Alliance & Leicester plc
2009 Annual Report

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Chief Executive's Review

Overview

We have seen an excellent performance in 2009 despite continued turbulent market conditions, returning Alliance & Leicester to profit in the first year post acquisition by Santander UK plc Performance in the year was underpinned by sustained but prudent lending, continued growth in retail and corporate deposits and a focus on delivering excellent value-for-money products and services to our customers This was supported by reduced costs as part of the integration with Santander UK plc

On 25 February 2010 we announced that, subject to UK Financial Services Authority support and Court approval, our business would be transferred into Santander UK plc later this year under a scheme allowed by Part VII of the Financial Services and Markets Act 2000 We expect to complete the transfer of our branches and customers onto Partenon, Santander's IT system, by the end of the year, which will coincide with our rebranding to Santander By the end of the year our customers will have access to approximately 1,300 branches We are on target to deliver the £180m of cost savings that we identified at the time of our acquisition by 2011

Funding, Liquidity and Capital

We have continued to manage our balance sheet prudently, whilst continuing to support the UK economy with strong SME net lending growth At the same time we have sought to reduce certain portfolios, such as the Treasury asset portfolio, some non-core corporate lending and further reduce the unsecured personal loan book Funding and liquidity have been managed on a Santander UK group basis In March 2010, the Group issued through the Fosse Master Trust the first publicly-placed mortgage-backed securitisation transaction from a UK bank since 2007 (other recent transactions from UK banks had included an investor put) The transaction was denominated in both pounds sterling and euro and raised approximately £1 4bn

Key Financial Highlights

Alliance & Leicester returned to profit in 2009 Statutory profit before tax was £57m (2008 £1,288m loss), with statutory revenue growth over 47% and cost reduction of 30% Personal Financial Services trading profit before tax (management's preferred profit measure, described in the Business Review - Summary on page 10) increased by £220m to £384m compared to £164m in 2008

> Personal Financial Services income benefitted from a stable mortgage book with improved margins given the low interest rate environment, and new business margins in excess of stock margins Deposit growth was also positive across savings, banking and investments, and largely protected from the decline in interest rates by proactive hedging strategies Income also benefitted from lower costs of strategic funding, partially offset by lower Unsecured Personal Loan insurance-related income in line with industry trends Corporate Banking related income was broadly stable, with the run-down portfolios offsetting income growth from increased lending to SME's

> Personal Financial Services trading expenses were significantly lower than the prior year, largely due to savings resulting from integration benefits with Santander UK plc

> As expected in light of the recessionary conditions experienced in the UK for much of 2009, the trading provisions charge increased in 2009, reflecting the effects of decreases in house prices and increased unemployment However, the second half of the year saw a flattening of recent trends, most noticeably in relation to mortgages with a slower growth in arrears This reflects, in part, the better than expected unemployment trends and the persistent low interest rate environment, but also collection efforts and the overall quality of the book We have preserved conservative levels of coverage (provisions as a proportion of non-performing loans), and our arrears and repossession levels remained significantly better than industry benchmarks from the Council of Mortgage Lenders

> The corporate and treasury asset portfolios are performing in line with expectations at the time of acquisition Balances in the run down portfolios have been reduced by 19% and 36% respectively, through natural maturities and some disposals of assets with a focus on those considered to be higher risk

Looking ahead

Our integration into the Santander UK group is about to enter its final phase We expect to complete the transfer of our branches and customers onto Partenon, Santander's IT system, by the end of the year, which will coincide with our rebranding to Santander

In summary, 2009 has been a very successful year for Alliance & Leicester, which would not have been possible without the continued support, dedication and commitment of our staff, as well as from many people and units of the Santander group, of which I am very proud Together, we are making significant progress in transforming the business and I would like to take this opportunity to thank them for their outstanding contribution in 2009

We believe that 2010 will mark a further significant step in our business as we complete our integration into Santander UK plc With the ongoing benefit from our Group strength, we believe that our business continues to be well-positioned for the challenges and opportunities ahead as part of Santander UK plc

António Horta Osório

António Horta-Osório
Chief Executive

Forward-looking Statements

Alliance & Leicester plc and its subsidiaries (together 'Alliance & Leicester') may from time to time make written or oral forward-looking statements Examples of such forward-looking statements include, but are not limited to

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

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

By their very nature, forward-looking statements cannot be objectively verified, are speculative and involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved Alliance & Leicester 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 Alliance & Leicester or on Alliance & Leicester's behalf Some of these factors are considered in detail in the Risk Management section on page 15 and the Risk Factors section on page 108 and may include

- inflation, interest rate, exchange rate, basis spread, market and monetary fluctuations,
- lack of liquidity in funding markets and sources of funding in periods of economic and political crisis,
- the effect of, and changes to, government supervision and regulation of financial services institutions in response to recent market conditions and turmoil in the broader financial services industry,
- extraordinary governmental actions including nationalisation of financial services institutions in response to recent market conditions and turmoil in the broader financial services industry,
- the effects of market conditions and extent of economic activity in the UK and other geographical markets,
- the length and severity of current market turmoil and its impact on credit quality, consumer confidence, market volatility, loan delinquencies and defaults,
- the effects of counterparty defaults on the financial services industry,
- the effects of competition in the geographic and business areas in which Alliance & Leicester conducts operations,
- changes in consumer spending, saving and borrowing habits in the UK,
- illiquidity and volatility in UK real estate markets,
- the impact of lower than expected investment returns on the funding of private and public sector defined benefit pensions,
- the effects of changes in laws, regulations, taxation or accounting standards or practices, or the effects of the interpretation of laws by the courts,
- the ability to increase market share and control expenses,
- the timely development of and acceptance of new Alliance & Leicester products and services and the perceived overall value of these products and services by customers,
- acquisitions and disposals,
- the ability to realise anticipated saving and operational benefits from the integration with Santander UK plc and its subsidiaries,
- technological changes,
- the possibility of foreign exchange controls, expropriation, nationalisation or confiscation of assets in countries in which Alliance & Leicester conducts operations,
- consumer perception as to the continuing availability of credit and price competition, and
- Alliance & Leicester's success at managing the risks of the foregoing

Alliance & Leicester cautions that the foregoing list of important factors is not exhaustive When relying on forward-looking statements to make decisions with respect to Alliance & Leicester, investors and others should carefully consider the foregoing factors and other uncertainties and events Such forward-looking statements speak only as of the date on which they are made and are based on the knowledge, information available and views taken on the date on which they are made, such knowledge, information and views may change at any time Alliance & Leicester does not undertake any obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise

Business Overview

This Business and Financial Review 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 3

General

Alliance & Leicester plc (the 'Company') and its subsidiaries (together, 'Alliance & Leicester' or the 'Group') operate primarily in the UK, under UK law and regulation and are part of Santander UK plc (together with its subsidiaries 'Santander UK'), which in turn is part of Banco Santander, S A (together with its subsidiaries 'Santander') Alliance & Leicester is a significant financial services provider in the UK, operating across the full range of personal financial services The registered office of the Company is Carlton Park, Narborough, Leicester LE19 0AL Telephone number 0116 201 1000

Summary history

The Alliance & Leicester Building Society ('the Society') was formed in 1985 with the merger of two long-standing building societies, the Alliance Building Society and the Leicester Building Society In 1997, the Society transferred its entire business to Alliance & Leicester plc as part of the conversion and listing on the London Stock Exchange and Alliance & Leicester plc commenced trading as a bank A list of the Company's principal subsidiaries and their country of incorporation can be found on page 80

On 10 October 2008, Banco Santander, S A completed the acquisition of the entire issued ordinary share capital of the Company, implemented by means of a scheme of arrangement under Section 425 of the Companies Act 1985, making the Company a wholly owned subsidiary of Banco Santander, S A Banco Santander, S A is one of the largest banks in the world by market capitalisation Founded in 1857, Banco Santander, S A has more than 90 million customers and over 14,000 branches

In December 2008, following the acquisition by Banco Santander, S A of Alliance & Leicester plc, Santander UK plc (formerly Abbey National plc) injected approximately £950m of capital into Alliance & Leicester plc through a subscription for (i) 234,113,712 new Alliance & Leicester plc ordinary shares for cash at £2 99 per ordinary share, (ii) US$220m undated subordinated notes issued by Alliance & Leicester plc, and (iii) euro 115m undated subordinated notes issued by Alliance & Leicester plc Previously, in October 2008, Santander UK plc subscribed for US$100m undated floating rate subordinated notes issued by the Company As a result of the subscription for ordinary shares, Santander UK plc held 35 6% of the issued share capital of Alliance & Leicester plc at 31 December 2008

On 9 January 2009, in order to optimise the capital, liquidity funding and overall financial efficiency of the enlarged Santander group, Banco Santander, S A transferred all of its Alliance & Leicester plc shares to Santander UK plc in exchange for newly issued Santander UK plc ordinary shares Accordingly, Santander UK plc is now the immediate parent company of Alliance & Leicester plc

On 25 February 2010 it was announced that the Company intends to transfer its business into Santander UK plc later this year under a scheme allowed by Part VII of the Financial Services and Markets Act 2000 This transfer is subject to UK Financial Services Authority support and Court approval The transfer will provide benefits for the Company's customers and for Santander UK plc For Alliance & Leicester customers this includes access to Santander UK's full product range plus use of over 1,300 branches, four times as many branches currently available for Alliance & Leicester customers By rationalising systems and improving the sales and risk management processes through having a single view of customers' dealings, Santander UK plc will also benefit from the significant synergies that were announced to the market at the time of the acquisition of Alliance & Leicester plc by Banco Santander, S A in 2008

Corporate purpose and strategy

Alliance & Leicester's purpose is to maximise value for its shareholder, Santander UK plc, by focusing on offering a full commercial banking service in the UK providing value-for-money products to customers

Executive responsibility

Alliance & Leicester's management structure is headed by António Horta-Osório, Chief Executive, and consists of a number of business and support divisions The business divisions consist of

- **Retail Banking** - offers residential mortgages, savings and banking and other personal financial products to customers throughout the UK This division is co-headed by Alison Brittain and Antonio Lorenzo Alison Brittain is responsible for the Retail Distribution channel as well as business banking and e-commerce, while Antonio Lorenzo is responsible for the Intermediary channel
- **Corporate Banking** - offers banking services principally to small and mid-sized (SME) UK companies It also contains operations in run down This division is headed by Steve Pateman
- **Private Banking** - offers private banking services This division is headed by Antonio Lorenzo

Business Overview continued

The support divisions consist of

> **Retail Products and Marketing** - responsible for integrating and gaining the maximum value from Alliance & Leicester's products, marketing and brand communications to serve Alliance & Leicester's customers better This division is headed by Miguel-Ángel Rodríguez-Sola
> **Human Resources** - responsible for delivering the human resources strategy and personnel support This division is headed by Karen Fortunato
> **Manufacturing** - responsible for all information technology, cost control and operations activity, including service centres This division is headed by Juan Olaizola
> **Risk** - responsible for ensuring that the board of directors ("Board") and senior management team of Alliance & Leicester are provided with an appropriate risk policy and control framework, and to report any material risk issues to the Santander UK Risk Committee and the Board The division is headed by Juan Colombás
> **Internal Audit** - responsible for supervising the compliance, effectiveness and efficiency of Alliance & Leicester's internal control systems to manage its risks This division is headed by Jorge de la Vega

In addition there are a number of corporate units

> **Group Infrastructure** - manages the Treasury asset portfolio which is in run down This division is headed by Antonio Lorenzo
> **Strategy & Planning, Financial Accounting & Economics** - This unit reports to Antonio Lorenzo
> **Corporate Services** - This unit includes Legal, Secretariat, Compliance and Regulatory Risk Management and reports to Karen Fortunato
> **Service Quality** - This unit reports to Miguel-Ángel Rodríguez-Sola
> **Communications** - This unit is headed by Matthew Young
> **Santander Universities in the UK** - This unit is headed by Miguel-Ángel Rodríguez-Sola with oversight in line with the global Universities structure

Competitive environment, future trends and outlook

The economic environment in 2009 remained very difficult, with falling house prices, volatile share prices, rising unemployment, and difficulties facing banks, homeowners and savers The UK's retail banks underwent further significant changes, with the UK Government increasing its holdings of shares in The Royal Bank of Scotland Group plc and Lloyds Banking Group plc The UK Government continues to support UK banks during the current market turmoil through the Special Liquidity Scheme, the Asset Protection Scheme, the Credit Guarantee Scheme and the UK Banking Act 2009

Alliance & Leicester's main competitors are other UK retail banks, building societies and other financial services providers such as insurance companies, supermarket chains and large retailers The market remains highly competitive, driven largely by market incumbents Management expects such competition to continue in response to competitor behaviour, consumer demand, technological changes, the impact of consolidation, regulatory actions and other factors

2010 is expected to be another difficult year for the UK economy Although the UK economy has begun to show signs of emerging from recession, unemployment is predicted to remain high, resulting in continuing difficulties for banks, homeowners and savers The outcome of the European Union's review of the UK Government's support for The Royal Bank of Scotland Group plc and Lloyds Banking Group plc may also trigger further restructuring of the retail banking sector in the UK Alliance & Leicester continues to benefit from the strength of its ultimate parent company, Banco Santander, S A and, as part of Santander, management remains confident of Alliance & Leicester's strength despite continuing challenging conditions in some of its core personal financial services markets

Personal Financial Services ('PFS')

The overview below reflects the reporting structure in place during 2009 in accordance with which the segmental information in the Business and Financial Review has been presented In this report, the Retail Banking, Corporate Banking, Private Banking and Group Infrastructure (formerly known as Treasury & Group Items) segments are referred to as the Personal Financial Services businesses There are no other businesses outside of PFS

Retail Banking

Retail Banking consists of residential mortgages, savings, personal loans and current accounts, plus other personal financial products

Residential Mortgages

Following the transfer of Alliance & Leicester to Santander UK plc in January 2009, together they are the second largest provider of residential mortgages in the UK measured by outstanding balances, providing mortgage loans for house purchases as well as home improvement loans to new and existing mortgage customers

Mortgage loans are offered in two payment types Repayment mortgages require both principal and interest to be repaid in monthly instalments over the life of the mortgage Interest-only mortgages require monthly interest payments and the repayment of principal at the end of the mortgage term This can be arranged via a number of investment products including Individual Savings Accounts and pension policies, or by the sale of the property

Business Overview continued

Alliance & Leicester's mortgage loans are usually secured by a first mortgage over property and are typically available over a 25-year term, although there is no minimum term Variable rate products charge interest at variable rates, including trackers which track the Bank of England base rate and those determined at the discretion of the Company by reference to the general level of market interest rates and competitive forces in the UK mortgage market Fixed rate products offer a predetermined interest rate, generally fixed for between two and five years, after which they bear interest at standard variable rates

The majority of new mortgage business is through fixed rate business, normally with an incentive period for the first two to five years In line with the rest of the UK market, a significant proportion (although reduced compared with the previous year) of mortgages are repaid at the end of the fixed or incentive period, with the customer moving to a new incentive product The remainder stay on Alliance & Leicester's standard variable rate

Savings

Alliance & Leicester provides a wide range of retail savings accounts in the UK, including on-demand, notice, and investment accounts and Individual Savings Accounts Interest rates on savings in the UK are primarily set with reference to the general level of market interest rates and the level of competition for such funds

Banking and Consumer Credit

Alliance & Leicester offers a range of personal banking services including current accounts, credit cards and unsecured personal loans Credit scoring is used for initial lending decisions and behavioural scoring is used for certain products for further lending

Credit cards

Credit cards are issued through a sister company outside the Group, Santander Cards Limited Previously, the Group's principal credit card offering was delivered through a strategic alliance with MBNA Europe Bank Limited, which was responsible for taking the credit risk and managing the credit card base This arrangement ceased in 2009 Retail Banking earns a commission from Santander Cards Limited on every credit card sold

Other Personal Financial Products

Alliance & Leicester also provides a range of insurance and investment products to its customers These products are supplied and managed by a number of third party providers

Corporate Banking

Corporate Banking provides a range of banking services through its network of Regional Business Centres and specialist businesses A broad range of banking products is offered including loans, current accounts, deposits, treasury services, asset finance, cash transmission, trade finance and invoice discounting The Regional Business Centres have seen significant growth in their customer base in 2009 and primarily service small and medium-sized UK companies The specialist businesses within Corporate Banking service customers in various business sectors including Real Estate and Infrastructure Corporate Banking is also responsible for managing the run down of certain portfolios, including aviation and shipping

Private Banking

Private Banking consists solely of Alliance & Leicester International Limited which uses the Alliance & Leicester International brand Its office is in the Isle of Man, with a focus on attracting deposits by offering a range of savings accounts denominated in sterling, US dollars and euro

Group Infrastructure (formerly known as Treasury & Group Items)

Group Infrastructure consists of the Treasury asset portfolio The Group's structural balance sheet shape and tactical liquidity risk is managed on a group basis by Santander UK plc

Business Review – Summary

The results discussed below are not necessarily indicative of Alliance & Leicester's results in future periods The following information contains certain forward-looking statements See 'Forward-Looking Statements' on page 3 The following discussion is based on, and should be read in conjunction with the Consolidated Financial Statements elsewhere in this Annual Report and Accounts

Executive Summary

Alliance & Leicester has prepared this Business and Financial Review in a manner consistent with the way management views the business as a whole As a result, Alliance & Leicester presents the following key sections to the Business and Financial Review

> **Business Review Summary** – this contains an explanation of the basis of Alliance & Leicester's results and any potential changes to that basis in the future, a summarised consolidated statutory Income Statement with commentary, a summary of the nature of adjustments between Alliance & Leicester's statutory basis of accounting (as described in the Accounting Policies section on pages 54 to 67) and Alliance & Leicester's management basis of accounting (known as the 'trading' basis) and a description of key performance indicator arrangements,

> **Personal Financial Services** – this contains a supplementary summary of the results, and commentary thereon, by Income Statement line item on a trading basis for each segment Additional information is provided for the Retail Banking segment due to its significance to the Group's results, and

> **Other Material Items** – this contains information about the statutory to trading basis adjustments

Basis of results presentation

The Group's business is managed and reported on the basis of the following segments

> Retail Banking,

> Corporate Banking,

> Private Banking, and

> Group Infrastructure

In 2009, the off-shore deposit-taking company was managed and reported separately from the rest of the Retail Banking businesses and renamed Private Banking The segmental analysis of the Group's results for 2008 has been amended to reflect this change In addition, in 2009, the Group's transfer pricing arrangements were updated to reflect the greater benefit of retail deposits in a period of higher funding costs The prior year's segmental analysis has been adjusted for consistency

Critical Factors Affecting Results

Critical accounting policies and areas of significant management judgement

The preparation of Alliance & Leicester's Consolidated Financial Statements requires management to make estimates and judgements that affect the reported amount of assets and liabilities at the date of the Consolidated Financial Statements and the reported amount of income and expenses during the reporting period Management evaluates its estimates and judgements on an ongoing basis Management bases its estimates and judgements on historical experience and on other factors that are believed to be reasonable under the circumstances Actual results may differ from these estimates under different assumptions or conditions Estimates and judgements that are considered important to the portrayal of Alliance & Leicester's financial condition including, where applicable, quantifications of the effects of reasonably possible ranges of such estimates and judgements, are set out in the Accounting Policies in the Consolidated Financial Statements

Impact of the current credit environment

Further information about the impact of the current credit environment is contained in the Risk Management Report on page 29, in addition to the information relating to the valuation of financial instruments included in the Group's critical accounting policies disclosures referred to above

Current and future accounting developments under IFRS

Details can be found in the Accounting Policies on page 54 of the Consolidated Financial Statements

Group Summary

On 9 January 2009, in order to optimise the capital, liquidity funding and overall financial efficiency of the enlarged Santander group, Banco Santander, S A transferred all of its Alliance & Leicester plc shares to Santander UK plc in exchange for Santander UK plc newly issued ordinary shares Accordingly, Santander UK plc is now the immediate parent company of Alliance & Leicester plc

On 25 February 2010 it was announced that the Company intends to transfer its business into Santander UK plc later this year under a scheme allowed by Part VII of the Financial Services and Markets Act 2000 This transfer is subject to UK Financial Services Authority support and Court approval The transfer will provide benefits for the Company's customers and for Santander UK plc For Alliance & Leicester customers this includes access to Santander UK's full product range plus use of over 1,300 branches, four times as many branches currently available for Alliance & Leicester customers By rationalising systems and improving the sales and risk management processes through having a single view of customers' dealings, Santander UK plc will also benefit from the significant synergies that were announced to the market at the time of the acquisition of Alliance & Leicester plc by Banco Santander, S A in 2008

Business Review – Summary continued

Summarised consolidated statutory income statement

	2009 £m	2008 £m
Net interest income	**762**	384
Non-interest income	**451**	440
Total operating income	**1,213**	824
Administration expenses	**(606)**	(927)
Depreciation and amortisation	**(121)**	(114)
Total operating expenses excluding provisions and charges	**(727)**	(1,041)
Impairment losses on loans and advances	**(348)**	(1,033)
Provisions for other liabilities and charges	**(81)**	(38)
Total operating provisions and charges	**(429)**	(1,071)
Profit/(loss) before tax	**57**	(1,288)
Taxation credit	**3**	370
Profit/(loss) for the year	**60**	(918)

2009 compared to 2008

Profit before tax of £57m compares to a loss of £1,288m in 2008 Material movements by line include

> Net interest income of £762m compared to £384m in 2008 increased by £378m reflecting a broadly stable customer asset base, with stronger growth in both retail and corporate deposits Lending-related income, particularly mortgages, benefitted from wider margins given the lower interest rates and the sustained improvement in new business margins as well as increased standard variable rate balances Deposit-related income was boosted by growth in balances, notably bank account liability balances, and hedging strategies to protect against low interest rates, partially offset by competition Corporate Banking related income grew slightly, with run-down balances more than offset by lending to UK SME's, up 16% 2009 also benefitted from the removal of expensive strategic funding established by Alliance & Leicester during the liquidity crisis and before the acquisition by Banco Santander, S A

> Non-interest income of £451m compared to £440m in 2008 increased by £11m, mainly due to the non-recurrence of adverse mark-to-market volatility in 2008 pre-acquisition This was partly offset by lower fees on unsecured lending products, as part of our stated strategy to reduce unsecured lending exposures, and lower fees from current accounts In addition, mortgage fees were adversely impacted by a reduction in the volume of mortgage redemptions given decreased activity in the market as a result of declining house prices and lower levels of supply

> Administration expenses of £606m compared to £927m in 2008 decreased by £321m This was mainly due to the non-recurrence in 2009 of write-offs in 2008 of the development costs previously capitalised relating to a new banking IT platform which was not put in place following the Company's acquisition by Banco Santander, S A , and redundancy costs related to plans initiated in the final quarter of 2008 The remaining administrative expenses decrease was largely due to the removal of duplications across back office and support functions due to the integration of the Group with Santander UK plc

> Depreciation and amortisation of £121m compared to £114m in 2008 increased by £7m, as a result of growing our business lending to small and medium sized enterprises (SMEs)

> Impairment losses on loans and advances of £348m compared to £1,033m in 2008 decreased by £685m, mainly due to a significant reduction in impairment losses on the Group's treasury asset portfolio However, this was partly offset by increases in impairment charges across retail products with the largest increase relating to mortgages, as the impact of falling house prices and the lagged effect of unemployment, as anticipated, started to emerge Most of the impact came through in the first half of the year, with the second half performance stabilising and in some areas improving

> Provisions for other liabilities and charges were £81m in 2009 (2008 £38m), and principally related to claims for misselling of Payment Protection Insurance (PPI) products prior to Banco Santander, S A 's acquisition of Alliance & Leicester

Adjustments between the statutory basis and the trading basis

Alliance & Leicester plc's Board reviews discrete financial information for each of its segments that includes measures of operating results and assets The segments are managed primarily on the basis of their results, which are measured on a 'trading' basis The trading basis differs from the statutory basis as a result of the application of various adjustments, as presented below

Management considers that the trading basis provides the most appropriate way of reviewing the performance of the business The adjustments are

> **Reorganisation and other items** – These comprise implementation costs in relation to the integration of Alliance & Leicester into Santander UK plc, as well as certain remediation administration expenses, credit provisions and other one-off items Management needs to understand the underlying drivers of the cost base that will remain after these exercises are complete, and does not want this view to be clouded by these costs, which are managed independently

> **Depreciation of operating lease assets** – The operating lease businesses are managed as financing businesses and, therefore, management needs to see the margin earned on the businesses Residual value risk is separately managed As a result, the depreciation is netted against the related income

> **Hedging and other variances** – The Balance Sheet and Income Statement are subject to mark-to-market volatility including that arising from the accounting for elements of derivatives deemed under IFRS to be ineffective as hedges Where appropriate, such volatility is separately identified to enable management to view the underlying performance of the business

> **Treasury asset portfolio** – This portfolio is managed separately as a run-down portfolio

> **Capital and other charges** – These principally comprise internal nominal charges for capital invested in the Group's businesses Management implemented this charge with effect from 2009 to assess the effectiveness of capital investments

For a detailed explanation of these items, see 'Other Material Items' in the Business and Financial Review

Key performance indicators

Following the transfer of the Company by Banco Santander, S A to Santander UK plc in January 2009, key performance indicators are set at the Santander UK level, rather than separately for the Group Detailed information on the key performance indicators of Santander UK, of which Alliance & Leicester is a part, is set out in the Business Review – Summary in the Santander UK plc 2009 Annual Report, which is available on the Santander UK corporate website (www aboutsantander co uk)

Business Review – Personal Financial Services

This section contains a summary of the results, and commentary thereon, by Income Statement line item on a trading basis for each segment within the Group, together with reconciliations from the trading basis to the statutory basis Additional information is provided on the adjustments between the trading basis and the statutory basis in the Business Review – Other Material Items

Profit/(loss) before tax by segment

31 December 2009	Retail Banking £m	Corporate Banking £m	Private Banking £m	Group Infrastructure £m	Total £m
Net interest income/(expense)	835	162	8	(177)	828
Non-interest income/(expense)	179	110	1	(30)	260
Total trading income/(expense)	1,014	272	9	(207)	1,088
Total trading expenses	(331)	(141)	(5)	(23)	(500)
Impairment losses on loans and advances	(143)	(4)	-	(57)	(204)
Trading profit/(loss) before tax	540	127	4	(287)	384
Adjust for					
– Reorganisation and other items	(66)	(85)	-	(14)	(165)
– Hedging and other variances	-	-	-	57	57
– Treasury asset portfolio	-	-	-	(219)	(219)
– Capital and other charges	(75)	(70)	-	145	-
Profit/(loss) before tax	399	(28)	4	(318)	57

31 December 2008	Retail Banking £m	Corporate Banking £m	Private Banking £m	Group Infrastructure £m	Total £m
Net interest income/(expense)	592	147	10	(132)	617
Non-interest income/(expense)	211	131	2	(14)	330
Total trading income/(expense)	803	278	12	(146)	947
Total trading expenses	(370)	(194)	(4)	(32)	(600)
Impairment losses on loans and advances	(133)	(50)	-	-	(183)
Trading profit/(loss) before tax	300	34	8	(178)	164
Adjust for					
– Reorganisation and other items	(366)	(202)	-	(321)	(889)
– Hedging and other variances	-	-	-	(78)	(78)
– Treasury asset portfolio	-	-	-	(485)	(485)
Loss/(profit) before tax	(66)	(168)	8	(1,062)	(1,288)

2009 compared to 2008

> Personal Financial Services trading profit before tax of £384m increased by £220m on the previous year (2008 £164m) driven by strong income growth across all businesses (up 15%) which exceeded the increase in impairment losses, as well as continued cost control resulting in a £100m reduction in expenses

> Retail Banking trading profit before tax increased by £240m to £540m (2008 £300m) Trading income benefited from a significant improvement in mortgage margins both in terms of new lending and retention of existing business, as well as increased retention levels on standard variable rate and other longer term products In addition, the Retail Banking business delivered strong growth in customer deposits, together with effective management of deposit margins in a low interest rate environment There was also a significant increase in bank account openings and investment product sales These positive income trends were partly offset by lower fee income from current accounts, a reduction in the volume of mortgage redemptions and lower unsecured lending volumes Trading expenses decreased, largely due to the removal of duplications across back office and support functions due to the integration with Santander UK plc, whilst impairment losses were broadly flat

> Corporate Banking trading profit before tax increased by £93m to £127m (2008 £34m) This movement was largely due to lower operating expenses benefiting from integration synergies and lower impairment losses

> Private Banking trading profit before tax decreased by £4m to £4m (2008 £8m) reflecting some margin pressures given the competitive market environment

> Group Infrastructure trading loss before tax increased by £109m to £(287)m (2008 £(178)m) reflecting reduced strategic funding costs more than offset by a lower return on liquid assets, and changes to transfer pricing arrangements to reflect current market conditions that benefited the operating business units

Business Review – Personal Financial Services continued

Trading net interest income by segment

	2009 £m	2008 £m
Retail Banking	**835**	592
Corporate Banking	**162**	147
Private Banking	**8**	10
Group Infrastructure	**(177)**	(132)
Trading net interest income	**828**	617
Adjust for		
- Reorganisation and other items	**50**	(269)
- Hedging and other variances	**43**	36
- Treasury asset portfolio	**(159)**	-
Net interest income	**762**	384

2009 compared to 2008

Retail Banking net interest income increased by £243m to £835m (2008 £592m), largely driven by balanced growth in customer lending and deposits across a mix of products combined with effective margin management, as well as hedging strategies which helped to offset the impact of lower interest rates In addition, income from existing mortgage balances increased as more customers reverted to standard variable rate, and margins improved in both the mortgage and unsecured loan portfolios

Corporate Banking net interest income increased by £15m to £162m (2008 £147m) with the impact of certain lending portfolios being run down more than offset by lending to SMEs, and higher asset margins as new business lending and pricing was altered to reflect the market environment in terms of funding cost and competitors' de-leveraging In addition, liabilities grew significantly, improving income.

Private Banking net interest income decreased by £2m to £8m (2008 £10m) due to competitive pressures

Group Infrastructure net interest expense increased by £45m to £177m (2008 £132m) reflecting lower strategic funding costs more than offset by a lower return on liquid assets and changes to transfer pricing arrangements to reflect current market conditions that benefited the operating business units

Trading non-interest income by segment

	2009 £m	2008 £m
Retail Banking	**179**	211
Corporate Banking	**110**	131
Private Banking	**1**	2
Group Infrastructure	**(30)**	(14)
Trading non-interest income	**260**	330
Adjust for		
– Reorganisation and other items	**104**	158
– Depreciation of operating lease assets	**73**	66
– Hedging and other variances	**14**	(114)
Non-interest income	**451**	440

2009 compared to 2008

Retail Banking trading non-interest income decreased by £32m to £179m (2008 £211m), largely due to lower fees on unsecured lending products, as part of our stated strategy to reduce unsecured lending exposures, and lower fees from current accounts In addition, mortgage fees were adversely impacted by a reduction in the volume of mortgage redemptions given decreased activity in the market as a result of declining house prices and lower levels of supply

Corporate Banking non-interest income decreased by £21m to £110m (2008 £131m), reflecting lower money transmission fees

Private Banking non-interest income decreased by £1m to £1m (2008 £2m), principally due to lower annual, transaction and new business fees

Group Infrastructure non-interest expense increased slightly to £30m (2008 £14m) principally due to the non-recurrence in 2009 of gains on the buy-back of debt securities in 2008

Total trading expenses by segment

	2009 £m	2008 £m
Retail Banking	**331**	370
Corporate Banking	**141**	194
Private Banking	**5**	4
Group Infrastructure	**23**	32
Total trading expenses	**500**	600
Adjust for		
– Reorganisation and other items	**154**	375
– Depreciation of operating lease assets	**73**	66
Expenses	**727**	1,041

Business Review – Personal Financial Services continued

2009 compared to 2008

Total trading expenses of £500m were £100m lower than the previous year (2008 £600m), largely due to savings across each business segment resulting from integration initiatives post the acquisition by Santander UK plc

Trading impairment losses on loans and advances by segment

	2009 £m	2008 £m
Retail Banking	**143**	133
Corporate Banking	**4**	50
Group Infrastructure	**57**	-
Trading impairment losses on loans and advances	**204**	183
Adjust for		
– Reorganisation and other items	**84**	365
– Treasury asset portfolio	**60**	485
Impairment losses on loans and advances	**348**	1,033

2009 compared to 2008

Trading impairment losses on loans and advances increased by £21m to £204m (2008 £183m) as general economic conditions continued to deteriorate

Retail Banking trading impairment losses on loans and advances increased by £10m to £143m (2008 £133m) and are distributed across all products, with the largest increase relating to mortgages as the impact of falling house prices and the lagged effect of unemployment, as anticipated, started to emerge Most of the impact came through in the first half of the year, with the second half performance stabilising and in some areas improving With respect to mortgages, the second half of the year saw a slower rate of growth in arrears, with fewer losses than observed earlier in the year, in part as a result of collection activities and mitigating actions taken, but also due to the low interest rate environment and the slight upturn in house prices The improvement in performance across all portfolios in the second half of the year exceeded set expectations

Corporate Banking trading impairment losses on loans and advances decreased by £46m to £4m (2008 £50m) The low level of impairment losses is a reflection of the prudent lending criteria with respect to the growth businesses and provisions made by Santander on acquisition with respect to the non-growth portfolios to reflect expected losses in those portfolios as required under acquisition accounting being treated as non-trading

Group Infrastructure trading impairment losses on loans and advances increased by £57m to £57m (2008 £nil) reflecting additional losses on the treasury asset portfolio offset within net interest income

Non-performing loans

	2009 £m	2008 £m
Total non-performing loans ('NPLs')	**996**	873
Total loans and advances to customers	**50,022**	51,147
Total provisions (on a statutory basis)	**653**	582
NPLs as a % of loans and advances	**1 99%**	1 71%
Provisions as a % of NPLs	**66%**	67%

In 2009, the value of non-performing loans increased to £996m (2008 £873m) and non-performing loans as a percentage of loans and advances increased to 1 99% (2008 1 71%) The non-performing loan ratio increased due to rising secured (residential and commercial properties) and corporate arrears reflecting continued market deterioration The overall coverage was broadly flat

Trading provisions for other liabilities and charges by segment

	2009 £m	2008 £m
Private Banking	-	
Trading provisions for other liabilities and charges	-	-
Adjust for		
- Reorganisation and other costs	**81**	38
Provisions for other liabilities and charges	**81**	38

2009 compared to 2008

In 2009 and 2008 there were no net trading provisions for other liabilities and charges

Other Material Items

Adjustments between the statutory basis and the trading basis

Alliance & Leicester plc's Board reviews discrete financial information for each of its segments that includes measures of operating results and assets, which are measured on a 'trading' basis The trading basis differs from the statutory basis as a result of the application of various adjustments, as presented below, and described in the Business Review – Summary on page 9 Management considers that the trading basis provides the most appropriate way of reviewing the performance of the business Management reviews the Group's performance on a basis consistent with its presentation at the Santander UK level Therefore those items that either eliminate, or are treated as non-trading, at the Santander UK level are treated as non-trading by the Group

The trading adjustments consist of

Reorganisation and other items

	2009 £m	2008 £m
Cost reduction programme	64	62
Credit provisions	84	365
Misselling remediation and administration costs	66	47
Adjustment of mortgage effective interest rate assumptions	-	187
Acquisition costs and other one-off items	(49)	228
	165	889

These comprise implementation costs in relation to the integration of Alliance & Leicester into Santander UK plc, as well as certain remediation administration expenses, credit provisions and other one-off items

Following the acquisition by Banco Santander S A a further cost reduction programme is now taking place The level of costs is consistent with the prior year

The amount of credit provisions included as non-trading of £84m in 2009 represents the provisions made by Banco Santander S A on acquisition with respect to the non-growth portfolios to reflect expected losses in those portfolios as required under acquisition accounting The amount of credit provisions included as non trading of £365m in 2008 represented refinements to accounting estimates reflecting the state of the UK economy and were in line with expectations at the time of the acquisition by Banco Santander S A

Misselling remediation and administration costs mainly relate to a provision for the misselling of payment protection insurance on unsecured personal loans

In 2008, the mortgage effective interest rate assumptions were adjusted, reflecting the change in approach to the management of the mortgage portfolio going forward, resulting in a £187m reduction in net interest income

The credit in 2009 with respect to acquisition and other one-off items represents the write-back of unclaimed shares from the original conversion of the Company from a building society to a bank in 1997 which under the articles of association can no longer be claimed In 2008, acquisition costs were mainly the write down of intangible assets, largely relating to software, that had no future value, and capitalised funding costs written off as funding transactions were terminated following funding being provided by Santander UK

Hedging and other variances

	2009 £m	2008 £m
Hedging and other variances	(57)	78

The Balance Sheet and Income Statement are subject to a certain amount of mark-to-market volatility including from the accounting for elements of derivatives deemed under IFRS to be ineffective as hedges In 2009, the credit of £57m consists of preference share dividends of £51m which are treated as interest expense on a trading basis together with some mark to market volatility In 2008, the impact of volatility was a charge of £78m, which was mainly due to mark-to-market losses on treasury assets including structured investment vehicles, due to widening asset spreads

Treasury asset portfolio

	2009 £m	2008 £m
Treasury asset portfolio	219	485

The loss in the year principally represents the unwind of the available-for-sale securities reserve In the wider Santander UK group's consolidated statutory results, this loss was recognised on acquisition In 2008, the Group incurred significant losses on its treasury asset portfolio This portfolio is managed separately as a run-down portfolio

During 2009, there was an £180m of unwind of the available-for-sale reserve Of this amount, £21m has been shown as impairment losses as it related to assets sold, with the balance included in net interest income There was a further £39m of impairment losses recognised on the consolidation of the assets of the Group's Conduit vehicles, as described in 'Exposure to Off-Balance Sheet Entities sponsored by the Group' in the Risk Management Report on page 36

In 2008 there were impairment losses of £485m These largely arose on structured investment vehicles and some bank floating rate notes For more information see the Risk Management Report on pages 29 to 37 In addition, in 2008 the Group elected to apply the amendment to IAS 39 regarding the reclassification of financial assets out of 'fair value through profit & loss' and 'available-for-sale' categories into 'loans & receivables' For further information, see Note 18 to the Consolidated Financial Statements Any impairments relating to these assets is included above

Other Material Items continued

Capital and other charges

Capital charges principally comprise internal nominal charges for capital invested in the Group's businesses Management implemented this charge to assess if capital is invested effectively On a consolidated basis, the total of these internal reallocations is £nil

Legal proceedings

Alliance & Leicester is party to various legal proceedings in the ordinary course of business, the ultimate resolution of which is not expected to have a material adverse effect on the financial position or the results of operations of Alliance & Leicester See Note 33 to the Consolidated Financial Statements

Audit fees

See Note 7 to the Consolidated Financial Statements

Risk Management

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

Summary

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

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

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

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

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

- **Risks in Retail Banking** – The risks in this segment are described on pages 22 to 26, comprising
  - **Credit risk**, including its management, an analysis of types and credit quality of retail lending and disclosures relating to provisioning, arrears and recoveries
  - **Market risk**, including its management

- **Risks in Corporate Banking** – The risks in this segment are described on pages 26 to 28, comprising
  - **Credit risk**, including its management and mitigation
  - **Market risk**, including its management

- **Risks in Private Banking** – The risks in this segment are described on page 28, comprising a description of credit risk and market risk in the entities which this segment incorporates

- **Risks in Group Infrastructure** – The risks in this segment are described on pages 28 to 29, comprising
  - **Credit risk**, including its management and mitigation
  - **Market risk**, including its management

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

Introduction

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

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

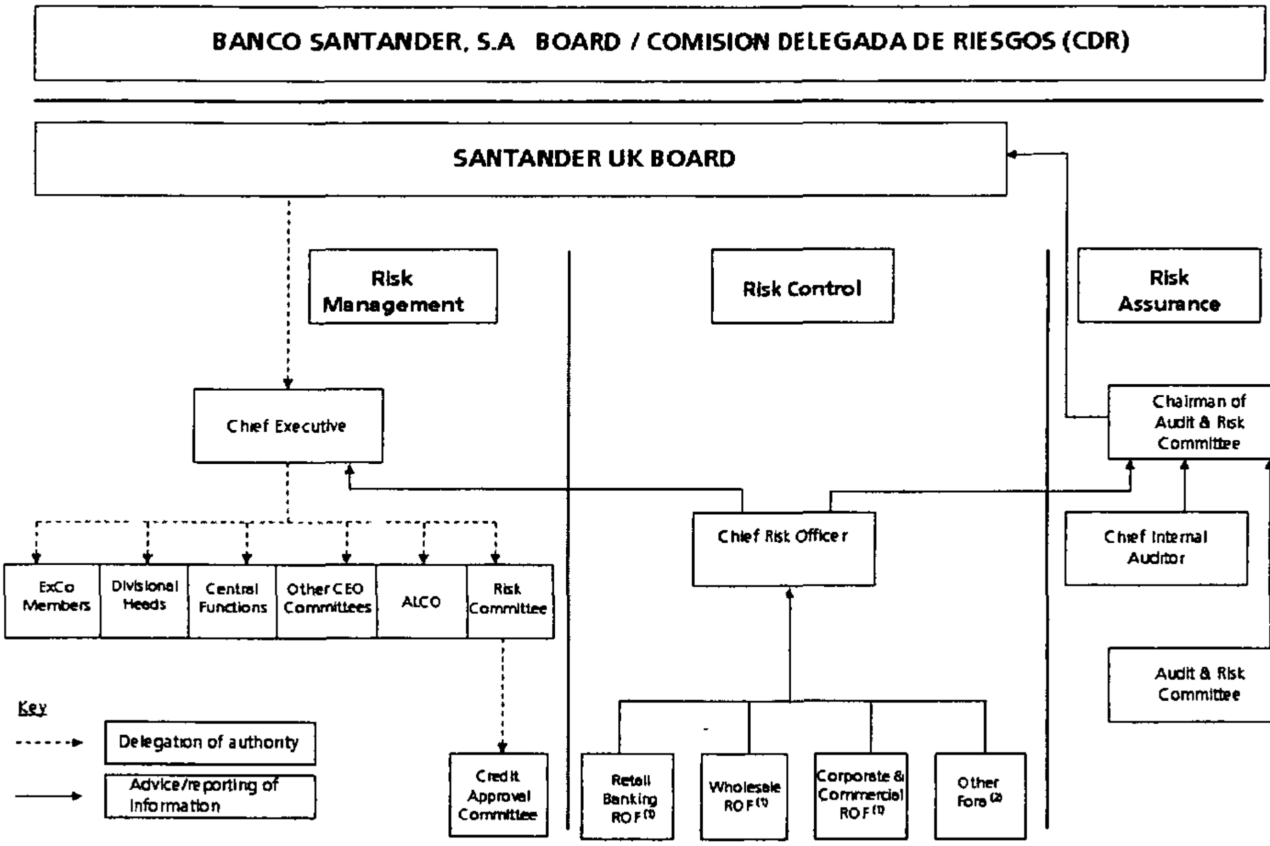
Understanding and controlling risk in a business is critical for the effective management of the business Santander UK's Risk Framework ensures that risk is managed and controlled on behalf of shareholders, customers, depositors, employees and the Group's regulators Effective and efficient risk governance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

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

Risk Management continued

Risk Governance Framework

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



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

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

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

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

First tier of risk governance in Santander UK

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

Risk Committee

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

Second tier of risk governance in Santander UK

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

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

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

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

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

Third tier of risk governance in Santander UK

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

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

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

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

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

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

Financial Risks and Risk Management

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

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

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

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

Risk Management continued

Financial Instruments

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

Operational Risk – Group-wide (unaudited)

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

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

Managing operational risk (unaudited)

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

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

Key operational risk activity in 2009 (unaudited)

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

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

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

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

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

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

Credit Risk – Group-wide

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

Significant concentrations of credit risk

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

> the residential mortgage portfolio and unsecured personal lending businesses in Retail Banking,

> secured lending and derivatives exposures to companies in Corporate Banking, and

> the portfolio of assets in Group Infrastructure inconsistent with the Group's future strategy such as the Treasury asset portfolio

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

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

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

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

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

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

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

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

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

Risk Management continued

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

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

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

Market risk – Group-wide

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

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

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

Pension obligation risk – Group-wide

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

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

Liquidity risk – Group wide

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

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

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

Maturities of financial liabilities

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

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

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

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

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

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

Risk Management continued

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

Current market conditions

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

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

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

Risk Management in Retail Banking

Credit risk in Retail Banking

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

Managing credit risk

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

Residential mortgages and secured lending

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

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

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

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

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

Mortgage credit quality[1]

	2009	2008
Loan-to-value analysis		
New business		
< 75%	**82%**	62%
75% - 90%	**18%**	36%
> 90%	**-**	2%
	100%	100%
Average loan-to-value of new business (at inception)	**60%**	63%
Average loan-to-value of stock	**51%**	49%
Borrower profile		
New business		
First-time buyers	**16%**	21%
Home movers	**45%**	48%
Remortgages	**39%**	31%
	100%	100%
Average earnings multiple (at inception)	**2.8**	3 1

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

Loan-to-value analysis

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

> Arrears more than 90 days past due have increased from 0 84% in December 2008 to 1 00% at the end of 2009 In the same period, industry arrears more than 90 days past due, as published by the UK Council of Mortgage Lenders have increased from 1 88% to 2 38%

> Completions in excess of 75% LTV have fallen from 38% in 2008 to 18% in 2009

Mortgage arrears and repossessions

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

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

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

Mortgage arrears	Group[1] (Percentage of total mortgage loans by number)	CML[2] (unaudited)
31 to 60 days in arrears		
31 December 2008	0 76	-
31 December 2009	**0 54**	**-**
61 to 90 days in arrears		
31 December 2008	0 37	-
31 December 2009	**0.28**	**-**
3 to 5 months in arrears		
31 December 2008	0 47	1 01
31 December 2009	**0.42**	**0 97**
6 to 11 months in arrears		
31 December 2008	0 26	0 62
31 December 2009	**0.30**	**0 81**
12 months or more in arrears		
31 December 2008	0 10	0 25
31 December 2009	**0.28**	**0 60**

(1) Group data is not readily available for arrears less than 31 days
(2) Council of Mortgage Lenders data is not available for arrears less than 3 months

Risk Management continued

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

Properties in possession	Group	CML (unaudited)
	(Percentage of total mortgage loans by number)	
31 December 2008	0 03	0 21
31 December 2009	**0 02**	**0 14**

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

Restructured loans

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

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

Unsecured personal loan arrears

	2009 £m	2008 £m
Total unsecured personal loan arrears[1,2]	**81**	213
Total unsecured personal loan asset	**2,294**	3,534
Unsecured personal loan arrears as a % of asset	**3.53**	6 03

(1) Unsecured personal loans include current account customers
(2) Unsecured personal loans are defined as the balances of accounts that are three or more months in arrears (> 4 instalments)

Provisions on loans and advances to customers

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

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

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

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

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

Retail Banking analysis of provisions on loans and advances to customers

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

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

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

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

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

Retail Banking recoveries

An analysis of the Retail Banking recoveries is presented below

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

Risk Management continued

Retail Banking non-performing loans and advances[1]

	2009 £m	2008 £m
Non-performing loans and advances that are impaired	**178**	186
Non-performing loans and advances that are not impaired	**295**	344
Total non-performing loans and advances[2]	**473**	530
Non-performing loans and advances as a percentage of loans and advances to customers[3]	**1 18%**	1 29%
Provision as a percentage of total non-performing loans and advances	**48 97%**	56 2%

(1) Loans and advances are classified as non-performing typically when the counterparty fails to make payments when contractually due for three months or longer
(2) All non-performing loans are UK
(3) Loans and advances to customers exclude finance leases

In 2009, non-performing loans and advances as a percentage of loans and advances to customers (excluding finance leases) was 1 18% This reflects the impact of the deteriorating market environment on the performance of the unsecured personal loan and residential mortgage portfolio and a refinement in accounting estimates

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

Market risk in Retail Banking

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

Risk Management in Corporate Banking

Credit risk in Corporate Banking

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

Managing credit risk

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

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

Credit risk on derivative instruments is calculated using the potential future mark-to-market exposure of the instruments at a 97 5% (95% prior to acquisition) statistical confidence level and adding this value to the current value The resulting "loan equivalent" or credit risk is then included against credit limits, along with other non-derivative exposures In addition, there is a policy framework to enable the collateralisation of derivative instruments including swaps If collateral is deemed necessary to reduce credit risk, any unsecured risk threshold, and the nature of any collateral to be accepted, is determined by management's credit evaluation of the counterparty

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

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

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

Corporate Banking recoveries

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

Corporate Banking arrears

	2009 £m	2008 £m
Total Corporate lending arrears	**410**	89
Total Corporate lending assets	**9,224**	9,948
Corporate lending arrears as a % of asset	**4.4%**	0 89%

Corporate Banking non-performing loans and advances[1]

	2009 £m	2008 £m
Non-performing loans and advances that are impaired	**173**	343
Non-performing loans and advances that are not impaired	**338**	-
Total non-performing loans and advances[2]	**511**	343
Non-performing loans and advances as a percentage of loans and advances to customers[3]	**5 54%**	3 45%
Provision as a percentage of total non-performing loans and advances	**51%**	83%

(1) Loans and advances are classified as non-performing typically when the counterparty fails to make payments when contractually due for three months or longer
(2) All non-performing loans are UK
(3) Loans and advances to customers exclude finance leases

In 2009, non-performing loans and advances as a percentage of loans and advances to customers (excluding finance leases) increased to 5 54% This reflects the impact of the continued deteriorating market condition on the performance of the corporate and real estate portfolio In 2008, non-performing loans and advances as a percentage of loans and advances (excluding finance leases) to customers increased to 3 45% from 0 12% in 2007 This reflected the impact of deteriorating market condition on the performance of the corporate and real estate portfolio Interest income recognised on impaired loans amounted to £1m (2008 £2m)

Credit risk mitigation

Collateralisation

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

Restructured loans

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

Risk Management continued

Market risk in Corporate Banking

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

Risk Management in Private Banking

Credit risk in Private Banking

Alliance & Leicester International

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

Market risk in Private Banking

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

Managing market risk

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

Risk Management in Group Infrastructure

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

Credit risk in Group Infrastructure

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

Managing credit risk

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

Market risk in Group Infrastructure

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

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

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

Impact of the Current Credit Environment

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

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

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

Classification in the Consolidated Balance Sheet

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

2009		Type of Financial Instrument analysed further						OECD Govt	
Balance sheet line item	Note	FRN	ABS	CDO	CLO	Other	Sub-total	debts	Total
		£m	£m	£m	£m	£m	£m	£m	£m
Financial assets designated at fair value – debt securities	13	-	-	50	-	-	50	-	50
Available for sale – debt securities	17	-	-	-	-	-	-	3	3
Loans and receivables securities	18	6,749	2,336	80	639	24	9,828	-	9,828
		6,749	2,336	130	639	24	9,878	3	9,881

2008		Type of Financial Instrument analysed further						OECD Govt	
Balance sheet line item	Note	FRN	ABS	CDO	CLO	Other	Sub-total	debts	Total
		£m	£m	£m	£m	£m	£m	£m	£m
Financial assets designated at fair value – debt securities	13	-	63	-	-	-	63	-	63
Available for sale – debt securities	17	-	-	-	-	-	-	1,648	1,648
Loans and receivables securities	18	9,933	3,653	164	321	179	14,250	-	14,250
		9,933	3,716	164	321	179	14,313	1,648	15,961

Summary

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

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

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

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

Risk Management continued

Fair value of debt securities by credit rating of the issuer or counterparty[1]

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

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

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

Floating Rate Notes

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

2009

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

2008

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

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

2009

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

2008

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

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

Asset-Backed Securities

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

2009

	Nominal value		Book value	Fair value	Fair value as % of nominal	2009 movement Income statement	Reserves	Other
Country	£m	%	£m	£m	%	£m	£m	£m
UK								
ABS	142	5	141	140	99	-	-	-
MBS	727	29	693	606	83	(7)	(28)	-
	869	34	834	746	86	(7)	(28)	-
US								
ABS	553	22	506	483	87	(8)	(37)	-
MBS	269	11	195	125	46	(8)	(29)	(9)
	822	33	701	608	74	(16)	(66)	(9)
Rest of Europe								
ABS	68	3	61	56	82	-	(2)	(6)
MBS	622	24	591	520	84	(6)	(20)	-
	690	27	652	576	83	(6)	(22)	(6)
Rest of the World								
MBS	152	6	149	139	91	(1)	(2)	-
Total	2,533	100	2336	2,069	82	(30)	(118)	(15)

2008

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

Risk Management continued

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

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

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

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

2008

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

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

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

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

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

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

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

Monoline Insurers

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

Risk Management continued

Collateralised Debt Obligations

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

2009

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

2008

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

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

2009

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

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

2009

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

2008

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

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

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

Collateralised Loan Obligations

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

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

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

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

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

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

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

Risk Management continued

2008

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

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

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

Other investments

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

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

Exposure to Off-Balance Sheet Entities sponsored by the Group

Secured Loan to Conduit

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

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

As at 31 December 2008

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

Lending Activities

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

Directors

Board of Directors
As at 31 December 2009

Chairman

Lord Burns

Lord Burns (age 66) was appointed Chairman on 12 October 2008 He is also Chairman of Santander UK plc, Channel 4 Television Corporation and Glas Cymru Cyfyngedig (Welsh Water) and a Non-Executive Director of Pearson plc and Banco Santander, S A His current professional roles include President of the Society of Business Economists, Fellow of the London Business School, Companion of the Institute of Management, President of the National Institute of Economic and Social Research and Vice President of the Royal Economic Society He was formerly Permanent Secretary to the Treasury and chaired the Parliamentary Financial Services and Markets Bill Joint Committee He was a Non-Executive Director of British Land plc (2000-2005) and Legal & General Group plc (1991-2001) He was also Chairman of the National Lottery Commission (2000-2001) and Marks and Spencer Group plc (2006-2008)

Executive Directors

António Horta-Osório
Chief Executive

António Horta-Osório (age 46) was appointed Chief Executive on 12 October 2008 He was a Non-Executive Director of Santander UK plc from 1 December 2004 until his appointment as Chief Executive in August 2006 He joined Santander UK plc from Banco Santander Totta in Portugal where he was Chief Executive Officer since 1999 He is also Executive Vice President of Banco Santander, S A and a member of its management committee as well as Non-Executive Chairman of Banco Santander Totta and a Non-Executive Director to the Court of The Bank of England He was previously Chief Executive Officer of Banco Santander Brasil (1996-1999) António started his career at Citibank Portugal, where he was head of Capital Markets and at the same time was an assistant professor at the Universidade Católica Portuguesa He then worked for Goldman Sachs in New York and London, focusing on corporate finance activities in Portugal and, in 1993, joined the Santander group as Chief Executive Officer of Banco Santander de Negócios Portugal He is a graduate in Management and Business Administration at Universidade Católica Portuguesa, has an MBA from INSEAD, where he was awarded the Henry Ford II Prize, and an AMP from Harvard Business School

Antonio Lorenzo
Chief Financial Officer

Antonio Lorenzo (age 43) was appointed as an Executive Director and Chief Finance Officer on 1 June 2009 He is also an Executive Director of Santander UK plc and his additional responsibilities include heading up the Private Banking division and the Intermediary division Antonio first joined the Banco Santander, S A group as a Financial Controller of the Global Wholesale division (Spain) in 1998 In 2003, Antonio moved to Chile to head Latam and Global Wholesale Banking MI division Before he joined the Santander group, Antonio worked at Arthur Andersen (Spain) He was part of the Financial Services Audit Team and was an advisor in the Treasury and Capital Markets area At that time he taught Auditing at the European University of Madrid He is a member of the official Registry of Auditors of Spain and holds two Bachelors degrees, in Economics (Universidad Complutense de Madrid) and Law (UNED)

Juan Colombás
Chief Risk Officer

Juan Colombás (age 47) was appointed as an Executive Director on 31 July 2009 and is responsible for the Risk division He is also an Executive Director of Santander UK plc, having joined in 2006 as Chief Risk Officer Juan has over 23 years of experience in a range of Risk, Control and Business Management roles across the Corporate Banking, Investment Banking, Retail Distribution and Risk Divisions of the Santander group Juan joined the Commercial Banking Division and Internal Audit Division of Banco Hispano Americano as a trainee in 1986 He graduated top of his class in BSc Industrial Chemical Engineering and has a Financial Management Degree and an MBA

Alison Brittain
Executive Director, Retail Distribution

Alison Brittain (age 45) was appointed as an Executive Director on 12 October 2008 and became responsible for Branch Distribution, Telephone Distribution, e-commerce, Business Banking and Commercial Mortgages on 16 January 2009 She is also an Executive Director of Santander UK plc and was previously Managing Director of the Barclays and Woolwich Retail Network and the Small Business Banking division of Barclays Bank plc

Non-Executive Directors

Juan Rodríguez Inciarte
Deputy Chairman
Juan Inciarte (age 57) was appointed Non-Executive Director on 12 October 2008 He joined Banco Santander, S A in 1985 After holding various positions, he was appointed to the Board of Directors in 1991, holding this office until 1999 He is currently a Board Member and Head of Strategy of Banco Santander, S A , a Director of Santander Consumer Finance, S A , Non-Executive Director of Santander UK plc, Director of ABN AMRO Holding N V and Director of RFS Holdings B V In addition, he is a director of Banco Banif S A and of Vista Capital de Expansion S A For several years he served on the Board of Directors of First Union Corporation (now Wachovia Bank) in the US, the Board of Directors and Executive Committee of San Paolo-IMI in Italy and the Boards of The Royal Bank of Scotland plc and National Westminster Bank plc (from 1998 – 2004) He also held the positions of Executive Director of NIBC Bank N V in the Netherlands (from 2005 – 2007), Director and Member of the Executive Committee of Sovereign Bancorp in the US (from 2006 – 2008) and Director of Compañía Española de Petróleos (from 1999 – 2009) He is also Chairman of the US-Spain Council and a Fellow of The Chartered Institute of Bankers in Scotland

Jane Barker
Jane Barker (age 60) was appointed Non-Executive Director in 2004 She is Chief Executive Officer of Equitas Limited, the company set up to re-insure and run-off the 1992 and prior years' non-life liabilities of Lloyd's of London syndicates and a Non-Executive Director of Santander UK plc She is Deputy Chairman of the Royal College of Music and was previously a member of the council and chair of the Audit Committee of the Open University Her previous roles have included being Finance Director of the London Stock Exchange

Roy Brown
Roy Brown (age 63) was appointed Non-Executive Deputy Chairman and Senior Independent Director in May 2007 Following the acquisition of the Company by Banco Santander, S A he became a Non-Executive Director on 12 October 2008 He is a Chartered Engineer and is Chairman of GKN plc and a Non-Executive Director of Santander UK plc Formerly, he was Senior Independent Director of HMV Group plc, Executive Director of Unilever plc and NV, a Non-Executive Director of Brambles Industries plc, the British United Provident Association Ltd (BUPA) and the Franchise Board of Lloyd's of London

José María Carballo
José María Carballo (age 66) was appointed Non-Executive Director on 12 October 2008 He is a Non-Executive Director of Santander UK plc, Chairman of La Unión Resinera Española, Chairman of Vista Desarrollo, Director of Vista Capital Expansion S A S G E C R , Director of Teleférico Pico del Teide S A and Director of Santander Banif Inmobiliario F I I He is also Vice President and Honorary Treasurer of the Iberoamerican Benevolent Society (UK) He was Executive Vice President of Banco Santander, S A from 1989-2001 and Chief Executive Officer of Banco Santander de Negocios from 1989 to 1993 Until 1989 he was Executive Vice President responsible for Europe at Banco Bilbao Vizcaya He was also Executive Vice President of Banco de Bilbao in New York until 1983

José María Fuster
José María Fuster (age 51) was appointed Non-Executive Director on 12 October 2008 He is Executive Vice President of Operations and Technology and Chief Information Officer of Banco Santander, S A , Non-Executive Director of Banesto and a Non-Executive Director of Santander UK plc He joined Banesto in 1998 and was appointed as Chief Information Officer of Banco Santander, S A in 2003 He started his professional career with International Business Machines, S A and Arthur Andersen as a consultant He has also worked for Citibank España S A and National Westminster Bank plc

Rosemary Thorne
Rosemary Thorne (age 58) was appointed Non-Executive Director on 12 October 2008 She is also a Non-Executive Director on the board of Smurfit Kappa Group plc and a Non-Executive Director of Santander UK plc She was Group Finance Director of Ladbrokes plc until April 2007, Non-Executive Director of Cadbury Schweppes plc until September 2007 and Senior Independent Director on the board of Virgin Radio Holdings Limited until June 2008 Previously, she was Group Financial Controller of Grand Metropolitan Public Limited Company (prior to its merger with Guinness plc to become Diageo plc) and spent almost eight years as the Group Finance Director of J Sainsbury plc She joined the board of Bradford & Bingley plc in 1999 as Group Finance Director, initially working on its demutualisation and flotation, resulting in a place in the FTSE 100 in December 2000 She remained in this role for a further five years She was a member of the Financial Reporting Council and Financial Reporting Review Panel for nine years and a member of The Hundred Group of Finance Directors Main Committee for 15 years

Keith Woodley
Keith Woodley (age 70) was appointed Non-Executive Director on 12 October 2008 He is also Non-Executive Director of Santander UK plc He is a former Non-Executive Director of National and Provincial Building Society and a former partner of Deloitte Haskins & Sells A past President of the Institute of Chartered Accountants in England and Wales, he is a Council Member and Pro-Chancellor of the University of Bath

Directors' Report

Corporate Structure

Alliance & Leicester plc (the 'Company') is a wholly owned-subsidiary of Santander UK plc (formerly Abbey National plc, together with its subsidiaries 'Santander UK') and the ordinary shares of the Company are not traded on the London Stock Exchange The Company and its subsidiaries are part of Banco Santander, S A (together with its subsidiaries, 'Santander') The Company is incorporated in England and has its registered office at Carlton Park, Narborough, Leicester LE19 0AL

Note 19 to the Consolidated Financial Statements provides a list of the principal subsidiaries of the Company and the nature of each subsidiary's business as well as details of branches

Corporate Governance

The Company is subject to the Listing Rules and the Disclosure & Transparency Rules of the UK Financial Services Authority, because it has preference shares listed on the London Stock Exchange As it does not have listed ordinary shares, the Company is exempt from the requirement to make certain disclosures that are normally part of the continuing obligations of listed companies in the UK This exemption applies, among other things, to corporate governance and certain Directors' remuneration disclosures

Principal Activities and Business Review

The principal activity of Alliance & Leicester plc, company number 3263713, and its subsidiaries (together 'Alliance & Leicester' or the 'Group') continues to be the provision of an extensive range of personal financial services In addition, Alliance & Leicester provides a wide range of banking and financial services to business and public sector customers The Company is authorised and regulated by the UK Financial Services Authority

The Company is required to set out in this report a fair view of the development and performance of the business of the Group during the year ended 31 December 2009 and of the position of the Group at the end of the year The information that fulfils this requirement can be found in the Chief Executive's Review on page 2 The Chief Executive's Review also contains a description of the likely future developments of the Group When reading the Chief Executive's Review, reference should be made to the Forward-looking Statements section on page 3

Further information on the development and performance of the business of the Group, both at a consolidated level and analysed by division can be found in the following sections:

> An analysis of the Group's development and performance during the year is contained in the Business Review - Summary on pages 7 to 9

> A further detailed analysis of the Business Review – Personal Financial Services businesses is contained in the Business Review - Personal Financial Services on pages 10 to 12

The Company is also required to describe the principal risks and uncertainties facing the Group Financial risks are described in the Risk Management Report for each segment of the business by type of risk on pages 15 to 37 and material risk factors are described in the Risk Factors section on pages 108 to 113

Results and Ordinary Dividends

The results of the Group are discussed in the Principal Activities and Business Review above The Directors do not recommend the payment of a final ordinary dividend (2008 nil) No interim ordinary dividends were paid in 2009 (2008 18 0 pence per ordinary share)

Events after the Balance Sheet date

On 25 February 2010 it was announced that the Company intends to transfer its business into Santander UK plc later this year under a scheme allowed by Part VII of the Financial Services and Markets Act 2000 This transfer is subject to UK Financial Services Authority support and Court approval The transfer will provide benefits for the Company's customers and for Santander UK plc For Alliance & Leicester customers this includes access to Santander UK's full product range plus use of over 1,300 branches, four times as many branches currently available for Alliance & Leicester customers By rationalising systems and improving the sales and risk management processes through having a single view of customers' dealings, Santander UK plc will also benefit from the significant synergies that were announced to the market at the time of the acquisition of Alliance & Leicester plc by Banco Santander, S A in 2008

On 26 February 2010 it was announced that as the Company's preference shares will not transfer to Santander UK plc under the proposed Part VII Transfer, the Company and Santander UK plc have agreed that the holders of the Company's preference shares should be given the opportunity to exchange their Alliance & Leicester plc preference shares for new preference shares to be issued by Santander UK plc It is intended that the exchange will be carried out by a scheme of arrangement under Part 26 of the Companies Act 2006, which, if approved by the Court as well as holders of the Company's preference shares and Santander UK plc (as holder of the ordinary shares of Alliance & Leicester plc), the Company's preference shares would be substituted with new preference shares to be issued by Santander UK plc on substantially similar terms

In March 2010 the Group issued through the Fosse Master Trust the first publicly-placed mortgage-backed securitisation transaction from a UK bank since 2007, other recent transactions from UK banks had included an investor put The transaction was denominated in both pounds sterling and euro and raised approximately £1 4bn

There were no other significant events after the balance sheet date

Going Concern

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out above The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements The Company's objectives, policies and processes for managing its capital are described in Note 44 to the financial statements

Details of the Company's financial risk management objectives, its financial instruments and hedging activities, and its exposures to credit risk, interest rate risk, liquidity risk, operational risk and other risks are set out in the Risk Management Report on pages 15 to 37 and material risk factors are described in the Risk Factors section on pages 108 to 113

The Company is part of the Santander UK group The Company is reliant on Santander UK plc and other companies in the Santander UK group for a significant proportion of its funding The Board of Santander UK plc has confirmed that Santander UK plc and the Santander UK group are going concerns, and that it will provide funding to the Company for the foreseeable future In giving this commitment to provide funding to Alliance & Leicester plc, the Board of Santander UK plc has considered the uncertainties within Alliance & Leicester plc when preparing the forecasts and budgets of the combined business of the Santander UK group

The Company has given a full and unconditional guarantee in respect of the unsubordinated liabilities of Santander UK plc incurred prior to 31 July 2012 under a deed poll guarantee entered into by the Company on 19 March 2009 Santander UK plc has given a reciprocal guarantee in respect of the unsubordinated liabilities of the Company incurred prior to 31 July 2012

After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future As set out above, there is an intention to substantially reduce trading in the next twelve months, subject to UK Financial Services Authority support and Court approval, by the transfer of the Alliance & Leicester business into Santander UK plc under a scheme allowed by Part VII of the Financial Services and Markets Act 2000 IAS 1 requires that financial statements for any Company that has ceased to trade, or substantially reduced trading, or where there is an intention for the Company to cease to trade, or substantially reduce trading in the next twelve months, are prepared on an "other than going concern" basis Accordingly the financial statements have been prepared on an "other than going concern" basis as there is the intention to substantially reduce trading in the next twelve months In accordance with Santander UK's accounting policy of accounting for internal reorganisations, the assets and liabilities of the Alliance & Leicester business will be transferred to Santander UK at their book values in Alliance & Leicester Preparation of the financial statements on an "other than going concern" basis has therefore had no impact on the amounts reported

Directors

The members of the Company's board of directors (the 'Board') at 31 December 2009 are named on pages 38 and 39 For each Director, the date of appointment is shown As at 31 December 2009, the Board comprised a Chairman, four Executive Directors including the Chief Executive, and seven Non-Executive Directors At the date of publication of this report, the Board composition remains the same The roles of Chairman and Chief Executive are separated and clearly defined The Chairman is primarily responsible for the working of the Board and the Chief Executive for the running of the business and implementation of Board strategy and policy The following Executive Directors resigned on 30 April 2009 and 31 May 2009 respectively, David Bennett and Nathan Bostock

Non-Executive Directors have been appointed for an indefinite term (other than Jane Barker, Roy Brown, Keith Woodley and Rosemary Thorne, who have been appointed for a three year term after which their appointments may be extended upon mutual agreement)

When they were appointed, the appointments of Terence Burns, António Horta-Osório, Antonio Lorenzo, Juan Colombás, Juan Rodriguez Inciarte, José María Fuster, José María Carballo, Alison Brittain, Rosemary Thorne and Keith Woodley were all proposed by Banco Santander, S A The Company may pay an Executive Director instead of allowing them to work during their notice period

Remuneration

The remuneration of the Directors of Alliance & Leicester plc is set out in the 'Directors' Remuneration' table in the Report & Accounts of Santander UK plc

Retirement Benefits (audited)

Defined benefit pension plans are provided to certain of the Group's employees See Note 32 to the Consolidated Financial Statements for a description of the plans and related costs and obligations Retirement benefits are no longer accruing for any Directors under the Alliance & Leicester Defined Benefit Scheme (2008 one) in respect of their qualifying service to Alliance & Leicester

Third Party Indemnities

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

Financial Risk Management Objectives

The financial risk management objectives and policies of the Group, the policy for hedging each major type of forecast transaction for which hedge accounting is used, and the exposure of the Group to price risk, credit risk, liquidity risk and cash-flow risk are outlined in the Risk Management Report on pages 15 to 37

Directors' Report continued

Pension Funds

The assets of the Alliance & Leicester Pension Scheme are held separately from those of the Group and are under the control of the trustees As at 31 December 2009 the Alliance & Leicester Pension Scheme had nine trustees, of whom five are selected by the Group (one of whom is an independent trustee) and four are elected by eligible members Asset management of the schemes is delegated to a number of fund managers and the trustees receive independent professional advice on the performance of the managers Legal advice to the trustees is provided by an external firm of solicitors The audits of the pension scheme are separate from that of Alliance & Leicester and are undertaken by KPMG LLP Further information is provided in Note 32 to the Consolidated Financial Statements

Market Value of Land and Buildings

On the basis of a periodic review process, the estimated aggregate market value of the Group's land and buildings was not significantly different from the fixed asset net book value of £200m, as disclosed in Note 21 to the Consolidated Financial Statements It is considered that, except where specific provisions have been made, the land and buildings have a value in use to the Group that exceeds the estimated market value, and the net book value is not impaired

Disability

The Group is committed to equality of access and quality of service for disabled people and embraces the spirit of the UK Disability Discrimination Acts 1995 and 2005 throughout its business operations The Group has processes in place to help recruit, train, develop, retain and promote employees with disabilities and is committed to giving full and fair consideration to applications for employment made by disabled persons, for continuing the employment of, and arranging appropriate training for, existing employees who have become disabled

Employee Involvement

Employee Share Ownership

During 2008, eligible employees were able to participate in a ShareSave plan, or a Share Incentive Plan to acquire partnership shares which gave employees the opportunity to save money from their pre-tax salary Through these share plans, a number of employees owned shares in the Company At the time of the acquisition by Banco Santander, S A , shares held in the Alliance & Leicester Share Incentive Plan were converted into Banco Santander, S A shares on the same basis as all other shareholders Options granted under the Alliance & Leicester ShareSave Plan became exercisable from 7 October 2008 and lapsed on 7 April 2009

In recognition of the Banco Santander, S A acquisition of the Company all employees were given 100 free shares in Banco Santander, S A on 1 December 2008 These shares were granted using an HM Revenue & Customs approved Share Incentive Plan The free shares will be held in trust on the employee's behalf for a minimum of three years

An invitation under the Santander UK Sharesave Scheme was made in September 2009, as part of which the scheme was extended to other UK companies within the Santander Group The option price for the 2009 invitation was set at a 20% discount to the average middle market quotation of Banco Santander S A shares over the first three dealing days of September 2009

Communication

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

Consultation

The Group has for many years worked closely with the Communication Workers Union ('CWU') and the Public and Commercial Services Union ('PCS'), who are the independent trade unions that it recognises to act as the voice of the Group employees CWU and PCS are affiliated with the Trade Union Congress and operate from their own offices CWU and PCS are involved in major Group initiatives and the Company consults them on significant proposals within the business Consultation takes place at both national and local levels The Group holds regular consultation and negotiation meetings to enable collaborative working and ensure that communication is open and two-way

Donations

Alliance & Leicester made total community contributions of £146,000 (2008 £710,000) to a wide range of charities For 2009 Alliance & Leicester's employees chose St Joseph's Hospice, based in Liverpool, and DLRAA, the Derbyshire, Leicestershire and Rutland Air Ambulance to be Alliance & Leicester's two charities of the year

Political Contributions

No contributions were made for political purposes and no political expenditure was incurred

Suppliers

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

Policy and Practice on Payment of Creditors

The Group continues to be a signatory of the Better Payment Practice Code, more details on which can be found at www payontime co uk The Group's policy is to agree the terms of payment at the start of business with a supplier, to ensure suppliers are aware of the payment terms and to pay in accordance with the terms and conditions agreed, except where the supplier fails to comply with those terms and conditions The Group's practice on payment of creditors has been quantified under the terms of Schedule 7 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 Based on the ratio of the aggregate amounts owed to trade creditors at the end of the year to the aggregate amounts invoiced by suppliers during the year to 31 December 2009, trade creditor days for the Group were 7 days (2008 7 days)

Business Principles

The Group's Statement of Business Principles was formally adopted in 2005 The principles have been communicated to all employees

The principles require staff to act at all times with the highest standards of business conduct in order to protect Alliance & Leicester's reputation and ensure a company culture which is free from any risk of corruption, compromise or conflicts of interest The Statement of Business Principles sets out the conduct of the business and requires staff to

- Treat Customers Fairly
- Enhance shareholder value through sound corporate governance
- Take responsibility for the Company's success and reputation
- Maintain high standards of integrity in business relationships
- Support local communities through volunteering, charitable giving and sponsorship
- Act responsibly to minimise the impact of business on the environment

The Company's parent company, Santander UK plc, is committed to maintaining high ethical standards and has developed policies in this regard A review during 2008 of such policies by Santander UK plc has resulted in the adoption of Banco Santander, S A 's General Code of Conduct As part of the integration process it is intended that Alliance & Leicester will align its Business Principles to that General Code of Conduct

Supervision and Regulation

As a firm authorised by the UK Financial Services Authority, the Company is subject to UK financial services laws and regulations, which are discussed below Recent significant regulatory developments which will affect the Group are also highlighted below

UK

In the UK, the Financial Services Authority is the single independent regulator for the regulation of deposit taking, investment business, mortgages and insurance The UK Financial Services Authority was set up by the government and exercises statutory powers under the UK Financial Services and Markets Act 2000 ('FSMA') The Company, together with several of its subsidiaries, is authorised by the UK Financial Services Authority to carry on a range of regulated activities in the UK, which include mortgages, banking, insurance and investment business The UK Financial Services Authority must adhere to four regulatory objectives, as prescribed in FSMA, which set out the parameters of regulation market confidence, public awareness, the protection of consumers, and the reduction of financial crime Based on these regulatory objectives, the UK Financial Services Authority has formulated an extensive handbook of rules and guidance to which authorised firms are subject

Banks, insurance companies and other financial institutions in the UK are subject to the UK Financial Services Compensation Scheme (the 'FSCS') The FSCS covers claims made against authorised firms (or any participating EEA firms) where they are unable, or likely to be unable, to pay claims against them In relation to each of deposits, investments, and mortgage advice and arranging, the FSCS provides cover for 100% of the first £50,000 of a claim, with £50,000 being the maximum amount payable per customer The FSCS also extends (up to various amounts) to certain long term and general insurance contracts, including general insurance advice and arranging

European Union

The Group is directly affected by laws emanating from the European Union, primarily through directives that must be implemented by the UK as a Member State of the European Union

Basel II

Basel II is a supervisory framework for the risk and capital management of banks and is structured around three pillars Pillar 1 specifies minimum capital requirements for banks and new methodologies for calculating risk weighted assets Pillar 2 describes the supervisory review process and outlines the internal capital adequacy assessment process ('ICAAP') required by banks applying Pillar 1 methodologies Pillar 3 requires disclosure of risk and capital information The Group's capital and risk management disclosures are set out in Note 44 to the Consolidated Financial Statements on page 106

Directors' Report continued

In the European Union, Basel II was implemented by the Capital Requirements Directive ('CRD') with effect from 1 January 2007 In the UK, the Financial Services Authority implemented the CRD by including it in UK Financial Services Authority rules These new UK Financial Services Authority rules took effect from 1 January 2007 Throughout 2009 the Group has applied the Basel II framework to its capital calculations, its ICAAP and to its risk and capital disclosures to the market

Other Changes to Capital Adequacy and Liquidity Arrangements
In October 2008, the UK Government announced a UK banking support scheme that addressed both capital and liquidity requirements of the UK banking industry To fulfil its agreed commitment to this scheme, Banco Santander, S A subscribed for £1bn of Santander UK plc's Core Tier 1 capital issued on 12 October 2008 This capital was, in turn, transferred to Alliance & Leicester plc in December 2008 as planned As part of the UK Government's banking support scheme, the Group has participated in the UK Special Liquidity Scheme

During 2009, the Group commenced a comprehensive programme of work to ensure compliance with the requirements of the UK Financial Services Authority's new liquidity regime as laid out in PS09/16 The work is carried out with sponsorship from an Executive Director, by a dedicated project team complemented by relevant external resources where appropriate During 2010 the Group is required to complete an Individual Liquidity Adequacy Assessment as part of the UK Financial Services Authority's Supervisory Liquidity Review Process This includes an assessment of liquidity requirements using the UK Financial Services Authority prescribed stresses The sources of liquidity risk that are currently analysed within the liquidity risk and control framework are covered by the UK Financial Services Authority stresses, although precise calibration may differ in the final liquidity guidance to be set by the UK Financial Services Authority

A number of consultations are currently underway on proposals to change regulatory capital requirements in both a UK and international context These include proposals from the Basel Committee on Banking Supervision in respect of capital and liquidity as well as the proposition for recovery and resolution plans in the UK Taken in aggregate, there is a potential for these reforms to have a significant effect The Group is currently engaged in the assessment of their possible impact and any response that could be required

Other Regulatory Developments
There are a number of other regulatory developments going through a consultation and implementation process which may have some effect on the Group's business These include the Financial Services Compensation Scheme arrangements, consumer credit regulations, financial stability, and conduct of business arrangements such as those resulting from the Retail Distribution review, Mortgage Market review and payment protection insurance

Management's Report on Internal Control of the Financial Reporting

Internal control over financial reporting is a component of an overall system of internal control The Group's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting, 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, and as endorsed by the European Union The Group's internal control over financial reporting includes

> Policies and procedures that relate to the maintenance of records that fairly and accurately reflect the transactions and disposition 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

Management is responsible for establishing and maintaining adequate internal control over the financial reporting of the Group Management assessed the effectiveness of the Group's internal control over financial reporting as of 31 December 2009 based on the criteria established in the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission Based on this assessment, management believes that, as of 31 December 2009, the Group's internal control over financial reporting is effective

Relevant Audit Information

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

> so far as the Director is aware, there is no relevant audit information of which the Group's auditors are unaware, and
> the Director has taken all steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Group's auditors are aware of that information

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

Statement of Directors' Responsibilities

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

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

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

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

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

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

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

Auditors

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

By Order of the Board

Karen M Fortunato
Company Secretary
27 April 2010
Alliance & Leicester plc, Carlton Park, Narborough, Leicester LE19 0AL

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Independent Auditors' Report to the Members of Alliance & Leicester plc

We have audited the financial statements of Alliance & Leicester plc for the year ended 31 December 2009 which comprise the Consolidated Income Statement, the Consolidated and Company Statements of Comprehensive Income, the Consolidated and Company Balance Sheets, the Consolidated and Company Statements of Changes in Equity, the Consolidated and Company Cash Flow Statements, the Accounting Policies and the related Notes 1 to 44 The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006

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

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

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

Opinion on financial statements
In our opinion,

> the financial statements give a true and fair view of the state of the Group's and the Company's affairs as at 31 December 2009 and of the Group's profit for the year then ended,
> the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union,
> the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006, and
> the financial statements have been prepared in accordance with the requirements of the Companies Act 2006

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

Modified opinion
In forming our opinion on the financial statements, which is not qualified, we have considered the adequacy of the disclosure made in Note 1 to the financial statements, which explains that the financial statements have been prepared on a basis other than that of a going concern

Opinion on other matter prescribed by the Companies Act 2006
In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

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

Manbhinder Rana (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditors
London, UK
27 April 2010

Consolidated Income Statement

For the years ended 31 December 2009 and 2008

	Notes	2009 £m	2008 £m
Interest and similar income	2	**2,364**	4 032
Interest expense and similar charges	2	**(1,602)**	(3,648)
Net interest income		**762**	384
Fee and commission income	3	**397**	471
Fee and commission expense	3	**(44)**	(79)
Net fee and commission income		**353**	392
Net trading and other income	4	**98**	48
Total operating income		**1,213**	824
Administration expenses	5	**(606)**	(927)
Depreciation and amortisation	6	**(121)**	(114)
Total operating expenses excluding provisions and charges		**(727)**	(1 041)
Impairment losses on loans and advances	8	**(348)**	(1,033)
Provisions for other liabilities and charges	31	**(81)**	(38)
Total operating provisions and charges		**(429)**	(1,071)
Profit/(loss) before tax		**57**	(1,288)
Taxation credit	9	**3**	370
Profit/(loss) for the year		**60**	(918)
Attributable to			
Equity holders of the parent		**24**	(954)
Innovative Tier 1 holders	34	**17**	17
Preference shareholders	35	**19**	19

The Notes on pages 68 to 107 are an integral part of these Consolidated Financial Statements

All profits/(losses) during the year were generated from continuing operations

Consolidated Statement of Comprehensive Income

For the years ended 31 December 2009 and 2008

	Notes	2009 £m	2008 £m
Profit/(loss) for the year		**60**	(918)
Other comprehensive income/(loss)			
Actuarial losses on retirement benefit obligations	32	**(192)**	(60)
Gains/(losses) on available-for-sale securities		**180**	(241)
Share-based payments		**-**	(7)
(Losses)/gains on cash flow hedges taken directly to equity		**(15)**	259
Tax on items taken directly to equity		**3**	8
Net loss recognised directly in equity		**(24)**	(41)
Losses on available-for-sale securities transferred to profit or loss on sale		**-**	32
Cash flow hedges transferred to profit or loss		**-**	(11)
Tax on items transferred to profit		**-**	(6)
Net transfers to profit		**-**	15
Total other comprehensive income for the year before tax		**(27)**	(28)
Tax relating to components of other comprehensive income		**3**	2
Total comprehensive income/(loss) for the year		**36**	(944)
Attributable to			
Equity holders of the parent		**-**	(980)
Innovative Tier 1 holders	34	**17**	17
Preference shareholders	35	**19**	19

Consolidated Balance Sheet

As at 31 December 2009 and 2008

	Notes	2009 £m	2008 £m
Assets			
Cash and balances at central banks	11	**446**	1,553
Derivative financial instruments	12	**1,108**	2,876
Financial assets designated at fair value	13	**50**	63
Loans and advances to banks	14	**49,857**	1,239
Loans and advances to customers	15	**46,796**	51,402
Available-for-sale securities	17	**11**	1,658
Loan and receivable securities	18	**9,828**	14,250
Macro hedge of interest rate risk		**444**	713
Intangible assets	20	**38**	17
Property, plant and equipment	21	**206**	223
Operating lease assets	22	**312**	348
Current tax assets		**81**	17
Deferred tax assets	23	**409**	626
Other assets	24	**352**	259
Total assets		**109,938**	75,244
Liabilities			
Deposits by banks	25	**52,458**	11,516
Deposits by customers	26	**43,436**	39,765
Derivative financial instruments	12	**198**	1,533
Financial liabilities designated at fair value	27	**83**	728
Debt securities in issue	28	**9,981**	17,477
Subordinated liabilities	29	**1,028**	1,436
Other liabilities	30	**503**	631
Provisions	31	**12**	34
Current tax liabilities		**20**	1
Deferred tax liabilities	23	**255**	278
Retirement benefit obligations	32	**150**	17
Total liabilities		**108,124**	73,416
Equity			
Innovative Tier 1	34	**297**	311
Preference shares	35	**294**	294
		591	605
Share capital	35	**928**	328
Share premium account	35	**124**	724
Other reserves		**75**	(39)
Retained earnings		**96**	210
Total ordinary shareholders' equity		**1,814**	1,828
Total liabilities and equity		**109,938**	75,244

The Notes on pages 68 to 107 are an integral part of these Consolidated Financial Statements

The Financial Statements on pages 48 to 107 were approved and authorised for issue by the Board on 27 April 2010 and signed on its behalf by

Antonio Lorenzo
Chief Financial Officer

Company Registered Number 3263713

Consolidated Statement of Changes in Equity

For the years ended 31 December 2009 and 2008

				Other reserves							
	Share Capital £m	Share Premium £m	Other equity £m	Capital redemption reserve £m	Available for sale reserve £m	Cash flow hedging reserve £m	Share based payment reserve £m	Retained earnings £m	Total £m	Non-controlling interest £m	Total £m
1 January 2008	210	125	605	90	(143)	(14)	26	1,421	2,320	4	2,324
Total comprehensive income (gross)	-	-	-	-	(209)	248	(7)	(978)	(946)	-	(946)
Tax relating to components of other comprehensive income	-	-	-	-	59	(70)	(2)	15	2	-	2
Dividends declared	-	-	-	-	-	-	-	(265)	(265)	-	(265)
Issue of share capital	118	599	-	-	-	-	-	-	717	-	717
Transfer from share-based payment reserve	-	-	-	-	-	-	(17)	17	-	-	-
Disposal	-	-	-	-	-	-	-	-	-	(4)	(4)
31 December 2008	328	724	605	90	(293)	164	-	210	1,828	-	1,828
1 January 2009	**328**	**724**	**605**	**90**	**(293)**	**164**	**-**	**210**	**1,828**	**-**	**1,828**
Total comprehensive income (gross)	-	-	-	-	**180**	**(15)**	-	**(132)**	**33**	-	**33**
Tax relating to components of other comprehensive income	-	-	-	-	**(55)**	**4**	-	**54**	**3**	-	**3**
Dividends declared	-	-	-	-	-	-	-	**(36)**	**(36)**	-	**(36)**
Issue of share capital	**600**	**(600)**	-	-	-	-	-	-	-	-	-
Other movements	-	-	**(14)**	-	-	-	-	-	**(14)**	-	**(14)**
31 December 2009	**928**	**124**	**591**	**90**	**(168)**	**153**	**-**	**96**	**1,814**	**-**	**1,814**

Consolidated Cash Flow Statement

For the years ended 31 December 2009 and 2008

	Notes	2009 £m	2008 £m
Net cash flow from operating activities			
Profit/(loss) for the year		**60**	(918)
Adjustments for			
Non-cash items included in net profit		**342**	901
Change in operating assets		**(23,587)**	(411)
Change in operating liabilities		**37,789**	4,059
Income taxes (paid)/received		**(3)**	21
Effects of exchange rate differences		**(841)**	-
Net cash flow from operating activities	37	**13,760**	3,652
Net cash flow from investing activities			
Acquisition of subsidiaries, net of cash acquired		-	(19)
Purchase of tangible and intangible fixed assets		**(132)**	(241)
Proceeds from sale of tangible and intangible fixed assets		**44**	48
Purchase of non-trading securities		**(3)**	(743)
Proceeds from sale of non-trading securities		**1,650**	2,660
Net cash flow from investing activities		**1,559**	1,705
Net cash flow (used in) financing activities			
Issue of debt securities		-	4,066
Repayment of debt securities		-	(11,346)
Issue of ordinary shares		-	701
Repayment of loan capital		**(2,381)**	-
Preference dividend paid		**(19)**	(19)
Interest paid on innovative Tier 1		**(17)**	(17)
Ordinary dividends paid		-	(229)
Net cash flow (used in) financing activities		**(2,417)**	(6,844)
Net increase/(decrease) in cash and cash equivalents		**12,902**	(1,487)
Cash and cash equivalents at beginning of the year		**2,369**	3,856
Cash and cash equivalents at the end of the year		**15,271**	2,369

The Notes on pages 68 to 107 are an integral part of these Consolidated Financial Statements

Company Balance Sheet

As at 31 December 2009 and 2008

	Notes	2009 £m	2008 £m
Assets			
Cash and balances at central banks	11	**446**	1,553
Derivative financial instruments	12	**582**	2,190
Financial assets designated at fair value	13	**50**	63
Loans and advances to banks	14	**46,208**	1,236
Loans and advances to customers	15	**52,132**	52,604
Available-for-sale securities	17	**8**	1,654
Loan and receivable securities	18	**9,994**	14,321
Macro hedge of interest rate risk		**306**	557
Investment in subsidiary undertakings	19	**887**	1,091
Intangible assets	20	**38**	16
Property, plant and equipment	21	**133**	148
Current tax assets		**76**	58
Deferred tax assets	23	**286**	358
Other assets	24	**310**	1,431
Total assets		**111,456**	77,280
Liabilities			
Deposits by banks	25	**54,085**	13,585
Deposits by customers	26	**47,691**	41,222
Derivative financial instruments	12	**318**	1,671
Financial liabilities designated at fair value	27	**83**	728
Debt securities in issue	28	**5,879**	12,084
Subordinated liabilities	29	**1,028**	1,436
Other liabilities	30	**540**	4,649
Provisions	31	**11**	-
Deferred tax liabilities	23	**-**	73
Retirement benefit obligations	32	**150**	17
Total liabilities		**109,785**	75,465
Equity			
Innovative Tier 1	34	**297**	311
Preference shares	35	**294**	294
		591	605
Share capital	35	**928**	328
Share premium account	35	**124**	724
Other reserves		**60**	(62)
Retained earnings		**(32)**	220
Total ordinary shareholders' equity		**1,671**	1,815
Total liabilities and equity		**111,456**	77,280

The Notes on pages 68 to 107 are an integral part of these Consolidated Financial Statements

The Financial Statements on pages 48 to 107 were approved and authorised for issue by the Board on 27 April 2010 and signed on its behalf by

Antonio Lorenzo
Chief Financial Officer

Company Registered Number 3263713

Company Statement of Comprehensive Income

For the years ended 31 December 2009 and 2008

	Notes	2009 £m	2008 £m
Loss for the year		**(78)**	(275)
Other comprehensive income/(loss)			
Actuarial losses on retirement benefit obligations	32	**(192)**	(60)
Gains/(losses) on available-for-sale securities		**180**	(241)
Share-based payments		**-**	(7)
(Losses)/gains on cash flow hedges taken directly to equity		**(4)**	235
Tax on items taken directly to equity		**-**	15
Net loss recognised directly in equity		**(16)**	(58)
Gains on available-for-sale securities transferred to profit or loss on sale		**-**	14
Impairment losses transferred to profit or loss		**-**	18
Cash flow hedges transferred to profit or loss		**-**	(24)
Tax on items transferred to profit		**-**	(2)
Net transfers to profit		**-**	6
Total other comprehensive income/(loss) for the year before tax		**(16)**	(65)
Tax relating to components of other comprehensive income		**-**	13
Total comprehensive income/(loss) for the year		**(94)**	(327)
Attributable to			
Equity holders of the parent		**(130)**	(363)
Innovative Tier 1 holders	34	**17**	17
Preference shareholders	35	**19**	19

Company Statement of Changes in Equity

For the years ended 31 December 2009 and 2008

				Other reserves					
	Share Capital £m	Share Premium £m	Other equity £m	Capital redemption reserve £m	Available for sale reserve £m	Cash flow hedging reserve £m	Share based payment reserve £m	Retained earnings £m	Total £m
1 January 2008	210	125	605	90	(143)	(11)	26	788	1,690
Transfer from share-based payment reserve	-	-	-	-	-	-	(17)	17	-
Total comprehensive income (gross)	-	-	-	-	(209)	211	(7)	(335)	(340)
Tax relating to components of other comprehensive income	-	-	-	-	59	(59)	(2)	15	13
Dividends	-	-	-	-	-	-	-	(265)	(265)
Issue of share capital	118	599		-	-	-	-	-	717
31 December 2008	328	724	605	90	(293)	141	-	220	1,815
1 January 2009	**328**	**724**	**605**	**90**	**(293)**	**141**	**-**	**220**	**1,815**
Total comprehensive income (gross)	**-**	**-**	**-**	**-**	**180**	**(4)**	**-**	**(270)**	**(94)**
Tax relating to components of other comprehensive income	**-**	**-**	**-**	**-**	**(55)**	**1**	**-**	**54**	**-**
Dividends	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(36)**	**(36)**
Transfer between reserves	**600**	**(600)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Other movements	**-**	**-**	**(14)**	**-**	**-**	**-**	**-**	**-**	**(14)**
31 December 2009	**928**	**124**	**591**	**90**	**(168)**	**138**	**-**	**(32)**	**1,671**

Company Cash Flow Statement

For the years ended 31 December 2009 and 2008

	Notes	2009 £m	2008 £m
Net cash flow from operating activities			
Loss for the year		**(78)**	(275)
Adjustments for			
Non-cash items included in net loss		**854**	619
Change in operating assets		**(23,858)**	(1,937)
Change in operating liabilities		**36,180**	4,488
Income taxes (paid)/received		**(3)**	32
Effects of exchange rate differences		**(409)**	-
Net cash flow from operating activities	37	**12,686**	2,927
Net cash flow from investing activities			
Increase in investment in subsidiaries		**-**	(5)
Purchase of tangible and intangible fixed assets		**(116)**	(86)
Proceeds from sale of tangible and intangible fixed assets		**64**	1
Purchase of non-trading securities		**(3)**	(822)
Proceeds from sale of non-trading securities		**1,649**	2,463
Net cash flow from investing activities		**1,594**	1,551
Net cash flow used in financing activities			
Issue of debt securities		**-**	3,676
Repayment of debt securities		**-**	(10,058)
Issue of ordinary shares		**-**	701
Repayment of loan capital		**(1,749)**	-
Preference dividend paid		**(19)**	(19)
Interest paid on innovative Tier 1		**(17)**	(17)
Ordinary dividends paid		**-**	(229)
Net cash flow used in financing activities		**(1,785)**	(5,946)
Net increase/(decrease) in cash and cash equivalents		**12,495**	(1,468)
Cash and cash equivalents at beginning of the year		**2,367**	3,835
Cash and cash equivalents at the end of the year		**14,862**	2,367

The Notes on pages 68 to 107 are an integral part of these Consolidated Financial Statements

Accounting Policies

International Financial Reporting Standards

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

Disclosures required by IFRS 7 'Financial Instruments Disclosure' relating to the nature and extent of risks arising from financial instruments can be found in the Risk Management section on pages 15 to 37 which forms part of these Consolidated Financial Statements

Recent developments

In 2009, the Group adopted the following new or revised IFRS

a) IAS 23 'Borrowing Costs' - On 29 March 2007, the IASB issued an amendment to IAS 23 'Borrowing costs' which removes the option to expense borrowing costs incurred during the acquisition, construction or production of a qualifying asset The adoption of the amendment to IAS 23 did not have a material impact on the Group's profit or loss or financial position

b) IAS 1 'Presentation of Financial Statements' - On 6 September 2007, the IASB issued an amendment to IAS 1 'Presentation of Financial Statements' which changes the way in which non-owner changes in equity are required to be presented As a result, a 'Statement of Changes in Equity' has been included as a separate primary financial statement showing changes in equity during the periods presented In addition, the Statement of Recognised Income and Expense has been replaced with a 'Statement of Comprehensive Income' The adoption of the amendment to IAS 1 did not have any impact on the Group's profit or loss or financial position

c) IFRS 2 'Share based payments - vesting conditions and cancellations' - On 17 January 2008, the IASB issued an amendment to IFRS 2 'Share based payments' which requires share option awards lapsing due to a failure to meet the service condition to be treated as cancellations rather than forfeitures The adoption of the amendment to IFRS 2 did not have a material impact on the Group's profit or loss or financial position

d) IFRS 7 'Financial Instruments Disclosures - Improving Disclosures about Financial Instruments' - On 5 March 2009, the IASB issued an amendment to IFRS 7 'Financial Instruments Disclosures' which requires enhanced disclosures about fair value measurements and liquidity risk Among other things, the amendment (1) requires disclosure of any change in the method for determining fair value and the reasons for the change, (2) establishes a three-level hierarchy for making fair value measurement disclosures, (3) requires disclosure for each fair value measurement in the balance sheet of which level in the hierarchy was used, and any transfers between levels, with additional disclosures whenever level 3 of the hierarchy is used including a measure of sensitivity to a change in input data, (4) clarifies that the current maturity analysis for non-derivative financial liabilities should include issued financial guarantee contracts, and (5) amends the required disclosure of a maturity analysis for derivative financial liabilities The disclosures required by the amendment to IFRS 7 may be found on pages 21 and 104 to 106

Future developments

The Group has not yet adopted the following new or revised IFRS or IFRIC interpretations, which have been issued but which are not yet effective for the Group

a) IFRS 3 'Business Combinations' - On 10 January 2008, the IASB issued an amendment to IFRS 3 'Business Combinations' which clarifies and changes certain elements of accounting for a business combination, including measurement of contingent consideration, step acquisition and intangible assets and also widens the scope of this standard There are also associated amendments to IAS 27, IAS 28 and IAS 31 The amendment to IFRS 3 is effective for periods beginning on or after 1 July 2009

b) IFRS 9 'Financial Instruments' - On 12 November 2009, the IASB issued IFRS 9 'Financial Instruments', which significantly overhauls the accounting requirements for financial instruments under IFRS IFRS 9 is mandatory for annual periods beginning on or after 1 January 2013, with early application permitted IFRS 9 requires that a financial asset be classified into one of three categories for measurement and income recognition (1) Amortised cost, (2) Fair value through profit or loss (FVTPL) and (3) Fair value through other comprehensive income The standard requires reclassification between amortised cost and FVTPL (or vice versa) if a financial asset no longer meets the criteria for its original classification IFRS 9 replaces the existing classification and measurement requirements in IAS 39 for financial assets It changes the manner in which entities classify and measure investments in debt and equity securities, loan assets, trade receivables and derivative financial assets by requiring entities to classify financial assets as being measured at either amortized cost or fair value depending on the entity's business model and the contractual cash flow characteristics of the asset The Group is currently evaluating the requirements of IFRS 9

Basis of preparation

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

Going concern

The Company's objectives, policies and processes for managing its capital are described in Note 44 Details of the Company's financial risk management objectives, its financial instruments and hedging activities, and its exposures to credit risk, interest rate risk, liquidity risk, operational risk and other risks are set out in the Risk Management Report on pages 15 to 37

The Company is part of the Santander UK group The Company is reliant on Santander UK plc and other companies in the Santander UK group for a significant proportion of its funding The Board of Santander UK plc has confirmed that Santander UK plc and the Santander UK group are going concerns, and that it will provide funding to the Company for the foreseeable future In giving this commitment to provide funding to Alliance & Leicester plc, the Board of Santander UK plc has considered the uncertainties within Alliance & Leicester plc when preparing the forecasts and budgets of the combined business of the Santander UK group

The Company has given a full and unconditional guarantee in respect of the unsubordinated liabilities of Santander UK plc incurred prior to 31 July 2012 under a deed poll guarantee entered into by the Company on 19 March 2009 Santander UK plc has given a reciprocal guarantee in respect of the unsubordinated liabilities of the Company incurred prior to 31 July 2012

After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future As set out in Note 42, there is an intention to substantially reduce trading in the next twelve months, subject to UK Financial Services Authority support and Court approval, by the transfer of the Alliance & Leicester business into Santander UK plc under a scheme allowed by Part VII of the Financial Services and Markets Act 2000 IAS 1 requires that financial statements for any Company that has ceased to trade, or substantially reduced trading, or where there is an intention for the Company to cease to trade, or substantially reduce trading in the next twelve months, are prepared on an "other than going concern" basis Accordingly the financial statements have been prepared on an "other than going concern" basis as there is the intention to substantially reduce trading in the next twelve months In accordance with Santander UK's accounting policy of accounting for internal reorganisations, the assets and liabilities of the Alliance & Leicester business will be transferred to Santander UK at their book values in Alliance & Leicester Preparation of the financial statements on an "other than going concern" basis has therefore had no impact on the amounts reported

Consolidation

a) Subsidiaries

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

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

b) Jointly controlled entities

Jointly controlled entities are entities over which the Group has joint control established by contractual agreement with other parties Interests in joint ventures through which the Group carries on its business are classified as jointly controlled entities and accounted for using the equity method The share of any losses is restricted to a level that reflects an obligation to fund such losses

Foreign currency translation

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

Income statements and cash flows of foreign entities are translated into the Group's reporting currency at average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December Exchange differences arising from the translation of the net investment in foreign entities are taken to shareholders' equity When a foreign entity is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale

Accounting Policies continued

Foreign currency transactions are translated into the functional currency of the Company 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 deferred in equity under the cash flow hedge

The amount of exchange rate differences recognised in profit or loss on items not at fair value through profit and loss was £832m charge (2008 £nil) This was offset by income/charges on items held at fair value

Revenue recognition

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

(b) Fee and commissions income
Fees and commissions that are not an integral part of the effective interest rate are recognised when the service has been provided For retail products, fee and commission income consists principally of collection services fees, commission on foreign currencies, and fees for non-banking financial products Revenue from these income streams is recognised as earned when the service is provided

For insurance products, fee and commission income consists principally of commissions earned on the sale of building and contents insurance, life protection insurance and payment cover insurance

Asset management fee and commission income comprises portfolio and other management advisory and service fees, investment fund management fees, and fees for private banking, financial planning and custody services Portfolio and other management advisory and service fees are recognised based on the applicable service contracts Asset management fees related to investment funds are recognised rateably over the period the service is provided The same principle is applied for private banking, financial planning and custody services that are continuously provided over an extended period of time

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

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

Pensions and other post retirement benefits

Group companies have various pension schemes The schemes are generally funded through payments to trustee-administered funds as determined by periodic actuarial calculations A defined benefit plan is a pension plan that defines 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 A defined contribution plan is a pension plan under which the Group pays fixed contributions as they fall due into a separate entity (a fund) and will have no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods

The liability recognised in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date, less the fair value of plan assets The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method Full actuarial valuations of the Group's principal defined benefit schemes are carried out every year The Group is responsible for the actuarial valuations and in doing so considers or relies in part on a report of a third party expert The present value of the defined benefit obligation is determined by the estimated future cash outflows using interest rates of high quality corporate bonds, which have terms to maturity closest to the terms of the related liability adjusted where necessary to match those terms The Group's consolidated income statement includes the current service cost of providing pension benefits, the expected return on schemes' assets net of expected administration costs, and the interest cost on the schemes' liabilities Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are taken directly to reserves and recognised in the statement of comprehensive income Past-service costs are charged immediately to the income statement, unless the changes are conditional on the employees remaining in service for a specified period of time, known as the vesting period In this case, the past-service costs are amortised on a straight-line basis over the average period until the benefits become vested

For defined contribution plans, the Group pays contributions to trustee-administered funds as they fall due Once the contributions have been paid, the Group has no further payment obligations The regular contributions constitute net periodic costs for the year in which they are due and as such are included in staff costs

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

Prior to the acquisition of Alliance & Leicester by Banco Santander, S A , share options were satisfied by the issue of new Alliance & Leicester shares The Group engaged in equity-settled share-based payment transactions in respect of services received from certain of its employees Shares of the Company were allotted by the Company for the Share Option Plan, the ShareSave plan, the Restricted Share plan, the Share Incentive Plan, awards granted under the Long Term Incentive Plan and Deferred Bonus Plans to satisfy share options as they vested All awards granted under the Alliance & Leicester share plans were 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 The cost of the employee services received in respect of the shares or share options granted was recognised in the income statement within administration expenses, over the period that the services are received, which is the vesting period The fair value of the options granted under the Share Option Plan, the Restricted Share plan, awards granted under the Long Term Incentive Plan and senior manager Deferred Bonus Plan were determined using option pricing models, which take into account the exercise price of the option, the current share price, the risk free interest rate, the expected volatility of the Company's share price over the life of the option, the dividend growth rate and other relevant factors

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 Further details on the Schemes can be found in Notes 39 and 41

Goodwill and other intangible assets

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable 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 at each balance sheet date, or more frequently when events or changes in circumstances dictate It is 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 sold

Software development costs are capitalised when they are associated with identifiable and unique software products that are expected to provide future economic benefits and the cost of these products can be measured reliably 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 Costs associated with maintaining software programmes are expensed as incurred

Property, plant and equipment

Property, plant and equipment include owner-occupied properties, office fixtures and equipment 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 net trading and other income Repairs and renewals are charged to the income statement when the expenditure is incurred

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

Owner-occupied properties	Not exceeding 50 years
Office fixtures and equipment	3 to 15 years
Computer software	3 to 7 years

Depreciation is not charged on freehold land and assets under construction

Accounting Policies continued

Financial assets

The Group classifies its financial assets as financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets Management determines the classification of its investments at initial recognition Financial assets that are classified at fair value through profit or loss, which have not been designated as such or are not accounted for as derivatives or assets classified as 'available-for-sale', may subsequently in rare circumstances, be reclassified to the available-for-sale, loans and receivables or held to maturity categories In order to meet the criteria for reclassification, the asset must no longer be held for the purpose of selling or repurchasing in the near term and must also meet the definition of the category into which it is to be reclassified had it not been required to classify it at fair value through profit or loss at initial recognition The reclassified value is the fair value of the asset at the date of reclassification

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

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

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

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

(c) Available-for-sale financial assets
Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale and are not categorised into any of the other categories described They are initially recognised at fair value including direct and incremental transaction costs They are subsequently held at fair value Gains and losses arising from changes in fair value are included as a separate component of equity until sale when the cumulative gain or loss is transferred to the income statement Interest is determined using the effective interest method

Gains and losses arising on securities prior to reclassification in the available-for-sale reserve is being recognised on a straight-line basis over the period to maturity of the assets, which is considered to be immaterially different to using the effective interest rate basis

Income on investments in equity shares and other similar interests is recognised in the income statement as and when dividends are declared and interest is accrued Impairment losses and foreign exchange translation differences on monetary items are recognised in the income statement The investments are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership Available-for-sale securities are classified as available-for-sale

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

Valuation of financial instruments

In 2008, the Group adopted the amendment to IAS 39 published on 13 October 2008 and, where permitted, reclassified financial assets held-for-trading and available-for-sale assets to loans and receivables with effect from 1 July 2008 (see Note 18)
Financial instruments that are classified at fair value through profit or loss (including those held for trading purposes) or available-for-sale, and all derivatives, are stated at fair value The fair value of such financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing, knowledgeable parties, other than in a forced or liquidation sale

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

Subsequent measurement

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

Level 1 Unadjusted quoted prices for identical assets or liabilities in an active market that the Group has the ability to access at the measurement date Level 1 positions include equity securities and debt securities

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

Level 3 Inputs to the pricing or valuation techniques that are significant to the overall fair value measurement of the asset or liability are unobservable Level 3 positions consist solely of debt securities containing embedded derivatives

The Group assesses active markets for equity instruments based on the average daily trading volume both in absolute terms and relative to the market capitalisation for the instrument The Group assesses active markets for debt instruments based on both the average daily trading volume and the number of days with trading activity The Group assesses active markets for exchange traded derivatives based on the average daily trading volume both in absolute terms and relative to the market capitalisation for the instrument Market activity and liquidity is discussed in the relevant monthly Risk Forum as well as being part of the daily update given by each business at the start of the trading day This information, together with the observation of active trading and the magnitude of the bid-offer spreads allow consideration of the liquidity of a financial instrument

All underlying assets and liabilities are reviewed to consider the appropriate adjustment to mark the mid price reported in the trading systems to a realisable value This process takes into account the liquidity of the position in the size of the adjustment required These liquidity adjustments are presented and discussed at the monthly Risk Forum

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

Financial instruments valued using observable market prices
If a quoted market price in an active market is available for an instrument, the fair value is calculated based on the market price

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

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

Accounting Policies continued

Offsetting financial assets and liabilities

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

Sale and repurchase agreements (including stock borrowing and lending)

Securities sold subject to a linked repurchase agreement ('repos') are retained in the Financial Statements as 'Loan and receivable securities' and the counterparty liabilities are included in 'Deposits by customers'

Derivative financial instruments

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

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

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

Hedge accounting

The Group designates certain derivatives as hedging instruments of the fair value of recognised assets or liabilities or firm commitments (fair value hedge) The Group also designates cash flow hedges to hedge exposures to variability in cash flows, such as variable rate financial assets and liabilities Hedge accounting is used for derivatives designated in this way provided certain criteria are met

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

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

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

For fair value hedges, changes in the fair value of the hedged risk and hedged item are recognised in net trading and other income Hedge ineffectiveness represents the amount by which the changes in the fair value of the hedging derivative differ from changes in the fair value of the hedged item Such gains and losses are recorded in current period earnings within net trading and other income

For cash flow hedges, the effective portion of change in the fair value of the hedging instrument is recognised in equity, and recycled to profit or loss in the periods when the hedged item will affect profit or loss Hedge ineffectiveness represents the amount by which the changes in the fair value of the hedging derivative differ from changes in the fair value of the hedged item Such gains and losses are recorded in current period earnings within net trading and other income Gains and losses on components of a hedging derivative that are excluded from assessing hedge effectiveness are also included in net trading and other income

Securitisation transactions

The Group has entered into certain arrangements where undertakings have issued mortgage-backed securities or have entered into funding arrangements with lenders in order to finance specific loans and advances to customers As the Group has retained substantially all the risks and rewards of the underlying assets, all such financial instruments continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction

Impairment of financial assets

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

(a) Financial assets carried at amortised cost
Retail assets
Impairment losses are assessed individually for the financial assets that are individually significant and individually or collectively for assets that are not individually significant Balance sheet provisions are maintained at the level that management deems sufficient to absorb probable incurred losses in the Group's loan portfolio from homogeneous portfolios of assets and individually identified loans

A provision for observed losses is established for all past due loans after a specified period of repayment default where it is probable that some of the capital will not be repaid or recovered through enforcement of any applicable security Once a loan misses a payment (breach of contractual terms) an assessment of the likelihood of collecting the principal and overdue payments is made This assessment is generally made using statistical techniques based on historic experience These determinations are supplemented by various formulaic calculations and the application of management judgement

For individually assessed assets, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of the estimated future cash flows from the asset or group of assets discounted at the original effective interest rate of the asset

In making collective assessment for impairment, financial assets are assessed for each portfolio segmented by similar risk characteristics For each risk segment, future cash flows from these portfolios are estimated through the use of historical loss experience The historical loss experience is adjusted for current observable data, including estimated current property prices, to reflect the effects of current conditions not affecting the period of historical experience The loss is discounted at the effective interest rate, except where portfolios meet the criteria for short-term receivables The unwind of the discount over time is reported through interest receivable within the income statement, with the provision on the balance sheet increasing

Loans that are part of a homogeneous pool of similar loans are placed on default status based on the number of months in arrears, which is determined through the number of missed payments or the number of months in collection Loans that are not part of a homogeneous pool of similar loans are analysed based on the number of months in arrears on a case-by-case basis and are placed on default status when the probability of default is likely

Generally, the length of time before an asset is placed on default status for provisioning is when one payment is missed Repayment default periods vary depending on the nature of the collateral that secures the advances On advances secured by residential property, the default period is three months

On unsecured advances, such as personal term loans, the default period is generally four missed payments (three months in arrears) Exceptions to the general rule exist with respect to revolving facilities, such as bank overdrafts, which are placed on default upon a breach of the contractual terms governing the applicable account

A provision for inherent losses is made for loan losses that have been incurred but have not been separately identified at the balance sheet date because the loan is not yet past due An example of this situation is where a borrower has not yet missed a payment but is experiencing financial difficulties at the reporting date, e g due to loss of employment or divorce In these circumstances, an inherent loss had been incurred at the reporting date The provision for inherent losses is determined on a portfolio basis based on management's best estimate of the current position based on past experience adjusted by current trends These statistical techniques involve the following (i) estimation of a period of time called the emergence period, which is discussed below, (ii) assessment of the number of accounts that go into arrears over the emergence period, and (iii) application of the provision methodology outlined for observed provisions to these accounts identified as impaired as a result of this exercise Accounts that suffered credit deterioration after the reporting date are accordingly excluded from the statistical analysis

The emergence period
This is the period which the Group's statistical analysis shows to be the period in which losses that had been incurred but have not been separately identified at the balance sheet date, become evident as the loans turn into past due Based on the Group's statistical analysis at 31 December 2009, the emergence period was two to three months for unsecured lending and 12 months for secured lending The longer emergence period for secured lending reflects the fact that a customer is more likely to default on unsecured debt before defaulting on secured lending The factors considered in determining the length of the emergence period for unsecured lending are recent changes in customers' debit/credit payment profiles and credit scores The factors considered for secured lending are the frequency and duration of exceptions from adherence to the contractual payment schedule

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

Accounting Policies continued

Impairment losses are recognised in the income statement and the carrying amount of the financial asset or group of financial assets is reduced by establishing an allowance for impairment losses If in a subsequent period the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance For secured loans, a write-off is only made when all collection procedures have been exhausted and the security has been sold For unsecured loans, a write-off is only made when all internal avenues of collecting the debt have been exhausted and the debt is passed over to external collection agencies Write-offs are charged against previously established provisions for impairment

Recoveries of loan losses are not included in the loan loss allowance, but are taken to income and offset against charges for loan losses Loan loss recoveries are classified in the income statement as 'Impairment losses on loans and advances to customers'

Corporate assets
Impairments for these assets are assessed on both an individual and a collective basis For individual assets impairment reviews are conducted monthly for those assets on the Group's 'Watchlist' of new, emerging and serious circumstances relating to the portfolio, with a particular focus on the following scenarios (1) where an asset has a payment default which has been outstanding for 90 days or more, (2) where non-payment defaults have occurred and/or where it has become evident that some sort of workout or rescheduling exercise is to be undertaken, or (3) where, for example with Real Estate Finance, it has become evident that the value of the Group's security is no longer considered adequate

In such situations, the file is transferred to the Corporate Banking Workouts team within Credit Risk As part of their assessment, a full review of the expected future cash flows in relation to the relevant asset, appropriately discounted, will be undertaken with the result compared with the current net book value of the asset Any shortfall evidenced as a result of such a review, particularly where the shortfall is likely to be permanent, will lead to a suitable impairment recommendation

Collective impairments are also looked at for portfolios where it is felt that market events, either specific or general, are likely to determine that losses are already inherent in a portfolio notwithstanding that these events may not have manifested themselves in specific defaults or other triggers that would lead to an individual impairment assessment The amount of any such collective impairment will, for each portfolio concerned, represent management's best estimate of likely loss levels and will take into account *inter alia* estimates of future actual default rates and likely recovery levels

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

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

Loans and receivables securities
Loans and receivables securities are assessed individually for impairment An impairment loss is incurred if there is objective evidence that an event has occurred since initial recognition of the assets that has an impact in the estimated future cash flows of the loans and receivables securities

(b) Available-for-sale financial assets
The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired In assessing whether assets are impaired, a significant or prolonged decline in the fair value of the security below its cost is considered evidence The cumulative loss is measured as the difference between the acquisition cost and the current fair value, less any impairment loss previously reported in the income statement and is removed from equity and recognised in the income statement

If in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase is due to an event occurring after the impairment loss was recognised in the income statement (with objective evidence to support this), the impairment loss is reversed through the income statement

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 Net selling price is calculated by reference to the amount at which the asset could be disposed of in a binding sale agreement in an arm's length transaction evidenced by an active market or recent transactions for similar assets, less costs to sell. Value in use is calculated by discounting the expected future cash flows obtainable as a result of the asset's continued use, including those resulting from its ultimate disposal, at a market based discount rate on a pre-tax basis

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

Leases

The Group as lessor – Operating lease assets are recorded at deemed cost and depreciated over the life of the asset after taking into account anticipated residual values Operating lease rental income and depreciation is recognised on a straight-line basis over the life of the asset Amounts due from lessees under finance leases and hire purchase contracts are recorded as receivables at the amount of the Group's net investment in the leases Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases and hire purchase contracts

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

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

Income taxes, including deferred taxes

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

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

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

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the Group is able to control reversal of the temporary difference and it is probable that it will not reverse in the foreseeable future

The 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 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

Accounting Policies continued

Financial liabilities

Financial liabilities are initially recognised when the Group becomes contractually bound to the transfer of economic benefits in the future
(a) Financial liabilities at fair value through profit or loss
Financial liabilities are classified as fair value through profit or loss if they are either held for trading or otherwise designated at fair value through profit or loss on initial recognition A financial liability is classified as held for trading if it is a derivative or it is incurred principally for the purpose of selling or being unwound in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking

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

Derivative financial instruments and Financial liabilities designated at fair value are classified as fair value through profit or loss, unless in a hedge relationship

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

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

Borrowings

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

Share capital

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

Provisions

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

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

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

Financial guarantee contracts

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

Dividends

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

Critical accounting policies and areas of significant management judgement

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

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

(a) Provisions for loans and advances

The Group estimates provisions for loans and advances to banks, loans and advances to customers, and loan and receivables securities with the objective of maintaining balance sheet provisions at the level believed by management to be sufficient to absorb actual losses ('observed provisions') and inherent losses ('incurred but not yet observed provisions') in the Group's loan portfolio from homogeneous portfolios of assets and individually identified loans in connection with loans and advances to banks and loans and advances to customers The calculation of provisions on impaired loans and advances is based on the likelihood of the asset being written off (or repossessed in the case of mortgage loans) and the estimated loss on such a write-off These assessments are made using statistical techniques based on historic experience These determinations are supplemented by various formulaic calculations and the application of management judgement

The Group considers accounting estimates related to provisions for loans and advances 'critical accounting estimates' because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and advances are based on recent performance experience, and (ii) any significant difference between the Group's estimated losses (as reflected in the provisions) and actual losses will require the Group to take provisions which, if significantly different, could have a material impact on its future income statement and its balance sheet The Group's assumptions about estimated losses are based on past performance, past customer behaviour, the credit quality of recent underwritten business and general economic conditions, which are not necessarily an indication of future losses

Provisions for loans and advances, less amounts released and recoveries of amounts written off in previous years are charged to the line item 'Impairment losses on loans and advances' in the income statement The provisions are deducted from the 'Loans and advances to banks', 'Loan and receivable securities' and the 'Loans and advances to customers' line items on the balance sheet If the Group believes that additions to the provisions for such credit losses are required, then the Group records additional provisions for credit losses, which would be treated as a charge in the line item 'Impairment losses on loans and advances to customers' in the income statement

The Consolidated Financial Statements for the year ended 31 December 2009 include a provision charge for loans and advances in connection with retail lending for an amount equal to £139m and corporate lending for an amount equal to £91m The provision for retail lending increased reflecting higher default rates in the unsecured portfolios and increased reserving due to a further general deterioration in economic conditions The provision for corporate lending reflected the current economic down turn and the impact this is having on the corporate sector In calculating the retail and corporate lending provisions, within the Retail Banking and Corporate Banking segments, a range of outcomes was calculated based principally on management's conclusions regarding the current economic outlook relative to historic experience Had management used different assumptions regarding the current economic outlook, a larger or smaller provision for loans and advances would have resulted that could have had a material impact on the Group's reported loss before tax in 2009

Specifically, if management's conclusions as to the current economic outlook were different, but within the range of what management deemed to be reasonably possible economic outlooks, the provision charge for loans and advances in the Retail Banking segment could have decreased in 2009 from an actual provision charge of £139m (2008 £274m) by up to £52m (2008 £22m), with a potential corresponding increase (2008 reduction) in the Group's profit (2008 loss) before tax in 2009 of up to 91% (2008 2%), or increased by up to £6m (2008 £29m), with a potential corresponding decrease (2008 increase) in the Group's profit (2008 loss) before tax in 2009 of up to 11% (2008 2%) The provision charge for loans and advances in the Corporate Banking segment could have decreased in 2009 from an actual provision charge of £91m (2008 £275m) by up to £4m (2008 £51m), with a potential corresponding increase (2008 decrease) in the Group's profit (2008 loss) before tax in 2009 of up to 7% (2008 4%), or increased by up to £3m (2008 £29m), with a potential corresponding decrease (2008 increase) in the Group's profit (2008 loss) before tax in 2009 of up to 5% (2008 2%)

The actual provision charge for retail lending of £139m (2008 £274m) and corporate lending of £91m (2008 £275m) in 2009 was based on what management estimated to be the most probable economic outlook within the range of reasonably possible assumptions

The provision charge for the Treasury asset portfolio (securities, loans and advances to banks and the Conduit shown in loans and advances to customers) of £118m (2008 £485m) was based on management's assessment of impairment of each individual asset based on data available at 31 December 2009 A detailed analysis of the Treasury asset portfolio by type of instrument, credit structure, credit rating and geography can be found in the Risk Management Report on pages 29 to 37

(b) Valuation of financial instruments

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

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

Accounting Policies continued

The Group trades in a wide variety of financial instruments in the major financial markets and therefore considers a range of interest rates, volatility, exchange rates, counterparty credit ratings, valuation adjustments and other similar inputs, all of which vary across maturity bands These are chosen to best reflect the particular characteristics of each transaction Had management used different assumptions regarding the interest rates, volatility, exchange rates, the credit rating of the counterparty, and valuation adjustments, a larger or smaller change in the valuation of financial assets and financial liabilities including derivatives where quoted market prices are not available would have resulted that could have had a material impact on the Group's reported profit before tax in 2008 Due to the individual nature of these contracts, the Group does not believe generally it is appropriate to apply a global adjustment to management's estimates, as it would not give a meaningful sensitivity with respect to financial instrument fair values based on data other than market prices

(c) Provisions for misselling

The Group estimates provisions for misselling with the objective of maintaining reserve levels believed by management to be sufficient to absorb current estimated probable losses in connection with compensation from customers who claim reimbursement of payment protection insurance ('PPI') The calculation of provisions for misselling is based on the estimated number of claims that may be received, of those, the number that will be upheld, and the estimated average settlement per case These assessments are based on management's estimate for each of these three factors In certain instances, the extent to which the Group is required to uphold claims is driven by binding legal decisions or precedents, as described in Note 33

The Group considers accounting estimates related to misselling provisions 'critical accounting estimates' because (i) they are highly susceptible to change from period to period per the three factors above, and (ii) any significant difference between the Group's estimated losses as reflected in the provisions and actual losses will require the Group to take provisions which, if significantly different, could have a material impact on its future income statement and its balance sheet The Group's assumptions about estimated losses are based on past claims uphold rates, past customer behaviour, and past average settlements, which are not necessarily an indication of future losses

Provisions for misselling are charged to the line item 'Provisions for other liabilities and charges' in the income statement The provision is included in the 'Provisions' line item on the balance sheet If the Group believes that additions to the misselling provision are required, then the Group records additional provisions, which would be treated as a charge in the line item 'Provisions for other liabilities and charges' in the income statement

The Consolidated Financial Statements for the year ended 31 December 2009 include a provision charge for misselling in the Retail Banking segment for an amount equal to £70m (2008 £38m) The balance sheet provision decreased from £34m in 2008 to £nil in 2009, reflecting settlement of claims principally relating to Payment Protection Insurance In calculating the misselling provision within the Retail Banking segment, management's best estimate of the provision was calculated based on conclusions regarding the number of claims that may be received, of those, the number that will be upheld, and the estimated average settlement per case Had management used different assumptions regarding these factors, a larger or smaller provision for misselling would have resulted in the Retail Banking segment that could have had a material impact on the Group's reported profit before tax in 2009

Specifically, if management's conclusions as to the number of claims that will be received, of those, the number that will be upheld, and the estimated average settlement per case were different, but within the range of what management deemed to be reasonably possible, the provision charge for misselling in the Retail Banking segment could have decreased in 2009 by up to £4m (2008 £25m), with a potential corresponding increase (2008 decrease) in the Group's profit (2008 loss) before tax in 2009 of up to 8% (2008 2%), or increased by up to £5m (2008 £16m), with a potential corresponding decrease (2008 increase) in the Group's profit (2008 loss) before tax in 2009 of up to 9% (2008 1%) The actual charge in 2009 was based on what management estimated to be the most probable number of claims that will be received, of those, the number that will be upheld, and the estimated average settlement per case within the range of reasonably possible outcomes

(d) Pensions

The Group operates a funded and an unfunded defined benefit pension scheme as described in Note 32 to the Consolidated Financial Statements The assets of the funded scheme are measured at their fair values at the balance sheet date The liabilities of the schemes are estimated by projecting forward the growth in current accrued pension benefits to reflect inflation and salary growth to the date of pension payment, discounted to present value using the interest rate applicable to high quality AA rated corporate bonds of the same currency and term as the scheme liabilities 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 In determining the value of scheme liabilities, assumptions are made by management as to mortality, price inflation, discount rates, pension increases, and earnings growth 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

The Group considers accounting estimates related to pension provisions 'critical accounting estimates' because (i) they are highly susceptible to change from period to period, and (ii) any significant difference between the Group's estimates of the scheme liabilities and actual liabilities could significantly alter the amount of the surplus or deficit recognised in the balance sheet and the pension cost charged to the income statement The Group's assumptions principally about mortality, but also about price inflation, discount rates, pension increases, and earnings growth, are based on past experience and current economic trends, which are not necessarily an indication of future experience

Pension service costs are charged to the line item 'Administration expenses', with the interest cost on liabilities and the expected return on scheme assets included within 'Net trading and other income' in the income statement The provision is included in the 'Retirement benefit obligations' line item in the balance sheet If the Group believes that increases to the pensions cost are required, then the Group records additional costs that would be treated as a charge in the line item Administration expenses or Net trading and other income in the income statement

The Consolidated Financial Statements for the year ended 31 December 2009 include current year defined benefit service cost of £8m and a pension scheme deficit of £139m The current year service cost of £8m (2008 £19m) was reduced, reflecting reductions in scheme membership, salary reviews, changes in pension increases, changes in mortality assumptions, changes in price inflation assumptions and changes in discount rates The current year pension scheme deficit of £139m (2008 £7m) was increased, reflecting changes in price inflation assumptions, changes in discount rates, reductions in scheme membership, salary reviews, changes in pension increases and changes in mortality assumptions In calculating the current year service cost and deficit, a range of outcomes was calculated based principally on management's estimates regarding mortality, price inflation, discount rates, pension increases, and earnings growth Had management used different assumptions principally regarding mortality, but also price inflation, discount rate, pensions increases and earnings growth, a larger or smaller charge for pension costs would have resulted that could have had a material impact on the Group's reported profit before tax in 2009

Specifically, if management's conclusions as to mortality, price inflation, discount rates, pensions increases and earnings growth were different, but within the range of what management deemed to be reasonably possible conclusions, the charge for pension costs could have decreased in 2009 from an actual pension charge of £8m (2008 £19m) by up to £2m (2008 £10m), with a potential corresponding increase (2008 decrease) in the Group's profit (2008 loss) before tax in 2009 of up to 4% (2008 1% decrease in loss), or increased by up to £2m (2008 £5m), with a potential corresponding decrease (2008 increase) in the Group's profit (2008 loss) before tax in 2009 of up to 4% (2008 0%) The actual current year service pension charge of £8m (2008 £19m) in 2009 was based on what management estimated to be the most probable mortality, price inflation, discount rates, pensions increases and earnings growth within the range of reasonably possible values In addition, if management's conclusions as to mortality, price inflation, discount rates, pensions increases and earnings growth were different, but within the range of what management deemed to be reasonably possible conclusions, the value of the deficit at the year end could have moved in 2009 from an actual deficit of £139m (2008 £7m deficit) to a deficit of up to £9m (2008 surplus of up to £117m), or increased to a deficit of up to £243m (2008 deficit of up to £90m)

(e) Deferred tax

The Group recognises deferred tax assets with respect to tax losses carried forward to the extent that it is probable that future taxable profits will be available against which the unused tax losses and unused tax credits can be utilised At 31 December 2009 and 2008 the Group has recognised such deferred tax assets in full As at 31 December 2009 this amounted to £297m (2008 £368m) The value of the deferred tax asset is based on management's best estimate of the amount that will be recoverable in the foreseeable future This estimate is based on management's assessment of future taxable profits that are expected to arise over this period

The Group considers accounting estimates related to deferred tax assets 'critical accounting estimates' because (i) they are highly susceptible to change from period to period as the assumptions about future taxable profits represent forward-looking estimates which are inherently vulnerable to changes in economic and market conditions, and (ii) any significant shortfall between the Group's estimated taxable profits and actual taxable profits could require the Group to take charges which, if significant, could have a material impact on its future income statement and its balance sheet The Group's assumptions about estimated future taxable profits are based on assumptions about future performance within the Santander UK plc group, of which Alliance & Leicester plc has become a part, and general economic conditions, which are not necessarily an indication of future performance

Changes to the value of deferred tax assets are charged to the line item 'Taxation credit' in the income statement The changes in deferred tax assets are deducted from the 'Deferred tax assets' line item on the balance sheet

The Consolidated Financial Statements for the year ended 31 December 2009 do not include a charge for changes in the value of deferred tax assets arising in connection with the non recoverability of taxable losses If management estimates of future tax profits were not met, it is possible that the deferred tax asset would still be recovered, but over a longer period, therefore it is not possible to quantify reliably a meaningful sensitivity or range of possible outcomes Under current UK tax legislation, the tax losses in respect of which deferred tax assets have been recognised do not expire

It is management's view that the recoverable value of the deferred tax asset will be unaffected by the scheme allowed by Part VII of the Financial Services and Markets Act 2000 under which the Company intends to transfer Alliance & Leicester plc's business into Santander UK plc later this year, as described in Note 42

Notes to the Financial Statements

1. Segments

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

> Retail Banking,
> Corporate Banking,
> Private Banking, and
> Group Infrastructure

In 2009, the off-shore deposit-taking company was managed and reported separately from the rest of the Retail Banking businesses and renamed Private Banking The segmental analysis of the Group's results for 2008 has been amended to reflect this change In addition, in 2009, the Group's transfer pricing arrangements were updated to reflect the greater benefit of retail deposits in a period of higher funding costs 2008 has been adjusted for consistency

The Group's segments are strategic business units that offer different products and services They are managed separately because each business requires different technology and marketing strategies The Group has four segments Retail Banking offers a range of personal banking, savings and mortgage products and services Corporate Banking offers banking services principally to small and mid-sized UK companies It also contains operations in run down Private Banking offers specialist banking services Group Infrastructure consists of Asset and Liability Management activities and the Treasury asset portfolio

The segment information below is presented on the basis used by the Company's Board to evaluate performance, in accordance with IFRS 8 The Company's Board reviews discrete financial information for each of its segments, including measures of operating results and assets The segments are managed primarily on the basis of their results, which are measured on a 'trading' basis The trading basis differs from the statutory basis (described in the Accounting Policies section on pages 54 to 67) as a result of the application of various adjustments Management considers that the trading basis provides the most appropriate way of reviewing the performance of the business Management reviews the Group's performance on a basis consistent with its presentation at the Santander UK group level Therefore those items that either eliminate, or are treated as non-trading, at a Santander UK group level are treated as non-trading by the Group

The adjustments are

> **Reorganisation and other items** – These comprise implementation costs in relation to the integration of Alliance & Leicester into Santander UK plc, as well as certain remediation administration expenses, credit provisions and other one-off items Management needs to understand the underlying drivers of the cost base that will remain after these exercises are complete, and does not want this view to be clouded by these costs, which are managed independently
> **Depreciation of operating lease assets** – The operating lease businesses are managed as financing businesses and, therefore, management needs to see the margin earned on the businesses Residual value risk is separately managed As a result, the depreciation is netted against the related income
> **Hedging and other variances** – The Balance Sheet and Income Statement are subject to mark-to-market volatility including that arising from the accounting for elements of derivatives deemed under IFRS to be ineffective as hedges Where appropriate, such volatility is separately identified to enable management to view the underlying performance of the business
> **Treasury asset portfolio** – This portfolio is managed separately as a run-down portfolio
> **Capital and other charges** – These principally comprise internal nominal charges for capital invested in the Group's businesses Management implemented this charge with effect from 2009 to assess the effectiveness of capital investments

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

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

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

Notes to the Financial Statements continued

2009	Retail Banking £m	Corporate Banking £m	Private Banking £m	Group Infra-structure £m	Total £m	Adjustments £m	Group Total £m
Net interest income	835	162	8	(177)	828	(66)	762
Non-interest income	179	110	1	(30)	260	191	451
Total trading income	1,014	272	9	(207)	1,088	125	1,213
Administration expenses	(301)	(128)	(4)	(19)	(452)	(154)	(606)
Depreciation and amortisation	(30)	(13)	(1)	(4)	(48)	(73)	(121)
Total trading expenses	(331)	(141)	(5)	(23)	(500)	(227)	(727)
Impairment losses on loans and advances	(143)	(4)	-	(57)	(204)	(144)	(348)
Provisions for other liabilities and charges	-	-	-	-	-	(81)	(81)
Trading profit/(loss) before tax	540	127	4	(287)	384	(327)	57
Adjust for							
Reorganisation and other items	(66)	(85)	-	(14)	(165)		
Hedging and other variances	-	-	-	57	57		
Treasury asset portfolio	-	-	-	(219)	(219)		
Capital and other charges	(75)	(70)	-	145	-		
Profit/(loss) before tax	399	(28)	4	(318)	57		
Average number of staff	5,375	404	31	91	5,901		
Total assets	56,643	19,595	4	33,696	109,938		

Adjustments comprise	Net interest income £m	Non interest income £m	Administration expenses £m	Depreciation and amortisation £m	Impairment losses on loans and advances £m	Provisions for other liabilities and charges £m	Profit/(loss) before tax £m
Reorganisation and other items	50	104	(154)	-	(84)	(81)	(165)
Depreciation on operating lease assets	-	73	-	(73)	-	-	-
Hedging and other variances	43	14	-	-	-	-	57
Treasury asset portfolio	(159)	-	-	-	(60)	-	(219)
	(66)	191	(154)	(73)	(144)	(81)	(327)

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

2008	Retail Banking £m	Corporate Banking £m	Private Banking £m	Group Infrastructure £m	Total £m	Adjustments £m	Group Total £m
Net interest income	592	147	10	(132)	617	(233)	384
Non-interest income	211	131	2	(14)	330	110	440
Total trading income	803	278	12	(146)	947	(123)	824
Administration expenses	(344)	(174)	(4)	(30)	(552)	(375)	(927)
Depreciation and amortisation	(26)	(20)	-	(2)	(48)	(66)	(114)
Total trading expenses	(370)	(194)	(4)	(32)	(600)	(441)	(1,041)
Impairment losses	(133)	(50)	-	-	(183)	(850)	(1,033)
Provisions for other liabilities and charges	-	-	-	-	-	(38)	(38)
Trading profit/(loss) before tax	300	34	8	(178)	164	(1,452)	(1,288)
Adjust for							
Reorganisation and other items	(366)	(202)	-	(321)	(889)		
Hedging and other variances	-	-	-	(78)	(78)		
Treasury asset portfolio	-	-	-	(485)	(485)		
Profit/(loss) before tax	(66)	(168)	8	(1,062)	(1,288)		
Average number of staff	5,370	404	31	91	5,896		
Total assets	40,891	9,954	3	24,396	75,244		

Notes to the Financial Statements continued

Adjustments comprise	Net interest income £m	Non interest income £m	Administration expenses £m	Depreciation and amortisation £m	Impairment losses on loans and advances £m	Provisions for other liabilities and charges £m	Profit/(loss) before tax £m
Reorganisation and other items	(269)	158	(375)	-	(365)	(38)	(889)
Depreciation on operating lease assets	-	66	-	(66)	-	-	-
Hedging and other variances	36	(114)	-	-	-	-	(78)
Treasury asset portfolio	-	-	-	-	(485)	-	(485)
	(233)	110	(375)	(66)	(850)	(38)	(1,452)

No geographical analysis is presented because substantially all of the Group's activities are in the UK

2. Net interest income

	Group 2009 £m	2008 £m
Interest and similar income		
On loans and advances to Group undertakings	203	-
Loans and advances to banks	1	242
Loans and advances to customers	1,938	2,987
Other interest-earning financial assets	222	803
Total interest and similar income	2,364	4,032
Interest expense and similar charges		
On deposits by Group undertakings	428	-
Deposits by banks	166	1,017
Deposits by customers	505	1,262
Debt securities in issue	341	1,219
Other interest-bearing financial liabilities	162	150
Total interest expense and similar charges	1,602	3,648
Net interest income	762	384

3. Net fee and commission income

	Group 2009 £m	2008 £m
Fee and commission income		
Retail products	332	418
Insurance products	47	53
Asset management	18	-
Total fee and commission income	397	471
Fee and commission expense.		
Other fees paid	44	79
Total fee and commission expense	44	79
Net fee and commission income	353	392

4. Net trading and other income

	Group 2009 £m	2008 £m
Net trading and funding of other items by the trading book	-	(7)
Income from operating lease assets	95	88
Losses on assets designated at fair value through profit or loss	(2)	(11)
Funding on liabilities designated at fair value through profit or loss	-	(1)
Gains on derivatives managed with assets / liabilities held at fair value through profit or loss	-	-
Excess on sale of credit cards to MBNA	-	16
Profit on sale of fixed assets	1	-
Mark-to-market losses on credit default swaps	17	(115)
Hedge ineffectiveness and other	(13)	78
	98	48

5. Administration expenses

	Group 2009 £m	2008 £m
Staff costs		
Wages and salaries	**184**	221
Social security costs	**19**	20
Pensions costs – defined contribution plans	**11**	10
– defined benefit plans	**7**	15
Other personnel costs	**21**	74
	242	340
Property, plant and equipment expenses	**68**	39
Information technology expenses	**43**	42
Intangible and tangible assets write offs	**-**	163
Other administrative expenses	**253**	343
	606	927

Other personnel costs include restructuring costs

6. Depreciation and amortisation

	Group 2009 £m	2008 £m
Depreciation of property, plant and equipment excluding operating lease assets	**36**	32
Depreciation of operating lease assets	**74**	66
Amortisation of intangible assets	**11**	16
	121	114

7. Audit services

The fees for audit services payable to the Company's auditors, Deloitte LLP, are analysed as follows

	Group 2009 £m	2008 £m
Fees payable to the Company's auditors for the audit of the Group's annual accounts	**0 3**	0 8
Fees payable to the Company's auditors and its associates for the audit of the Company's subsidiaries pursuant to legislation	**0.6**	0 6
Total audit fees	**0 9**	1 4

8. Impairment losses on loans and advances

	Group 2009 £m	2008 £m
Impairment losses on loans and advances	**363**	1,045
Recoveries of loans and advances	**(15)**	(12)
	348	1,033

Notes to the Financial Statements continued

9. Taxation credit

	Group 2009 £m	2008 £m
Current tax		
UK corporation tax on profit of the year	**(161)**	–
Adjustments and reclassifications in respect of prior periods	**(36)**	(45)
Overseas taxation	**1**	1
Total current tax credit	**(196)**	(44)
Deferred tax charge/(credit)		
Current year	**151**	(340)
Adjustments and reclassifications in respect of prior periods	**42**	14
Total deferred tax charge/(credit)	**193**	(326)
Tax credit for the year	**(3)**	(370)

UK corporation tax is calculated at 28% (2008 28 5%) of the estimated assessable profits for the year The low effective corporation tax rate reflects non-equalised items The standard rate of UK corporation tax reduced from 30% to 28% with effect from 1 April 2008 Taxation for other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions

The tax on the Group's profit/(loss) before tax differs from the theoretical amount that would arise using the basic tax rate of the Company as follows

	Group 2009 £m	2008 £m
Profit/(loss) before tax	**57**	(1,288)
Tax calculated at a tax rate of 28% (2008 28 5%)	**16**	(367)
Effect of non-allowable provisions and other non-equalised items	**(23)**	24
Tax relief in respect of Innovative Tier 1	**-**	(5)
Impact of loss of capital allowances	**-**	4
Effect of non-UK profits and losses	**(2)**	(2)
Effect of change in tax rate on deferred tax provision	**-**	7
Adjustment to prior year provisions	**6**	(31)
Income tax credit	**(3)**	(370)

In addition to the income tax expense charged to profit or loss, a deferred tax asset of £1m (2008 £3m) has been recognised in equity in the year Further information about deferred income tax is presented in Note 23

10. Loss on ordinary activities after tax

The loss after tax of the Company attributable to the shareholders is £78m (2008 £275m) As permitted by Section 408 of the UK Companies Act 2006, the Company's profit and loss account has not been presented in these Consolidated Financial Statements

11. Cash and balances at central banks

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Cash in hand	**400**	457	**400**	457
Balances with central banks	**46**	1,096	**46**	1,096
	446	1,553	**446**	1,553

For regulatory purposes, certain minimum cash balances are required to be maintained with the Bank of England At 31 December 2009, these amounted to £46m (2008 £48m)

12 Derivative financial instruments

All derivatives are required to be classified as held at fair value through profit or loss and classified as held for trading (except where in a hedge relationship) and held at fair value through profit or loss Derivatives are held for trading or for risk management purposes The Group chooses to designate certain derivatives as in a hedging relationship if they meet specific criteria

Derivatives held for trading purposes

The Group does not hold derivative products for trading purposes Derivatives held for economic hedging purposes that do not qualify for hedge accounting under IAS 39 are required to be classified as "held for trading purposes" Responsibility for implementing derivative hedging with the external market is transferred to Santander UK

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

Derivatives held for risk management purposes

The main derivatives are interest rate and cross-currency swaps, which are used to hedge the Group's exposure to interest rates and exchange rates These risks are inherent in non-trading assets, liabilities and positions, including fixed-rate lending and structured savings products within the relevant operations throughout the Group, including medium-term note issues, capital issues and fixed-rate asset purchases Such risks may also be managed using natural offsets within other on-balance sheet instruments as part of an integrated approach to risk management

Derivative products which are combinations of more basic derivatives (such as swaps with embedded option features), or which have leverage features, may be used in circumstances where the underlying position being hedged contains the same risk features In such cases, the derivative used will be structured to match the risks of the underlying asset or liability Exposure to market risk on such contracts is therefore hedged The fair values of derivative instruments held both for trading and hedging purposes are set out in the following tables The tables below show the contract or underlying principal amounts, positive and negative fair values of derivatives analysed by contract Contract or notional amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts of risk The fair values represent the amount at which a contract could be exchanged in an arm's length transaction, calculated at market rates at the balance sheet date

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

			Group
2009 **Derivatives held for trading**	**Contract/notional Amount £m**	**Fair value Assets £m**	**Fair value Liabilities £m**
Exchange rate contracts			
– Cross-currency swaps	4,053	758	20
– Foreign exchange swaps and forwards	428	3	22
	4,481	761	42
Interest rate contracts			
– Interest rate swaps	2,493	89	134
– Caps, floors and swaptions	1,044	21	20
	3,537	110	154
Credit contracts			
– Credit default swaps	15	-	2
Total derivative assets and liabilities held for trading	8,033	871	198

			Group
2009 **Derivatives held for fair value hedging**	**Contract/notional Amount £m**	**Fair value Assets £m**	**Fair value Liabilities £m**
Interest rate contracts			
– Interest rate swaps	2,562	237	-
Total derivative assets and liabilities held for fair value hedging	2,562	237	-
Total recognised derivative assets and liabilities	10,595	1,108	198

Notes to the Financial Statements continued

2009 Derivatives held for trading	Contract/notional Amount £m	Fair value Assets £m	Company Fair value Liabilities £m
Exchange rate contracts			
– Cross-currency swaps	1,450	176	45
– Foreign exchange swaps and forwards	428	3	22
	1,878	179	67
Interest rate contracts			
– Interest rate swaps	8,284	142	223
– Caps, floors and swaptions	1,044	21	20
	9,328	163	243
Credit contracts			
– Credit default swaps	162	2	8
Total derivative assets and liabilities held for trading	11,368	344	318

2009 Derivatives held for fair value hedging	Contract/notional Amount £m	Fair value Assets £m	Company Fair value Liabilities £m
Interest rate contracts			
– Interest rate swaps	2,562	238	-
Total derivative assets and liabilities held for fair value hedging	2,562	238	-
Total recognised derivative assets and liabilities	13,930	582	318

2008 Derivatives held for trading	Contract/notional Amount £m	Fair value Assets £m	Group Fair value Liabilities £m
Exchange rate contracts			
– Cross-currency swaps	6,044	1,738	21
– Foreign exchange swaps and forwards	2,461	–	336
	8,505	1,738	357
Interest rate contracts			
– Interest rate swaps	20,629	386	286
– Caps, floors and swaptions	496	7	1
	21,125	393	287
Credit contracts			
– Credit default swaps	25	1	12
Total derivative assets and liabilities held for trading	29,655	2,132	656

2008 Derivatives held for hedging	Contract/notional Amount £m	Fair value Assets £m	Group Fair value Liabilities £m
Exchange rate contracts			
– Cross-currency swaps	170	80	–
Interest rate contracts			
– Interest rate swaps	39,291	664	877
Total derivative assets and liabilities held for hedging	39,461	744	877
Total recognised derivative assets and liabilities	69,116	2,876	1,533

2008 Derivatives held for trading	Contract/notional Amount £m	Fair value Assets £m	Company Fair value Liabilities £m
Exchange rate contracts			
– Cross-currency swaps	2,790	714	83
– Foreign exchange swaps and forwards	2,486	–	334
	5,276	714	417
Interest rate contracts			
– Interest rate swaps	32,953	562	431
– Caps, floors and swaptions	496	6	1
	33,449	568	432
Credit contracts			
– Credit default swaps	185	(11)	66
Total derivative assets and liabilities held for trading	38,910	1,271	915

2008 Derivatives held for hedging	Contract/notional Amount £m	Fair value Assets £m	Company Fair value Liabilities £m
Exchange rate contracts			
– Cross-currency swaps	170	73	–
Interest rate contracts			
– Interest rate swaps	37,581	498	627
Total derivative assets and liabilities held for hedging	37,751	571	627
Accrued interest	–	348	129
Total recognised derivative assets and liabilities	76,661	2,190	1,671

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

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Net gains/(losses)				
– on hedging instruments	**436**	(521)	**436**	(297)
– on hedged items attributable to hedged risks	**(394)**	509	**(394)**	343
Transferred from the cash flow reserve	**(48)**	11	**(48)**	24
Other	**-**	21	**-**	156
	(6)	20	**(6)**	226

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

The Company previously applied cash flow hedge accounting to cash flow hedges of interest rate risk on a portfolio of variable rate assets Due to the administrative burden associated with the detailed hedge accounting provisions of IAS 39 the Company opted to cease claiming hedge accounting during 2009

13. Financial assets designated at fair value

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Debt securities	**50**	63	**50**	63

Financial assets are designated at fair value through profit or loss where this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis, or where a contract contains one or more embedded derivatives

Debt securities representing holdings of collateralised synthetic obligations of £50m (2008 £nil) and asset-backed securities of £nil (2008 £63m) have been designated at fair value through profit or loss

> The collateralised synthetic obligations contain embedded derivatives which would otherwise require bifurcation and separate recognition as derivatives The collateralised synthetic obligations were initially recognised in 2009 upon the consolidation of the assets of the Group's Conduit vehicles as described in 'Exposure to Off-Balance Sheet Entities sponsored by the Group - Secured Loan to Conduit' in the Risk Management Report

> The asset-backed securities were managed, and their performance was evaluated, on a fair value basis in accordance with a documented investment strategy and information about them was provided internally on that basis to the Group's key management personnel

The maximum exposure to credit risk on the financial assets held at fair value through profit or loss at the balance sheet date was £94m (2008 £97m) for the Group and £94m (2008 £97m) for the Company

Debt securities can be analysed by listing status as follows

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Listed outside UK	**50**	38	**50**	38
Unlisted	**-**	25	**-**	25
	50	63	**50**	63

Notes to the Financial Statements continued

14 Loans and advances to banks

	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
Placements with other banks	**325**	1,239	**297**	1,236
Amounts due from fellow subsidiaries	**49,532**	–	**45,911**	–
	49,857	1,239	**46,208**	1,236

Repayable	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
On demand	**2,621**	816	**2,222**	814
In not more than 3 months	**12,204**	77	**12,193**	77
In more than 3 months but not more than 1 year	**14,529**	346	**13,256**	345
In more than 1 year but not more than 5 years,	**15,343**	-	**15,343**	-
Due in more than 5 years	**5,160**	-	**3,194**	-
	49,857	1,239	**46,208**	1,236

15. Loans and advances to customers

	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
Loans secured on residential properties	**37,729**	37,665	**37,728**	37,665
Corporate loans	**7,598**	9,058	**4,408**	5,419
Finance leases	**1,602**	1,791	-	-
Other secured advances	**37**	57	**29**	10
Other unsecured advances	**215**	3,477	**215**	188
Amounts due from subsidiaries	-	-	**10,255**	9,661
Amounts due from fellow subsidiaries	**38**	-	**38**	-
Loans and advances to customers	**47,219**	52,048	**52,673**	52,943
Less loan loss allowances	**(423)**	(646)	**(541)**	(339)
Loans and advances to customers, net of loan loss allowances	**46,796**	51,402	**52,132**	52,604

Repayable	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
On demand	**275**	108	**681**	3,374
In no more than 3 months	**1,827**	831	**4,722**	5,211
In more than 3 months but not more than 1 year	**1,488**	3,262	**2,508**	2,721
In more than 1 year but not more than 5 years	**8,894**	10,282	**10,156**	7,118
In more than 5 years	**34,735**	37,565	**34,606**	34,519
Loans and advances to customers	**47,219**	52,048	**52,673**	52,943
Less loan loss allowances	**(423)**	(646)	**(541)**	(339)
Loans and advances to customers, net of loan loss allowances	**46,796**	51,402	**52,132**	52,604

The Group's leasing subsidiary, Alliance & Leicester Commercial Finance plc and its subsidiaries, enters into finance lease and hire purchase arrangements with customers

Gross investment in finance leases and hire purchase contracts receivable	2009 £m	2008 £m
Within 1 year	**240**	333
Between 1-5 years	**543**	699
In more than 5 years	**1,570**	1,556
	2,353	2,588
Unearned future finance income on finance leases and hire purchase contracts	**(751)**	(797)
Net investment in finance leases and hire purchase contracts	**1,602**	1,791

The net investment in finance leases and hire purchase contracts is analysed as follows	2009 £m	2008 £m
Within 1 year	**246**	230
Between 1-5 years	**435**	484
In more than 5 years	**921**	1,077
Net investment in finance leases and hire purchase contracts	**1,602**	1,791

Included in the carrying value of Net investment in finance leases and hire purchase contracts is £13m (2008 £48m) residual value at the end of the current lease terms, which will be recovered through re-letting or sale

Included within loans and advances to customers are £nil (2008 £3,222m) of mortgage advances assigned to a bankruptcy remote special purpose entity, Alliance & Leicester Covered Bonds LLP These loans provide security to issues of covered bonds made by the Company

Loans and advances to customers have the following interest rate structures

	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
Fixed rate	**15,084**	24,788	**14,984**	19,765
Variable rate	**32,135**	27,260	**37,689**	33,178
Less loan loss allowances	**(423)**	(646)	**(541)**	(339)
	46,796	51,402	**52,132**	52,604

Movement in loan loss allowances

2009 (Group)	Loans secured on residential property £m	Corporate loans £m	Finance leases £m	Other secured advances £m	Other unsecured advances £m	Total £m
As at 1 January 2009						
- Individually assessed	45	138	4	1	289	477
- Collectively assessed	14	132	1	-	22	169
	59	270	5	1	311	646
Disposal of portfolio						
- Individually assessed	-	-	-	-	(73)	(73)
- Collectively assessed	-	-	-	-	(11)	(11)
	-	-	-	-	(84)	(84)
Charge/(release) to the income statement						
- Individually assessed	34	122	5	(1)	113	273
- Collectively assessed	41	(34)	-	-	(9)	(2)
	75	88	5	(1)	104	271
Write offs	(16)	(96)	(8)	-	(290)	(410)
At 31 December 2009						
- Individually assessed	63	164	1	-	39	267
- Collectively assessed	55	98	1	-	2	156
	118	262	2	-	41	423

During the year, Alliance & Leicester Personal Finance Limited sold its unsecured loan portfolio to Santander UK plc There was no profit or loss on the sale

2008 (Group)	Loans secured on residential property £m	Corporate loans £m	Finance leases £m	Other secured advances £m	Other unsecured advances £m	Total £m
As at 1 January 2008						
- Individually assessed	8	-	4	1	115	128
- Collectively assessed	4	18	7	-	6	35
	12	18	11	1	121	163
Charge/(release) to the income statement						
- Individually assessed	46	155	-	-	272	473
- Collectively assessed	10	114	(6)	-	16	134
	56	269	(6)	-	288	607
Write offs	(9)	(17)	-	-	(98)	(124)
At 31 December 2008						
- Individually assessed	45	138	4	1	289	477
- Collectively assessed	14	132	1	-	22	169
	59	270	5	1	311	646

2009 (Company)	Loans secured on residential property £m	Amounts due from subsidiaries £m	Corporate loans £m	Finance leases £m	Other secured advances £m	Other unsecured advances £m	Total £m
As at 1 January 2009	59	39	160	–	1	105	364
Charge/(release) to the income statement	75	222	27	–	(1)	47	370
Write-offs	(17)	–	(66)	–	–	(110)	(193)
At 31 December 2008	117	261	121	–	–	42	541

Notes to the Financial Statements continued

Company

2008	Loans secured on residential property £m	Amounts due from subsidiaries £m	Corporate loans £m	Finance leases £m	Other secured advances £m	Other unsecured advances £m	Total £m
As at 1 January 2008	12	–	–	–	14	18	44
Charge to the income statement	56	20	–	–	88	173	337
Write-offs	(9)	(6)	–	–	(5)	(22)	(42)
At 31 December 2008	59	14	–	–	97	169	339

Recoveries

Group

	Loans secured on residential property £m	Corporate loans £m	Finance leases £m	Other secured advances £m	Other unsecured advances £m	Total £m
2009	-	2	-	-	13	15
2008	1	1	-	-	10	12

16. Securitisation of assets

Loans and advances to customers include portfolios of residential mortgage loans, which are subject to non-recourse finance arrangements These loans have been purchased by, or assigned to, special purpose securitisation companies, and have been funded primarily through the issue of mortgage-backed securities No gain or loss has been recognised as a result of these sales These securitisation companies are consolidated and included in the Group financial statements as subsidiaries

The Company receives payments from the securitisation companies in respect of fees for administering the loans, and payment of deferred consideration for the sale of the loans While any notes remain outstanding from a securitised company, the Company has no right or obligation to repurchase the benefit of any securitised loan from that securitised company, except if certain representations and warranties given by the Company at the time of transfer are breached

Master Trust Structures
The Group makes use of a type of securitisation known as a master trust structure In this structure, a pool of assets is assigned to a trust company by the asset originator, initially funded by the originator A funding entity acquires beneficial interests in a share of the portfolios of assets with funds borrowed from qualifying special purpose entities, which at the same time issue asset-backed securities to third-party investors or the Company The purpose of the special purpose entities is to obtain funding through the issue of asset-backed securities, or to use the asset-backed securities as collateral for raising funds The share of the pool of assets not purchased from the trust company by the funding entity is known as the beneficial interest of the originator

The Company established the Fosse Master Trust securitisation structure in 2006 Notes were issued by Fosse Master Issuer plc to third party investors and the proceeds loaned to Fosse Funding (No 1) Limited, which in turn used the funds to purchase beneficial interests in mortgages held by Fosse Trustee Limited The Company raised £2,502m in 2007, £396m in 2008 and £nil in 2009 from securitisations involving the Fosse Master Trust Mortgage backed notes totalling £0 6bn equivalent were redeemed during the year

In March 2010 the Group issued through the Fosse Master Trust the first publicly-placed mortgage-backed securitisation transaction from a UK bank since 2007, other recent transactions from UK banks had included an investor put The transaction was denominated in both pounds sterling and euro and raised approximately £1 4bn

The Company established the Langton Master Trust securitisation structure on 25 January 2008 Notes are issued by Langton Securities (2008-1) plc, Langton Securities (2008-2) plc and Langton Securities (2008-3) plc to the Company, either for the purpose of creating collateral to be used for funding or for subsequent transfer of Notes to investors outside the Group Each entity loaned the proceeds of the Notes issued to Langton Funding (No 1) Limited, which in turn used the funds to purchase a beneficial interest in the mortgages held by Langton Mortgages Trustee Limited

The Company and its subsidiaries are under no obligation to support any losses that may be incurred by the Fosse and Langton companies or holders of the securities and do not intend to provide such required support Holders of the securities are only entitled to obtain payment of principal and interest to the extent that the resources of the companies are sufficient to support such payments, and the holders of the securities have agreed in writing not to seek recourse in any other form

The Company 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 The Company and its subsidiaries have no right or obligation to repurchase the benefit of any securitised loan, except if certain representations and warranties given by the Company or its subsidiaries at the time of transfer are breached

Bracken Securities plc

In October 2007 the Company securitised £10,367m of residential mortgage assets to Bracken Securities plc Notes of £10,367m were issued by Bracken Securities plc to the Company, either for the purpose of creating collateral to be used for funding or for subsequent transfer of Notes to investors outside the Group

Outstanding balances of assets securitised and non-recourse finance at 31 December 2009 were as follows

Securitisation company	Closing date of securitisation	Gross assets Securitised £m	Non-recourse Finance £m	Issued to A&L as collateral £m
Fosse Master Issuer plc	28 Nov 2006	1,859	1,924	-
Fosse Master Issuer plc	1 Aug 2007	2,050	2,080	-
Fosse Master Issuer plc	21 Aug 2008	287	314	-
Bracken Securities plc	11 Oct 2007	6,736	-	6,909
Langton Securities (2008-1) plc	25 Jan 2008	1,227	-	1,228
Langton Securities (2008-2) plc	5 Mar 2008	2,210	-	2,211
Langton Securities (2008-3) plc	17 Jun 2008	3,521	-	3,522
Beneficial interest in mortgages held by Fosse Master Trust Ltd		2,251	-	-
Beneficial interest in mortgages held by Langton Master Trust Ltd		1,572	-	-
		21,713	4,318	13,870

The securitisation companies have cash deposits totalling £115m, which have been accumulated to finance the redemption of a number of Securities issued by the Securitisation Companies The securitisation companies' contractual interest in advances secured on residential property is therefore reduced by this amount The Company does not own directly, or indirectly, any of the share capital of any of the above Securitisation Companies or their parents

Issues under the Group's covered bond programmes are not included in the tables above For more information, see Note 28

17. Available-for-sale securities

	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
Debt securities	3	1,648	–	1,644
Equity securities	8	10	8	10
	11	1,658	8	1,654

Maturities of debt securities

	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
Due in less than 3 months	-	1,644	-	1,644
Due in more than 3 months but less than 1 year	3	-	-	-
Due in more than 1 year but not more than 5 years	-	4	-	-
	3	1,648	-	1,644

Debt securities do not include any Treasury Bills (2008 £1,644m) in either the Group or Company Equity securities do not bear interest and are all unlisted

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

	Group £m	Company £m
At 1 January 2009	1,658	1,654
Additions	3	3
Redemptions and maturities	(1,650)	(1,649)
At 31 December 2009	11	8

	Group £m	Company £m
At 1 January 2008	12,773	12,761
Additions	2,078	2,078
Redemptions and maturities	(2,385)	(2,385)
Transfers	(13,436)	(13,428)
Movement in fair value	(251)	(251)
Other movements	2,879	2,879
At 31 December 2008	1,658	1,654

Notes to the Financial Statements continued

18. Loan and receivable securities

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Loan and receivable securities	9,828	14,250	9,994	14,321

In 2008, the Group applied the amendment to IAS 39 regarding the reclassification of financial assets out of 'fair value through profit & loss' and 'available-for-sale' categories into 'loans & receivables' If these assets had remained as 'available-for-sale', the pre-tax impact on the 'available-for-sale' reserve would have been a credit of £577m (2008 charge of £1,018m) based on exit prices for these debt securities rather than their recoverable values The credit for the year is a result of the significant improvement in the mark-to-market deficit and effective disposal programme The net income recognised in the income statement on these assets in 2009 was £128m The pre-tax charge to the 'available-for-sale' reserve on these assets in 2008 prior to the reclassification was £264m

The amount reclassified out of 'held-for-trading' and into 'loans & receivables' in 2008 was £732m If these assets had remained as 'held-for-trading' a £25m fair value gain (2008 £54m fair value loss) would have been recognised in the income statement The net income recognised in the income statement on these assets in 2009 was £27m The loss recognised in income in 2008 on these assets prior to the reclassification was £6m There has been no change in the way net interest income is recognised in the income statement on these assets reclassified The reclassifications were made as there was no active trading market in the assets The reduction in the carrying value of the reclassified assets prior to their reclassification is expected to be recovered over the period to maturity of the assets This is being recognised on a straight-line basis over the period to maturity, which is considered to be immaterially different to using an Effective Interest Rate basis

The assets were reclassified as the Group identified that a rare circumstance of extreme market illiquidity had arisen At the date of reclassification, management had the intention to hold the assets for the foreseeable future or until maturity, and the assets would have met the 'loans and receivables' classification had they not originally been required to be classified as held-for-trading or designated as available-for-sale

In 2009, the Group recognised additional securities as a result of the requirement to consolidate the assets of the Group's Conduit vehicles, rather than recognising the Group's loans to the Conduit vehicles and treating the assets of the Conduit vehicles as off-balance sheet, as described in "Exposure to Off-Balance Sheet Entities sponsored by the Group - Secured Loan to Conduit" in the Risk Management Report on page 36 Upon initial recognition by the Group, these securities were classified as 'loans and receivables' as the Group identified that a rare circumstance of extreme market illiquidity existed at that time

Detailed analysis of these securities is contained in the Risk Management Report

19. Investment in subsidiary undertakings

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

			Company
	Cost £m	**Impairment £m**	**Net book value £m**
At 1 January 2009	**1,097**	**(6)**	**1,091**
Disposals within the Group	**(158)**	**-**	**(158)**
Impairments	**-**	**(46)**	**(46)**
At 31 December 2009	**939**	**(52)**	**887**

	Cost £m	Impairment £m	Net book value £m
At 1 January 2008	1,091	-	1,091
Additions	6	-	6
Impairments	-	(6)	(6)
At 31 December 2008	1,097	(6)	1,091

The principal subsidiaries of Alliance & Leicester plc at 31 December 2009 are shown below The Directors consider that to give full particulars of all subsidiary undertakings would lead to a statement of excessive length In accordance with Section 410(2) of the Companies Act 2006, the following information relates to those subsidiary undertakings whose results or financial position, in the opinion of the Directors, principally affect the results of the Group Full particulars of all subsidiary undertakings will be annexed to the Company's next annual return in accordance with Section 410(3)(b) of the Companies Act 2006

Principal subsidiary	Nature of business	% interest held	Country of incorporation or registration
Alliance & Leicester Personal Finance Limited	Unsecured lending	100	England & Wales
Alliance & Leicester International Limited*	Offshore deposit taking	100	Isle of Man
Alliance & Leicester Commercial Finance plc*	Asset Finance	100	England & Wales

* Held indirectly through subsidiary companies

All the above companies are included in the Consolidated Financial Statements 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 Company has a branch in the Isle of Man The ability of Alliance & Leicester International Limited to pay dividends to the Company is restricted by regulatory capital requirements

20 Intangible assets

a) Goodwill

	Group 2009 £m	Group 2008 £m
Cost		
At 1 January	22	11
Acquisitions	-	11
At 31 December	22	22
Accumulated impairment		
At 1 January	22	2
Impairment losses	-	20
At 31 December	22	22
Net book value	-	-

Impairment of goodwill

A review of the economic value of goodwill was carried out at 31 December 2008 The goodwill on the Group's balance sheet was considered fully impaired

b) Other intangibles

	Group		
	Software development cost £m	Intangible assets under development £m	Total £m
Cost			
At 1 January 2009	46	-	46
Additions	32	-	32
At 31 December 2009	78	-	78
Accumulated amortisation/impairment			
At 1 January 2009	29	-	29
Charge for the year	11	-	11
At 31 December 2009	40	-	40
Net book value	38	-	38

	Group		
	Software development cost £m	Intangible assets under development £m	Total £m
Cost			
At 1 January 2008	54	71	125
Additions	14	52	66
Disposals	(22)	(123)	(145)
At 31 December 2008	46	-	46
Accumulated amortisation/impairment			
At 1 January 2008	18	-	18
Charge for the year	16	-	16
Disposals	(5)	-	(5)
At 31 December 2008	29	-	29
Net book value	17	-	17

	Company		
	Software development cost £m	Intangible assets under development £m	Total £m
Cost			
At 1 January 2009	44	-	44
Additions	33	-	33
At 31 December 2009	77	-	77
Accumulated amortisation/impairment			
At 1 January 2009	28	-	28
Charge for the year	11	-	11
At 31 December 2009	39	-	39
Net book value	38	-	38

Notes to the Financial Statements continued

	Software development cost £m	Intangible assets under development £m	Company Total £m
Cost			
At 1 January 2008	54	71	125
Additions	10	52	62
Disposals	(20)	(123)	(143)
At 31 December 2008	44	-	44
Accumulated amortisation/impairment			
At 1 January 2008	18	-	18
Charge for the year	14	-	14
Disposals	(4)	-	(4)
At 31 December 2008	28	-	28
Net book value	16	-	16

Disposals in 2008 include the costs capitalised in relation to the development of a new banking engine which were written off following the acquisition of the Company by Banco Santander, S A as it intends to implement its banking system, Partenon

21. Property, plant and equipment (excluding operating lease assets)

	Owner-occupied properties £m	**Office fixtures and equipment £m**	Group **Total £m**
Cost			
At 1 January 2009	**363**	**242**	**605**
Additions	**-**	**19**	**19**
Disposals	**-**	**(46)**	**(46)**
At 31 December 2009	**363**	**215**	**578**
Accumulated depreciation			
At 1 January 2009	**190**	**192**	**382**
Charge for the year	**10**	**26**	**36**
Disposals	**-**	**(46)**	**(46)**
At 31 December 2009	**200**	**172**	**372**
Net book value	**163**	**43**	**206**

	Owner-occupied properties £m	Office fixtures and equipment £m	Group Total £m
Cost			
At 1 January 2008	360	440	800
Additions	4	9	13
Disposals	(1)	(207)	(208)
At 31 December 2008	363	242	605
Accumulated depreciation			
At 1 January 2008	184	364	548
Charge for the year	7	25	32
Disposals	(1)	(206)	(207)
Impairment	-	9	9
At 31 December 2008	190	192	382
Net book value	173	50	223

	Owner-occupied properties £m	**Office fixtures and equipment £m**	Company **Total £m**
Cost			
At 1 January 2009	**256**	**226**	**482**
Additions	**-**	**83**	**83**
Disposals	**-**	**(110)**	**(110)**
At 31 December 2009	**256**	**199**	**455**
Accumulated depreciation			
At 1 January 2009	**157**	**177**	**334**
Charge for the year	**9**	**25**	**34**
Disposals	**-**	**(46)**	**(46)**
At 31 December 2009	**166**	**156**	**322**
Net book value	**90**	**43**	**133**

	Owner-occupied properties £m	Office fixtures and equipment £m	Company Total £m
Cost			
At 1 January 2008	252	425	677
Additions	5	8	13
Disposals	(1)	(207)	(208)
At 31 December 2008	256	226	482
Accumulated depreciation			
At 1 January 2008	152	351	503
Charge for the year	6	24	30
Disposals	(1)	(206)	(207)
Impairment	–	8	8
At 31 December 2008	157	177	334
Net book value	99	49	148

At 31 December 2009 capital expenditure contracted, but not provided for was £nil (2008 £nil) in respect of property, plant and equipment Of the carrying value as at 31 December 2009, £nil (2008 £nil) related to assets under construction The cost of office fixtures and equipment held under finance leases was £26m (2008 £26m)

At the balance sheet date, the Group and Company had contracted with lessees for the following future minimum lease payments in leases relating to freehold properties

	Group		Company	
Leases which expire	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Within 1 year	**1**	–	**1**	–
Between 1-5 years	**2**	3	**1**	2
In more than 5 years	**3**	5	**3**	5
	6	8	**5**	7

22. Operating lease assets

	Group	
	2009 £m	2008 £m
Cost		
At 1 January	**475**	355
Additions	**81**	152
Disposals	**(101)**	(32)
At 31 December	**455**	475
Depreciation and impairment		
At 1 January	**127**	71
Charge for the year	**74**	66
Disposals	**(58)**	(10)
At 31 December	**143**	127
Net book value	**312**	348

The operating lease assets of the Group consist of commercial vehicles Future minimum lease receipts under non-cancellable operating leases are due over the following periods

	Group	
	2009 £m	2008 £m
In no more than 1 year	**71**	81
In more than 1 year but no more than 5 years	**96**	133
In more than 5 years	**26**	17
Total	**193**	231

The Company has no operating lease assets

Notes to the Financial Statements continued

23. Deferred tax

Deferred taxes are calculated on temporary differences under the liability method using the tax rates expected to apply when the liability is settled or the asset is realised The movement on the deferred tax account was as follows

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
At 1 January	**348**	5	**285**	(8)
Income statement (charge)/credit	**(193)**	326	**3**	279
Credited/(charged) to equity	**1**	3	**(2)**	14
Deferred tax on acquisitions and disposals	**(2)**	14	-	-
At 31 December	**154**	348	**286**	285

Deferred tax assets and liabilities are attributable to the following items

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Deferred tax liabilities				
Provision for loan impairment and other provisions	-	-	-	(1)
Accelerated tax depreciation	**(236)**	(193)	-	(2)
Cash flow hedging	**(6)**	(64)	-	(47)
Other temporary differences	**(13)**	(21)	-	(23)
	(255)	(278)	-	(73)

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Deferred tax assets				
Pensions and other post-retirement benefits	**41**	20	**41**	20
Accelerated book depreciation	**120**	202	**3**	-
Cash flow hedging	**(53)**	-	**(53)**	-
Provision for loan impairment and other provisions	**6**	22	**3**	-
Other temporary differences	**(2)**	14	**(5)**	-
Tax losses carried forward	**297**	368	**297**	338
	409	626	**286**	358

The deferred tax assets scheduled above have been recognised in both the Company and the Group on the basis that sufficient future taxable profits are forecast within the foreseeable future, in excess of the profits arising from the reversal of existing taxable temporary differences, to allow for the utilisation of the assets as they reverse Under current UK tax legislation, the tax losses in respect of which deferred tax assets have been recognised do not expire The benefit of the tax losses carried forward in the Company may only be realised by utilisation against the future taxable profits of the Company In 2008, deferred tax assets and liabilities are not offset as it is uncertain whether there will be an intention to settle on a net basis or to realise the asset and settle the liability simultaneously

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

	Group	
	2009 £m	2008 £m
Accelerated tax depreciation	**123**	(16)
Pensions and other post-retirement benefits	**27**	-
Provision for loan impairment and other provisions	**(7)**	(8)
Tax losses carried forward	**31**	(309)
Other temporary differences	**19**	7
	193	(326)

24. Other assets

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Trade and other receivables	**297**	171	**282**	1,337
Prepayments	**26**	74	**22**	82
Accrued income	**29**	14	**6**	12
	352	259	**310**	1,431

25. Deposits by banks

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Amounts due to subsidiaries	**-**	-	**2,112**	2,090
Amounts due to fellow subsidiaries	**51,317**	-	**51,215**	-
Items in the course of transmission	**57**	178	**46**	160
Sale and repurchase agreements	**-**	8,816	**-**	8,816
Other deposits	**1,084**	2,522	**712**	2,519
	52,458	11,516	**54,085**	13,585

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Repayable				
On demand	**16,155**	1,279	**16,163**	1,907
In not more than 3 months	**12,020**	6,897	**12,462**	8,333
In more than 3 months but not more than 1 year	**3,100**	517	**4,216**	521
In more than 1 year but not more than 5 years	**12,228**	2,823	**12,254**	2,824
In more than 5 years	**8,955**	-	**8,990**	-
	52,458	11,516	**54,085**	13,585

26. Deposits by customers

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Retail deposits	**26,477**	24,978	**24,490**	23,050
Amounts due to subsidiaries	**-**	-	**6,242**	3,385
Amounts due to fellow subsidiary	**10,460**	8,741	**10,460**	8,741
Wholesale deposits by customers	**6,499**	6,046	**6,499**	6,046
	43,436	39,765	**47,691**	41,222
Repayable				
On demand	**27,547**	28,435	**28,586**	30,556
In no more than 3 months	**12,497**	8,025	**15,917**	7,592
In more than 3 months but no more than 1 year	**2,678**	3,119	**2,494**	2,902
In more than 1 year but not more than 5 years	**713**	95	**694**	81
In more than 5 years	**1**	91	**-**	91
	43,436	39,765	**47,691**	41,222

Retail deposits and wholesale deposits by customers are interest-bearing

27. Financial liabilities designated at fair value

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Deposits by banks	**44**	153	**44**	153
Deposits by customers	**12**	252	**12**	252
Debt securities in issue	**27**	323	**27**	323
	83	728	**83**	728

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

No material amount of the movements in the fair value of the above debt securities in issue reflects any element of the Group's own credit risk This was calculated by applying current spreads at the next call date or maturity date to the nominal value of the security to determine the extra cost of the debt security for the remaining period of the debt security were it to have been issued at current spreads

The amount that would be required to be contractually paid at maturity of the deposits by banks, deposits by customers, and debt securities in issue above is £5m lower (2008 £14m higher) than the carrying value

Notes to the Financial Statements continued

28. Debt securities in issue

	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
Bonds and medium-term notes				
- Euro 10bn Global Covered Bond Programme	-	2,800	-	2,800
- US$40bn Euro Medium Term Note Programme	5,879	9 683	5,879	9,284
	5,879	12,483	5,879	12,084
Securitisation programmes				
- Fosse	4,102	4 331	-	-
Other debt securities in issue	-	663	-	-
	9,981	17,477	5,879	12,084

Euro 10bn Global Covered Bond Programme

Alliance & Leicester plc previously issued certain Covered Bonds under the euro 10bn Global Covered Bond Programme On 17 November 2009, the outstanding Covered Bonds issued under the Programme were redeemed and the Programme was discontinued

The Programme provided that Covered Bonds may be listed or admitted to trading, on the official list of the UK Listing Authority and on the London Stock Exchange's Regulated Market or any other stock exchanges or regulated or unregulated markets The Programme also provided for the issue of unlisted Covered Bonds and/or Covered Bonds not admitted to trading on any regulated or unregulated market

Alliance & Leicester Covered Bonds LLP ("LLP") guaranteed payments of interest and principal under the Covered Bonds pursuant to a guarantee which was secured over its portfolio of mortgages and its other assets Recourse against LLP under its guarantee was limited to its portfolio of mortgages and such assets

US$40bn Euro Medium Term Note Programme

In January 2009, it was decided that no further issuance would be made under the US$40bn Euro Medium Term Note Programme Outstanding notes will remain in issue until maturity

Alliance & Leicester plc issued both senior notes and subordinated notes and from time to time issued notes denominated in any currency as agreed with the relevant dealer under the US$40bn Euro Medium Term Notes Programme The notes are direct, unsecured and unconditional obligations of Alliance & Leicester plc The Programme provided for issuance of Fixed Rate Notes, Floating Rate Notes, Index Linked Notes, Dual Currency Notes and Zero-Coupon Notes The notes are listed on the London Stock Exchange or may be listed on any other or further stock exchange(s) or may be unlisted, as agreed

The notes were issued in bearer form The maximum aggregate nominal amount of all notes from time to time outstanding under the Programme did not exceed US$40bn (or its equivalent in other currencies), subject to any modifications in accordance with the terms of the Programme agreement

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

	Interest Rate	Maturity	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
Euro	0 00% – 3 99%	Up to 2010	934	1,897	934	1,897
		2011 – 2019	2,041	1,939	2,041	1,939
		2040 – 2059	1,836	-	-	-
	4 00% – 4 99%	Up to 2010	-	443	-	443
		2011 – 2019	-	193	-	193
	5 00% – 7 99%	Up to 2010	276	406	276	406
		2011 – 2019	-	148	-	148
		2030 – 2039	-	139	-	-
		2040 – 2059	-	2,105	-	-
US Dollar	0 00% – 3 99%	Up to 2010	309	753	309	753
		2011 – 2019	618	95	618	-
		2040 – 2059	917	-	-	-
	4 00% – 6 87%	Up to 2010	20	390	20	390
		2011 – 2019	49	743	49	743
		2040 – 2059	-	1,650	-	-
Pounds sterling	0 00% – 3 99%	Up to 2010	121	3,048	121	3,047
		2011 – 2019	207	427	207	427
		2040 – 2059	1,349	-	-	-
	4 00% – 6 99%	Up to 2010	626	693	626	693
		2011 – 2019	302	113	302	113
		2040 – 2059	-	1,388	-	-
Other currencies	0 00% – 5 99%	Up to 2010	337	852	337	852
		2011 – 2019	39	40	39	40
	6 00% – 8 99%	2011 – 2039	-	15	-	-
			9,981	17,477	5,879	12,084

29. Subordinated liabilities

	Group and Company	
	2009	2008
	£m	£m
Dated subordinated liabilities		
5 875% Subordinated notes 2031	**168**	191
5 25% Subordinated notes 2023	**162**	171
Subordinated floating rate EURIBOR notes 2017	**133**	145
Subordinated floating rate US$ LIBOR notes 2015	**93**	102
Subordinated floating rate EURIBOR notes 2017	**89**	97
9 625% Subordinated notes 2023	**383**	399
	1,028	1,105
Undated subordinated liabilities		
Subordinated floating rate US$ LIBOR notes (US$ 100m)	-	69
Subordinated floating rate US$ LIBOR notes (US$ 220m)	-	151
Subordinated floating rate EURIBOR notes (euro 115m)	-	111
	-	331
Total subordinated liabilities	**1,028**	1,436

The subordinated floating rate notes pay a rate of interest related to the LIBOR of the currency of denomination

In 2009, the subordinated floating rate US$ LIBOR notes (US$ 100m), subordinated floating rate US$ LIBOR notes (US$ 220m) and subordinated floating rate EURIBOR notes (euro 115m) were redeemed in full

The subordinated liabilities are redeemable in whole at the option of the Company, on any interest payment date, in the event of certain tax changes affecting the treatment of payments of interest on the subordinated liabilities in the UK, at their principal amount together with any accrued interest

Subordinated liabilities in issue are repayable

	Group and Company	
	2009	2008
	£m	£m
In more than 5 years	**1,028**	1,105
Undated	-	331
	1,028	1,436

30. Other liabilities

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Trade and other payables	**443**	600	**539**	4,545
Deferred income	**60**	31	**1**	104
	503	631	**540**	4,649

Trade and other payables include £37m (2008 £40m) of finance lease obligations mainly relating to a lease and leaseback of Group property The maturity of net obligations under finance leases are as follows

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Within 1 year	**5**	4	-	-
Between 1-5 years	**20**	21	-	1
In more than 5 years	**12**	15	-	-
	37	40	-	1

Future minimum lease payments are

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Within 1 year	**7**	6	-	-
Between 1-5 years	**25**	27	-	1
In more than 5 years	**13**	17	-	-
	45	50	-	1

Notes to the Financial Statements continued

At the balance sheet date, the Group and the Company had contracted with lessees for the following future minimum lease payments on sub-leases

	Group		Company	
Leases which expire	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Within 1 year	-	1	-	-
Between 1-5 years	-	2	-	-
	-	3	-	-

During the year, £3m (2008 £3m) was incurred as a finance lease interest charge

31. Provisions

			Group
	Misselling £m	**Other £m**	**Total £m**
At 1 January 2009	**34**	**-**	**34**
Additional provisions	**70**	**11**	**81**
Disposal of subsidiary undertakings	**(16)**	**(14)**	**(30)**
Used during the year	**(88)**	**(3)**	**(91)**
Reclassifications	**-**	**18**	**18**
At 31 December 2009	**-**	**12**	**12**
To be settled			
Within 12 months	**-**	**12**	**12**

			Company
	Misselling £m	**Other £m**	**Total £m**
At 1 January 2009	**-**	**-**	**-**
Additional provisions	**-**	**11**	**11**
At 31 December 2009	**-**	**11**	**11**
To be settled			
Within 12 months	**-**	**11**	**11**

			Group
	Misselling £m	Other £m	Total £m
At 1 January 2008	-	-	-
Additional provisions	38	-	38
Used during the year	(4)	-	(4)
At 31 December 2008	34	-	34
To be settled			
Within 12 months	34	-	34

There were no provisions in the Company in 2008

The misselling provision comprises various claims with respect to product misselling In calculating the misselling provision, management's best estimate of the provision was calculated based on conclusions regarding the number of claims that will be received, of those, the number that will be upheld, and the estimated average settlement per case Further information on misselling provisions can be found in 'Critical Accounting Policies' within the Accounting Policies on page 66

32 Retirement benefit obligations

The amounts recognised in the balance sheet were as follows

	Group and Company	
	2009 £m	2008 £m
Assets/(liabilities)		
Funded defined benefit pension scheme	-	4
Funded defined benefit pension scheme	(126)	-
Unfunded defined benefit pension scheme	(13)	(11)
Net defined benefit obligation	(139)	(7)
Post-retirement medical benefits (unfunded)	(11)	(10)
Total net liabilities	(150)	(17)

The total net deficit on the Group's defined benefit schemes, and other post-retirement benefit schemes, increased significantly from £17m at 31 December 2008 to £150m at 31 December 2009 The key reason for the increase was a reduction of 100 basis points in the net discount rate (i e the discount rate less the inflation rate) used to value the defined benefit scheme liabilities The increase in assumed inflation also impacted the expected rate of pension increase, in turn leading to a further increase in scheme liabilities These changes have increased the scheme liabilities, partly offset by contributions made and increase in asset values

Defined Contribution Pension schemes

The Group operates one defined contribution scheme, which is part of the Alliance & Leicester Pension Scheme Employees of the Group were eligible to join the scheme from 1 April 1998 The assets of the schemes are held and administered separately from those of the Company in a separate trustee-administered fund

An expense of £11m (2008 £10m) was recognised for defined contribution plans in the year, and is included in staff costs classified within administration expenses in the income statement None of this amount was recognised in respect of key management personnel for the years ended 31 December 2009 and 2008

Defined Benefit Pension schemes

The Group operates one defined benefit pension scheme, the Alliance & Leicester Pension Scheme, covering 30% (2008 31%) of the Group's employees The defined benefit section of this scheme closed to new entrants on 31 March 1998 and has a defined contribution section for employees who joined the Company after this date As the defined benefit section of the scheme is closed to new entrants, under the projected unit method, the current service cost when expressed as a percentage of pensionable salaries, will gradually increase over time

Formal actuarial valuations of the scheme are carried out on a biennial basis by an independent professionally qualified actuary and updated for accounting purposes at each balance sheet date The latest formal actuarial valuation was made as at 31 March 2008

The total amount charged to the income statement was determined as follows

	Group	
	2009 £m	2008 £m
Current service cost	8	19
Past service cost	14	-
Expected return on pension scheme assets	(75)	(84)
Interest cost	77	75
	24	10

The net (liability)/asset recognised in the balance sheet was determined as follows

	Group and Company				
	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Present value of funded defined benefit obligation	(1,477)	(1,209)	(1,324)	(1,327)	(1,305)
Fair value of plan assets	1,351	1,213	1,377	1,311	1,230
	(126)	4	53	(16)	(75)
Unfunded benefit obligation	(13)	(11)	(11)	(10)	(9)
	(139)	(7)	42	(26)	(84)

Notes to the Financial Statements continued

Movements in the defined benefit obligations during the year were as follows

	Group and Company	
	2009	2008
	£m	£m
Balance at 1 January	**(1,220)**	(1,335)
Current service cost	**(8)**	(19)
Interest cost	**(77)**	(75)
Employee contributions	**(4)**	(2)
Past service cost	**(14)**	–
Actuarial (loss)/gain	**(222)**	170
Actual benefit payments	**55**	41
Balance at 31 December	**(1,490)**	(1,220)

Movements in the present value of fair value of scheme assets during the year were as follows

	Group and Company	
	2009	2008
	£m	£m
Balance at 1 January	**1,213**	1,377
Expected return on scheme assets	**75**	84
Actuarial gain/(loss) on scheme assets	**30**	(230)
Company contributions paid	**83**	20
Employee contributions	**5**	2
Actual benefit payments	**(55)**	(40)
Balance at 31 December	**1,351**	1,213

The amounts recognised in the Consolidated Statement of Comprehensive Income for each of the five years indicated were as follows

	Group and Company				
	2009	2008	2007	2006	2005
	£m	£m	£m	£m	£m
Actuarial (gain)/loss on scheme assets	**(30)**	230	3	(13)	(108)
Actuarial loss/(gain) on scheme liabilities	**222**	(170)	(57)	(34)	130
Total net actuarial loss/(gain)	**192**	60	(54)	(47)	22

The actual return on scheme assets was a gain of £105m (2008 £146m loss) Cumulative net actuarial loss of £179m (2008 £13m gain) has been recognised in the Consolidated Statement of Comprehensive Income The Group's pension schemes did not directly hold any equity securities of the Company or any of its related parties at 31 December 2009 In addition, the Group does not hold insurance policies over the schemes, and has not entered into any significant transactions with the schemes

The assets of the funded plans are held independently of the Group's assets in separate trustee administered funds The principal duty of the trustees is to act in the best interests of the members of the scheme Ultimate responsibility for investment strategy rests with the trustees of the scheme who are required under the Pensions Act 2004 to prepare a statement of investment principles

The trustees of the Group's scheme have developed the following investment objectives

> To maintain a portfolio of suitable assets of appropriate quality, suitability and liquidity 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 pension scheme provides, as set out in the trust deed and rules

> To limit the risk of the assets failing to meet the liabilities, over the long-term and on a shorter-term basis as required by prevailing legislation

> To minimise the long-term costs of the pension scheme by maximising the return on the assets whilst having regard to the objectives shown above

Asset allocation strategies were reviewed in 2008 and 2009, and automatic rebalancing to the central benchmark positions was suspended as a result of the unprecedented volatility in asset markets during this period Future allocation strategies will be set to allow for a more dynamic approach Implementation of these strategies began in 2009 and will continue during 2010 whilst taking into account market conditions

The statement of investment principles for the scheme adopted in 2009 has set the long-term target allocation of plan assets at 25% Equities, 25% alternative return-seeking assets (including Property), 25% Bonds and 25% Gilts Movement towards this long term target commenced during the year and progress will be dependent on market conditions

The categories of assets in the scheme by value and as a percentage of total scheme assets for the Group and Company are as follows

	2009 £m	2009 %	2008 £m	2008 %
UK equities	**283**	**21**	283	23
Overseas equities	**269**	**20**	218	18
Corporate bonds	**333**	**25**	228	19
Government Fixed Interest	**247**	**18**	252	21
Government Index Linked	**128**	**10**	117	10
Property funds	**58**	**4**	64	5
Cash	**3**	**-**	5	-
Other	**30**	**2**	46	4
	1,351	**100**	1,213	100

Other assets consist of annuities and derivatives that are used to protect against inflation and interest rate movements

The expected rates of return by asset class used to calculate the expected return for the year were

	Group and Company	
	2009 %	2008 %
Equities	**8 1**	7 8
Corporate bonds	**6 2**	5 0
Government bonds	**3 9**	5 0
Property	**6 3**	6 4

The expected return on plan assets is determined by considering the expected returns available on the assets underlying the current investment policy, as follows

>	Equities	Long-term median real rate of return experienced after considering projected movements in asset indices
>	Corporate bonds	Gross redemption yields as at the balance sheet date, less a margin for default risk
>	Government bonds	Gross redemption yields as at the balance sheet date
>	Property funds	Average of returns for UK equities and government bonds
>	Cash	Expected long term bank rate, after considering projected inflation rate

Actuarial assumptions

The principal actuarial assumptions used were as follows

	2009 %	2008 %
To determine benefit obligations		
- Discount rate for scheme liabilities	**5 8**	6 4
- General price inflation	**3 4**	3 0
- General salary increase	**3 4**	3 5
- Expected rate of pension increase	**3 3**	3 0
To determine net periodic benefit cost:		
- Discount rate	**6.4**	5 7
- Expected rate of pension increase	**3.0**	3 3
- Expected rate of return on plan assets	**6 4**	6 5
Medical cost trend rates		
- Initial rate	**5 5**	6 0
- Ultimate rate	**4 5**	4 5
- Year of ultimate rate	**2013**	2013

	Years	Years
Longevity at 60 for current pensioners, on the valuation date.		
- Males	**27 6**	27 5
- Females	**30 0**	29 9
Longevity at 60 for future pensioners currently aged 40, on the valuation date		
- Males	**29 7**	29 6
- Females	**31 3**	31 2

The rate used to discount the retirement benefit obligation is determined to reflect duration of the liabilities based on the annual yield at 31 December of the sterling 15+ year AA Corporate Bond iBoxx Index, representing the market yield of high quality corporate bonds on that date, adjusted to match the terms of the scheme liabilities The inflation assumption is set based on the Bank of England projected inflation rates over the duration of scheme liabilities weighted by projected scheme cash flows

Notes to the Financial Statements continued

The mortality assumption used in preparation of the valuation was the Continuous Mortality Investigation Table PXA 92MCC 2009 with a future improvement underpin of 1% for males and 0 5% for females The table above shows that a member retiring at age 60 as at 31 December 2009 is assumed to live for, on average, 27 6 years for a male and 30 0 years for a female In practice, there will be variation between individual members but these assumptions are expected to be appropriate across all members It is assumed that younger members will live longer in retirement than those retiring now This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 40 now, when they retire in 20 years time at age 60

The Group determined its expense measurements above based upon long-term assumptions taking into account target asset allocations of assets set at the beginning of the year, offset by actual returns during the year Year-end obligation measurements are determined by reference to market conditions at the balance sheet date Assumptions are set in consultation with third party advisors and in-house expertise

The Group currently expects to contribute £19m to its defined benefit pension schemes in 2010 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
2010	55
2011	57
2012	59
2013	61
2014	63
Five years ended 2019	347

Post Retirement Medical Benefit Plans

The Group also operates unfunded post retirement medical benefit plans for a number of its former employees The post retirement medical benefit plans in operation are accounted for in the same manner as defined benefit pension plans

Formal actuarial valuations of the liabilities of the schemes are carried out on a triennial basis by an independent professionally qualified actuary and updated for accounting purposes at each balance sheet date The latest formal actuarial valuation was made as at 31 December 2006 and updated to 31 December 2009 by a qualified independent actuary

Actuarial assumptions used for the Group's post retirement medical benefit plan are the same as those used for the Group's defined benefit pension schemes There was an actuarial loss during the year of £1m (2008 £nil) on the Group's post-retirement medical benefits liability A one percentage point movement in medical cost trends would increase or decrease the post-retirement medical benefit liability and interest cost by £1m (2008 £1m)

33. Contingent liabilities and commitments

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

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Guarantees given to subsidiaries	-	-	208,232	-
Guarantees given to third parties	137	202	137	200
Formal standby facilities, credit lines and other commitments with original term to maturity of				
– 1 year or less	2,014	380	1,620	323
– More than 1 year	137	1,595	137	725
	2,288	2,177	210,126	1,248

Unauthorised overdraft fees

A number of financial institutions have been involved in legal proceedings with the Office of Fair Trading ("OFT"), regarding the legal status and enforceability of unarranged overdraft fees (the "OFT Proceedings") The Company was not a party to the OFT Proceedings but its parent company, Santander UK plc, was The OFT Proceedings were concerned with whether certain of the financial institutions' terms and conditions are subject to the fairness test in the Unfair Terms in Consumer Contract Regulations 1999 (the "Regulations") and whether they are capable of being 'penalties' at common law

In April 2008 the High Court confirmed that the then current terms and conditions of Santander UK plc were not capable of being penalties at common law This finding was not appealed by the OFT The High Court also found that the relevant terms were assessable for fairness under the Regulations On 26 February 2009, the Court of Appeal dismissed the appeal against the High Court's judgment made by the relevant financial institutions and held that unarranged overdraft fees were assessable for fairness under the Regulations

The House of Lords gave the relevant financial institutions permission to appeal this judgment The hearing before the House of Lords took place on 23 to 25 June 2009 The Supreme Court (previously The House of Lords) gave its judgment on 25 November 2009 and ruled that the level of the unauthorised overdraft fees of the relevant financial institutions could not be assessed for fairness under the Regulations (to the extent that the terms pursuant to which the fees are levied are in plain and intelligible language), although they may be assessed for fairness on some other basis

On 22 December 2009, the OFT announced that it would not be continuing with its investigation into the fairness of unarranged overdraft fees

The Company has rejected the vast majority of complaints which remained in respect of unarranged overdraft fees after the Supreme Court decision, and it is understood that the Financial Ombudsman Service has also rejected the vast majority of complaints that it had had on hold since the commencement of the OFT Proceedings The Company has started to invite County Courts to dismiss those claims against them which have been stayed since the commencement of the OFT Proceedings and which relate to the issues covered in the OFT Proceedings It is presently anticipated that the Company will continue with this approach

Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS), the UK's statutory fund of last resort for customers of authorised financial services firms, pays compensation if a firm is unable to meet its obligations as they fall due As a result of the failure of a number of deposit-taking institutions during the second half of 2008, the FSCS now stands as a creditor of Bradford & Bingley plc and the administrations of Heritable Bank, Kaupthing Singer & Friedlander and Landsbanki "Icesave" The FSCS has borrowed from HM Treasury to fund the compensation costs associated with those failures These borrowings are currently on an interest-only basis until 31 March 2012

The FSCS fulfils its obligations by raising management expenses levies and compensation levies on the industry In relation to compensation relating to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits, subject to a threshold set by the UK Financial Services Authority establishing the maximum that the FSCS can levy for compensation in any one year The limit on the FSCS management expenses for the three years from September 2008 in relation to the above-mentioned failures has been capped at £1bn per annum The FSCS has the power to raise levies on firms who have ceased to participate in the scheme and are in the process of ceasing to be authorised (so called 'exit levies') for the amount that the firm would otherwise have been asked to pay during the relevant levy year The Group has an accrual for its share of management expenses levies for the 2009/10 and 2010/11 levy years as at 31 December 2009 of £25m (2008 £21m)

The FSCS will receive funds from asset sales, surplus cash flow, or other recoveries from each of the above-named banks These recoveries will be used to reduce the principal amount outstanding on the FSCS's borrowings Only after the interest-only period which is expected to end on 31 March 2012 will a schedule for repayment of any remaining principal outstanding (after recoveries) on the borrowings be agreed between the FSCS and HM Treasury It is expected that, from that point, the FSCS will begin to raise compensation levies (principal repayments) relating to the above-named banks No provision for compensation levies, which could be significant, has been made in these Consolidated Financial Statements

Regulatory

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

Obligations under stock borrowing and lending agreements

Obligations under stock borrowing and lending agreements represent contractual commitments to return stock borrowed These obligations totalling £13,619m at 31 December 2009 (2008 £2,795m) are offset by a contractual right to receive stock under other contractual agreements

Other off-balance sheet commitments

The Group has commitments to lend at fixed interest rates which expose it to interest rate risk

Operating lease commitments

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Rental commitments under operating leases expiring				
– No later than 1 year	**14**	1	**13**	1
– Later than 1 year but no later than 5 years	**38**	7	**38**	7
– Later than 5 years	**32**	64	**32**	124
	84	72	**83**	132

At 31 December 2009, the Group held various leases on land and buildings, many for extended periods, and other leases for equipment, which require the following aggregate minimum lease payments

Leases expiring year ended 31 December	Group £m	Company £m
2010	**14**	**13**
2011	**11**	**11**
2012	**10**	**10**
2013	**9**	**9**
2014	**8**	**8**
Total thereafter	**32**	**32**

Notes to the Financial Statements continued

Group rental expense comprises

	Group 2009 £m	2008 £m
In respect of minimum rentals	37	12
Less sub-lease rentals	–	(1)
	37	11

34. Innovative Tier 1

On 22 March 2004, the Company issued £300m of innovative Tier 1 capital securities The Tier 1 securities are perpetual securities and pay a coupon on 22 March each year, with the first coupon paid on 22 March 2005 At each payment date, the Company can decide whether to declare or defer the coupon indefinitely If a coupon is deferred then the Company may not pay a dividend on any share until it next makes a coupon payment The Company can be obliged to make payment in the event of winding up

The coupon is 5 827% per annum until 22 March 2016 Thereafter the coupon steps up to a rate, reset every five years, of 2 13% per annum above the gross redemption yield on a UK Government Treasury Security The Tier 1 securities are redeemable at the option of the Company on 22 March 2016 or on each payment date thereafter No such redemption may be made without the consent of the UK Financial Services Authority In both 2009 and 2008 the coupon of £17 5m was paid

35. Share capital and preference shares

	Ordinary shares of 50 pence each £m
Share capital	
Issued and fully paid share capital	
At 1 January 2009	**328**
Shares issued	**600**
At 31 December 2009	**928**
At 1 January 2008	210
Shares issued	118
At 31 December 2008	328

The Company has one class of ordinary shares which carry no right to fixed income On 10 June 2009 the Company issued 116,583 ordinary shares of £0 50 each to Alliance & Leicester Share Ownership Trust Limited as nominee and on behalf of participants in the Alliance & Leicester Deferred Bonus Scheme These shares were subsequently transferred to Santander UK plc in accordance with the Scheme of Arrangement, in exchange for 38,817 shares in Banco Santander, S A

On 30 June 2009 the Company issued 1,200,000,000 ordinary shares of £0 50 each in capital of the Company to Santander UK plc, utilising £600,000,000 of the Company's share premium account to issue new bonus shares at par

	Ordinary shares of 50 pence each £m
Share premium account	
At 1 January 2009	**724**
Shares issued	**(600)**
At 31 December 2009	**124**
At 1 January 2008	125
Shares issued	599
At 31 December 2008	724

Preference shares

On 24 May 2006, the Company issued £300m fixed/floating rate non-cumulative callable preference shares, resulting in net proceeds of £294m The preference shares entitle the holders to a fixed non-cumulative dividend, at the discretion of the Board, of 6 22% per annum payable annually from 24 May 2007 until 24 May 2019 and quarterly thereafter at a rate of 1 13% per annum above three month sterling LIBOR The preference shares are redeemable only at the option of the Company on 24 May 2019 or on each quarterly dividend payment date thereafter No such redemption may be made without the consent of the UK Financial Services Authority

On 26 February 2010 it was announced that as the Company's preference shares will not transfer to Santander UK plc under the proposed Part VII Transfer, the Company and Santander UK plc have agreed that the holders of the Company's preference shares should be given the opportunity to exchange their Alliance & Leicester plc preference shares for new preference shares to be issued by Santander UK plc It is intended that the exchange will be carried out by a scheme of arrangement under Part 26 of the Companies Act 2006, which, if approved by the Court as well as holders of the Company's preference shares and Santander UK plc (as holder of the ordinary shares of Alliance & Leicester plc), the Company's preference shares would be substituted with new preference shares to be issued by Santander UK plc on substantially similar terms

36. Dividends

Analysis of dividends paid is as follows

	Group and Company	
	2009 Pence per Share	2008 Pence per Share
Ordinary shares (equity)		
2007 interim	-	18 8
2007 final	-	36 5
2008 interim	-	18 0
	-	73 3

37. Cash flow statement

a) Reconciliation of profit/(loss) after tax to net cash flow from operating activities·

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Profit/(loss) for the year	**60**	(918)	**(78)**	(275)
Non-cash items included in net profit				
Increase in prepayments and accrued income	**(128)**	(4)	**(142)**	(7)
(Decrease)/increase in accruals and deferred income	**(358)**	(36)	**130**	(29)
Depreciation and amortisation	**121**	114	**45**	44
Provisions for liabilities and charges	**81**	15	**11**	(19)
Provision for impairment	**363**	1,033	**532**	783
Other non-cash items	**263**	(221)	**278**	(153)
	402	(17)	**776**	344
Changes in operating assets and liabilities				
Net decrease in trading assets	**-**	1,439	**-**	1,439
Net decrease/(increase) in derivative assets	**1,768**	(1,905)	**1,608**	(1,286)
Net decrease/(increase) in financial assets designated at fair value	**13**	828	**13**	(27)
Net (increase)/decrease in loans and advances to banks and customers	**(25,553)**	5,114	**(26,703)**	4,750
Net decrease/(increase) in other assets	**185**	(5,887)	**1,224**	(6,813)
Net increase/(decrease) in deposits by banks and deposits by customers	**44,991**	2,794	**46,870**	4,583
Net (decrease)/increase in derivative liabilities	**(1,335)**	990	**(1,353)**	1,013
Net decrease in financial liabilities designated at fair value	**(650)**	(3,299)	**(650)**	(3,299)
Net (decrease)/increase in debt issued	**(4,760)**	3,603	**(4,513)**	2,582
Net decrease in other liabilities	**(457)**	(29)	**(4,174)**	(391)
Effects of exchange rate differences	**(841)**	-	**(409)**	-
Net cash flow from operating activities before tax	**13,763**	3,631	**12,689**	2,895
Income tax (paid)/received	**(3)**	21	**(3)**	32
Net cash flow from operating activities	**13,760**	3,652	**12,686**	2,927

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

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Cash and balances with central banks	**446**	1,553	**446**	1,553
Loans and advances to banks	**14,825**	816	**14,416**	814
Cash and cash equivalents	**15,271**	2,369	**14,862**	2,367

Notes to the Financial Statements continued

38 Collateral pledged and received

The Group pledges assets as collateral in the following areas of the business

The Company enters into securitisation transactions whereby portfolios of residential mortgage loans are purchased by or assigned to special purpose securitisation companies, and have been funded through the issue of mortgage-backed securities Holders of the securities are only entitled to obtain payments of principal and interest to the extent that the resources of the securitisation companies are sufficient to support such payments and the holders of the securities have agreed in writing not to seek recourse in any other form At 31 December 2009, £21,713m (2008 £22,582m) of residential mortgage loans were so assigned

In 2008, the Company also established a covered bond programme, whereby securities are secured by a pool of ring-fenced residential mortgages At 31 December 2009, £nil (2008 £3,222m) of residential mortgage loans had been so secured

Collateral is also provided in the normal course of derivative business to counterparties As at 31 December 2009, £21m (2008 £196m) of such collateral in the form of cash had been pledged

The Company enters into sale and repurchase agreements and similar transactions, which are accounted for as secured borrowings Upon entering into such transactions, the Company provides collateral equal to 100%-131% of the borrowed amount The fair value of assets that were so pledged at 31 December 2009 was £19,395m (2008 £21,133m)

The Company also enters into purchase and resale agreements and similar transactions whereby the Company receives collateral The Company is permitted to sell or re-pledge the collateral held The carrying amount of assets that were so provided at 31 December 2009 was £4,643m (2008 £2,795m) of which £4,643m (2008 £2,763m) was sold or re-pledged

39. Share-based compensation

During the year ended 31 December 2009, the Group had four share-based payment arrangements, including Share Incentive Plan (SIP) partnership shares Three other share-based payment arrangements ceased to operate in 2008 following the acquisition by Banco Santander, S A The Executive Directors of the Company also participate in schemes as disclosed in the Annual Report & Accounts of Santander UK plc

Options held under the ShareSave plan, share option plan and senior manager deferred bonus scheme became exercisable on 7 October 2008 and lapsed, if they had not been exercised, on 7 April 2009 Shares acquired upon exercise of the option in that period were automatically exchanged for Banco Santander, S A shares in the same three for one ratio as was applicable to all shareholders upon acquisition by Banco Santander, S A Outstanding executive deferred bonus scheme options were all exercised on 7 October 2008 and Long-Term Incentive Plan (LTIP) shares all lapsed on 7 October 2008 Restricted share plan shares vested and were converted to Banco Santander, S A shares on acquisition in the same three for one ratio, in accordance with the scheme rules

The following table summarises the movement in the number of options over shares between those outstanding at the beginning and end of the year, together with the changes in weighted average exercise price over the same period

2009	ShareSave No of shares	Share option plan No of shares	Senior manager deferred bonus[1] No of shares
Outstanding at 1 January	**564,675**	**2,232,426**	**64,726**
Lapsed	**(564,675)**	**(2,232,426)**	**-**
Exercised	**-**	**-**	**(64,726)**
Outstanding at 31 December 2009[3]	**-**	**-**	**-**
Weighted average exercise price in 2009	**-**	**-**	**285 5p**

2008	ShareSave No of shares	Share option plan No of shares	Executive deferred bonus No of shares	Restricted share plan No of shares	Long term incentive plan (LTIP) No of shares	Senior manager deferred bonus[1] No of shares
Outstanding at 1 January	3,388,840	3,830,524	58,721	306,932	1,083,669	243,597
Granted[4]	-	376,255	-	627,598	676,876	291,901
Lapsed	(2,768,842)	(1,974,353)	(32,514)	(627,361)	(1,736,241)	(137,725)
Exercised	(55,323)	-	(26,207)	(307,169)	(24,304)	(333,047)
Outstanding at 31 December 2008	564,675	2,232,426	-	-	-	64,726
Exercisable at 31 December 2008	564,675	2,232,426	-	-	-	64,726
Weighted average exercise price in 2008	630 2p	n/a	525 5p	274 2p	525 5p	285 5p
Range of exercise prices for options	632p - 815p	544p - 1,093p	n/a	n/a	n/a	n/a
Weighted average remaining contractual	n/a	n/a	n/a	n/a	n/a	n/a
Weighted average fair value options	n/a	84p	n/a	390p	428p	1,553p[2]

(1) The figures in the table relate to the level of bonus deferred i e excluding the matching element
(2) The option value includes the deferred share and the fair value of the matched element less the cash bonus foregone
(3) Upon exercise Alliance & Leicester plc shares were automatically converted to Banco Santander S A shares in the ratio three to one
(4) No shares have been granted under any of the schemes since acquisition by Banco Santander S A on 7 October 2008

The Share Incentive Plan (SIP) was available to all employees Prior to the Company's acquisition by Banco Santander, S A, participants could elect to invest up to £125 per month from pre-tax salary to purchase shares at the prevailing market price Shares can be released from Trust after five years free of income tax and national insurance contributions

On the acquisition of the Company by Banco Santander, S A , Alliance & Leicester plc shares held in the SIP were converted to Banco Santander, S A shares on the same three for one basis as was applicable to all other shareholders upon acquisition by Banco Santander, S A These will remain in the SIP Trust under the terms of the SIP rules 195,454 SIP partnership shares were issued during 2008 prior to acquisition, at the then prevailing market rate of Alliance & Leicester plc shares, at a weighted average price of 428p per share All were converted to Banco Santander, S A shares on acquisition No Banco Santander SIP shares have been issued since acquisition

For these schemes, the estimated fair value is calculated as the value of the share price option plus the present value of any deferred dividends

The assumptions used in the model are as follows

Input	Assumption
Share price	Price at date of grant
Exercise price	Per scheme rules
Expected volatility	Estimated by calculating the annualised, exponential weighted monthly volatility of share price over prior two years
Option life	Per scheme rules
Risk free rate	Generated from LIBOR swap curve

40. Directors' emoluments and interests

Any loans, quasi loans and credit transactions entered into or agreed by the Company or its subsidiaries with persons who are or were Directors, Other Key Management Personnel and each of their connected persons during the year are set out in the Annual Report & Accounts of Santander UK plc for 2009, and for 2008 are set out below

Other Key Management Personnel Loans*	Number of persons	Aggregate amount Outstanding £000
2008	2	217

* Other Key Management Personnel are defined as the Executive Committee of the Company and the Board and Executive Committee of Alliance & Leicester s parent company Santander UK plc who served during the year

Secured and unsecured loans 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 or customers within the Group Such loans do not involve more than the normal risk of collectability or present any unfavourable features

41. Related party disclosures

Transactions with Directors, Other Key Management Personnel and each of their connected persons

Any transactions undertaken by Directors, Other Key Management Personnel and their connected persons with the Group in the course of normal banking are set out in the Annual Report & Accounts of Santander UK plc, and for 2008 are set out below

2008	Number of Directors and Other Key Management Personnel(2)	Amounts in respect of Directors, Other Key Management Personnel(1) and their connected persons £000
Secured loans, unsecured loans and overdrafts		
Loans outstanding at 1 January	4	541
Net movements in the year	(2)	(324)
Loans outstanding at 31 December	2	217
Deposit, bank and instant access accounts and investments		
Deposits, bank instant access accounts and investments at 1 January	10	850
Net movements in the year	(6)	(580)
Deposit, bank and instant access accounts and investments at 31 December	4	270
Life assurance policies		
Life assurance policies at 1 January and 31 December	-	-

(1) In 2008 other Key Management Personnel are defined as the Executive Committee of the Company and the Board and Executive Committee of Alliance & Leicester's parent company, Santander UK plc who served during the year

(2) In 2007 only the Board of Directors of the Company were Key Management Personnel

Secured and unsecured loans 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 and customers within the 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 within the Group

Notes to the Financial Statements continued

No life assurance policies and investments were entered into by Directors, Other Key Management Personnel and their connected persons with the Company or its subsidiaries during the year

Remuneration of Key Management Personnel
The remuneration of the Directors, and Other Key Management Personnel of Alliance & Leicester plc, in aggregate for each of the categories specified in IAS 24 Related Party Disclosures for 2009 is set out in the Annual Report & Accounts of Santander UK plc, and for 2008 is set out below Further information about the aggregate remuneration of the Directors in 2009 is provided in the 'Directors' Remuneration' table in the Annual Report & Accounts of Santander UK plc

Key management compensation	2008 £m
Short-term employee benefits	3 7
Post-employment benefits	0 4
Termination benefits	2 2
Share-based payments	2 3
	8 6

Company Share Option Plan
In 2008, Executive Directors and Other Key Management Personnel were granted options over shares in the Company under the Alliance & Leicester Company Share Option Plan These options lapsed on 7 April 2009

In 2005, three Executive Directors and five Other Key Management Personnel were granted options over shares in the Company The amount of shares participants would receive at the end of the three-year period depended on the Earnings per Share performance of the Company in this period The performance condition was not met and the options lapsed on 7 April 2008

Deferred Bonus Scheme
In 2005 and 2004, three Executive Directors and five Other Key Management Personnel were granted deferred and matching options over shares in the Company under the Alliance & Leicester Deferred Bonus Scheme The amount of matching shares Executive Directors would receive at the end of the three-year period depended on the Company's Total Shareholder Return against a competitor benchmark group The conditions attached to the matching shares were not met at the end of the three-year period and the matching options awarded to Executive Directors lapsed During 2009, all remaining deferred and matching options were exercised During 2008, three Executive Directors exercised deferred options and four Key Management Personnel exercised deferred and matching options on 7 October 2008

Long-Term Incentive Plan
In 2008, three Executive Directors and six Other Key Management Personnel were granted conditional awards of shares in the Company under the Alliance & Leicester plc Long-Term Incentive Plan for a total fair value of £518,893, (based on the fair value of £4 28 per share) The value attributable to 2008 of these conditional awards is included in the charge for share-based payments in 2008 in Note 39 Under the Alliance & Leicester plc Long-Term Incentive Plan granted on 27 March 2008, certain Executive Directors, Other Key Management Personnel (as defined in Note 40 above) and other nominated individuals were granted a conditional award of shares in the Company The amount of shares participants would receive throughout a three-year period depended on the performance of the Company during this period All awards under the Alliance & Leicester plc Long-Term Incentive Plan depended on the Company's Total Shareholder Return against a competitor benchmark group, Return on Equity and Earnings per Share performance These conditions were not met at 9 October 2008, when the Scheme of Arrangement for the acquisition of the Company by Banco Santander, S A was completed, and the awards lapsed

Parent undertaking and controlling party
At 31 December 2009, the Company's ultimate parent undertaking and controlling party was Banco Santander, S A , a company incorporated in Spain Banco Santander, S A is the parent undertaking of the largest Group of undertakings for which Group accounts are drawn up and of which the Company is a member See Note 42 below for changes in Company ownership since 31 December 2009

Copies of all sets of Group accounts, which include the results of the Company, are available from Secretariat, 2 Triton Square, Regent's Place, London NW1 3AN

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

								Group
	Interest, fees and other income received		Interest, fees and other expenses paid		Amounts owed by related parties		Amounts owed to related parties	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Ultimate parent company	–	–	**10**	–	–	–	**(276)**	–
Parent company	**(1)**	–	**20**	–	**1,096**	–	**(436)**	–
Fellow subsidiaries	**(289)**	3	**416**	38	**48,808**	149	**(61,798)**	9,465
	(290)	3	**446**	38	**49,904**	149	**(62,510)**	9,465

Notes to the Financial Statements continued

	Interest, fees and other income received		Interest, fees and other expenses paid		Amounts owed by related parties		Company Amounts owed to related parties	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Ultimate parent company	**-**	-	**10**	-	**-**	-	**(276)**	-
Parent company	**-**	-	**20**	-	**5**	-	**(340)**	-
Subsidiaries	**(400)**	1,376	**271**	636	**10,523**	11,272	**(8,478)**	9,717
Fellow subsidiaries	**(275)**	3	**416**	38	**46,277**	149	**(61,799)**	9,465
	(675)	1,379	**717**	674	**56,805**	11,421	**(70,893)**	19,182

The balances above include debt securities in issue held by related parties In addition, transactions with pension schemes operated by the Group are described in Note 32 Transactions with fellow subsidiaries mainly relate to funding received from Santander UK plc

42. Events after the balance sheet date

On 25 February 2010 it was announced that the Company intends to transfer its business into Santander UK plc later this year under a scheme allowed by Part VII of the Financial Services and Markets Act 2000 This transfer is subject to UK Financial Services Authority support and Court approval The transfer will provide benefits for the Company's customers and for Santander UK plc For Alliance & Leicester plc customers this includes access to Santander UK's full product range plus use of over 1,300 branches, four times as many branches currently available for Alliance & Leicester plc customers By rationalising systems and improving the sales and risk management processes through having a single view of customers' dealings, Santander UK plc will also benefit from the significant synergies that were announced to the market at the time of the acquisition of Alliance & Leicester plc by Banco Santander, S A in 2008

On 26 February 2010 it was announced that as the Company's preference shares will not transfer to Santander UK plc under the proposed Part VII Transfer, the Company and Santander UK plc have agreed that the holders of the Company's preference shares should be given the opportunity to exchange their Alliance & Leicester plc preference shares for new preference shares to be issued by Santander UK plc It is intended that the exchange will be carried out by a scheme of arrangement under Part 26 of the Companies Act 2006, which, if approved by the Court as well as holders of the Company's preference shares and Santander UK plc (as holder of the ordinary shares of Alliance & Leicester plc), the Company's preference shares would be substituted with new preference shares to be issued by Santander UK plc on substantially similar terms

In March 2010 the Group issued through the Fosse Master Trust the first publicly-placed mortgage-backed securitisation transaction from a UK bank since 2007, other recent transactions from UK banks had included an investor put The transaction was denominated in both pounds sterling and euro and raised approximately £1 4bn

Notes to the Financial Statements continued

43. Financial instruments

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

								Group
	Held at fair value				Held at amortised cost		Non-financial assets / liabilities	Total
31 December 2009	Trading	Derivatives held for hedging	Designated at fair value through P&L	Available-for-sale	Loans and receivables	Financial liabilities at amortised cost		
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Cash & balances at central banks	-	-	-		446	-	-	446
Derivative financial instruments	871	237	-		-	-	-	1,108
Financial assets designated at FV	-	-	50	-	-	-	-	50
Loans and advances to banks	-	-	-	-	49,857	-	-	49,857
Loans and advances to customers	-	-	-	-	46,796	-	-	46,796
Available-for-sale securities	-	-	-	11	-	-	-	11
Loans and receivables securities	-	-	-	-	9,828	-	-	9,828
Macro hedge of interest rate risk	-	-	-	-	444	-	-	444
Intangible assets	-	-	-	-	-	-	38	38
Property, plant and equipment	-	-	-	-	-	-	206	206
Operating lease assets	-	-	-	-	-	-	312	312
Current tax assets	-	-	-	-	-	-	81	81
Deferred tax assets	-	-	-		-	-	409	409
Other assets	-	-	-	-	326	-	26	352
	871	237	50	11	107,697	-	1,072	109,938
Liabilities								
Deposits by banks	-	-	-	-	-	52,458	-	52,458
Deposits by customers	-	-	-	-	-	43,436	-	43,436
Derivative financial liabilities	198	-	-	-	-	-	-	198
Financial liabilities at FVTPL	-	-	83	-	-	-	-	83
Debt securities in issue	-	-	-	-	-	9,981	-	9,981
Subordinated liabilities	-	-	-	-	-	1,028	-	1,028
Other liabilities	-	-	-	-	-	443	60	503
Provisions	-	-	-	-	-	-	12	12
Current tax liabilities	-	-	-	-	-	-	20	20
Deferred tax liabilities	-	-	-	-	-	-	255	255
Retirement benefit obligations	-	-	-	-	-	-	150	150
	198	-	83	-	-	107,346	497	108,124

								Company
	Held at fair value				Held at amortised cost		Non-financial assets / liabilities	Total
31 December 2009	Trading	Derivatives held for hedging	Designated at fair value through P&L	Available-for-sale	Loans and receivables	Financial liabilities at amortised cost		
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Cash & balances at central banks	-	-	-	-	446	-	-	446
Derivative financial instruments	344	238	-	-	-	-	-	582
Financial assets designated at FV	-	-	50	-	-	-	-	50
Loans and advances to banks	-	-	-	-	46,208	-	-	46,208
Loans and advances to customers	-	-	-	-	52,132	-	-	52,132
Available-for-sale securities	-	-	-	8	-	-	-	8
Loan and receivables securities	-	-	-	-	9,994	-	-	9,994
Marco hedge of interest rate risk	-	-	-	-	306	-	-	306
Investment in sub undertakings	-	-	-	-	-	-	887	887
Intangible assets	-	-	-	-	-	-	38	38
Property, plant and equipment	-	-	-	-	-	-	133	133
Current tax assets	-	-	-	-	-	-	76	76
Deferred tax assets	-	-	-	-	-	-	286	286
Other assets	-	-	-	-	288	-	22	310
	344	238	50	8	109,374	-	1,442	111,456

Notes to the Financial Statements continued

	Held at fair value				Held at amortised cost		Company	
	Trading	Derivatives held for hedging	Designated at fair value through P&L	Available-for-sale	Loans and Receivables	Financial liabilities at amortised cost	Non-financial assets / liabilities	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Liabilities								
Deposits by banks	-	-	-	-	-	54,085	-	54,085
Deposits by customers	-	-	-		-	47,691	-	47,691
Derivative financial liabilities	318		-	-	-	-	-	318
Financial liabilities at FVTPL	-	-	83	-	-	-	-	83
Debt securities in issue	-	-	-	-	-	5,879	-	5,879
Subordinated liabilities	-	-	-	-	-	1,028	-	1,028
Other liabilities	-	-	-	-	-	539	1	540
Provisions	-	-	-		-	-	11	11
Retirement benefit obligations	-	-	-	-	-	-	150	150
	318	-	83	-	-	109,222	162	109,785

At 31 December 2008	Held at fair value				Held at amortised cost		Group	
	Trading	Derivatives held for hedging	Designated at fair value through P&L	Available-for-sale	Loans and Receivables	Financial liabilities at amortised cost	Non-financial assets / liabilities	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Cash & balances at central banks	-	-	-		1,553	-	-	1,553
Derivative financial instruments	2,132	744	-	-	-	-	-	2,876
Financial assets designated at FV	-	-	63	-	-	-	-	63
Loans and advances to banks	-	-	-	-	1,239	-	-	1,239
Loans and advances to customers	-	-	-	-	51,402	-	-	51,402
Available-for-sale securities	-	-	-	1,658	-	-	-	1,658
Loans and receivables securities	-	-	-	-	14,250	-	-	14,250
Macro hedge of interest rate risk	-	-	-	-	713	-	-	713
Intangible assets	-	-	-	-	-	-	17	17
Property, plant and equipment	-	-	-	-	-	-	223	223
Operating lease assets	-	-	-	-	-	-	348	348
Current tax assets	-	-	-	-	-	-	17	17
Deferred tax assets	-	-	-	-	-	-	626	626
Other assets	-	-	-	-	185	-	74	259
	2,132	744	63	1,658	69,342	-	1,305	75,244
Liabilities								
Deposits by banks	-	-	-		-	11,516	-	11,516
Deposits by customers	-	-	-	-	-	39,765	-	39,765
Derivative financial liabilities	656	877	-	-	-	-	-	1,533
Financial liabilities at FVTPL	-	-	728	-	-	-	-	728
Debt securities in issue	-	-	-	-	-	17,477	-	17 477
Subordinated liabilities	-	-	-	-	-	1,436	-	1,436
Other liabilities	-	-	-	-	-	600	31	631
Provisions	-	-	-	-	-	-	34	34
Current tax liabilities	-	-	-	-	-	-	1	1
Deferred tax liabilities	-	-	-	-	-	-	278	278
Retirement benefit obligations	-	-	-	-	-	-	17	17
	656	877	728	-	-	70,794	361	73,416

At 31 December 2008	Held at fair value				Held at amortised cost		Company	
	Trading	Derivatives held for hedging	Designated at fair value through P&L	Available-for-sale	Loans and Receivables	Financial liabilities at amortised cost	Non-financial assets / liabilities	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Cash & balances at central banks	-	-	-	-	1,553	-	-	1,553
Derivative financial instruments	1,461	729	-	-	-	-	-	2,190
Financial assets designated at FV	-	-	63	-	-	-	-	63
Loans and advances to banks	-	-	-	-	1,236	-	-	1,236
Loans and advances to customers	-	-	-	-	52,604	-	-	52,604
Available-for-sale securities	-	-	-	1,654	-	-	-	1,654
Loans and receivables securities	-	-	-	-	14,321	-	-	14,321
Marco hedge of interest rate risk	-	-	-	-	557	-	-	557
Investment in sub undertakings	-	-	-	-	-	-	1,091	1,091
Intangible assets	-	-	-	-	-	-	16	16
Property, plant and equipment	-	-	-	-	-	-	148	148
Current tax assets		-	-	-	-	-	58	58
Deferred tax assets	-	-	-	-	-	-	358	358
Other assets	-	-	-	-	1,349	-	82	1,431
	1,461	729	63	1,654	71,620	-	1,753	77,280

Notes to the Financial Statements continued

	Held at fair value				Held at amortised cost			Company
	Trading	Derivatives held for hedging	Designated at fair value through P&L	Available-for-sale	Loans and Receivables	Financial liabilities at amortised cost	Non-financial assets / liabilities	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Liabilities								
Deposits by banks	-	-	-			13,585	-	13,585
Deposits by customers	-	-				41 222	-	41 222
Derivative financial liabilities	976	695	-		-			1 671
Financial liabilities at FVTPL	-	-	728	-	-			728
Debt securities in issue	-	-	-	-	-	12 084	-	12,084
Subordinated liabilities	-	-	-	-	-	1,436		1,436
Other liabilities	-	-	-		-	4,545	104	4,649
Deferred tax liabilities	-	-		-	-	-	73	73
Retirement benefit obligations	-	-	-	-	-	-	17	17
	976	695	728	-	-	72 872	194	75 465

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

			Group
2009	**Carrying Value £m**	**Fair value £m**	**Surplus/ (deficit) £m**
Assets			
Cash and balances at central banks	**446**	**446**	**-**
Loans and advances to banks	**49,857**	**50,296**	**439**
Loans and advances to customers	**46,796**	**47,418**	**622**
Loans & receivables securities	**9,828**	**9,377**	**(451)**
Liabilities			
Deposits by banks	**52,458**	**53,231**	**(773)**
Deposits by customers	**43,436**	**43,414**	**22**
Debt securities in issue	**9,981**	**9,846**	**135**
Subordinated liabilities	**1,028**	**1,226**	**(198)**

			Company
2009	**Carrying Value £m**	**Fair value £m**	**Surplus/ (deficit) £m**
Assets			
Cash and balances at central banks	**446**	**446**	**-**
Loans and advances to banks	**46,208**	**46,584**	**376**
Loans and advances to customers	**52,132**	**52,718**	**586**
Loans & receivables securities	**9,994**	**9,543**	**(451)**
Liabilities			
Deposits by banks	**54,085**	**54,858**	**(773)**
Deposits by customers	**47,691**	**47,674**	**17**
Subordinated liabilities	**1,028**	**1,226**	**(198)**

			Group
2008	Carrying Value £m	Fair value £m	Surplus/ (deficit) £m
Assets			
Cash and balances at central banks	1,553	1,553	-
Loans and advances to banks	1,239	1,240	1
Loans and advances to customers	51,402	52,377	975
Loans & receivables securities	14,250	13,153	(1,097)
Liabilities			
Deposits by banks	11,516	11,501	15
Deposits by customers	39,765	39,826	(61)
Debt securities in issue	17,477	16,605	872
Subordinated liabilities	1,436	1,411	25

			Company
2008	Carrying Value £m	Fair value £m	Surplus/ (deficit) £m
Assets			
Cash and balances at central banks	1,553	1,553	–
Loans and advances to banks	1,236	1,237	1
Loans and advances to customers	52,604	53,275	671
Loans & receivables securities	14,321	13,224	(1,097)
Liabilities			
Deposits by banks	13,585	13,570	15
Deposits by customers	41,222	41,283	(61)
Debt securities in issue	12,084	11,790	294
Subordinated liabilities	1,436	1,411	25

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

Fair value measurement
The fair value of financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale If a quoted market price is available for an instrument, the fair value is calculated based on the market price Where quoted market prices are not available, fair value is determined using pricing models which use a mathematical methodology based on accepted financial theories, depending on the product type and its components Further information on fair value measurement can be found in the Group's Accounting Policies from pages 58 to 59 and the Valuation techniques section below on page 105 to the Consolidated Financial Statements

Fair value management
The fair value exposures, as tabled above, are managed by using a combination of hedging derivatives and offsetting on balance sheet positions The approach to specific categories of financial instruments is described below

Assets:
Cash and balances at central banks/Loans and advances to banks
The carrying amount is deemed a reasonable approximation of the fair value, because they are short term in nature

Loans and advances to customers
Loans and advances to personal customers are made both at variable and at fixed rates As there is no active secondary market in the UK for such loans and advances, there is no reliable market value available for such a significant portfolio
a) Variable rate
The Directors believe that the carrying value of the variable rate loans may be assumed to be their fair value
b) Fixed rate
Certain of the loans secured on residential properties are at a fixed rate for a limited period, typically two to five years from their commencement At the end of this period these loans revert to the relevant variable rate The excess of fair value over carrying value of each of these loans has been estimated by reference to the market rates available at the balance sheet date for similar loans of maturity equal to the remaining fixed period

Loan and receivable securities
These debt securities are valued with the assistance of valuations prepared by an independent, specialist valuation firm

Liabilities.
Deposits by banks
The carrying amount is deemed a reasonable approximation of the fair value, because it is short-term in nature

Deposits by customers
The majority of deposit liabilities are payable on demand and therefore can be deemed short term in nature with the fair value equal to the carrying value However, given the long-term and continuing nature of the relationships with the Group's customers, the Directors believe there is significant value to the Group in this source of funds Certain of the deposit liabilities are at a fixed rate until maturity The deficit of fair value over carrying value of these liabilities has been estimated by reference to the market rates available at the balance sheet date for similar deposit liabilities of similar maturities

The fair value of such deposits liabilities has been estimated using the same valuation technique for financial instruments accounted for at fair value as described in the Valuation techniques section below on page 105 to the Consolidated Financial Statements

Notes to the Financial Statements continued

Debt securities in issue and subordinated liabilities

Where reliable prices are available, the fair value of debt securities in issue and subordinated liabilities has been calculated using quoted market prices Other market values have been determined using the same valuation technique for financial instruments accounted for at fair value as described in the Valuation techniques section below on page 105 to the Consolidated Financial Statements

Fair value valuation bases

The following tables summarise the fair values at 31 December 2009 and 2008 of the asset and liability classes accounted for at fair value, by the valuation methodology used by the Group to determine their fair value The tables also disclose the percentages that the recorded fair values of financial assets and liabilities represent of the total assets and liabilities, respectively, that are recorded at fair value in the balance sheet

At 31 December 2009

		Quoted prices in active markets		Internal models based on: Market observable data		Internal models based on: Significant unobservable data		Total		Valuation technique
Balance sheet category		**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**	
Assets										
Derivative assets	Exchange rate contracts	-	-	761	65	-	-	761	65	A
	Interest rate contracts	-	-	347	30	-	-	347	30	A & C
Financial assets at FVTPL	Debt securities	-	-	-	-	50	4	50	4	A
	Equity securities	1	-	-	-	-	-	1	-	-
Available-for-sale financial assets	Debt securities	3	-	-	-	-	-	3	-	-
	Equity securities	8	1	-	-	-	-	8	1	B
Total assets at fair value		12	1	1,108	95	50	4	1,170	100	
Liabilities										
Derivative liabilities	Exchange rate contracts	-	-	42	15	-	-	42	15	A
	Interest rate contracts	-	-	154	55	-	-	154	55	A & C
	Equity & credit contracts	-	-	2	1	-	-	2	1	B
Financial liabilities at FVTPL	Deposits by banks	-	-	45	16	-	-	45	16	A
	Deposits by customers	-	-	12	3	-	-	12	3	A
	Debt securities in issue	-	-	27	10	-	-	27	10	A
Total liabilities at fair value		-	-	282	100	-	-	282	100	

At 31 December 2008

		Quoted prices in active markets		Internal models based on market observable data		Total		Valuation technique
Balance sheet category		£m	%	£m	%	£m	%	
Assets								
Trading assets	Debt securities	-	-	1,818	40	1,818	40	A
Derivative assets	Exchange rate contracts	-	-	1,058	23	1,058	23	A
Financial assets at FVTPL	Debt securities	-	-	63	1	63	1	A
Available-for-sale financial assets	Debt securities	1 648	36	-	-	1,648	36	-
	Equity securities	-	-	10	-	10	-	B
Total assets at fair value		1,648	36	2 949	64	4 597	100	
Liabilities								
Derivative liabilities	Exchange rate contracts	-	-	357	16	357	16	A
	Interest rate contracts	-	-	1,164	51	1,164	51	A&C
	Equity & credit contracts	-	-	12	1	12	1	B
Financial liabilities at FVTPL	Deposits by banks	-	-	153	7	153	7	A
	Deposits by customers	-	-	252	11	252	11	A
	Debt securities in issue	-	-	323	14	323	14	A
Total liabilities at fair value		-	-	2,261	100	2,261	100	

Valuation techniques

The main valuation techniques employed in the Group's internal models to measure the fair value of the financial instruments disclosed above at 31 December 2009 and 2008 are set out below In substantially all cases, the principal inputs into these models are derived from observable market data The Group did not make any material changes to the valuation techniques or internal models it used during the years ended 31 December 2009 and 2008 The Group developed a discounted cash flow model during 2008 for credit default swaps, the effect of which was immaterial

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

B In the valuation of equity financial instrument requiring dynamic hedging (principally equity securities, options and other structured instruments), proprietary stochastic volatility models are used These types of models are widely accepted in the financial services industry Observable market inputs are used in these models to generate variables such as the bid-offer spread, foreign currency exchange rates, credit risk, volatility, correlation between indices and market liquidity as appropriate

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 determining fair value, the Group also considers the credit risk of its counterparties, as well as its own creditworthiness, on all over-the-counter (OTC) derivatives in the trading book The Group attempts to mitigate credit risk to third parties by entering into netting and collateral arrangements Net counterparty exposure (counterparty positions netted by offsetting transactions and both cash and securities collateral) is then valued for counterparty creditworthiness and this resultant value is incorporated into the fair value of the respective instruments

The credit risk adjustment is measured as a lifetime expected loss for each counterparty based on the probability of default, the loss given default and the expected exposure of the OTC derivative position with the counterparty

The probability of default is calculated at the counterparty level through the use of internal rating models The loss given default ("LGD") is calculated at the facility level and takes into account the counterparty characteristics as well as the instrument traded Credit ratings and LGD are updated by the credit team as new relevant information becomes available and at periodic reviews performed at least annually

The expected exposure is calculated on a portfolio level and is based on the underlying risks of the portfolio The main drivers of the expected exposure are the size of the risk position with the counterparty along with the prevailing market environment

Broker quotes and external consensus market data are used for validating the fair values of some items in the trading portfolio, or designated at fair value through profit or loss All derivatives pricing models are validated independently by the Quantitative Risk Group ('QRG') A validation report is produced for each model-derived payment that assesses the mathematical assumptions behind the model and the implementation of the model and its integration within the trading system Where there is observable market data the models calibrate to market Where pricing data is unobservable then the input parameters are regularly reviewed by QRG The source of pricing data is considered as part of the process that determines the classification of the level of a financial instrument

The Group also considers its own creditworthiness when determining the fair value of an instrument, including OTC derivative instruments and financial liabilities held at fair value through profit or loss if the Group believes market participants would take that into account when transacting the respective instrument The approach to measuring the impact of the Group's credit risk on an instrument is done in the same manner as for third party credit risk The impact of the Group's credit risk is considered when calculating the fair value of an instrument, even when credit risk is not readily observable such as in OTC derivatives contracts The Group has not realised any profit or loss on revaluing fair values of derivatives to reflect its own creditworthiness If the Group had reflected such adjustments it would not have had a material impact on the valuations

The fair values of the financial instruments arising from the Group's internal models take into account, among other things, contract terms and observable market data, which include such factors as bid-offer spread, interest rates, credit risk, exchange rates, the quoted market price of raw materials and equity securities, volatility and prepayments

The estimates thus obtained could vary if other valuation methods or assumptions were used The Group believes its valuation methods are appropriate and consistent with other market participants Nevertheless, the use of different valuation methods or assumptions 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

Internal models based on observable market data

During 2008 and 2009, there were no transfers between Level 1 and Level 2 financial instruments

Internal models based on information other than market data

The collateralised synthetic obligations (CSOs) securities are valued using internal models based on information other than market data These debt securities were initially recognised at transaction price and subsequently measured using valuation prepared by an independent, third party specialist professional valuation firm At 31 December 2009, the value of these securities was £50m (2008 £nil)

Notes to the Financial Statements continued

Internal valuation review
In all instances, risk control teams review positions to assess a realistic realisable value for the position and develop a methodology for any adjustment to fair value which marks the position to that value using information relevant to that asset Consideration is given to the quality of the information available that provides the current mark-to-model valuation and estimates of how different these valuations could be on an actual trade, taking into consideration how active the market is For spot assets that cannot be sold due to illiquidity, forward estimates are discounted to provide an estimate of a realisable value over time All adjustments for illiquid positions are regularly reviewed to reflect changing market conditions

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

	Fair value through profit or loss £m
At 1 January 2009	-
Total gains or losses recognised in profit/loss	-
Transfers in	50
At 31 December 2009	50
Total gains or losses recognised in profit/loss relating to those assets and liabilities held at the end of the year	-

Financial instrument assets and liabilities at 31 December 2009
Financial instrument assets valued using internal models based on information other than market data were 4% (2008 nil%) of total assets measured at fair value and 0 05% (2008 nil%) of total assets at 31 December 2009

Assets designated at fair value through profit or loss valued using internal models based on information other than market data increased in 2009 due to the recognition of collateralised synthetic obligations ('CSOs') upon the consolidation of the assets of the Group's Conduit vehicles as described in 'Exposure to Off-Balance Sheet Entities sponsored by the Group - Secured Loan to Conduit' in the Risk Management Report

Effect of changes in significant unobservable assumptions to reasonably possible alternatives
No sensitivities are presented for the FVTPL – debt securities as they have been valued by an independent, specialist valuation firm

44. Capital Management and Resources

Capital management and capital allocation
The Santander UK plc Board is responsible for capital management strategy and policy and ensuring that capital resources are appropriately monitored and controlled within regulatory and internal limits within the Santander UK group of companies ('Santander UK') Authority for capital management flows to the Chief Executive and from him to specific individuals who are members of Santander UK's Asset and Liability Management Committee ('ALCO')

ALCO adopts a centralised capital management approach that is driven by Santander UK's corporate purpose and strategy This approach takes into account the regulatory and commercial environment in which Santander UK operates, Santander UK's risk appetite, the management strategy for each of Santander UK's material risks (including whether or not capital provides an appropriate risk mitigant) and the impact of appropriate adverse scenarios and stresses on Santander UK's capital requirements This approach is reviewed annually as part of Santander's UK's Internal Capital Adequacy Assessment Process ('ICAAP')

Santander UK manages its capital requirements, debt funding and liquidity on the basis of policies and plans reviewed regularly at ALCO and as part of the ICAAP process To support its capital and senior debt issuance programmes, Santander UK is rated on a stand-alone basis

On an ongoing basis, and in accordance with the latest ICAAP review, Santander UK forecasts its regulatory and internal capital requirements based on the approved capital volumes allocated to business units as part of the corporate planning process and the need to have access to a capital buffer Capital allocation decisions are made as part of planning based on the relative returns on capital using both economic and regulatory capital measures Capital allocations are reviewed in response to changes in risk appetite and risk management strategy, changes to the commercial environment, changes in key economic indicators or when additional capital requests are received

This combination of regulatory and economic capital ratios and limits, internal buffers and restrictions, together with the relevant costs of differing capital instruments and a consideration of the various other capital management techniques are used to shape the most cost-effective structure to fulfil Santander UK's capital needs

Capital adequacy
From 1 January 2007, the Group has managed its capital on a Basel II basis Throughout 2009, the Group held capital over and above its regulatory requirements, and managed internal capital allocations and targets in accordance with its capital and risk management policies

Group Capital

	31 December 2009 £m	31 December 2008 £m
Core Tier 1 capital	**1,303**	1,352
Deductions from Core Tier 1 capital	**(139)**	(78)
Total Core Tier 1 capital after deductions	**1,164**	1,274
Other Tier 1 capital	**569**	605
Total Tier 1 capital after deductions	**1,733**	1,879
Tier 2 capital	**939**	1,306
Deductions from Tier 2 capital	**(101)**	(61)
Total Tier 2 capital after deductions	**838**	1,245
Deductions from total Tier 1 and Tier 2 capital	**-**	-
Tier 3 capital	**-**	147
Total capital resources	**2,571**	3,271

The Group's Tier 1 capital consists of shareholders' equity and audited profits for the years ended 31 December 2009 and 31 December 2008 after adjustment to comply with UK Financial Services Authority rules Tier 1 deductions relate to intangible assets recognised during the year and expected losses in excess of credit provisions for portfolios on the IRB approach for measuring credit risk In addition, the Group has elected to deduct certain securitisation positions from capital rather than treat these exposures as a risk weighted asset

The decrease in Tier 2 capital represents subordinated debt redeemed during the year

Risk Factors

An investment in Alliance & Leicester plc (the 'Company') and its subsidiaries (together, 'Alliance & Leicester' or the 'Group') involves a number of risks, the material ones of which are set forth below

Alliance & Leicester's risk management measures may not be successful

The management of risk is an integral part of all Alliance & Leicester's activities Risk constitutes Alliance & Leicester's exposure to uncertainty and the consequent variability of return Specifically, risk equates to the adverse impacts on profitability arising from different sources of uncertainty including Credit Risk (Retail), Credit Risk (Wholesale), Credit Risk (Corporate and Commercial), Market Risk (Traded and non-Traded), Operational Risk, Asset Backed Funding Risk, Concentration Risk, Liquidity Risk, Reputational Risk, Business and Strategic Risk, Pension Obligation Risk, Residual Value Risk and Regulatory Risk Alliance & Leicester seeks to monitor and manage its risk exposure through a variety of separate but complementary financial, credit, market, operational, compliance and legal reporting systems While Alliance & Leicester employs a broad and diversified set of risk monitoring and risk mitigation techniques, such techniques, and the judgements that accompany their application, cannot anticipate every unfavourable event or the specifics and timing of every outcome Accordingly, Alliance & Leicester's ability to successfully identify and balance risks and rewards, and to manage all material risks, is an important factor that can significantly affect results of operations

Risks concerning borrower credit quality and general economic conditions are inherent in Alliance & Leicester's business

Risks arising from changes in credit quality and the recoverability of loans and amounts due from borrowers and counterparties are inherent in a wide range of Alliance & Leicester's businesses Adverse changes in the credit quality of Alliance & Leicester's borrowers and counterparties or a general deterioration in UK or global economic conditions, or arising from systemic risks in the financial system, could reduce the recoverability and value of Alliance & Leicester's assets and require an increase in Alliance & Leicester's level of provisions for bad and doubtful debts Likewise, a significant reduction in the demand for Alliance & Leicester's products and services could negatively impact Alliance & Leicester's business and financial condition Since August 2007, the global financial system has experienced difficult credit and liquidity conditions and disruptions leading to less liquidity, greater volatility, an increase in general fraud and money laundering activity (first and third party), and general widening of spreads

In September 2008, global financial markets deteriorated sharply following the bankruptcy filing by Lehman Brothers Holdings Inc Since then, a number of other major financial institutions, including some of the largest global commercial banks, investment banks, mortgage lenders, mortgage guarantors and insurance companies, have experienced significant difficulties

Governments and central banks took concerted action to make substantial funds and guarantees available to boost liquidity and confidence in their financial systems, stimulate lending and support important institutions at risk of failing, in addition to cutting taxes and lowering interest rates As a consequence, conditions eased in 2009 and most leading developed economies, including the United Kingdom, began to emerge from recession, although the pace and depth of recovery was uneven across asset markets However, the financial services industry continued to face an unusually high degree of uncertainty

Despite the stabilisation in conditions experienced in 2009, dramatic declines in the previous two years in the housing markets in the UK combined with increasing unemployment continue to adversely affect the credit performance of real estate related exposures, resulting in significant write-downs of asset values by financial institutions, including Alliance & Leicester These write-downs, initially of asset backed securities but spreading to other securities and loans, caused many financial institutions to seek additional capital, to reduce or eliminate dividends, to merge with larger and stronger competitors or, in some cases, to fail

This market turmoil and reduction of available credit have contributed to decreasing consumer confidence, increased market volatility, reduced business activity and, consequently, increasing commercial and consumer loan delinquencies These market developments may further affect consumer confidence levels and may cause adverse changes in payment patterns, causing further increases in delinquencies and default rates, which may impact Alliance & Leicester's write-offs/charge-offs and provision for credit losses These market conditions could materially and adversely affect Alliance & Leicester's financial condition and results of operations

In the United Kingdom, the contraction in economic output appears to have ceased with the country emerging slowly from recession in the last quarter of 2009 However, economic indicators remain weak and the risk of the country slipping back into recession in 2010, prolonging the recovery, remains Government measures to tackle the record levels of national debt, including taxation rises and public spending cuts, are also likely to result in a slower recovery than other recent recessions Political involvement in the regulatory environment and the major financial institutions in which the state has a direct financial interest will continue Government demands for increased credit to support the economic recovery will increase competition for deposits, narrowing margins The combination of slow economic recovery, government intervention and competition for deposits will maintain the pressure on Alliance & Leicester's retail business model Credit quality should improve in some sectors as the economy returns to growth but could be adversely affected by any increase in unemployment into 2010

The soundness of other financial institutions could materially and adversely affect Alliance & Leicester's business

Alliance & Leicester's ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships Alliance & Leicester has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, investment banks, mutual funds, and other institutional clients As a result, defaults by, or even rumours or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by Alliance & Leicester or by other institutions Many of these transactions expose Alliance & Leicester to credit risk in the event of default of Alliance & Leicester's counterparty or client

In addition, Alliance & Leicester's credit risk may be increased when the collateral held by us cannot be realised or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due to Alliance & Leicester There is no assurance that any such losses would not materially and adversely affect Alliance & Leicester's results of operations

Risks associated with liquidity and funding are inherent in Alliance & Leicester's business

Alliance & Leicester receives a large proportion of its funding and liquidity from its parent company Santander UK plc However, liquidity risks are inherent in any retail and commercial bank While Santander UK plc and Alliance & Leicester have implemented liquidity management processes to mitigate and control these risks, unforeseen systemic market factors in particular make it difficult to eliminate these risks completely Adverse and continued constraints in the supply of liquidity, including inter-bank lending, may materially and adversely affect the cost of funding the business and extreme liquidity constraints may impact Alliance & Leicester's current operations as well as limit growth possibilities These events may also have a material adverse effect on the market value and liquidity of bonds issued by Alliance & Leicester in the secondary markets From 2007 to date, the prime residential mortgage securitisation and covered bond markets have experienced severe disruption as a result of a material reduction in investor demand for these securities These severe disruptions have resulted in extraordinary government intervention into the financial services sector as a whole These markets, which are important sources of funding for Santander UK plc and Alliance & Leicester, were effectively closed to new external issuances of securities Global investor confidence also remains low and credit remains relatively scarce

Continued or worsening disruption and volatility in the global financial markets could have a material adverse effect on Santander UK plc and Alliance & Leicester's ability to access capital and liquidity on financial terms acceptable to them, if at all If capital markets financing ceases to become available, or becomes excessively expensive, Alliance & Leicester may be forced to raise the rates it pays on deposits to attract more customers While central banks around the world have taken coordinated efforts to increase liquidity in the financial markets by taking measures such as increasing the amounts they lend directly to financial institutions, lowering interest rates and significantly increasing temporary reciprocal currency arrangements (or 'swap lines'), it is not known how long these market conditions will continue, or whether they will worsen, or how long central bank schemes will continue or on what terms The persistence of these adverse market conditions could have a material adverse effect on Santander UK plc and Alliance & Leicester's liquidity and funding

Any reduction in Alliance & Leicester's credit rating could increase its cost of funding and adversely affect its interest margins

Credit ratings affect the cost and other terms upon which Alliance & Leicester is able to obtain funding Rating agencies regularly evaluate Alliance & Leicester and their ratings of Alliance & Leicester's short-term and long-term debt are based on a number of factors, including Alliance & Leicester's financial strength as well as conditions affecting the financial services industry generally In light of the difficulties in the financial services industry and the financial markets, there can be no assurance that the rating agencies will maintain Alliance & Leicester's current ratings or outlooks Any reduction in those ratings and outlooks could increase the cost of Alliance & Leicester's funding, adversely affect Alliance & Leicester's interest margins and/or impact its liquidity position

Market risks associated with fluctuations in interest rates, bond and equity prices and other market factors are inherent in Alliance & Leicester's business

The most significant market risks Alliance & Leicester faces are interest rates and bond and equity price risks Changes in the general level of interest rates, as well as changes in the shape of yield curves and basis spreads may adversely affect the interest rate margin realised between lending rates and borrowing costs in Alliance & Leicester's banking operation Significant declines in housing markets over the past two years have negatively impacted the credit performance of real estate-related loans and resulted in significant write-downs of asset values by many financial institutions These write-downs, initially of asset-backed securities but spreading to other securities and loans, have caused many financial institutions to seek additional capital, to reduce or eliminate dividends, to merge with larger and stronger institutions and, in some cases, to fail Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced or ceased providing funding to borrowers, including to other financial institutions

As a result of these market forces, volatility in interest rates and basis spreads has increased, which has increased Alliance & Leicester's borrowing costs, while decreasing values of global debt and equity markets have had an adverse effect on the value of Alliance & Leicester's investment portfolio Any increase in capital markets funding costs or deposit rates could entail a re-pricing of loans, which would result in a reduction of volumes, and may also have an adverse effect on Alliance & Leicester's interest margins Alliance & Leicester also sponsors a number of defined benefit staff pension schemes, and its obligations to those schemes may increase depending on the performance of financial markets Although Alliance & Leicester is undertaking measures to mitigate and control the effects of these conditions, there can be no assurances that such controls will insulate Alliance & Leicester from deteriorating market conditions

Risks associated with strategic decisions regarding organic growth, and potential acquisitions and disposals

Alliance & Leicester allocates substantial management and planning resources developing strategic plans for organic growth and identifying possible acquisitions and disposals and the potential restructuring of Alliance & Leicester's businesses If the outcomes of these plans do not match expectations, Alliance & Leicester's earnings may not develop as forecast

Risk Factors continued

Santander UK plc and Alliance & Leicester may fail to realise the anticipated benefits of integrating the businesses
The success of the transfer of Alliance & Leicester to Santander UK plc and subsequent integration will depend, in part, on Santander UK plc's ability to realise the anticipated benefits from combining Santander UK plc's business with the business of Alliance & Leicester It is possible that the integration process could take longer or be more costly than anticipated or could result in the loss of key employees, the disruption of each company's ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect the ability of each company to maintain relationships with clients, customers or employees In addition, Alliance & Leicester is currently run by management and employees who have not previously been exposed to Santander UK plc's business culture or philosophy

The efforts to integrate these companies are also likely to divert management attention and resources If the integration of Alliance & Leicester with Santander UK plc takes longer than anticipated or Santander UK plc is not able to integrate the aforementioned businesses, the anticipated benefits of integrating the businesses may not be realised fully or at all, or may take longer to realise than expected

Alliance & Leicester's business is concentrated in the UK and on the offering of mortgage-related products and services
Alliance & Leicester's business is principally concentrated in the UK and on the offering of mortgage-related products and services As a consequence, Alliance & Leicester's financial condition and results of operations are highly dependent on economic conditions in the UK generally, and the UK property market, in particular Beginning in the second half of 2008, UK and global economic conditions deteriorated significantly and global financial markets experienced acute turbulence The UK economy contracted further in 2009 overall, though it returned to slight positive GDP growth in the last quarter In 2008 and much of 2009, the UK property market suffered a significant correction as a consequence of housing demand being constrained by a combination of subdued earnings growth, greater pressure on housing finances, rising unemployment, changes in interest rates, a decline in the availability of mortgage finance and the continued effect of global market volatility

UK and global economic conditions and uncertainties may have an adverse effect on the quality of Alliance & Leicester's loan portfolio and may result in a rise in delinquency and default rates and write offs/charge-offs There can be no assurance that Alliance & Leicester will not have to increase its provisions for loan losses in the future as a result of future increases in non-performing loans or for other reasons beyond its control Any increases in Alliance & Leicester's provisions for loan losses could materially and adversely affect Alliance & Leicester's financial condition and results of operations

Alliance & Leicester's business is conducted in a highly competitive environment
The market for UK financial services is highly competitive and the financial crisis has re-shaped the banking landscape in the United Kingdom, reinforcing both the importance of a retail deposit funding base and strong capitalisation The financial industry's renewed focus on building retail deposit bases has resulted in greater pricing competition in terms of interest rates offered, and management expects such competition to intensify in response not only to regulatory actions but to other factors, including competitor behaviour, consumer demand, technological changes, the impact of consolidation If financial markets remain unstable, financial institution consolidation may continue Moreover, the UK government has effectively nationalised some of the country's largest banks and has implemented a preferred equity programme open to all financial institutions and another programme to guarantee short-term and certain medium-term debt of financial institutions, among other measures These measures could lead to increased government ownership and control over financial institutions in the UK and further consolidation in the financial industry, all of which could adversely affect Alliance & Leicester's business, financial condition and results of operations Alliance & Leicester's financial condition and results of operations may be materially and adversely affected by competition, including declining lending margins or competition for savings driving up funding costs that cannot be recovered from borrowers If Alliance & Leicester is not successful in retaining and strengthening customer relationships, it may lose market share, incur losses on some or all of its activities or fail to attract new deposits and retain existing deposits, which could materially and adversely affect its financial position and results of operations

Operational risks are inherent in Alliance & Leicester's business
Operational losses can result from fraud, criminal acts, errors by employees, failure to document transactions properly or to obtain proper authorisation, failure to comply with regulatory requirements and conduct of business rules, failure or breakdown of accounting, data processing and other record keeping systems, natural disasters, or failure or breakdown of external systems, including those of the Alliance & Leicester's suppliers or counterparties

Alliance & Leicester's business could be affected if its capital is not managed effectively
Effective management of Alliance & Leicester's capital position is important to its ability to operate its business, to continue to grow organically and to pursue its strategy Any future change that limits Alliance & Leicester's ability to manage its balance sheet and capital resources effectively or to access funding on commercially acceptable terms could have a material adverse effect on Alliance & Leicester's financial condition and regulatory capital position

Alliance & Leicester relies on recruiting, retaining and developing appropriate senior management and skilled personnel

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

Reputational risk could cause harm to Alliance & Leicester and its business prospects

Alliance & Leicester's ability to attract and retain customers and conduct business transactions with its counterparties could be adversely affected to the extent that its reputation, or the reputation of affiliates operating under the Alliance & Leicester brand, is damaged Failure to address, or appearing to fail to address, various issues that could give rise to reputational risk could cause harm to Alliance & Leicester and its business prospects Reputational issues include, but are not limited to appropriately addressing potential conflicts of interest, legal and regulatory requirements, ethical issues, adequacy of anti-money laundering processes, privacy issues, record-keeping, sales and trading practices, proper identification of the legal, reputational, credit, liquidity and market risks inherent in products offered, and general company performance The failure to address these issues appropriately could make customers unwilling to do business with Alliance & Leicester, which could adversely affect its results of operations

Alliance & Leicester's businesses are subject to substantial legislation, regulatory and governmental oversight

Alliance & Leicester is subject to financial services laws, regulations, administrative actions and policies in each location in which it operates and, indirectly, in Spain, as a result of being part of Banco Santander, S A During the recent market turmoil, there have been unprecedented levels of government and regulatory intervention and scrutiny, and changes to the regulations governing financial institutions In addition, in light of the financial crisis, regulatory and governmental authorities are considering, or may consider, further enhanced or new legal or regulatory requirements intended to prevent future crises or otherwise ensure the stability of institutions under their supervision in addition to those measures that have already been announced For instance, the UK Government published a White Paper on 8 July 2009 (HM Treasury paper "Reforming Financial Markets" (CM 7667)) which contained a number of proposals for reforming the UK financial system, including more stringent capital and liquidity requirements for systemically significant firms, requirements for banks to develop detailed plans for winding down their businesses and enhanced regulatory powers for the UK Financial Services Authority A number of the proposals set out in the White Paper now form part of the Financial Services Bill that was published on 19 November 2009 and which is currently going through the UK Parliamentary approval process In November 2009, the UK Financial Services Authority also released the Banking Conduct of Business sourcebook, a set of rules and guidance that regulate how authorised banks conduct business with their customers, including rules relating to communications, cancellation rights and information rights of customers

Recent proposals and measures taken by governmental and regulatory authorities and future changes in supervision and regulation, in particular in the UK, which are beyond Alliance & Leicester's control, could materially affect Alliance & Leicester's business, the products and services offered or the value of assets as well as Alliance & Leicester's operations and result in significant increases in operational costs Changes in UK legislation and regulation to address the stability of the financial sector may also affect the competitive position of the UK banks, including Alliance & Leicester, particularly if such changes are implemented before international consensus is reached on key issues affecting the industry, for instance in relation to the UK Financial Services Authority's proposals on liquidity risk management (see the risk factor "Alliance & Leicester is subject to regulatory capital and liquidity requirements that could limit its operations" below for further details) Certain proposed regulatory changes in the area of asset-backed securitisation, which has historically been a major source of funding for Santander UK, may impact the ability to use securitisation as a source of funding in the future Although Alliance & Leicester works closely with its regulators and continually monitors the situation, future changes in regulation, fiscal or other policies can be unpredictable and are beyond the control of Alliance & Leicester No assurance can be given generally that laws or regulations will be adopted, enforced or interpreted in a manner that will not have an adverse effect on Alliance & Leicester's business The resolution of a number of issues, including regulatory investigations and reviews and court cases affecting the UK financial services industry, including Alliance & Leicester, could have a negative impact on Alliance & Leicester's results of operations or on its relations with some of its customers and potential customers

Alliance & Leicester is subject to regulatory capital and liquidity requirements that could limit its operations

Alliance & Leicester is subject to capital adequacy requirements adopted by the UK Financial Services Authority for banks, which provide for a minimum ratio of total capital to risk-adjusted assets both on a consolidated basis and on a solo basis, expressed as a percentage If Alliance & Leicester fails to maintain its ratios this may result in administrative actions or sanctions against it which may impact Alliance & Leicester's ability to fulfil its obligations

Risk Factors continued

However, in response to the recent financial crises, the UK Financial Services Authority will impose more stringent capital adequacy requirements, including increasing the minimum regulatory capital requirements imposed on Alliance & Leicester For instance, the UK Financial Services Authority has adopted a supervisory approach in relation to certain UK banks, including Alliance & Leicester, under which those banks are expected to maintain tier 1 capital in excess of the minimum levels required by existing UK Financial Services Authority rules The UK Financial Services Authority is also consulting on changes to the eligibility criteria for tier 1 capital as well as requirements that may result in banks increasing the level of regulatory capital held in respect of trading book risks, implementing the recent amendments to the EU-wide capital adequacy requirements (as set out in the amended Directive 2006/48/EC and Directive 2006/49/EC, collectively referred to as the "Capital Requirements Directive")

In December 2009, the Basel Committee on Banking Supervision also published and is currently consulting on a number of proposals to reform international capital adequacy and liquidity standards in order to increase resilience in the banking sector to financial and economic stresses Proposals include phasing out innovative tier 1 instruments with incentives to redeem and implementing a leverage ratio on institutions in addition to current risk-based regulatory capital requirements Measures are also proposed to promote the building of counter-cyclical capital buffers that may be drawn upon in stress scenarios, such as limiting the ability of institutions to distribute capital (dividend payments, discretionary bonus payments, share repurchases) in the event that the institution's capital (over and above minimum capital adequacy requirements) fall under prescribed thresholds, thereby conserving capital in stress scenarios

On 5 October 2009, the UK Financial Services Authority published its new liquidity rules which significantly broaden the scope of the existing liquidity regime and are designed to enhance regulated firms' liquidity risk management practices As part of these reforms, the UK Financial Services Authority is also expected to gradually implement requirements for financial institutions to hold prescribed levels of liquid assets and have in place other sources of liquidity to address the institution-specific and market-wide liquidity risks that institutions may face in short-term and prolonged stress scenarios

These measures could have a material adverse effect on Alliance & Leicester's results of operations, financial condition and prospects There is a risk that changes to the UK capital adequacy regime may result in increased minimum capital requirements, which could reduce available capital and thereby affect Alliance & Leicester's ability to pay dividends, continue organic growth or pursue acquisitions or other strategic opportunities In addition, changes to the eligibility criteria for tier 1 capital may impact Alliance & Leicester's ability to raise tier 1 capital or the eligibility of existing tier 1 capital resources (although this risk may be mitigated if the UK Financial Services Authority adopt measures to grandfather the regulatory capital treatment of existing tier 1 resources that do not comply with any revised criteria)

There is also a risk that implementing and maintaining enhanced liquidity risk management systems may incur significant costs and more stringent requirements to hold liquid assets and liquidity facilities may materially impact Alliance & Leicester's lending business as more funds may be required to acquire or maintain liquidity resources

In the United Kingdom Alliance & Leicester is responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers

In the United Kingdom, the Financial Services Compensation Scheme (the "FSCS") was established under FSMA and is the UK's statutory fund of last resort for customers of authorised financial services firms The FSCS can pay compensation to customers if a UK Financial Services Authority authorised firm is unable, or likely to be unable, to pay claims against it (for instance, an authorised bank is unable to pay claims by depositors) The FSCS is funded by levies on firms authorised by the UK Financial Services Authority, including Alliance & Leicester and other members of the Group

In the event that the FSCS raises funds from authorised firms, raises those funds more frequently or significantly increases the levies to be paid by such firms, the associated costs to Alliance & Leicester may have a material impact on its results of operations or financial condition The recent measures taken to protect the depositors of deposit-taking institutions involving the FSCS have resulted in a significant increase in the levies made by the FSCS on the industry and may do so in the future if similar measures are required to protect depositors of other institutions

In addition, regulatory reform initiatives in the UK and internationally may result in further changes to the FSCS, which could result in additional costs and risks for Alliance & Leicester For instance, the UK Government has proposed a consultation on pre-funding the FSCS, which may affect the profitability of Alliance & Leicester (and other members of the Group required to contribute to the FSCS), although it has made clear that pre-funding would not be introduced before 2012 Furthermore, the UK Financial Services Authority has proposed that UK deposit-taking institutions develop systems by 31 December 2010 to enable the institution to produce an aggregated view of each customer's eligibility for compensation in the event of a failure (a "Single Customer View"), which may require Alliance & Leicester to incur significant costs arising from the development and implementation of systems and controls that would enable Single Customer Views to be produced

To the extent that other jurisdictions where Alliance & Leicester operates have introduced or plan to introduce similar compensation, contributory or reimbursement schemes, the Group may incur additional costs and liabilities which may negatively impact its results of operations or financial condition

The UK Banking Act 2009 may adversely affect the Group's business

The UK Banking Act 2009 (the "Act") came into force on 21 February 2009 The Act creates a special resolution regime ("SRR") which provides the UK HM Treasury, the Bank of England and the UK Financial Services Authority (the 'Authorities') with a variety of tools for dealing with UK institutions which are authorised deposit takers (such as the Company) which are failing, and in certain circumstances, their holding companies The Act replaced the emergency powers contained in the Banking (Special Provisions) Act 2008 (which powers ceased to be exercisable on 21 February 2009, when the Act came into force)

The Act enables the Authorities, in specified circumstances, to (i) take a bank or a bank holding company into temporary public ownership ("TPO"), (ii) transfer all or part of the business of a bank to a private sector purchaser ('PSP'), or (iii) transfer all or part of the business of a bank to a bridge bank owned by the Bank of England ('Bridge Bank') The SRR also comprises a new insolvency procedure and a new administration procedure, each of specific application to banks

Risk Factors continued

TPO and PSP transfers may be effected via a compulsory transfer of securities in the affected entity (which includes bonds) PSP and Bridge Bank transfers may be effected via a compulsory transfer of the affected entity's assets and liabilities

SRR transfers are subject to the satisfaction of two general conditions In summary, the UK Financial Services Authority must determine that (i) the bank is failing or likely to fail to meet its regulatory threshold conditions (within the meaning of section 41(1) of the UK Financial Services and Markets Act 2000), and (ii) having regard to timing and other relevant circumstances, it is not reasonably likely that (ignoring the stabilisation powers under the Act), action will be taken by or in respect of the bank that will enable the bank to satisfy the threshold conditions (ignoring for this purpose, UK HM Treasury or Bank of England financial assistance) There are additional trigger conditions which must be satisfied, the nature of which depends on the nature of the transfer and certain statutory objectives to which the Authorities must have regard in operating the SRR

SRR transfers under the Act may impact the rights of transferors and third parties in relation to the affected institution Legal or contractual rights which would operate to inhibit the transfer or which would otherwise be triggered by the transfer (and in certain other circumstances) can be disregarded and SRR transfers can take effect free from trusts, liabilities or other encumbrances A PSP or Bridge Bank transfer may involve a partial transfer of the affected institution's property which could lead to the rights and obligations of counterparties of the affected institution being split between the transferor and transferee entity (although the Act and the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 do restrict partial property transfers to some extent including protection such that certain partial property transfers may not provide for the transfer of some, but not all, of the property, rights and liabilities which are, or form part of, a "capital market arrangement" (as that expression is currently defined in the UK Insolvency Act 1986) to which the relevant institution is a party)

The Act confers wide-ranging ancillary powers on the Authorities to enable SRR transfers and to ensure the continuity of the transferred business In particular, the UK HM Treasury is given the power to change the law, either generally or specifically and with immediate or with retrospective effect, if the UK HM Treasury feels it is necessary or desirable in order to make a power under the SRR more effective The Act includes provisions to effect the payment of compensation to transferors under an SRR transfer and third parties In general, there is considerable uncertainty about the scope of the powers afforded to the Authorities under the Act and how the Authorities may choose to exercise them

If an instrument or order were made under the Act in respect of Alliance & Leicester, such instrument or order (as the case may be) may (amongst other things) (i) result in a compulsory transfer of securities or property of Alliance & Leicester and/or (ii) impact on the rights of holders of securities and/or result in the nullification or modification of the terms and conditions of such securities and/or (iii) result in the de-listing of the securities

At present, no instruments or orders have been made under the Act in respect of Alliance & Leicester and there has been no indication that any such order will be made, but there can be no assurance that this will not change and/or that holders of securities will not be adversely affected by any such order if made in the future

Risks concerning enforcement of judgements made in the United States

Alliance & Leicester plc is a public limited company registered in England and Wales All of the Company's Directors live outside the United States of America As a result, it may not be possible to serve process on such persons in the United States of America or to enforce judgements obtained in US courts against them or Santander UK based on the civil liability provisions of the US federal securities laws or other laws of the United States of America or any state thereof The Directors' Report on pages 40 to 45 has been prepared and presented in accordance with and in reliance upon English company law and the liabilities of the Directors in connection with that Report shall be subject to the limitations and restrictions provided by such law Under the UK Companies Act 2006, a safe harbour limits the liability of Directors in respect of statements in and omissions from the Directors' Report on pages 40 to 45 Under this safe harbour, the Directors would be liable to the Company (but not to any third party) if the Directors' Report contains errors as a result of recklessness or knowing misstatement or dishonest concealment of a material fact, but would not otherwise be liable

Contact Information

Alliance & Leicester plc registered office and principal office

Alliance & Leicester plc
Carlton Park
Narborough
Leicester
LE19 0AL
Registered Number 3263713
Registered in England and Wales

Santander shareholder department

Banco Santander, S A
2 Triton Square
Regent's Place
London
NW1 3AN

Phone numbers

Alliance & Leicester Switchboard
0116-201-1000

Santander Shareholder Services
0871-384-2000
+44 (0)-121-415-7188 (overseas)

GUARANTEE

THIS INSTRUMENT by way of deed poll is executed on 19 March 2009 by **ALLIANCE & LEICESTER PLC** (registered in England No 03263713) whose registered office is at Carlton Park, Narborough, Leicester LE19 0AL (the "Guarantor")

WHEREAS ABBEY NATIONAL PLC, a company incorporated in England (number 2294747) whose registered office is at 2 Triton Square, Regent's Place London NW1 3AN (the "**Company**"), has requested the Guarantor and the Guarantor has agreed to guarantee payment of all Obligations (as hereinafter defined) in accordance with, and as limited by, the terms and conditions of this Deed (this "**Guarantee**")

NOW IN WITNESS THEREOF the Guarantor hereby covenants and agrees as follows

1 In this Guarantee, unless the context otherwise requires

"Creditor" means any person (other than the Company or any subsidiary of the Company (as defined in section 736 of the Companies Act 1985) or any individual who is a connected person of the Company within the meaning of section 252 of the Companies Act 2006) to whom an Obligation is from time to time owed

"Obligation" means any obligation or liability, either primary or contingent, lawfully incurred by the Company to any person on or before 31 July 2012 (whether before or after the execution of this Guarantee) under or in respect of any dealing, transaction or engagement whatsoever, including without prejudice to the generality of the foregoing, for

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

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

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

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

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

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

(vii) any payments of interest due from the Company with respect to any of the foregoing transactions (whether or not the liability to pay such interest arises on or before 31 July 2012) together with all reasonable costs, commissions and other expenses incurred by any person in connection with the enforcement of this Guarantee, but excluding

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

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

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

Cross Guarantee continued

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

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

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

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

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

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

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

8 Any demand shall be given in writing addressed to the Guarantor at the registered or principal office of the Guarantor and served by hand or sent by post, marked for the attention of the Company Secretary A demand so made shall be deemed to have been duly made if left at such address on the day it was so left or, if sent by post, two weekdays after the time when the same was put in the post and in proving delivery it shall be sufficient to prove that the same was properly addressed and put in the post

9 The liability of the Guarantor under this Guarantee shall not be affected by the liquidation, winding-up or other incapacity of the Company In the event that any payment to a Creditor from the Company in respect of an Obligation is avoided or reduced by virtue of any enactments for the time being in force relating to liquidation or insolvency the Creditor shall be entitled to recover the value or amount thereof from the Guarantor as if such payment by the Company had not been made

Cross Guarantee continued

10 This Guarantee shall remain in full force and effect irrespective of the validity, regularity, legality or enforceability against the Company of, or of any defence or counter-claim whatsoever, available in relation to, any Obligations whether or not any action has been taken to enforce the same or any judgement obtained against the Company or any other person, whether or not any time or indulgence has been granted to the Company or any other person by or on behalf of any Creditor, whether or not there have been any dealings or transactions between the Company or any other person and any of the Creditors, whether or not the Company or any other person has been dissolved, liquidated, merged, consolidated, become bankrupt or has changed its status, functions, control or ownership, whether or not the Company or any other person has been prevented from making payment by foreign exchange provisions applicable at its place of registration or incorporation and whether or not any circumstances have occurred which might otherwise constitute a legal or equitable discharge of or defence to a guarantor

11 In the event that any of the terms or provisions of this Guarantee are or shall become invalid, illegal or unenforceable, the remaining terms and provisions hereof shall survive unaffected

12 The Guarantor shall be permitted from time to time and at any time to amend or vary the terms of this Guarantee PROVIDED THAT the liability of the Guarantor to a Creditor in respect of any Obligation incurred before, or arising out of an Obligation entered into before, the date of such variation or amendment, shall not be in any way reduced or limited by such variation or amendment Any person shall be entitled to rely on a certificate given by a director or other duly authorised officer of the Guarantor as to the existence and extent of this Guarantee and any such variation and/or amendment of this Guarantee on entering into any dealing, transaction or arrangement with the Company under or in respect of which an Obligation would or might be incurred by the Company to that person

13 This Guarantee shall be governed by and construed in accordance with English law

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

THE COMMON SEAL of **ALLIANCE & LEICESTER PLC**
was hereunto affixed in the presence of

Shaun Patrick Coles
Deputy Company Secretary

Directors' Responsibility Statement

We confirm to the best of our knowledge

1 The financial statements, prepared in accordance with International Financial Reporting Standards, as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole, and

2 The management report, which is incorporated into the Directors' Report, includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face

By order of the Board

Antonio Lorenzo
Chief Financial Officer
27 April 2010