net Asset Value (NAV) basis. Where there is a time lag between the NAV and the balance sheet date, management adjusts the value of the assets for capital changes. The lack of quoted observable prices and the bespoke valuation method for the individual assets as well as the lagged valuation of the unquoted equities, unquoted corporate bonds and other assets not quoted in active markets, as well as investments in property, infrastructure and hedge funds, give rise to a high level of estimation uncertainty and complexity in the valuation and therefore represent a key audit matter.	**Testing of key management controls** We understood and evaluated the design and operating effectiveness of the key controls over the determination of the significant actuarial assumptions used in calculating the valuation of future pension obligations and the valuation of the scheme's illiquid assets. These controls included: – Review and approval by the Pensions Committee of key methodologies and assumptions; – Quarterly review and approval by management of the financial and demographic assumptions based on the actuary's report and other data inputs; – Management's lookback test that compares the funds' latest audited financial statements against the unaudited NAV; and – Controls around the comparison of the valuation provided by the valuations manager or management's expert against the valuation provided by the custodian on a more recent date. We noted no significant exceptions in the design or operating effectiveness of the above controls. We also performed the following substantive procedures: **Defined benefit obligations:** – We engaged our actuarial experts to evaluate the judgements made by management in determining the key financial and mortality assumptions used in the calculation of the liability. We assessed the reasonableness of the methodologies and assumptions adopted using our knowledge of market practice and industry developments, PwC developed benchmarks and external market data. We used sensitivity analysis to determine the impact of alternative assumptions. – We considered the objectivity and competence of management's actuarial expert. We reviewed the expert's IAS 19 report and discussed with the expert the methods adopted to determine the valuation of the obligations. We confirmed our understanding of the actuary's roll forward methodology used in determining the accounting valuation. **Illiquid pension assets:** – For direct property, we obtained the valuation report prepared by management's expert and assessed the reasonableness of the methodology and key assumptions used by the valuer, with the support of our auditors' expert. We reviewed the reasonableness of the valuation for a sample of properties with reference to the prior year valuation. – For unquoted equities, unquoted corporate bonds and other assets not quoted in active markets, as well as investments in property, infrastructure and hedge funds, we obtained third-party confirmations directly from investment managers and compared these against management's reported value. We reperformed management's valuation calculation and compared our recalculation to the third-party confirmations, and we understood and tested material capital changes in the period between the valuation and the entity's balance sheet date where there was a time lag. – We assessed whether there is evidence which corroborates or contradicts the valuation, such as agreeing NAV statements from investment managers to audited fund financial statements where they were available, performing back testing of fair values to any recent transactions and reviewing controls reports for the investment managers where available. – We considered the objectivity and competence of management's property valuation expert and the investment managers. Based on the evidence obtained, we found the valuation of the Scheme's defined benefit obligations and the valuation of the Scheme's illiquid assets to be reasonable. We read and assessed the disclosures made in the financial statements, including the disclosures of the assumptions, and found them to be appropriate.

Key audit matter	How our audit addressed the key audit matter
Impairment assessment of goodwill (group and parent)	
Refer to the Board Audit Committee Chair's report, note 1 (Accounting Policies and Critical Accounting Estimates) and note 20 (Intangible Assets). The group has a goodwill balance of £1.2bn at 31 December 2021 which relates to the Personal Financial Services Cash Generating Unit (CGU) within Santander UK plc (SUK). The UK banking market continues to be impacted by economic uncertainty due to COVID-19 pandemic. The carrying value of this asset is contingent upon future cash flows, the value of which has been impacted by these developments. Management performed an impairment assessment using a value in use methodology and concluded that no impairment existed as at 31 December 2021. The impairment assessment is complex and involves subjective assumptions. The forecast cash flows, the discount rate and the terminal growth rate assumptions and the method for determining the amount of regulatory capital and carrying value of the Personal Financial Services CGU are judgemental. Due to the magnitude of these balances and these judgements, this impairment assessment represents a key audit matter.	To address the risk of impairment of the goodwill relating to the Personal Financial Services CGU, we performed a number of audit procedures over the assessment performed by management. We challenged and tested the reasonableness of management's methodology and key assumptions. Our work included the following: – We tested the mathematical integrity of the impairment models. – We performed a comparison of the performance of SUK in recent years to the budgets and 3 year plans for the equivalent periods to assess the accuracy of the budgeting and forecasting process. – We engaged specialists to assist in the assessment of the reasonableness of the methodology and certain key assumptions, for example, the determination of the carrying value of the Personal Financial Services CGU, the amount of capital to be retained in the business, the discount rate and the terminal growth rate. – We agreed the cash flow forecasts to the Board approved three-year plans and tested the reasonableness of adjustments to the plans included in the value in use model. – We reviewed the forecasts, identified the key assumptions and assessed these for reasonableness using our understanding of the group gathered from our audit work and the market, external evidence and sensitivity analysis. Based on the procedures performed and evidence obtained, we found management's conclusion that no impairment existed at 31 December 2021 to be appropriate. We assessed the disclosures made in the financial statements. We are satisfied that these disclosures are appropriate and in compliance with the accounting requirements.
Legal and regulatory matters (group and parent)	
Refer to the Board Audit Committee Chair's report, note 1 (Accounting Policies and Critical Accounting Estimates), note 29 (Provisions), note 31 (Contingent Liabilities and Commitments). Included within Provisions is the group's best estimate of the cost of present obligations related to past events, including the impact of legal actions and regulatory investigations. Significant judgement may be required when accounting for provisions, including in determining whether a present obligation exists and in estimating the probability and amount of any outflows. These judgements are based on the specific facts available and often require specialist professional advice. There can be a wide range of possible outcomes and uncertainties, particularly in relation to legal actions and regulatory investigations. As a result it is often not possible to make reliable estimates of the likelihood and amount of any potential outflows. The key matters are a dispute with a third party in relation to liability for PPI redress in respect of a specific portfolio, an investigation by German authorities into tax arbitrage transactions and an enforcement action by a UK regulatory authority. The potential cost to the group of each of these matters is material. The assessment of present obligations involves judgement and these matters are the subject of ongoing monitoring by those charged with governance. As a result, the provisions and disclosures in respect of these exposures represents a key audit matter.	We evaluated and challenged the provisioning methodologies and underlying assumptions used by management. Where no provision was made, we challenged management's conclusion in the context of the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets. Our work included: – We understood the risks facing the group, the status of the investigations and the legal case. – We evaluated management's assessment of the potential outcomes and associated probabilities. – We reviewed reports provided to governance committees. We discussed the status of the key matters with the Board Audit Committee. – We evaluated the advice received from management's external legal experts. We held discussions with these experts to confirm our understanding of their views on certain judgements applied by management and obtained a written confirmation of the key facts and status of each case. – We held discussions with an external regulator and reviewed correspondence with that regulator. – We considered market practice in dealing with similar matters. Based on the procedures performed and evidence obtained, we found management's conclusions to be appropriate. Given the uncertainty associated with the calculation of the provisions and the contingent liabilities, we evaluated the disclosures made in the financial statements. In particular, we focused on challenging management around whether the disclosures were sufficiently clear in highlighting the uncertainties. We considered the completeness of information disclosed, in particular where management concluded that it was not possible to determine a possible loss reliably or that it was seriously prejudicial to disclose certain information. We evaluated the disclosures against the requirements of IAS 37. We found the disclosures to be appropriate.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the group and the company, the accounting processes and controls, and the industry in which they operate.

The group comprises the company and a number of subsidiaries which predominantly operate within the UK. The Company is the principal operating subsidiary within the group. We considered which entities ("components") required a full scope audit either due to being individually financially significant (defined as 15% of adjusted profit before tax) or due to their risk characteristics, including a consideration of the history of misstatements due to fraud or error, in the context of the group's consolidated financial statements. We identified the significant audit risks and key audit matters and these all relate to the company. We concluded that we should perform a full scope audit of the company. As previously mentioned, the group changed its operating segments in 2021. We structured our audit procedures in line with these operating segments. Almost all of the audit work is undertaken by PwC UK engagement teams, led by the group audit partner.

We then considered the components in the group that had either financially significant or unusual account balances which were required to be brought into scope. Where this was the case, we performed specific audit procedures over these account balances. We adopted this approach for Santander Consumer (UK) plc. Although the profit before tax of Santander Consumer (UK) plc is close to 15% of the group, taking into account the small proportion of the group's balance sheet and the audit risks, we determined not to perform a full scope audit, consistent with the prior years.

Certain processes and controls supporting the group's operations are also undertaken by Banco Santander S.A. in Spain, including the hosting and monitoring of certain IT systems. Some audit procedures on group operations were performed by PwC Spain.

As part of the planning and execution of the audit, we worked closely with the PwC Consumer (UK) plc and PwC Spain auditors throughout the year to ensure that the procedures performed on our behalf were sufficient for our purposes. We reviewed the results of their work and held meetings with the auditors to discuss their findings.

The procedures which we performed over the reporting units accounted for 94.0% of total operating income and 94.2% of total assets of the group.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Financial statements - group	Financial statements - company
Overall materiality	£59 million (2020: £57 million).	£50 million (2020: £50 million).
How we determined it	3% of adjusted profit before tax (2020: 5% of the adjusted average profit before tax for the last three years)	4% of adjusted profit before tax (2020: 5% of the adjusted average profit before tax for the last three years)
Rationale for benchmark applied	We initially set materiality using a benchmark of forecasted profit before tax (PBT), adjusted for certain non-recurring items, as these items do not reflect the underlying business performance and are not expected to recur. PBT is a primary measure used by the shareholder in assessing the performance of the group and is a generally accepted benchmark for determining audit materiality. In the prior year, we used a three years average PBT to adjust for the volatility in profits caused by the global pandemic. However, in the current year as the group's profitability was forecast to return to pre global pandemic levels, we deemed it appropriate to use the current year's forecasted adjusted PBT as our benchmark. As the full year results exceeded forecasts, we determined it appropriate to maintain our overall materiality at the £59 million calculated in our audit plan, which equates to 3% of the full year actual adjusted PBT.	We initially set materiality using a benchmark of forecasted profit before tax (PBT), adjusted for certain non-recurring items, as these items do not reflect the underlying business performance and are not expected to recur. PBT is a primary measure used by the shareholder in assessing the performance of the group and is a generally accepted benchmark for determining audit materiality. In the prior year, we used a three years average PBT to adjust for the volatility in profits caused by the global pandemic. However, in the current year as the group's profitability was forecast to return to pre global pandemic levels, we deemed it appropriate to use the current year's forecasted adjusted PBT as our benchmark. As the full year results exceeded forecasts, we determined it appropriate to maintain our overall materiality at the £50 million calculated in our audit plan, which equates to 4% of the full year actual adjusted PBT.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £8 million and £50 million, based on the relative size of each in scope component and assessment of our audit risk. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% (2020: 75%) of overall materiality, amounting to £44 million (2020: £43 million) for the group financial statements and £37 million (2020: £38 million) for the company financial statements.

In determining the performance materiality, we considered a number of factors - the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls - and concluded that an amount in the middle of our normal range was appropriate.

We agreed with the Board Audit Committee that we would report to them misstatements identified during our audit above £4 million (group audit) (2020: £4 million) and £4 million (company audit) (2020: £4 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

Our evaluation of the directors' assessment of the group's and the company's ability to continue to adopt the going concern basis of accounting included:

- A risk assessment to identify factors that could impact the going concern basis of accounting, including the current and forecast financial performance, regulatory metrics and the sector in which the group operates;
- Evaluation of the reasonableness of the group's three year plan, including testing the mathematical accuracy of the forecasts, testing key assumptions and a sensitivity analysis using our understanding of the group and its financial and operating performance obtained during the course of our audit;
- Review of the group's ICAAP and ILAAP, regulatory correspondence and reports provided to governance forums, and testing of the total capital resources and liquidity financing facilities;
- Evaluation of the results of stress testing performed by management; and
- Reviewing the appropriateness of the disclosures in the Annual Report.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group's and the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the group's and the company's ability to continue as a going concern.

In relation to the directors' reporting on how they have applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on our work undertaken in the course of the audit, the Companies Act 2006 requires us also to report certain opinions and matters as described below.

Strategic report and Directors' Report
In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Directors' Report for the year ended 31 December 2021 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the group and company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Directors' Report.

Corporate governance statement

ISAs (UK) require us to review the directors' statements in relation to going concern, longer-term viability and that part of the corporate governance statement relating to the company's compliance with the provisions of the UK Corporate Governance Code, which the Listing Rules of the Financial Conduct Authority specify for review by auditors of premium listed companies. Our additional responsibilities with respect to the corporate governance statement as other information are described in the Reporting on other information section of this report.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement, included within the Directors' report is materially consistent with the financial statements and our knowledge obtained during the audit, and we have nothing material to add or draw attention to in relation to:

- The directors' confirmation that they have carried out a robust assessment of the emerging and principal risks;
- The disclosures in the Annual Report that describe those principal risks, what procedures are in place to identify emerging risks and an explanation of how these are being managed or mitigated;
- The directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the group's and company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- The directors' explanation as to their assessment of the group's and company's prospects, the period this assessment covers and why the period is appropriate; and
- The directors' statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of its assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Our review of the directors' statement regarding the longer-term viability of the group was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statement; checking that the statement is in alignment with the relevant provisions of the UK Corporate Governance Code; and considering whether the statement is consistent with the financial statements and our knowledge and understanding of the group and company and their environment obtained in the course of the audit.

In addition, based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement is materially consistent with the financial statements and our knowledge obtained during the audit:

- The directors' statement that they consider the Annual Report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for the members to assess the group's and company's position, performance, business model and strategy;
- The section of the Annual Report that describes the review of effectiveness of risk management and internal control systems; and
- The section of the Annual Report describing the work of the Board Audit Committee.

We have nothing to report in respect of our responsibility to report when the directors' statement relating to the company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified under the Listing Rules for review by the auditors.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements
As explained more fully in the Statement of the Directors' responsibilities, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the company or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for presenting and marking up the consolidated financial statements in compliance with the requirements set out in the Delegated Regulation 2019/815 on European Single Electronic Format ("ESEF Regulation").

Auditors' responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the group and industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of banking laws and regulations such as, but not limited to, regulations relating to consumer credit and unethical and prohibited business practices, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to management bias through judgements and assumptions in significant accounting estimates. The group engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the group engagement team and/or component auditors included:

- Discussions with management, including the Chief Legal and Regulatory Officer, Internal Audit and those charged with governance in relation to known or suspected instances of non-compliance with laws and regulation and fraud;
- Evaluation of the completeness of matters identified by management which might impact financial reporting, including but not restricted to the procedures below;
- Evaluation and testing of the operating effectiveness of management's entity level controls designed to prevent and detect irregularities, in particular their code of conduct and whistleblowing helpline;
- Assessment of matters reported on the group's whistleblowing helpline and the results of management's investigation of such matters;
- Observing the effectiveness of key governance forums, reviewing management information presented and reviewing minutes of executive management meetings;
- Reviewing key correspondence with the Financial Conduct Authority and Prudential Regulation Authority and meeting with these regulators during the year;
- Challenging assumptions and judgements made by management in their significant accounting estimates, in particular in relation to the expected credit loss allowance for loans and advances to customers, legal and regulatory matters, the valuation of defined benefit pension surplus and the impairment assessment of goodwill (see related key audit matters above);
- Identifying and testing journal entries, in particular any journal entries posted by senior management and testing period end adjustments; and
- Incorporated unpredictability into the nature, timing and/or extent of our testing.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

It is also our responsibility to assess whether the consolidated financial statements have been prepared, in all material respects, in compliance with the requirements laid down in the ESEF Regulation.

Use of this report
This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, 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.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.

Report on other legal and regulatory requirements

We have checked the compliance of the consolidated financial statements of the Group as at 31 December 2021 with the relevant statutory requirements set out in the ESEF Regulation that are applicable to financial statements. That is, for the Group:

- The consolidated financial statements are prepared in a valid xHTML format;
- The XBRL markup of the consolidated financial statements uses the core taxonomy and the common rules on markups specified in the ESEF regulation.

In our opinion, the consolidated financial statements of the Group as at 31 December 2021, identified as PTCQB104N23FMNK2RZ28-2021-12-31.zip, have been prepared, in all material respects, in compliance with the requirements laid down in the ESEF Regulation.

Appointment

Following the recommendation of the Board Audit Committee, we were appointed by the members on 31 March 2016 to audit the financial statements for the year ended 31 December 2016 and subsequent financial periods. The period of total uninterrupted engagement is 6 years, covering the years ended 31 December 2016 to 31 December 2021.

Other matter

Other Code provisions

The directors have prepared a corporate governance statement and requested that we review it as though the company were a premium listed company. Auditors of premium listed companies are required to report when the directors' statement relating to the company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors. We have nothing to report in respect of this requirement.

Laura Needham (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
1 March 2022

Consolidated Income Statement

For the years ended 31 December

	Notes	2021 £m	2020[1] £m	2019[1] £m
Interest and similar income	3	**4,762**	5,031	5,817
Interest expense and similar charges	3	**(813)**	(1,643)	(2,593)
Net interest income		**3,949**	3,388	3,224
Fee and commission income	4	**697**	680	1,038
Fee and commission expense	4	**(411)**	(361)	(414)
Net fee and commission income		**286**	319	624
Other operating income	5	**264**	145	187
Total operating income		**4,499**	3,852	4,035
Operating expenses before credit impairment write-backs/losses, provisions and charges	6	**(2,510)**	(2,390)	(2,439)
Credit impairment write-backs/ (losses)	8	**233**	(638)	(199)
Provisions for other liabilities and charges	8	**(377)**	(264)	(426)
Total operating credit impairment write-backs/losses, provisions and charges		**(144)**	(902)	(625)
Profit from continuing operations before tax		**1,845**	560	971
Tax on profit from continuing operations		**(492)**	(121)	(268)
Profit from continuing operations after tax		**1,353**	439	703
Profit/(loss) from discontinued operations after tax	**43**	**31**	32	30
Profit after tax		**1,384**	471	733
Attributable to:				
Equity holders of the parent		**1,365**	452	714
Non-controlling interests	34	**19**	19	19
Profit after tax		**1,384**	471	733

(1) Adjusted to reflect the presentation of discontinued operations as set out in Note 43.

The accompanying Notes to the Financial Statements form an integral part of these Consolidated Financial Statements.

Consolidated Statement of Comprehensive Income

For the years ended 31 December

	2021 £m	2020 £m	2019 £m
Profit after tax	**1,384**	471	733
Other comprehensive(expense)/income that may be reclassified to profit or loss subsequently:			
Movement in fair value reserve (debt instruments):			
– Change in fair value	**(111)**	114	147
– Income statement transfers	**110**	(107)	(147)
– Taxation	**(2)**	(2)	—
	(3)	5	—
Cash flow hedges:			
– Effective portion of changes in fair value	**(873)**	971	(857)
– Income statement transfers	**358**	(809)	1,013
– Taxation	**141**	(52)	(41)
	(374)	110	115
Currency translation on foreign operations	**—**	—	(4)
Net other comprehensive (expense)/income that may be reclassified to profit or loss subsequently	**(377)**	115	111
Other comprehensive income/(expense) that will not be reclassified to profit or loss subsequently:			
Pension remeasurement:			
– Change in fair value	**1,264**	(505)	(522)
– Taxation	**(419)**	133	131
	845	(372)	(391)
Own credit adjustment:			
– Change in fair value	**—**	(3)	(77)
– Taxation	**—**	—	19
	—	(3)	(58)
Net other comprehensive income/(expense) that will not be reclassified to profit or loss subsequently	**845**	(375)	(449)
Total other comprehensive income/(expense) net of tax	**468**	(260)	(338)
Total comprehensive income	**1,852**	211	395
Attributable to:			
Equity holders of the parent	**1,833**	194	374
Non-controlling interests	**19**	17	21
Total comprehensive income	**1,852**	211	395

The accompanying Notes to the Financial Statements form an integral part of these Consolidated Financial Statements.

Consolidated Balance Sheet

At 31 December

	Notes	2021 £m	2020 £m
Assets			
Cash and balances at central banks		**48,139**	41,250
Financial assets at fair value through profit or loss:			
– Derivative financial instruments	11	**1,681**	3,406
– Other financial assets at fair value through profit or loss	12	**185**	208
Financial assets at amortised cost:			
– Loans and advances to customers	13	**210,094**	208,750
– Loans and advances to banks		**1,169**	1,682
– Reverse repurchase agreements – non trading	16	**12,683**	19,599
– Other financial assets at amortised cost	17	**506**	1,163
Financial assets at fair value through other comprehensive income	18	**5,851**	8,950
Interests in other entities	19	**201**	172
Intangible assets	20	**1,545**	1,646
Property, plant and equipment	21	**1,548**	1,734
Current tax assets		**347**	264
Retirement benefit assets	30	**1,572**	495
Other assets		**1,577**	3,013
Total assets		**287,098**	292,332
Liabilities			
Financial liabilities at fair value through profit or loss:			
– Derivative financial instruments	11	**777**	1,584
– Other financial liabilities at fair value through profit or loss	22	**803**	1,434
Financial liabilities at amortised cost:			
– Deposits by customers	23	**192,926**	195,135
– Deposits by banks	24	**33,855**	20,958
– Repurchase agreements – non trading	25	**11,718**	15,848
– Debt securities in issue	26	**25,520**	35,566
– Subordinated liabilities	27	**2,228**	2,556
Other liabilities	28	**2,189**	2,337
Provisions	29	**364**	464
Deferred tax liabilities		**579**	111
Retirement benefit obligations	30	**37**	403
Total liabilities		**270,996**	276,396
Equity			
Share capital	32	**3,105**	3,105
Share premium	32	**5,620**	5,620
Other equity instruments	33	**2,191**	2,191
Retained earnings		**5,053**	4,348
Other reserves		**133**	510
Total shareholders' equity		**16,102**	15,774
Non-controlling interests	34	**—**	162
Total equity		**16,102**	15,936
Total liabilities and equity		**287,098**	292,332

The accompanying Notes to the Financial Statements form an integral part of these Consolidated Financial Statements.

The Financial Statements were approved and authorised for issue by the Board on1 March 2022 and signed on its behalf by:

Nathan Bostock
Chief Executive Officer
Company Registered Number: 2294747

Madhukar Dayal
Chief Financial Officer

Consolidated Cash Flow Statement[1]

For the years ended 31 December

	2021 £m	2020 £m	2019 £m
Cash flows from operating activities			
Profit after tax	**1,384**	471	733
Adjustments for:			
Non-cash items included in profit:			
– Depreciation and amortisation	**501**	562	543
– Provisions for other liabilities and charges	**381**	273	441
– Impairment losses	**(228)**	672	239
– Corporation tax charge	**504**	134	279
– Other non-cash items	**(147)**	(267)	(439)
– Pension charge/(credit) for defined benefit pension schemes	**38**	38	35
	1,049	1,412	1,098
Net change in operating assets and liabilities:			
– Cash and balances at central banks	**(64)**	(147)	(71)
– Derivative assets	**1,725**	(90)	1,943
– Other financial assets at fair value through profit or loss	**1,007**	1,603	1,664
– Loans and advances to banks and customers	**(971)**	(2,654)	170
– Reverse repurchase agreements - non trading	**7,024**	3,924	(5,044)
– Other assets	**324**	(340)	247
– Deposits by banks and customers	**10,735**	19,977	641
– Repurchase agreements - non trading	**(7,550)**	(2,958)	5,943
– Derivative liabilities	**(807)**	136	79
– Other financial liabilities at fair value through profit or loss	**(1,109)**	(1,618)	(959)
– Debt securities in issue	**(329)**	(223)	(529)
– Other liabilities	**(603)**	(921)	(514)
	9,382	16,689	3,570
Corporation taxes paid	**(427)**	(159)	(292)
Effects of exchange rate differences	**(542)**	410	(1,079)
Net cash flows from operating activities	**10,846**	18,823	4,030
Cash flows from investing activities			
Purchase of property, plant and equipment and intangible assets	**(613)**	(373)	(505)
Proceeds from sale of property, plant and equipment and intangible assets	**437**	166	108
Purchase of financial assets at amortised cost and financial assets at FVOCI	**(1,256)**	(3,015)	(5,013)
Proceeds from sale and redemption of financial assets at amortised cost and financial assets at FVOCI	**4,509**	9,858	8,300
Net cash flows from investing activities	**3,077**	6,636	2,890
Cash flows from financing activities			
Issue of other equity instruments	**210**	—	500
Issue of debt securities and subordinated notes	**2,878**	5,614	4,145
Issuance costs of debt securities and subordinated notes	**(6)**	(13)	(15)
Repayment of debt securities and subordinated notes	**(11,914)**	(12,037)	(7,969)
Repurchase of preference shares	**—**	—	(14)
Disposal of non-controlling interests	**(181)**	—	—
Repurchase of other equity instruments	**(210)**	—	(304)
Dividends paid on ordinary shares	**(1,358)**	(129)	(315)
Dividends paid on preference shares and other equity instruments	**(147)**	(148)	(142)
Dividends paid on non-controlling interests	**—**	(15)	(12)
Principal elements of lease payments	**(25)**	(45)	(54)
Net cash flows from financing activities	**(10,753)**	(6,773)	(4,180)
Change in cash and cash equivalents	**3,170**	18,686	2,740
Cash and cash equivalents at beginning of the year	**47,682**	28,951	26,264
Effects of exchange rate changes on cash and cash equivalents	**(18)**	45	(53)
Cash and cash equivalents at the end of the year	**50,834**	47,682	28,951
Cash and cash equivalents consist of:			
Cash and balances at central banks	**48,139**	41,250	21,180
Less: regulatory minimum cash balances	**(918)**	(854)	(707)
	47,221	40,396	20,473
Other cash equivalents: Loans and advances to banks - Non trading	**1,074**	1,435	1,995
Other cash equivalents: Reverse repurchase agreements	**2,539**	5,851	6,483
Cash and cash equivalents at the end of the year	**50,834**	47,682	28,951

(1) For more information on cash flows and amounts restated see Note 35.

The accompanying Notes to the Financial Statements form an integral part of these Consolidated Financial Statements.

Consolidated Statement of Changes in Equity

For the years ended 31 December

	Share capital	Share premium	Other equity instruments	Other reserves			Retained earnings	Total	Non-controlling interests	Total
				Fair value	Cash flow hedging	Currency translation				
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	**3,105**	**5,620**	**2,191**	**28**	**481**	**1**	**4,348**	**15,774**	**162**	**15,936**
Profit after tax	—	—	—	—	—	—	1,365	1,365	19	1,384
Other comprehensive (expense)/income, net of tax:										
– Fair value reserve (debt instruments)	—	—	—	(3)	—	—	—	(3)	—	(3)
– Cash flow hedges	—	—	—	—	(374)	—	—	(374)	—	(374)
– Pension remeasurement	—	—	—	—	—	—	845	845	—	845
Total comprehensive income	—	—	—	(3)	(374)	—	2,210	1,833	19	1,852
Issue of other equity instruments	—	—	210	—	—	—	—	210	—	210
Repurchase of other equity instruments	—	—	(210)	—	—	—	—	(210)	—	(210)
Disposal of non-controlling interests	—	—	—	—	—	—	—	—	(181)	(181)
Dividends on ordinary shares	—	—	—	—	—	—	(1,358)	(1,358)	—	(1,358)
Dividends on preference shares and other equity instruments	—	—	—	—	—	—	(147)	(147)	—	(147)
Dividends on non-controlling interests	—	—	—	—	—	—	—	—	—	—
Tax on non-controlling interests and other equity instruments	—	—	—	—	—	—	—	—	—	—
At 31 December 2021	**3,105**	**5,620**	**2,191**	**25**	**107**	**1**	**5,053**	**16,102**	**—**	**16,102**
At 1 January 2020	3,105	5,620	2,191	23	371	1	4,546	15,857	160	16,017
Profit after tax	—	—	—	—	—	—	452	452	19	471
Other comprehensive income, net of tax:										
– Fair value reserve (debt instruments)	—	—	—	5	—	—	—	5	—	5
– Cash flow hedges	—	—	—	—	110	—	—	110	—	110
– Pension remeasurement	—	—	—	—	—	—	(370)	(370)	(2)	(372)
– Own credit adjustment	—	—	—	—	—	—	(3)	(3)	—	(3)
Total comprehensive income	—	—	—	5	110	—	79	194	17	211
Dividends on ordinary shares	—	—	—	—	—	—	(129)	(129)	—	(129)
Dividends on preference shares and other equity instruments	—	—	—	—	—	—	(148)	(148)	—	(148)
Dividends on non-controlling interests	—	—	—	—	—	—	—	—	(15)	(15)
At 31 December 2020	3,105	5,620	2,191	28	481	1	4,348	15,774	162	15,936
At 1 January 2019	3,119	5,620	1,991	23	256	5	4,744	15,758	151	15,909
Profit after tax	—	—	—	—	—	—	714	714	19	733
Other comprehensive income, net of tax:										
– Cash flow hedges	—	—	—	—	115	—	—	115	—	115
– Pension remeasurement	—	—	—	—	—	—	(393)	(393)	2	(391)
– Own credit adjustment	—	—	—	—	—	—	(58)	(58)	—	(58)
– Currency translation on foreign operations	—	—	—	—	—	(4)	—	(4)	—	(4)
Total comprehensive income	—	—	—	—	115	(4)	263	374	21	395
Issue of other equity instruments	—	—	500	—	—	—	—	500	—	500
Repurchase of other equity instruments	(14)	—	(300)	—	—	—	(4)	(318)	—	(318)
Dividends on ordinary shares	—	—	—	—	—	—	(315)	(315)	—	(315)
Dividends on preference shares and other equity instruments	—	—	—	—	—	—	(142)	(142)	—	(142)
Dividends on non-controlling interests	—	—	—	—	—	—	—	—	(12)	(12)
At 31 December 2019	3,105	5,620	2,191	23	371	1	4,546	15,857	160	16,017

The accompanying Notes to the Financial Statements form an integral part of these Consolidated Financial Statements.

Company Balance Sheet

At 31 December

	Notes	2021 £m	2020 £m
Assets			
Cash and balances at central banks		**48,139**	41,250
Financial assets at fair value through profit or loss:			
– Derivative financial instruments	11	**1,875**	3,568
– Other financial assets at fair value through profit or loss	12	**94**	101
Financial assets at amortised cost:			
– Loans and advances to customers	13	**222,861**	227,217
– Loans and advances to banks		**1,200**	1,600
– Reverse repurchase agreements – non trading	16	**12,683**	19,599
– Other financial assets at amortised cost	17	**2,090**	5,251
Financial assets at fair value through other comprehensive income	18	**5,833**	8,929
Interests in other entities	19	**1,247**	1,248
Intangible assets	20	**1,524**	1,615
Property, plant and equipment	21	**935**	982
Current tax assets	9	**445**	354
Retirement benefit assets	30	**1,572**	481
Other assets		**1,122**	2,530
Total assets		**301,620**	314,725
Liabilities			
Financial liabilities at fair value through profit or loss:			
– Derivative financial instruments	11	**1,242**	2,748
– Other financial liabilities at fair value through profit or loss	22	**804**	1,434
Financial liabilities at amortised cost:			
– Deposits by customers	23	**205,034**	216,075
– Deposits by banks	24	**38,845**	25,705
– Repurchase agreements – non trading	25	**11,718**	15,845
– Debt securities in issue	26	**24,554**	32,844
– Subordinated liabilities	27	**2,233**	2,586
Other liabilities	28	**1,938**	2,021
Provisions	29	**364**	460
Deferred tax liabilities	9	**598**	215
Retirement benefit obligations	30	**37**	403
Total liabilities		**287,367**	300,336
Equity			
Share capital	32	**3,105**	3,105
Share premium	32	**5,620**	5,620
Other equity instruments	33	**2,191**	2,191
Retained earnings		**3,303**	3,177
Other reserves		**34**	296
Total shareholders' equity		**14,253**	14,389
Total liabilities and equity		**301,620**	314,725

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

The profit after tax of the Company attributable to shareholders was £786m (2020: £261m). As permitted by Section 408 of the UK Companies Act 2006, the Company's individual Income Statement has not been presented.

The Financial Statements were approved and authorised for issue by the Board on 1 March 2022 and signed on its behalf by:

Nathan Bostock
Chief Executive Officer

Madhukar Dayal
Chief Financial Officer

Company Registered Number: 2294747

Company Cash Flow Statement

For the years ended 31 December

	2021 £m	2020 £m	2019 £m
Cash flows from operating activities			
Profit after tax	**786**	261	336
Adjustments for:			
Non-cash items included in profit:			
– Depreciation and amortisation	**373**	454	434
– Provisions for other liabilities and charges	**385**	264	433
– Impairment losses	**(205)**	609	239
– Corporation tax charge	**327**	117	248
– Other non-cash items	**215**	(238)	(686)
– Pension charge/(credit) for defined benefit pension schemes	**29**	26	23
	1,124	1,232	691
Net change in operating assets and liabilities:			
– Cash and balances at central banks	**(64)**	(147)	(71)
– Derivative assets	**1,694**	(66)	1,610
– Other financial assets at fair value through profit or loss	**984**	1,584	1,575
– Loans and advances to banks and customers	**4,449**	(3,100)	(10,818)
– Reverse repurchase agreements – non trading	**7,024**	3,924	(5,044)
– Other assets	**475**	(310)	1,765
– Deposits by banks and customers	**2,160**	18,689	2,484
– Repurchase agreements – non trading	**(7,546)**	(2,956)	5,937
– Derivative liabilities	**(1,507)**	397	(499)
– Other financial liabilities at fair value through profit or loss	**(1,108)**	(1,645)	(558)
– Debt securities in issue	**(380)**	(52)	(528)
– Other liabilities	**(534)**	(790)	(669)
	5,647	15,528	(4,816)
Corporation taxes paid	**(360)**	(86)	(233)
Effects of exchange rate differences	**(557)**	430	(886)
Net cash flows from operating activities	**6,640**	17,365	(4,908)
Cash flows from investing activities			
Purchase of property, plant and equipment and intangible assets	**(327)**	(184)	(236)
Proceeds from sale of property, plant and equipment and intangible assets	**52**	44	33
Purchase of financial assets at amortised cost and financial assets at FVOCI	**(1,256)**	(3,185)	(6,211)
Proceeds from sale and redemption of financial assets at amortised cost and financial assets at FVOCI	**7,010**	10,141	8,300
Net cash flows from investing activities	**5,479**	6,816	1,886
Cash flows from financing activities			
Issue of other equity instruments	**210**	—	500
Issue of debt securities and subordinated notes	**2,876**	5,610	3,881
Issuance costs of debt securities and subordinated notes	**(4)**	(10)	(11)
Repayment of debt securities and subordinated notes	**(10,282)**	(10,782)	(6,315)
Repurchase of preference shares	**—**	—	(14)
Repurchase of other equity instruments	**(210)**	—	(304)
Dividends paid on ordinary shares	**(1,358)**	(129)	(315)
Dividends paid on preference shares and other equity instruments	**(147)**	(148)	(142)
Principal elements of lease payments	**(23)**	(43)	(53)
Net cash flows from financing activities	**(8,938)**	(5,502)	(2,773)
Change in cash and cash equivalents	**3,181**	18,679	(5,795)
Cash and cash equivalents at beginning of the year	**47,671**	28,947	34,792
Effects of exchange rate changes on cash and cash equivalents	**(18)**	45	(50)
Cash and cash equivalents at the end of the year	**50,834**	47,671	28,947
Cash and cash equivalents comprise of:			
Cash and balances at central banks	**48,139**	41,250	21,180
Less: regulatory minimum cash balances	**(918)**	(854)	(707)
	47,221	40,396	20,473
Other cash equivalents: Loans and advances to banks - Non trading	**1,074**	1,424	1,991
Other cash equivalents: Reverse repurchase agreements	**2,539**	5,851	6,483
Cash and cash equivalents at the end of the year	**50,834**	47,671	28,947

(1) For more information on cash flows and amounts restated see Note 35.

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

Company Statement of Changes in Equity

For the years ended 31 December

	Share capital £m	Share premium £m	Other equity instruments £m	Other reserves: Fair value £m	Other reserves: Cash flow hedging £m	Retained earnings £m	Total £m
At 1 January 2021	**3,105**	**5,620**	**2,191**	**29**	**267**	**3,177**	**14,389**
Profit after tax	**—**	**—**	**—**	**—**	**—**	**786**	**786**
Other comprehensive income, net of tax:							
– Fair value reserve (debt instruments)	**—**	**—**	**—**	**(3)**	**—**	**—**	**(3)**
– Cash flow hedges	**—**	**—**	**—**	**—**	**(259)**	**—**	**(259)**
– Pension remeasurement	**—**	**—**	**—**	**—**	**—**	**844**	**844**
– Own credit adjustment	**—**	**—**	**—**	**—**	**—**	**1**	**1**
Total comprehensive income	**—**	**—**	**—**	**(3)**	**(259)**	**1,631**	**1,369**
Issue of other equity instruments	**—**	**—**	**210**	**—**	**—**	**—**	**210**
Repurchase of other equity instruments	**—**	**—**	**(210)**	**—**	**—**	**—**	**(210)**
Dividends on ordinary shares	**—**	**—**	**—**	**—**	**—**	**(1,358)**	**(1,358)**
Dividends on preference shares and other equity instruments	**—**	**—**	**—**	**—**	**—**	**(147)**	**(147)**
At 31 December 2021	**3,105**	**5,620**	**2,191**	**26**	**8**	**3,303**	**14,253**
At 1 January 2020	3,105	5,620	2,191	25	143	3,563	14,647
Profit after tax	—	—	—	—	—	261	261
Other comprehensive income, net of tax:							
– Fair value (debt instruments)	—	—	—	4	—	—	4
– Cash flow hedges	—	—	—	—	124	—	124
– Pension remeasurement	—	—	—	—	—	(367)	(367)
– Own credit adjustment	—	—	—	—	—	(3)	(3)
Total comprehensive income	—	—	—	4	124	(109)	19
Dividends on ordinary shares	—	—	—	—	—	(129)	(129)
Dividends on preference shares and other equity instruments	—	—	—	—	—	(148)	(148)
At 31 December 2020	3,105	5,620	2,191	29	267	3,177	14,389
At 1 January 2019	3,119	5,620	1,991	25	(3)	4,144	14,896
Profit after tax	—	—	—	—	—	336	336
Other comprehensive income, net of tax:							
– Cash flow hedges	—	—	—	—	146	—	146
– Pension remeasurement	—	—	—	—	—	(398)	(398)
– Own credit adjustment	—	—	—	—	—	(58)	(58)
Total comprehensive income	—	—	—	—	146	(120)	26
Issue of other equity instruments	—	—	500	—	—	—	500
Repurchase of other equity instruments	(14)	—	(300)	—	—	(4)	(318)
Dividends on ordinary shares	—	—	—	—	—	(315)	(315)
Dividends on preference shares and other equity instruments	—	—	—	—	—	(142)	(142)
At 31 December 2019	3,105	5,620	2,191	25	143	3,563	14,647

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

1. ACCOUNTING POLICIES

These financial statements are prepared for Santander UK plc (the Company) and the Santander UK plc group (the Santander UK group) under the UK Companies Act 2006. The principal activity of the Santander UK group is the provision of a wide range of banking and financial services to personal, business and corporate customers. Santander UK plc is a public company, limited by shares and incorporated in England and Wales having a registered office at 2 Triton Square, Regent's Place, London, NW1 3AN, phone number 0870-607-6000. It is an operating company undertaking banking and financial services transactions.

Basis of preparation

These financial statements incorporate the financial statements of the Company and entities it controls (its subsidiaries) made up to 31 December each year. The consolidated financial statements have been prepared on the going concern basis using the historical cost convention, except for financial assets and liabilities that have been measured at fair value. An assessment of the appropriateness of the adoption of the going concern basis of accounting is disclosed in the statement of going concern in the Directors' report.

On 31 December 2020, International Financial Reporting Standards (IFRSs) as adopted by the European Union at that date were brought into UK law and became UK-adopted International Accounting Standards (IAS), with future changes being subject to endorsement by the UK Endorsement Board. The Company and its subsidiaries transitioned to UK-adopted IAS in its consolidated financial statements on 1 January 2021. This change constitutes a change in accounting framework. Although there was a change in accounting framework, this change had no impact on recognition, measurement or disclosures in the periods reported in these financial statements.

Compliance with International Financial Reporting Standards

The consolidated financial statements of the Santander UK group and the separate financial statements of the Company comply with UK-adopted IAS. The financial statements are also prepared in accordance with IFRSs as issued by the International Accounting Standards Board (IASB), including interpretations issued by the IFRS Interpretations Committee, as there are no applicable differences from IFRSs as issued by the IASB for the periods presented.

Disclosures required by IFRS 7 'Financial Instruments: Disclosure' relating to the nature and extent of risks arising from financial instruments, and IAS 1 'Presentation of Financial Statements' relating to objectives, policies and processes for managing capital, can be found in the risk governance, credit risk, market risk, liquidity risk and capital risk sections of the Risk review and are labelled as audited. Those disclosures form an integral part of these financial statements.

Climate change

Santander UK continues to develop its assessment of the potential impacts that climate change and the transition to a low carbon economy may have on the assets and liabilities recognised and presented in its financial statements.

Santander UK is mindful of its responsibilities as a responsible lender and is focused on ways to meet the objectives of the Paris Agreement on climate change and to support the UK's transition to a climate-resilient, net zero economy.

Santander UK's current climate change strategy focuses on three main areas to achieve Banco Santander's ambition to reach net zero emissions by 2050:

1. Managing climate risks by integrating climate considerations into risk management frameworks, screening and stress testing our portfolio for climate related financial risks, and setting risk appetites to help steer our portfolio in line with the Paris Agreement,
2. Supporting our customers' transition by developing products and services that promote a reduction in CO_2 emissions, and
3. Reducing emissions in our operations and supply chain by focusing on continuous improvement in our operations, and environmental and energy management systems in accordance with ISO14001 and 15001, promoting responsible procurement practices and employee engagement.

Santander UK's current climate change strategy and its view of the risks associated with climate change and the transition to a low carbon economy are reflected in its critical judgements and accounting estimates, although climate change risk did not have a significant impact at 31 December 2021, consistent with management's assessment that climate change and the transition to a low carbon economy are not currently expected to have a meaningful impact on the viability of the Santander UK group in the medium term.

At 31 December 2021, management specifically considered the potential impact of climate change and the transition to a low carbon economy on:

- Loans and advances to customers (see Note 13 and the credit risk section of the Risk review). Some climate change risks arise due to the requirements of IFRS 9 and others relate to specific portfolios and sectors:
  - ECL calculations are based on multiple forward-looking economic scenarios developed by management covering a period of five years, during which timeframe climate change risks may crystallise.
  - For Mortgages in Retail Banking and Commercial Real Estate lending in Corporate & Commercial Banking, the value of property collateral might be affected by physical impacts related to the frequency and scale of extreme weather events, such as flood and subsidence risk, or changing environmental performance standards for property.
  - For automotive loans in Consumer Finance, the residual value of automotive vehicles might be impacted by diesel obsolescence and the transition to electric vehicles.
  - For corporate lending in Corporate & Commercial Banking, certain sectors give rise to fossil fuel exposures, such as Oil & Gas, Mining & Extraction and Power Generation.
- Goodwill impairment assessment (see Note 20). Estimates underpinning the determination of whether or not goodwill balances are impaired are partly based on forecast business performance beyond the time horizon for management's detailed plans.

Future changes to Santander UK's climate change strategy may impact Santander UK's critical judgements and accounting estimates and result in material changes to financial results and the carrying values of certain assets and liabilities in future reporting periods.

Accounting developments

Interest Rate Benchmark Reform

In 2019, the IASB issued 'Interest Rate Benchmark Reform: Amendments to IFRS 9, IAS 39 and IFRS 7'. The Santander UK group applies IAS 39 hedge accounting so the amendments to IFRS 9 do not apply. Although the IAS 39 and IFRS 7 amendments, which apply to all hedging relationships directly affected by uncertainties related to interbank offered rate (IBOR) reform, became effective from 1 January 2020, following their endorsement, the Santander UK group early adopted those amendments in the preparation of the financial statements for the year ended 31 December 2019. The exceptions given by the IAS 39 amendments meant that IBOR reform had no impact on hedge relationships for affected hedges.

In 2020, the IASB issued 'Interest Rate Benchmark Reform – Phase 2 - Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16'. These amendments apply only to changes required by IBOR reform to financial instruments and hedging relationships. Although the amendments became effective from 1 January 2021 and are applied retrospectively without restating comparative information, following their endorsement, the Santander UK group early adopted the amendments in the preparation of the financial statements for the year ended 31 December 2020. The amendments address the accounting issues for financial instruments when IBOR reform is implemented including providing a practical expedient for changes to contractual cash flows, giving relief from specific hedge accounting requirements, and specifying a number of additional disclosures to enable users of financial statements to understand the effect of IBOR reform on an entity's financial instruments and risk management strategy.

Further details of the impact of these amendments on the financial statements for the year ended 31 December 2021 and the additional disclosures required are provided in Note 43.

Other changes

The Santander UK group adopted IFRS 16 and amendments to IAS 12 in 2019, with the impact included in the statement of changes in equity for that year end.

Future developments

At 31 December 2021, for the Santander UK group, there were no significant new or revised standards and interpretations, and amendments thereto, which have been issued but which are not yet effective, or which have otherwise not been early adopted where permitted.

Comparative information

As required by US public company reporting requirements, these financial statements include two years of comparative information for the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows and related notes.

Consolidation

a) Subsidiaries

The consolidated financial statements incorporate the financial statements of the Company and entities (including structured entities) controlled by it and its subsidiaries. Control is achieved where the Company (i) has power over the investee; (ii) is exposed, or has rights, to variable returns from its involvement with the investee; and (iii) has the ability to use its power to affect its returns. The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above. When the Company has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Company considers all relevant facts and circumstances in assessing whether or not the Company's voting rights in an investee are sufficient to give it power, including:

- The size of the Company's holding of voting rights relative to the size and dispersion of holdings of the other vote holders
- Potential voting rights held by the Company, other vote holders or other parties
- Rights arising from other contractual arrangements
- Any additional facts and circumstances that indicate that the Company has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, the results of a subsidiary acquired or disposed of during the year are included in the consolidated income statement and the consolidated statement of comprehensive income from the date the Company gains control until the date the Company loses control. Inter-company transactions, balances and unrealised gains on transactions between Santander UK group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered.

The acquisition method of accounting is used to account for the acquisition of subsidiaries which meet the definition of a business. The cost of an acquisition is measured at the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition. Acquisition-related costs are expensed as incurred. The excess of the cost of acquisition, as well as the fair value of any interest previously held, over the fair value of the Santander UK group's share of the identifiable net assets of the subsidiary at the date of acquisition is recorded as goodwill. When the Santander UK group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), less liabilities of the subsidiary and any non-controlling interests. Amounts previously recognised in other comprehensive income in relation to the subsidiary are accounted for (i.e. reclassified to profit or loss or transferred directly to retained earnings) in the same manner as would be required if the relevant assets or liabilities are disposed of. The fair value of any investment retained in a former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IFRS 9 or, when applicable, the costs on initial recognition of an investment in an associate or joint venture.

Business combinations between entities under common control (i.e. fellow subsidiaries of Banco Santander SA, the ultimate parent) are outside the scope of IFRS 3 – 'Business Combinations', and there is no other guidance for such transactions under IFRS. The Santander UK group elects to account for business combinations between entities under common control at their book values in the acquired entity by including the acquired entity's results from the date of the business combination and not restating comparatives. Reorganisations of entities within the Santander UK group are also accounted for at their book values.

Interests in subsidiaries are eliminated during the preparation of the consolidated financial statements. Interests in subsidiaries in the Company unconsolidated financial statements are held at cost subject to impairment.

Credit protection entities established as part of significant risk transfer (SRT) transactions are not consolidated by the Santander UK group in cases where third party investors have the exposure, or rights, to all of the variability of returns from the performance of the entities.

b) Joint ventures

Joint ventures are joint arrangements whereby the parties that have joint control of the arrangement have rights to its net assets. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control. Accounting policies of joint ventures have been aligned to the extent there are differences from the Santander UK group's policies. Investments in joint ventures are accounted for by the equity method of accounting and are initially recorded at cost and adjusted each year to reflect the Santander UK group's share of their post-acquisition results. When the Santander UK group's share of losses of a joint venture exceeds its interest in that joint venture, the Santander UK group discontinues recognising its share of further losses. Further losses are recognised only to the extent that the Santander UK group has incurred legal or constructive obligations or made payments on behalf of the joint venture..

Foreign currency translation

Items included in the financial statements of each entity in the Santander UK group are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity (the functional currency). The consolidated financial statements are presented in sterling, which is the functional currency of the Company.

Income statements and cash flows of foreign entities are translated into the Santander UK group's presentation currency at average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December. Exchange differences on the translation of the net investment in foreign entities are recognised in other comprehensive income. When a foreign entity is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Foreign currency transactions are translated into the functional currency of the entity involved at the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement unless recognised in other comprehensive income in connection with a cash flow hedge. Non-monetary items denominated in a foreign currency measured at historical cost are not retranslated. Exchange rate differences arising on non-monetary items measured at fair value are recognised in the consolidated income statement except for differences arising on equity securities measured at fair value through other comprehensive income (FVOCI), which are recognised in other comprehensive income.

Revenue recognition

a) Interest income and expense

Interest and similar income comprise interest income on financial assets measured at amortised cost, investments in debt instruments measured at FVOCI and interest income on hedging derivatives. Interest expense and similar charges comprises interest expense on financial liabilities measured at amortised cost, and interest expense on hedging derivatives. Interest income on financial assets measured at amortised cost, investments in debt instruments measured at FVOCI and interest expense on financial liabilities other than those at fair value through profit or loss (FVTPL) is determined using the effective interest rate method.

The effective interest rate is the rate that discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the gross carrying amount of the financial asset (i.e. its amortised cost before any impairment allowance) or to the amortised cost of a financial liability. When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument excluding expected credit losses. The calculation includes all amounts paid or received by the Santander UK group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of the financial instrument and all other premiums or discounts.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for financial assets that have subsequently become credit-impaired (i.e. Stage 3), for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e. net of the ECL provision). For more information on stage allocations of credit risk exposures, see 'Significant increase in credit risk' in the 'Santander UK group level – credit risk management' section of the Risk review.

b) Fee and commission income and expense
Fees and commissions that are not an integral part of the effective interest rate are recognised when the service is performed. Most fee and commission income is recognised at a point in time. Certain commitment, upfront and management fees are recognised over time but are not material. For retail and corporate products, fee and commission income consists principally of collection services fees, commission on foreign currencies, commission and other fees received from retailers for processing credit card transactions, fees received from other credit card issuers for providing cash advances for their customers through the Santander UK group's branch and ATM networks, annual fees payable by credit card holders and fees for non-banking financial products.

For insurance products, fee and commission income consists principally of commissions and profit share arising from the sale of building and contents insurance and life protection insurance. Commissions arising from the sale of buildings and contents insurance are recognised over the period of insurance cover, adjusted to take account of cancelled policies. Profit share income from the sale of buildings and contents insurance which is not subject to any adjustment is recognised when the profit share income is earned. Commissions and profit share arising from the sale of life protection insurance is subject to adjustment for cancellations of policies within 3 years from inception.

Fee and commission income which forms an integral part of the effective interest rate of a financial instrument (for example certain loan commitment fees) is recognised as an adjustment to the effective interest rate and recorded in 'Interest income'.

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

d) Other operating income
Other operating income includes all gains and losses from changes in the fair value of financial assets and liabilities held at fair value through profit or loss (comprising financial assets and liabilities held for trading, trading derivatives and other financial assets and liabilities at fair value through profit or loss), together with related interest income, expense, dividends, and changes in fair value of any derivatives managed in conjunction with these assets and liabilities. Changes in fair value of derivatives in a fair value hedging relationship are also recognised in other operating income. Other operating income also includes income from operating lease assets, and profits and losses arising on the sales of property, plant and equipment and subsidiary undertakings.

Borrowing costs
Borrowing costs directly attributable to the acquisition, construction, or production of qualifying assets, including computer software, which are assets that necessarily take a substantial period of time to develop for their intended use, are added to the cost of those assets, until the assets are substantially ready for their intended use. All other borrowing costs are recognised in profit or loss in the period in which they occur.

Pensions and other post-retirement benefits
a) Defined benefit schemes
A defined benefit scheme is a pension scheme that guarantees an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service or compensation. Pension costs are charged to 'Administration expenses', within the line item 'Operating expenses before impairment losses, provisions and charges' with the net interest on the defined benefit asset or liability included within 'Net interest income' in the income statement. The asset or liability recognised in respect of defined benefit pension schemes is the present value of the defined benefit obligation at the balance sheet date, less the fair value of scheme assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The assets of the schemes are measured at their fair values at the balance sheet date.

The present value of the defined benefit obligation is estimated by projecting forward the growth in current accrued pension benefits to reflect inflation and salary growth to the date of pension payment, then discounted to present value using the yield applicable to high-quality AA rated corporate bonds of the same currency and which have terms to maturity closest to the terms of the scheme liabilities, adjusted where necessary to match those terms. In determining the value of scheme liabilities, demographic and financial assumptions are made by management about life expectancy, inflation, discount rates, pension increases and earnings growth, based on past experience and future expectations. Financial assumptions are based on market conditions at the balance sheet date and can generally be derived objectively.

Demographic assumptions require a greater degree of estimation and judgement to be applied to externally derived data. Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). An asset is only recognised to the extent that the surplus can be recovered through reduced contributions in the future or through refunds from the scheme. The income statement includes the net interest income/expense on the net defined benefit liability/asset, current service cost and any past service cost and gain or loss on settlement. Remeasurement of defined benefit pension schemes, including return on scheme assets (excludes amounts included in net interest), actuarial gains and losses (arising from changes in demographic assumptions, the impact of scheme experience and changes in financial assumptions) and the effect of the changes to the asset ceiling (if applicable), are recognised in other comprehensive income. Remeasurement recognised in other comprehensive income will not be reclassified to the income statement. Past service costs are recognised as an expense in the income statement at the earlier of when the scheme amendment or curtailment occurs and when the related restructuring costs or termination benefits are recognised. Curtailments include the impact of significant reductions in the number of employees covered by a scheme, or amendments to the terms of the scheme so that a significant element of future service will no longer qualify for benefits or will qualify only for reduced benefits. Curtailment gains and losses on businesses that meet the definition of discontinued operations are included in profit or loss for the year from discontinued operations. Gains and losses on settlements are recognised when the settlement occurs.

b) Defined contribution plans
A defined contribution plan is a pension scheme under which the Santander UK group pays fixed contributions as they fall due into a separate entity (a fund). The pension paid to the member at retirement is based on the amount in the separate fund for each member. The Santander UK group has no legal or constructive obligations to pay further contributions into the fund to 'top up' benefits to a certain guaranteed level. The regular contributions constitute net periodic costs for the year in which they are due and are included in staff costs within Operating expenses in the income statement.

c) Post-retirement medical benefit plans
Post-retirement medical benefit liabilities are determined using the projected unit credit method, with actuarial valuations updated at each year-end. The expected benefit costs are accrued over the period of employment using an accounting methodology similar to that for the defined benefit pension scheme.

Share-based payments

The Santander UK group engages in cash-settled and equity-settled share-based payment transactions in respect of services received from certain of its employees. Shares of the Santander UK group's parent, Banco Santander SA are purchased in the open market by the Santander UK group (for the Employee Sharesave scheme) or are purchased by Banco Santander SA or another Banco Santander subsidiary (including awards granted under the Long-Term Incentive Plan and the Deferred Shares Bonus Plan) to satisfy share options or awards as they vest.

Options granted under the Employee Sharesave scheme and awards granted under the Transformation Incentive Plan are accounted for as cash-settled share-based payment transactions. Awards granted under the Long-Term Incentive Plan and Deferred Shares Bonus Plan are accounted for as equity-settled share-based payment transactions.

The fair value of the services received is measured by reference to the fair value of the shares or share options initially on the date of the grant for both the cash and equity settled share-based payments and then subsequently at each reporting date for the cash-settled share-based payments. The cost of the employee services received in respect of the shares or share options granted is recognised in the income statement in administration expenses over the period that the services are received i.e. the vesting period.

A liability equal to the portion of the services received is recognised at the fair value determined at each balance sheet date for cash-settled share-based payments. A liability equal to the amount to be reimbursed to Banco Santander SA is recognised at the fair value determined at the grant date for equity-settled share-based payments.

The fair value of the options granted under the Employee Sharesave scheme is determined using an option pricing model, which takes into account the exercise price of the option, the current share price, the risk-free interest rate, the expected volatility of the Banco Santander SA share price over the life of the option and the dividend growth rate. The fair value of the awards granted for the Long-Term Incentive Plan was determined at the grant date using an option pricing model, which takes into account the share price at grant date, the risk-free interest rate, the expected volatility of the Banco Santander SA share price over the life of the award and the dividend growth rate. Vesting conditions included in the terms of the grant are not taken into account in estimating fair value, except for those that include terms related to market conditions. Non-market vesting conditions are taken into account by adjusting the number of shares or share options included in the measurement of the cost of employee service so that, ultimately, the amount recognised in the income statement reflects the number of vested shares or share options. Where vesting conditions are related to market conditions, the charges for the services received are recognised regardless of whether or not the market–related vesting conditions are met, provided that the non-market vesting conditions are met.

Where an award has been modified, as a minimum, the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award or incremental fair value of the modification of the award is recognised in addition to the expense of the original grant, measured at the date of modification, over the modified vesting period.

Cancellations in the vesting period are treated as an acceleration of vesting and recognised immediately for the amount that would otherwise have been recognised for services over the vesting period.

Goodwill and other intangible assets

Goodwill represents the excess of the cost of an acquisition, as well as the fair value of any interest previously held, over the fair value of the share of the identifiable net assets of the acquired subsidiary, associate, or business at the date of acquisition. Goodwill on the acquisition of subsidiaries and businesses is included in intangible assets. Goodwill on acquisitions of associates is included as part of investment in associates. Goodwill is tested for impairment annually, or more frequently when events or changes in circumstances dictate, and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity or business include the carrying amount of goodwill relating to the entity or business sold.

Other intangible assets are recognised if they arise from contractual or other legal rights or if they are capable of being separated or divided from Santander UK and sold, transferred, licensed, rented or exchanged. The value of such intangible assets, where they are available for use, is amortised on a straight-line basis over their useful economic life of three to seven years and the assets are reviewed annually for impairment indicators and tested for impairment where indicators are present. Other intangible assets that are not yet available for use are tested for impairment annually or more frequently when events or changes in circumstances dictate.

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

Property, plant and equipment

Property, plant and equipment include owner-occupied properties (including leasehold properties), office fixtures and equipment and computer software. Property, plant and equipment also includes operating leases where the Santander UK group is the lessor and right-of-use assets where the Santander UK group is the lessee, as described further in 'Leases' below. As lessor, the Santander UK group leases properties, vehicles and other equipment which are classified as operating leases because they do not transfer substantially all of the risks and rewards incidental to ownership of the assets. Property, plant and equipment are carried at cost less accumulated depreciation and accumulated impairment losses. A review for indications of impairment is carried out at each reporting date. Gains and losses on disposal are determined by reference to the carrying amount and are reported in other operating income. Repairs and renewals are charged to the income statement when the expenditure is incurred. Internally developed software meeting the criteria set out in 'Goodwill and other intangible assets' above and externally purchased software are classified in property, plant and equipment where the software is an integral part of the related computer hardware (for example operating system of a computer). Classes of property, plant and equipment are depreciated on a straight-line basis over their useful life, as follows:

Owner-occupied properties	Not exceeding 50 years
Office fixtures and equipment	3 to 15 years
Computer software	3 to 7 years
Right-of-use assets (see 'Leases – The Santander UK group as lessee' below)	Shorter of the lease term or the useful life of the underlying asset

Depreciation is not charged on freehold land and assets under construction. Depreciation on operating lease assets where the Santander UK group is the lessor is described in 'Leases' below.

Financial instruments

a) Initial recognition and measurement

Financial assets and liabilities are initially recognised when the Santander UK group becomes a party to the contractual terms of the instrument. The Santander UK group determines the classification of its financial assets and liabilities at initial recognition and measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at FVTPL, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs of financial assets and financial liabilities carried at FVTPL are expensed in profit or loss. Immediately after initial recognition, an expected credit loss (ECL) allowance is recognised for financial assets measured at amortised cost and investments in debt instruments measured at FVOCI.

A regular way purchase is a purchase of a financial asset under a contract whose terms require delivery of the asset within the timeframe established generally by regulation or convention in the marketplace concerned. Regular way purchases of financial assets classified as loans and receivables, issues of equity or financial liabilities measured at amortised cost are recognised on settlement date; all other regular way purchases and issues are recognised on trade date.

b) Financial assets and liabilities

i) Classification and subsequent measurement

The Santander UK group classifies its financial assets in the measurement categories of amortised cost, FVOCI and FVTPL.

Financial assets and financial liabilities are classified as FVTPL where there is a requirement to do so or where they are otherwise designated at FVTPL on initial recognition. Financial assets and financial liabilities which are required to be held at FVTPL include:

- Financial assets and financial liabilities held for trading
- Debt instruments that do not have solely payments of principal and interest (SPPI) characteristics. Otherwise, such instruments are measured at amortised cost or FVOCI, and
- Equity instruments that have not been designated as held at FVOCI.

Financial assets and financial liabilities are classified as held for trading if they are derivatives or if they are acquired or incurred principally for the purpose of selling or repurchasing in the near-term, or form part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking.

In certain circumstances, other financial assets and financial liabilities are designated at FVTPL where this results in more relevant information. This may arise because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains or losses on them on a different basis, where the assets and liabilities are managed and their performance evaluated on a fair value basis or, in the case of financial liabilities, where it contains one or more embedded derivatives which are not closely related to the host contract.

The classification and measurement requirements for financial asset debt and equity instruments and financial liabilities are set out below.

Financial assets: debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans and government and corporate bonds. Classification and subsequent measurement of debt instruments depend on the Santander UK group's business model for managing the asset, and the cash flow characteristics of the asset.

Business model

The business model reflects how the Santander UK group manages the assets in order to generate cash flows and, specifically, whether the Santander UK group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of the assets. If neither of these is applicable, such as where the financial assets are held for trading purposes, then the financial assets are classified as part of an 'other' business model and measured at FVTPL. Factors considered in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the assets' performance is evaluated and reported to key management personnel, and how risks are assessed and managed.

SPPI

Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Santander UK group assesses whether the assets' cash flows represent SPPI. In making this assessment, the Santander UK group considers whether the contractual cash flows are consistent with a basic lending arrangement (i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement). Where the contractual terms introduce exposure to risk or volatility that is inconsistent with a basic lending arrangement, the related asset is classified and measured at FVTPL.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are SPPI.

Based on these factors, the Santander UK group classifies its debt instruments into one of the following measurement categories:

- Amortised cost – Financial assets that are held for collection of contractual cash flows where those cash flows represent SPPI, and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any ECL recognised and measured as presented in Note 13. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method. When estimates of future cash flows are revised, the carrying amount of the respective financial assets or financial liabilities is adjusted to reflect the new estimate discounted using the original effective interest rate. Any changes are recognised in the income statement.
- FVOCI – Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent SPPI, and that are not designated at FVTPL, are measured at FVOCI. Movements in the carrying amount are recognised in OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Other operating income'. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.
- FVTPL – Financial assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL. A gain or loss on a debt instrument that is subsequently measured at FVTPL, including any debt instruments designated at fair value, is recognised in profit or loss and presented in the income statement in 'Other operating income' in the period in which it arises.

The Santander UK group reclassifies financial assets when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent.

Financial assets: equity instruments

Equity instruments are instruments that meet the definition of equity from the issuer's perspective, being instruments that do not contain a contractual obligation to pay cash and that evidence a residual interest in the issuer's net assets. All equity investments are subsequently measured at FVTPL, except where management has elected, at initial recognition, to irrevocably designate an equity investment at FVOCI. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal. ECLs (and reversal of ECLs) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognised in profit or loss as other income when the right to receive payments is established. Gains and losses on equity investments at FVTPL are included in 'Other operating income' in the income statement.

Financial liabilities

Financial liabilities are classified as subsequently measured at amortised cost, except for:

- Financial liabilities at FVTPL: this classification is applied to derivatives and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at FVTPL are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability) and partially in profit or loss (the remaining amount of change in the fair value of the liability)
- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Santander UK group recognises any expense incurred on the financial liability, and
- Financial guarantee contracts and loan commitments.

Contracts involving the receipt of cash on which customers receive an index-linked return are accounted for as equity index-linked deposits. The principal products are Capital Guaranteed/Protected Products which give the customers a limited participation in the upside growth of an equity index. In the event the index falls in price, a cash principal element is guaranteed/protected. The equity index-linked deposits contain embedded derivatives. These embedded derivatives, in combination with the principal cash deposit element, are designed to replicate the investment performance profile tailored to the return agreed in the contracts with customers. The cash principal element is accounted for as deposits by customers at amortised cost. The embedded derivatives are separated from the host instrument and are separately accounted for as derivatives.

Sale and repurchase agreements (including stock borrowing and lending)

Securities sold subject to a commitment to repurchase them at a predetermined price (repos) under which substantially all the risks and rewards of ownership are retained by the Santander UK group remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resell (reverse repos) are not recognised on the balance sheet and the consideration paid is recorded as an asset. The difference between the sale and repurchase price is treated as trading income in the income statement, except where the repo is not treated as part of the trading book, in which case the difference is recorded in interest income or expense.

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

Day One profit adjustments

The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, sometimes the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Santander UK group recognises a trading gain or loss at inception (Day One gain or loss), being the difference between the transaction price and the fair value. When significant unobservable parameters are used, the entire Day One gain or loss is deferred and is recognised in the income statement over the life of the transaction until the transaction matures, is closed out, the valuation inputs become observable or an offsetting transaction is entered into.

ii) Impairment of debt instrument financial assets

The Santander UK group assesses on a forward-looking basis the ECL associated with its debt instrument assets carried at amortised cost and FVOCI and with the exposure arising from financial guarantee contracts and loan commitments. The Santander UK group recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes
- The time value of money, and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Grouping of instruments for losses measured on a collective basis

We typically group instruments and assess them for impairment collectively where they share risk characteristics (as described in the Credit risk section of the Risk review) using one or more statistical models. Where we have used internal capital or similar models as the basis for our ECL models, this typically results in a large number of relatively small homogenous groups which are determined by the permutations of the underlying characteristics in the statistical models. We calculate separate collective provisions for instruments in Stages 1, 2 and 3 where the instrument is not individually assessed, as described below.

Individually assessed impairments (IAIs)

We assess significant Stage 3 cases individually. We do this for Corporate & Commercial Banking cases, and CIB cases before its transfer, but not for Business Banking cases in Retail Banking which we assess collectively. To calculate the estimated loss, we estimate the future cash flows under several scenarios each of which uses case-specific factors and circumstances. We then probability-weight the net present value of the cash flows under each scenario to arrive at a weighted average provision requirement. We update our assessment process every quarter and more frequently if there are changes in circumstances that might affect the scenarios, cash flows or probabilities we apply.

For more on how ECL is calculated, see the Credit risk section of the Risk review.

Write-off

For secured loans, a write-off is only made when all collection procedures have been exhausted and the security has been sold and/or a claim made on any mortgage indemnity guarantee or other insurance. In the corporate loan portfolio, there may be occasions where a write-off occurs for other reasons, such as following a consensual restructure or refinancing of the debt or where the debt is sold for strategic reasons into the secondary market at a value lower than its face value.

There is no threshold based on past due status beyond which all secured loans are written off as there can be significant variations in the time needed to enforce possession and sale of the security, especially due to the different legal frameworks that apply in different regions of the UK. For unsecured loans, a write-off is only made when all internal avenues of collecting the debt have been exhausted. Where appropriate the debt is passed over to external collection agencies. A past due threshold is applied to unsecured debt where accounts that are 180 days past due are written off unless there is a dispute awaiting resolution. 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.

All write-offs are assessed / made 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 exception to this is in cases where fraud has occurred, where the exposure is written off once investigations have been completed and the probability of recovery is minimal. The time span between discovery and write-off will be short and may not result in an impairment loss allowance being raised. The write-off policy is regularly reviewed. Write-offs are charged against previously established loss allowances.

Recoveries

Recoveries of credit impairment losses are not included in the impairment loss allowance but are taken to income and offset against credit impairment losses. Recoveries of credit impairment losses are classified in the income statement as 'Credit impairment losses'.

iii) Modifications of financial assets

The treatment of a renegotiation or modification of the contractual cash flows of a financial asset normally depends upon whether the renegotiation or modification is due to financial difficulties of the borrower or for other commercial reasons.

- ***Contractual modifications due to financial difficulties of the borrower:*** where the Santander UK group modifies the contractual conditions to enable the borrower to fulfil their payment obligations, the asset is not derecognised. The gross carrying amount of the financial asset is recalculated as the present value of the renegotiated/modified contractual cash flows that are discounted at the financial asset's original EIR and any gain or loss arising from the modification is recognised in the income statement.
- ***Contractual modifications for other commercial reasons:*** an assessment is performed to determine whether the terms of the new agreement are substantially different from the terms of the existing agreement, after considering changes in the cash flows arising from the modified terms and the overall instrument risk profile. Where terms are substantially different, such modifications are treated as a new transaction resulting in derecognition of the original financial asset, and the recognition of a 'new' financial asset with any difference between the carrying amount of the derecognised asset and the fair value of the new asset is recognised in the income statement as a gain or loss on derecognition. Where terms are not substantially different, the carrying value of the financial asset is adjusted to reflect the present value of modified cash flows discounted at the original EIR with any gain or loss arising from modification recognised immediately in the income statement.

Any other contractual modifications, such as where a regulatory authority imposes a change in certain contractual terms or due to legal reasons, are assessed on a case-by-case basis to establish whether or not the financial asset should be derecognised. For IBOR reform see Note **42**.

iv) Derecognition other than on a modification

Financial assets are derecognised when the rights to receive cash flows have expired or the Santander UK group has transferred its contractual right to receive the cash flows from the assets and either: (1) substantially all the risks and rewards of ownership have been transferred; or (2) the Santander UK group has neither retained nor transferred substantially all of the risks and rewards but has transferred control.

Financial liabilities are derecognised when extinguished, cancelled or expired.

c) Financial guarantee contracts and loan commitments

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of the amount of the loss allowance, and the premium received on initial recognition less income recognised in accordance with the principles of IFRS 15. Loan commitments are measured as the amount of the loss allowance (determined in accordance with IFRS 9 as described in Credit risk section of the Risk review). The Santander UK group has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

For financial guarantee contracts and loan commitments, the loss allowance is recognised as a provision and charged to credit impairment losses in the income statement. The loss allowance in respect of revolving facilities is classified in loans and advances to customers to the extent of any drawn balances. The loss allowance in respect of undrawn amounts is classified in provisions. When amounts are drawn, any related loss allowance is transferred from provisions to loans and advances to customers.

Derivative financial instruments (derivatives)

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

Derivatives are held for risk management purposes. Derivatives are classified as held for trading unless they are designated as being in a hedge accounting relationship. The Santander UK group chooses to designate certain derivatives as in a hedging relationship if they meet specific criteria, as further described in 'Hedge accounting' below.

Derivatives are recognised initially (on the date on which a derivative contract is entered into), and are subsequently remeasured, at their fair value. Fair values of exchange-traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are estimated using valuation techniques, including discounted cash flow and option pricing models.

Certain derivatives may be embedded in hybrid contracts, such as the conversion option in a convertible bond. If the hybrid contract contains a host that is a financial asset, then the Santander UK group assesses the entire contract as described in the financial asset section above for classification and measurement purposes. Otherwise, embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement. Contracts containing embedded derivatives are not subsequently reassessed for separation unless either there has been a change in the terms of the contract which significantly modifies the cash flows (in which case the contract is reassessed at the time of modification) or the contract has been reclassified (in which case the contract is reassessed at the time of reclassification).

All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative, except where netting is permitted. The method of recognising fair value gains and losses depends on whether derivatives are held for trading or are designated as hedging instruments and, if the latter, the nature of the risks being hedged. Gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement and included in Other operating income.

Offsetting financial assets and liabilities

Financial assets and liabilities including derivatives are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously. The Santander UK group is party to a number of arrangements, including master netting arrangements under industry standard agreements which facilitate netting of transactions in jurisdictions where netting agreements are recognised and have legal force. The netting arrangements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis.

Hedge accounting

The Santander UK group applies hedge accounting to represent, to the maximum possible extent permitted under accounting standards, the economic effects of its risk management strategies. Derivatives are used to hedge exposures to interest rates, exchange rates and certain indices such as retail price indices.

At the time a financial instrument is designated as a hedge (i.e. at the inception of the hedge), the Santander UK group formally documents the relationship between the hedging instrument(s) and hedged item(s), its risk management objective and strategy for undertaking the hedge. The documentation includes the identification of each hedging instrument and respective hedged item, the nature of the risk being hedged (including the benchmark interest rate being hedged in a hedge of interest rate risk) and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value attributable to the hedged risk is to be assessed. Accordingly, the Santander UK group formally assesses, both at the inception of the hedge and on an ongoing basis, whether the hedging derivatives have been and will be highly effective in offsetting changes in the fair value attributable to the hedged risk during the period that the hedge is designated. A hedge is normally regarded as highly effective if, at inception and throughout its life, the Santander UK group can expect, and actual results indicate, that changes in the fair value or cash flow of the hedged items are effectively offset by changes in the fair value or cash flow of the hedging instrument. If at any point it is concluded that it is no longer highly effective in achieving its documented objective, hedge accounting is discontinued.

Where derivatives are held for risk management purposes, and when transactions meet the required criteria for documentation and hedge effectiveness, the derivatives may be designated as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments (fair value hedges); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (cash flow hedges); or (iii) a hedge of a net investment in a foreign operation (net investment hedges). The Santander UK group applies fair value and cash flow hedge accounting, but not hedging of a net investment in a foreign operation.

a) Fair value hedge accounting

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. Where the hedged item is measured at amortised cost, the fair value changes due to the hedged risk adjust the carrying amount of the hedged asset or liability. Changes in the fair value of portfolio hedged items are presented separately in the consolidated balance sheet in macro hedge of interest rate risk and recognised in the income statement within other operating income. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the income statement. For fair value hedges of interest rate risk, the cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement using the effective interest method over the period to maturity. For portfolio hedged items, the cumulative adjustment is amortised to the income statement using the straight-line method over the period to maturity.

b) Cash flow hedge accounting

The effective portion of changes in the fair value of qualifying cash flow hedges is recognised in other comprehensive income in the cash flow hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement. The Santander UK group is exposed to cash flow interest rate risk on its floating rate assets, foreign currency risk on its fixed rate debt issuances denominated in foreign currency and equity price risk arises from the Santander UK group operating the Employee Sharesave scheme. Cash flow hedging is used to hedge the variability in cash flows arising from these risks.

Securitisation transactions

The Santander UK group has entered into arrangements where undertakings have issued mortgage-backed and other asset-backed securities or have entered into funding arrangements with lenders in order to finance specific loans and advances to customers. The Santander UK group has also entered into synthetic securitisation arrangements, as part of significant risk transfer (SRT) transactions to reduce its risk-weighted assets, where undertakings have issued credit-linked notes and deposited the funds raised as collateral for credit protection in respect of specific loans and advances to customers. As the Santander UK group has retained substantially all the risks and rewards of the underlying assets, such financial instruments continue to be recognised on the balance sheet, and a liability recognised for the proceeds of the funding transaction, or in the case of SRT transactions, collateral deposited.

Impairment of non-financial assets

At each balance sheet date, or more frequently when events or changes in circumstances dictate, property plant and equipment (including operating lease assets) and intangible assets (including goodwill) are assessed for indicators of impairment. If indications are present, these assets are subject to an impairment review. The impairment review comprises a comparison of the carrying amount of the asset or cash generating unit with its recoverable amount: the higher of the asset's or cash-generating unit's fair value less costs to sell and its value in use. The cash-generating unit represents the lowest level at which non-financial assets, including goodwill, are monitored for internal management purposes and is not larger than an operating segment.

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Value in use is calculated by discounting management's expected future cash flows obtainable as a result of the asset's continued use (after making allowance for increases in regulatory capital requirements), including those resulting from its ultimate disposal, at a market-based discount rate on a pre-tax basis. The recoverable amounts of goodwill have been based on value in use calculations.

The carrying values of property, plant and equipment, goodwill and other intangible assets are written down by the amount of any impairment and the loss is recognised in the income statement in the period in which it occurs. A previously recognised impairment loss relating to property, plant and equipment may be reversed in part or in full when a change in circumstances leads to a change in the estimates used to determine the property, plant and equipment's recoverable amount. The carrying amount of the property, plant and equipment will only be increased up to the amount that would have been had the original impairment not been recognised. Impairment losses on goodwill are not reversed. For conducting goodwill impairment reviews, cash generating units are the lowest level at which management monitors the return on investment on assets.

Leases

a) The Santander UK group as lessor

Operating lease assets are recorded at cost and depreciated over the life of the asset after taking into account anticipated residual value (RV). Operating lease rental income and depreciation is recognised on a straight-line basis over the life of the asset. After initial recognition, residual values are reviewed regularly, and any changes are recognised prospectively through remaining depreciation charges.

Amounts due from lessees under finance leases and hire purchase contracts are recorded as receivables at the amount of the Santander UK group's net investment in the leases. Finance lease income is allocated to accounting periods to reflect a constant periodic rate of return on the Santander UK group's net investment outstanding in respect of the leases and hire purchase contracts. A provision is recognised to reflect a reduction in any anticipated unguaranteed RV. A provision is also recognised for voluntary termination of the contract by the customer, where appropriate.

b) The Santander UK group as lessee

The Santander UK group assesses whether a contract is or contains a lease at the inception of the contract and recognises a right-of-use (ROU) asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments for all leases, except for leases with a term of 12 months or less which are expensed in the income statement on a straight-line basis over the lease terms. Lease payments exclude irrecoverable VAT which is expensed in the income statement as lease payments are made.

The lease liability, which is included in Other liabilities on the balance sheet, is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the incremental borrowing rate appropriate to the lease term. The lease liability is subsequently measured at amortised cost using the effective interest rate method. Remeasurement of the lease liability occurs if there is a change in the lease payments (when a corresponding adjustment is made to the ROU asset), the lease term or in the assessment of an option to purchase the underlying asset.

At inception, the ROU asset, which is included in Property, plant and equipment on the balance sheet, comprises the lease liability, initial direct costs and the obligations to restore the asset, less any incentives granted by the lessor. The ROU asset is depreciated over the shorter of the lease term or the useful life of the underlying asset and is reviewed for impairment as for owned assets. The obligation to restore the asset is included in Provisions on the balance sheet. These provisions are reassessed on a semi-annual basis and will normally run off over the period of the leases concerned. Where a property is disposed of earlier than anticipated, any remaining provision relating to that property is released.

Income taxes, including deferred taxes

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

Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date. Current taxes associated with the repurchase of equity instruments are reported directly in equity.

A current tax liability for the current or prior period is measured at the amount expected to be paid to the tax authorities. Where the amount of the final tax liability is uncertain or where a position is challenged by a taxation authority, the liability recognised is the most likely outcome. Where a most likely outcome cannot be determined, a weighted average basis is applied.

Deferred income tax is the tax expected to be payable or recoverable on income tax losses available to carry forward and on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which the assets may be utilised as they reverse. Such deferred tax liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill. Deferred tax assets and liabilities are not recognised from the initial recognition of other assets (other than in a business combination) and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled, or the asset is realised based on rates enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items recognised in other comprehensive income or directly in equity, in which case the deferred tax is also recognised in other comprehensive income or directly in equity. Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the Santander UK group is able to control reversal of the temporary difference and it is probable that it will not reverse in the foreseeable future. The Santander UK group reviews the carrying amount of deferred tax assets at each balance sheet date and reduces it to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax relating to actuarial gains and losses on defined benefits is recognised in other comprehensive income. Deferred tax relating to fair value re-measurements of financial instruments accounted for at FVOCI and cash flow hedging instruments is charged or credited directly to other comprehensive income and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

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

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, including cash and non-restricted balances with central banks, treasury bills and other eligible bills, loans and advances to banks and short-term investments in securities. Balances with central banks represent amounts held at the Bank of England as part of the Santander UK group's liquidity management activities. In addition, it includes certain minimum cash balances held for regulatory purposes required to be maintained with the Bank of England.

Provisions

Provisions are recognised for present obligations arising as consequences of past events where it is more likely than not that a transfer of economic benefits will be necessary to settle the obligation, and it can be reliably estimated.

Customer remediation provisions are made for the estimated cost of making redress payments with respect to the past sales of products, using conclusions such as the number of claims the number of those that will be upheld, the estimated average settlement per case and other related costs. Provision is made for the anticipated cost of restructuring, including redundancy costs, when an obligation exists. An obligation exists when the Santander UK group has a detailed formal plan for restructuring a business, has raised valid expectations in those affected by the restructuring, and has started to implement the plan or announce its main features.

When a leasehold property ceases to be used in the business, provision is made where the unavoidable costs of the future obligations relating to the lease are expected to exceed anticipated rental income. The net costs are discounted using market rates of interest to reflect the long-term nature of the cash flows.

Loan commitments are measured as the amount of the loss allowance, determined in line with IFRS 9 as set out in the Credit risk section of the Risk review.

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

Share capital

a) Share issue costs

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

b) Dividends

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

Discontinued operations

A discontinued operation is a component of the Santander UK group that has been disposed of or is classified as held for sale and that represents a separate major line of business or geographical area of operations, is part of a single coordinated plan to dispose of such a line of business or area of operations, or is a subsidiary acquired exclusively with a view to resale. The results of discontinued operations are presented separately in the income statement.

CRITICAL JUDGEMENTS AND ACCOUNTING ESTIMATES

The preparation of the consolidated financial statements requires management to make judgements and accounting estimates that affect the reported amount of assets and liabilities at the date of the consolidated financial statements and the reported amount of income and expenses during the reporting period. Management evaluates its judgements and accounting estimates, which are based on historical experience and on various other factors that are believed to be reasonable under the circumstances, on an ongoing basis. Actual results may differ from these accounting estimates under different assumptions or conditions.

In the course of preparing the consolidated financial statements, no significant judgements have been made in the process of applying the accounting policies, other than those involving estimations about credit impairment losses, provisions and contingent liabilities, pensions and goodwill. Management have considered the impact of Covid-19, climate change and the transition to a low carbon economy on critical judgements and accounting estimates.

The following accounting estimates, as well as the judgements inherent within them, are considered important to the portrayal of the Santander UK group's financial results and financial condition because: (i) they are highly susceptible to change from period to period as assumptions are made to calculate the estimates, and (ii) any significant difference between the estimated amounts and actual amounts could have a material impact on the Santander UK group's future financial results and financial condition. In calculating each accounting estimate, a range of outcomes was calculated based principally on management's conclusions regarding the input assumptions relative to historical experience. The actual estimates were based on what management concluded to be the most probable assumptions within the range of reasonably possible assumptions.

a) Credit impairment losses

The application of the ECL impairment methodology for calculating credit impairment allowances is highly susceptible to change from period to period. The methodology requires management to make judgmental assumptions in determining the estimates. Any significant difference between the estimated amounts and actual amounts could have a material impact on the future financial results and financial condition. The impact of Covid-19 continues to increase the uncertainty around ECL impairment calculations and has required management to make additional judgements and accounting estimates that affect the amount of assets and liabilities at the reporting date and the amount of income and expenses in the reporting period. The key additional judgements due to the impact of Covid-19 continue to mainly reflect the increased uncertainty around forward-looking economic data and the need for additional post model adjustments.

Key judgements	– Determining an appropriate definition of default – Establishing the criteria for a significant increase in credit risk (SICR) and, for corporate borrowers, internal credit risk rating – Determining appropriate post model adjustments – Assessing individual corporate Stage 3 exposures
Key estimates	– Forward-looking multiple economic scenario assumptions – Probability weights assigned to multiple economic scenarios

For more on each of these key judgements and estimates, including the impact of Covid-19, climate change and the transition to a low carbon economy on them, see 'Critical judgements and accounting estimates applied in calculating ECL' in the 'Credit risk – credit risk management' section of the Risk review.

Sensitivity of ECL allowance

For detailed disclosures, see 'Sensitivity of ECL allowance' in the 'Credit risk – Santander UK group level – credit risk management' section of the Risk review.

b) Provisions and contingent liabilities

Key judgements	– Determining whether a present obligation exists – Assessing the likely outcome of future legal decisions
Key estimates	– Probability, timing, nature and amount of any outflows that may arise from past events

Included in Litigation and other regulatory provisions in Note 29 are amounts in respect of management's best estimates of liability relating to a legal dispute regarding allocation of responsibility for a specific PPI portfolio of complaints, and Plevin related litigation. Note 31 provides disclosure relating to ongoing factual issues and reviews that could impact the timing and amount of any outflows.

Note 31 Contingent liabilities and commitments' includes disclosure relating to an investigation in relation to the historical involvement of Santander UK plc, Santander Financial Services plc and Cater Allen International Limited (all subsidiaries of Santander UK Group Holdings plc) in German dividend tax arbitrage transactions, as well as an FCA civil regulatory investigation which commenced in July 2017 into our compliance with the Money Laundering Regulations 2007 and potential breaches of FCA principles and rules relating to anti-money laundering and financial crime systems and controls. It also includes disclosure relating to certain leases in which current and former Santander UK group members were the lessor that are currently under review by HMRC in connection with claims for tax allowances.

These judgements are based on the specific facts available and often require specialist professional advice. There can be a wide range of possible outcomes and uncertainties, particularly in relation to legal actions, and regulatory and consumer credit matters. As a result, it is often not possible to make reliable estimates of the likelihood and amount of any potential outflows, or to calculate any resulting sensitivities. For more on each of these key judgements and estimates, see Notes 29 and 31.

c) Pensions

The Santander UK group operates a number of defined benefit pension schemes as described in Note 30 and estimates their position as described in the accounting policy 'Pensions and other post retirement benefits'.

Key judgements	– Setting the criteria for constructing the corporate bond yield curve used to determine the discount rate – Determining the methodology for setting the inflation assumption
Key estimates	– Discount rate applied to future cash flows – Rate of price inflation – Expected lifetime of the schemes' members – Valuation of pension fund assets whose values are not based on market observable data

For more on each of these key judgements and estimates, including the impact of Covid-19 on them, see Note 30.

Sensitivity of defined benefit pension scheme estimates

For detailed disclosures see 'Actuarial assumption sensitivities' in Note 30.

The Scheme was invested in certain assets whose values are not based on market observable data, such as investments in private equity funds and property. Due diligence has been conducted to ensure the values obtained in respect of these assets are appropriate and represent fair value. Given the nature of these investments, we are unable to prepare sensitivities on how their values could vary as market conditions or other variables change.

d) Goodwill

The carrying amount of goodwill is based on the application of judgements including the basis of goodwill impairment calculation assumptions. Santander UK undertakes an annual assessment to evaluate whether the carrying value of goodwill is impaired, carrying out this assessment more frequently if reviews identify indicators of impairment or when events or changes in circumstances dictate.

Key judgements:	– Determining the basis of goodwill impairment calculation assumptions, including management's planning assumptions considering internal capital allocations needed to support Santander UK's strategy, current market conditions and the macro-economic outlook.
Key estimates:	– Forecast cash flows for cash generating units, including estimated allocations of regulatory capital – Growth rate beyond initial cash flow projections – Discount rates which factor in risk-free rates and applicable risk premiums All of these variables are subject to fluctuations in external market rates and economic conditions beyond management's control

For more on each of these key judgements and estimates, see Note 20.

Sensitivity of goodwill

For detailed disclosures, see 'Sensitivities of key assumptions in calculating VIU' in Note 20.

2. SEGMENTS

Santander UK's principal activity is financial services, mainly in the UK. The business is managed and reported on the basis of the following segments, which are strategic business units that offer different products and services, have different customers and require different technology and marketing strategies.

- **Retail Banking** consists of two business units, Homes and Everyday Banking. Homes provides prime UK mortgage lending to owner occupiers and buy-to-let landlords with small portfolios. Everyday Banking provides banking services and unsecured lending to individuals and small businesses as well alongside wealth management for high-net-worth clients.
- **Consumer Finance** provides prime auto consumer financing for individuals, businesses, and automotive distribution networks.
- **Corporate & Commercial Banking** provides banking products and services to SMEs, mid-sized and larger corporates, typically with annual turnovers of between £2m and £500m as well as to Local Authorities and Housing Associations.
- **Corporate Centre** provides treasury services for asset and liability management of our balance sheet, as well as management of non-core and legacy portfolios.
- **Corporate and Investment Banking** provided services to corporate clients with an annual turnover of £500m and above. Santander UK transferred a significant part of the Corporate & Investment Banking business to the London branch of Banco Santander SA under a part VII banking business transfer scheme which completed on 11 October 2021. The residual parts of the business have been wound down or transferred to other segments. At 31 December 2021, the Corporate & Investment Banking business met the requirements for presentation as discontinued operations. For more details, see Note 43.

Retail Banking delivers products through our omni-channel presence comprising branches, ATMs, telephony, digital and intermediary channels. Corporate and Commerical Banking expertise is provided by relationship managers, product specialists and through digital and telephony channels, and cover clients' needs both in the UK and overseas.

The segmental basis of presentation in this Annual Report has changed following a management review of our structure. Previously, Consumer Finance was managed as part of Retail Banking.

The segmental data below is presented in a manner consistent with the internal reporting to the committee which is responsible for allocating resources and assessing performance of the segments and has been identified as the chief operating decision maker. The segmental data is prepared on a statutory basis of accounting, in line with the accounting policies set out in Note 1. Transactions between segments are on normal commercial terms and conditions. Internal charges and internal UK transfer pricing adjustments are reflected in the results of each segment. Revenue sharing agreements are used to allocate external customer revenues to a segment on a reasonable basis. Funds are ordinarily reallocated between segments, resulting in funding cost transfers disclosed in operating income. Interest charged for these funds is based on Santander UK's cost of wholesale funding. Interest income and interest expense have not been reported separately. The majority of segment revenues are interest income in nature and net interest income is relied on primarily to assess segment performance and to make decisions on the allocation of segment resources.

Results by segment

2021	Retail Banking £m	Consumer Finance £m	Corporate & Commercial Banking £m	Corporate & Investment Banking £m	Corporate Centre £m	Total £m
Net interest income/(expense)	3,356	233	401	—	(41)	3,949
Non-interest income	205	178	109	—	58	550
Total operating income	3,561	411	510	—	17	4,499
Operating expenses before credit impairment write-backs, provisions and charges	(1,701)	(163)	(365)	—	(281)	(2,510)
Credit impairment write-backs	98	33	91	—	11	233
Provisions for other liabilities and charges	(185)	4	(34)	—	(162)	(377)
Total operating credit impairment write-backs, provisions and charges	(87)	37	57	—	(151)	(144)
Profit/(loss) from continuing operations before tax	1,773	285	202	—	(415)	1,845
Revenue from external customers	4,010	489	553	—	(553)	4,499
Inter-segment revenue	(449)	(78)	(43)	—	570	—
Total operating income	3,561	411	510	—	17	4,499
Revenue from external customers includes the following fee and commission income disaggregated by income type:[1]						
– Current account and debit card fees	428	—	50	—	—	478
– Insurance, protection and investments	67	—	—	—	—	67
– Credit cards	73	—	—	—	—	73
– Non-banking and other fees[2]	2	10	62	—	5	79
Total fee and commission income	570	10	112	—	5	697
Fee and commission expense	(380)	—	(22)	—	(9)	(411)
Net fee and commission income/(expense)	190	10	90	—	(4)	286
Customer loans	183,023	4,984	16,997	—	2,284	207,288
Total assets[3]	190,629	8,873	16,997	—	70,599	287,098
Customer deposits	156,991	—	25,597	—	3,627	186,215
Total liabilities	157,622	1,173	25,613	—	86,588	270,996
Average number of full-time equivalent staff	16,149	670	2,281	528	76	19,704

(1) The disaggregation of fees and commission income as shown above is not included in reports provided to the chief operating decision maker but is provided to show the split by reportable segments.
(2) Non-banking and other fees include mortgages (except mortgage account fees), consumer finance, commitment commission, asset finance, invoice finance and trade finance.
(3) Includes customer loans, net of credit impairment loss allowances.

2020	Retail Banking[5] £m	Consumer Finance[5] £m	Corporate & Commercial Banking £m	Corporate & Investment Banking[4] £m	Corporate Centre £m	Total £m
Net interest income/(expense)	2,753	264	363	—	8	3,388
Non-interest income	245	127	94	—	(2)	464
Total operating income/(expense)	2,998	391	457	—	6	3,852
Operating expenses before credit impairment losses, provisions and charges	(1,792)	(166)	(324)	—	(108)	(2,390)
Credit impairment losses	(264)	(44)	(294)	—	(36)	(638)
Provisions for other liabilities and charges	(157)	(8)	(6)	—	(93)	(264)
Total operating credit impairment losses, provisions and charges	(421)	(52)	(300)	—	(129)	(902)
Profit/(loss) from continuing operations before tax	785	173	(167)	—	(231)	560
Revenue from external customers	3,669	501	549	—	(867)	3,852
Inter-segment revenue	(671)	(110)	(92)	—	873	—
Total operating income/(expense)	2,998	391	457	—	6	3,852
Revenue from external customers includes the following fee and commission income disaggregated by income type:[1]						
– Current account and debit card fees	442	—	42	—	—	484
– Insurance, protection and investments	65	—	—	—	—	65
– Credit cards	66	—	—	—	—	66
– Non-banking and other fees[2]	3	10	50	—	2	65
Total fee and commission income	576	10	92	—	2	680
Fee and commission expense	(335)	—	(22)	—	(4)	(361)
Net fee and commission income	241	10	70	—	(2)	319
Customer loans	175,380	8,025	17,626	2,784	3,196	207,011
Total assets[3]	183,154	11,143	17,626	2,784	77,625	292,332
Customer deposits	152,167	—	24,985	6,506	2,049	185,707
Total liabilities	152,687	2,397	25,011	6,517	89,784	276,396
Average number of full-time equivalent staff	18,198	640	2,405	716	39	21,998

2019						
Net interest income	2,581	246	422	—	(25)	3,224
Non-interest income	531	155	109	—	16	811
Total operating income	3,112	401	531	—	(9)	4,035
Operating expenses before credit impairment losses, provisions and charges	(1,860)	(179)	(334)	—	(66)	(2,439)
Credit impairment (losses)/write-backs	(129)	(27)	(45)	—	2	(199)
Provisions for other liabilities and charges	(273)	(8)	(24)	—	(121)	(426)
Total operating credit impairment losses, provisions and (charges)/releases	(402)	(35)	(69)	—	(119)	(625)
Profit/(loss) from continuing operations before tax	850	187	128	—	(194)	971
Revenue from external customers	3,748	525	633	—	(871)	4,035
Inter-segment revenue	(636)	(124)	(102)	—	862	—
Total operating income	3,112	401	531	—	(9)	4,035
Revenue from external customers includes the following fee and commission income disaggregated by income type:[1]						
– Current account and debit card fees	711	—	43	—	—	754
– Insurance, protection and investments	69	—	—	—	—	69
– Credit card fees	86	—	—	—	—	86
– Non-banking and other fees[2]	33	13	65	—	18	129
Total fee and commission income	899	13	108	—	18	1,038
Fee and commission expense	(372)	—	(24)	—	(18)	(414)
Net fee and commission income	527	13	84	—	0	624
Customer loans	171,078	7,684	18,391	4,041	3,814	205,008
Total assets[3]	178,665	10,748	18,391	4,046	69,852	281,702
Customer deposits	142,735	—	20,546	6,102	2,332	171,715
Total liabilities	143,570	2,748	20,572	6,233	92,562	265,685
Average number of full-time equivalent staff	19,669	612	2,464	804	21	23,570

(1) The disaggregation of fees and commission income as shown above is not included in reports provided to the chief operating decision maker but is provided to show the split by reportable segments.
(2) Non-banking and other fees include mortgages (except mortgage account fees), consumer finance, commitment commission, asset finance, invoice finance and trade finance.
(3) Includes customer loans, net of credit impairment loss allowances.
(4) Restated to reflect the presentation of CIB as a discontinued operation, as set out in Note 43.
(5) Restated to reflect the resegmentation of the Retail Banking segment into the Retail Banking and Consumer Finance segments described above.

Geographical information is not provided, as substantially all of Santander UK's activities are in the UK.

3. NET INTEREST INCOME

	Group		
	2021	2020[3]	2019[3]
	£m	£m	£m
Interest and similar income:			
Loans and advances to customers[3]	**4,619**	4,745	5,130
Loans and advances to banks	**52**	49	137
Reverse repurchase agreements – non trading	**35**	118	244
Other	**56**	119	306
Total interest and similar income[1]	**4,762**	5,031	5,817
Interest expense and similar charges:			
Deposits by customers	**(430)**	(1,011)	(1,540)
Deposits by banks	**(25)**	(28)	(102)
Repurchase agreements – non trading	**(3)**	(43)	(126)
Debt securities in issue	**(252)**	(440)	(678)
Subordinated liabilities	**(92)**	(111)	(137)
Other	**(11)**	(10)	(10)
Total interest expense and similar charges[2]	**(813)**	(1,643)	(2,593)
Net interest income	**3,949**	3,388	3,224

(1) This includes £22m (2020: £38m) of interest income on financial assets at FVOCI.
(2) This includes £317m (2020: £451m) of interest expense on derivatives hedging debt issuances and £3m (2020: £3m) of interest expense on lease liabilities.
(3) Restated to reflect the presentation of discontinued operations, as set out in Note 43.

4. NET FEE AND COMMISSION INCOME

	Group		
	2021	2020[2]	2019[2]
	£m	£m	£m
Fee and commission income:			
Current account and debit card fees	**478**	484	754
Insurance, protection and investments	**67**	65	69
Credit cards	**73**	66	86
Non-banking and other fees[1]	**79**	65	129
Total fee and commission income	**697**	680	1,038
Total fee and commission expense	**(411)**	(361)	(414)
Net fee and commission income	**286**	319	624

(1) Non-banking and other fees include mortgages (except mortgage account fees), consumer finance, commitment commission, asset finance, invoice finance and trade finance.
(2) Restated to reflect the presentation of discontinued operations, as set out in Note 43.

5. OTHER OPERATING INCOME

	Group		
	2021	2020[1]	2019[1]
	£m	£m	£m
Net losses on financial instruments designated at fair value through profit or loss	**(24)**	(77)	(142)
Net gains on financial instruments mandatorily at fair value through profit or loss	**(2)**	46	70
Hedge ineffectiveness	**13**	20	8
Net profit on sale of financial assets at fair value through other comprehensive income	**6**	17	15
Income from operating lease assets	**136**	126	124
Other	**135**	13	112
	264	145	187

(1) Restated to reflect the presentation of discontinued operations, as set out in Note 43..

Assets and liabilities held at FVTPL, including derivatives, are predominantly used to provide customers with risk management solutions, and to manage and hedge the Santander UK group's own risks, and do not give rise to significant overall net gains/(losses) in the income statement.

'Net gains on financial instruments mandatorily at FVTPL' includes fair value losses of £15m (2020: gains of £89m, 2019: losses of £42m) on embedded derivatives bifurcated from certain equity index-linked deposits, as described in the derivatives accounting policy in Note 1. The embedded derivatives are economically hedged, the results of which are also included in this line item and amounted to gains of £15m (2020: losses of £88m, 2019: gains of £43m). As a result, the net fair value movements recognised on the equity index-linked deposits and the related economic hedges were net gains of nil (2020: £1m, 2019: £1m).

In 2019, 'Net profit on sale of financial assets at FVOCI' included additional consideration of £15m in connection with the 2017 Vocalink Holdings Limited shareholding sale.

Exchange rate differences recognised in the Consolidated Income Statement on items not at fair value through profit or loss were £242m income (2020: £751m expense, 2019: £1,102m income) and are presented in the line 'Other'. These are principally offset by related releases from the cash flow hedge reserve of £358m expense (2020: £809m income, 2019: £1,013m expense) as set out in the Consolidated Statement of Comprehensive Income, which are also presented in 'Other'. Exchange rate differences on items measured at FVTPL are included in the line items relating to changes in fair value.

In 2021, the Santander UK group repurchased certain debt securities and subordinated liabilities as part of ongoing liability management exercises, resulting in a loss of £1m (2020 loss of £24m, 2019: nil).

Other includes £73m of property gains from the sale of our London head office and branch properties.

6. OPERATING EXPENSES BEFORE CREDIT IMPAIRMENT LOSSES, PROVISIONS AND CHARGES

	Group			Company		
	2021	2020[1]	2019[1]	**2021**	2020[1]	2019[1]
	£m	£m	£m	**£m**	£m	£m
Staff costs:						
Wages and salaries	**745**	788	801	**577**	601	609
Performance-related payments	**183**	97	159	**159**	80	134
Social security costs	**112**	101	111	**89**	80	89
Pensions costs: – defined contribution plans	**64**	66	66	**49**	50	51
– defined benefit plans[2]	**38**	38	35	**29**	26	23
Other share-based payments	**—**	—	—	**—**	—	—
Other personnel costs	**41**	33	40	**38**	30	35
	1,183	1,123	1,212	**941**	867	941
Other administration expenses	**826**	706	684	**977**	880	865
Depreciation, amortisation and impairment	**501**	561	543	**373**	453	434
	2,510	2,390	2,439	**2,291**	2,200	2,240

(1) Adjusted to reflect the presentation of discontinued operations as set out in Note 43.
(2) Pension costs for defined benefit plans include £5m for curtailment as set out in Note 30.

Staff costs

'Performance-related payments' include bonuses paid in cash and share awards granted under the arrangements described in Note 37. Included in this are equity-settled share-based payments, none of which related to option-based schemes. These are disclosed in the table below as 'Share awards'. Performance-related payments above include amounts related to deferred performance awards as follows:

	Costs recognised in 2021			Costs expected to be recognised in 2022 or later		
	Arising from awards in current year	Arising from awards in prior year	Total	Arising from awards in current year	Arising from awards in prior year	Total
	£m	£m	£m	£m	£m	£m
Cash	**3**	**5**	**8**	9	6	15
Shares	**3**	**5**	**8**	8	6	14
	6	**10**	**16**	17	12	29

The following table shows the amount of bonus awarded to employees for the performance year 2021. In the case of deferred cash and share awards, the final amount paid to an employee is influenced by forfeiture provisions and any performance conditions to which these awards are subject. The deferred share award amount is based on the fair value of these awards at the date of grant.

	Expenses charged in the year		Expenses deferred to future periods		Total	
	2021	2020	**2021**	2020	**2021**	2020
	£m	£m	**£m**	£m	**£m**	£m
Cash award – not deferred	**156**	77	**—**	—	**156**	77
– deferred	**8**	9	**15**	11	**23**	20
Shares award – not deferred	**11**	3	**—**	—	**11**	3
– deferred	**8**	8	**14**	11	**22**	19
Total discretionary bonus	**183**	97	**29**	22	**212**	119

On 26 October 2018, the High Court handed down a judgement concluding that defined benefit schemes should equalise pension benefits for men and women in relation to GMP and concluded on the methods that were appropriate. The estimated increase in liabilities at the date of the judgement was £40m and was based on a number of assumptions and the actual impact may be different. This was reflected in the income statement and in the closing net accounting surplus of the Scheme in 2018. The allowance included in the Scheme liabilities at 31 December 2021 decreased by £5m (2020: £5m, 2019: £5m) to £45m (2020: £50m, 2019: £45m) to reflect the latest assumptions. This change was recognised in other comprehensive income. Work is being undertaken by the Trustee to implement GMP equalisation.

'Other share-based payments' consist of options granted under the Employee Sharesave scheme which comprise the Santander UK group's cash-settled share-based payments. For more, see Note 37.

The average number of full-time equivalent staff was 19,704 (2020: 21,998, 2019: 23,570). For the Company, the average number of full-time equivalent staff was 15,188 (2020: 16,530, 2019: 17,640).

Depreciation, amortisation and impairment
In 2021, depreciation, amortisation and impairment included depreciation of £81m (2020: £92m, 2019: £103m) on operating lease assets (where the Santander UK group is the lessor) with a net book value of £595m at 31 December 2021 (2020: £542m, 2019: £574m). It also included depreciation of £19m (2020: £58m,2019: £60m) on right-of-use assets with a net book value of £118m at 31 December 2021 (2020: £100m, 2019: £152m).

'Other administration expenses' includes £23m (2020: £10m, 2019: £13m) expenses related to short-term leases.

In 2021, 'Depreciation, amortisation and impairment' included an impairment charge of £88m (2020:£0m) associated with branch and head office site closures as part of the transformation programme. For more, see Note 21. For the Company, in 2021 impairment associated with the closure of branches and head office sites as part of the transformation programme was £63m (2020: £0m).

7. AUDIT AND OTHER SERVICES

	Group		
	2021	2020	2019
	£m	£m	£m
Audit fees:			
Fees payable to the Company's auditor and its associates for the audit of the Santander UK group's annual accounts	**11.2**	10.0	8.0
Fees payable to the Company's auditor and its associates for other services to the Santander UK group:			
– Audit of the Santander UK group's subsidiaries	**0.9**	1.4	1.3
Total audit fees[1]	**12.1**	11.4	9.3
Non-audit fees:			
Audit-related assurance services	**0.8**	0.8	0.8
Other assurance services	**0.1**	0.3	0.2
Other non-audit services	**0.2**	0.0	0.2
Total non-audit fees	**1.1**	1.1	1.2

(1) 2021 audit fees included £1.2m (2020: £0.8m, 2019: £0.1m) which related to the prior year.

Audit-related assurance services mainly comprises services performed in connection with review of the financial information of the Company and reporting to the Company's UK regulators.

Of the total non-audit fees, £0.4m (2020: £0.4m, 2019: £0.6m) accords with the definition of 'Audit Fees' per US Securities and Exchange Commission (SEC) guidance, £0.7m (2020: £0.7m, 2019: £0.4m) accords with the definition of 'Audit related fees' per that guidance and £nil (2020: £nil, 2019: £0.2m) accords with the definition of 'All other fees' per that guidance.

In 2021, the Company's auditors earned £27,000 fees (2020: £24,000, 2019: no fees) payable by entities outside the Santander UK group for the review of the financial position of corporate and other borrowers.

In 2021, the Company's auditors earned £1.4m (2020: £1.5m, 2019: £1.5m), in relation to incremental work undertaken in support of the audit of Banco Santander SA.

8. CREDIT IMPAIRMENT LOSSES AND PROVISIONS

	Group		
	2021	2020[1]	2019[1]
	£m	£m	£m
Credit impairment (write-backs)/losses:			
Loans and advances to customers	**(186)**	665	217
Recoveries of loans and advances, net of collection costs	**(17)**	(24)	(40)
Off-balance sheet exposures (See Note 29)	**(30)**	(3)	22
	(233)	638	199
Provisions for other liabilities and charges (excluding off-balance sheet credit exposures) (See Note 29)	**386**	258	420
Provisions for residual value and voluntary termination	**(9)**	6	6
	377	264	426
	144	902	625

(1) Adjusted to reflect the presentation of discontinued operations as set out in Note 43.

In 2021 and 2020 there were no material credit impairment losses on loans and advances to banks, non-trading reverse repurchase agreements, other financial assets at amortised cost and financial assets at FVOCI.

9. TAXATION

	Group		
	2021	2020[1]	2019[1]
	£m	£m	£m
Current tax:			
UK corporation tax on profit for the year	**401**	107	254
Adjustments in respect of prior years	**(24)**	(24)	(25)
Total current tax	**377**	83	229
Deferred tax:			
Charge for the year	**100**	34	46
Adjustments in respect of prior years	**15**	4	(7)
Total deferred tax	**115**	38	39
Tax on profit from continuing operations	**492**	121	268

(1) Adjusted to reflect the presentation of discontinued operations as set out in Note 43.

The standard rate of UK corporation tax was 27% for banking entities and 19% for non-banking entities (2020: 27% for banking entities and 19% for non-banking entities; 2019: 27% for banking entities and 19% 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 Santander UK group's effective tax rate for 2021 was 26.7% (2020: 21.6%, 2019: 27.6%). The tax on profit before tax differs from the theoretical amount that would arise using the basic corporation tax rate as follows:

	Group		
	2021	2020[1]	2019[1]
	£m	£m	£m
Profit from continuing operations before tax	**1,845**	560	971
Tax calculated at a tax rate of 19% (2020: 19%, 2019: 19%)	**351**	106	184
Bank surcharge on profits	**104**	27	62
Non-deductible preference dividends paid	**9**	8	8
Non-deductible UK Bank Levy	**14**	19	24
Non-deductible conduct remediation, fines and penalties	**6**	(4)	44
Other non-deductible costs and non-taxable income	**37**	25	31
Effect of change in tax rate on deferred tax provision	**9**	6	(14)
Tax relief on dividends in respect of other equity instruments	**(40)**	(40)	(39)
Adjustment to prior year provisions	**2**	(26)	(32)
Tax on profit from continuing operations	**492**	121	268

(1) Adjusted to reflect the presentation of discontinued operations as set out in Note 43.

The UK government announced in its budget on 3 March 2021 that it would increase the main rate of corporation tax by 6% to 25% with effect from 1 April 2023. This change was substantively enacted on 24 May 2021 and, as a result, the effect has been reflected in the closing deferred tax position included in these financial statements. The comparative 2020 results reflected an increase in tax rates by 2% following an announcement in the 2020 budget to reverse a previously planned rate reduction from April 2020.

A reduction in the Bank Surcharge rate from 8% to 3% was announced in October 2021 to be effective from 1 April 2023. This change in rate was substantively enacted on 2 February 2022 and as a result, the effects of this change have not been reflected in the closing balance sheet position for deferred tax. The effect of the change, had it been substantively enacted by the balance sheet date, would be expected to reduce the tax expense for the period by £23m and reduce the deferred tax liability by £90m.

Current tax assets and liabilities

Movements in current tax assets and liabilities during the year were as follows:

	Group		Company	
	2021	2020	2021	2020
	£m	£m	£m	£m
Assets	**264**	200	**354**	298
Liabilities	**—**	—	**—**	—
At 1 January	**264**	200	**354**	298
Income statement charge (including discontinued operations)	**(389)**	(96)	**(269)**	(30)
Other comprehensive income credit	**33**	1	**—**	—
Corporate income tax paid	**427**	159	**360**	86
Other movements	**12**	—	**—**	—
	347	264	**445**	354
Assets	**347**	264	**445**	354
Liabilities	**—**	—	**—**	—
At 31 December	**347**	264	**445**	354

The amount of corporation income tax paid differs from the tax charge for the period as a result of the timing of payments due to the tax authorities, the effects of movements in deferred tax, adjustments to prior period current tax provisions and current tax recognised directly in other comprehensive income.

Santander UK proactively engages with HM Revenue & Customs to resolve tax matters relating to prior years. The accounting policy for recognising provisions for such matters are described in Note 1. It is not expected that there will be any material movement in such provisions within the next 12 months.

Deferred tax

The table below shows the deferred tax assets and liabilities including the movement in the deferred tax account during the year. Deferred tax balances are presented in the balance sheet after offsetting assets and liabilities where the Santander UK group and Company has the legal right to offset and intends to settle on a net basis.

	Group							
	Fair value of financial instruments	Pension remeasurement	Cash flow hedges	Fair value reserve	Tax losses carried forward	Accelerated tax depreciation	Other temporary differences	Total
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	**(65)**	**(26)**	**(99)**	**(11)**	**15**	**38**	**37**	**(111)**
Income statement (charge)/credit	**(58)**	**(67)**	**—**	**—**	**(7)**	**40**	**(23)**	**(115)**
Transfers/reclassifications	**—**	**4**	**(16)**	**1**	**—**	**(10)**	**(19)**	**(40)**
Credited/(charged) to other comprehensive income	**—**	**(419)**	**108**	**(2)**	**—**	**—**	**—**	**(313)**
At 31 December 2021	**(123)**	**(508)**	**(7)**	**(12)**	**8**	**68**	**(5)**	**(579)**
At 1 January 2020	(52)	(96)	(58)	(8)	13	17	35	(149)
Income statement (charge)/credit	(13)	(63)	—	—	2	21	15	(38)
Transfers/reclassifications	—	—	12	(1)	—	—	(13)	(2)
Credited/(charged) to other comprehensive income	—	133	(53)	(2)	—	—	—	78
At 31 December 2020	(65)	(26)	(99)	(11)	15	38	37	(111)

	Company							
	Fair value of financial instruments	Pension remeasurement	Cash flow hedges	Fair value reserve	Tax losses carried forward	Accelerated tax depreciation	Other temporary differences	Total
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	**(101)**	**(24)**	**(99)**	**(11)**	**12**	**11**	**(3)**	**(215)**
Income statement (charge)/ credit	**(20)**	**(66)**	**—**	**—**	**(7)**	**34**	**1**	**(58)**
Transfers/reclassifications	**—**	**—**	**—**	**1**	**—**	**—**	**1**	**2**
Credited/(charged) to other comprehensive income	**—**	**(419)**	**94**	**(2)**	**—**	**—**	**—**	**(327)**
At 31 December 2021	**(121)**	**(509)**	**(5)**	**(12)**	**5**	**45**	**(1)**	**(598)**
At 1 January 2020	(88)	(96)	(49)	(8)	11	9	15	(206)
Income statement (charge)/credit	(13)	(60)	—	—	1	2	(17)	(87)
Transfers/reclassifications	—	—	1	(1)	—	—	(1)	(1)
Credited/(charged) to other comprehensive income	—	132	(51)	(2)	—	—	—	79
At 31 December 2020	(101)	(24)	(99)	(11)	12	11	(3)	(215)

The deferred tax assets and liabilities above have been recognised in both the Company and the Santander UK group on the basis that sufficient future taxable profits are forecast within the foreseeable future, in excess of the profits arising from the reversal of existing taxable temporary differences, to allow for the utilisation of the assets as they reverse. Based on the conditions at the balance sheet date, management determined that a reasonably possible change in any of the key assumptions underlying the estimated future taxable profits in the Santander UK group's three-year plan (described in Note 20) would not cause a reduction in the deferred tax assets recognised. At 31 December 2021, both the Santander UK group and the Company had a recognised deferred tax asset in respect of UK capital losses carried forward of £5m (2020: £12m) included within tax losses carried forward. There are £nil unrecognised deferred tax assets on capital losses carried forward (2020: £nil).

10. DIVIDENDS ON ORDINARY SHARES

Dividends on ordinary shares declared and paid in the year were as follows:

	Group and Company					Group and Company
	2021	2020	2019	2021	2020	2019
	Pence per share	Pence per share	Pence per share	£m	£m	£m
In respect of current year – first interim	**0.90**	0.42	0.53	**281**	129	164
– second interim	**3.47**	—	0.49	**1,077**	—	151
	4.37	0.42	1.02	**1,358**	129	315

In 2021, an interim dividend of £1,358m (2020: £129m) was paid on the Company's ordinary shares in issue related to 2021 profit and an assessment of capital surpluses. Dividends were paid in line with our dividend policy following review and approval by the Santander UK Board.

11. DERIVATIVE FINANCIAL INSTRUMENTS

a) Use of derivatives

The Santander UK group undertakes derivative activities primarily to provide customers with risk management solutions and to manage and hedge the Santander UK group's own risks.

The Santander UK group's derivative activities do not give rise to significant open positions in portfolios of derivatives. Any residual position is managed to ensure that it remains within acceptable risk levels, with matching transactions used to achieve this where necessary. When entering into derivatives, the Santander UK group employs the same credit risk management procedures to assess and approve potential credit exposures that are used for traditional lending.

For information on how the Santander UK group is managing the transition to alternative benchmark interest rates, see 'Managing IBOR transition' in the Banking market risk section of the Risk review and Note 42.

b) Analysis of derivatives

The table below includes the notional amounts of transactions outstanding at the balance sheet date; they do not represent actual exposures.

				Group		
		2021			2020	
		Fair value			Fair value	
	Notional amount	Assets	Liabilities	Notional amount	Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Derivatives held for trading:						
Exchange rate contracts	**11,036**	**159**	**168**	14,951	395	418
Interest rate contracts	**25,148**	**463**	**485**	40,160	888	542
Equity and credit contracts	**1,056**	**161**	**54**	1,140	123	55
Total derivatives held for trading	**37,240**	**783**	**707**	56,251	1,406	1,015
Derivatives held for hedging						
Designated as fair value hedges:						
Exchange rate contracts	**590**	**39**	**—**	789	84	6
Interest rate contracts	**80,514**	**904**	**737**	93,748	1,225	1,885
	81,104	**943**	**737**	94,537	1,309	1,891
Designated as cash flow hedges:						
Exchange rate contracts	**22,239**	**996**	**338**	27,020	1,978	409
Interest rate contracts	**21,466**	**180**	**216**	19,407	467	23
	43,705	**1,176**	**554**	46,427	2,445	432
Total derivatives held for hedging	**124,809**	**2,119**	**1,291**	140,964	3,754	2,323
Derivative netting[1]		**(1,221)**	**(1,221)**		(1,754)	(1,754)
Total derivatives	**162,049**	**1,681**	**777**	197,215	3,406	1,584

(1) Derivative netting excludes the effect of cash collateral, which is offset against the gross derivative position. The amount of cash collateral received that had been offset against the gross derivative assets was £189m (2020: £330m) and the amount of cash collateral paid that had been offset against the gross derivative liabilities was £202m (2020: £651m).

	Company					
	2021			2020		
		Fair value			Fair value	
	Notional amount	Assets	Liabilities	Notional amount	Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Derivatives held for trading:						
Exchange rate contracts	**22,664**	**461**	**536**	29,869	912	1,176
Interest rate contracts	**52,083**	**997**	**789**	79,351	2,331	1,030
Equity and credit contracts	**1,056**	**161**	**54**	1,143	123	55
Total derivatives held for trading	**75,803**	**1,619**	**1,379**	110,363	3,366	2,261
Derivatives held for hedging						
Designated as fair value hedges:						
Exchange rate contracts	**230**	**7**	**—**	316	3	6
Interest rate contracts	**78,732**	**596**	**728**	88,667	688	1,874
	78,962	**603**	**728**	88,983	691	1,880
Designated as cash flow hedges:						
Exchange rate contracts	**15,733**	**731**	**157**	17,393	968	338
Interest rate contracts	**16,874**	**143**	**199**	13,965	297	23
	32,607	**874**	**356**	31,358	1,265	361
Total derivatives held for hedging	**111,569**	**1,477**	**1,084**	120,341	1,956	2,241
Derivative netting[1]		**(1,221)**	**(1,221)**		(1,754)	(1,754)
Total derivatives	**187,372**	**1,875**	**1,242**	230,704	3,568	2,748

(1) Derivative netting excludes the effect of cash collateral, which is offset against the gross derivative position. The amount of cash collateral received that had been offset against the gross derivative assets was £189m (2020: £330m) and the amount of cash collateral paid that had been offset against the gross derivative liabilities was£202m (2020: £651m).

For information about the impact of netting arrangements on derivative assets and liabilities in the table above, see Note 41.

The reduction in the notional value of interest rate derivatives held for trading in 2021 reflected the completion of a series of derivative trade compressions to reduce our gross LIBOR exposure.

The table below analyses the notional and fair values of derivatives by trading and settlement method.

	Notional				Asset		Liability	
		Traded over the counter						
2021	Traded on recognised exchanges £m	Settled by central counterparties £m	Not settled by central counterparties £m	Total £m	Traded on recognised exchanges £m	Traded over the counter £m	Traded on recognised exchanges £m	Traded over the counter £m
Exchange rate contracts	**—**	**—**	**33,865**	**33,865**	**—**	**1,194**	**—**	**507**
Interest rate contracts	**—**	**117,559**	**9,569**	**127,128**	**—**	**326**	**—**	**216**
Equity and credit contracts	**—**	**—**	**1,056**	**1,056**	**—**	**161**	**—**	**54**
	—	**117,559**	**44,490**	**162,049**	**—**	**1,681**	**—**	**777**
2020								
Exchange rate contracts	—	—	42,760	42,760	—	2,457	—	833
Interest rate contracts	—	144,343	8,972	153,315	—	826	—	696
Equity and credit contracts	—	—	1,140	1,140	—	123	—	55
	—	144,343	52,872	197,215	—	3,406	—	1,584

c) Analysis of derivatives designated as hedges

The Santander UK group applies hedge accounting on both a fair value and cash flow basis depending on the nature of the underlying exposure. We establish the hedge ratio by matching the notional of the derivative with the underlying position being hedged. Only the designated risk is hedged and therefore other risks, such as credit risk are managed but not hedged. For interest rate hedges, the designated hedged risk is determined with reference to the underlying benchmark rate.

Fair value hedges

Portfolio hedges of interest rate risk

Santander UK holds various portfolios of fixed rate assets and liabilities which expose it to changes in fair value due to movements in market interest rates. We manage these exposures by entering into interest rate swaps. Each portfolio contains assets or liabilities that are similar in nature and share the risk exposure that is designated as being hedged.

The interest rate risk component is the change in fair value of fixed rate instruments for changes in the designated benchmark rate. Such changes are usually the largest component of the overall change in fair value. Separate hedges are maintained for each underlying currency. Effectiveness is assessed by comparing changes in fair value of the hedged item attributable to changes in the designated benchmark interest rate, with changes in the fair value of the interest rate swaps.

Micro hedges of interest rate risk and foreign currency risk

Santander UK accesses international markets to obtain funding, issuing fixed rate debt in its functional currency and other currencies. We are therefore exposed to changes in fair value due to changes in market interest rates and/or foreign exchange rates, principally in USD and EUR, which we mitigate through the use of receive fixed/pay floating rate interest rate swaps and/or receive fixed/pay floating rate cross currency swaps.

The interest rate risk component is the change in fair value of the fixed rate debt due to changes in the benchmark rate. The foreign exchange component is the change in the fair value of the fixed rate debt issuance due to changes in foreign exchange rates prevailing from the time of execution. Effectiveness is assessed by using linear regression techniques to compare changes in the fair value of the debt caused by changes in the benchmark interest rate and foreign exchange rates, with changes in the fair value of the interest rate swaps and/or cross currency swaps.

Cashflow hedges

Hedges of interest rate risk

Santander UK manages its exposure to the variability in cash flows of floating rate assets and liabilities attributable to movements in market interest rates by entering into interest rate swaps. The interest rate risk component is determined with reference to the underlying benchmark rate attributable to the floating rates asset or liability. Designated benchmark rates referenced are currently SONIA or USD LIBOR. Effectiveness is assessed by comparing changes in the fair value of the interest rate swap with changes in the fair value of the hedged item attributable to the hedged risk, applying a hypothetical derivative method using linear regression techniques.

Hedges of foreign currency risk

As Santander UK obtains funding in international markets, we assume significant foreign currency risk exposure, mainly in USD and EUR. In addition, the Santander UK group also holds debt securities for liquidity purposes which assumes foreign currency exposure, principally in JPY.

Santander UK manages the exposures to the variability in cash flows of foreign currency denominated assets and liabilities to movements in foreign exchange rates by entering into either foreign exchange contracts (spot, forward and swaps) or cross currency swaps. These instruments are entered into to match the cash flow profile and maturity of the estimated interest and principal repayments of the hedged item.

The foreign currency risk component is the change in cash flows of the foreign currency debt arising from changes in the relevant foreign currency forward exchange rate. Such changes constitute a significant component of the overall changes in cash flows of the instrument. Effectiveness is assessed by comparing changes in the fair value of the cross currency or foreign exchange swaps with changes in the fair value of the hedged debt attributable to the hedged risk applying a hypothetical derivative method using linear regression techniques.

IBOR Reform

Note 42 includes details of the notional value of hedging instruments by benchmark interest rate impacted by IBOR reform and the notional amounts of assets, liabilities and off-balance sheet commitments affected by IBOR reform that have yet to transition to an alternative benchmark interest rate.

Hedge effectiveness measurement

Hedge effectiveness is assessed by using either dollar offset or linear regression techniques to compare changes in the fair value of the hedged item attributable to changes in the designated hedged risk and the hedging instrument. For cash flow hedges, a hypothetical derivative method is used to model the cash flows of the hedged item.

Possible sources of hedge ineffectiveness

For both fair value and cash flow hedges, hedge ineffectiveness can arise from hedging derivatives with a non-zero fair value at the date of initial designation. In addition, for:

Fair value hedges

Hedge ineffectiveness can also arise due to differences in discounting between the hedged item and the hedging instrument as cash collateralised swaps discount using Overnight Indexed Swaps discount curves not applied to the hedged item; and where counterparty credit risk impacts the fair value of the derivative but not the hedged item. For portfolio hedges of interest rate risk, it can also arise due to differences in the expected and actual volume of prepayments.

Cash flow hedges

Hedge ineffectiveness can also arise due to differences in the timing of cash flows between the hedged item and the hedging instrument. For micro hedges of interest rate risk, it can also arise due to differences in the basis of cash flows between the hedged item and the hedging instrument.

Maturity profile and average price/rate of hedging instruments

The following table sets out the maturity profile and average price/rate of the hedging instruments used in the Santander UK group's hedging strategies:

							Group
2021	Hedging Instruments	≤1 month	>1 and ≤3 months	>3 and ≤12 months	>1 and ≤5 years	>5 years	Total
Fair value hedges:							
Interest rate risk	Interest rate contracts- Nominal amount (£m)	**3,121**	**6,223**	**21,442**	**44,507**	**4,991**	**80,284**
	Average fixed interest rate - GBP	**0.59 %**	**0.42 %**	**0.09 %**	**0.88 %**	**3.13 %**	
	Average fixed interest rate - EUR	**0.51 %**	**1.74 %**	**1.08 %**	**0.81 %**	**2.61 %**	
	Average fixed interest rate - USD	**1.91 %**	**0.96 %**	**1.44 %**	**2.76 %**	**4.05 %**	
Interest rate/FX risk	Exchange rate contracts - Nominal amount (£m)	**—**	**—**	**107**	**381**	**102**	**590**
	Interest rate contracts - Nominal amount (£m)	**—**	**—**	**—**	**193**	**37**	**230**
	Average GBP - EUR exchange rate	**—**	**—**	**1.21**	**1.16**	**1.17**	
	Average fixed interest rate - EUR	**— %**	**— %**	**3.29 %**	**2.03 %**	**2.62 %**	
Cash flow hedges:							
Interest rate risk	Interest rate contracts – Nominal amount (£m)	**1,010**	**481**	**871**	**7,669**	**5,137**	**15,168**
	Average fixed interest rate - GBP	**1.97 %**	**0.44 %**	**0.08 %**	**1.39 %**	**0.97 %**	
FX risk	Exchange rate contracts- Nominal amount (£m)	**2,703**	**936**	**2,057**	**6,715**	**2,124**	**14,535**
	Interest rate contracts- Nominal amount (£m)	**—**	**—**	**—**	**2,438**	**887**	**3,325**
	Average GBP - JPY exchange rate	**—**	**142.91**	**148.86**	**—**	**—**	
	Average GBP - EUR exchange rate	**1.17**	**—**	**1.18**	**1.16**	**1.17**	
	Average GBP - USD exchange rate	**1.34**	**1.34**	**1.33**	**1.34**	**1.39**	
Interest rate/FX risk	Exchange rate contracts - Nominal amount (£m)	**620**	**—**	**840**	**4,765**	**1,479**	**7,704**
	Interest rate contracts - Nominal amount (£m)	**—**	**—**	**—**	**2,049**	**924**	**2,973**
	Average GBP - EUR exchange rate	**1.28**	**—**	**1.39**	**1.20**	**1.20**	
	Average GBP - USD exchange rate	**—**	**—**	**—**	**1.61**	**1.38**	
	Average fixed interest rate – GBP	**2.26 %**	**— %**	**1.17 %**	**2.72 %**	**3.41 %**	

2020							
Fair value hedges:							
Interest rate risk	Interest rate contracts- Nominal amount (£m)	2,429	7,617	27,791	47,749	7,889	93,475
	Average fixed interest rate - GBP	0.69 %	0.65 %	0.82 %	0.73 %	3.61 %	
	Average fixed interest rate - EUR	1.18 %	0.23 %	3.02 %	0.98 %	2.34 %	
	Average fixed interest rate - USD	1.87 %	1.72 %	2.89 %	2.49 %	4.16 %	
Interest rate/FX risk	Exchange rate contracts - Nominal amount (£m)	—	—	132	461	196	789
	Interest rate contracts - Nominal amount (£m)	—	—	—	236	37	273
	Average GBP - EUR exchange rate	—	—	1.14	1.17	1.17	
	Average fixed interest rate - EUR	—	—	4.64 %	1.78 %	3.56 %	
Cash flow hedges:							
Interest rate risk	Interest rate contracts - Nominal amount (£m)	—	897	2,528	7,964	1,061	12,450
	Average fixed interest rate - GBP	—	0.46 %	0.57 %	1.45 %	1.33 %	
FX risk	Exchange rate contracts- Nominal amount (£m)	1,439	2,015	3,877	7,113	1,119	15,563
	Interest rate contracts- Nominal amount (£m)	—	—	—	366	—	366
	Average GBP - JPY exchange rate	—	137.98	135.61	132.27	—	
	Average GBP - EUR exchange rate	—	—	0.00	1.16	1.18	
	Average GBP - USD exchange rate	1.29	1.32	1.32	1.30	—	
Interest rate/FX risk	Exchange rate contracts - Nominal amount (£m)	732	—	2,583	6,550	1,592	11,457
	Interest rate contracts - Nominal amount (£m)	732	—	882	4,062	915	6,591
	Average GBP - EUR exchange rate	—	—	1.35	1.25	1.20	
	Average GBP - USD exchange rate	1.46	—	0.00	1.61	1.38	
	Average fixed interest rate - GBP	2.01 %	—	3.18 %	2.48 %	3.39 %	

							Company
2021	Hedging instruments	≤1 month	>1 month and ≤3 months	>3 and ≤12 months	>1 and ≤5 years	>5 years	Total
Fair value hedges:							
Interest rate risk	Interest rate contracts – Nominal amount (£m)	**3,121**	**6,223**	**21,442**	**43,523**	**4,193**	**78,502**
	Average fixed interest rate – GBP	**0.59 %**	**0.42 %**	**0.09 %**	**0.75 %**	**2.72 %**	
	Average fixed interest rate – EUR	**0.51 %**	**1.74 %**	**1.08 %**	**0.81 %**	**0.48 %**	
	Average fixed interest rate – USD	**1.91 %**	**0.96 %**	**1.44 %**	**2.76 %**	**4.05 %**	
Interest rate/FX risk	Exchange rate contracts – Nominal amount (£m)	**—**	**—**	**—**	**193**	**37**	**230**
	Interest rate contracts – Nominal amount (£m)	**—**	**—**	**—**	**193**	**37**	**230**
	Average GBP - EUR exchange rate	**—**	**—**	**—**	**1.14**	**1.13**	
	Average fixed interest rate – EUR	**—**	**—**	**—**	**0.36 %**	**0.00 %**	
Cash flow hedges:							
Interest rate risk	Interest rate contracts – Nominal amount (£m)	**1,010**	**481**	**871**	**4,978**	**4,076**	**11,416**
	Average fixed interest rate - GBP	**1.97 %**	**0.44 %**	**0.08 %**	**1.40 %**	**0.87 %**	
FX risk	Exchange rate contracts – Nominal amount (£m)	**2,703**	**936**	**2,057**	**4,126**	**1,073**	**10,895**
	Interest rate contracts – Nominal amount (£m)	**—**	**—**	**—**	**2,438**	**887**	**3,325**
	Average GBP - JPY exchange rate	**—**	**142.91**	**148.86**	**—**	**—**	
	Average GBP - EUR exchange rate	**1.17**	**—**	**1.18**	**1.20**	**1.17**	
	Average GBP - USD exchange rate	**1.34**	**1.34**	**1.33**	**1.35**	**1.39**	
Interest rate/FX risk	Exchange rate contracts – Nominal amount (£m)	**620**	**—**	**—**	**3,103**	**1,115**	**4,838**
	Interest rate contracts – Nominal amount (£m)	**—**	**—**	**—**	**1,209**	**924**	**2,133**
	Average GBP - EUR exchange rate	**1.28**	**—**	**—**	**1.24**	**—**	
	Average GBP - USD exchange rate	**—**	**—**	**—**	**1.61**	**1.38**	
	Average fixed interest rate – GBP	**1.92 %**	**—**	**—**	**2.90 %**	**3.05 %**	
2020							
Fair value hedges:							
Interest rate risk	Interest rate contracts – Nominal amount (£m)	2,351	7,396	25,984	46,580	6,083	88,394
	Average fixed interest rate – GBP	0.69 %	0.65 %	0.61 %	0.73 %	3.02 %	
	Average fixed interest rate – EUR	1.18 %	0.23 %	0.97 %	0.98 %	0.58 %	
	Average fixed interest rate – USD	1.87 %	1.72 %	2.89 %	2.41 %	4.16 %	
Interest rate/FX risk	Exchange rate contracts – Nominal amount (£m)	—	—	43	236	37	316
	Interest rate contracts – Nominal amount (£m)	—	—	—	236	37	273
	Average GBP - EUR exchange rate	—	—	—	1.15	1.13	
	Average fixed interest rate - EUR	—	—	—	0.44 %	—	
Cash flow hedges:							
Interest rate risk	Interest rate contracts – Nominal amount (£m)	—	897	2,528	5,361	0	8,786
	Average fixed interest rate - GBP	—	0.46 %	0.57 %	1.48 %	0.00 %	
FX risk	Exchange rate contracts – Nominal amount (£m)	1,260	2,015	3,877	4,423	—	11,575
	Interest rate contracts – Nominal amount (£m)	—	—	—	366	—	366
	Average GBP - JPY exchange rate	—	137.98	135.61	132.27	—	
	Average GBP - EUR exchange rate	—	—	—	1.19	—	
	Average GBP - USD exchange rate	1.29	1.32	1.32	1.30	—	
Interest rate/FX risk	Exchange rate contracts – Nominal amount (£m)	732	—	0	3,929	1,157	5,818
	Interest rate contracts – Nominal amount (£m)	732	—	0	3,166	915	4,813
	Average GBP - EUR exchange rate	—	—	—	1.26	—	
	Average GBP - USD exchange rate	1.46	—	—	1.61	1.38	
	Average fixed interest rate – GBP	2.01 %	—	0.00 %	2.71 %	3.04 %	

Net gains or losses arising from fair value and cash flow hedges included in other operating income

	Group			Company		
	2021 £m	2020 £m	2019 £m	2021 £m	2020 £m	2019 £m
Fair value hedging:						
Gains/(losses) on hedging instruments	**852**	(299)	(360)	**1,064**	(324)	(319)
(Losses)/gains on hedged items attributable to hedged risks	**(800)**	365	414	**(1,033)**	356	341
Fair value hedging ineffectiveness	**52**	66	54	**31**	32	22
Cash flow hedging ineffectiveness	**(39)**	(46)	(46)	**(29)**	14	9
	13	20	8	**2**	46	31

Hedge ineffectiveness can be analysed by risk category as follows:

	Group					
	2021			2020		
	Change in FV of hedging instruments £m	Change in FV of hedged items £m	Recognised in income statement £m	Change in FV of hedging instruments £m	Change in FV of hedged items £m	Recognised in income statement £m
Fair value hedges:						
Interest rate risk	**874**	**(834)**	**40**	(358)	385	27
Interest rate/FX risk	**(22)**	**34**	**12**	59	(20)	39
	852	**(800)**	**52**	(299)	365	66

		Group						
		2021				2020		
		Hedging Instruments				Hedging Instruments			
	Income statement line item affected by reclassification	Change in FV £m	Recognised in OCI £m	Recognised in Income Statement £m	Reclassified from reserves to income £m	Change in FV £m	Recognised in OCI £m	Recognised in Income Statement £m	Reclassified from reserves to income £m
Cash flow hedges:									
Interest rate risk	Net interest income	**(317)**	**305**	**(12)**	**73**	185	(179)	6	33
FX risk	Net interest income/other operating income	**(54)**	**54**	**—**	**(158)**	(42)	38	(4)	2
Interest rate/FX risk	Net interest income/other operating income	**(541)**	**514**	**(27)**	**(273)**	782	(830)	(48)	773
		(912)	**873**	**(39)**	**(358)**	925	(971)	(46)	808

	Company					
	2021			2020		
	Change in FV of hedging instruments £m	Change in FV of hedged items £m	Recognised in income statement £m	Change in FV of hedging instruments £m	Change in FV of hedged items £m	Recognised in income statement £m
Fair value hedges:						
Interest rate risk	**1,043**	**(1,019)**	**24**	(368)	396	28
Interest rate/FX risk	**21**	**(14)**	**7**	44	(40)	4
	1,064	**(1,033)**	**31**	(324)	356	32

		Company							
		2021				2020			
		Hedging Instruments				Hedging Instruments			
	Income statement line item affected by reclassification	Change in FV £m	Recognised in OCI £m	Recognised in Income Statement £m	Reclassified from reserves to income £m	Change in FV £m	Recognised in OCI £m	Recognised in Income Statement £m	Reclassified from reserves to income £m
Cash flow hedges:									
Interest rate risk	Net interest income	**(214)**	**210**	**(4)**	**44**	81	(78)	3	9
FX risk	Net interest income/other operating income	**73**	**(76)**	**(3)**	**45**	(94)	87	(7)	(91)
Equity risk	Operating expenses	**—**	**—**	**—**	**—**	—	—	—	—
Interest rate/FX risk	Net interest income/other operating income	**(190)**	**168**	**(22)**	**(38)**	452	(434)	18	331
		(331)	**302**	**(29)**	**51**	439	(425)	14	249

In 2021, cash flow hedge accounting of £14m (2020: £4m) had to cease due to the hedged cash flows no longer being expected to occur.

The following table provides a reconciliation by risk category of components of equity and analysis of OCI items (before tax) resulting from hedge accounting.

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Balance at 1 January	**644**	**481**	368	192
Effective portion of changes in fair value:				
– Interest rate risk	**(305)**	**179**	(210)	78
– Foreign currency risk	**(54)**	**(38)**	76	(87)
– Equity risk	**—**	**—**	—	—
– Interest rate/foreign currency risk	**(514)**	**830**	(168)	434
	(873)	**971**	(302)	425
Income statement transfers				
– Interest rate risk	**(73)**	**(33)**	(44)	(9)
– Foreign currency risk	**158**	**(2)**	(45)	91
– Equity risk	**—**	**—**	—	—
– Interest rate/foreign currency risk	**273**	**(773)**	38	(331)
	358	**(808)**	(51)	(249)
Balances at 31 December	**129**	**644**	15	368

Hedged exposures

Santander UK hedges its exposures to various risks, including interest rate risk and foreign currency risk, as set out in the following table.

	Group									
	2021					2020				
		Accumulated amount of FV hedge adjustments			Change in value to calculate hedge ineffectiveness		Accumulated amount of FV hedge adjustments			Change in value to calculate hedge ineffectiveness
	Carrying value	Hedged item	Portfolio hedge of interest rate risks	Of which Discontinued hedges		Carrying value	Hedged item	Portfolio hedge of interest rate risks	Of which Discontinued hedges	
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Fair value hedges										
Interest rate risk:										
Loans and advances to customers	**58,455**	**—**	**80**	**491**	**(1,092)**	54,118	—	1,189	892	334
Other financial assets at amortised cost	**160**	**—**	**2**	**3**	**(12)**	772	—	36	13	121
Reverse repurchase agreements – non trading	**9,570**	**—**	**(5)**	**—**	**(6)**	12,149	—	1	—	3
Other financial assets at FVOCI	**3,728**	**23**	**—**	**47**	**(112)**	5,129	155	—	74	88
Deposits by customers	**(1,665)**	**(46)**	**—**	**(44)**	**104**	(7,309)	(158)	(10)	(77)	(73)
Deposits by banks	**—**	**—**	**—**	**—**	**—**	—	—	—	—	—
Debt securities in issue	**(2,567)**	**(140)**	**(114)**	**(185)**	**235**	(5,885)	(375)	(137)	(239)	(61)
Subordinated liabilities	**(293)**	**(75)**	**(8)**	**(70)**	**49**	(636)	(185)	(41)	(166)	(27)
Interest rate/FX risk:										
Other financial assets at FVOCI	**227**	**—**	**—**	**1**	**(20)**	299	5	—	—	15
Debt securities in issue	**(423)**	**(55)**	**—**	**(47)**	**55**	(621)	(94)	—	(76)	(34)
Subordinated liabilities	**2**	**2**	**—**	**2**	**(1)**	3	3	—	3	(1)
	67,194	**(291)**	**(45)**	**198**	**(800)**	58,019	(649)	1,038	424	365

		Group					
		2021			2020		
	Hedged item balance sheet line item	Change in value to calculate hedge ineffectiveness	Cash flow hedge reserve	Balances on cash flow hedge reserve for discontinued hedges	Change in value to calculate hedge ineffectiveness	Cash flow hedge reserve	Balances on cash flow hedge reserve for discontinued hedges
		£m	£m	£m	£m	£m	£m
Cash flow hedges:							
Interest rate risk:	Loans and advances to customers	**235**	**(135)**	**(2)**	(183)	165	1
	Cash and balances at central banks	**71**	**(79)**	**—**	(2)	1	—
	Reverse repurchase agreements – non trading	**—**	**—**	**—**	(2)	1	—
	Deposits by banks	**(1)**	**1**	**—**	7	(2)	—
	Debt securities in issue	**—**	**—**	**—**	—	—	—
	Repurchase agreements – non trading	**—**	**—**	**—**	1	(1)	—
FX risk:	Other financial assets at FVOCI	**(195)**	**(1)**	**—**	40	6	—
	Not applicable – highly probable forecast transactions	**149**	**1**	**—**	33	3	—
	Deposits by customers	**9**	**9**	**10**	(5)	14	—
	Deposits by banks	**—**	**—**	**—**	—	—	—
	Debt securities in issue	**85**	**57**	**(4)**	(15)	(60)	—
	Repurchase agreements – non trading	**6**	**—**	**—**	(15)	—	—
Equity risk:	Other liabilities	**—**	**—**	**—**	—	—	—
Interest rate/FX risk:	Debt securities in issue/loans and advances to customers	**410**	**105**	**(4)**	(569)	236	(2)
	Deposits by customers	**93**	**38**	**—**	(132)	87	—
	Subordinated liabilities/loans and advances to customers	**11**	**133**	**80**	(130)	194	—
		873	**129**	**80**	(972)	644	(1)

	Company									
	2021					2020				
		Accumulated amount of FV hedge adjustments			Change in value to calculate hedge ineffectiveness		Accumulated amount of FV hedge adjustments			Change in value to calculate hedge ineffectiveness
	Carrying value	Hedged item	Portfolio hedge of interest rate risks	Of which Discontinued hedges		Carrying value	Hedged item	Portfolio hedge of interest rate risks	Of which Discontinued hedges	
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Fair value hedges										
Interest rate risk:										
Loans and advances to customers	**58,456**	**—**	**(280)**	**131**	**(1,084)**	52,396	—	758	468	332
Other financial assets at amortised cost	**160**	**—**	**2**	**3**	**(12)**	772	—	36	13	121
Reverse repurchase agreements – non trading	**9,570**	**—**	**(5)**	**—**	**(6)**	12,149	—	1	—	3
Other financial assets at FVOCI	**3,728**	**23**	**—**	**47**	**(112)**	5,129	155	—	74	88
Deposits by customers	**(1,665)**	**(45)**	**—**	**(44)**	**98**	(7,213)	(149)	(10)	(73)	(70)
Debt securities in issue	**(584)**	**(16)**	**—**	**—**	**54**	(2,197)	(86)	—	(4)	(45)
Subordinated liabilities	**(252)**	**(34)**	**—**	**(20)**	**43**	(614)	(163)	—	(103)	(33)
Interest rate/FX risk:										
Other financial assets at FVOCI	**227**	**—**	**—**	**1**	**(20)**	299	5	—	—	15
Debt securities in issue	**—**	**—**	**—**	**—**	**1**	(43)	—	—	—	(59)
Subordinated liabilities	**(45)**	**(45)**	**—**	**(45)**	**5**	(50)	(50)	—	(50)	4
	69,595	**(117)**	**(283)**	**73**	**(1,033)**	60,628	(288)	785	325	356

		Company					
		2021			2020		
	Hedged item balance sheet line item	Change in value to calculate hedge ineffectiveness	Cash flow hedge reserve	Balances on cash flow hedge reserve for discontinued hedges	Change in value to calculate hedge ineffectiveness	Cash flow hedge reserve	Balances on cash flow hedge reserve for discontinued hedges
		£m	£m	£m	£m	£m	£m
Cash flow hedges:							
Interest rate risk:	Loans and advances to customers	**140**	**(116)**	**(2)**	(82)	59	1
	Cash and balances at central banks	**71**	**(80)**	**—**	(2)	1	—
	Reverse repurchase agreements – non trading	**—**	**—**	**—**	(2)	1	—
	Deposits by banks	**(1)**	**1**	**—**	7	(2)	—
	Repurchase agreements – non trading	**—**	**—**	**—**	1	(1)	—
FX risk:	Other financial assets at FVOCI	**(195)**	**(1)**	**—**	40	6	—
	Not applicable – highly probable forecast transactions	**148**	**1**	**—**	34	3	—
	Deposits by customers	**10**	**10**	**10**	(5)	16	1
	Debt securities in issue	**(45)**	**42**	**—**	33	(3)	—
	Repurchase agreements – non trading	**6**	**—**	**—**	(15)	—	—
Interest rate/FX risk:	Debt securities in issue/loans and advances to customers	**73**	**12**	**(20)**	(184)	43	(29)
	Deposits by customers	**94**	**35**	**(11)**	(136)	83	(15)
	Subordinated liabilities/loans and advances to customers	**1**	**111**	**65**	(114)	162	2
		302	**15**	**42**	(425)	368	(40)

12. OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Loans and advances to customers:				
Loans to housing associations	**12**	13	**12**	13
Other loans	**62**	86	**61**	86
	74	99	**73**	99
Debt securities	**111**	109	**21**	2
	185	208	**94**	101

For the Santander UK group, other financial assets at FVTPL comprised £12m (2020: £13m) of financial assets designated at FVTPL and £173m (2020: £195m) of financial assets mandatorily held at FVTPL. For the Company, other financial assets at FVTPL comprised £12m (2020: £13m) of financial assets designated at FVTPL and £82m (2020: £88m) of financial assets mandatorily held at FVTPL.

Loans and advances to customers principally represented other loans, being a portfolio of roll-up mortgages. These are managed, and have their performance evaluated, on a fair value basis in accordance with a documented investment strategy, and information about them is provided on that basis to management. Since 2009, the Santander UK group's policy has been not to designate similar new loans at FVTPL.

The net (loss)/gain in the year attributable to changes in credit risk for loans and advances at FVTPL was £nil (2020: £nil, 2019: £nil). The cumulative net loss attributable to changes in credit risk for loans and advances at FVTPL at 31 December 2021 was £2m (2020: £2m).

13. LOANS AND ADVANCES TO CUSTOMERS

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Loans secured on residential properties	**174,712**	166,714	**174,712**	166,714
Corporate loans	**19,282**	23,613	**19,053**	22,981
Finance leases	**3,916**	6,554	**—**	—
Secured advances	**—**	—	**—**	—
Other unsecured loans	**9,404**	9,933	**8,408**	8,643
Accrued interest and other adjustments	**452**	861	**452**	861
Amounts due from fellow Banco Santander subsidiaries and joint ventures	**3,175**	2,425	**96**	191
Amounts due from Santander UK Group Holdings plc	**6**	7	**6**	7
Amounts due from subsidiaries	**—**	—	**21,100**	29,187
Loans and advances to customers	**210,947**	210,107	**223,827**	228,584
Credit impairment loss allowances on loans and advances to customers	**(828)**	(1,303)	**(966)**	(1,367)
RV and voluntary termination provisions on finance leases	**(25)**	(54)	**—**	—
Net loans and advances to customers	**210,094**	208,750	**222,861**	227,217

For movements in expected credit losses, see the 'Movement in total exposures and the corresponding ECL' table in the Santander UK group level - Credit risk review section of the Risk review.

Finance lease and hire purchase contract receivables may be analysed as follows:

	Group					
	2021			2020		
	Gross investment	**Unearned finance income**	**Net investment**	Gross investment	Unearned finance income	Net investment
	£m	**£m**	**£m**	£m	£m	£m
No later than one year	**1,906**	**(5)**	**1,901**	3,468	(297)	3,171
Later than one year and not later than two years	**1,324**	**(200)**	**1,124**	1,829	(173)	1,656
Later than two years and not later than three years	**771**	**(141)**	**630**	1,099	(106)	993
Later than three years and not later than four years	**343**	**(82)**	**261**	575	(55)	520
Later than four years and not later than five years	**38**	**(38)**	**—**	231	(25)	206
Later than five years	**—**	**—**	**—**	8	—	8
	4,382	**(466)**	**3,916**	7,210	(656)	6,554

At 31 December 2021 and 2020, the Company had no finance lease and hire purchase contract receivables. The Santander UK group enters into finance leasing arrangements primarily for the financing of motor vehicles and a range of assets for its corporate customers. Included in the carrying value of net investment in finance leases and hire purchase contracts is £1,510m (2020: £3,552m) of unguaranteed RV at the end of the current lease terms, which is expected to be recovered through re-payment, re-financing or sale. Contingent rent income of £nil (2020: £nil, 2019: £nil) was earned in the year, which was classified in 'Interest and similar income'. Finance income on the net investment in finance leases was £243m (2020: £308m, 2019: £299m).

Finance lease receivable balances are secured over the asset leased. The Santander UK group is not permitted to sell or repledge the asset in the absence of default by the lessee. The Directors consider that the carrying amount of the finance lease receivables approximates to their fair value.

Included within loans and advances to customers are advances assigned to bankruptcy remote structured entities and Abbey Covered Bonds LLP. These loans provide security to issues of covered bonds and mortgage-backed or other asset-backed securities issued by the Santander UK group. For more, see Note 14.

At 31 December 2021 and 2020, the Santander UK group had contracted with lessees for the following future undiscounted minimum lease payments receivable under operating leases.

	Group		Company	
	2021	2020	2021	2020
	£m	£m	£m	£m
No later than one year	**31**	17	**30**	16
Later than one year and not later than two years	**27**	16	**26**	13
Later than two years and not later than three years	**21**	15	**21**	11
Later than three years and not later than four years	**15**	11	**14**	10
Later than four years and not later than five years	**11**	10	**10**	9
Later than five years	**28**	29	**21**	21
	133	98	**122**	80

14. SECURITISATIONS AND COVERED BONDS

The information in this Note relates to securitisations and covered bonds for consolidated structured entities, used to obtain funding or collateral. It excludes structured entities relating to credit protection transactions.
The Santander UK group uses structured entities to securitise some of the mortgage and other loans to customers that it originates. The Santander UK group also issues covered bonds, which are guaranteed by, and secured against, a pool of the Santander UK group's mortgage loans transferred to Abbey Covered Bonds LLP. The Santander UK group issues mortgage-backed securities, other asset-backed securities and covered bonds mainly in order to obtain diverse, low-cost funding, but also to use as collateral for raising funds via third party bilateral secured funding transactions or for liquidity purposes in the future. The Santander UK group has successfully used bilateral secured transactions as an additional form of medium-term funding; this has allowed the Santander UK group to further diversify its medium-term funding investor base.

Loans and advances to customers include portfolios of residential mortgage loans, and receivables derived from credit agreements with retail customers for the purchases of financed vehicles, which are subject to non-recourse finance arrangements. These loans and receivables have been purchased by, or assigned to, structured entities or Abbey Covered Bonds LLP, and have been funded primarily through the issue of mortgage-backed securities, other asset-backed securities or covered bonds. No gain or loss has been recognised as a result of these sales. The structured entities and Abbey Covered Bonds LLP are consolidated as subsidiary undertakings. The Company and its subsidiaries do not own directly, or indirectly, any of the share capital of any of the structured entities.

a) Securitisations

i) Master trust structures

The Santander UK group makes use of master trust structures, whereby a pool of residential mortgage loans is assigned to a trust company by the asset originator. A funding entity acquires a beneficial interest in the pool of assets held by the trust company with funds borrowed from qualifying structured entities, which at the same time issue asset-backed securities to third-party investors or the Santander UK group.

Santander UK plc and its subsidiaries receive payments from the securitisation companies in respect of fees for administering the loans, and payment of deferred consideration for the sale of the loans. Santander UK plc and its subsidiaries have no right or obligation to repurchase any securitised loan, except if certain representations and warranties given by Santander UK plc or its subsidiaries at the time of transfer are breached and, in certain cases, if there is a product switch or further advance, if a securitised loan is in arrears for over two months or if a securitised loan does not comply with regulatory requirements.

In April 2020, Santander UK plc followed FCA guidance on how they expect mortgage lenders and administrators to treat customers fairly during the Covid-19 pandemic and restructured all its securitisations to accommodate its obligations as servicer under the principles set out in the FCA Handbook and Mortgage Conduct of Business rules.

The granting of payment holidays to any securitised loans results in a corresponding decrease in revenue receipts available to the trust company to distribute to the funding entity on each distribution date. To mitigate the potential impact to the securitisations, the qualifying structured entities were amended to direct a cash payment to the funding entity in an amount equal to the funding entity's share of the aggregate amount of the interest that would have been due on any loans which are the subject of a payment holiday. To effect such cash payment, Santander UK plc's share of revenue receipts is reduced by such amount and the funding entity's share of revenue receipts increased accordingly, making the impact neutral to the securitisation.

ii) Other securitisation structures

The Santander UK group also makes use of auto loan securitisations, whereby a pool of auto loans originated by a member of the Santander UK group is sold to a special purpose vehicle by the asset originator. The special purpose vehicle funds the purchase of the auto loans by issuing asset-backed securities to third-party investors. A proportion of the securities are also retained by members of the Santander UK group. Members of the Santander UK group also receive payments from the special purpose vehicle in respect of fees for administering the auto loans, and payment of deferred consideration for the sale of the auto loans. The seller has no right or obligation to repurchase any securitised loan, except if certain representations and warranties given by the Seller at the time of transfer are breached and, in certain cases, if there has been a subsequent variation in the terms of the underlying auto loan not permitted under the sale agreement.

b) Covered bonds

Santander UK plc also issues covered bonds, which are its direct, unsecured and unconditional obligation. The covered bonds benefit from a guarantee from Abbey Covered Bonds LLP. Santander UK plc makes a term advance to Abbey Covered Bonds LLP equal to the sterling proceeds of each issue of covered bonds. Abbey Covered Bonds LLP uses the proceeds of the term advance to purchase portfolios of residential mortgage loans and their security from Santander UK plc. Under the terms of the guarantee, Abbey Covered Bonds LLP has agreed to pay an amount equal to the guaranteed amounts when the same shall become due for payment, but which would otherwise be unpaid by Santander UK plc.

c) Analysis of securitisations and covered bonds

The Santander UK group's principal securitisation programmes and covered bond programme, together with the balances of the advances subject to securitisation (or for the covered bond programme assigned) and the carrying value of the notes in issue at 31 December 2021 and 2020 are listed below.

	Gross assets		External notes in issue		Notes issued to Santander UK plc/subsidiaries as collateral	
	2021	2020	**2021**	2020	**2021**	2020
	£m	£m	**£m**	£m	**£m**	£m
Mortgage-backed master trust structures:						
– Holmes	**2,294**	3,073	**430**	829	**183**	334
– Fosse	**2,154**	2,258	**288**	290	**1,402**	1,402
– Langton	**—**	2,782	**—**	—	**—**	2,355
	4,448	8,113	**718**	1,119	**1,585**	4,091
Other asset-backed securitisation structures:						
– Motor	**38**	189	**41**	104	**—**	97
– Auto ABS UK Loans	**—**	1,460	**—**	1,107	**—**	361
	38	1,649	**41**	1,211	**—**	458
Total securitisation programmes	**4,486**	9,762	**759**	2,330	**1,585**	4,549
Covered bond programmes						
– Euro 35bn Global Covered Bond Programme	**15,713**	23,670	**12,760**	19,285	**—**	—
Total securitisation and covered bond programmes (See Note 26)	**20,199**	33,432	**13,519**	21,615	**1,585**	4,549

Auto ABS UK Loans was held in PSA Finance UK Limited (PSA), which was a subsidiary of the Santander UK group. On 30 July 2021, the Santander UK group through Santander Consumer (UK) plc sold its entire 50% shareholding in PSA Finance UK Limited to PSA Financial Services Spain EFC SA, a joint venture between Santander Consumer Finance SA, a fellow subsidiary of Banco Santander SA, and Banque PSA Finance SA, the auto finance arm of Group PSA Peugeot Citroën. For more on PSA, see Note 19.

The following table sets out the internal and external issuances and redemptions in 2021 and 2020 for each securitisation and covered bond programme.

	Internal issuances		External issuances		Internal redemptions		External redemptions	
	2021	2020	**2021**	2020	**2021**	2020	**2021**	2020
	£bn	£bn	**£bn**	£bn	**£bn**	£bn	**£bn**	£bn
Mortgage-backed master trust structures:								
– Holmes	**—**	—	**—**	—	**0.2**	0.3	**0.4**	0.9
– Langton	**—**	—	**—**	—	**2.4**	—	**—**	—
Other asset-backed securitisation structures:								
– Motor	**—**	—	**—**	—	**0.1**	0.1	**0.1**	0.2
– Auto ABS UK Loans	**—**	—	**—**	0.3	**0.1**	—	**0.1**	0.1
Covered bond programme	**—**	—	**—**	3.0	**—**	—	**6.5**	2.7
	—	—	**—**	3.3	**2.8**	0.4	**7.1**	3.9

In 2021, all the remaining Langton bonds were redeemed and all the remaining associated mortgages were repurchased by Santander UK plc. There was no gain or loss on redemption.

Issuances and redemptions for Auto ABS UK Loans are included until 30 July 2021, the date on which the Santander UK Group sold its entire shareholding in PSA Finance UK Limited.

Holmes Funding Ltd has a beneficial interest of £0.5bn (2020: £1.0bn) in the residential mortgage loans held by Holmes Trustees Ltd. The remaining share of the beneficial interest in residential mortgage loans held by Holmes Trustees Ltd belongs to Santander UK plc.

Fosse Funding (No.1) Ltd has a beneficial interest of £1.6bn (2020: £1.7bn) in the residential mortgage loans held by Fosse Trustee (UK) Ltd. The remaining share of the beneficial interest in residential mortgage loans held by Fosse Trustee (UK) Ltd belongs to Santander UK plc.

Langton Funding (No.1) Ltd has a beneficial interest of £nil (2020: £2.4bn) in the residential mortgage loans held by Langton Mortgage Trustee (UK) Ltd, following the redemption of the remaining Langton bonds and repurchase of the associated mortgages by Santander UK plc. At 31 December 2021, Langton Mortgage Trustee (UK) Ltd was in the process of being liquidated, and all residential mortgage loans previously held by Langton Mortgage Trustee (UK) Ltd had been repurchased by Santander UK plc. At 31 December 2020, the remaining share of the beneficial interest in residential mortgage loans held by Langton Mortgage Trustee (UK) Ltd belonged to Santander UK plc.

The Holmes securitisation companies have cash deposits of £60m (2020: £186m), which have been accumulated to finance the redemption of a number of securities issued by the Holmes securitisation companies. The share of Holmes Funding Ltd in the trust assets is therefore reduced by this amount.

15. TRANSFERS OF FINANCIAL ASSETS NOT QUALIFYING FOR DERECOGNITION

The Santander UK group enters into transactions in the normal course of business by which it transfers recognised financial assets directly to third parties or to structured entities. These transfers may give rise to the full or partial derecognition of those financial assets. Transferred financial assets that do not qualify for derecognition consist of (i) securities held by counterparties as collateral under repurchase agreements, (ii) securities lent under securities lending agreements, and (iii) loans that have been securitised under arrangements by which the Santander UK group retains a continuing involvement in such transferred assets. .

As the substance of the sale and repurchase and securities lending transactions is secured borrowings, the asset collateral continues to be recognised in full and the related liability reflecting the Santander UK group's obligation to repurchase the transferred assets for a fixed price at a future date is recognised in deposits from banks or customers, as appropriate. As a result of these transactions, the Santander UK group is unable to use, sell or pledge the transferred assets for the duration of the transaction. The Santander UK group remains exposed to interest rate risk and credit risk on these pledged instruments. The counterparty's recourse is not limited to the transferred assets.

The Santander UK group securitisation transfers do not qualify for derecognition. The Santander UK group remains exposed to credit risks arising from the mortgage loans or credit agreements and has retained control of the transferred assets. Circumstances in which the Santander UK group has continuing involvement in the transferred assets may include retention of servicing rights over the transferred assets (the servicing fee in respect of which is dependent on the amount or timing of the cash flows collected from, or the non-performance of, the transferred assets), entering into a derivative transaction with the securitisation vehicle, retaining an interest in the securitisation vehicle or providing a cash reserve fund. Where the Santander UK group has continuing involvement, it continues to recognise the transferred assets to the extent of its continuing involvement and recognises an associated liability. The net carrying amount of the transferred assets and associated liabilities reflects the rights and obligations that the Santander UK group has retained.

The following table analyses the carrying amount of financial assets that did not qualify for derecognition and their associated financial liabilities:

	Group			
	2021		2020	
Nature of transaction	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Sale and repurchase agreements	**171**	**(172)**	1,597	(1,340)
Securities lending agreements	**1,892**	**(1,742)**	918	(752)
Securitisations (See Notes 14 and 26)	**4,486**	**(759)**	6,980	(2,330)
	6,549	**(2,673)**	9,495	(4,422)

	Company			
	2021		2020	
Nature of transaction	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Sale and repurchase agreements	**171**	**(172)**	974	(840)
Securities lending agreements	**1,253**	**(1,242)**	149	(136)
	1,424	**(1,414)**	1,123	(976)

16. REVERSE REPURCHASE AGREEMENTS – NON TRADING

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Agreements with banks	**447**	1,258	**447**	1,258
Agreements with customers	**12,236**	18,341	**12,236**	18,341
	12,683	19,599	**12,683**	19,599

17. OTHER FINANCIAL ASSETS AT AMORTISED COST

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Asset backed securities	**443**	491	**2,027**	4,579
Debt securities	**63**	672	**63**	672
	506	1,163	**2,090**	5,251

A significant portion of the debt securities are held in our eligible liquidity pool and consist mainly of government bonds and covered bonds. Detailed disclosures can be found in the 'Liquidity risk' section of the Risk review.

The Company's asset backed securities include investments in debt securities issued by Santander UK structured entities.

18. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Debt securities	**5,833**	8,929	**5,833**	8,929
Loans and advances to customers	**18**	21	**—**	—
	5,851	8,950	**5,833**	8,929

A significant portion of the debt securities are held in our eligible liquidity pool and consist mainly of government bonds and covered bonds. Detailed disclosures can be found in the 'Liquidity risk' section of the Risk review.

19. INTERESTS IN OTHER ENTITIES

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Subsidiaries	**—**	—	**1,247**	1,247
Joint Ventures	**201**	172	**—**	1
	201	172	**1,247**	1,248

The Santander UK group consists of a parent company, Santander UK plc, incorporated and domiciled in the UK and a number of subsidiaries and joint ventures held directly and indirectly by it. Details of subsidiaries and joint ventures are set out in the Shareholder Information section and form an integral part of these financial statements.

a) Interests in subsidiaries

The Company holds directly or indirectly 100% of the issued ordinary share capital of its principal subsidiaries. All companies operate principally in their country of incorporation or registration.

The movement in the Company's interests in subsidiaries was as follows:

	Company		
	Cost	Impairment	Net book value
	£m	£m	£m
At 1 January 2021	**1,249**	**(2)**	**1,247**
At 31 December 2021	**1,249**	**(2)**	**1,247**
At 1 January 2020	1,245	(2)	1,243
Reversal	4	—	4
At 31 December 2020	1,249	(2)	1,247

Subsidiaries with significant non-controlling interests

The only subsidiary with significant non-controlling interests was PSA Finance UK Limited (PSA), which operates in the UK. On 30 July 2021, Santander UK through Santander Consumer (UK) plc sold its entire 50% shareholding in PSA to PSA Financial Services Spain EFC SA, a joint venture between Santander Consumer Finance SA, a fellow subsidiary of Banco Santander SA, and Banque PSA Finance SA, the auto finance arm of Group PSA Peugeot Citroën. The impact of the sale was to derecognise total assets of £3.2bn, total liabilities of £2.9bn and a non-controlling interest of £0.15bn. No material gain or loss arose on sale. In 2021, until the date of sale, and 2020, the proportion of ownership interests and voting rights held by non-controlling interests was 50%.

	2021 £m	2020 £m
Profit attributable to non-controlling interests	**19**	19
Accumulated non-controlling interests of the subsidiary	—	162
Dividends paid to non-controlling interests	—	15
Summarised financial information:		
Total assets	—	3,451
Total liabilities	—	3,127
Profit for the year	—	38
Total comprehensive income for the year	—	33

Interests in consolidated structured entities

Structured entities are formed by Santander UK to accomplish specific and well-defined objectives. Santander UK consolidates these structured entities when the substance of the relationship indicates control, as described in Note 1. In addition to the structured entities disclosed in Note 14 which are used for securitisation and covered bond programmes, the only other structured entities consolidated by Santander UK are described below. All the external assets and liabilities in these entities are included in the financial statements and in relevant Notes. Other than as set out below, no significant judgements were required with respect to control or significant influence.

Motor Securities 2018-1 Designated Activity Company (Motor 2018)

Motor 2018 is a credit protection entity, and a Designated Activity Company limited by shares, incorporated in Ireland. It has issued a series of credit linked notes varying in seniority which reference portfolios of Santander UK group loans. Concurrently, these entity sells credit protection to Santander UK in respect of the referenced loans and, in return for a fee, is liable to make protection payments to Santander UK upon the occurrence of a credit event in relation to any of the referenced loans. Motor 2018 is consolidated as Santander UK holds a variable interest by retaining the junior tranche of notes issued by the entity.

b) Interests in joint ventures

Santander UK does not have any individually material interests in joint ventures. As set out in the accounting policies in Note 1, interests in joint ventures are accounted for using the equity method. In 2021, Santander UK's share in the profit after tax of its joint ventures was £22m (2020: £20m) before elimination of transactions between Santander UK and the joint ventures. At 31 December 2021, the carrying amount of Santander UK's interest was £201m (2020: £172m). At 31 December 2021 and 2020, the joint ventures had no commitments and contingent liabilities.

c) Interests in unconsolidated structured entities

Structured entities sponsored by the Santander UK group

Santander UK has interests in structured entities which it sponsors but does not control. Santander UK considers itself a sponsor of a structured entity when it facilitates the establishment of the structured entity. Other than as set out below, no significant judgements were required with respect to control or significant influence. The structured entities sponsored but not consolidated by Santander UK are as follows.

i) Santander (UK) Common Investment Fund

The Santander (UK) Common Investment Fund (the Fund) is a common investment fund that was established to hold the assets of the Santander (UK) Group Pension Scheme. The Fund is not consolidated by Santander UK, but its assets of £14,100m (2020: £13,553m) are accounted for as part of the defined benefit assets and obligations recognised on Santander UK's balance sheet. For more on the Fund, see Note 30. As the Fund holds the assets of the pension scheme, it is outside the scope of IFRS 10. Santander UK's maximum exposure to loss is the carrying amount of the assets held.

ii) Credit protection entities

Santander UK has established three (2020: three) unconsolidated credit protection entities, which are Designated Activity Companies limited by shares, incorporated in Ireland. Each entity has issued a series of credit linked notes varying in seniority which reference portfolios of Santander UK group loans. Concurrently, these entities sell credit protection to Santander UK in respect of the referenced loans and, in return for a fee, are liable to make protection payments to Santander UK upon the occurrence of a credit event in relation to any of the referenced loans. Senior credit linked notes, which amounted to £1,184m (2020: £2,160m), are issued to, and held by, Santander UK. Junior credit linked notes, which amounted to £619m (2020: £678m), are all held by third party investors and suffer the first losses incurred in the referenced portfolios. Funds raised by the sale of the credit linked notes are deposited with Santander UK as collateral for the credit protection.

The senior credit linked notes, along with the deposits and associated guarantees, are presented on a net basis, to reflect a legal right of set-off between the principal amounts of senior notes and the cash deposits. Deposits and associated guarantees in respect of the junior credit linked notes are included in 'Deposits by customers' (see Note 23). The entities are not consolidated by Santander UK because the third-party investors have the exposure, or rights, to all of the variability of returns from the performance of the entities. No assets are transferred to, or income received from, these entities. Since the credit linked notes (including those held by Santander UK) are fully cash collateralised, Santander UK's maximum exposure to loss is equal to any unamortised fees paid to the entities in connection with the credit protection outlined above.

Structured entities not sponsored by the Santander UK group

Santander UK also has interests in structured entities which it does not sponsor or control. These consist of holdings of mortgage and other asset backed securities issued by entities that were established and/or sponsored by other unrelated financial institutions. These securities comprise the asset backed securities included in Note 17. Management has concluded that the Santander UK group has no control or significant influence over these entities and that the carrying value of the interests held in these entities represents the maximum exposure to loss.

20. INTANGIBLE ASSETS

a) Goodwill

	Group			Company		
	Cost	Accumulated impairment	Net book value	Cost	Accumulated impairment	Net book value
	£m	£m	£m	£m	£m	£m
At 31 December 2020, 1 January 2021 and 31 December 2021	**1,269**	**(66)**	**1,203**	**1,194**	**—**	**1,194**

Impairment of goodwill
In 2021 and 2020, no impairment of goodwill was recognised. Goodwill is tested for impairment annually at 30 November, with a review for impairment indicators at 30 June and 31 December. Goodwill is tested for impairment if reviews identify an impairment indicator or when events or changes in circumstances dictate. Impairment is required where the book value of goodwill exceeds its recoverable amount.

The annual review identified the continuing uncertainty due to the Covid-19 pandemic and its potential impact on the carrying value of goodwill as impairment indicators for all cash-generating units (CGUs). As a result, management updated the impairment test at 31 December 2021 for all CGUs.

Basis of the recoverable amount
The recoverable amount of all CGUs was determined based on its value in use (VIU) methodology at each testing date. For each CGU, the VIU is calculated by discounting management's cash flow projections for the CGU. The cash flow projections also take account of increased internal capital allocations needed to achieve internal and regulatory capital targets including the leverage ratio. The key assumptions used in the VIU calculation for each CGU are set out below. The Retail Banking segment consists of the Private Banking CGU and the rest of Retail Banking, known as the Personal Financial Services CGU.

Key assumptions in the Value in use calculation

	Goodwill		Discount rate		Growth rate beyond initial cash flow projections	
	2021	2020	**2021**	2020	**2021**	2020
CGU	**£m**	£m	**%**	%	**%**	%
Personal Financial Services	**1,169**	1,169	**13.6**	13.6	**1.6**	1.6
Private Banking	**30**	30	**16.3**	8.9	**1.6**	1.6
Other	**4**	4	**13.6**	13.6	**1.6**	1.6
	1,203	1,203				

The CGUs do not carry on their balance sheets any other intangible assets with indefinite useful lives.

Management's judgement in estimating the cash flows of a CGU

The cash flow projections for the purpose of impairment testing for each CGU are derived from the latest 3-year plan presented to the Board. The Board challenges and endorses management's planning assumptions in light of internal capital allocations needed to support Santander UK's strategy, current market conditions and the macro-economic outlook. For the goodwill impairment tests conducted at 31 December 2021, the determination of the carrying value of the Personal Financial Services CGU was based on an allocation of regulatory capital and management's cash flow projections until the end of 2023. The assumptions included in the cash flow projections reflect an allocation to the cost of capital to support future growth, as well as the expected impact of Covid-19 on the UK economic environment and the financial outlook within which the CGUs operate. The cash flow projections are supported by Santander UK's base case economic scenario. For more on the base case economic scenario, including our forecasting approach and the assumptions in place at 31 December 2021, see the Credit risk – Santander UK group level section of the Risk review. The cash flow projections take into account the likely impact of future climate change.

Cash flow projections for the purpose of impairment testing do not take account of any adverse outcomes arising from contingent liabilities (see Note 31), whose existence will be confirmed by uncertain future events or where any obligation is not probable or otherwise cannot be measured reliably, nor do they take account of the benefits arising from Santander UK's transformation plans that had not yet been implemented or committed at 31 December 2021.

Discount rate
The rate used to discount the cash flows is based on the cost of equity assigned to each CGU, which is derived using a capital asset pricing model (CAPM). The CAPM depends on a number of inputs reflecting financial and economic variables, including the risk-free rate and a premium to reflect the inherent risk of the business being evaluated. These variables are based on the market's assessment of the economic variables and management's judgement. In determining the discount rate, management have identified the cost of equity associated with market participants that closely resemble our CGUs and adjusted them for tax to arrive at the pre-tax equivalent rate. As the discount rate is derived from market data, it takes into account the likely impact of future climate change.

Growth rate beyond initial cash flow projections
The growth rate for periods beyond the initial cash flow projections is used to extrapolate the cash flows in perpetuity because of the long-term perspective of CGUs. In line with the accounting requirements, management uses the UK Government's official estimate of UK long-term average GDP growth rate, as this is lower than management's estimate of the long-term average growth rate of the business. The estimated UK long-term average GDP growth rate has regard to the long-term impact of inherent uncertainties, such as Brexit, climate change and Covid-19.

Goodwill arising on the acquisition of Personal Financial Services and Private Banking
The VIU of each CGU remains higher than the carrying value of the related goodwill. The VIU review at 31 December 2021 did not indicate the need for an impairment in the Company's goodwill balances. Management considered the level of headroom and the uncertainty relating to the respective estimates of the VIU for those CGUs but determined that there was a sufficient basis to conclude that no impairment was required.

Sensitivities of key assumptions in calculating the

At 31 December 2021 and 31 December 2020, the VIU of the Personal Financial Services CGU was sensitive to reasonably possible changes in the key assumptions supporting the recoverable amount.

The table below presents a summary of the key assumptions underlying the most sensitive inputs to the model for the Personal Financial Services CGU, the key risks associated with each and details of a reasonably possible change in assumptions. The sensitivity analysis presented below has been prepared on the basis that a change in each key assumption would not have a consequential impact on other assumptions used in the impairment review. However, due to the interrelationships between some of the assumptions, a change in one of the assumptions might impact one or more of the other assumptions and could result in a larger or smaller overall impact.

The VIU calculation is not sensitive overall to the UK long-term average GDP growth rate assumption given the amount of headroom as the increased profit after tax generated by growth of the business is mostly offset by the need to retain more profit to meet increased regulatory capital requirements driven by the growth in assets. No reasonably possible change in the growth rate assumption would have resulted in an impairment.

Reasonably possible changes in key assumptions

CGU	Input	Key assumptions	Associated risks	Reasonably possible change
Personal Financial Services	Cash flow projections	– BoE Bank Rate – UK house price growth – UK mortgage loan market growth	– Uncertain market outlook – Persistent low interest rate environment	– Cash flow projections decrease by 5% (2020: 5%).
	Discount rate	– Discount rate used is a reasonable estimate of a suitable market rate for the profile of the business.	– Market rates of interest rise.	– Discount rate increases by 100 basis points (2020: 100 basis points).

At 31 December 2021 and 31 December 2020, a reasonably possible change in the key assumptions in relation to the VIU calculation for the goodwill balance in the Personal Financial Services CGU would have resulted in an impairment as follows.

		Impairment	
		2021	2020
CGU	Reasonably possible change	**£m**	£m
Personal Financial Services	Cash flow projections decrease by 5% (2020: 5%)	**—**	—
	Discount rate increases by 100 basis points (2020: 100 basis points)	**276**	—

Sensitivity of Value in use changes to current assumptions to achieve nil headroom

Although there was no impairment of goodwill at 31 December 2021, the test for the Personal Financial Services CGU remains sensitive to some of the assumptions used, as described above. In addition, the changes in assumptions detailed below for the discount rate and cash flow projections would eliminate the current headroom. As a result, there is a risk of impairment in the future should business performance or economic factors diverge from forecasts.

In 2021, there was a decrease in headroom arising from a higher capital allocation to our Retail Banking business which was partially offset by higher profitability.

The sensitivity analysis presented below has been prepared on the basis that a change in each key assumption would not have a consequential impact on other assumptions used in the impairment review. However, due to the interrelationships between some of the assumptions, a change in one of the assumptions might impact one or more of the other assumptions and could result in a larger or smaller overall impact.

2021 **CGU**	**Carrying value** **£m**	**Value in use** **£m**	**Headroom** **£m**	**Increase in post tax discount rate** **bps**	**Decrease in cash flows** **%**
Personal Financial Services	**8,433**	**9,100**	**667**	**68**	**7**
2020					
Personal Financial Services	6,758	8,602	1,844	239	22

b) Other intangibles

	Group			Company		
	Cost	Accumulated amortisation/ impairment	Net book value	Cost	Accumulated amortisation/ impairment	Net book value
	£m	£m	£m	£m	£m	£m
At 1 January 2021	**1,304**	**(861)**	**443**	**1,343**	**(922)**	**421**
Additions	**84**	**—**	**84**	**84**	**—**	**84**
Disposals	**(54)**	**53**	**(1)**	**(54)**	**53**	**(1)**
Charge	**—**	**(158)**	**(158)**	**—**	**(154)**	**(154)**
Impairment	**—**	**(26)**	**(26)**	**—**	**(20)**	**(20)**
At 31 December 2021	**1,334**	**(992)**	**342**	**1,373**	**(1,043)**	**330**
At 1 January 2020	1,249	(686)	563	1,291	(751)	540
Additions	102	—	102	99	—	99
Disposals	(47)	47	—	(47)	47	—
Charge	—	(197)	(197)	—	(193)	(193)
Impairment	—	(25)	(25)	—	(25)	(25)
At 31 December 2020	1,304	(861)	443	1,343	(922)	421

Other intangibles which consist of computer software, include computer software under development of £83m (2020: £99m), of which £31m is internally generated (2020: £68m). For the Company, all computer software is externally generated.

The impairment charge of £26m (2020: £25m) relates to computer software no longer expected to yield future economic benefits as it has become obsolete.

21. PROPERTY, PLANT AND EQUIPMENT

	Group					
	Property £m	Office fixtures and equipment £m	Computer software £m	Operating lease assets £m	Right-of-use assets £m	Total[2] £m
Cost:						
At 1 January 2021	**1,272**	**1,375**	**436**	**720**	**218**	**4,021**
Additions	**126**	**26**	**—**	**284**	**65**	**501**
Disposals	**(420)**	**(352)**	**(2)**	**(249)**	**(29)**	**(1,052)**
At 31 December 2021	**978**	**1,049**	**434**	**755**	**254**	**3,470**
Accumulated depreciation:						
At 1 January 2021	**489**	**1,068**	**434**	**178**	**118**	**2,287**
Charge for the year[1]	**32**	**86**	**1**	**81**	**19**	**219**
Impairment during the year	**46**	**28**	**—**	**—**	**23**	**97**
Disposals	**(233)**	**(325)**	**(1)**	**(99)**	**(23)**	**(681)**
At 31 December 2021	**334**	**857**	**434**	**160**	**137**	**1,922**
Net book value	**644**	**192**	**—**	**595**	**117**	**1,548**
Cost:						
At 1 January 2020	1,270	1,436	439	738	212	4,095
Additions	61	43	2	185	8	299
Disposals	(59)	(104)	(5)	(203)	(2)	(373)
At 31 December 2020	1,272	1,375	436	720	218	4,021
Accumulated depreciation:						
At 1 January 2020	454	1,016	434	164	60	2,128
Charge for the year[1]	55	111	—	92	58	316
Impairment during the year	24	—	—	—	—	24
Disposals	(44)	(59)	—	(78)	—	(181)
At 31 December 2020	489	1,068	434	178	118	2,287
Net book value	783	307	2	542	100	1,734

(1) Following a review of the estimated useful lives of property as part of Santander UK's transformation program, the charge for the period includes accelerated property depreciation of £9m (2020: £9m).
(2) Property, plant and equipment includes assets under construction of £106m (2020: £55m).

	Company				
	Property £m	Office fixtures and equipment £m	Computer software £m	Right-of-use assets £m	Total[2] £m
Cost:					
At 1 January 2021	**1,032**	**1,324**	**425**	**198**	**2,979**
Additions	**125**	**27**	**(1)**	**65**	**216**
Disposals	**(234)**	**(328)**	**—**	**(24)**	**(586)**
At 31 December 2021	**923**	**1,023**	**424**	**239**	**2,609**
Accumulated depreciation:					
At 1 January 2021	**441**	**1,018**	**423**	**115**	**1,997**
Charge for the year[1]	**23**	**87**	**1**	**18**	**129**
Impairment during the year	**21**	**28**	**—**	**23**	**72**
Disposals	**(198)**	**(302)**	**(1)**	**(23)**	**(524)**
At 31 December 2021	**287**	**831**	**423**	**133**	**1,674**
Net book value	**636**	**192**	**1**	**106**	**935**
Cost:					
At 1 January 2020	1,030	1,406	428	193	3,057
Additions	61	21	2	7	91
Disposals	(59)	(103)	(5)	(2)	(169)
At 31 December 2020	1,032	1,324	425	198	2,979
Accumulated depreciation:					
At 1 January 2020	418	986	423	59	1,886
Charge for the year	52	110	—	56	218
Impairment during the year	—	18	—	—	18
Disposals	(29)	(96)	—	—	(125)
At 31 December 2020	441	1,018	423	115	1,997
Net book value	591	306	2	83	982

(1) Following a review of the estimated useful lives of property as part of Santander UK's transformation program, the charge for the year includes accelerated property depreciation of £9m (2020: £9m).
(2) Property, plant and equipment includes assets under construction of £106m (2020: £55m).

In Q2 2021, we sold our current head office site in Triton Square, London to a wholly owned subsidiary of Banco Santander SA. Property, office fixtures and equipment and right-of-use assets were impaired in the period as a result of our multi-year transformation project. The impairment relates to leasehold properties within the scope of our branch network restructuring programme and head office sites which are either closing or consolidating.

As part of our plan to be the best bank to work for in the UK, we are building a new head office in Milton Keynes to meet the flexible needs of a modern workforce. It represents a planned investment of more than £200m, funded from existing resources. Site works began in Q1 2020 with practical completion expected in March 2023. Expenditure at 31 December 2021 was approximately £57m.

22. OTHER FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
US$30bn Euro Medium Term Note Programme	**5**	102	**5**	102
Structured Notes Programmes	**413**	805	**413**	805
Eurobonds	**142**	150	**142**	150
Structured deposits	**223**	375	**223**	375
Collateral and associated financial guarantees	**20**	2	**21**	2
	803	1,434	**804**	1,434

For the Santander UK group and the Company, all (2020: all) of the other financial liabilities at FVTPL were designated as such.

Collateral and associated financial guarantees in the table above represent collateral received, together with associated credit protection guarantees, in respect of the proceeds of the retained senior tranches of credit linked notes described in Note 12. The financial guarantees are valued using the same parameters as the related credit linked notes, such that changes in the respective valuations are offset exactly, and there is no charge or credit to the income statement.

Gains and losses arising from changes in the credit spread of securities issued by the Santander UK group reverse over the contractual life of the debt, provided that the debt is not repaid at a premium or a discount. The net loss during the year attributable to changes in the Santander UK group's own credit risk on the above securities was £12m (2020: £3m loss, 2019: £77m loss). The cumulative net loss attributable to changes in the Santander UK group's own credit risk on the above securities at 31 December 2021 was £10m (2020: £3m).

At 31 December 2021, the amount that would be required to be contractually paid at maturity of the securities above was £nil higher (2020: £11m lower) than the carrying value.

23. DEPOSITS BY CUSTOMERS

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Demand and time deposits[1]	**185,843**	185,879	**181,282**	181,112
Amounts due to other Santander UK Group Holdings plc subsidiaries	**59**	59	**17,628**	26,666
Amounts due to Santander UK Group Holdings plc[2]	**5,874**	7,883	**5,874**	7,883
Amounts due to fellow Banco Santander subsidiaries and joint ventures	**1,150**	1,314	**250**	414
	192,926	195,135	**205,034**	216,075

(1) Includes equity index-linked deposits of £549m (2020: £577m). The capital amount guaranteed/protected and the amount of return guaranteed in respect of the equity index-linked deposits were £549m and £2m (2020: £577m and £2m) respectively.
(2) Includes downstreamed funding from our immediate parent company Santander UK Group Holdings plc.

24. DEPOSITS BY BANKS

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Items in the course of transmission	**414**	375	**413**	374
Deposits held as collateral	**931**	2,063	**810**	1,487
Other deposits[1]	**32,507**	18,519	**32,491**	18,511
Amounts due to Santander UK subsidiaries	**3**	1	**5,131**	5,333
	33,855	20,958	**38,845**	25,705

(1) Includes drawdown from the TFS of £0.0bn (2020: £6.3bn) and drawdown from the TFSME of £31.9bn (2020: £11.7bn).

25. REPURCHASE AGREEMENTS – NON TRADING

	Group		Company	
	2021	2020	2021	2020
	£m	£m	£m	£m
Agreements with banks	**4,145**	6,358	**4,145**	6,354
Agreements with customers	**7,573**	9,490	**7,573**	9,491
	11,718	15,848	**11,718**	15,845

26. DEBT SECURITIES IN ISSUE

	Group		Company	
	2021	2020	2021	2020
	£m	£m	£m	£m
Medium-term notes:				
– US$30bn Euro Medium Term Note Programme	**1,405**	1,694	**1,405**	1,697
– Euro 30bn Euro Medium Term Note Programme[1]	**1,261**	1,061	**1,261**	1,061
– US SEC-registered Debt Programme – Santander UK plc[2]	**4,185**	5,457	**4,195**	5,472
	6,851	8,212	**6,861**	8,230
Euro 35bn Global Covered Bond Programme (See Note 14)	**12,760**	19,285	**12,602**	18,932
US$20bn Commercial Paper Programmes	**2,704**	2,824	**2,704**	2,824
Certificates of deposit	**2,387**	2,858	**2,387**	2,858
Credit linked notes	**59**	57	**—**	—
Securitisation programmes (See Note 14)	**759**	2,330	**—**	—
	25,520	35,566	**24,554**	32,844

(1) Restated for 2020 to reclassify £673m previously disclosed as Euro 750m Senior Unsecured Notes to Euro 30bn Euro Medium Term Note Programme due to an administrative error.
(2) Restated for 2020 to reclassify £734m previously disclosed as US$1bn Senior Unsecured Notes to US SEC-registered Debt Programme - Santander UK plc due to an administrative error.

27. SUBORDINATED LIABILITIES

	Group		Company	
	2021	2020	2021	2020
	£m	£m	£m	£m
£325m Sterling preference shares	**344**	344	**344**	344
Undated subordinated liabilities	**240**	557	**243**	584
Dated subordinated liabilities	**1,644**	1,655	**1,646**	1,658
	2,228	2,556	**2,233**	2,586

In 2021, the Santander UK group repurchased certain debt securities and subordinated liabilities as part of ongoing liability management exercises, resulting in a loss of £1m. In 2020, the Santander UK group repurchased certain debt securities and subordinated liabilities as part of ongoing liability management exercises, resulting in a loss of £24m.

The above securities will, in the event of the winding up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer, other than creditors whose claims rank equally with, or are junior to, the claims of the holders of the subordinated liabilities. The subordination amongst each of the subordinated liabilities upon a winding up of the issuer is specified in their respective terms and conditions.

In 2021 and 2020, the Santander UK group had no defaults of principal, interest or other breaches with respect to its subordinated liabilities. No repayment or purchase by the issuer of the subordinated liabilities may be made prior to their stated maturity without the consent of the PRA.

Undated subordinated liabilities

		Group		Company	
		2021	2020	**2021**	2020
	First call date	**£m**	£m	**£m**	£m
10.0625% Exchangeable capital securities	n/a	**205**	205	**205**	205
7.125% 30 Year Step-up perpetual callable subordinated notes	2030	**35**	352	**38**	379
		240	557	**243**	584

In common with other debt securities issued by Santander UK group companies and notwithstanding the issuer's first call dates in the table above, in the event of certain tax changes affecting the treatment of payments of interest on subordinated liabilities in the UK, the 7.125% 30 Year Step-up perpetual callable subordinated notes are redeemable at any time, and the 10.0625% Exchangeable capital securities are redeemable on any interest payment date – each in whole at the option of Santander UK plc, at their principal amount together with any accrued interest.

The 10.0625% Exchangeable capital securities are exchangeable into fully paid 10.375% non-cumulative non-redeemable sterling preference shares of £1 each, at the option of Santander UK plc, on the business day immediately following any interest payment date.

Dated subordinated liabilities

		Group		Company	
		2021	2020	**2021**	2020
	Maturity	**£m**	£m	**£m**	£m
5% Subordinated notes (US$1,500m)	2023	**548**	542	**547**	541
4.75% Subordinated notes (US$1,000m)	2025	**541**	536	**541**	536
7.95% Subordinated notes (US$1,000m)	2029	**221**	242	**221**	242
6.50% Subordinated notes	2030	**28**	31	**30**	33
5.875%Subordinated notes	2031	**9**	10	**10**	12
5.625%Subordinated notes (US$500m)	2045	**297**	294	**297**	294
		1,644	1,655	**1,646**	1,658

The dated subordinated liabilities are redeemable in whole at the option of Santander UK plc in the event of certain tax changes affecting the treatment of payments of interest on the subordinated liabilities in the UK, at their principal amount together with any accrued interest.

28. OTHER LIABILITIES

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Lease liabilities	**132**	97	**122**	80
Other	**2,057**	2,240	**1,816**	1,941
	2,189	2,337	**1,938**	2,021

29. PROVISIONS

	Group							
	Customer remediation[2]	Litigation and other regulatory[2]	Bank Levy	Property	ECL on undrawn facilities and guarantees	Restructuring	Other[2]	Total
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	69	198	34	45	75	39	4	464
Additional provisions (See Note 8)	25	72	52	52	—	80	109	390
Provisions released (See Note 8)	—	—	—	(2)	(30)	—	(2)	(34)
Utilisation and other	(50)	(104)	(98)	(21)	(7)	(91)	(98)	(469)
Recharge[1]	—	—	13	—	—	—	—	13
At 31 December 2021	44	166	1	74	38	28	13	364

(1) Recharge in respect of the UK Bank Levy paid on behalf of other UK entities in the Banco Santander group

(2) For 2021, operational loss provisions as they relate to customer accounts are included in 'Customer remediation', and 'Restructuring' provisions are now shown separately. As a result, provisions of £61m, £121m and £39m at 1 January 2021 have been reclassified from 'Regulatory and other' to 'Customer remediation', 'Litigation and other regulatory' and 'Restructuring' provisions, respectively, and £8m and £76m of 'Conduct remediation' provisions at 1 January 2021 have been reclassified to 'Customer remediation' and 'Litigation and other regulatory' provisions, respectively.

Provisions expected to be settled within no more than 12 months after 31 December 2021 were £180m (2020: £323m).

	Company							
	Customer remediation[2]	Litigation and other regulatory[2]	Bank Levy	Property	ECL on undrawn facilities and guarantees	Restructuring	Other[2]	Total
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	69	198	34	45	75	39	4	464
Additional provisions (See Note 8)	25	72	52	52	—	80	104	385
Provisions released (See Note 8)	—	—	—	(2)	(30)	—	(2)	(34)
Utilisation and other	(50)	(104)	(98)	(21)	(7)	(91)	(93)	(464)
Recharge[1]	—	—	13	—	—	—	—	13
At 31 December 2021	44	166	1	74	38	28	13	364

(1) Recharge in respect of the UK Bank Levy paid on behalf of other UK entities in the Banco Santander group

(2) For 2021, operational loss provisions as they relate to customer accounts are included in 'Customer remediation', and 'Restructuring' provisions are now shown separately. As a result, provisions of £61m, £121m and £39m at 1 January 2021 have been reclassified from 'Regulatory and other' to 'Customer remediation', 'Litigation and other regulatory' and 'Restructuring' provisions, respectively, and £8m and £76m of 'Conduct remediation' provisions at 1 January 2021 have been reclassified to 'Customer remediation' and 'Litigation and other regulatory' provisions, respectively.

Provisions expected to be settled by the Company within no more than 12 months after 31 December 2021 were £180m (2020: £322m).

In 2021, the analysis of the provisions balance in the table above was enhanced to reflect its changing composition. PPI and Other products were combined with operational loss provisions relating to customer accounts which were previously included in 'Regulatory and Other' to give a clearer view of the overall 'Customer remediation' provision. Restructuring provisions relating to redundancy costs associated with transformation and organisational changes previously included in 'Regulatory and Other' are now shown separately to provide better insight.

a) Customer remediation

Customer remediation provisions included the estimated cost of making redress payments with respect to the past sales of products and systems issues, as well as operational loss provisions relating to customers' accounts.

At 31 December 2021, there was no provision remaining for PPI redress and related costs (2020: £59m).

An additional provision of £16m was recognised in December 2021 for interest and fees charged on discount plans. The remaining customer remediation provisions relate to sales of other products, primarily in regard to mortgage endowments, and other system issues around interest and fee charging, including an amount of £6m (2020: £47m) that arose from a systems-related historical issue identified by Santander UK, relating to compliance with certain requirements of the Consumer Credit Act (CCA). As detailed in Note 31, there are aspects of the issue which remain under review.

b) Litigation and other regulatory

Litigation and other regulatory provisions principally comprised amounts in respect of litigation and other regulatory charges, operational loss and operational risk provisions, and related expenses. A number of uncertainties exist with respect to these provisions given the uncertainties inherent in litigation and other regulatory matters, that affect the amount and timing of any potential outflows with respect to which provisions have been established. These provisions are reviewed at least quarterly.

Although the deadline for bringing PPI complaints has passed, customers can still commence Plevin related litigation. An increase in provision of £21m has been made for the best estimate of any obligation to pay compensation in respect of current stock and estimated future claims. There are ongoing factual issues to be resolved regarding such litigation which may have legal consequences including the volume and quality of future litigation claims. As a result, the extent of the potential liability and amount of any compensation to be paid remains uncertain.

The balance also included an amount in respect of our best estimate of liability relating to a legal dispute regarding allocation of responsibility for a specific PPI portfolio of complaints, further described in Note 31. No further information on the best estimate is provided on the basis that it would be seriously prejudicial.

In 2021 there were charges of £29m for legal provisions and £22m for other regulatory issues.

c) Bank Levy

A rate of 0.10% applies for 2021 (2020: 0.14%).

d) Property

Property provisions include leasehold vacant property provisions, dilapidation provisions for leased properties within the scope of IFRS 16, and decommissioning and disposal costs relating to vacant freehold properties. Leasehold vacant property provisions are made by reference to an estimate of any expected sub-let income, compared to the head rent, and the possibility of disposing of Santander UK's interest in the lease, taking into account conditions in the property market.

Property provisions included £52m of transformation charges in 2021. These relate to a multi-year project to deliver on our strategic priorities and enhance efficiency in order for us to better serve our customers and meet our medium-term targets. These charges consist of costs relating to leasehold properties within the scope of our branch network restructuring programme and head office closures. They also include decommissioning costs relating to freehold head office sites which are either closing or consolidating.

e) ECL on undrawn facilities and guarantees

Provisions include expected credit losses relating to guarantees given to third parties and undrawn loan commitments. Off balance sheet ECL of £7m was included in the transfer of the CIB business of Santander UK SLB.

f) Restructuring

Restructuring provisions relate to severance costs associated with transformation and organisational changes. The provision includes a charge of £76m as part of our multi-year transformation programme to improve future returns, focused on simplifying, digitising and automating the bank.

g) Other

Other provisions include provisions that do not fit into any of the other categories, such as fraud losses and some categories of operational losses.

In 2021 there were charges for operational risk provisions of £94m, including Authorised Push Payment fraud losses.

30. RETIREMENT BENEFIT PLANS

The amounts recognised in the balance sheet were as follows:

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Assets/(liabilities)				
Funded defined benefit pension scheme - surplus	**1,572**	495	**1,572**	481
Funded defined benefit pension scheme - deficit	**—**	(361)	**—**	(361)
Unfunded pension and post-retirement medical benefits	**(37)**	(42)	**(37)**	(42)
Total net assets	**1,535**	92	**1,535**	78

Remeasurement losses/(gains) recognised in other comprehensive income during the year were as follows:

	Group		
	2021	2020	2019
	£m	£m	£m
Pension remeasurement	**(1,264)**	505	522

a) Defined contribution pension plans

The majority of employees are members of a defined contribution Master Trust, LifeSight. This is the plan into which eligible employees are enrolled automatically. The assets of LifeSight are held in separate trustee-administered funds. Funds arising from Additional Voluntary Contributions (AVCs) are largely held within the main defined benefit scheme operated by the Santander UK group.

An expense of £64m (2020: £66m) was recognised for defined contribution plans in the period and is included in staff costs within operating expenses (see Note 6).

b) Defined benefit pension schemes

The Santander UK group operates a number of defined benefit pension schemes. The main scheme is the Santander (UK) Group Pension Scheme (the Scheme). It comprises seven legally segregated sections. The Scheme covers 11% (2020: 11%) of the Santander UK group's current employees and is a funded defined benefit scheme which is closed to new members.

The corporate trustee of the Scheme is Santander (UK) Group Pension Scheme Trustees Limited (the Trustee), a private limited company incorporated in 1996 and a wholly-owned subsidiary of Santander UK Group Holdings plc. The principal duty of the Trustee is to act in the best interests of the members of the Scheme. The Trustee board comprises five (2020:five) Directors selected by Santander UK Group Holdings plc, plus five (2020: five) member-nominated Directors selected from eligible members who apply for the role.

The assets of the funded schemes including the Scheme are held independently of the Santander UK group's assets in separate trustee administered funds. Investment strategy across the sections of the Scheme remains under regular review. Investment decisions are delegated by the Trustee to a common investment fund, managed by Santander (CF Trustee) Limited, a private limited company owned by five Trustee directors, three appointed by Santander UK plc and two by the Trustee. The Santander (CF Trustee) Limited directors' principal duty, within the investment powers delegated to them, is to act in the best interest of the members of the Scheme. Ultimate responsibility for investment policy and strategy rests with the Trustee of the Scheme who is required under the Pensions Act 2004 to prepare a statement of investment principles. The defined benefit pension schemes expose the Santander UK group to risks such as investment risk, interest rate risk, longevity risk and inflation risk. The Santander UK group does not hold any insurance policies over the defined benefit pension schemes and has not entered into any significant transactions with them.

Formal actuarial valuations of the assets and liabilities of the defined benefit schemes are carried out on at least a triennial basis by independent professionally qualified actuaries and valued for accounting purposes at each balance sheet date. The Scheme Trustee is responsible for the actuarial valuations and in doing so considers, or relies in part on, a report of a third-party expert. The latest formal actuarial valuation for the Scheme at 31 March 2019 was finalised in August 2019, with a deficit to be funded of £1,136m. The next scheduled triennial funding valuation will be at 31 March 2022. Any funding surpluses can be recovered by Santander UK plc from the Scheme through refunds as the Scheme is run off over time or could be used to pay for the cost of benefits which are accruing.

The main differences between the assumptions used for assessing the defined benefit liabilities for the funding valuation and those used for IAS 19 is that the financial and demographic assumptions used for the funding valuation are generally more prudent than those used for the IAS 19 valuation.

The total amount charged to the income statement was as follows:

	Group		
	2021	2020	2019
	£m	£m	£m
Net interest income	**(5)**	(10)	(23)
Current service cost	**38**	36	34
Past service and GMP costs	**—**	1	1
Past service curtailment costs	**5**	—	—
Administration costs	**8**	8	8
	46	35	20

On 26 October 2018, the High Court handed down a judgement concluding that defined benefit schemes should equalise pension benefits for men and women in relation to GMP and concluded on the methods that were appropriate. The estimated increase in liabilities at the date of the judgement was £40m and was based on a number of assumptions and the actual impact may be different. This was reflected in the income statement and in the closing net accounting surplus of the Scheme in 2018. The allowance included in the Scheme liabilities at 31 December 2021 decreased by £5m (2020: £5m, 2019: £5m) to £45m (2020: £50m, 2019: £45m) to reflect the latest assumptions. This change was recognised in other comprehensive income. Work is being undertaken by the Trustee to implement GMP equalisation.

On 20 November 2020, a further court ruling on the GMP equalisation case took place on the issue of whether or not there is an obligation to equalise transfers that occurred prior to October 2018. It was concluded that historic transfers should be equalised. The potential additional liability was estimated and was not material. As a result, no additional liability has been recognised.

Past service curtailment costs of £5m were recognised in 2021 in connection with redundancies arising from branch closures and rationalisation of office sites.

The amounts recognised in other comprehensive income were as follows:

	Group		
	2021	2020	2019
	£m	£m	£m
Return on plan assets (excluding amounts included in net interest expense)	**(454)**	(1,328)	(855)
Actuarial (gains)/losses arising from changes in demographic assumptions	**(17)**	34	42
Actuarial gains arising from experience adjustments	**(19)**	(141)	(42)
Actuarial (gains)/losses arising from changes in financial assumptions	**(774)**	1,940	1,377
Pension remeasurement	**(1,264)**	505	522

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

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
At 1 January	**(13,887)**	(12,158)	**(13,843)**	(12,113)
Current service cost paid by Santander UK plc	**(29)**	(24)	**(29)**	(23)
Current service cost paid by subsidiaries	**(9)**	(12)	**(9)**	(12)
Current service cost paid by fellow Banco Santander subsidiaries	**—**	—	**—**	—
Interest cost	**(188)**	(253)	**(187)**	(252)
Employer salary sacrifice contributions	**(9)**	(2)	**(9)**	(2)
Past service cost	**—**	(1)	**—**	(1)
Past service curtailment costs	**(5)**	—	**(5)**	—
Remeasurement due to actuarial movements arising from:				
– Changes in demographic assumptions	**17**	(34)	**17**	(34)
– Experience adjustments	**19**	141	**19**	137
– Changes in financial assumptions	**774**	(1,940)	**771**	(1,937)
Benefits paid	**398**	396	**397**	394
Derecognition of pension scheme liabilities arising from the sale of PSA	**41**	—	**—**	—
At 31 December	**(12,878)**	(13,887)	**(12,878)**	(13,843)

Movements in the fair value of the schemes' assets were as follows:

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
At 1 January	**13,979**	12,547	**13,921**	12,485
Interest income	**193**	263	**193**	262
Contributions paid by employer and scheme members	**246**	245	**246**	244
Contributions paid by fellow Banco Santander subsidiaries	**—**	—	**—**	—
Administration costs paid	**(8)**	(8)	**(8)**	(8)
Return on plan assets (excluding amounts included in net interest expense)	**454**	1,328	**458**	1,332
Benefits paid	**(398)**	(396)	**(397)**	(394)
Derecognition of pension scheme assets arising from the sale of PSA	**(53)**	—	**—**	—
At 31 December	**14,413**	13,979	**14,413**	13,921

The composition and fair value of the schemes' assets by category was:

	Quoted prices in active markets		Prices not quoted in active markets		Total		Group Valuation
2021	£m	%	£m	%	£m	%	technique
UK equities	**38**	**—**	**—**	**—**	**38**	**—**	**A**
Overseas equities	**1,401**	**10**	**1,065**	**7**	**2,466**	**17**	**A,C**
Corporate bonds	**1,607**	**11**	**312**	**2**	**1,919**	**13**	**A,C**
Government fixed interest bonds	**2,788**	**19**	**—**	**—**	**2,788**	**19**	**A**
Government index-linked bonds	**9,159**	**64**	**—**	**—**	**9,159**	**64**	**A**
Property	**—**	**—**	**1,409**	**10**	**1,409**	**10**	**B**
Derivatives	**—**	**—**	**(83)**	**(1)**	**(83)**	**(1)**	**A**
Cash	**—**	**—**	**2,290**	**16**	**2,290**	**16**	**A**
Repurchase agreements[1]	**—**	**—**	**(6,582)**	**(45)**	**(6,582)**	**(45)**	**A**
Infrastructure	**—**	**—**	**390**	**3**	**390**	**3**	**B,C**
Annuities	**—**	**—**	**291**	**2**	**291**	**2**	**D**
Longevity swap	**—**	**—**	**(8)**	**0**	**(8)**	**0**	**D**
Other	**—**	**—**	**336**	**2**	**336**	**2**	**C**
	14,993	**104**	**(580)**	**(4)**	**14,413**	**100**	
2020							
UK equities	40	0	—	—	40	0	A
Overseas equities	1,271	9	1,004	7	2,275	16	A,C
Corporate bonds	1,121	8	457	3	1,578	11	A,C
Government fixed interest bonds	1,618	12	—	—	1,618	12	A
Government index-linked bonds	6,695	48	—	—	6,695	48	A
Property	—	—	1,454	10	1,454	10	B
Derivatives	—	—	312	2	312	2	A
Cash	—	—	1,161	8	1,161	8	A
Repurchase agreements[1]	—	—	(2,198)	(15)	(2,198)	(15)	A
Infrastructure	—	—	406	3	406	3	B,C
Annuities	—	—	309	2	309	2	D
Longevity swap	—		0	0	0	0	D
Other	—	—	329	3	329	3	C
	10,745	77	3,234	23	13,979	100	

(1) Sale and repurchase agreements net of purchase and resale agreements.

2021	Quoted prices in active markets £m	Quoted prices in active markets %	Prices not quoted in active markets £m	Prices not quoted in active markets %	Total £m	Total %	Company Valuation technique
UK equities	**38**	**—**	**—**	**—**	**38**	**—**	**A**
Overseas equities	**1,401**	**10**	**1,065**	**7**	**2,466**	**17**	**A,C**
Corporate bonds	**1,607**	**11**	**312**	**2**	**1,919**	**13**	**A,C**
Government fixed interest bonds	**2,788**	**19**	**—**	**—**	**2,788**	**19**	**A**
Government index-linked bonds	**9,159**	**64**	**—**	**—**	**9,159**	**64**	**A**
Property	**—**	**—**	**1,409**	**10**	**1,409**	**10**	**B**
Derivatives	**—**	**—**	**(83)**	**(1)**	**(83)**	**(1)**	**A**
Cash	**—**	**—**	**2,290**	**16**	**2,290**	**16**	**A**
Repurchase agreements[1]	**—**	**—**	**(6,582)**	**(45)**	**(6,582)**	**(45)**	**A**
Infrastructure	**—**	**—**	**390**	**3**	**390**	**3**	**B,C**
Annuities	**—**	**—**	**291**	**2**	**291**	**2**	**D**
Longevity swap	**—**	**—**	**(8)**	**0**	**(8)**	**0**	**D**
Other	**—**	**—**	**336**	**2**	**336**	**2**	**C**
	14,993	**104**	**(580)**	**(4)**	**14,413**	**100**	
2020							
UK equities	40	—	—	—	40	—	**A**
Overseas equities	1,268	9	1,004	7	2,272	16	**A,C**
Corporate bonds	1,066	8	457	3	1,523	11	**A,C**
Government fixed interest bonds	1,618	12	—	—	1,618	12	**A**
Government index-linked bonds	6,695	48	—	—	6,695	48	**A**
Property	—	—	1,454	10	1,454	10	**B**
Derivatives	—	—	312	2	312	2	**A**
Cash	—	—	1,161	8	1,161	8	**A**
Repurchase agreements[1]	—	—	(2,198)	(15)	(2,198)	(15)	**A**
Infrastructure	—	—	406	3	406	3	**B,C**
Annuities	—	—	309	2	309	2	**D**
Longevity swap	—	—	—	—	—	—	**D**
Other	—	—	329	3	329	3	**C**
	10,687	77	3,234	23	13,921	100	

(1) Sale and repurchase agreements net of purchase and resale agreements

Valuation techniques

At a high level, the main methods for measuring the fair value of the Scheme's assets at 31 December 2021 and 2020 are set out below.

A. The asset valuation is provided by the asset manager. The valuation is based on observable market data, and where relevant is typically based on bid price values, or the single price if only one price is available.
B. The underlying asset valuations are prepared by an independent expert, adjusted for any cash movements where necessary since the latest valuation.
C. Assets are valued by reference to the latest manager statements provided by the managers, adjusted for any cash movements since the latest valuation.
D. Assets relating to insured liabilities are valued by the actuaries based on our year-end accounting assumptions.

The 'Other' category includes hedge fund investments.

At 31 December 2021, the value of the insured annuities included the value of a pensioner buy-in that was entered into on 27 May 2020 by the Trustee with an insurance company. This transaction insured 100% of the SMA section pensioner liabilities and 50% of the SPI section pensioner liabilities based on membership in the Scheme at 31 December 2018. In March 2021, the Trustee entered into a longevity swap. Approximately 85% of pensioner liabilities were covered by the longevity swap at inception. The value of the swap at 31 December 2021 was a liability of £8m.

At 31 December 2021, as highlighted above the Scheme was invested in certain assets who values are not based on market observable data, such as the investments in unquoted equities and bonds, as well as property, infrastructure and hedge funds. The valuation of these assets relies on unobservable data as these assets do not have a readily available quoted price in an active market. A large proportion of the property is directly held and valued using a bespoke valuation method taking both the nature of the properties and the tenancy schedules as inputs to derive the fair value. Where there is a time lag between the net asset value and the balance sheet date, management adjusts the value of the assets for any cash movements. Due diligence has been conducted to ensure the values obtained in respect of these assets are appropriate and represent fair value. Given the nature of these investments, we are unable to prepare sensitivities on how their values could vary as market conditions or other variables change.

A strategy is in place to manage interest rate and inflation risk relating to the liabilities. In H1 2021, the level of interest rate and inflation rate hedging was increased. The Scheme also has in place an equity collar to manage equity risk and hedges a proportion of its foreign exchange exposure to manage currency risk. At 31 December 2021 the equity collar had a notional value of £1,259m (2020: £1,076m) and the currency forwards had a notional value of £2,296m (2020: £2,378m). Some asset de-risking took place in 2021, with disinvestments made from listed equities. Significant investments were made in quoted corporate bonds over the year, funded from the government bond portfolio and listed equities. The Trustee has established the Sustainability Committee which is responsible for overseeing the Scheme's policies, regulatory obligations and priorities in respect of climate change and wider Environmental, Social and

Governance (ESG) related matters. This includes the monitoring of climate change related risks and opportunities, scenario analysis and monitoring of investments from an ESG perspective.

The Santander UK group's pension schemes did not directly hold any equity securities of the Company or any of its related parties at 31 December 2021 and 2020. The Santander UK group's pension scheme assets do not include any property or other assets that are occupied or used by the Santander UK group.

The Santander UK group's employee pension funds recognise the magnitude of the challenges that climate and energy transition pose to governments, companies and civil society. They are also aware of their impact on the ability to comply with their fiduciary duty providing long-term risk-adjusted returns to their members. They have therefore initiated the necessary actions to consider employee pension plans targets of net zero, showing their full support for the Santander UK group's vision, commitment to sustainability and climate change.

Funding

In August 2019, in compliance with the Pensions Act 2004, the Trustee and the Santander UK group agreed to a new recovery plan in respect of the Scheme and schedule of contributions following the finalisation of the 31 March 2019 actuarial valuation. The funding target for this actuarial valuation is for the Scheme to have sufficient assets to make payments to members in respect of the accrued benefits as and when they fall due. In accordance with the terms of the Trustee agreement in place at the time, the Santander UK group contributed £241m in 2021 (2020: £236m) to the Scheme, of which £194m (2020: £187m) was in respect of agreed deficit repair contributions. The agreed schedule of the Santander UK group's remaining contributions to the Scheme broadly comprises contributions of £187m each year from 30 September 2019 to 31 March 2026. In addition, the Santander UK group has agreed to pay further contingent contributions should the funding position have fallen behind plan, and to date these have been paid into the Group section from 1 July 2021 onwards at a level of £1m per month. The Santander UK group also meets Scheme administration expenses. The funding valuation is used to judge the amount of cash contributions the Santander UK group needs to put into the pension scheme. It will always be different to the IAS 19 accounting deficit, which is an accounting rule concerning employee benefits and shown on the balance sheet of our financial statements.

Actuarial assumptions

The principal actuarial assumptions used for the defined benefit schemes were:

	Group and Company		
	2021	2020	2019
	%	%	%
To determine benefit obligations[1]:			
– Discount rate for scheme liabilities	**1.9**	1.3	2.1
– General price inflation	**3.4**	3.0	3.0
– General salary increase	**1.0**	1.0	1.0
– Expected rate of pension increase	**3.2**	2.9	2.9
	Years	Years	Years
Longevity at 60 for current pensioners, on the valuation date:			
– Males	**27.5**	27.5	27.3
– Females	**30.1**	30.0	29.8
Longevity at 60 for future pensioners currently aged 40, on the valuation date:			
– Males	**29.0**	29.0	28.9
– Females	**31.6**	31.5	31.3

(1) The discount rate and inflation related assumptions set out in the table at 31 December 2021 reflect the assumptions calculated based on the Scheme's duration and cash flow profile as a whole. The actual assumptions used were determined for each section independently based on each section's duration and cash flow profile.

At 30 September 2021, changes were made to the assumptions to reflect management's current views. This included refinements to the inflation assumptions, and a move to section specific financial assumptions to better reflect each individual section's duration and cash flow profile. The mortality assumption was also refined to reflect the latest 2020 projections model from the Continuous Mortality Investigation (CMI). The overall impact of these changes was small with the majority of the liability movement being due to changes in market conditions.

Discount rate for scheme liabilities

The rate used to discount the retirement benefit obligation for accounting purposes is based on the annual yield at the balance sheet date of high-quality corporate bonds on that date. There are only a limited number of higher quality Sterling-denominated corporate bonds, particularly those that are longer-dated. Therefore, in order to set a suitable discount rate, we need to construct a corporate bond yield curve. The model which we use for constructing the curve uses corporate bond data but excludes most convertible and asset-backed bonds. The curve is then constructed from this data by extrapolating the horizontal forward curve from 30 years, with the level of this forward rate being the average of the fitted forward rates over the 15 to 30 year range. When considering an appropriate assumption, we project forward the expected cash flows of the Scheme and adopt a single equivalent cash flow weighted discount rate, subject to management judgement. In 2021, a review of the assumptions was carried out. We moved to using section specific discount rates, derived using the same methodology as before when calculating the discount rate for the Scheme, but based on the cash flows for each section.

General price inflation

Consistent with our discount rate methodology, we set the inflation assumption using the expected cash flows of the Scheme, fitting them to an inflation curve to give a weighted average inflation assumption. We then deduct an inflation risk premium to reflect the compensation holders of fixed rate instruments expect to receive for taking on the inflation risk. This premium is subject to a cap, to better reflect management's view of inflation expectations. In 2020, management amended the general price inflation assumptions to reflect the expectation that the Retail Price Index would be brought in line with the Consumer Price Index from 2030. At 31 December 2020, this change increased the liabilities of the Scheme by £64m. In 2021, a review of the assumptions was carried out, and similar to the discount rate we moved to using section specific inflation rates, derived using the same methodology as before, but based on the cash flows for each section.

General salary increase

From 1 March 2015, a cap on pensionable pay increases of 1% each year was applied to staff in the Scheme.

Expected rate of pension increase

The pension increase assumption methodology uses a stochastic model, which is calibrated to consider both the observed historical volatility term structure and derivative pricing. The model allows for the likelihood that high or low inflation in one-year feeds into inflation remaining high or low in the next year.

Mortality assumptions

The mortality assumptions are based on an independent analysis of the Scheme's actual mortality experience, carried out as part of the triennial actuarial valuation, together with recent evidence from the Continuous Mortality Investigation. An allowance is then made for expected future improvements to life expectancy based on the Continuous Mortality Investigation Tables. Following this review the S3 Medium all pensioner mortality table was adopted with appropriate adjustments to reflect the actual mortality experience. For future improvements, at 31 December 2021 the CMI 2020 projection model was adopted, with model parameters selected having had regard to the Scheme's membership profile with an initial addition to improvements of 0.15% per annum, together with a long-term rate of future improvements to life expectancy of 1.25% for male and female members. No weight was placed on the 2020 data in the model, reflecting the uncertainty regarding whether, and how much, 2020 mortality data reflects likely future experience. Both the mortality table and the projection model are published by the Continuous Mortality Investigation.

In 2019, the methodology for setting the demographic assumptions was changed to better represent current expectations, following a review carried out by the Trustee as part of the 2019 triennial valuation and a separate review conducted on early retirement experience. These reviews resulted in changes in the assumptions for commutation, family statistics and early retirement, which were retained at 31 December 2021.

Actuarial assumption sensitivities

The sensitivity analyses below have been determined based on reasonably possible changes of the respective assumptions occurring at the end of the reporting period, while holding all other assumptions constant.

		(Decrease)/increase	
		2021	2020
Assumption	Change in pension obligation at period end from	£m	£m
Discount rate	25 bps increase	**(571)**	(662)
General price inflation[1]	25 bps increase	**392**	365
Mortality	Each additional year of longevity assumed	**478**	515

(1) The general price inflation sensitivity of £365m at 31 December 2020 has been restated to correct an administrative error. The correction does not impact the actual reported values.

The 25bps sensitivity to the inflation assumption includes the corresponding impact of changes in future pension increase assumptions before and after retirement. The sensitivity analysis presented above may not be representative of the actual change in the defined benefit obligation as it is unlikely that the changes in assumptions would occur in isolation of one another as some of the assumptions may be correlated. Furthermore, in presenting the sensitivity analysis, the present value of the defined benefit obligation has been calculated using the projected unit credit method at the end of the reporting period, which is the same method used to calculate the defined benefit obligation recognised in the balance sheet. There were no changes in the methods and assumptions used in preparing the sensitivity analyses from prior years.

The benefits expected to be paid in each of the next five years, and in the aggregate for the five years thereafter are:

Year ending 31 December	£m
2022	**387**
2023	**335**
2024	**356**
2025	**381**
2026	**401**
Five years ending 2031	**2,240**

The average duration of the defined benefit obligation at 31 December 2021 was18.3 years (2020: 19.4 years).

Covid-19

While Covid-19 resulted in some volatility in the IAS 19 position, there was recovery over 2021. Actions taken in 2021 to increase hedging and reduce asset risk, in line with the agreements already in place with the Trustee, served to improve the Scheme's resilience to market volatility.

The Santander UK group has collaborated with the Trustee to ensure the delivery of key functions and services could be maintained throughout the Covid-19 pandemic, to include most vitally the payment of pensions to members. At the start of the Covid-19 pandemic, an enhanced risk monitoring framework was also established to identify and monitor such risks and ensure they were adequately managed.

31. CONTINGENT LIABILITIES AND COMMITMENTS

	Group		Company	
	2021	2020	2021	2020
	£m	£m	£m	£m
Guarantees given to subsidiaries	**—**	—	**4,564**	4,799
Guarantees given to third parties	**363**	939	**363**	939
Formal standby facilities, credit lines and other commitments	**37,346**	42,221	**36,973**	41,508
	37,709	43,160	**41,900**	47,246

At 31 December 2021, the Santander UK group had credit impairment loss provisions relating to guarantees given to third parties and undrawn loan commitments. See Note 29 for further details. The Company has no material expected credit losses on guarantees provided to subsidiaries. For segmental and credit risk staging analysis relating to off-balance sheet exposures, see the credit quality table in the 'Santander UK group level – credit risk review' section.

Where the items set out below can be reliably estimated, they are disclosed in the table above.

Guarantees given to subsidiaries
Santander UK plc has agreed to guarantee the payment of all obligations or liabilities (whether actual or contingent or for the payment of any amount or delivery of any property) incurred by Cater Allen Limited (whether as principal or surety) to any person on or before 31 December 2022 under or in respect of any dealing, transaction or engagement whatsoever, including without prejudice to the generality of the foregoing.

Capital support arrangements
At 31 December 2021 Santander UK plc, Cater Allen Limited and certain other non-regulated subsidiaries of Santander UK plc were party to a capital support deed dated 13 November 2018 (the RFB Sub-Group Capital Support Deed). These parties were permitted by the PRA to form a core UK group as defined in the PRA Rulebook, a permission which expired on 31st December 2021. Exposures of each of the regulated entities to other members of the core UK group were exempt from large exposure limits that would otherwise apply and these exposures were risk-weighted at 0%. The purpose of the RFB Sub-Group Capital Support Deed was to facilitate the prompt transfer of available capital resources from, or repayment of liabilities by, the non-regulated parties to any of the regulated parties in the event that one of the regulated parties breached or was at risk of breaching its capital resources or risk concentrations requirements.

A new RFB Sub-Group Capital Support Deed was entered into on 17 December 2021 and effective from 1 January 2022. This reflected the latest version of associated regulation and the addition of two further Santander UK plc subsidiaries including Santander ISA Managers Limited, an entity regulated by the FCA. The parties to the new RFB Sub-Group Capital Support Deed were granted a new permission by the PRA to form a core UK group from 1 January 2022 to 31 December 2024, following expiry of the previous core UK group permission on 31 December 2021. Where applicable this new permission also provides for intra-group exposures to be excluded from the leverage exposure measure.

Liquidity support arrangements
Under the PRA's liquidity rules, Santander UK plc and its subsidiary Cater Allen Limited form the RFB Domestic Liquidity Sub-group (the RFB DoLSub), which allows the entities to collectively meet regulatory requirements for the purpose of managing liquidity risk. Each member of the RFB DoLSub will support the other by transferring surplus liquidity in times of stress.

Guarantees given to third parties
Guarantees given to third parties consist primarily of letters of credit, bonds and guarantees granted as part of normal product facilities which are offered to customers.

Formal standby facilities, credit lines and other commitments
Standby facilities, credit lines and other commitments are also granted as part of normal product facilities which are offered to customers. Retail facilities comprise undrawn facilities granted on flexible mortgages, bank overdrafts and credit cards. On flexible mortgages, the credit limit is set at the point of granting the loan through property value and affordability assessments. Ongoing assessments are made to ensure that credit limits remain appropriate considering any change in the security value or the customer's financial circumstances. For unsecured overdraft facilities and credit cards, the facilities are granted based on new business risk assessment and are reviewed more frequently based on internal, as well as external data. The delinquency status of the account would result in the withdrawal of the facility. Corporate facilities can comprise standby and revolving facilities which are subject to ongoing compliance with covenants and may require the provision of agreed security. Failure to comply with these terms can result in the withdrawal of the unutilised facility headroom.

FSCS
The FSCS is the UK's independent statutory compensation fund for customers of authorised financial services firms and pays compensation if a firm is unable to pay certain claims against it. The FSCS is funded by levies on the industry (and recoveries and borrowings where appropriate).

Loan representations and warranties
In connection with the securitisations and covered bond transactions described in Note 14, the Santander UK group entities selling the relevant loans into the applicable securitisation or covered bond portfolios make representations and warranties with respect to such loans, in each case as of the date of the sale of the loans into the applicable portfolio. These representations and warranties cover, among other things, the ownership of the loan by the relevant Santander UK group entity, absence of a material breach or default by the relevant borrower under the loan, the loan's compliance with applicable laws and absence of material disputes with respect to the relevant borrower, asset and loan. The specific representations and warranties made by Santander UK group companies which act as sellers of loans in these securitisations and covered bond transactions depend in each case on the nature of the transaction and the requirements of the transaction structure. In addition, market conditions and credit rating agency requirements may affect the representations and warranties required of the relevant Santander UK group companies in these transactions.

In the event that there is a material breach of the representations and warranties given by Santander UK plc as seller of loans under the residential mortgage-backed securitisations or the covered bond programmes included in Note 14, or if such representations and warranties prove to be materially untrue at the date when they were given (being the sale date of the relevant mortgage loans), Santander UK plc may be required to repurchase the affected mortgage loans (generally at their outstanding principal balance plus accrued interest). These securitisations and covered bond programmes are collateralised by prime residential mortgage loans. Santander UK plc is principally a retail prime lender and has no appetite or product offering for any type of sub-prime business. In addition, Santander UK plc's credit policy explicitly prohibits such lending.

Similarly, under the auto loan securitisations in Note 14, in the event that there is a breach or inaccuracy in respect of a representation or warranty relating to the loans, the relevant Santander UK group entity who sold the auto loans into the securitisation portfolio will be required to repurchase such loans from the structure (also at their outstanding principal balance plus accrued interest). In addition to breaches of representation and warranties, under the auto loan securitisations, the seller may also have a repurchase obligation if certain portfolio limits are breached (which include, amongst other things, limits as to the size of a loan given to an individual customer, LTV ratio, average term to maturity and average seasoning).

In the case of a repurchase of a loan from the relevant securitisation or covered bond programmes, the Santander UK group may bear any subsequent credit loss on such loan. The Santander UK group manages and monitors its securitisation and covered bond activities closely to minimise potential claims.

Other legal actions and regulatory matters
Santander UK engages in discussion, and co-operates, with the FCA, PRA, CMA and other regulators and government agencies in various jurisdictions in their supervision and review of Santander UK including reviews exercised under statutory powers, regarding its interaction with past and present customers, both as part of general thematic work and in relation to specific products, services and activities. During the ordinary course of business, Santander UK is also subject to complaints and threatened legal proceedings brought by or on behalf of current or former employees, customers, investors or other third parties, in addition to legal and regulatory reviews, challenges and tax or enforcement investigations or proceedings in various jurisdictions. All such matters are assessed periodically to determine the likelihood of Santander UK incurring a liability.

In those instances where it is concluded that it is not yet probable that a quantifiable payment will be made, for example because the facts are unclear or further time is required to fully assess the merits of the case or to reasonably quantify the expected payment, no provision is made. In addition, where it is not currently practicable to estimate the possible financial effect of these matters, no provision is made.

Payment Protection Insurance

In relation to a specific PPI portfolio of complaints, a legal dispute regarding allocation of liability remains in its early stages. The dispute relates to the liability for PPI mis-selling complaints relating to pre-2005 PPI policies underwritten by AXA France IARD and AXA France Vie (together, AXA France - previously Financial Insurance Company Ltd and Financial Assurance Company Ltd respectively) and involves Santander Cards UK Limited (a former GE Capital Corporation entity and distributor of pre-2005 PPI known as GE Capital Bank Limited which was acquired by Banco Santander SA in 2008 and subsequently transferred to Santander UK plc) and a Banco Santander SA subsidiary Santander Insurance Services UK Limited (together the Santander Entities). During the relevant period, AXA France were owned by Genworth Financial International Holdings, Inc (Genworth).

In September 2015 AXA S.A. acquired AXA France from Genworth. In July 2017, the Santander Entities notified AXA France that they did not accept liability for losses on PPI policies relating to this period. Santander UK plc entered into a Complaints Handling Agreement (CHA) with AXA France pursuant to which it agreed to handle complaints on their behalf, and AXA France agreed to pay redress assessed to be due to relevant policyholders on a without prejudice basis. A standstill agreement was entered into between the Santander Entities and AXA France as a condition of the CHA.

In July 2020, Genworth announced that it had agreed to pay AXA circa £624m in respect of PPI mis-selling losses in settlement of the related dispute concerning obligations under the sale and purchase agreement pursuant to which Genworth sold AXA France to AXA. The CHA between Santander UK plc and AXA France terminated on 26 December 2020. On 30 December 2020, AXA France provided written notice to the Santander Entities to terminate the standstill agreement. During 2021, AXA France commenced litigation against the Santander Entities seeking recovery of £636m and any further losses relating to pre-2005 PPI. The Santander Entities acknowledged service indicating their intention to defend the claim in full and have issued an application for AXA France's claim to be struck out/summarily dismissed, which is being heard by the Commercial Court in February 2022. This dispute remains at an early stage and there are ongoing factual issues to be resolved which may have legal consequences including in relation to liability. These issues create uncertainties which mean that it is difficult to reliably predict the outcome or the timing of the resolution of the matter. The Litigation and other regulatory provision in Note 29 includes our best estimate of the Santander Entities' liability to the specific portfolio. Further information has not been provided on the basis that it would be seriously prejudicial to the Santander Entities' interests in connection with the dispute.

In addition, and in relation to PPI more generally the Litigation and other regulatory provision includes an amount relating to litigation challenging the FCA's industry guidance on the treatment of Plevin / recurring non-disclosure assessments. This provision is based on current stock levels, future projected claims, and average redress. There remains a risk that volumes received in future may be higher than forecast. The provision in Note 29 includes our best estimate of Santander UK's liability for the specific issue. The actual cost of customer compensation could differ from the amount provided.

German dividend tax arbitrage transactions

In June 2018 the Cologne Criminal Prosecution Office and the German Federal Tax Office commenced an investigation in relation to the historical involvement of Santander UK plc, Santander Financial Services plc and Cater Allen International Limited (all subsidiaries of Santander UK Group Holdings plc) in German dividend tax arbitrage transactions (known as cum/ex transactions). These transactions allegedly exploited a loophole of a specific German settlement mechanism through short-selling and complex derivative structuring which resulted in the German government either refunding withholding tax where such tax had not been paid or refunding it more than once. The German authorities are investigating numerous institutions and individuals in connection with alleged transactions and practices which may be found to be illegal under German law.

During 2021 we continued to cooperate with the German authorities and, with the assistance of external experts, to progress an internal investigation into the matters in question. From Santander UK plc's perspective, the investigation is focused principally on the period 2009-2011 and remains on-going. There remain factual issues to be resolved which may have legal consequences including potentially material financial penalties. These issues create uncertainties which mean that it is difficult to predict the resolution of the matter including timing or the significance of the possible impact. Any potential losses, claims or expenses suffered or incurred by Santander Financial Services plc in respect of these matters have been fully indemnified by Santander UK plc, as part of the ring-fencing transfer scheme between Santander UK plc, Santander Financial Services plc and Banco Santander SA.

Consumer credit

The Santander UK group's unsecured lending and other consumer credit business is governed by consumer credit law and related regulations, including the CCA. Claims brought by customers in relation to these requirements, including potential breaches, could result in costs to the Santander UK group where such potential breaches are not found to be de minimis. The CCA includes very detailed and prescriptive requirements for lenders, including in relation to post contractual data.

Customer remediation provisions include an amount of £6m (2020: £47m) arising from a systems-related historical issue identified by Santander UK, relating to compliance with certain requirements of the CCA. This provision has been based on detailed reviews of relevant systems related to consumer credit business operations, supported by external legal and regulatory advice. The Customer remediation provision in Note 29 includes our best estimate of Santander UK's liability for the specific issue. The actual cost of customer compensation could differ from the amount provided. It is not practicable to provide an estimate of the risk and amount of any further financial impact.

FCA civil regulatory investigation into Santander UK plc financial crime systems and controls, and compliance with the Money Laundering Regulations 2007

In 2021, Santander UK plc continued to cooperate with an FCA civil regulatory investigation which commenced in July 2017 into our compliance with the Money Laundering Regulations 2007 and potential breaches of FCA principles and rules relating to anti-money laundering and financial crime systems and controls. The FCA's investigation focuses primarily on the period 2012 to 2017 and includes consideration of high-risk customers including Money Service Bureaus. It is not currently possible to make a reliable assessment of any liability resulting from the investigation including any financial penalty.

Taxation

The Santander UK group engages in discussion, and co-operates, with HM Revenue & Customs (HMRC) in their oversight of the Santander UK group's tax matters. The Santander UK group adopted the UK's Code of Practice on Taxation for Banks in 2010.

Certain leases in which the Santander UK group is or was the lessor have been under review by HMRC in connection with claims for tax allowances. Under the terms of the lease agreements, the Santander UK group is fully indemnified in all material respects by the respective lessees for any liability arising from the disallowance of tax allowances plus accrued interest.

During 2021, an outline agreement in principle in respect of a number of these lease arrangements was reached directly between the lessee and HMRC. It is anticipated that this agreement will be executed in H1 2022 which would result in a final payment by the lessee to HMRC in the region of £50m and conclude the review by HMRC. There is the possibility that the Santander UK Group would need to make the payment to HMRC and reclaim this from the lessee under the indemnity arrangements.

Certain other lease arrangements, where the tax liabilities are considered immaterial, remain under review. Whilst legal opinions have been obtained to support the Santander UK group's position, the matter remains uncertain pending formal resolution with HMRC and any subsequent litigation. These matters moved to formal litigation in 2017, as required under the terms of the leases, and it is currently anticipated that hearings will be held at the First Tier Tax Tribunal in 2022.

Other

On 2 November 2015, Visa Europe Ltd agreed to sell 100% of its share capital to Visa Inc. The deal closed on 21 June 2016. As a member and shareholder of Visa Europe Ltd, Santander UK received upfront consideration made up of cash and convertible preferred stock. The convertible preferred stock is now held by Santander Equity Investments Limited (SEIL), outside the ring-fenced bank. Conversion of the preferred stock into Class A Common Stock of Visa Inc. depends on the outcome of litigation against Visa involving UK & Ireland (UK&I) multilateral interchange fees (MIFs). In June 2020, the Supreme Court issued a judgement finding that MIFs restricted competition.

In addition, Santander UK and certain other UK&I banks have agreed to indemnify Visa Inc. in the event that the preferred stock is insufficient to meet the costs of this litigation. Visa Inc. has recourse to this indemnity once more than €1bn of losses relating to UK&I MIFs have arisen or once the total value of the preferred stock issued to UK&I banks on closing has been reduced to nil. Whilst Santander UK's liability under this indemnity is capped at €39.85m, Visa Inc. may have recourse to a general indemnity in place under Visa Europe Operating Regulations for damages not satisfied through the above mechanism. At this stage, it is unclear whether the litigation will give rise to more than €1bn of losses relating to UK&I MIFs which means it is difficult to predict the resolution of the matter including the timing or the significance of the possible impact.

As part of the sale of subsidiaries, businesses and other entities, and as is normal in such circumstances, Santander UK plc (and/or, where relevant, its subsidiaries) has given warranties and indemnities to the purchasers.

Obligations under stock borrowing and lending agreements

Obligations under stock borrowing and lending agreements represent contractual commitments to return stock borrowed. These obligations are offset by a contractual right to receive stock under other contractual agreements. See Note 36.

Other off-balance sheet commitments

The Santander UK group has commitments to lend at fixed interest rates which expose us to interest rate risk. For more, see the Risk review.

32. SHARE CAPITAL

	Group and Company		
		Ordinary shares of £0.10 each	Total
Issued and fully paid share capital	No.	£m	£m
At 31 December 2020, 1 January 2021 and 31 December 2021	**31,051,768,866**	**3,105**	**3,105**

	Group and Company	
	2021	2020
Share premium	£m	£m
At 1 January and 31 December	**5,620**	5,620

The Company has one class of ordinary shares which carries no right to fixed income. The Company's £325m sterling preference shares are classified as Subordinated Liabilities as described in Note 27.

33. OTHER EQUITY INSTRUMENTS

			Group and Company	
	Interest rate		2021	2020
	%	Next call date	£m	£m
£300m Step-up Callable Perpetual Reserve Capital Instruments	7.037	February 2026	**235**	235
AT1 securities:				
- £500m Fixed Rate Reset Perpetual AT1 Capital Securities	6.75	June 2024	**496**	496
- £750m Fixed Rate Reset Perpetual AT1 Capital Securities	7.375	June 2022	**750**	750
- £500m Fixed Rate Reset Perpetual AT1 Capital Securities	5.18	n/a	**—**	210
- £500m Fixed Rate Reset Perpetual AT1 Capital Securities	6.30	March 2025	**500**	500
- £210m Fixed Rate Reset Perpetual AT1 Capital Securities	4.25	March 2026	**210**	—
			2,191	2,191

Step-up Callable Perpetual Reserve Capital Instruments

These instruments are redeemable by Santander UK plc on 14 February 2026 or on any coupon payment date thereafter, subject to the prior approval of the PRA. They are perpetual and pay interest annually. The coupon rate resets every five years, based on the UK five-year benchmark gilt rate. Interest payments may be deferred by Santander UK plc. The instruments are not redeemable at the option of the holders and the holders do not have any rights against other Santander UK group companies.

AT1 securities

The AT1 securities issued by the Company were subscribed by its immediate parent company, Santander UK Group Holdings plc. The AT1 securities are perpetual and pay a distribution on 24 March, June, September and December. At each distribution payment date, the Company can decide whether to pay the distribution, which is non-cumulative, in whole or in part. The distribution rate resets every five years. The securities will be automatically written down and the investors will lose their entire investment in the securities should the CET1 capital ratio of the Santander UK prudential consolidation group fall below 7%. They are redeemable at the option of the Company on their first call date or on any reset date thereafter in the cases of the 6.75% and 7.375% Fixed Rate Reset Perpetual AT1 Capital Securities, and on any distribution payment date thereafter in the case of the 6.30% Fixed Rate Reset Perpetual AT1 Capital Securities and on any day falling in the period commencing on (and including) 24 March 2026 and ending on (and including) the First Reset Date; or on any Distribution Payment Date subsequent to the First Reset Date, in the case of the 4.25% Fixed Rate Reset Perpetual AT1 Capital Securities . No such redemption may be made without the consent of the PRA.

In March 2021, Santander UK plc purchased and redeemed the remaining £210m of the original £500m 5.18%Fixed Rate Reset Perpetual AT1 Capital Securities and issued £210m 4.25% Fixed Rate Reset Perpetual AT1 Capital Securities, which were fully subscribed by the Company's immediate parent company, Santander UK Group Holdings plc.

34. NON-CONTROLLING INTERESTS

	2021	2020
	£m	£m
PSA Finance UK Limited	—	162
	—	162

PSA Finance UK Limited was the only subsidiary in the Santander UK group that gave rise to significant non-controlling interests. See Note 19 for summarised financial information of PSA Finance UK Limited.

On 30 July 2021, Santander UK through Santander Consumer (UK) plc sold its entire 50% shareholding in PSA to PSA Financial Services Spain EFC SA, a joint venture between Santander Consumer Finance SA, a fellow subsidiary of Banco Santander SA, and Banque PSA Finance SA, the auto finance arm of Group PSA Peugeot Citroën. The impact of the sale was to derecognise total assets of £3.2bn, total liabilities of £2.9bn and a non-controlling interest of £0.15bn. No material gain or loss arose on sale.

35. NOTES TO CASH FLOWS

Changes in liabilities arising from financing activities

The table below shows the changes in liabilities arising from financing activities. The changes in equity arising from financing activities are set out in the Consolidated Statement of Changes in Equity.

	Group											
	2021						2020					
	Balance sheet line item						Balance sheet line item					
	Debt securities in issue	Subordinated liabilities	Other equity instruments	Lease liabilities	Dividends paid	Total	Debt securities in issue	Subordinated liabilities	Other equity instruments	Lease liabilities	Dividends paid	Total[1]
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January	**35,566**	**2,556**	**2,191**	**97**	**—**	**40,410**	41,129	3,528	2,191	137	—	46,985
Proceeds from issue of debt securities	**2,872**	**—**	**—**	**—**	**—**	**2,872**	5,602	—	—	—	—	5,602
Repayment of debt securities	**(11,910)**	**—**	**—**	**—**	**—**	**(11,910)**	(11,378)	—	—	—	—	(11,378)
Repayment of subordinated liabilities	**—**	**(4)**	**—**	**—**	**—**	**(4)**	—	(659)	—	—	—	(659)
Issue of other equity instruments	**—**	**—**	**450**	**—**	**—**	**450**	—	—	—	—	—	—
Repurchase of other equity instruments	**—**	**—**	**(500)**	**—**	**—**	**(500)**	—	—	—	—	—	—
Payment of lease liability	**—**	**—**	**—**	**(25)**	**—**	**(25)**	—	—	—	(45)	—	(45)
Dividends paid	**—**	**—**	**—**	**—**	**(1,494)**	**(1,494)**	—	—	—	—	(292)	(292)
Liability-related other changes	**(447)**	**(4)**	**—**	**61**	**—**	**(390)**	(250)	(10)	—	6	—	(254)
Non-cash changes:												
– Unrealised foreign exchange	**(806)**	**6**	**—**	**—**	**—**	**(800)**	376	22	—	—	—	398
– Other changes	**245**	**(326)**	**50**	**—**	**1,494**	**1,463**	87	(325)	—	—	292	54
At 31 December	**25,520**	**2,228**	**2,191**	**133**	**—**	**30,072**	35,566	2,556	2,191	98	—	40,411

(1) Restated for 2020 to include changes in liabilities arising from financing activities relating to lease liabilities.

	Company											
	2021						2020					
	Balance sheet line item						Balance sheet line item					
	Debt securities in issue	Subordinated liabilities	Other equity instruments	Lease liabilities	Dividends paid	Total	Debt securities in issue	Subordinated liabilities	Other equity instruments	Lease liabilities	Dividends paid	Total[1]
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January	**32,844**	**2,586**	**2,191**	**80**	**—**	**37,701**	36,966	3,563	2,191	119	—	42,839
Proceeds from issue of debt securities	**2,872**	**—**	**—**	**—**	**—**	**2,872**	5,600	—	—	—	—	5,600
Repayment of debt securities	**(10,278)**	**—**	**—**	**—**	**—**	**(10,278)**	(10,124)	—	—	—	—	(10,124)
Repayment of subordinated liabilities	**—**	**(4)**	**—**	**—**	**—**	**(4)**	—	(658)	—	—	—	(658)
Issue of other equity instruments	**—**	**—**	**210**	**—**	**—**	**210**	—	—	—	—	—	—
Repurchase of other equity instruments	**—**	**—**	**(210)**	**—**	**—**	**(210)**	—	—	—	—	—	—
Payment of lease liability	**—**	**—**	**—**	**(23)**	**—**	**(23)**	—	—	—	(43)	—	(43)
Dividends paid	**—**	**—**	**—**	**—**	**(1,489)**	**(1,489)**	—	—	—	—	(277)	(277)
Liability-related other changes	**(508)**	**(4)**	**—**	**65**	**—**	**(447)**	(73)	(10)	—	7	—	(76)
Non-cash changes:												
– Unrealised foreign exchange	**(820)**	**6**	**—**	**—**	**—**	**(814)**	396	22	—	—	—	418
– Other changes	**444**	**(351)**	**—**	**—**	**1,489**	**1,582**	79	(331)	—	—	277	25
At 31 December	**24,554**	**2,233**	**2,191**	**122**	**—**	**29,100**	32,844	2,586	2,191	83	—	37,704

(1) Restated for 2020 to include changes in liabilities arising from financing activities relating to lease liabilities.

In addition, in 2021, there was a disposal of non-controlling interests of £181m .

Footnotes to the consolidated cash flow

For 2021, Principal elements of lease payments are included as a separate line item in the Consolidated Cash Flow Statement. As a result, cash flows of £45m for 2020 (2019: £54m) have been reclassified from 'Other liabilities' within operating activities to 'Principal elements of lease payments' within financing activities. Total cash outflow for leases was £28m (2020: £48m).

Net cash flows from operating activities includes interest received of £4,806m (2020: £5,139m, 2019: £5,801m), interest paid of £1,064m (2020: £1,857m, 2019: £2,538m) and dividends received of £nil (2020: £nil, 2019: £nil).

Restatements in the consolidated cash flow

Reverse repurchase agreements with a contractual maturity of greater than 3 months and repurchase agreements were previously included in cash and cash equivalents. In 2021, such agreements are no longer included in cash and cash equivalents, and line items have been added in the cash flow statement within 'net change in operating assets and liabilities' for 'reverse repurchase agreements - non trading' and 'repurchase agreements - non trading'. As a result, cash and cash equivalents for 2020 and 2019 have been restated by £2,100m and £1,134m respectively.

Footnotes to the Company cash flow

For 2021, Principal elements of lease payments are included as a separate line item in the Consolidated Cash Flow Statement. As a result, cash flows of £43m for 2020 (2019: £53m) have been reclassified from 'Other liabilities' within operating activities to 'Principal elements of lease payments' within financing activities. Total cash outflow for leases was £25m (2020: £46m).

Net cash flows from operating activities includes interest received of £4,945m (2020: £5,313m, 2019: £6,032m), interest paid of £1,490m (2020: £2,542m,2019: £3,206m) and dividends received of £230m (2020: £nil, 2019: £nil).

Restatements in the Company cash flow

Reverse repurchase agreements with a contractual maturity of greater than 3 months and repurchase agreements were previously included in cash and cash equivalents. In 2021, such agreements are no longer included in cash and cash equivalents, and line items have been added in the cash flow statement within 'net change in operating assets and liabilities' for 'reverse repurchase agreements - non trading' and 'repurchase agreements - non trading'. As a result, cash and cash equivalents for 2020 and 2019 have been restated by £2,096m and £1,128m respectively.

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

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

a) Assets charged as security for liabilities

The financial assets below are analysed between those assets accounted for on-balance sheet and off-balance sheet.

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
On-balance sheet:				
Cash and balances at central banks	**1,580**	985	**1,580**	985
Loans and advances to banks	**284**	550	**284**	550
Loans and advances to customers – securitisations and covered bonds (See Note 14)	**19,432**	31,138	**—**	—
Loans and advances to customers – other	**41,936**	23,655	**41,936**	23,655
Other financial assets at amortised cost	**—**	648	**—**	648
Financial assets at fair value through other comprehensive income	**4,363**	5,581	**4,363**	5,581
Total on-balance sheet	**67,595**	62,557	**48,163**	31,419
Total off-balance sheet	**14,449**	24,701	**14,449**	24,701

The Santander UK group provides assets as collateral in the following areas of the business.

Sale and repurchase agreements

The Santander UK group enters into sale and repurchase agreements and similar transactions of debt securities, which are accounted for as secured borrowings. Upon entering into such transactions, the Santander UK group provides collateral in excess of the borrowed amount. The carrying amount of assets that were so provided at 31 December 2021 was £15,368m (2020: £25,874m), of which £639m (2020: £1,392m) was classified within 'Loans and advances to customers – securitisations and covered bonds' in the table above.

Securitisations and covered bonds

As described in Note 14 to the Consolidated Financial Statements in the 2020 Annual Report, Santander UK plc and certain of its subsidiaries issue securitisations and covered bonds. At 31 December 2021, there were £20,199m (2020: £33,432m) of gross assets in these secured programmes, of which £767m (2020: £2,294m) related to internally retained issuances that were available for use as collateral for liquidity purposes in the future.

At 31 December 2021, a total of £1,855m (2020: £4,530m) of notes issued under securitisation and covered bond programmes had been retained internally, a proportion of which had been used as collateral via third party bilateral secured funding transactions, which totalled £500m at 31 December 2021 (2020: £1,114m), or for use as collateral for liquidity purposes in the future.

Stock borrowing and lending agreements
Asset balances under stock borrowing and lending agreements represent stock lent by the Santander UK group. These balances amounted to £45,936m at 31 December 2021 (2020: £30,040m) and are offset by contractual commitments to return stock borrowed or cash received.

Derivatives business
In addition to the arrangements described, collateral is also provided in the normal course of derivative business to counterparties. At 31 December 2021 £1,947m (2020: £1,598m) of such collateral in the form of cash had been provided by the Santander UK group and is included in the table.

b) Collateral accepted as security for assets

The collateral held as security for assets, analysed between those liabilities accounted for on balance sheet and off-balance sheet, was:

	Group		Company	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
On-balance sheet:				
Deposits by banks	**931**	2,063	**810**	1,487
Total on-balance sheet	**931**	2,063	**810**	1,487
Total off-balance sheet	**17,781**	30,510	**17,781**	30,510

Purchase and resale agreements
The Santander UK group also enters into purchase and resale agreements and similar transactions of debt securities, which are accounted for as collateralised loans. Upon entering into such transactions, the Santander UK group receives collateral in excess of the loan amount. The level of collateral held is monitored daily and if required, further calls are made to ensure the market values of collateral remains at least equal to the loan balance. The subsidiaries are permitted to sell or repledge the collateral held in the absence of default. At 31 December 2021, the fair value of such collateral received was £14,562m (2020: £25,972m). Of the collateral received, almost all was sold or repledged. The subsidiaries have an obligation to return collateral that they have sold or pledged.

Stock borrowing and lending agreements
Obligations representing contractual commitments to return stock borrowed by the Santander UK group amounted to £3,219m at 31 December 2021 (2020: £4,538m) and are offset by a contractual right to receive stock lent.

Derivatives business
In addition to the arrangements described, collateral is also received from counterparties in the normal course of derivative business. At 31 December 2021, £931m (2020: £2,063m) of such collateral in the form of cash had been received by the Santander UK group and is included in the table.

Lending activities
In addition to the collateral held as security for assets, the Santander UK group may obtain a charge over a customer's property in connection with its lending activities. Details of these arrangements are set out in the 'Credit risk' section of the Risk review.

37. SHARE-BASED COMPENSATION

The Santander UK group operates share schemes and arrangements for eligible employees. The main current schemes are the Sharesave Schemes, the Deferred Shares Bonus Plan, the Partnership Shares scheme and the Transformation Incentive Plan. All the share options and awards relate to shares in Banco Santander SA.

The amount charged to the income statement in respect of share-based payment transactions is set out in Note 6.

At 31 December 2021, the carrying amount of liabilities arising from share-based payment transactions, excluding any cash element was £3.7m (2020: £0.5m), of which £0.4m had vested at 31 December 2021 (2020: £nil).

a) Sharesave Schemes

The Santander UK group launched its fourteenth HM Revenue & Customs approved Sharesave invitation under Banco Santander SA sponsorship in September 2021. Sharesave invitations have been offered since 2008 under broadly similar terms. Under the Sharesave Scheme's HMRC-approved savings limits, eligible employees may enter into contracts to save between £5 and £500 per month. For all schemes, at the end of a fixed term of three or five years after the grant date, the employees can use these savings to buy shares in Banco Santander SA at a discount, calculated in accordance with the rules of the scheme. The option price is calculated as the average middle market quoted price of Banco Santander SA shares over the first three dealing days prior to invitation and discounted by up to 20%. This year a 10% discount was applied. The vesting of awards under the scheme depends on continued employment with the Banco Santander SA group. Participants in the scheme have six months from the date of vest to exercise the option.

The table below summarises movements in the number of options, and changes in weighted average exercise price over the same period.

	2021		2020	
	Number of options '000	Weighted average exercise price £	Number of options '000	Weighted average exercise price £
Outstanding at 1 January	**21,162**	**2.32**	23,373	3.03
Granted	**9,414**	**2.43**	11,642	1.65
Exercised	**(48)**	**1.86**	(860)	2.75
Forfeited/expired	**(4,535)**	**2.95**	(12,993)	2.96
Outstanding at 31 December	**25,993**	**2.25**	21,162	2.32
Exercisable at 31 December	**1,321**	**2.75**	1,805	3.59

The weighted average share price at the date the options were exercised was £2.65 (2020: £2.92).

The following table summarises the range of exercise prices and weighted average remaining contractual life of the options at 31 December 2021 and 2020.

	2021		2020	
Range of exercise prices	Weighted average remaining contractual life Years	Weighted average exercise price £	Weighted average remaining contractual life Years	Weighted average exercise price £
£1 to £2	**3**	**1.65**	4	1.65
£2 to £3	**3**	**2.81**	2	2.81
£3 to £4	**1**	**3.38**	1	3.38
£4 to £5	**1**	**4.02**	1	4.02

The fair value of each option at the date of grant is estimated using an analytical model that also reflects the correlation between EUR and GBP. This model uses assumptions on the share price, the EUR/GBP FX rate, the EUR/GBP risk-free interest rate, dividend yields, the expected volatilities of both the underlying shares and EUR/GBP for the expected lives of options granted. The weighted average grant-date fair value of options granted during the year was £0.20 (2020: £0.21).

b) Deferred shares bonus plan

Deferred bonus awards are designed to align employee performance with shareholder value and encourage increased retention of senior employees. Those employees who are designated as Material Risk Takers receive part of their annual bonus as a deferred award comprising 50% in conditional shares, and 50% in cash. Either 40% (for any variable pay award of less than £500,000) or 60% (for any variable pay award greater than £500,000) is deferred over a four, five or seven year period from the anniversary of the initial award. Deferred bonus awards in shares are subject to an additional one-year retention period from the point of delivery. Any deferred awards are dependent on continued employment and subject to Santander UK's discretion, and the vesting of deferred bonus awards are subject to risk and performance adjustment.

c) Partnership Shares scheme

A Partnership Shares scheme is operated for eligible employees under the Share Incentive Plan (SIP) umbrella. Participants can choose to invest up to £1,800 per tax year (or no more than 10% of an employee's salary for the tax year) from pre-tax salary to buy Banco Santander SA shares. Shares are held in trust for the participants. There are no vesting conditions attached to these shares, and no restrictions as to when the shares can be removed from the trust. However, if a participant chooses to sell the shares before the end of five years, they will be liable for the taxable benefit received when the shares are taken out of the trust. The shares can be released from trust after five years free of income tax and national insurance contributions. 3,618,796 shares were outstanding at 31 December 2021 (2020: 3,254,900 shares).

d) Transformation Incentive Plan

This is a one-off long-term incentive plan which is designed to recognise the achievement of financial targets and an enhanced customer experience, whilst maintaining appropriate conduct controls and risk management, over the course of our transformation period.

Awards under the plan were based on performance in 2020 and granted in 2021 and performance will be assessed over the period 1 January 2021 to 31 December 2023. Awards were granted half in cash and half in share based awards (linked to the Banco Santander SA share price) and will vest in accordance with regulatory requirements. The total value of share-based awards granted in 2021 was £6m and the liability arising from share-based payment transactions, excluding any cash element was £1m.

38. TRANSACTIONS WITH DIRECTORS AND OTHER KEY MANAGEMENT PERSONNEL

a) Remuneration of Directors and Other Key Management Personnel

The remuneration of the Directors and Other Key Management Personnel of the Santander UK group is set out in aggregate below.

Directors' remuneration	2021 £	2020 £	2019 £
Salaries and fees	**5,495,852**	5,353,980	5,025,665
Performance-related payments[1]	**5,195,722**	1,458,911	3,864,965
Other fixed remuneration (pension and other allowances & non-cash benefits)	**929,935**	1,107,348	1,367,069
Expenses	**17,097**	6,772	42,526
Total remuneration	**11,638,606**	7,927,011	10,300,225

Directors' and Other Key Management Personnel compensation	2021 £	2020 £	2019 £
Short-term employee benefits[2]	**25,114,949**	18,432,698	21,925,975
Post-employment benefits[3]	**1,344,883**	2,084,645	3,590,466
Total compensation	**26,459,832**	20,517,343	25,516,441

(1) In line with the Code, a proportion of the performance-related payment was deferred. Further details can be found in the Directors Remuneration Report.
(2) In addition to the remuneration in the table above, grants of shares in Banco Santander SA were made as buy-outs of deferred performance-related payments of shares in connection with previous employment for one member of Key Management Personnel of £107,225 of which £25,413 vested in the year (2020: two individuals, one to a director of £1,293,678 of which £242,605 vested in the year and one to Key Management Personnel of £924,133 of which £60,500 vested in the year).
(3) One Termination payment of £346,154 was paid in 2021 to a Director (2020: nil ; 2019: £1,076,435 for one individual.

In 2021, the remuneration, excluding pension contributions, of the highest paid Director, was £4,638,290 (2020: £2,134,134) of which £2,913,000 (2020: £726,040) was performance related. In 2021, the accrued defined benefit pension relating to the highest paid director was £22,119 per annum (2020: £21,309 per annum for the same individual).

b) Retirement benefits

Defined benefit pension schemes are provided to certain employees. See Note 30 for details of the schemes and the related costs and obligations. One director has a deferred pension benefit accruing under a defined benefit scheme. Ex gratia pensions paid to former Directors of Santander UK plc in 2021, which have been provided for previously, amounted to £370,668 (2020: £366,248; 2019: £335,202). In 1992, the Board decided not to award any new such ex gratia pensions.

c) Transactions with Directors, Other Key Management Personnel and each of their connected persons

Directors, Other Key Management Personnel (defined as the Executive Committee of Santander UK plc who served during the year) and their connected persons have undertaken the following transactions with the Santander UK group in the ordinary course of business.

	2021		2020	
	No.	£000	No.	£000
Secured loans, unsecured loans and overdrafts				
At 1 January	**12**	**3,640**	18	4,920
Net movements	**(6)**	**(3,280)**	(6)	(1,280)
At 31 December	**6**	**360**	12	3,640
Deposit, bank and instant access accounts and investments				
At 1 January	**23**	**8,195**	32	11,975
Net movements	**(2)**	**(1,643)**	(9)	(3,780)
At 31 December	**21**	**6,552**	23	8,195

In 2021 and 2020, no Director held any interest in the shares of any company in the Santander UK group and no Director exercised or was granted any rights to subscribe for shares in any company in the Santander UK group. In addition, in 2021 and 2020, no Directors exercised share options over shares in Banco Santander SA, the ultimate parent company of the Company.

Secured loans, unsecured loans and overdrafts are made to Directors, Other Key Management Personnel and their connected persons, in the ordinary course of business, with terms prevailing for comparable transactions and on the same terms and conditions as applicable to other employees in the Santander UK group. Such loans do not involve more than the normal risk of collectability or present any unfavourable features. Amounts deposited by Directors, Other Key Management Personnel and their connected persons earn interest at the same rates as those offered to the market or on the same terms and conditions applicable to other employees in the Santander UK group. Deposits, bank and instant access accounts and investments are entered into by Directors, Other Key Management Personnel and their connected persons on normal market terms and conditions, or on the same terms and conditions as applicable to other employees in Santander UK group.

In 2021, loans were made to four Directors (2020: seven Directors), with a principal amount of £348,306 outstanding at 31 December 2021 (2020: £1,829,267). In 2021, loans were made to two Other Key Management Personnel (2020: five), with a principal amount of £11,678 outstanding at 31 December 2021 (2020: £1,811,171).

In 2021 and 2020, there were no other transactions, arrangements or agreements with Santander UK in which Directors, Other Key Management Personnel or their connected persons had a material interest. In addition, in 2021 and 2020, no Director had a material interest in any contract of significance with Santander UK other than a service contract.

39. RELATED PARTY DISCLOSURES

a) Parent undertaking and controlling party

The Company's immediate parent is Santander UK Group Holdings plc, a company incorporated in England and Wales. Its ultimate parent and controlling party is Banco Santander SA, a company incorporated in Spain. The smallest and largest groups into which the Santander UK group's results are included are the group accounts of Santander UK Group Holdings plc and Banco Santander SA respectively, copies of which may be obtained from Shareholder Relations, 2 Triton Square, Regent's Place, London NW1 3AN, on the corporate website (www.aboutsantander.co.uk) or on the Banco Santander corporate website (www.santander.com).

b) Transactions with related parties

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

	Group									
	Interest, fees and other income received			Interest, fees and other expenses paid			Amounts owed by related parties		Amounts owed to related parties	
	2021	2020	2019	**2021**	2020	2019	**2021**	2020	**2021**	2020
	£m	£m	£m	**£m**	£m	£m	**£m**	£m	**£m**	£m
Ultimate parent	**(164)**	(119)	(130)	**33**	105	266	**816**	1,557	**(1,150)**	(2,151)
Immediate parent	**(6)**	(7)	(7)	**263**	316	317	**7**	8	**(10,935)**	(10,121)
Fellow subsidiaries	**(57)**	(58)	(66)	**163**	157	173	**159**	223	**(534)**	(559)
Associates & joint ventures	**(34)**	(29)	(29)	**4**	—	—	**3,075**	2,234	**(918)**	(1,034)
	(261)	(213)	(232)	**463**	578	756	**4,057**	4,022	**(13,537)**	(13,865)

	Company									
	Interest, fees and other income received			Interest, fees and other expenses paid			Amounts owed by related parties		Amounts owed to related parties	
	2021	2020	2019	**2021**	2020	2019	**2021**	2020	**2021**	2020
	£m	£m	£m	**£m**	£m	£m	**£m**	£m	**£m**	£m
Ultimate parent	**(160)**	(101)	(63)	**34**	84	199	**815**	1,550	**(1,150)**	(2,143)
Immediate parent	**(6)**	(7)	(7)	**263**	316	317	**7**	8	**(10,935)**	(10,121)
Subsidiaries	**(390)**	(655)	(670)	**820**	932	1,185	**22,841**	33,969	**(23,143)**	(33,196)
Fellow subsidiaries	**(55)**	(49)	(56)	**150**	140	146	**159**	219	**(591)**	(609)
Associates & joint ventures	**—**	—	—	**—**	—	—	**1**	—	**(18)**	(134)
	(611)	(812)	(796)	**1,267**	1,472	1,847	**23,823**	35,746	**(35,837)**	(46,203)

For more on this, see 'Balances with other Banco Santander companies' in the Risk review. In addition, transactions with pension schemes operated by the Santander UK group are described in Note 30.

The above transactions were made in the ordinary course of business, on substantially 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.

In 2020, Santander Consumer (UK) plc (SCUK) purchased a 50% share in a new joint venture, Volvo Car Financial Services UK Limited. In 2021, £390m of dealer lending was transferred from SCUK to the new entity.

In October 2020, Santander UK plc transferred a portfolio of mortgage assets with a book value of £3,163m to Santander Financial Services plc for a cash consideration of £3,174m, including a purchase price premium of £11m.

In 2021, SCUK sold its entire 50% shareholding in PSA Finance UK Limited to PSA Financial Services Spain EFC SA, a joint venture between Santander Consumer Finance SA, a fellow subsidiary of Banco Santander SA, and Banque PSA Finance SA. For more details, see Note 34.

In 2021, a significant part of the Corporate & Investment Banking business of Santander UK was transferred to the London branch of Banco Santander SA by way of a Part VII banking business transfer scheme. For more details, see Note 43.

In 2021, we sold our current head office site in Triton Square, London to a wholly owned subsidiary of our parent.

40. FINANCIAL INSTRUMENTS

a) Measurement basis of financial assets and liabilities

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. Note 1 describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised.

b) Fair value measurement and hierarchy

(i) Fair value measurement

The fair value of financial instruments is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which Santander UK has access at that date. The fair value of a liability reflects its non-performance risk.

Financial instruments valued using observable market prices

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

Financial instruments valued using a valuation technique

In the absence of a quoted market price in an active market, management uses internal models to make its best estimate of the price that the market would set for that financial instrument. In order to make these estimations, various techniques are employed, including extrapolation from observable market data and observation of similar financial instruments with similar characteristics. Wherever possible, valuation parameters for each product are based on prices directly observable in active markets or that can be derived from directly observable market prices. Chosen valuation techniques incorporate all the factors that market participants would take into account in pricing transactions.

Santander UK manages certain groups of financial assets and liabilities on the basis of its net exposure to either market risks or credit risk. As a result, it has elected to use the exception under IFRS 13 which permits the fair value measurement of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position for a particular risk exposure or paid to transfer a net short position for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions.

(ii) Fair value hierarchy

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

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

Level 1	Unadjusted quoted prices for identical assets or liabilities in an active market that Santander UK can access at the measurement date. Active markets are assessed by reference to average daily trading volumes in absolute terms and, where applicable, by reference to market capitalisation for the instrument.
Level 2	Quoted prices in inactive markets, quoted prices for similar assets or liabilities, recent market transactions, inputs other than quoted market prices for the asset or liability that are observable either directly or indirectly for substantially the full term, and inputs to valuation techniques that are derived principally from or corroborated by observable market data through correlation or other statistical means for substantially the full term of the asset or liability.
Level 3	Significant inputs to the pricing or valuation techniques are unobservable. These unobservable inputs reflect the assumptions that market participants would use when pricing assets or liabilities and are considered significant to the overall valuation.

Changes in the observability of significant valuation inputs during the reporting period may result in a transfer of assets and liabilities within the fair value hierarchy. The Santander UK group recognises transfers between levels of the fair value hierarchy when there is a significant change in either its principal market or the level of observability of the inputs to the valuation techniques at the end of the reporting period.

c) Valuation techniques

The main valuation techniques employed in internal models to measure the fair value of the financial instruments at 31 December 2021 and 2020 are set out below. In substantially all cases, the principal inputs into these models are derived from observable market data. Santander UK did not make any material changes to the valuation techniques and internal models it used in 2021, 2020 and 2019. During 2021, Santander UK updated the interest rate market data valuation inputs to reflect the cessation of LIBOR at the end of 2021, using risk-free rates in line with market practice..

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

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

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

D. In the valuation of linear instruments such as credit risk and fixed-income derivatives, credit risk is measured using dynamic models similar to those used in the measurement of interest rate risk. In the case of non-linear instruments, if the portfolio is exposed to credit risk such as credit derivatives, the probability of default is determined using the credit default spread market. The main inputs used to determine the underlying cost of credit of credit derivatives are quoted credit risk premiums and the correlation between the quoted credit derivatives of various issuers.

The fair values of the financial instruments arising from Santander UK's internal models take into account, among other things, contract terms and observable market data, which include such factors as bid-offer spread, interest rates, credit risk, exchange rates, the quoted market price of equity securities, volatility and prepayments. In all cases, when it is not possible to derive a valuation for a particular feature of an instrument, management uses judgement to determine the fair value of the particular feature. In exercising this judgement, a variety of tools are used including proxy observable data, historical data and extrapolation techniques. Extrapolation techniques take into account behavioural characteristics of equity markets that have been observed over time, and for which there is a strong case to support an expectation of a continuing trend in the future. Estimates are calibrated to observable market prices when they become available.

Santander UK believes its valuation methods are appropriate and consistent with other market participants. Nevertheless, the use of different valuation methods or assumptions, including imprecision in estimating unobservable market inputs, to determine the fair value of certain financial instruments could result in different estimates of fair value at the reporting date and the amount of gain or loss recorded for a particular instrument. Most of the valuation models are not significantly subjective, because they can be tested and, if necessary, recalibrated by the internal calculation of and subsequent comparison to market prices of actively traded securities, where available.

d) Control framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker. To this end, ultimate responsibility for the determination of fair values lies with the Risk Department. For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or verification is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, Santander UK will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable.

The factors that are considered in this regard include:

- The extent to which prices may be expected to represent genuine traded or tradeable prices
- The degree of similarity between financial instruments
- The degree of consistency between different sources
- The process followed by the pricing provider to derive the data
- The elapsed time between the date to which the market data relates and the balance sheet date
- The manner in which the data was sourced.

The source of pricing data is considered as part of the process that determines the classification of the level of a financial instrument. Consideration is given to the quality of the information available that provides the current mark-to-model valuation and estimates of how different these valuations could be on an actual trade, taking into consideration how active the market is. For spot assets that cannot be sold due to illiquidity, forward estimates are discounted to estimate a realisable value over time. Adjustments for illiquid positions are regularly reviewed to reflect changing market conditions.

For fair values determined using a valuation model, the control framework may include, as applicable, independent development and / or validation of: (i) the logic within the models; (ii) the inputs to those models; and (iii) any adjustments required outside the models. Internal valuation models are validated independently within the Risk Department. A validation report is produced for each model-derived valuation that assesses the mathematical assumptions behind the model, the implementation of the model and its integration within the trading system.

e) Fair values of financial instruments carried at amortised cost

The following tables analyse the fair value of the financial instruments carried at amortised cost at 31 December 2021 and 2020, including their levels in the fair value hierarchy - Level 1, Level 2 and Level 3. 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. Cash and balances at central banks, which consist of demand deposits with the Bank of England, together with cash in tills and ATMs, have been excluded from the table as the carrying amount is deemed an appropriate approximation of fair value. The fair value of the portfolio of UK Government debt securities, included in other financial assets at amortised cost, is the only material financial instrument categorised in Level 1 of the fair value hierarchy.

	Group									
	2021					2020				
	Fair value				Carrying	Fair value				Carrying
	Level 1	Level 2	Level 3	Fair value	value	Level 1	Level 2	Level 3	Fair value	value
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets										
Loans and advances to customers	—	—	212,811	212,811	210,094	—	—	211,279	211,279	208,750
Loans and advances to banks	—	1,169	—	1,169	1,169	—	1,682	—	1,682	1,682
Reverse repurchase agreements - non trading	—	12,453	226	12,679	12,683	—	19,382	226	19,608	19,599
Other financial assets at amortised cost	164	348	—	512	506	799	393	—	1,192	1,163
	164	13,970	213,037	227,171	224,452	799	21,457	211,505	233,761	231,194
Liabilities										
Deposits by customers	—	48	192,898	192,946	192,926	—	108	195,134	195,242	195,135
Deposits by banks	—	33,770	85	33,855	33,855	—	20,951	16	20,967	20,958
Repurchase agreements - non trading	—	11,718	—	11,718	11,718	—	15,847	—	15,847	15,848
Debt securities in issue	963	23,926	1,218	26,107	25,520	—	34,967	1,430	36,397	35,566
Subordinated liabilities	37	2,350	238	2,625	2,228	—	2,830	239	3,069	2,556
	1,000	71,812	194,439	267,251	266,247	—	74,703	196,819	271,522	270,063

	Company									
	2021					2020				
	Fair value				Carrying	Fair value				Carrying
	Level 1	Level 2	Level 3	Total	value	Level 1	Level 2	Level 3	Total	value
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets										
Loans and advances to customers	—	—	225,587	225,587	222,861	—	—	229,679	229,679	227,217
Loans and advances to banks	—	1,200	—	1,200	1,200	—	1,600	—	1,600	1,600
Reverse repurchase agreements - non trading	—	12,453	226	12,679	12,683	—	19,382	226	19,608	19,599
Other financial assets at amortised cost	164	1,931	—	2,095	2,090	799	4,481	—	5,280	5,251
	164	15,584	225,813	241,561	238,834	799	25,463	229,905	256,167	253,667
Liabilities										
Deposits by customers	—	48	205,006	205,054	205,034	—	108	216,074	216,182	216,075
Deposits by banks	—	33,631	5,214	38,845	38,845	—	20,365	5,349	25,714	25,705
Repurchase agreements - non trading	—	11,718	—	11,718	11,718	—	15,844	—	15,844	15,845
Debt securities in issue	963	23,105	1,218	25,286	24,554	—	32,577	1,430	34,007	32,844
Subordinated liabilities	37	2,350	238	2,625	2,233	—	2,680	239	2,919	2,586
	1,000	70,852	211,676	283,528	282,384	—	71,574	223,092	294,666	293,055

The carrying value above of any financial assets and liabilities that are designated as hedged items in a portfolio (or macro) fair value hedge relationship excludes gains and losses attributable to the hedged risk, as this is included in other assets on the balance sheet.

Valuation methodology for financial instruments carried at amortised cost
The valuation approach to specific categories of financial instruments is described below.

Assets:
Loans and advances to customers
The approach to estimating the fair value of loans and advances to customers has been determined by discounting expected cash flows to reflect either current market rates or credit spreads relevant to the specific industry of the borrower. The determination of their fair values is an area of considerable estimation and uncertainty as there is no observable market and values are significantly affected by customer behaviour.

i) Advances secured on residential property
The fair value of the mortgage portfolio is calculated by discounting contractual cash flows by different spreads for each LTV Band, after taking account of expected customer prepayment rates. The spread is based on new business interest rates derived from publicly available competitor market information.

ii) Corporate loans
The determination of the fair values of performing loans is calculated by discounting the contractual cash flows and also deducting other costs relating to expected credit losses, cost of capital, credit risk capital, operational risk capital, cost of funding and operating costs.

iii) Other loans
These consist of unsecured personal loans, credit cards, overdrafts and consumer (auto) finance. The weighted average lives of these portfolios are short and relate to relatively new business. As a result, contractual interest rates approximate new business interest rates, and therefore no mark-to-market surplus or deficit has been recorded with respect to the performing book, with the exception of unsecured personal loans and consumer (auto) finance loans, where a small surplus or deficit has been recognised based on the differential between existing portfolio margins and the current contractual interest rates.

Loans and advances to banks
These comprise secured loans, short-term placements with banks including collateral and unsettled financial transactions. The secured loans have been valued based on a discounted spread for the term of the loans using valuation technique A as described above. The carrying amount of the other items is deemed a reasonable approximation of their fair value, as the transactions are very short-term in duration.

Reverse repurchase agreements - non-trading
The fair value of the reverse repurchase agreements - non trading has been estimated using valuation technique A as described above, using a spread appropriate to the underlying collateral.

Other financial assets at amortised cost
These consist of asset backed securities and debt securities. The asset backed securities can be complex products and in some instances are valued with the assistance of an independent, specialist valuation firm. These fair values are determined using industry-standard valuation techniques, including discounted cash flow models. The inputs to these models used in these valuation techniques include quotes from market makers, prices of similar assets, adjustments for differences in credit spreads, and additional quantitative and qualitative research. The debt security investments consist of a portfolio of government debt securities. The fair value of this portfolio has been determined using quoted market prices.

Liabilities:

Deposits by customers

The majority of deposit liabilities are payable on demand and therefore can be deemed short-term in nature with the fair value equal to the carrying value. Certain of the deposit liabilities are at a fixed rate until maturity. The deficit/surplus of fair value over carrying value of these liabilities has been estimated by reference to the market rates available at the balance sheet date for similar deposit liabilities of similar maturities. The fair value of such deposit liabilities has been estimated using valuation technique A as described above.

Deposits by banks

The fair value of deposits by banks, including repos, has been estimated using valuation technique A as described above, discounted at the appropriate credit spread.

Repurchase agreements - non trading

The fair value of the repurchase agreements - non trading has been estimated using valuation technique A as described above, discounted at a spread appropriate to the underlying collateral.

Debt securities in issue and subordinated liabilities

Where reliable prices are available, the fair value of debt securities in issue and subordinated liabilities has been calculated using quoted market prices.

f) Fair values of financial instruments measured at fair value

The following tables summarise the fair values of the financial assets and liabilities accounted for at fair value at 31 December 2021 and 31 December 2020, analysed by their levels in the fair value hierarchy - Level 1, Level 2 and Level 3.

										Group
		2021				2020				
		Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total	Valuation technique
		£m	£m	£m	£m	£m	£m	£m	£m	
Assets										
Derivative financial instruments	Exchange rate contracts	—	**1,193**	**1**	**1,194**	—	2,455	2	2,457	A
	Interest rate contracts	—	**1,547**	—	**1,547**	—	2,566	14	2,580	A & C
	Equity and credit contracts	—	**116**	**45**	**161**	—	71	52	123	B & D
	Netting	—	**(1,221)**	—	**(1,221)**	—	(1,754)	—	(1,754)	
		—	**1,635**	**46**	**1,681**	—	3,338	68	3,406	
Other financial assets at FVTPL	Loans and advances to customers	—	—	**74**	**74**	—	—	99	99	A
	Debt securities	—	—	**111**	**111**	—	—	109	109	A, B & D
	Equity securities	—	—	—	—	—	—	—	—	B
	Reverse repurchase agreements – non trading	—	—	—	—	—	—	—	—	A
		—	—	**185**	**185**	—	—	208	208	
Financial assets at FVOCI	Debt securities	**5,833**	—	—	**5,833**	8,501	428	—	8,929	D
	Loans and advances to customers	—	—	**18**	**18**	—	—	21	21	D
		5,833	—	**18**	**5,851**	8,501	428	21	8,950	
Total assets at fair value		**5,833**	**1,635**	**249**	**7,717**	8,501	3,766	297	12,564	
Liabilities										
Derivative financial instruments	Exchange rate contracts	—	**506**	—	**506**	—	833	—	833	A
	Interest rate contracts	—	**1,436**	**2**	**1,438**	—	2,447	3	2,450	A & C
	Equity and credit contracts	—	**24**	**30**	**54**	—	26	29	55	B & D
	Netting	—	**(1,221)**	—	**(1,221)**	—	(1,754)	—	(1,754)	
		—	**745**	**32**	**777**	—	1,552	32	1,584	
Other financial liabilities at FVTPL	Debt securities in issue	—	**555**	**5**	**560**	—	1,051	6	1,057	A
	Structured deposits	—	**223**	—	**223**	—	375	—	375	A
	Repurchase agreements – non trading	—	—	—	—	—	—	—	—	A
	Collateral and associated financial guarantees	—	**19**	**1**	**20**	—	—	2	2	D
		—	**797**	**6**	**803**	—	1,426	8	1,434	
Total liabilities at fair value		—	**1,542**	**38**	**1,580**	—	2,978	40	3,018	

		Company								
		2021				2020				
		Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Valuation technique
Assets										
Derivative financial instruments	Exchange rate contracts	**—**	**1,198**	**1**	**1,199**	—	1,881	2	1,883	A
	Interest rate contracts	**—**	**1,541**	**195**	**1,736**	—	2,578	738	3,316	A & C
	Equity and credit contracts	**—**	**116**	**45**	**161**	—	71	52	123	B & D
	Netting	**—**	**(1,221)**	**—**	**(1,221)**	—	(1,754)	—	(1,754)	
		—	**1,634**	**241**	**1,875**	—	2,776	792	3,568	
Other financial assets at FVTPL	Loans and advances to customers	**—**	**—**	**73**	**73**	—	—	99	99	A
	Debt securities	**—**	**1**	**20**	**21**	—	—	2	2	C
	Equity securities	**—**	**—**	**—**	**—**	—	—	—	—	B
	Reverse repurchase agreements – non trading	**—**	**—**	**—**	**—**	—	—	—	—	A
		—	**1**	**93**	**94**	—	—	101	101	
Financial assets at FVOCI	Debt securities	**5,833**	**—**	**—**	**5,833**	8,501	428	—	8,929	D
	Loans and advances to customers	**—**	**—**	**—**	**—**	—	—	—	—	D
		5,833	**—**	**—**	**5,833**	8,501	428	—	8,929	
Total assets at fair value		**5,833**	**1,635**	**334**	**7,802**	8,501	3,204	893	12,598	
Liabilities										
Derivative financial instruments	Exchange rate contracts	**—**	**693**	**—**	**693**	—	1,520	—	1,520	A
	Interest rate contracts	**—**	**1,705**	**11**	**1,716**	—	2,924	3	2,927	A & C
	Equity and credit contracts	**—**	**24**	**30**	**54**	—	26	29	55	B
	Netting	**—**	**(1,221)**	**—**	**(1,221)**	—	(1,754)	—	(1,754)	B
		—	**1,201**	**41**	**1,242**	—	2,716	32	2,748	
Other financial liabilities at FVTPL	Debt securities in issue	**—**	**556**	**5**	**561**	—	1,051	6	1,057	A
	Structured deposits	**—**	**223**	**—**	**223**	—	375	—	375	A
	Repurchase agreements – non trading	**—**	**—**	**—**	**—**	—	—	—	—	A
	Collateral and associated financial guarantees	**—**	**19**	**1**	**20**	—	—	2	2	
		—	**798**	**6**	**804**	—	1,426	8	1,434	
Total liabilities at fair value		**—**	**1,999**	**47**	**2,046**	—	4,142	40	4,182	

Transfers between levels of the fair value hierarchy

In 2021 there were no significant (2020: no significant) transfers of financial instruments between levels of the fair value hierarchy.

g) Fair value adjustments

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

Santander UK 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 magnitude and types of fair value adjustment are listed in the following table:

	2021 £m	2020 £m
Risk-related:		
- Bid-offer and trade specific adjustments	**(9)**	(8)
- Uncertainty	**20**	23
- Credit risk adjustment	**6**	11
- Funding fair value adjustment	**3**	3
	20	29
Model-related	**—**	—
Day One profit	**—**	—
	20	29

Risk-related adjustments

Risk-related adjustments are driven, in part, by the magnitude of Santander UK's market or credit risk exposure, and by external market factors, such as the size of market spreads.

(i) Bid-offer and trade specific adjustments

Portfolios are marked at bid or offer, as appropriate. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the cost that would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the position. For debt securities, the bid-offer spread is based on a market price at an individual security level. For other products, the major risk types are identified. For each risk type, the net portfolio risks are first classified into buckets, and then a bid-offer spread is applied to each risk bucket based upon the market bid-offer spread for the relevant hedging instrument.

(ii) Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, a range of possible values exists that the financial instrument or market parameter may assume, and an adjustment may be needed to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model.

(iii) Credit risk adjustment

Credit risk adjustments comprise credit and debit valuation adjustments. The credit valuation adjustment (CVA) is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the counterparty may default, and Santander UK may not receive the full market value of the transactions. The debit valuation adjustment (DVA) is an adjustment to the valuation of the OTC derivative contracts to reflect within the fair value the possibility that Santander UK may default, and that Santander UK may not pay full market value of the transactions.

Santander UK calculates a separate CVA and DVA for each Santander UK legal entity, and within each entity for each counterparty to which the entity has exposure. Santander UK calculates the CVA by applying the probability of default of the counterparty to the expected positive exposure to the counterparty, and multiplying the result by the loss expected in the event of default i.e. LGD. Conversely, Santander UK calculates the DVA by applying the PD of the Santander UK group, conditional on the non-default of the counterparty, to the expected positive exposure of the counterparty to Santander UK and multiplying the result by the LGD. Both calculations are performed over the life of the potential exposure.

For most products Santander UK uses a simulation methodology to calculate the expected positive exposure to a counterparty. This incorporates a range of potential exposures across the portfolio of transactions with the counterparty over the life of the portfolio. The simulation methodology includes credit mitigants such as counterparty netting agreements and collateral agreements with the counterparty.

The methodologies do not, in general, account for wrong-way risk. Wrong-way risk arises where the underlying value of the derivative prior to any credit risk adjustment is positively correlated to the probability of default of the counterparty. When there is significant wrong-way risk, a trade-specific approach is applied to reflect the wrong-way risk within the valuation. Exposure to wrong-way risk is limited via internal governance processes and deal pricing. Santander UK considers that an appropriate adjustment to reflect wrong-way risk is £nil (2020: £nil).

(iv) Funding fair value adjustment (FFVA)

The FFVA is an adjustment to the valuation of OTC derivative positions to include the net cost of funding uncollateralised derivative positions. This is calculated by applying a suitable funding cost to the expected future funding exposure of any uncollateralised component of the OTC derivative portfolio.

Model-related adjustments

Models used for portfolio valuation purposes may be based upon a simplifying set of assumptions that do not capture all material market characteristics. Additionally, markets evolve, and models that were adequate in the past may require development to capture all material market characteristics in current market conditions. In these circumstances, model limitation adjustments are adopted. As model development progresses, model limitations are addressed within the core revaluation models and a model limitation adjustment is no longer needed.

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

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

			Balance sheet value		Fair value movements recognised in profit/(loss)		
			2021	2020	2021	2020	2019
Balance sheet line item	Category	Financial instrument product type	£m	£m	£m	£m	£m
1. Derivative assets	Equity and credit contracts	Reversionary property interests	**45**	51	**—**	3	2
2. FVTPL assets	Loans and advances to customers	Roll-up mortgage portfolio	**48**	56	**(5)**	6	—
3. FVTPL assets	Loans and advances to customers	Other loans	**26**	43	**(2)**	3	1
4. FVTPL assets	Debt securities	Reversionary property securities	**91**	107	**5**	6	(17)
5. FVTPL assets	Debt securities	Credit linked notes	**20**	2	**(5)**	(16)	7
6. FVOCI assets	Loans and advances to customers	Other loans	**18**	21	**(3)**	(4)	(2)
7. Derivative liabilities	Equity contracts	Property options and forwards	**(30)**	(29)	**(1)**	(3)	—
8. FVTPL liabilities	Financial guarantees	Credit protection guarantee	**(1)**	(2)	**6**	16	(7)
			217	249	**(5)**	11	(16)
Other Level 3 assets			**1**	17	**(1)**	7	16
Other Level 3 liabilities			**(7)**	(9)	**2**	(1)	(5)
Total net assets			**211**	257	**—**	—	—
Total income/(expense)					**(4)**	17	(5)

Valuation techniques

1. Derivative assets – Equity and credit contracts

These are valued using a probability weighted set of HPI forward prices, which are assumed to be a reasonable representation of the increase in value of the Santander UK group's reversionary interest portfolio underlying the derivatives. The probability used reflects the likelihood of the homeowner vacating the property and is calculated from mortality rates and acceleration rates which are a function of age and gender, obtained from the relevant mortality tables. Indexing is felt to be appropriate due to the size and geographical dispersion of the reversionary interest portfolio. These are determined using HPI Spot Rates adjusted to reflect estimated forward growth. Non-seasonally adjusted (NSA) national and regional HPI are used in the valuation model to avoid any subjective judgement in the adjustment process, which is made by Markit, which publishes the Halifax House Price Index.

The inputs used to determine the value of the reversionary property derivatives are HPI spot, HPI forward growth and mortality rates. The principal pricing parameter is HPI forward growth.

2. FVTPL assets – Loans and advances to customers – roll-up mortgage portfolio

These represent roll-up mortgages (sometimes referred to as lifetime mortgages), which are an equity release scheme under which a property owner takes out a loan secured against their home. The owner may not make any interest payments during their lifetime in which case the fixed interest payments are rolled up into the mortgage. The loan or mortgage (capital and rolled-up interest) is repaid upon the owner's vacation of the property and the value of the loan is only repaid from the value of the property. This is known as a 'no negative equity guarantee'. Santander UK suffers a loss if the sale proceeds from the property are insufficient to repay the loan, as it is unable to pursue the homeowner's estate or beneficiaries for the shortfall.

The value of the mortgage 'rolls up' or accretes until the owner vacates the property. In order to value the roll-up mortgages, Santander UK uses a probability-weighted set of European option prices (puts) determined using the Black-Scholes model, in which the 'no negative equity guarantee' are valued as short put options. The probability weighting applied is calculated from mortality rates and acceleration rates as a function of age and gender, taken from mortality tables.

The inputs used to determine the value of these instruments are HPI spot, HPI forward growth, HPI volatility, mortality rates and repayment rates. The principal pricing parameter is HPI forward growth. The HPI forward growth rate used is unobservable and is the same as used in the valuation of Instrument 1 above. The other parameters do not have a significant effect on the value of the instruments.

3. FVTPL assets – Loans and advances to customers – other loans

These relate to loans to transport and education companies. The fair value of these loans is estimated using the 'present value' model based on a credit curve derived from current market spreads. Loan specific credit data is unobservable, so a proxy population is applied based on industry sector and credit rating.

4. FVTPL assets – Debt securities

These consist of reversionary property securities and are an equity release scheme, where the property owner receives an upfront lump sum in return for paying a fixed percentage of the sales proceeds of the property when the owner vacates the property. These reversionary property securities are valued using a probability-weighted set of HPI forward prices which are assumed to be a reasonable representation of the increase in value of Santander UK's reversionary interest portfolio underlying the derivatives. The probability weighting used reflects the probability of the homeowner vacating the property through death or moving into care and is calculated from mortality rates and acceleration factors which are a function of age and gender, obtained from the relevant mortality table.

The inputs used to determine the value of these instruments are HPI spot, HPI forward growth and mortality rates. The principal pricing parameter is HPI forward growth. Discussion of the HPI spot rate, HPI forward growth rate and mortality rates for this financial instrument is the same as Instrument 1 above. An adjustment is also made to reflect the specific property risk. Specific property risk is from the difference between the specific properties in the portfolio, and the average price as expressed in the regionally weighted house price index.

5. FVTPL assets – Debt securities (Credit linked notes)

These consist of the retained senior tranches of credit linked notes in respect of credit protection vehicles sponsored by Santander UK and are mandatorily held at fair value through profit or loss. These vehicles provide credit protection on reference portfolios of Santander UK group loans with junior notes sold to external investors. The notes retained by Santander UK are classified as level 3 financial instruments as their valuation depends upon unobservable parameters relating to the underlying reference portfolios of loans, including credit spreads, correlations and prepayment speed, which have a significant effect on the overall valuation. For more information, see 'Credit protection entities' in Note 19.

6. FVOCI assets – Loans and advances to customers – other loans

These relate to shipping loans. The fair value of these loans is estimated using the 'present value' model based on a credit curve derived from current market spreads. Loan specific credit data is unobservable, so a proxy population is applied based on industry sector and credit rating.

7. Derivative liabilities – Equity contracts

There are three types of derivatives in this category:

European options – These are valued using a modified Black-Scholes model where the HPI is log-normally distributed with the forward rates determined from the HPI forward growth.

Asian options – Asian (or average value) options are valued using a modified Black-Scholes model, with an amended strike price and volatility assumption to account for the average exercise period, through a closed form adjustment that reflects the strike price relative to the distribution of stock prices at each relevant date. This is also known as the Curran model.

Forward contracts – Forward contracts are valued using a standard forward pricing model.

The inputs used to determine the value of the above instruments are HPI spot rate, HPI forward growth rate and HPI volatility. The principal pricing parameter is HPI forward growth rate, which is unobservable.

8. FVTPL liabilities – Financial guarantees

These relate to credit protection guarantees in respect of the proceeds of the retained senior tranches of credit linked notes described in Instrument 5 above, and have been designated at fair value through profit or loss. These instruments are valued using the same unobservable parameters described in Instrument 5 above, such that changes in the valuation of the senior tranches of the credit linked notes are offset by changes in the value of these credit protection guarantees. For more information, see 'Credit protection entities' in Note 19.

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

The following table sets out the movements in Level 3 financial instruments in 2021 and 2020:

	Assets					Liabilities			
	Derivatives	Other financial assets at FVTPL	Financial assets at FVOCI	Assets held for sale	Total	Derivatives	Other financial liabilities at FVTPL	Liabilities held for sale	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2021	**68**	**208**	**21**	**—**	**297**	**(32)**	**(8)**	**—**	**(40)**
Total (losses)/gains recognised:									
- Fair value movements	**(1)**	**(7)**	**(3)**	**—**	**(11)**	**—**	**7**	**—**	**7**
- Foreign exchange and other movements	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Transfers in	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Transfers out	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Netting[1]	**—**	**23**	**—**	**—**	**23**	**—**	**(5)**	**—**	**(5)**
Additions	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Sales	**—**	**(16)**	**—**	**—**	**(16)**	**—**	**—**	**—**	**—**
Settlements	**(21)**	**(23)**	**—**	**—**	**(44)**	**—**	**—**	**—**	**—**
At 31 December 2021	**46**	**185**	**18**	**—**	**249**	**(32)**	**(6)**	**—**	**(38)**
Gains/(losses) recognised in profit or loss/other comprehensive income relating to assets and liabilities held at the end of the period	**(1)**	**(7)**	**(3)**	**—**	**(11)**	**—**	**7**	**—**	**7**
At 1 January 2020	75	386	56	—	517	(32)	(61)	—	(93)
Total gains/(losses) recognised:									
- Fair value movements	10	(1)	(4)	—	5	(6)	18	—	12
- Foreign exchange and other movements	—	(5)	—	—	(5)	—	8	—	8
Transfers in	1	—	—	—	1	—	—	—	—
Transfers out	—	—	—	—	—	—	28	—	28
Netting[1]	—	(42)	—	—	(42)	—	—	—	—
Additions	2	—	—	—	2	—	(2)	—	(2)
Sales	—	(19)	(19)	—	(38)	—	—	—	—
Settlements	(20)	(111)	(12)	—	(143)	6	1	—	7
At 31 December 2020	68	208	21	—	297	(32)	(8)	—	(40)
Gains/(losses) recognised in profit or loss/other comprehensive income relating to assets and liabilities held at the end of the period	10	(6)	(4)	—	—	(6)	26	—	20

(1) This relates to the effect of netting on the fair value of the credit linked notes due to a legal right of set-off between the principal amounts of the senior notes and the associated cash deposits. For more, see 'ii) Credit protection entities' in Note 19.

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

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

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

		Significant unobservable input				Sensitivity	
			Assumption value				
2021	Fair value £m	Assumption description	Range[1]	Weighted average	Shift	Favourable changes £m	Unfavourable changes £m
1. Derivative assets – Equity and credit contracts:	**45**	HPI Forward growth rate	**0%-5%**	**2.56 %**	**1 %**	**6**	**(6)**
– Reversionary property derivatives		HPI Spot rate[2]	**n/a**	**483**	**10 %**	**6**	**(6)**
2. FVTPL – Loans and advances to customers:	**48**	HPI Forward growth rate	**0%-5%**	**2.68 %**	**1 %**	**2**	**(2)**
– Roll-up mortgage portfolio							
3. FVTPL – Loans and advances to customers:	**26**	Credit spreads	**0.07% - 1.44%**	**0.50 %**	**20 %**	**—**	**—**
– Other loans							
4. FVTPL – Debt securities:	**91**	HPI Forward growth rate	**0% -5%**	**2.56 %**	**1 %**	**1**	**(1)**
– Reversionary property securities		HPI Spot rate[2]	**n/a**	**483**	**10 %**	**4**	**(4)**
6. FVOCI - Loans and advances to customers:	**18**	Credit spreads	**0.15% - 0.19%**	**0.04 %**	**20 %**	**—**	**—**
– Other loans							
7. Derivative liabilities – Equity contracts:	**(30)**	HPI Forward growth rate	**0% -5%**	**2.39 %**	**1 %**	**2**	**(2)**
–Property-related options and forwards		HPI Spot rate[2]	**n/a**	**469**	**10 %**	**3**	**(3)**
2020							
1. Derivative assets – Equity and credit contracts:	51	HPI Forward growth rate	0% - 5%	2.57 %	1 %	8	(8)
– Reversionary property derivatives		HPI Spot rate[2]	n/a	445	10 %	7	(7)
2. FVTPL – Loans and advances to customers:	56	HPI Forward growth rate	0% - 5%	2.69 %	1 %	2	(2)
– Roll-up mortgage portfolio							
3. FVTPL – Loans and advances to customers:	43	Credit spreads	0.07% - 1.55%	0.44 %	20 %	—	—
– Other loans							
4. FVTPL – Debt securities:	107	HPI Forward growth rate	0% - 5%	2.57 %	1 %	1	(1)
– Reversionary property securities		HPI Spot rate[2]	n/a	445	10 %	5	(5)
6. FVOCI - Loans and advances to customers:	21	Credit spreads	0.15% - 0.53%	0.32 %	20 %	—	—
– Other loans							
7. Derivative liabilities – Equity contracts:	(29)	HPI Forward growth rate	0% - 5%	2.42 %	1 %	2	(2)
–Property-related options and forwards		HPI Spot rate[2]	n/a	433	10 %	3	(3)

(1) The range of actual assumption values used to calculate the weighted average disclosure.
(2) The HPI spot rate in the weighted average column represents the HPI spot rate index level at 31 December 2021 and 2020.

No sensitivities are presented for FVTPL assets – Debt securities, Credit Linked Notes (instrument 5) and FVTPL liabilities – financial guarantees (instrument 8), as the terms of these instruments are fully matched. As a result, any changes in the valuation of the credit linked notes would be offset by an equal and opposite change in the valuation of the financial guarantees.

i) Maturities of financial liabilities and off-balance sheet commitments

The table below analyses the maturities of the undiscounted cash flows relating to financial liabilities and off-balance sheet commitments of Santander UK based on the remaining period to the contractual maturity date at the balance sheet date. Deposits by customers largely consist of retail deposits. This table is not intended to show the liquidity of Santander UK.

						Group
2021	On demand £m	Not later than 3 months £m	Later than 3 months and not later than 1 year £m	Later than 1 year and not later than 5 years £m	Later than 5 years £m	Total £m
Financial liabilities						
Derivative financial instruments	**—**	**74**	**58**	**389**	**288**	**809**
Other financial liabilities at fair value through profit or loss	**—**	**6**	**8**	**553**	**236**	**803**
Deposits by customers	**177,926**	**3,107**	**4,691**	**5,750**	**1,583**	**193,057**
Deposits by banks	**1,377**	**551**	**41**	**31,986**	**—**	**33,955**
Repurchase agreements – non trading	**—**	**11,419**	**299**	**—**	**—**	**11,718**
Debt securities in issue	**—**	**4,993**	**2,725**	**11,921**	**6,552**	**26,191**
Subordinated liabilities	**—**	**32**	**98**	**1,547**	**2,020**	**3,697**
Lease liabilities	**—**	**—**	**32**	**78**	**31**	**141**
Total financial liabilities	**179,303**	**20,182**	**7,952**	**52,224**	**10,710**	**270,371**
Off-balance sheet commitments given	**20,519**	**5,359**	**5,734**	**5,523**	**574**	**37,709**
2020						
Financial liabilities						
Derivative financial instruments	—	279	133	582	638	1,632
Other financial liabilities at fair value through profit or loss	—	1	107	570	759	1,437
Deposits by customers	176,911	3,443	5,453	7,483	2,273	195,563
Deposits by banks	2,410	1,912	2,596	14,230	212	21,360
Repurchase agreements – non trading	—	15,350	500	—	—	15,850
Debt securities in issue	—	4,993	9,897	14,083	7,540	36,513
Subordinated liabilities	—	30	92	1,515	2,424	4,061
Lease liabilities	—	—	17	56	36	109
Total financial liabilities	179,321	26,008	18,795	38,519	13,882	276,525
Off-balance sheet commitments given	21,054	4,493	4,974	11,493	1,146	43,160

						Company
2021	£m	£m	£m	£m	£m	£m
Financial liabilities						
Derivative financial instruments	**—**	**100**	**62**	**588**	**552**	**1,302**
Other financial liabilities at fair value through profit or loss	**—**	**6**	**8**	**553**	**237**	**804**
Deposits by customers	**189,421**	**3,788**	**4,471**	**5,315**	**2,184**	**205,179**
Deposits by banks	**1,109**	**5,811**	**41**	**31,984**	**—**	**38,945**
Repurchase agreements – non trading	**—**	**11,419**	**299**	**—**	**—**	**11,718**
Debt securities in issue	**—**	**4,974**	**2,693**	**11,700**	**5,800**	**25,167**
Subordinated liabilities	**—**	**32**	**98**	**1,547**	**2,020**	**3,697**
Lease liabilities	**—**	**—**	**31**	**76**	**25**	**132**
Total financial liabilities	**190,530**	**26,130**	**7,703**	**51,763**	**10,818**	**286,944**
Off-balance sheet commitments given	**24,352**	**5,359**	**5,816**	**5,855**	**518**	**41,900**
2020						
Financial liabilities						
Derivative financial instruments	—	278	370	830	1,367	2,845
Other financial liabilities at fair value through profit or loss	—	1	107	570	759	1,437
Deposits by customers	196,826	4,309	5,523	7,628	2,224	216,510
Deposits by banks	1,940	7,131	2,596	14,229	212	26,108
Repurchase agreements – non trading	—	15,350	497	—	—	15,847
Debt securities in issue	—	4,786	9,788	13,110	5,963	33,647
Subordinated liabilities	—	30	92	1,515	2,424	4,061
Lease liabilities	—	—	16	46	26	88
Total financial liabilities	198,766	31,885	18,989	37,928	12,975	300,543
Off-balance sheet commitments given	25,125	4,489	4,737	11,803	1,092	47,246

As the above table is based on contractual maturities, no account is taken of call features related to subordinated liabilities. In addition, the repayment terms of debt securities may be accelerated in line with relevant covenants. Further, no account is taken of the possible early repayment of Santander UK's mortgage-backed non-recourse finance which is redeemed by Santander UK as funds become available from redemptions of the residential mortgages. Santander UK has no control over the timing and amount of redemptions of residential mortgages.

41. OFFSETTING FINANCIAL ASSETS AND LIABILITIES

Financial assets and financial liabilities are reported on a net basis on the balance sheet only if there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. The following table shows the impact of netting arrangements on:

- All financial assets and liabilities that are reported net on the balance sheet
- All derivative financial instruments and repurchase agreements and other similar secured lending and borrowing agreements that are subject to enforceable master netting arrangements or similar agreements, but do not qualify for balance sheet netting.

The table identifies the amounts that have been offset in the balance sheet and also those amounts that are covered by enforceable netting arrangements (offsetting arrangements and financial collateral) but do not qualify for netting under the requirements described above.

For derivative contracts, the 'Financial instruments' column identifies financial assets and liabilities that are subject to set off under netting agreements, such as the ISDA Master Agreement or derivative exchange or clearing counterparty agreements, whereby all outstanding transactions with the same counterparty can be offset and close-out netting applied across all outstanding transactions covered by the agreements if an event of default or other predetermined events occur. Financial collateral refers to cash and non-cash collateral obtained, typically daily or weekly, to cover the net exposure between counterparties by enabling the collateral to be realised in an event of default or if other predetermined events occur. For repurchase and reverse repurchase agreements and other similar secured lending and borrowing, the 'Financial instruments' column identifies financial assets and liabilities that are subject to set off under netting agreements, such as global master repurchase agreements and global master securities lending agreements, whereby all outstanding transactions with the same counterparty can be offset and close-out netting applied across all outstanding transactions covered by the agreements if an event of default or other predetermined events occur. Financial collateral typically comprises highly liquid securities which are legally transferred and can be liquidated if a counterparty defaults.

Santander UK engages in a variety of counterparty credit mitigation strategies in addition to netting and collateral arrangements. Therefore, the net amounts presented in the tables below do not purport to represent Santander UK's actual credit exposure.

								Group
	Amounts subject to enforceable netting arrangements							
	Effects of offsetting on balance sheet			Related amounts not offset				
2021	Gross amounts £m	Amounts offset £m	Net amounts on balance sheet £m	Financial instruments £m	Financial collateral[1] £m	Net amount £m	Assets not subject to enforceable netting arrangements[2] £m	Balance sheet total[3] £m
Assets								
Derivative financial assets	**2,832**	**(1,221)**	**1,611**	**(754)**	**(693)**	**164**	**72**	**1,683**
Reverse repurchase, securities borrowing & similar agreements:								
– Amortised cost	**14,882**	**(2,199)**	**12,683**	**(435)**	**(12,248)**	**—**	**—**	**12,683**
– Fair value	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Loans and advances to customers and banks[4]	**4,251**	**(923)**	**3,328**	**—**	**—**	**3,328**	**207,935**	**211,263**
	21,965	**(4,343)**	**17,622**	**(1,189)**	**(12,941)**	**3,492**	**208,007**	**225,629**
Liabilities								
Derivative financial liabilities	**1,955**	**(1,221)**	**734**	**(754)**	**59**	**39**	**43**	**777**
Repurchase, securities lending & similar agreements:								
– Amortised cost	**13,917**	**(2,199)**	**11,718**	**(435)**	**(11,283)**	**—**	**—**	**11,718**
– Fair value	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Deposits by customers and banks[4]	**8,609**	**(923)**	**7,686**	**—**	**—**	**7,686**	**219,095**	**226,781**
	24,481	**(4,343)**	**20,138**	**(1,189)**	**(11,224)**	**7,725**	**219,138**	**239,276**
2020								
Assets								
Derivative financial assets	5,071	(1,754)	3,317	(782)	(1,840)	695	89	3,406
Reverse repurchase, securities borrowing & similar agreements:								
– Amortised cost	26,084	(6,485)	19,599	(129)	(19,470)	—	—	19,599
– Fair value	—	—	—	—	—	—	—	—
Loans and advances to customers and banks[4]	7,454	(1,073)	6,381	—	—	6,381	204,051	210,432
	38,609	(9,312)	29,297	(911)	(21,310)	7,076	204,140	233,437
Liabilities								
Derivative financial liabilities	3,261	(1,754)	1,507	(782)	(551)	174	77	1,584
Repurchase, securities lending & similar agreements:								
– Amortised cost	22,333	(6,485)	15,848	(129)	(15,719)	—	—	15,848
– Fair value	—	—	—	—	—	—	—	—
Deposits by customers and banks[4]	11,159	(1,073)	10,086	—	(502)	9,584	206,007	216,093
	36,753	(9,312)	27,441	(911)	(16,772)	9,758	206,084	233,525

(1) Financial collateral is reflected at its fair value, but has been limited to the net balance sheet exposure so as not to include any over-collateralisation.
(2) This column includes contractual rights of set-off that are subject to uncertainty under the laws of the relevant jurisdiction.
(3) The balance sheet total is the sum of 'Net amounts reported on the balance sheet' that are subject to enforceable netting arrangements and 'Amounts not subject to enforceable netting arrangements'.
(4) The amounts offset within loans and advances to customers/banks or deposits by customers/banks relate to offset mortgages which are classified as either and that are subject to netting.

	Company							
	Amounts subject to enforceable netting arrangements							
	Effects of offsetting on balance sheet			Related amounts not offset				
2021	Gross amounts £m	Amounts offset £m	Net amounts on balance sheet £m	Financial instruments £m	Financial collateral[1] £m	Net amount £m	Assets not subject to enforceable netting arrangements[2] £m	Balance sheet total[3] £m
Assets								
Derivative financial assets	**3,025**	**(1,221)**	**1,804**	**(899)**	**(573)**	**332**	**72**	**1,876**
Reverse repurchase, securities borrowing & similar agreements:								
– Amortised cost	**14,882**	**(2,199)**	**12,683**	**(435)**	**(12,248)**	**—**	**—**	**12,683**
– Fair value	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Loans and advances to customers and banks[4]	**22,479**	**(923)**	**21,556**	**—**	**—**	**21,556**	**202,504**	**224,061**
	40,386	**(4,343)**	**36,043**	**(1,334)**	**(12,821)**	**21,888**	**202,576**	**238,620**
Liabilities								
Derivative financial liabilities	**2,422**	**(1,221)**	**1,201**	**(899)**	**(127)**	**175**	**41**	**1,242**
Repurchase, securities lending & similar agreements:								
– Amortised cost	**13,917**	**(2,199)**	**11,718**	**(435)**	**(11,283)**	**—**	**—**	**11,718**
– Fair value	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Deposits by customers and banks[4]	**30,407**	**(923)**	**29,484**	**—**	**—**	**29,484**	**214,395**	**243,879**
	46,746	**(4,343)**	**42,403**	**(1,334)**	**(11,410)**	**29,659**	**214,436**	**256,839**
2020								
Assets								
Derivative financial assets	5,234	(1,754)	3,480	(1,392)	(1,308)	780	88	3,568
Reverse repurchase, securities borrowing & similar agreements:								
– Amortised cost	26,084	(6,485)	19,599	(129)	(19,470)	—	—	19,599
– Fair value	—	—	—	—	—	—	—	—
Loans and advances to customers and banks[4]	34,611	(1,073)	33,538	—	—	33,538	195,279	228,817
	65,929	(9,312)	56,617	(1,521)	(20,778)	34,318	195,367	251,984
Liabilities								
Derivative financial liabilities	4,426	(1,754)	2,672	(1,392)	(551)	729	76	2,748
Repurchase, securities lending & similar agreements:								
– Amortised cost	22,330	(6,485)	15,845	(129)	(15,716)	—	—	15,845
– Fair value	—	—	—	—	—	—	—	—
Deposits by customers and banks[4]	42,199	(1,073)	41,126	—	(502)	40,624	200,654	241,780
	68,955	(9,312)	59,643	(1,521)	(16,769)	41,353	200,730	260,373

(1) Financial collateral is reflected at its fair value, but has been limited to the net balance sheet exposure so as not to include any over-collateralisation.
(2) This column includes contractual rights of set-off that are subject to uncertainty under the laws of the relevant jurisdiction.
(3) The balance sheet total is the sum of 'Net amounts reported on the balance sheet' that are subject to enforceable netting arrangements and 'Amounts not subject to enforceable netting arrangements'.
(4) The amounts offset within loans and advances to customers/banks or deposits by customers/banks relate to offset mortgages which are classified as either and that are subject to netting.

42. INTEREST RATE BENCHMARK REFORM

In September 2019, the IASB amended IFRS 9 'Financial Instruments', IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 7 'Financial Instruments: Disclosures' to address issues affecting financial reporting in the period before the reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate (the Phase 1 amendments). These Phase 1 amendments provided temporary exceptions to specific hedge accounting requirements because of the uncertainty arising from the reform. After issuing the Phase 1 amendments, in August 2020, the IASB issued further amendments to various IFRSs to address issues that might affect financial reporting during the reform of an interest rate benchmark, including the effects of changes to contractual cash flows or hedging relationships arising from the replacement of an interest rate benchmark with an alternative benchmark rate (the Phase 2 amendments). The Phase 2 amendments do not supersede the Phase 1 amendments.

In March 2021, the FCA confirmed that all LIBOR settings will either cease to be provided by any administrator or no longer be representative:

- immediately after 31 December 2021, in the case of all sterling, euro, Swiss franc and Japanese yen settings, and the 1-week and 2-month US dollar settings; and
- immediately after 30 June 2023, in the case of the remaining US dollar settings (i.e. overnight, 1-month, 3-month, 6-month and 12-month).

Under the UK Benchmarks Regulation (BMR), the FCA may designate LIBOR, or individual tenor/currency LIBOR rates, as Article 23A benchmarks if the benchmark has become, or is at risk of becoming, unrepresentative. In September 2021, the FCA designated 1-month, 3-month, and 6-month GBP and JPY LIBOR as Article 23A benchmarks, with effect from 00:01 on 1 January 2022. This enabled the FCA to reduce disruption to holders of legacy contracts through requiring the continued provision of LIBOR rates using a modified methodology. This modified methodology is commonly referred to as a 'synthetic' LIBOR. The synthetic rates will be calculated using the methodology proposed by the FCA in June 2021, being the sum of the forward-looking term rate for the relevant currency/tenor combination and the applicable ISDA spread adjustment. Furthermore, pursuant to the Critical Benchmarks (References and Administrators' Liability) Act 2021, references to GBP and JPY LIBOR in contracts governed by a law of the United Kingdom are deemed to be references to the applicable synthetic LIBOR rate, subject to the operation of fallback provisions that are intended to transition the contract to an alternative reference rate on a particular date or, for example, on the applicable LIBOR rate becoming unrepresentative. The FCA has permitted legacy use of the 6 synthetic LIBOR settings in all contracts except cleared derivatives and does not propose to apply any limitations or conditionality to the above permissions, at least before the end of 2022. Consequently, the Phase 1 amendments continue to apply to Santander UK's GBP LIBOR cash flow hedges for these legacy contracts and for USD LIBOR cash flow hedges (but not any using 1-week or 2-month USD LIBOR settings).

Phase 1 amendments

The amendments provide temporary exceptions from applying specific hedge accounting requirements to hedging relationships that are directly affected by the IBOR reform. The exceptions have the effect that IBOR reform should not generally cause hedge accounting to terminate, however any hedge ineffectiveness continues to be recognised in the income statement. The exceptions end at the earlier of:

- when the uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows is no longer present, and
- discontinuance of the hedge relationship (or reclassification of all amounts from the cash flow hedge reserve).

The amendments apply to all hedging relationships directly affected by uncertainties related to IBOR reform and had no impact on hedge relationships for affected hedges. The main assumptions or judgements made by Santander UK in applying the amendments are outlined below.

- For cash flow hedges where the hedged items are tough legacy contracts (as explained above), Santander UK management has assumed that the interest rate benchmark on which hedged cash flows are based is not altered as a result of IBOR reform when assessing whether the future cash flows are highly probable. For discontinued hedging relationships, the same assumption has been applied for determining whether the hedged future cash flows are expected to occur.
- In making its prospective hedge effectiveness assessments, Santander UK assumes that the interest rate benchmark on which the hedged item and the hedging instrument are based is not altered as a result of IBOR reform.
- Santander UK will not discontinue hedge accounting during the period of IBOR-related uncertainty solely because the retrospective effectiveness falls outside the required 80-125% range.
- For hedges of a non-contractually specified benchmark portion of an interest rate, Santander UK only considers at inception of such a hedging relationship whether the separately identifiable requirement is met.

Phase 2 amendments

These amendments apply only to changes required by IBOR reform to financial instruments and hedging relationships. Changes are directly required by IBOR reform if, and only if, the change is necessary as a direct consequent of interest rate benchmark reform, and the new basis for determining the contractual cash flow is economically equivalent to the previous basis. The exceptions given by the amendments mean that IBOR reform did not result in the discontinuation of hedge accounting and any hedge ineffectiveness continued to be recognised in profit or loss for affected hedges at and for the year ended 31 December 2021. The amendments address the accounting issues for financial instruments when IBOR reform is implemented as described below.

Practical expedient for changes to contractual cash flows

For instruments to which the amortised cost measurement applies, the amendments require entities, as a practical expedient, to account for a change in the basis for determining the contractual cash flows by updating the effective interest rate using the guidance in IFRS 9 resulting in no immediate gain or loss being recognised, provided that, the change is directly required by IBOR reform and takes place on an economically equivalent basis. Whereas the majority of instruments referencing LIBOR or other IBORs transitioned to alternative benchmark interest rates during 2021, legacy contracts and USD LIBOR cash flow hedges remain. Santander UK has no lease contracts which are indexed to LIBOR or other IBORs. The practical expedient was applied to all instruments or contracts that transitioned to alternative benchmark interest rates during 2021 and had no material impact for the Santander UK group.

Relief from specific hedge accounting requirements

The table below sets out the hedge accounting amendments, and their impact for Santander UK, which provide additional temporary reliefs from applying specific IAS 39 hedge accounting requirements to hedging relationships directly affected by IBOR reform. For GBP LIBOR cash flow hedges of legacy contracts and for USD LIBOR cash flow hedges, the transition to alternative benchmark interest rates will take place during 2022 and, for USD LIBOR cash flow hedges, no later than June 2023.

Hedge accounting amendment	Impact for the Santander UK group
Allow amendment of the designation of a hedging relationship to reflect changes that are required by the reform. The hedge designation must be amended by the end of the reporting period in which the changes are made.	This amendment means any change to hedge documentation will not result in discontinuation of hedge accounting nor the designation of a new hedge relationship. It expects the majority of its hedge relationships will transition to alternative benchmark rates during 2021 and Santander UK group used this relief for those hedges that transitioned.
When a hedged item in a cash flow hedge is amended to reflect the changes that are required by the reform, the amount accumulated in the cash flow hedge reserve will be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.	This amendment would result in the release of the cash flow hedge reserve to profit or loss in the same period or periods in which the hedged cash flows that are now based on the alternative benchmark interest rate affect profit or loss. During the year, most of the Santander UK group's GBP LIBOR cash flow hedges transitioned to alternative benchmark interest rates.
An entity may, on an individual hedge basis, reset to zero the cumulative fair value changes of the hedged item and hedging instrument when ceasing to apply the retrospective effectiveness assessment relief provided by the Phase 1 amendments.	The Santander UK group assessed on a hedge-by-hedge basis as the hedging instruments transitioned away from LIBORs or other IBORs during 2021. Resetting the cumulative fair value changes to zero had no effect on the amounts recorded in profit or loss. All hedge ineffectiveness including any outside the 80-125% range arising from IBOR reform has been recognised in profit or loss.
When amending the hedge relationships for groups of items, hedged items are allocated to sub-groups based on the alternative benchmark interest rate being hedged, and the benchmark rate for each sub-group is designated as the hedged risk.	All hedge relationships have transitioned to alternative benchmark interest rates and hedge documentation was amended accordingly.
An alternative benchmark interest rate designated as a non-contractually specified risk component, that is not separately identifiable at the date when it is designated, is deemed to have met the requirements at that date if the entity reasonably expects that it will meet the requirements within a period of 24 months from the date of first designation. The 24-month period will apply to each alternative benchmark interest rate separately. The risk component will, however, be required to be reliably measurable.	The amendment eases transition to alternative benchmark interest rates by allowing hedging relationships to be designated and to continue even before the new benchmark interest rates are fully established as market benchmarks. For the Santander UK group, the majority of hedge relationships, where an alternative benchmark interest rate is to be designated as a non-contractually specified risk component, were GBP fair value hedge relationships and most transitioned to SONIA during the year, and this rate was considered separately identifiable.

For other changes that are not as a direct consequence of IBOR reform, Santander UK separately assesses those changes to determine if they result in derecognition or discontinuation of hedge accounting by applying the relevant accounting policies as set out in Note 1.

Managing LIBOR transition

Following the decision by global regulators to phase out IBORs and replace them with alternative reference rates, Santander UK set up a project to oversee the design of alternative reference rate products and the transition for any legacy contracts referencing affected IBOR rates. The CFO sponsored the project and it was driven by senior staff from across the business, including our client-facing business areas, Legal, Compliance, Risk, Operations and Technology, and Finance. It had a formal governance structure, including a Senior Management Forum that met monthly, and thematic and product working groups. ALCO, ERCC and the Board Risk Committee received regular reports.

IBOR reform exposed banks to various risks, which were monitored and managed closely. These included:

Conduct risk arising from discussions with clients and market counterparties due to the changes to existing contracts needed to effect IBOR transition

- Risk of financial losses to our clients and us if markets were disrupted due to IBOR transition
- Pricing risk from potential lack of market data if liquidity in IBORs reduced before some RFRs became liquid
- Operational risk arising from changes to IT systems and processes, and the risk of payments being disrupted if IBORs ceased to be available
- Accounting risk if hedging relationships failed, and from unrepresentative income statement volatility as financial instruments transition to RFRs.

While these risks were increased somewhat by diverging approaches to IBOR transition in different geographies, Santander UK's main exposures were to GBP LIBOR corporate loans and derivatives, and the IBOR reform developments in different countries were closely monitored.

Santander UK also recognised that IBOR transition presented potential challenges for customers. We communicated with customers and launched a website to provide more information and help outline options available. Santander UK also continued to participate actively in industry forums and consultations in 2021. New reference rate products were deployed to support the transition from IBORs and, in 2021, the majority of affected legacy contracts were transitioned from the LIBOR rates ceasing at the end of the year. Santander UK continues to work with its customers to agree the transition of the relatively small number of agreements that remained un-transitioned at the end of 2021.

The following tables show the notional amounts of assets, liabilities and off-balance sheet commitments at 31 December 2021 and 31 December 2020 affected by IBOR reform that have yet to transition to an alternative benchmark interest rate.

	Group			
	2021			
	GBP[3] LIBOR £m	USD[3] LIBOR £m	Other[3] £m	Total £m
Assets				
Derivatives[1][2]	—	1,480	—	1,480
Other financial assets at fair value through profit and loss	8	—	—	8
Financial assets at amortised cost	1,373	81	1	1,455
	1,381	1,561	1	2,943
Liabilities				
Derivatives[1][2]	338	1,831	—	2,169
Other financial liabilities at fair value through profit and loss	—	5	—	5
Financial liabilities at amortised cost[4]	34	185	—	219
	372	2,021	—	2,393
Off-balance sheet commitments given	338	59	—	397

	2020			
Assets				
Derivatives[1][2]	33,486	4,514	2,149	40,149
Other financial assets at fair value through profit and loss	968	22	—	990
Financial assets at amortised cost	15,062	1,191	90	16,343
Financial assets at fair value through comprehensive income	428	—	—	428
	49,944	5,727	2,239	57,910
Liabilities				
Derivatives[1][2]	35,217	5,205	88	40,510
Other financial liabilities at fair value through profit and loss	1,129	69	—	1,198
Financial liabilities at amortised cost	2,354	1,319	—	3,673
	38,700	6,593	88	45,381
Off-balance sheet commitments given	11,400	2,126	573	14,099

(1) Many of the Santander UK group's derivatives subject to IBOR reform are governed by ISDA definitions. In October 2020 ISDA issued an IBOR fallbacks supplement setting out how the amendments to new alternative benchmark rates will be accomplished, the effect of which is to create fallback provisions in derivatives that describe what floating rates will apply on the permanent discontinuation of certain key IBORs or upon ISDA declaring a non-representative determination of an IBOR. The Santander UK group has adhered to the protocol to implement the fallbacks to derivative contracts that were entered into before the effective date of the supplement (25 January 2021). If derivative counterparties also adhere to the protocol, new fallbacks will automatically be implemented in existing derivative contracts when the supplement becomes effective. Following the announcement by the FCA on 5 March 2021 that certain LIBOR settings will permanently cease immediately after 31 December 2021 (and for overnight, 1-month, 3-month, 6-month and 12-month US dollar LIBOR after 30 June 2023), the ISDA fallback spread adjustment is fixed as of the date of the FCA announcement. GBP & JPY LIBOR for certain legacy contracts has been extended until at least the end of 2022 but not for cleared derivative contracts.

(2) Derivatives shown in the table above exclude contracts that automatically transitioned under ISDA fall back protocols at 00:01 on 1 January 2022.

(3) Cessation dates are: GBP, JPY, NOK LIBOR & 1-week and 2-month USD LIBOR 31/12/2021 remaining USD LIBOR settings 30/06/23, EONIA 03/01/2022; GBP & JPY LIBOR for certain legacy contracts has been extended until at least 31/12/2022.

(4) Financial liabilities at amortised cost is comprised of securitisation issuance which was called in January 2022.

	Company			
	2021			
	GBP[3] LIBOR £m	USD[3] LIBOR £m	Other[3] £m	Total £m
Assets				
Derivatives[1][2]	—	1,480	—	1,480
Other financial assets at fair value through profit and loss	8	—	—	8
Financial assets at amortised cost	1,326	81	1	1,408
	1,334	1,561	1	2,896
Liabilities				
Derivatives[1][2]	338	1,831	—	2,169
Other financial liabilities at fair value through profit and loss	—	5	—	5
	338	1,836	—	2,174
Off-balance sheet commitments given	333	59	—	392

	2020			
	GBP[3] LIBOR £m	USD[3] LIBOR £m	Other[3] £m	Total £m
Assets				
Derivatives[1][2]	33,857	4,515	2,149	40,521
Other financial assets at fair value through profit and loss	968	—	—	968
Financial assets at amortised cost	18,461	1,191	90	19,742
Financial assets at fair value through comprehensive income	428	—	—	428
	53,714	5,706	2,239	61,659
Liabilities				
Derivatives[1][2]	36,246	5,403	88	41,737
Other financial liabilities at fair value through profit and loss	1,128	69	—	1,197
Financial liabilities at amortised cost	2,798	938	25	3,761
	40,172	6,410	113	46,695
Off-balance sheet commitments given	11,345	2,126	571	14,042

(1) Many of the Santander UK group's derivatives subject to IBOR reform are governed by ISDA definitions. In October 2020 ISDA issued an IBOR fallbacks supplement setting out how the amendments to new alternative benchmark rates will be accomplished, the effect of which is to create fallback provisions in derivatives that describe what floating rates will apply on the permanent discontinuation of certain key IBORs or upon ISDA declaring a non-representative determination of an IBOR. The Santander UK group has adhered to the protocol to implement the fallbacks to derivative contracts that were entered into before the effective date of the supplement (25 January 2021). If derivative counterparties also adhere to the protocol, new fallbacks will automatically be implemented in existing derivative contracts when the supplement becomes effective. Following the announcement by the FCA on 5 March 2021 that certain LIBOR settings will permanently cease immediately after 31 December 2021 (and for overnight, 1-month, 3-month, 6-month and 12-month US dollar LIBOR after 30 June 2023), the ISDA fallback spread adjustment is fixed as of the date of the FCA announcement. GBP & JPY LIBOR for certain legacy contracts has been extended until at least the end of 2022 but not for cleared derivative contracts.
(2) Derivatives shown in the table above exclude contracts that automatically transitioned under ISDA fall back protocols at 00:01 on 1 January 2022.
(3) Cessation dates are: GBP, JPY, NOK LIBOR & 1-week and 2-month USD LIBOR 31/12/2021 remaining USD LIBOR settings 30/06/23, EONIA 03/01/2022; GBP & JPY LIBOR for certain legacy contracts has been extended until at least 31/12/2022.

The following tables show the notional amount of derivatives in hedging relationships directly affected by uncertainties related to IBOR reform.

	Group 2021				Group 2020			
	GBP LIBOR £m	USD LIBOR £m	Other £m	Total £m	GBP LIBOR £m	USD LIBOR £m	Other £m	Total £m
Total notional value of hedging instruments:								
– Cash flow hedges	—	2,586	—	2,586	15,198	5,119	—	20,317
– Fair value hedges	—	160	—	160	32,223	1,077	778	34,078
	—	2,746	—	2,746	47,421	6,196	778	54,395
Maturing after cessation date[1]								
– Cash flow hedges	—	2,586	—	2,586	10,553	2,562	—	13,115
– Fair value hedges	—	160	—	160	12,477	162	720	13,359
	—	2,746	—	2,746	23,030	2,724	720	26,474

(1) Cessation dates are: GBP, JPY, NOK LIBOR & 1-week and 2-month USD LIBOR 31/12/2021, for remaining USD LIBOR settings 30/06/23, EONIA 03/01/2022; GBP & JPY LIBOR for certain legacy contracts has been extended until at least 31/12/2022.

	Company 2021				Company 2020			
	GBP LIBOR £m	USD LIBOR £m	Other £m	Total £m	GBP LIBOR £m	USD LIBOR £m	Other £m	Total £m
Total notional value of hedging instruments:								
– Cash flow hedges	—	2,586	—	2,586	9,297	4,939	—	14,236
– Fair value hedges	—	160	—	160	27,045	894	778	28,717
	—	2,746	—	2,746	36,342	5,833	778	42,953
Maturing after cessation date[1]								
– Cash flow hedges	—	2,586	—	2,586	6,984	2,562	—	9,546
– Fair value hedges	—	160	—	160	8,711	162	720	9,593
	—	2,746	—	2,746	15,695	2,724	720	19,139

(1) Cessation dates are: GBP, JPY, NOK LIBOR & 1-week and 2-month USD LIBOR 31/12/2021, for remaining USD LIBOR settings 30/06/23, EONIA 03/01/2022; GBP & JPY LIBOR for certain legacy contracts has been extended until at least 31/12/2022.

The Santander UK group's USD LIBOR cash flow hedges extend beyond the anticipated cessation dates for LIBOR. The Santander UK group expects that USD LIBOR will be replaced by SOFR but there remains uncertainty over the timing and amount of the replacement rate cash flows for USD LIBOR cash flow hedges. Hedging relationships impacted by uncertainty about IBOR reform may experience ineffectiveness due to market participants' expectations of when the shift from the existing IBOR benchmark rate to an alternative benchmark interest rate will occur or because transition of the hedged item and the hedging instrument could occur at different times.

The Santander UK group will cease to apply the assumptions that the hedged benchmark interest rate, the cash flows of the hedged item and/or hedging instrument will not be altered because of IBOR reform when the uncertainty arising from IBOR reform is no longer present. This will require amendment to hedge documentation by the end of the reporting period in which the changes occur. Cumulative changes in the hedged cash flows and the hedging instrument based on new alternative benchmark rates will also be remeasured when IBOR reform uncertainty is removed.

43. DISCONTINUED OPERATIONS

Discontinued operations

Transfer of the CIB business

Santander UK plc transferred a significant part of its Corporate & Investment Banking business to the London branch of Banco Santander SA under a Part VII banking business transfer scheme, which completed on 11 October 2021. The residual parts of the Corporate & Investment Banking business have been wound down or transferred to other segments.

At 31 December 2021, the Corporate & Investment Banking business met the requirements for presentation as discontinued operations.

The financial performance and cash flow information relating to the discontinued operations were as follows:

	2021	2020	2019
	£m	£m	£m
Net interest income	**32**	55	68
Net fee and commission income	**35**	66	63
Other operating income	**2**	2	8
Total operating income	**69**	123	139
Operating expenses before credit impairment losses, provisions and charges	**(33)**	(62)	(60)
Credit impairment losses	**11**	(7)	(22)
Provisions for other liabilities and charges	**(4)**	(9)	(16)
Total operating credit impairment losses, provisions and charges	**7**	(16)	(38)
Profit from discontinued operations before tax	**43**	45	41
Tax on profit from discontinued operations	**(12)**	(13)	(11)
Profit from discontinued operations after tax	**31**	32	30

Of the £2,784m of assets and £6,517m of liabilities relating to the Corporate & Investment Banking business at 31 December 2020 (see Note2):

- £1.9bn of assets and £2.1bn of liabilities were transferred to the London branch of Banco Santander SA under a Part VII banking business transfer scheme, which completed on 11 October 2021, in exchange for a net cash payment of £0.2bn;
- £1.0bn of liabilities were transferred elsewhere within Santander UK; and
- The remaining business either matured or customers closed their accounts.

There were no gains or losses recognised on the measurement to fair value less costs to sell or on the disposal of the asset groups constituting the discontinued operations.

In 2021, the net cash flows attributable to the operating activities, investing activities and financing activities in respect of discontinued operations were £3,612m outflow (2020: £1,815m outflow, 2019: £1,033m inflow), £nil (2020: £nil, 2019: £nil) and £nil (2020: £nil, 2019: £nil), respectively.

44. EVENTS AFTER THE BALANCE SHEET DATE

There have been no significant events between 31 December 2021 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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Subsidiaries and joint ventures

In accordance with Section 409 of the Companies Act 2006, details of the Company's subsidiaries and joint ventures at 31 December 2021 are set out below.

Subsidiaries

All subsidiaries are owned 100% and consolidated by Santander UK.

Incorporated and registered in England and Wales:

Name of subsidiary	Registered office[1]	Direct/Indirect ownership	Share class through which ownership is held	Proportion of ownership interest %
2 & 3 Triton Limited	A	Direct	Ordinary £1	100
A & L CF June (3) Limited	A	Indirect	Ordinary £1	—
A & L CF September (4) Limited	A	Indirect	Ordinary £1	—
Abbey National Nominees Limited	A	Direct	Ordinary £1	100
Abbey National Property Investments	A	Direct	Ordinary £1	100
Alliance & Leicester Personal Finance Limited	G	Direct	Ordinary £1	100
Cater Allen Limited	A	Indirect	Ordinary £1	—
First National Tricity Finance Limited	A	Indirect	Ordinary £1	—
Santander Asset Finance (December) Limited	G	Indirect	Ordinary £1	—
Santander Asset Finance plc	A	Direct	Ordinary £0.10	100
Santander Cards Limited	A	Indirect	Ordinary £1	—
Santander Cards UK Limited	A	Direct	Ordinary £1	100
Santander Consumer (UK) plc	B	Direct	Ordinary £1	100
Santander Consumer Credit Services Limited	A	Indirect	Ordinary £1	—
Santander Estates Limited	G	Direct	Ordinary £1	100
Santander Global Consumer Finance Limited	A	Indirect	Ordinary £0.0001	—
Santander Guarantee Company	A	Direct	Ordinary £1	100
Santander Lending Limited	A	Direct	Ordinary £1	100
Santander Private Banking UK Limited	A	Direct	Ordinary £1	100
Santander UK Operations Limited	A	Direct	Ordinary A £1	100
			Ordinary B £1	100
Santander UK (Structured Solutions) Limited	A	Direct	Ordinary £0.01	100
Santander UK Technology Limited	A	Direct	Ordinary £1	100
The Alliance & Leicester Corporation Limited	A	Direct	Ordinary £1	100
Time Retail Finance Limited (In liquidation)	F	Indirect	Ordinary £1	—
			Ordinary £0.0001	

(1) Refer to the key at the end of this section for the registered office address.

Incorporated and registered outside England and Wales:

Name of subsidiary	Registered office[1]	Direct/Indirect ownership	Share class through which ownership is held	Proportion of ownership interest %
Santander Cards Ireland Limited	I	Indirect	Ordinary €1	—
			Ordinary €1.27	
Santander ISA Managers Limited	H	Direct	Ordinary £1	100

(1) Refer to the key at the end of this section for the registered office address, including the country.

Other subsidiary undertakings

All entities are registered in England and Wales except for Motor Securities 2018-1 Designated Activity Company which is registered in Ireland.

The Company and its subsidiaries do not own directly, or indirectly, any of the share capital of any of the entities, however they are consolidated by the Santander UK group because the substance of the relationship indicates control, as described in Note 1 to the Consolidated Financial Statements.

Name of entity	Registered office[1]	Name of entity	Registered office[1]
Abbey Covered Bonds (Holdings) Limited	E	Langton Mortgages Trustee (UK) Limited	A
Abbey Covered Bonds (LM) Limited	E	Langton PECOH Limited	C
Abbey Covered Bonds LLP	A	Langton Securities (2008-1) plc	C
Fosse (Master Issuer) Holdings Limited	C	Langton Securities (2010-1) plc	C
Fosse Funding (No.1) Limited	C	Langton Securities (2010-2) plc	C
Fosse Master Issuer plc	C	Langton Securities Holdings Limited	C
Fosse PECOH Limited	C	MAC No.1 Limited	A
Fosse Trustee (UK) Limited	A	Motor 2016-1 Holdings Limited	C
Holmes Funding Limited	A	Motor 2016-1 plc	C
Holmes Holdings Limited	A	Motor 2017-1 Holdings Limited	C
Holmes Master Issuer plc	A	Motor 2017-1 plc	C
Holmes Trustees Limited	A	Motor Securities 2018-1 Designated Activity Company	K
Langton Funding (No.1) Limited	C	PECOH Limited	A

(1) Refer to the key at the end of this section for the registered office address.

Joint ventures

All of these entities, which are registered in England and Wales, are associated undertakings accounted for by the equity method of accounting, with 50% ownership being held.

Name of subsidiary	Registered office[1]	Direct/Indirect ownership	Share class through which ownership is held	Proportion of ownership interest %
Hyundai Capital UK Limited	J	Indirect	Ordinary £1	—
Volvo Car Financial Services UK Limited	L	Indirect	Ordinary £1	—

(1) Refer to the key at the end of this section for the registered office address.

Overseas branches

The Company has no overseas branches.

Key of registered office addresses

A 2 Triton Square, Regent's Place, London NW1 3AN
B Santander House, 86 Station Road, Redhill RH1 1SR
C 1 Bartholomew Lane, London EC2V 2AX
D 40a Station Road, Upminster, Essex RM14 2TR
E Wilmington Trust SP Services (London) Limited, 1 Kings Arms Yard, London EC2R 7AF
F Griffins, Tavistock House South, Tavistock Square, London WC1H 9LG
G Carlton Park, Narborough, Leicester LE19 0AL
H 287 St. Vincent Street, Glasgow, Scotland G2 5NB
I 25/28 North Wall Quay, Dublin 1, Ireland
J London Court, 39 London Road, Reigate RH2 9AQ
K 3rd Floor, Flemming Court, Flemming's Place, Dublin 4, Ireland
L Scandinavia House, Norreys Drive, Maidenhead, Berkshire SL6 4FL

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 Annual 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 in other written materials and in oral statements made by its officers, directors or employees to third parties. Examples of such forward-looking statements include, but are not limited to:

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

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

By their very nature, forward-looking statements 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. Some of these factors, which could affect Santander UK's business, financial condition and/or results of operations, are considered in detail in the Risk review, and they include:

- the effects of disruptions in the global economy and global financial markets
- the effects of the Covid-19 pandemic
- the effects of UK economic conditions
- the effects of the UK's withdrawal from the European Union
- the effects of climate change
- the effects of competition with other financial institutions, including new entrants into the financial services sector
- the risk that Santander UK's new or existing products and services may not become (or may not continue to be) successful
- the risk that Santander UK may be unable to continue offering products and services from third parties
- the extent to which Santander UK's loan portfolio is subject to prepayment risk
- the risk of damage to Santander UK's reputation
- the risk that Santander UK may be unable to manage the growth of its operations
- the effects of any changes to the reputation of Santander UK or its affiliates
- the extent to which regulatory capital, liquidity and leverage requirements, and any changes to these requirements may limit Santander UK's operations
- Santander UK's ability to access liquidity and funding on acceptable financial terms
- the effects of an adverse movement in external credit ratings assigned to Santander UK, any Santander UK member or any of their respective debt securities
- the effects of any changes in the pension liabilities and obligations of Santander UK
- the effects of fluctuations in interest rates and other market risks
- risks arising from the integrity and continued existence of reference rates
- the extent to which Santander UK may be required to record negative changes in positions recorded at fair value for its financial assets due to changes in market conditions
- Santander UK's ability to control the level of non-performing or poor credit quality loans and whether Santander UK's loan loss reserves are sufficient to cover loan losses
- the risk that the value of the collateral, including real estate, securing Santander UK's loans may not be sufficient and that Santander UK may be unable to realise the full value of the collateral securing its loan portfolio
- the effects of the financial services laws, regulations, government oversight, administrative actions and policies and any changes thereto in each location or market in which Santander UK operates
- the risk that Santander UK may become subject to the provisions of the Banking Act 2009, including the bail-in and write down powers thereunder
- the effects of any failure to comply with anti-money laundering, anti-terrorism, anti-corruption, anti-tax evasion or sanctions laws or regulations, or the risk of any failure to prevent or detect any illegal or improper activities fully or timeously
- the effects of taxation (and any changes to tax), in each location in which Santander UK operates
- Santander UK's exposure to any risk of loss from civil litigation and/or criminal legal or regulatory proceedings
- the risk of failing to successfully apply or to improve Santander UK's credit risk management systems
- the risk that Santander UK's data management policies and processes may not be sufficiently robust
- the effect of cyber-crime on Santander UK's business
- the risks arising from any non-compliance with Santander UK's policies, from any employee misconduct or human error, negligence and deliberate acts of harm or dishonesty, including fraud
- the risk of failing to effectively manage changes in Santander UK's information technology infrastructure and management information systems in a timely manner
- Santander UK's exposure to unidentified or unanticipated risks despite its risk management policies, procedures and methods
- the risks arising from Santander UK's reliance on third parties and affiliates for key infrastructure support, products and services
- the ability of Santander UK to recruit, retain and develop appropriate senior management and skilled personnel
- the effects of any inaccuracy within the judgements and accounting estimates which underpin aspects of the financial statements, and the consequent risk of any material misstatement of Santander UK's financial results
- the effect of any change in accounting standards

Please refer to our latest filings with the SEC (including, without limitation, our Annual Report on Form 20-F for the year ended 31 December 2021) 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 foregoing non-exhaustive list of important factors. 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.

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.