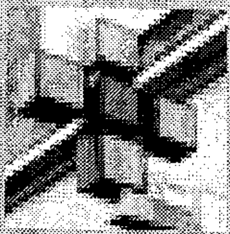
Alliance Leicester

3263713

Annual Report & Accounts 2001

In 2001, we have done th

simplifying



Branches

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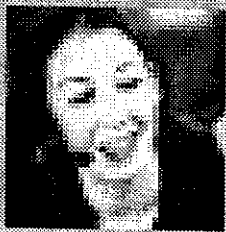

Technology

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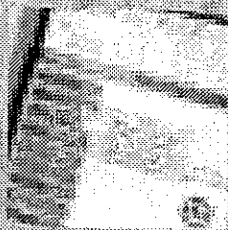

On-line Mortgages

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Legal & General

Partnerships

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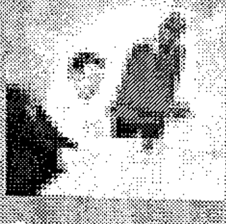


Customer Service Training

[illegible]

Following for our customers:

support

Smartermotoring

Launched an exciting new website to help customers find and purchase a new or used car. www.smartermotoring.com

Cash Handling

Offered new services such as cash depositing facilities to consolidate our position as the leading UK provider of cash and cheque handling.

Small Businesses

Developed a very attractive range of banking services and products for small businesses in the UK.

focus

Asset Finance

Delivered carefully planned and structured asset finance whilst maintaining our high asset quality, such as the funding provided to Humberside Police for a new helicopter to help reduce crime in their area.

Movingimproving

Piloted a movingimproving brand to provide a variety of lenders to help customers move home or simply make home improvements. www.movingimproving.com

partnerships

Contents

Alliance & Leicester's vision is to deliver value to our shareholders by becoming the UK's most customer focused financial services organisation – bar none.

During 2001, we have focused intensively on providing a range of products where we have a competitive advantage and can offer attractive pricing and efficient sales and service. This focus is paying off – with revenue growth, efficiency and customer measures all improving.

This momentum confirms our strategy is working.

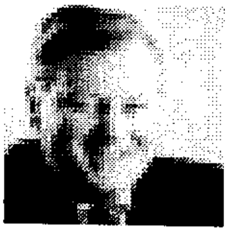
Highlights

- Pre-tax profit of £396m (2000: £447m), reflecting the planned £85m investment in the Group's strategy (2000: £48m), £13m investment in building our small business banking division, and a £14m reduction in loan loss recoveries. In addition, the figure includes a one-off profit of £12m from the rationalisation of London properties.
- Total dividend up 10% to 36.3p per share (2000: 33.0p per share).
- Total Shareholder Return of 23.5% (2000: (11.0%)).
- Record gross mortgage lending of £6.1bn, up 104% on 2000 and a market share of 3.8%.
- Asset quality remains strong: residential mortgage arrears down by 31% during 2001.
- Achieved the targeted £20 million annualised saving in core costs by the end of 2001, based on 2000 business volumes and prices.

John Windeler
Executive Chairman

Peter Barton
Non-Executive Deputy Chairman

Michael Allen
Non-Executive Director



Richard Banks
Distribution Director

David Bennett
Group Finance Director

David Brougham
Non-Executive Director

Frances Cairncross
Non-Executive Director

Nicholas Corah
Non-Executive Director (retired from Board 23 January 2002)

Mike McTighe
Non-Executive Director

Richard Pym
Managing Director, Retail Banking

Jonathan Watts
Non-Executive Director

Executive Chairman's Statement

Focusing on our strategic goals

As 2001 progressed we saw accelerating revenue and franchise growth at Alliance & Leicester. Our customers are seeing a real difference in what we can deliver for them directly and through the use of partnerships.

In July 2000 we set out a strategy, for Alliance & Leicester to become 'the most customer focused financial services organisation – bar none'. Our primary objective remains to grow shareholder value, and we'll achieve that by delivering our strategy. We knew that it would take time to build momentum before our financial results benefited from our strategy. The improvement in our performance in the latter months of 2001 provides real evidence that this is now happening, and that the Group has turned a corner.

Financial Results

Pre-tax profit in 2001 was £396m. This reflects the planned £85m investment in the Group's strategy (2000: £48m), £13m investment in building our small business banking division, and a £14m reduction in loan loss recoveries. In addition, the figure includes a one-off profit of £12m from the rationalisation of London properties.

The Board has proposed a final dividend of 24.5p, making a total dividend of 36.3p, a 10% increase on the equivalent figure in 2000.

Economic Outlook

In light of the increased economic uncertainty in the final quarter of 2001, we revised our priorities to ensure we deliver growth in shareholder value even if the economy should deteriorate, placing even greater emphasis on capital strength and balance sheet quality.

We are confident that our strong balance sheet, high quality personal lending, limited exposure to commercial lending and risk-averse treasury assets will allow us to come through any period of economic uncertainty very well compared with other banks.

Despite our prudent approach we have still delivered strong business growth during 2001.

Key Strategic Developments

During 2001 we have simplified a great many of the processes used across the Group, leading to improved efficiency and future cost savings. We are focusing on the Group's core strengths – those products and services in which we have well-established franchises and a strong brand. We are supplementing our core strengths with an effective and innovative use of partnerships, of which our selling of Legal & General's range of competitive investment products is a prime example.

This strategic approach means that we are able to provide a broad range of services for our customers, but we do not have to incur the cost and complexity of manufacturing all of these services ourselves.

Simplified Structure

As part of the drive to simplify our business, we have altered our organisation structure and staffing profile. This included a reduction in the number of management and a major review of non customer-facing roles within the Group.

The resulting reduction in the number of middle managers and non customer-facing staff has been achieved through voluntary means and has led to a greater proportion of Group employees undertaking roles that deal directly with customers.

In October the Group Board agreed a restructuring of the responsibilities of its executive directors. Under the revised structure the role of Group Managing Director ceased to exist, and Peter McNamara resigned from Alliance & Leicester plc, by mutual consent. I would like to thank Peter for his contribution to the Group.

We are committed to...

John Windeler with the Executive team
(from left to right)
Richard Banks (Distribution Director)
Richard Pym (Managing Director, Retail Banking)
John Windeler (Executive Chairman)
and David Bennett (Group Finance Director)

Executive Chairman's Review continued

Gaining Momentum and Achieving our Targets

During 2001, we gained significant momentum towards achieving our strategic objectives:

• Revenue Growth

Since we set our strategic targets in October 2000, revenue growth has accelerated. Group revenues grew by 1.5% in 2000. This increased to 1.8% (year-on-year) in the first half of 2001 – held back in particular by the performance in our unsecured personal lending business. Group revenues grew by 4.3% in the second half of 2001 (excluding the benefit of the rationalisation of London properties). Revenue growth accelerated markedly as the year progressed. Like-for-like revenue growth was 3.5% in the third quarter of 2001. In the final quarter, recovery in our unsecured lending business together with continuing good performances in other sectors resulted in like-for-like revenue growth increasing to 5.1% compared to the same period in 2000. Overall, group revenues grew by 4.0% in 2001. Excluding the impact of the rationalisation of London properties, income growth in 2001 was 3.1%.

We agreed in November that it was prudent and realistic to revise our revenue targets to reflect current economic uncertainties. We are now targeting revenue growth of 4% in 2002, and accelerated revenue growth during 2003. Our performance in the second half of 2001 gives us confidence that we will achieve these targets.

• Costs

We have delivered our stated target of achieving £20m of annualised cost savings in 2001, based on 2000 business volumes and prices.

We remain committed to achieving the significant savings we set out in our strategy announcement in October 2000. This includes a target that our underlying cost base by the end of 2003 will be £100m lower, on an annualised basis, than the cost base in 2000 (based on 2000 business volumes and prices).

• Capital

In line with our prudent view of the future economic environment, we did not complete the share buybacks which would have enabled our original 8% tier 1 capital target to be reached by the end of 2001. The Board has now committed to a new capital target of a 7.5% Tier 1 ratio by the end of 2002. Once economic conditions allow, we believe a low-risk bank such as Alliance & Leicester can be run on a lower level of equity capital than 7.5%.

Asset Quality

We view Alliance & Leicester's high quality assets as a key strength of the Group and there has been no deterioration in asset quality in any business sector.

We do not invest in corporate bonds, emerging markets, venture capital funds or hedge funds.

Customers

Our relationship with our customers is key to our strategy. During 2001 we implemented a number of initiatives aimed at transforming the service provided to our customers. These include:

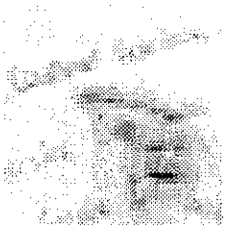
- Significantly increasing the number of our products which receive 'best buy' status. This includes the Premier Account, which provides the best value current account on the High Street.
- Introducing point-of-sale decisioning for unsecured personal loans into our branch network, so that branch customers can get an immediate decision on a personal loan application.
- Introducing a market-leading new internet application and case-tracking service for mortgage intermediaries.
- Selling a wide range of competitive Legal & General investment products.
- Increasing the number of customer facing staff in call centres and the branch network.
- Piloting retail sub-brands to support the sales of key products. These are the 'movingimproving' brand for mortgages, and 'smartermotoring.com' for the sale of cars and car-related products, including finance.
- Agreeing a strategic partnership with Securicor for the provision of wholesale cash handling services.
- Launching a competitive range of small business bank accounts.

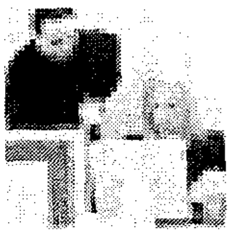
Staff

Developing our staff is an important part of our strategy, and benchmarking shows that we provide more training per staff member

...become the UK's most

Valuing Individual People ('VIP')





than the average financial services company. An important initiative for 2002 is that during the year all of the Group's employees will attend a 2-5 day training course called Valuing Individual People ('VIP'). This aims to support a culture of delivering excellent customer service across the Group. The majority of the Group's customer service areas, including our branch network, now have Investors in People ('IIP') accreditation. Some 84% of the Group's customer facing staff are now covered by IIP status.

Non-Executive Directors

On 23 January 2002, Nicholas Corah retired from the Board as a non-executive director after 23 years service. I would like to thank Nicholas for his contribution to the development of the Alliance & Leicester Group over this time.

Shareholders

Around 42% of Alliance & Leicester shares are held by individuals, with around 500,000 of our small shareholders also being customers of the Group. Our shareholders have benefited from a Total Shareholder Return of 23.5% during 2001, and 76.1% since flotation.

Community

Alliance & Leicester has strong links with the local communities, particularly those in Liverpool and Leicester where our principal administration centres are based.

In 2001 in Leicestershire the Group announced its agreement to support the Leicester Education Action Zone for the next 3 years. The support given to schools by the Education Action Zone over the last 2 years has resulted in better exam performances by children of all ages, and nine previously failing schools have now received a clean bill of health from Ofsted.

In Merseyside, the Group has been supporting many individual charities, including the Sefton Community Foundation (SCF) for the past two years. SCF is a charitable foundation which manages the 'Children's Fund Local Network' for Merseyside, a key part of the Department for Education and Employment's drive to help eradicate child poverty.

The Group operates a matched charity donation scheme by which money raised by staff is matched by the Group – during the last year over £46,000 was donated to charity through this scheme, whilst over £300,000 in total was donated to charities, in addition to gifts of clothes, food and staff time.

The Group also worked with a major national newspaper group to support the National Society for the Prevention of Cruelty to Children, including collecting unwanted European currency from the public.

Consolidation

Since our flotation in 1997, Alliance & Leicester's name has been regularly mentioned in association with potential sector consolidation. We have been clear and consistent in our statements on this subject: we believe that increased shareholder value can best be delivered by implementing our strategy. We have also consistently said that, as a Board, we have a duty to consider serious offers for the business should any occur which clearly represent superior returns to our shareholders. The limit on shareholdings, which was provided by the Building Societies Act, will be removed from the fifth anniversary of our flotation. The Board has never viewed this restriction as having any influence on Alliance & Leicester's corporate structure.

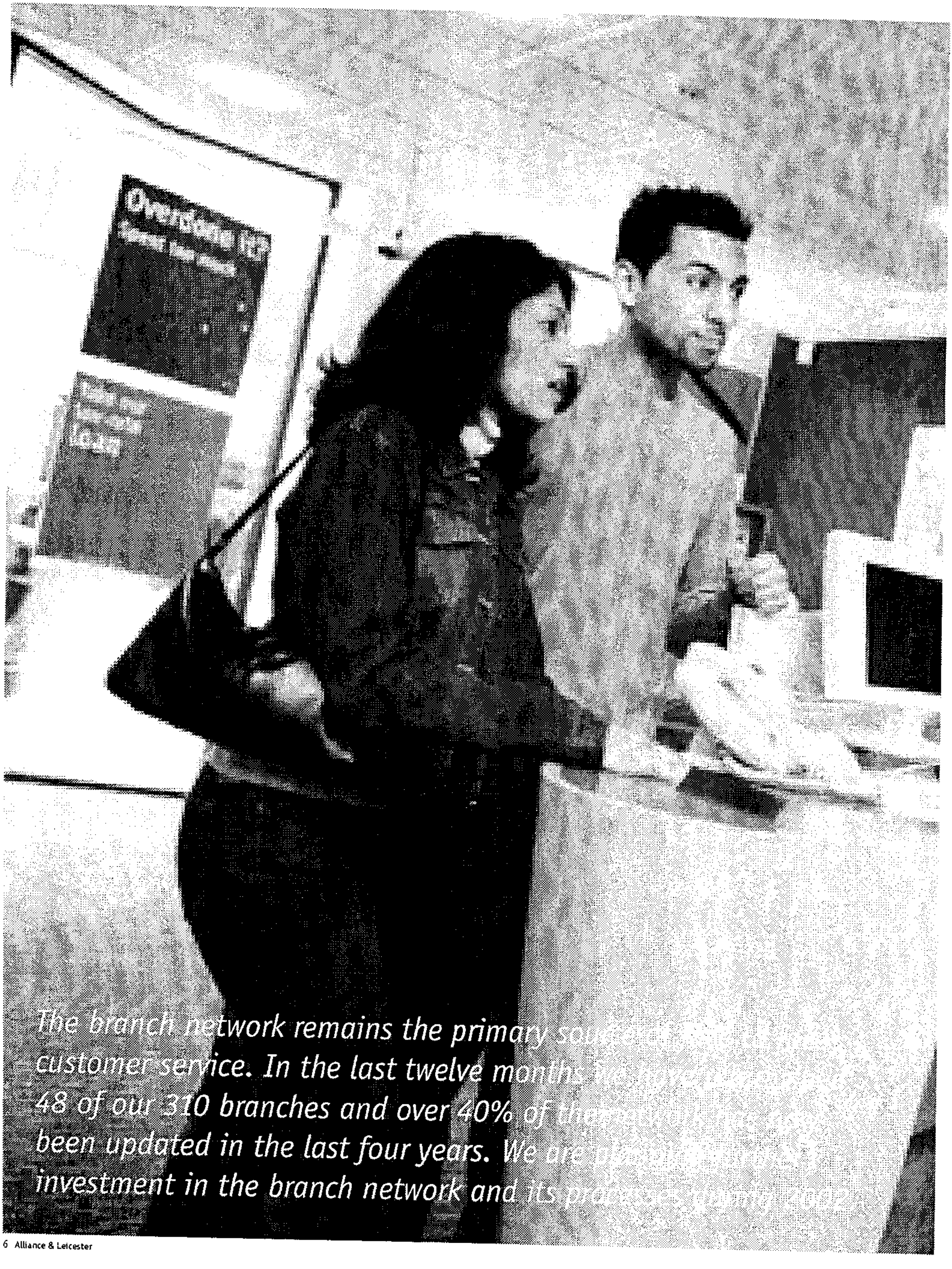
The Future

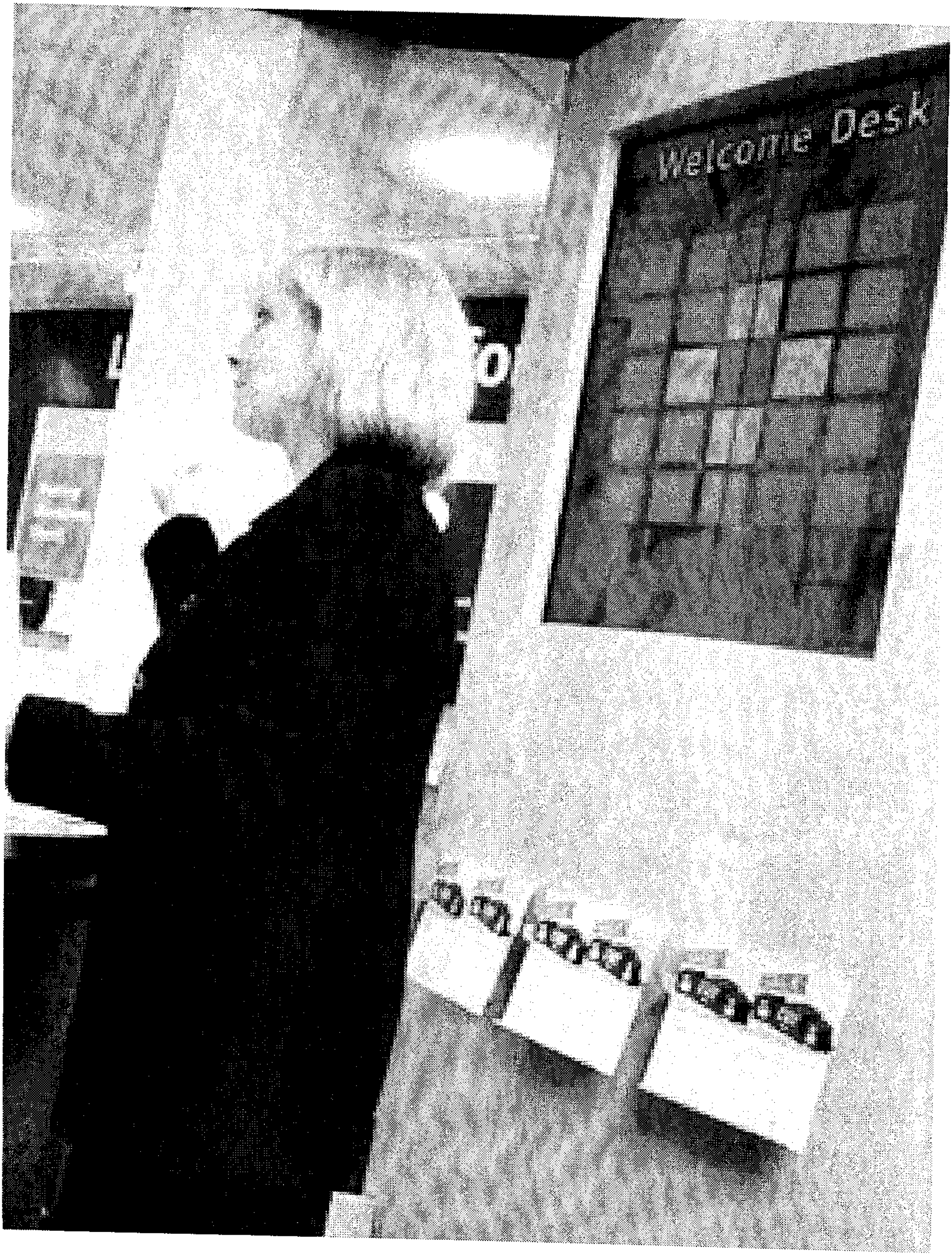
We believe that our results in 2001, particularly in the latter months of the year, provide evidence of growing momentum towards meeting our strategic targets. When we set out our strategy in 2000, we knew that we were embarking on a long-term programme, and accordingly we set targets out to the end of 2003.

The results we have achieved towards the end of 2001, and the initial business results experienced so far in 2002, give us real confidence that we can meet our targets, and grow Alliance & Leicester for the benefit of our shareholders, customers and staff.

John R. Windeler
Executive Chairman

customer focused financial


The branch network remains the primary
customer service. In the last twelve months
48 of our 310 branches and over 40% of the
been updated in the last four years. We
investment in the branch network and its


Welcome Desk

Richard Pym, Managing Director, Retail Banking (third left), with his Retail Banking management team.

Retail Banking Review

Building stronger relationships with our customers remains key to the implementation of our strategy. Alliance & Leicester has for a number of years provided a full range of financial services products to its customers, but only within the past couple of years have we focused on an explicit strategy of selling more to existing customers.

Strategy

Building stronger relationships with our customers remains key to the implementation of our strategy. Alliance & Leicester has for a number of years provided a full range of financial services products to its customers, but only within the past couple of years have we focused on an explicit strategy of selling more to existing customers. This strategy makes real economic sense for Alliance & Leicester, as it means that we can offer strong incentives for our existing customers to buy more from us, a strategy which is very difficult for most of our competitors to follow without cannibalising existing income flows.

The other key to our strategy is radical simplification of processes. We have reviewed our product portfolio, the methods by which we attract new customers and our cross sales processes to achieve this end. This review has concluded that the most successful and cost effective way to attract new customer relationships is via the sale of our 'core 4' products: mortgages, savings, personal unsecured loans and current accounts. In each of these products we have a sizeable customer base, an established brand and the core skills to drive growth. During 2002 our external customer recruitment campaigns will be developed and implemented around these four core products.

Our other personal customer products, for example credit cards, general insurance and life assurance, and long-term investment products, will remain important to our long-term success, generating income primarily by cross-selling to our existing 6 million customers. These products will be delivered in the most cost-effective way through a combination of partnerships, outsourcing and direct manufacture.

Franchise Growth

We have had a successful year growing our Retail Banking franchise:

• *Mortgages*

We have had a record year in mortgage lending. Gross lending was a record £6.1bn, representing 3.8% of the market. Net lending was a record £2.6bn, a market share of 4.8%, above our share of mortgage balances which has increased from 3.6% to 3.7%. Our mortgage balances have increased from £19.1bn at the end of 2000 to £21.7bn at the end of 2001.

• *Savings*

Personal customer deposit balances continued to increase, up from £16.0bn at the end of 2000 to £16.4bn as at the end of 2001. During the year we have continued to offer our savers a range of competitively priced products and seen significant inflows into our market leading branch based Easysaver account, which has attracted over 75,000 customers in the last 5 months. We view it as strategically important to maintain an attractively priced branch-based savings product, giving customers a good reason to visit our branches. Our savers have also benefited from a radical simplification in the number of savings products we offer, which reduced from 28 to 14 products during 2001.

• *Current Accounts*

We met our target of having 150,000 Premier Account holders by the end of 2001. The Premier Account is a regular 'best buy' product. It provides the most competitive current account on the High Street, together with discounts on a wide range of other Alliance & Leicester products, and free travel insurance. As planned, Premier Account customers hold on average

...services organisation by

Partnerships

[illegible] (Manufacturing & Operations Director) with [illegible] (Director, Business Partnerships) of Legal & General.

Our partnership with Legal & General for the provision of long-term investment products has proved extremely successful. Product sales have almost doubled since its launch in May, compared to the same period in 2000.

around four Alliance & Leicester products. It is our intention to strengthen further the appeal of Premier during 2002 and to continue to promote the benefits of this account. The Group's total current account base continues to grow. We now have 1.7 million accounts in total, and opened 144,000 new accounts in 2001.

• *Personal Loans*

As we disclosed in our interim results, volume and revenue performance in our unsecured personal lending business was disappointing in the first half of 2001. We took a number of management actions to address this issue including revising our marketing campaigns, simplifying the process for applying for loans in branches and refocusing staff effort on the product. As a result of these actions, this business is now performing strongly again. Gross lending in the final quarter of 2001 was 11% above the same period in 2000 and the proportion of customers buying payment protection insurance with their loans is now at the highest for two years. During the latter part of 2001 the decline in margin has also abated, with the margin on new loans now in line with book.

The performance in the first half meant that gross lending for 2001 as a whole totalled £1,387m, a reduction of 6% on 2000 levels, but the performance in the second half provides us with confidence that this business is now growing effectively again. At the end of 2001 unsecured lending balances were 3% higher than at the end of 2000, totalling £2,163m. The recovery in this business has been achieved without any reduction in asset quality.

• *Credit Cards*

We continue to grow the size of our credit card book despite increased competition in this market, with cards issued now in excess of 1.3 million. Our increased focus on cross selling credit cards to existing Alliance & Leicester customers has significantly reduced the cost of new card acquisitions. Both balances and cardholder expenditure have also grown and are 10% above the year end position in 2000.

• *Long-term Investments*

Our overall Group strategy places emphasis on the use of partnerships to provide our customers with competitive products for which we do not have either the scale or the in-house skills to provide ourselves. Our partnership with Legal & General for the provision of long-term investment products is an excellent example of this approach. The partnership has proved extremely successful with sales almost doubling since its launch in May, compared to the same period in 2000. We plan to increase further the size of our regulated sales force giving our customers even greater access to first class financial advice.

We welcome the FSA's announcement of their proposals regarding financial advice and 'polarisation'. When our arrangement with Legal & General was introduced, in May 2001, it was structured so as to allow Alliance & Leicester to offer products under a 'multi-tie' arrangement should this be favourable for our customers.

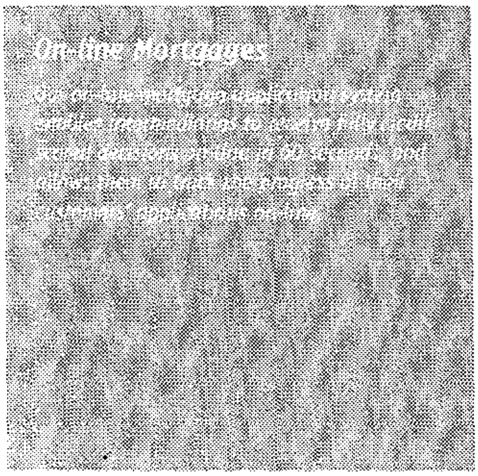
• *General Insurance and Life Assurance*

Strong growth in mortgage lending has assisted in the growth of new mortgage related insurance and life assurance policies with sales 30% up on the previous year. These two products are key to our relationship strategies and it is planned to develop further partnerships in these areas to strengthen our product range and distribution channels during 2002.

• *Recent Momentum*

In the final quarter of 2001, we achieved a 4.7% market share of gross mortgage lending, and the net lending share was higher still. Personal customer deposit balances continued to grow, and current account openings were more than 40% higher than in the final quarter of 2000, with 40,000 new accounts opened. Revenues in Retail Banking grew by 4.4% in the fourth quarter compared to the same period in 2000.

putting the customer first,




Retail Banking Review continued

Customer Relationships, Retention and Cross-sales

The average number of products held per personal customer has increased from 1.50 at the end of June 2000 to 1.57 at the end of 2001, on-track to meet our strategic target of 1.65 by the end of 2003. Providing real incentives for our customers to buy more from us remains integral to the Group's strategy, resulting in lower product selling costs.

We continue to attract around half a million new customers a year, and have around 6 million personal customers.

We met our target of retaining 93% of customers during the year. It has been particularly pleasing to see our success in the mortgage market where our market share of redemptions has continued to be below our share of the mortgage stock.

Customer Service & Distribution

The branch network remains the primary source of face to face customer service. In the last twelve months we have refurbished 48 of our 310 branches, and over 40% of the network has now been updated in the last four years. We are planning further investment in the branch network and its processes over the next twelve months in order to maximise the opportunities for cross-sales and simplify application processes for our customers.

During the year we have almost doubled the number of Alliance & Leicester-branded ATMs, giving our customers increased access to their cash, providing a profitable income stream, and increasing brand awareness. We now have over 1,700 ATMs across the UK in branches, post offices, convenience stores, department stores and other leisure locations. We plan to increase this number further in 2002.

In December 2001 we re-designed and re-launched our Retail Banking website to improve its sales capability. Very early results are encouraging. Sales of personal loans through the website were 71% higher in January 2002 than in January 2001.

The internet presents financial services providers with a number of opportunities to improve customer service and to provide products cost-effectively. During the year we have received favourable reviews for both our Retail Banking and corporate web sites. In 2001 we further developed our web-based services with two key developments: an on-line application service for mortgage intermediaries, and the launch of a website for motorists.

• *Intermediary On-line Mortgage Application System*

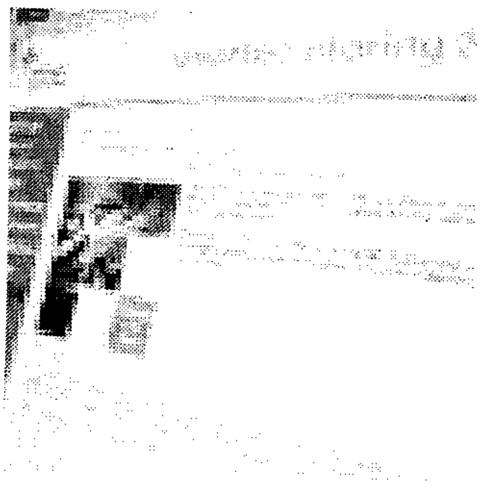
Alliance & Leicester's electronic mortgage application system, called 'ISIS', enables mortgage intermediaries to receive fully credit scored decisions on-line in 60 seconds. The system pre-populates relevant information so that intermediaries do not have to re-key details. It also allows mortgage intermediaries to track the progress of their customers' applications on-line.

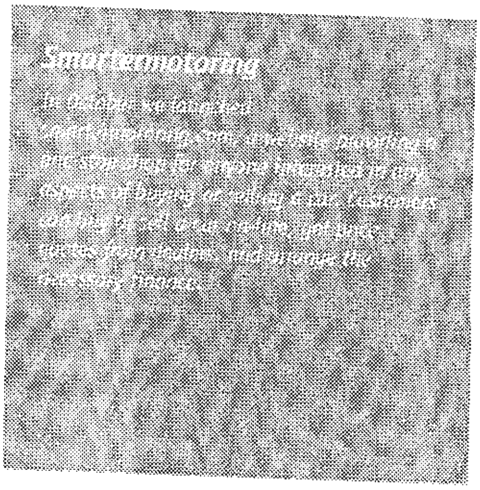
Since its launch in July 2001, take-up of the service has been very strong, and currently around 5,000 intermediaries have registered to use it. By the end of 2001 around 20% of intermediary applications were being received through this channel, and this grew further still in January 2002. We plan to grow the volume of business significantly through this channel during 2002 offering intermediaries a combination of good quality products with superior customer service. This approach helps the customer and the mortgage intermediary by providing improved service. It also reduces costs as the data is cheaper to process and more accurate than with a manual application.

• *Smartermotoring.com*

In October we launched 'smartermotoring.com', a website providing a one-stop shop for anyone interested in any aspects of buying or selling a car. Customers can buy or sell a car on-line, get price quotes from dealers, and arrange the necessary finance.

meeting customers' needs





Movingimproving

We are piloting the 'movingimproving' brand to cover a variety of services related to mortgages and housing. This includes specialised moving and improving branches, and movingimproving.com, a website offering house-buying and do-it-yourself advice, as well as related financial services.

Technology

In addition to the web-based examples already given, we are continuing to progress a number of other technology projects.

We are continuing, on schedule, to implement a new mortgage platform in partnership with Unisys. By the end of 2002 we expect to have implemented the new system and outsourced its maintenance to Unisys. We are implementing a number of system developments within the branch network to improve the application processes for our mortgage and personal loan products. By mid-2002, we will have introduced a greatly enhanced service for all of our current account and savings account customers who wish to access their products using the internet. This development uses the middleware components which enable us to link different product systems to a common customer interface.

We are developing a virtual contact centre integrating telephone and internet channels. This will improve customer service and significantly reduce costs, as even more calls will be dealt with at the first point of contact.

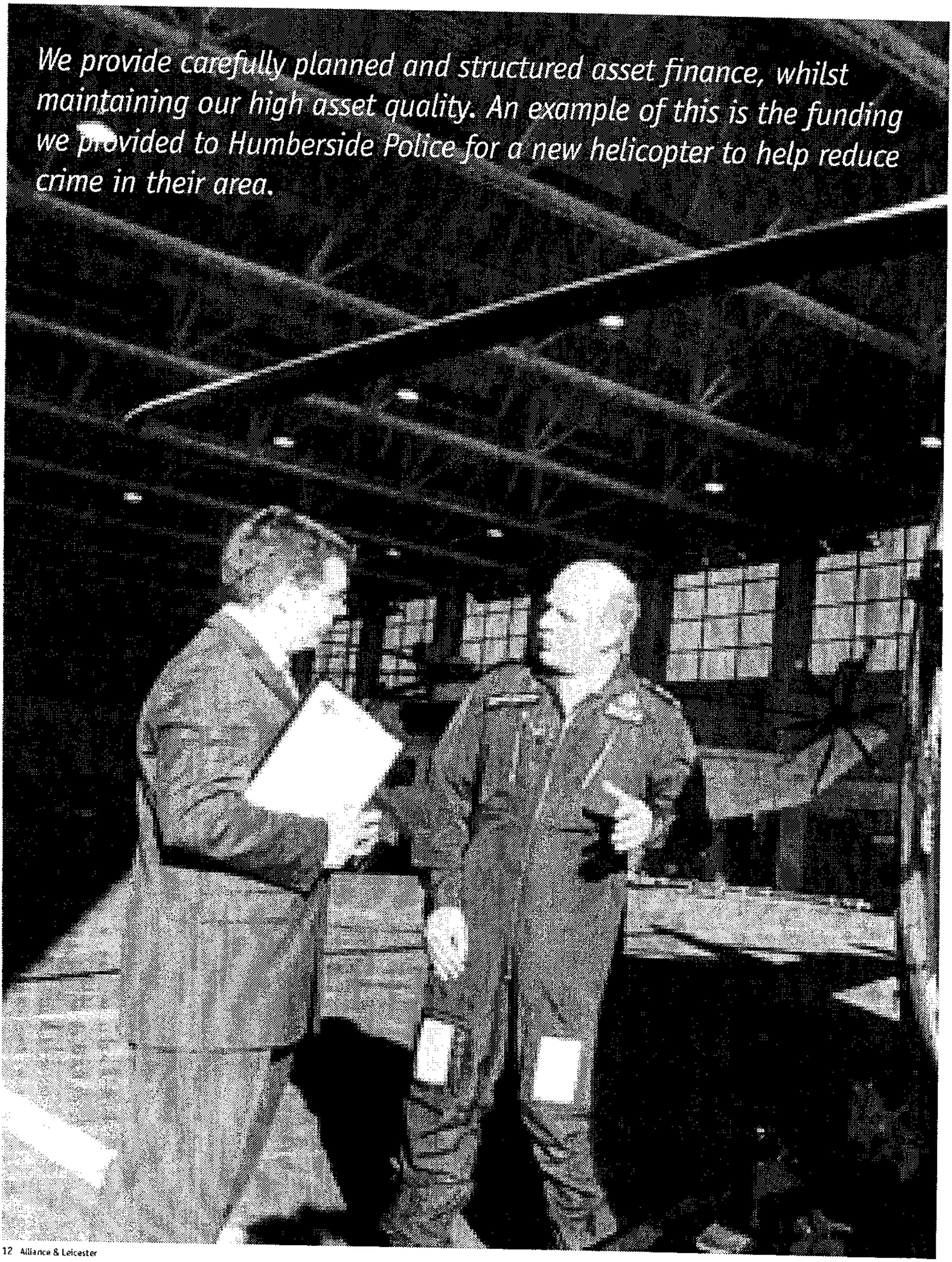
Asset Quality

Alliance & Leicester has built up a reputation for accepting only the highest quality lending applications. We no longer operate in potentially higher risk sectors of the housing market such as 'buy-to-let', and we do not undertake non-status lending. Benchmarking our asset quality against our competitors suggests that our arrears and bad debt ratios are consistently in the best quartile.

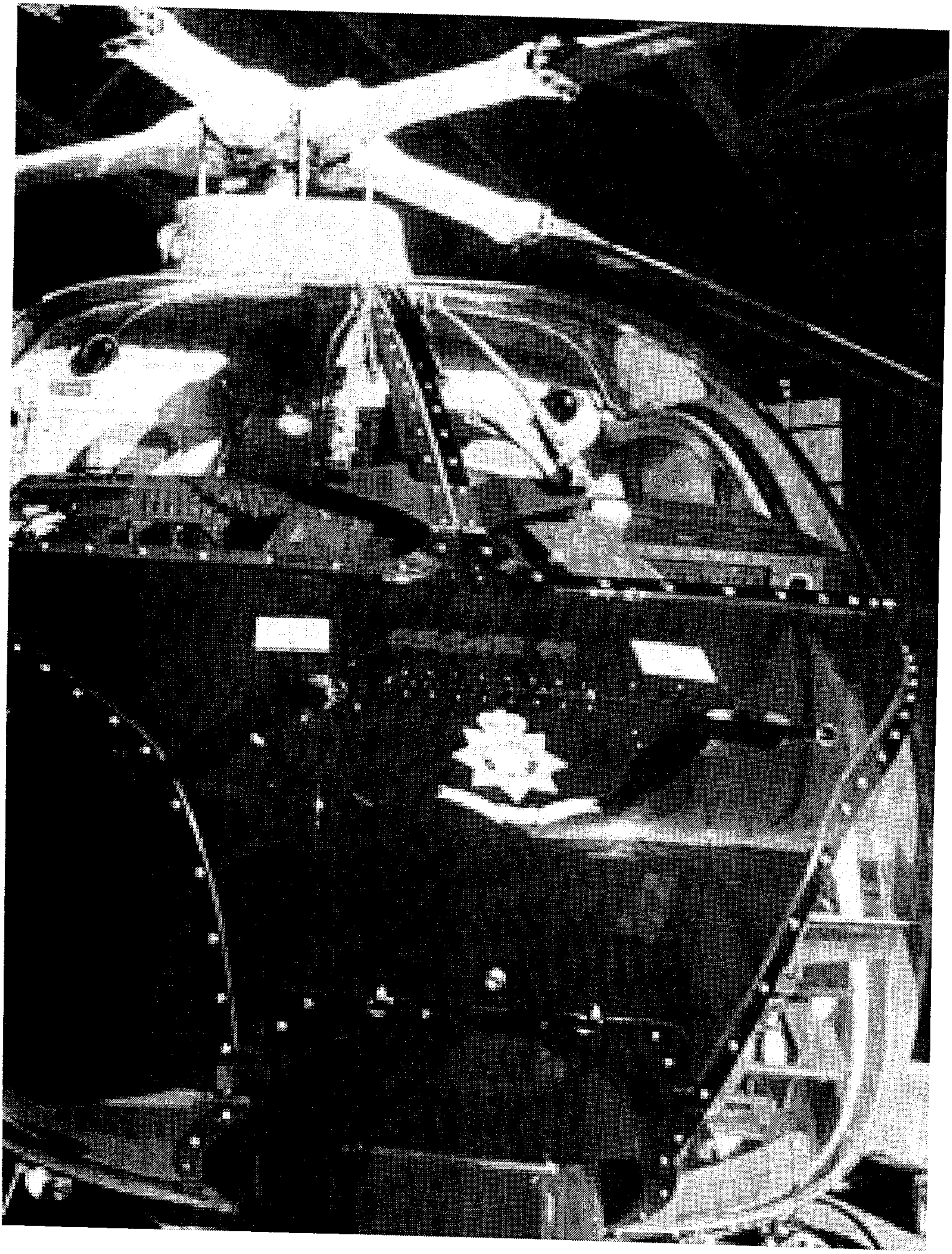
In the mortgage market we have maintained our policy of not lending at higher than 95% Loan To Value ('LTV') ratios. In October we implemented a policy of not lending above 90% LTV for properties valued over £100,000 in London and the South East. The number of loans which would have been affected by this policy in the first half of the year amounted to less than 1% of new business. In 2001 over 89% of our new mortgage lending had an LTV ratio below 90%, and over the last seven years more than 50% of our new lending has been at an LTV of less than 75%. Only around 7% of new mortgage loans in 2001 were for mortgages of over £150,000. We believe that our approach is prudent for our customers and for our shareholders.

Keeping asset quality high does mean that we have to turn down applications for loans from our customers. We would rather be able to meet our customers' financial needs, but the importance of asset quality is fundamental to the way we run our business, and sometimes customers do not meet our lending criteria. To help resolve this, in 2002 we will be piloting the sale of declined applications for mortgages and unsecured loans to a carefully selected group of more specialist lending companies.

and increasing their...



We provide carefully planned and structured asset finance, whilst maintaining our high asset quality. An example of this is the funding we provided to Humberside Police for a new helicopter to help reduce crime in their area.



Charles Tolder, Director, Commercial Banking (seated middle) with the Commercial Banking management team.

Commercial Banking Review

The Group's Commercial Banking business is built on our strong market shares in the cash handling and bill payments markets. These businesses operate in growing markets, and continue to provide good profit growth.

Overview

The Group's Commercial Banking business is built on our strong market shares in the cash handling and bill payments markets. These businesses operate in growing markets, and continue to provide good profit growth. Our strong position in these markets has provided an excellent customer base and the skills within the Group to develop into new, faster-growing markets.

The first example of this development was our entry into the merchant acquiring market (the electronic processing of debit and credit card transactions). We launched this business in 1996, competing in a market dominated by the 'big 4' banks. After 5 years, we have a profitable product and a market share of more than 6%. We intend to continue to grow this market share.

The other priorities for growth in Commercial Banking are our services for small business ('SME') customers – through Alliance & Leicester Business Banking – and the provision of asset finance. Our traditional cash handling business has led to us having around 145,000 small business, club and society customers, despite not providing a full range of small business banking services for such customers. During 2001 we have built the processes and products to compete in this market in a more focused way, and we have every expectation of growing this business strongly.

Our asset finance business has been helped by the purchase in 1996 of Sovereign Finance. Again, the fit of asset finance products with our traditional product and customer base is good, and the asset finance business has grown strongly, and prudently, over recent years.

Looking at each of the main four segments of our Commercial Banking business, and their performance during 2001:

Cash Handling

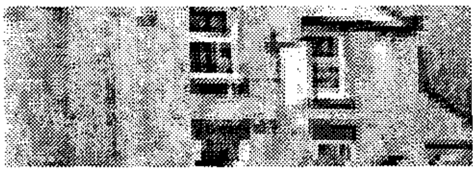
The volume of cash processed by Girobank continued to increase, reaching a record £59bn during 2001 (2000: £57bn). The value of cheques processed also increased to £24.4bn in 2001 (2000: £22.1bn). We continued to gain a number of new cash handling relationships, and to sell more cash to non Post Office users with sales reaching £12.8bn, an increase of £0.8bn on 2000.

Alliance & Leicester Cash Solutions ('ALCS'), a wholly-owned subsidiary of Alliance & Leicester plc, has entered into a 10-year contract with Securicor under which Securicor will provide cash centre services for ALCS's cash handling customers. As part of this new arrangement, ownership and running of the current Girobank cash centre at Basingstoke will pass to Securicor later in 2002.

ALCS will start selling new business in March, and from then all new 'wholesale' cash handling business in the Alliance & Leicester Group (broadly speaking, business requiring cash to be collected from the customer and taken by security carrier to a cash centre) will be sold and handled by ALCS.

Existing Girobank commercial cash handling customers will continue to be served under existing agreements between Girobank and Post Office Limited.

...choice. We are on track



We recognised that changes in the market for cash, and the future cash requirements of the Post Office, meant that new arrangements were necessary to provide a platform for continued growth in our cash handling business. This arrangement provides that platform for the 'wholesale' cash business.

Payments

Bill payment transactions grew by 6% to 222 million during the year (2000: 209 million). Our merchant acquiring business now has a market share of over 6%, processing 284 million transactions in 2001 (2000: 235 million). We intend to generate further cross-sales by actively promoting this product to our asset finance and small business customers.

Asset Finance and Commercial Lending

2001 has been a record year for our asset finance activities. Net advances of £978m for the year were 10% above 2000 levels. The asset finance book now totals £2.1bn.

Historically we have operated in all areas of asset finance. However, having reviewed the business we believe we can deliver increased shareholder value through specialising in selected industry groupings. This will enable us to understand better our customer needs as well as maintaining our high quality assets. This new focus will be developed and implemented in 2002.

During the second half of 2001 new lending was deliberately scaled back and we focused more on opportunities where we have an existing relationship or core competency. This reduction was further emphasised following the events of September 11 and our internal volume targets for this business in 2002 have been reduced to reflect this. Our very high shares of the cash and bill payments markets provide us with considerable opportunities to grow this book using existing relationships.

We aim to maintain our high asset quality through the use of our integrated commercial lending and asset finance credit and risk function. Lending has been developed in a structured and carefully planned manner focusing on sectors where we have established expertise. Substantially all of the big ticket loans are guaranteed via financial institutions and the loss charge in this sector remains at 2000 levels.

SME – Alliance & Leicester Business Banking

In the Small Business division 2001 was a year of development and implementation. We have completed the groundwork and can now focus on gaining momentum towards our aggressive strategic targets for this segment. Following this 'launch' phase, we have re-integrated management of the Small Business division with the rest of Commercial Banking so we can develop greater cross-sales, offer a full suite of services to customers, and obtain cost efficiencies.

This market for SME banking has been dominated by the 'big 4' banks. Alliance & Leicester Business Banking provides a very attractive set of products for SME customers – providing real choice in this market.

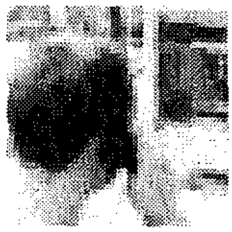
During the year we:

- started paying interest on small business current accounts.
- launched our flat-fee small business current account.
- improved the application process through the use of the internet and pre-completed forms.
- provided 24 hour banking to our SME customers.

During the year account openings for SME accounts increased by around 27% to 17,000. In total we now have around 145,000 small business, club and society customers. We retain our target of obtaining 10% of new small business bank accounts by the end of 2003.

Lending to SMEs is subject to individual credit sign off by credit specialists operating in a centrally based operation, using credit scoring techniques. We do not intend to expand significantly into lending for SME current account customers, and at the end of 2001 Alliance & Leicester Business Banking's lending to SMEs totalled just £5m.

to deliver real value...

The Group's Treasury Dealing room at Carlton Park.

Treasury & Group Review

The Treasury & Group sector consists of the Group's Treasury operations, the earnings from our excess capital and costs which are not apportioned to the individual business areas.

Treasury

Alliance & Leicester continues to operate a conservatively-run Treasury operation, the main roles of which are to manage the liquidity, funding and hedging requirements of the Group.

Key developments in the Treasury area during the year included the completion of a planned increase of our US Dollar Commercial Paper programme to US$4bn and the transfer of all dealing activities and outstanding liabilities and assets from Alliance & Leicester Group Treasury plc to Alliance & Leicester plc.

As determined by the Act of Parliament which provided the legal framework behind the integration, the financial results of Alliance & Leicester Group Treasury plc for the year have been consolidated into the results of Alliance & Leicester plc as though the integration had taken place on 1 January 2001.

During 2001 our holdings of instruments such as Floating Rate Notes and asset-backed securities were increased, in line with our aim to diversify our income streams, whilst our exposure to interest rate movements was reduced.

The Treasury division's assets are of the highest quality. They are either from banks or financial institutions, or are asset-backed. This prudent approach has meant that we have not suffered any exposure or write-offs due to the bankruptcy or financial difficulties of some of the world's largest companies. We expect our approach to continue to protect us from the impact of any economic slowdown during 2002.

The strength of Alliance & Leicester's name in the financial markets ensured that no funding difficulties were encountered in the aftermath of the terrorist activities of September 11.

The strength of the asset quality within Treasury is evidenced by the fact that at 31 December 2001, 96% of our Treasury exposures have a long-term credit rating at or above single 'A'. We do not invest in corporate bonds, emerging markets, venture capital funds or hedge funds.

Group

The Treasury & Group sector also contains the Group's excess capital. Since flotation we have reduced our Tier 1 capital ratio from over 13% at the time of flotation to 8.9% at the end of 2001. During the second half of 2001 we have prudently decided not to complete the share buyback programme which would have enabled our initial objective of an 8% Tier 1 capital target to be achieved.

...to our shareholders.

Financial Review

Results by Business Sector

The contribution to profit by each business sector, compared to 2000 is set out below.

	Six months ended 30.06.01 £m	Six months ended 31.12.01 £m	**Year ended 31.12.01 £m**	Year ended 31.12.00 (restated) £m
MLI*	143	133	**276**	298
Personal Banking	54	50	**104**	105
Retail Banking	197	183	**380**	403
Commercial Banking	34	40	**74**	72
Treasury & Group	7	20	**27**	20
Strategy	(30)	(55)	**(85)**	(48)
Total	208	188	**396**	447

*Mortgage Lending & Investments (MLI)

As stated in our interim results, in 2001 we changed the basis on which we allocate capital to our individual business sectors and introduced minor changes to our internal transfer pricing mechanisms. Previously, capital allocation to each of the Retail Banking and Commercial Banking sectors was based on providing an 8% Tier 1 and 3% Tier 2 backing for forecast year-end risk weighted assets. The new policy is based on providing 7% Tier 1 and 3.5% Tier 2 backing for average actual risk weighted assets. The 2000 results have been restated to reflect these changes. This has reduced 2000 pre-tax profits by £4m for each of the Retail Banking and Commercial Banking sectors, with a compensatory increase of £8m in pre-tax profits of the Treasury & Group sector.

Retail Banking

	Year ended 31.12.01 £m	Year ended 31.12.00 (restated) £m
Net interest income	**616**	621
Non-interest income	**234**	215
Total income	**850**	836
Operating expenses (Note 1)	**(414)**	(398)
Bad debt provisions	**(56)**	(35)
Profit before tax	**380**	403
Profit before tax:		
MLI	**276**	298
Personal Banking	**104**	105
Retail Banking	**380**	403
Net interest margin:		
MLI	**1.63%**	1.72%
Personal Banking	**5.32%**	5.90%
Retail Banking	**2.31%**	2.46%
Mean interest-earning assets (£m):		
MLI	**21,716**	20,828
Personal Banking	**4,906**	4,460
Retail Banking	**26,622**	25,288
Cost:income ratio:		
MLI	**43.1%**	41.2%
Retail Banking	**48.7%**	47.6%
Personal customer deposit balances (£m)	**16,441**	16,036
No. branches	**310**	309
No. ATMs	**1,730**	946

(Note 1) Throughout this document Operating expenses refer to Administrative expenses and depreciation on assets other than operating lease assets.

The Retail Banking sector pre tax profit of £380m is £23m lower than 2000, primarily due to increased mortgage volume related expenditure, lower commercial mortgage recoveries, lower income from unsecured lending and also higher personal banking loss charges reflecting growth in this business over recent years.

Net interest income
Net interest income of £616m is £5m lower than 2000. The overall margin of the sector has fallen from 2.46% to 2.31%.

The MLI net interest margin has fallen from 1.72% to 1.63%. This reflects a fall in interest spread, driven by an increase in the retail cost of funds relative to bank base rate, and lower earnings on interest free liabilities due to lower interest rates. Mortgage incentives, expressed as a discount to bank base rate, fell £4m to £56m. Further details are disclosed in Supplementary Information on page 75.

The Personal Banking margin has fallen from 5.90% to 5.32%. This margin pressure is primarily due to the older higher margin loans being replaced with lower margin loans.

Retail Banking	Year ended 31.12.01 £m	Year ended 31.12.00 (restated) £m
Net interest income	**616**	621
Average balances:		
Interest-earning assets (IEA)	**26,622**	25,288
Financed by:		
Interest-bearing liabilities	**24,214**	22,982
Interest-free liabilities	**2,408**	2,306
Average rates:	**%**	%
Bank base rate	**5.12**	5.96
Gross yield on average IEA	**6.50**	7.28
Cost of interest-bearing liabilities	**4.61**	5.31
Interest spread	**1.89**	1.97
Contribution of interest-free liabilities	**0.42**	0.49
Net interest margin on average IEA	**2.31**	2.46

Non-interest income
Non-interest income improved by 9% to £234m with higher ATM and credit card income, and income from the sale of long-term investment products, following the partnership with Legal & General.

Operating expenses
Operating expenses increased by £16m to £414m of which £10m related to the expansion of the ATM network. The remaining £6m increase reflects new business volume related growth in staff numbers, customer facing staff bonuses for sales performance, and increased outsourcing costs associated with new business mortgage processing.

The cost:income ratio of 48.7% for the sector reflects the expansion of the ATM network and the up-front costs associated with new business lending, which will lead to improved income in future years.

Provisions
The charge for bad and doubtful debts has increased by £21m to £56m. The main driver was a reduction in residential lending and other mortgage recoveries, which fell £14m, and an increase in the Personal Banking charge of £7m, primarily due to growth in balances with no deterioration in asset quality.

The arrears performance for both our mortgage and unsecured lending businesses continues to compare favourably with industry data. The value of residential mortgage arrears has fallen by 31% since December 2000 and now represents 0.06% of mortgage balances. For unsecured lending, the value of loans over 30 days in arrears as a percentage of total loans is approximately 30% lower than the average for Finance and Leasing Association members.

Commercial Banking

	Year ended 31.12.01 £m	Year ended 31.12.00 (restated)* £m
Net interest income	**81**	63
Non-interest income	**275**	273
Total income	**356**	336
Operating expenses	**(228)**	(217)
Depreciation on operating lease assets	**(48)**	(40)
Bad debt provisions	**(6)**	(7)
Profit before tax	**74**	72
Net interest margin (Note 1)	**2.55%**	2.76%
Mean interest – earning assets (Note 3) (£m)	**4,084**	3,310
Cost:income ratio (Note 2)	**74.0%**	73.4%
Commercial Customer deposit balances (£m)	**5,659**	5,288

*The 2000 results have been restated for the change in accounting presentation for operating lease income as explained in Note 2 on page 46. This is in addition to the revised sector capital allocation which is explained on page 17.

(Note 1) The net interest margin is calculated above, consistent with previous years, as net interest, including net income from operating lease assets, divided by average interest-earning assets including operating lease assets. Excluding net income from operating lease assets, and excluding operating lease assets from average interest-earning assets, the net interest margin is 2.13% (2000: 2.04%).

(Note 2) The cost:income ratio above has been calculated, consistent with previous years, as Operating expenses, which excludes depreciation on operating lease assets, divided by total income less depreciation on operating lease assets. Including depreciation on operating lease assets, the cost:income ratio is 77.5% (2000: 76.6%).

(Note 3) Included within Mean interest-earning assets are operating lease assets of £291m (2000: £226m).

Pre-tax profit of the Commercial Banking sector, including small business customers, increased by 3% to £74m. Total income has increased by 6% to £356m.

Net interest income
Net interest income increased by 29% from £63m to £81m with interest-earning assets increasing by 23%. The net interest margin fell to 2.55% reflecting the growth of lower margin asset finance business and a lower interest rate environment.

Non-interest income

Non-interest income rose to £275m, with increased income from cash and cheque handling fees, merchant acquiring and asset finance being partly offset by a reduction in bill payment income due to a higher proportion of payments being made by electronic means.

Operating expenses

Operating expenses, which excludes depreciation on operating lease assets, increased by £11m to £228m. Excluding incremental costs of £13m incurred to develop the small business customers division, the remaining core costs of the sector fell.

Provisions

The charge for bad and doubtful debts in 2000 included a £4m one-off provision in respect of a merchant acquiring customer in receivership. Excluding this, the charge has increased from £3m to £6m, reflecting growth in the book.

Treasury & Group

	Year ended 31.12.01 £m	Year ended 31.12.00 (restated) £m
Net interest income	**58**	55
Non-interest income	**12**	–
Total income	**70**	55
Operating expenses	**(42)**	(35)
Bad debt provisions	**(1)**	–
Profit before tax	**27**	20
Mean interest-earning assets	**18,698**	15,973

The Treasury & Group sector includes the Group's Treasury operations, central overheads and the earnings from the Group's excess capital. The principal objective of the Group's Treasury operation is to support the Group in delivering products and services to its personal and commercial customers. Treasury also provides services directly to its own customer base, offering a range of treasury services including money market deposits and foreign exchange.

Net interest income

Net interest income in the Treasury & Group sector includes income from the Group's capital not allocated to the other business sectors. The cumulative impact of the share buy back programme since flotation reduced net interest by £28m in the year, compared to £23m in 2000.

Non-interest income

Non-interest income reflects primarily the £12m one-off benefit arising from the rationalisation of the London premises.

Operating expenses

Operating expenses increased by £7m over 2000, mainly due to higher group pension costs and project related expenditure.

Provisions

The charge for bad and doubtful debts represents a general provision established in the Treasury sector in the first half year. No specific provisions are deemed necessary.

Summary Profit and Loss Account

	Six months ended 30.06.01 £m	Six months ended 31.12.01 £m	**Year ended 31.12.01 £m**	Year ended 31.12.00 (restated) £m
Net interest income	377	378	**755**	739
Non-interest income	246	275	**521**	488
Total income	623	653	**1,276**	1,227
Core expenses:				
Administrative expenses	(308)	(339)	**(647)**	(613)
Depreciation on assets other than operating lease assets	(20)	(17)	**(37)**	(37)
Operating expenses	(328)	(356)	**(684)**	(650)
Non-core expenses:				
Administrative expenses:				
Strategic investment	(30)	(55)	**(85)**	(48)
Depreciation on operating lease assets	(26)	(22)	**(48)**	(40)
Bad debt provisions	(31)	(32)	**(63)**	(42)
Profit before tax	208	188	**396**	447
Taxation	(59)	(50)	**(109)**	(111)
Profit after tax	149	138	**287**	336
Basic earnings per share	29.6p	27.4p	**57.0p**	63.9p
Underlying basic earnings per share*	29.6p	27.4p	**57.0p**	61.0p

*Excluding the exceptional tax credit in 2000 in relation to conversion costs (see page 21)

The results previously published for 2000 have been restated to reflect a change in presentation on operating lease assets, as explained in Note 2 to the Accounts.

Group pre-tax profit for the year was £396m (2000: £447m). This reflects the planned £85m investment in the Group's strategy (2000: £48m), £13m investment in building our small business banking division, and a £14m reduction in loan loss recoveries. In addition, the figure includes a one-off profit of £12m from the rationalisation of London properties.

The tax charge for 2000 included an exceptional tax credit of £15m in respect of conversion costs. Underlying earnings per share, excluding the exceptional tax credit in 2000, decreased by 4.0p to 57.0p.

Net Interest Income

The following table provides a detailed analysis of the net interest margin achieved on interest-earning assets.

	Six months ended 30.06.01 (restated) £m	Six months ended 31.12.01 £m	**Year ended 31.12.01 £m**	Year ended 31.12.00 (restated) £m
Net interest income	377	378	**755**	739
Net income on operating lease assets	11	12	**23**	29
Net income including income on operating lease assets	388	390	**778**	768
Average balances:				
Interest-earning assets (IEA) (Note 2)	33,479	35,839	**34,669**	30,778
Financed by:				
Interest-bearing liabilities	29,412	31,563	**30,497**	26,779
Interest-free liabilities	4,067	4,276	**4,172**	3,999
Average rates:	%	%	**%**	%
Bank base rate	5.62	4.63	**5.12**	5.96
Gross yield on average IEA	6.74	5.79	**6.24**	7.21
Cost of interest-bearing liabilities	5.01	4.12	**4.55**	5.42
Interest spread	1.73	1.67	**1.69**	1.79
Contribution of interest-free liabilities	0.61	0.49	**0.55**	0.70
Net interest margin on average IEA (Note 1)	2.34	2.16	**2.24**	2.49

(Note 1) The net interest margin above is calculated, consistent with previous years, as net interest including net income from operating lease assets, divided by average interest-earning assets including operating lease assets. Excluding net income from operating lease assets, and excluding operating lease assets from average interest-earning assets, the net interest margin is 2.20% for the year ended 31 December 2001 (2000: 2.42%), 2.29% for the six months ended 30 June 2001 and 2.11% for the six months ended 31 December 2001.

(Note 2) Average interest-earning assets excluding operating lease assets are £34,378m for year ended 31 December 2001 (2000: £30,552m), £33,198m for the six months ended 30 June 2001 and £35,535m for the six months ended 31 December 2001.

Group net interest of £778m was £10m higher than 2000 and the average total interest-earning assets were 13% higher than the previous year.

The net interest margin has fallen by 0.25% from 2.49% to 2.24% with a reduction in the interest spread of 0.10% and a reduction in the contribution from interest-free liabilities of 0.15% compared to 2000. The fall in interest spreads is driven by margin pressure in personal loans, retail savings and the impact of changing business mix driven by comparatively rapid growth in lower margin treasury and asset finance balances. The lower contribution from interest-free liabilities reflects lower market interest rates.

Non-Interest Income

	Six months ended 30.06.01 £m	Six months ended 31.12.01 £m	**Year ended 31.12.01 £m**	Year ended 31.12.00 (restated) £m
Fees and commissions receivable	235	266	**501**	452
Fees and commissions payable	(49)	(60)	**(109)**	(84)
Other operating income	23	35	**58**	51
Operating lease income	37	34	**71**	69
Total	246	275	**521**	488

Group non-interest income at £521m, is £33m higher than 2000 with increased income from long-term investment products, credit cards, unsecured loans, ATMs, cash and cheque handling, asset finance and merchant acquiring. It also reflects the £12m one-off benefit from the rationalisation of London premises.

Administrative expenses and depreciation

	Six months ended 30.06.01 £m	Six months ended 31.12.01 £m	**Year ended 31.12.01 £m**	Year ended 31.12.00 (restated) £m
Staff related expenditure	123	130	**253**	227
Post Office Counters	53	56	**109**	110
Marketing costs	35	40	**75**	74
Premises, equipment and other	78	92	**170**	164
Outsourcing costs	19	21	**40**	38
Core Administrative expenses	308	339	**647**	613
Depreciation on fixed assets other than operating lease assets	20	17	**37**	37
Operating expenses	328	356	**684**	650
Non-core expenses:				
Administrative expenses:strategic investment	30	55	**85**	48
Depreciation on operating lease assets	26	22	**48**	40
Total	384	433	**817**	738

Operating expenses of £684m have increased by £34m of which £13m was incurred in the development of our small business banking sector, and £10m on expansion of the ATM network. Inflation and pay increases amounted to £17m, and volume related cost increases to support business growth amounted to £12m.

In 2002 we are planning for the following compared to our core cost base of £650m in 2000: ATM costs of £10m and cost savings from the implementation of our strategy of £20m. There will also be inflation and volume related increases.

Strategy costs include investment in key customer processing systems, the provision of middleware functionality between our customer systems and our customer facing staff, and redundancy costs arising from the recent voluntary redundancy exercise announced in September 2001.

The total cost of £85m for strategic investment includes the £70m which we have previously signalled to the market, plus an additional £15m one-off cost for voluntary redundancies, which was originally planned to be incurred in 2002 and 2003. Our one-off strategic expenditure for those years will therefore decrease and we now expect £33m of strategic expenditure in 2002 (was £40m) and we expect £12m in 2003 (was £20m).

As stated previously, the cost:income ratio, included in the table on page 18, has been calculated as Operating expenses, which excludes depreciation on operating lease assets, divided by total income less depreciation on operating lease assets.

The Group cost:income ratio in total, excluding depreciation on operating lease assets, is 62.6% (2000: 58.8%). Excluding strategic investment costs, the Group core cost:income ratio is 55.7% (2000: 54.8%). Including depreciation on operating lease assets, the Group cost:income ratio is 64.0%, (2000: 60.2%), with a core Group cost:income ratio of 57.3%, (2000: 56.2%).

Provisions for bad and doubtful debts

The charge for losses on bad and doubtful debts can be analysed as follows:

	Year ended 31.12.01 £m	Year ended 31.12.00 £m
Residential property mortgages	(4)	(9)
Other mortgages	(5)	(14)
Unsecured loans, credit cards and current accounts	65	58
Retail Banking	56	35
Commercial secured and unsecured loans	2	5
Asset finance	4	2
Commercial Banking	6	7
Treasury & Group	1	–
Total	63	42

The loss charge for the Group in the second half of 2001 was £32m, which compares to £31m for the first half of 2001.

The closing balances of provisions were as follows:

	As at 31.12.01 £m	As at 31.12.00 £m
Residential property mortgages	21	29
Other mortgages	5	8
Unsecured loans, credit cards and current accounts	112	89
Retail Banking	138	126
Commercial secured and unsecured loans	9	7
Asset finance	11	9
Commercial Banking	20	16
Treasury & Group	1	–
Total provisions	159	142
General	34	35
Specific	125	107
Total	159	142

For residential lending, the ratio of closing provisions to gross loans and advances balances fell from 0.15% to 0.10%, reflecting increased house prices and reduced arrears. In addition to the £21m of residential provisions above, the Group has an offshore captive insurance subsidiary with available funds totalling £25m and a further £11m of high percentage loan fees held on balance sheet. These funds are disclosed in the Group balance sheet under the heading 'accruals and deferred income'. Together this pool provides £57m of cover within the Group for losses in the residential mortgage book. Further cover is provided through re-insurance of risk with external insurers.

The provision for unsecured loans, credit cards and current accounts has increased from £89m to £112m, and represents 3.51% (2000: 2.93%) of gross balances reflecting the lower rate of growth of the book.

The asset finance book is split between 'big-ticket' structured finance transactions of £918m (2000: £885m) and a small/medium ticket portfolio of £1,215m (2000: £834m). The total level of provision at 2001, including a £6m residual value provision, is £17m (2000: £15m), representing 1.4% of gross balances against the small/medium book (2000: 1.8%). Of the total book, agreements with banks, or balances guaranteed by banks, amounted to £1,062m (2000: £830m).

Taxation

A corporation tax rate of 30% (2000: 30%) has been used in preparing these results. The tax charge for the year of £109.1m (2000: £110.4m) represents 27.5% of profit before tax (2000: 24.7%). The comparative figure is significantly lower than 30% due to a favourable Special Commissioners decision on the tax deductibility of conversion costs which resulted in a tax credit in respect of prior years of £15.2m being reflected in the 2000 results. The underlying tax rate for 2000, excluding the tax credit in respect of conversion costs, was 28.1%.

Dividend

A final dividend of 24.5p per share is proposed, giving a total dividend of 36.3p for the year, up 10% on 2000. This compares to basic earnings per share of 57.0p. The directors have proposed the dividend for 2001 after considering the core profits of the business excluding strategy costs.

Balance sheet

The structure of the consolidated balance sheet as at 31 December 2001 is shown below in summary format:

	As at 31.12.01 £m	As at 31.12.00 (restated) £m
Assets		
Cash, treasury assets and loans and advances to banks	**10,429**	8,652
Loans and advances to customers:		
Residential mortgages including securitised advances	**21,951**	19,374
Less: non-recourse finance	**(200)**	(249)
Other secured loans	**697**	411
Unsecured consumer loans	**2,163**	2,108
Credit card balances	**841**	762
Other	**452**	298
Asset finance	**1,513**	1,323
	27,417	24,027
Intangible assets	**3**	4
Fixed assets:		
For use in the business	**302**	297
Leased to customers	**340**	287
Other assets	**673**	1,033
Long-term assurance business attributable to shareholders	**83**	75
Long-term assurance assets attributable to policyholders	**230**	341
Total Assets	**39,477**	34,716
Liabilities		
Customer accounts:		
Retail Banking	**16,441**	16,036
Commercial Banking	**5,659**	5,288
	22,100	21,324
Deposits by banks	**1,991**	1,402
Debt securities in issue	**11,054**	7,853
Other liabilities	**1,727**	1,677
Subordinated loan capital	**610**	462
Shareholders' funds	**1,765**	1,657
Long-term assurance liabilities attributable to policyholders	**230**	341
Total Liabilities	**39,477**	34,716

Total assets increased by £4.8bn in the year reflecting an increase in treasury assets of £1.8bn, a net increase in loans and advances to customers of £3.4bn offset by a reduction in fixed and other assets of £0.4bn. Long-term assurance attributable to policyholders has fallen due to the maturity of a bond in December 2001, and Stock Market falls. Since May 2001, new bond sales have been managed by Legal & General, and are therefore not held on the Alliance & Leicester balance sheet.

The increase in total assets has mainly been funded by the issue of debt securities, which increased by £3.2bn, and an increase in customer accounts of £0.8bn.

A £150m subordinated debt transaction was completed in August 2001 to support the capital management of the Group.

Capital structure

The Group's risk asset ratio is given in the table below:

	As at 31.12.01 £m	As at 31.12.00 £m
Capital: Tier 1	**1,716**	1,565
Tier 2	**667**	498
Deductions	**(82)**	(77)
Total capital	**2,301**	1,986
Total risk weighted assets	**19,362**	17,104
Risk asset ratios:		
Total capital	**11.9%**	11.6%
Tier 1	**8.9%**	9.2%

The Tier 1 ratio has reduced from 9.2% to 8.9% and the Group's objective is now to achieve a target ratio of 7.5% by the end of 2002.

The Group commenced its share buyback programme in June 1999. In total, since then, 80 million shares have been repurchased and cancelled, representing 14% of the capital base. No share buybacks were completed in 2001.

The Group's profit ratios compared to 2000 were as follows:

	Year ended 31.12.01 %	Year ended 31.12.00 %
Post tax return on mean capital	**16.8**	19.8
Post tax return on mean assets	**0.8**	1.0
Post tax return on mean risk weighted assets	**1.6**	2.1

To illustrate the return on underlying capital, at a 7.5% Tier 1 ratio the Group's post tax return on capital would be 20.3%.

Risk management and control

As a result of its normal business activities, the Group is exposed to a variety of risks, the most significant of which are operational risk, credit risk, market risk and liquidity risk.

Responsibility for approving policies for the management of operational risk lies with the Group Audit and Risk Committee (GARC), which is a sub-committee of the Group Board. Responsibility for approving policies for the management of credit, fraud, market and liquidity risks lies with the Group Credit Policy Committee (GCPC). The Group Asset and Liability Committee (ALCO) monitors market and liquidity risks and recommends policy in these areas to the GCPC. The GCPC is a sub-committee of the Group Board.

The GARC is also responsible for approving the Group's overall risk management framework.

Membership of the GARC comprises non-executive Group Board directors only. Membership of the remaining committees comprises Group Board directors and other senior management.

Operational risk

Operational risk is the potential for future loss, including reputational damage, arising from failures in systems, procedures or internal controls and processes. All of the Group's activities give rise to the potential for operational loss events.

The Group monitors its operational risks using a variety of techniques, including risk profiling. Risk profiling involves the identification of all the key risks in each business area and categorising the risk according to the likelihood of the risk materialising and the expected severity of any resulting losses.

Operational risk is managed through a combination of internal controls, processes and procedures and various risk mitigation techniques, including insurance and business continuity planning.

Credit risk

Credit risk is the potential risk of financial loss where counterparties are not able to meet their obligations as they fall due. The Group is firmly committed to the management of this risk in both its lending and wholesale money market activities.

The Group employs sophisticated credit scoring, behavioural scoring, underwriting and fraud detection techniques to support sound decision making and minimise losses in its lending activities. Behavioural scoring also operates within the personal account management and collections processes. A proactive approach to the control of bad and doubtful debts is maintained within the collections areas.

Lending policies and processes are defined, agreed and managed centrally. The GCPC ensures that any exposure to risk, or significant changes in policy or expansion into new areas of business remain within overall risk exposure levels agreed by the Board.

Experienced credit and risk functions operate within the Group, and are driven both by the recognised need to manage the potential and actual risks, but also by the need to continually develop new processes to ensure sound decisions into the future. In this way, any changes in risk from market, economic or competitive changes are identified and the appropriate controls developed and put in place.

Comprehensive management information on movement and performance within the various personal and corporate portfolios ensure that credit risk is effectively controlled and trends identified prior to any potential impact on performance. Group performance is also measured against the industry, where appropriate, to ensure debt default levels remain below that of the industry average. This management information is distributed widely across the Group and monitored within tight boundaries at Board and credit policy committees.

Policy statements, covering, amongst other things, criteria to be used in considering limits on counterparties and countries, are reviewed annually by the GCPC. Authorised limits on a counterparty are governed largely by the size of its capital base and, where published, credit ratings assigned by the major rating agencies. The Group has no treasury exposures to counterparties resident in South Korea, Thailand, the Philippines, Indonesia, Malaysia, South America or Russia.

Market risk

Market risk is the potential adverse change in Group income or the value of Group net worth arising from movements in interest rates, exchange rates or other market prices. Market risk exists to some extent in all the Group's businesses. The Group recognises that the effective management of market risk is essential to the maintenance of stable earnings and the preservation of shareholder value.

The Group's exposure to market risk is governed by a policy approved by the Group Board. This policy sets out the nature of risk which may be taken and aggregate risk limits. Based on these aggregate limits, the ALCO assigns risk limits to all Group businesses and monitors compliance with these limits. Each business has its own market risk policy which is approved by the ALCO. At each meeting the ALCO reviews reports showing the Group's exposure to market and liquidity risks.

The Group has established a transfer pricing system with the intention of transferring materially all of the market risks that arise in the various Group businesses to Group Treasury. Market risk is transferred to Group Treasury by way of appropriate hedging arrangements. Group Treasury plays a pivotal role in managing the Group's market risk. Group Treasury acts as a 'Risk Clearing House', managing these risks within its own limits, and seeks to take advantage of natural hedges within the Group's businesses.

Market risk is measured and reported using a variety of techniques, according to the appropriateness of the technique to the exposure concerned. The techniques used include interest rate gap analysis, scenario analysis and value at risk.

Interest rate risk

Interest rate risk is the most significant market risk to which the Group is exposed. This risk arises due to mismatches between the re-pricing dates of the interest bearing assets and liabilities on the Group's balance sheet and from the investment profile of the Group's reserves and other net non-interest bearing liabilities.

Outside of Group Treasury, interest rate risk primarily arises in the Group's mortgage, savings, leasing and personal loan businesses. The exposure in these portfolios is hedged with Group Treasury using interest rate swaps and other appropriate instruments.

Net non-interest bearing liabilities comprise mainly interest-free personal and corporate current accounts and shareholders' funds, and totalled £4.2bn at 31 December 2001 (2000: £4.3bn). Wherever it decides to invest these funds, the Group is exposed to market risk – if the funds are invested short term net interest income will be very volatile but the market value of the assets will be relatively stable, whilst investing the funds longer term will achieve more stability in net interest income but at the expense of greater volatility in the market value of the assets. In balancing these two extremes the Group's objective is to minimise volatility in net interest income over the medium term.

These balances, particularly current account balances, are constantly changing and it is therefore necessary to establish a view of the core balance and to keep this under review on a regular basis. This responsibility rests with the ALCO. At 31 December 2001, the core fund was £3.4bn (2000: £3.3bn) and the remainder, representing fluctuations above core balance levels on current accounts and capital not allocated to business units, was £0.8bn (2000: £1.0bn).

The following table summarises the repricing profile of the core fund.

	Less than 1 year	More than 1 year
31 December 2001		
Interest rate repricing profile	17%	83%
31 December 2000		
Interest rate repricing profile	23%	77%

A full interest rate repricing table is shown in Note 40 on Page 67.

Foreign exchange risk

The Group's policy is not to run material, speculative foreign exchange positions.

The Group offers foreign exchange services to customers through both Group Treasury and Girobank, and detailed limits and controls are established within those businesses to control the exposure. Girobank clears its positions with Group Treasury in accordance with the policy of transferring market risk positions to Group Treasury wherever possible.

As part of its normal operations Group Treasury raises and invests funds in currencies other than Sterling. The foreign exchange risks of these activities are hedged within Group Treasury's limits.

Equity risk

The Group's policy is to have no material net exposure to equity markets. The exposures arising from the Group's products are eliminated as far as is practicable by appropriate hedging contracts.

The Group markets a number of equity related products to its customers including Unit Trust and Stock Market Bond products. From 1 September 2001 Legal & General took responsibility for the management and administration of Alliance & Leicester's Unit Trust funds.

Liquidity risk

It is Group policy to ensure that resources are at all times available to meet the Group's obligations including the withdrawal of customer deposits, the draw-down of customer facilities and growth in the balance sheet. The development and implementation of policy is the responsibility of the ALCO. The day to day management of liquidity is the responsibility of Group Treasury, which provides funding to and takes surplus funds from each of the Group's businesses as required.

Liquidity policy is approved by the Group Board and agreed with the Financial Services Authority. Limits on potential cash flow mismatches over defined time horizons are the principal basis of liquidity control. The size of the Group's holdings of readily realisable liquid assets is primarily driven by such potential outflows.

Derivatives

A derivative is an off balance sheet agreement which defines certain financial rights and obligations which are contractually linked to interest rates, exchange rates or other market prices. Derivatives are an efficient and cost effective means of managing market risk and limiting counterparty exposures and are an indispensable tool in treasury management. Derivatives are primarily used by the Group for balance sheet management purposes. However, the bank also runs trading book positions in derivatives; details of the level of interest rate risk in the trading book are contained in Note 40 on page 68.

Types of derivatives and uses

The principal derivatives used in balance sheet risk management are interest rate swaps, forward rate agreements, futures, interest rate options and foreign exchange contracts which are used to hedge balance sheet exposures arising from fixed and capped rate mortgage lending, personal loans, leasing arrangements, funding and investment activities and foreign exchange services to customers.

The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the types of derivatives which are typically used in managing such risks. These risks may alternatively be managed using on balance sheet instruments or natural hedges that exist in the Group balance sheet.

Activity	Risk	Type of hedge
Fixed or capped rate lending	Sensitivity to increases in interest rates	Interest rate swaps and options
Fixed rate savings products and fixed rate funding	Sensitivity to falls in interest rates	Interest rate swaps and options
Equity linked investment products	Sensitivity to changes in equity indices and interest rates	Equity linked futures and options and interest rate swaps
Investment and funding in foreign currencies	Sensitivity to changes in foreign exchange rates	Foreign exchange contracts, cross-currency interest rate swaps
Customer foreign exchange business	Sensitivity to changes in foreign exchange rates	Foreign exchange contracts
Management of shareholders' funds and other net non-interest liabilities	Sensitivity to falls in interest rates	Interest rate contracts

Control of derivatives

With the exception of credit exposures, which are managed within policies approved by the GCPC, all limits over the use of derivatives are the responsibility of the ALCO.

All exchange traded instruments are subject to cash requirements under the standard margin arrangements applied by the individual exchanges and are not subject to significant credit risk. Other derivatives contracts are on an 'Over the Counter' basis with OECD financial institutions. The exposures arising from these contracts are shown in Note 40 to the Accounts on page 69.

The Group has strong links with its local communities, in particular providing support to schools within Leicestershire and Merseyside.

Community and Environmental Report

The Group seeks to support the communities in which it operates through the involvement of its staff and its charitable donations policy. The Group also recognises that it has a responsibility to act in a way that respects the environment and invests in environmentally friendly and sustainable products and services wherever it is practical to do so.

Community Involvement

Responsibility for community affairs rests with the Director of Corporate Communications, who reports to the Executive Chairman.

The Group aims to foster close ties with the communities in which it operates. It will continue to support and involve staff of the Alliance & Leicester Group in community related projects which contribute toward staff development needs and provide measurable benefit to the community. Central to this aim is the development of a volunteering programme which positively encourages links with outside 'partner' organisations and facilitates a co-ordinated response by employees and outside 'partners'.

Alliance & Leicester has joined Business in the Community's 'Cares' initiative which aims to increase the quality and quantity of employee volunteering across the UK. The Group's two main centres of operation in Leicester and Bootle are a particular focus of activity. Group employees are participating in both Leicestershire Cares and Liverpool Cares initiatives, with an emphasis on education.

The Group has been a main sponsor of the 'Beating the Odds' Appeal which seeks to provide help and support to schools in the Leicester Education Action Zone.

The Group intends that its volunteering efforts will be developed further in 2002. Under a 'matched donations' scheme the Group matches funds raised by staff for community related volunteering activities.

Charitable Donations

During 2001 the Group made donations for charitable purposes amounting to £314,000 including support for Business in the Community. The Group's Corporate Community Investment programme has given support to a number of organisations nationally and locally. That support has taken various forms including financial contributions, gifts in kind, management secondments and matching donations given by staff.

Environmental Policy

Responsibility for the Group's environmental policy rests with the Manufacture & Operations Director who reports to the Managing Director, Retail Banking.

Alliance & Leicester recognise that it has a responsibility to act in a way that respects the environment.

Environmental best practice is, wherever reasonably practicable, incorporated into decision-making processes. The Group will invest in environmentally-friendly and sustainable products and services wherever it is practical to do so, minimise energy usage, encourage energy efficiency (and encourage staff to be environmentally-friendly) and promote waste minimisation and environmentally-friendly waste disposal.

Alliance & Leicester sets objectives aimed at evaluating and managing the Group's impact on the environment. The measurement of these is tracked through the Group's progress compared against the progress of its peers in the Business in the Environment Index of Corporate Environmental Engagement.

If you want to know more about Alliance & Leicester's Environmental policy, please go to www.alliance-leicester-group.co.uk and click on the Group Information page, from where the Environmental section can be found within the Governance & Policies link.

During 2002 we will be working on the production of the next version of our Environmental Update that was first published in 2000. We will continue to work on improving the monitoring and targeting of energy use. We will continue to collate information on how the Group's activities impact on the environment and the Group's environmental programme will be developed to ensure further improvements in performance, data availability, environmental management and reporting. Much of this will be addressed in the wider context of Corporate Social Responsibility.

Health & Safety

Responsibility for the Group Health & Safety policy rests with the Director of Personnel & Development, who reports to the Managing Director, Retail Banking.

Work within the financial sector is generally regarded as 'low hazard' employment. However, the Group recognises every type of employment may involve the potential for injury, damage or loss.

It is the Group's policy to provide a safe and healthy working environment for its staff, customers and visitors to the Group's premises.

We believe the provision of a safe and healthy working environment is a positive business investment and we will seek to achieve Health & Safety excellence through statutory compliance.

To achieve our goal we have developed a formal Health & Safety Management System, which is now being implemented across the Group.

Customer Access to Services

Alliance & Leicester is mindful of its responsibilities under the Disability Discrimination Act 1995 and will take all reasonable measures to enable customers and potential customers to access the full range of Group products and services at all its premises. This is part of the Group's commitment to delivering its customer service objectives for all customers.

Access to services is particularly important in rural communities and the Group places particular value on its links with Post Offices. It supports financial inclusion initiatives including the promotion of education in financial matters.

Business Principles

The Group is positive about complying with its legal and regulatory obligations – this protects the Group's customers, shareholders and staff. Preservation and enhancement of the reputation of the Group will reinforce the Group's relationship with its shareholders, employees, customers and business partners. Earning and retaining the trust and confidence of customers is a high priority for the Group as this is essential for providing and sustaining long-term profitable relationships with them.

Board of Directors

John Windeler Aged [illegible]
Executive Chairman

Appointed to the Group Board on 27 April 1995, John Windeler is Executive Chairman. He has extensive experience in international money and securities markets, formerly as Executive Vice President of Irving Trust Bank, Group Chief Financial Officer at the National Australia Bank and Chief Executive of that bank's UK insurance division. He is Chairman of the Nomination Committee and a member of the Group Credit Policy Committee. He is also a non-executive director of BMS Associates Limited.

Peter Barton Aged [illegible]
Non-Executive Deputy Chairman

Appointed to the Group Board on 13 May 1998, Peter Barton is Chairman of the Remuneration Committee and of the Group Audit & Risk Committee. He is also a member of the Group Credit Policy and Nomination Committees. His other directorships include Foreign & Colonial US Smaller Companies plc and the Guinness Trust Group, and he is Chairman of Howard de Walden Estates Limited. He is a solicitor, investment banker and a Deputy Lieutenant of Greater London.

Michael Allen Aged [illegible]
Non-Executive Director

Appointed to the Group Board on 1 January 2000, Michael Allen is a member of the Remuneration and Nomination Committees. He was Group Vice President in Procter & Gamble's European operations, having held a number of senior management positions in the Group. He is a non-executive director of Safeway plc.

Richard Banks Aged 50
Distribution Director

Appointed to the Group Board on 1 February 1998, Richard Banks is Distribution Director with overall responsibility for the distribution of services to Alliance & Leicester's retail customer base. He was previously Managing Director of Girobank plc having held a number of senior positions in Girobank since he joined the Company in 1987.

David Bennett Aged [illegible]
Group Finance Director

Appointed to the Group Board on 1 January 2000, David Bennett is Group Finance Director with responsibility for financial planning and reporting, Group Treasury and market risk. He has many years' experience in the financial sector, as Finance Director of Cheltenham & Gloucester plc and then an Executive Director of the National Bank of New Zealand Ltd.

The Honourable David Brougham Aged [illegible]
Non-Executive Director

Appointed to the Group Board on 8 May 2000, David Brougham is Chairman of the Group Credit Policy Committee and a member of the Group Audit & Risk and Remuneration Committees. He is a director at Hampden Holdings Limited and Matrix E Ventures Fund VCT plc.

Frances Cairncross Aged [illegible]
Non-Executive Director

Appointed to the Group Board on 1 January 1992, Frances Cairncross is a member of the Remuneration and Nomination Committees. Currently Management Editor of 'The Economist', she is also chair of the Economic and Social Research Council and an honorary fellow of St Anne's College, Oxford.

Mike McTighe Aged [illegible]
Non-Executive Director

Appointed to the Group Board on 1 June 2000, Mike McTighe is a member of the Group Audit & Risk Committee. He is Chief Executive of Carrier 1 International, a pan-European telecommunications service provider. Formerly he was Chief Executive, Global Operations, at Cable & Wireless plc and President and Chief Executive Officer of Philips Consumer Communications LLP.

Richard Pym Aged 52
Managing Director, Retail Banking

Appointed to the Group Board on 1 September 1993, Richard Pym is Managing Director, Retail Banking with responsibility for the Group's Retail Banking business as well as Human Resources and Information Technology. He is a member of the Group Credit Policy Committee and a non-executive director of Selfridges plc. His previous career was with Thomson McLintock & Co, British Gas plc, BAT Industries plc and The Burton Group plc.

Jonathan Watts Aged 47
Non-Executive Director

Appointed to the Group Board on 8 May 2000, Jonathan Watts is Managing Director of COLT Telecommunications, Europe's largest business telephony, data and internet company. He previously held senior positions in the UK and overseas in a number of telecommunications and technology companies, including National Band Three Ltd, Aircall Holdings, Sintrom Plc, Datapoint Corp and Control Data Corp.

Directors' Report

The directors have pleasure in presenting their report and the consolidated financial statements of Alliance & Leicester plc for the year ended 31 December 2001.

Principal Activities and Business Review

The principal activity of Alliance & Leicester plc and its subsidiaries is the provision of a comprehensive range of personal financial services. In addition, the Group's principal subsidiary, Girobank plc, provides a wide range of banking and financial services to business and public sector customers.

The Group's business during the year and future plans are reviewed on pages 3 to 24.

Results and Dividends

The profit on ordinary activities before tax for the year ended 31 December 2001 was £396.4m (2000: £446.7m).

An interim net dividend of 11.8 pence per share (2000: 10.7 pence per share) was paid on 15 October 2001.

The directors propose a final net dividend for the year of 24.5 pence per share (2000: 22.3 pence per share) to be paid on 13 May 2002.

Directors

The following persons were directors of the Company during the year:

J R Windeler *Executive Chairman*

M P S Barton *Deputy Chairman*

M J Allen

R L Banks

D J Bennett

The Hon D Brougham

F A Cairncross

G N Corah *(to 23 January 2002)*

P D McNamara *(to 1 October 2001)*

R M McTighe

R A Pym

E J Watts

The names and brief biographies of the current directors are shown on page 27. Mr J R Windeler, Mr M P S Barton and Mr M J Allen will retire by rotation and, being eligible, will offer themselves for re-election at the forthcoming Annual General Meeting.

Directors' Interests in Contracts

No director had a material interest at any time during the year in any contract of significance, other than a service contract (see the Report on Directors' Remuneration on page 32), with the Company or any of its subsidiary undertakings.

Directors' Interests in Shares

Directors' interests in the shares of the Company and options to acquire shares are set out in the Report on Directors' Remuneration on pages 33 and 34.

Substantial Shareholders

Shareholders with an interest in the issued ordinary share capital of the Company disclosed in accordance with Sections 198-208 of the Companies Act 1985 are shown in note 34.

Corporate Governance

The Group's Statement of Corporate Governance is set out on pages 35 to 37.

Social Responsibilities

The Group's Community and Environmental Report is set out on pages 25 and 26.

Political Donations

No donations were made to political parties.

Staff

The Group's business strategy seeks the understanding and commitment of all staff to becoming the most customer-focused financial services provider, bar none. A range of initiatives was launched in 2001 to ensure that a greater proportion of staff are directly customer-facing and that all staff better understand how to provide excellent customer service. The VIP (Valuing Individual People) programme represents the largest single investment the Group has made in training and demonstrates the Company's commitment to valuing individual employees.

All staff are encouraged to be innovative in suggesting ways to improve customer service, generate revenue and control costs, and are rewarded for adopted ideas through a formal scheme.

All managers and staff have access to two new services launched in 2001 – HR.direct and HR.online – which provide a telephone helpline and intranet based service to deal with all types of Human Resources queries and issues.

The Group continues to place importance on effective communication and consultation with its staff. Regular staff involvement is achieved through two-way dialogue between staff and their managers, and consultative and negotiating committees, including discussion with trade unions. Regular meetings, group-wide team briefings, circulars and newsletters help to ensure that staff are aware of the organisation's performance and objectives. In addition, the Executive Chairman regularly addresses the Group's top managers on key issues, signposting future direction and responding to questions from around the Group. The Group encourages the involvement of employees in the performance of the Company through the employee ShareSave, ShareAward and SharePlan Schemes.

The Group has an equal opportunities policy. The aim of this policy is to ensure that no job application or staff member receives less favourable treatment on the grounds of race, colour, religion, nationality, ethnic or national origin, sexual orientation, marital status or physical disability. The Group continues to participate in a joint management/union equal opportunities forum to better facilitate constructive dialogue on equality issues.

It is the Group's policy to give all applications for employment from disabled people full consideration in relation to the vacancy concerned and their own aptitude and abilities. In the event of existing staff members becoming disabled, every effort is made to move them to suitable work within the Group if they cannot continue in their present job. The Group offers suitable training and career development for all disabled staff.

Responsibility for the Group's employment policy rests with the Director of Personnel & Development, who reports to the Managing Director, Retail Banking.

Creditor Payment Policy

The Group is a signatory of the DTI's Better Payment Practice Code. Information regarding this code and its purpose can be obtained from the Better Payment Practice Group's website at www.payontime.co.uk.

It is Group policy to:

- agree the terms of payment at the start of business with that supplier
- ensure suppliers are aware of the payment terms
- pay in accordance with any contractual and other legal obligations.

Trade creditor days of the Company for the year ended 31 December 2001 were 22 days (2000: 24 days) based on the ratio of Company trade creditors at the end of the year to the amounts invoiced during the year by trade creditors.

Authority to Purchase Shares

During the year, no shares were repurchased and cancelled.

Capital efficiency remains a key financial objective and shareholder authority will again be sought at the Annual General Meeting for the Company to purchase in the market up to 50,490,000 of its shares, representing some 10% of the issued share capital, in order to retain flexibility in managing the Company's capital requirements.

Special Business at the Annual General Meeting

The Annual General Meeting will be held on 7 May 2002. Shareholders will see from the Notice of the Annual General Meeting that they are asked to consider and, if thought fit, pass several resolutions relating to the Political Parties, Elections and Referendums Act 2000 as Special Business.

Auditors

A resolution re-appointing Deloitte & Touche as auditors and authorising the directors to determine their remuneration will be proposed at the Annual General Meeting.

On behalf of the Board
Julian Hepplewhite
Company Secretary

21 February 2002

Report on Directors' Remuneration

Remuneration Committee's Composition and Scope

The Board Remuneration Committee ('the Committee') comprises four non-executive directors:

Mr M P S Barton (Chairman and senior independent non-executive director)
Mr M J Allen
The Hon D Brougham
Miss F A Cairncross

Mr G N Corah, who retired from the Board on 23rd January 2002, was a member of the Committee throughout 2001.

The Committee is responsible for determining, pursuant to a policy framework on executive remuneration agreed by the Board, the pay and benefits and contractual arrangements of each executive director and for overseeing the Group's Share Schemes.

Within the parameters set by the Board, individual performance-related payments and share awards are made by the Committee with the objective of rewarding achievements and aligning the interests of the individual with those of the Group's shareholders. The individual salary, bonus and benefit levels of executive directors are normally reviewed annually by the Committee and due consideration is given to advice from independent advisers.

The Executive Chairman may attend meetings of the Committee except when his own remuneration is being considered.

Remuneration Policy and Its Development

The broad policy of the Board and the Remuneration Committee remains to set remuneration so as to attract and retain high calibre executives and to encourage and reward superior business performance. Remuneration for executive directors should reward both individual and company performance measured against performance criteria that are relevant and realistic but also challenging, so that good performance is encouraged. Of the total remuneration package of executive directors, a potentially significant proportion should relate directly to the performance of the Company and its share performance.

It remains the objective of both the Board and the Remuneration Committee to ensure a sufficiently direct and clearly defined 'line of sight' (i.e. a clear relationship between actions and the corresponding level of reward received) in order to deliver successful implementation of the Group's strategy and maximise shareholder value. That strategy focuses on business development and rigorous control of costs, with customer service as a key differentiator. Executive directors are required to build up over a period of five years, and retain, a minimum holding of shares in the Company with a value of the order of their annual basic salary under Remuneration Committee guidelines agreed in 2001.

In designing schemes of performance-related remuneration, the Committee has followed the provisions in Schedule A to the Combined Code.

Details of individual directors' remuneration, share options and long-term incentive schemes are set out on pages 32 to 34 of this report.

Components Of Emoluments

The main components of the remuneration package for executive directors are:

Basic Salary

Basic salary for executive directors takes into account the role and responsibilities, performance and experience of the individual. This is set against background information from independent advisers on salary levels for similar positions amongst a specific comparitor group of financial organisations and with due regard to general salary trends within companies in the FTSE 100.

Annual Bonus

At the discretion of the Committee, executive directors are eligible to receive an annual performance bonus. The amount of the bonus is determined by the Company's performance and the director's performance and is based on the achievement of corporate targets and individual performance goals specified and agreed at the beginning of each year together with a discretionary element to be determined by the Committee. Bonus ranges are reviewed in the context of prevailing market practice and overall remuneration.

Executive directors may be required to receive one-quarter of their annual bonus in the form of a deferred shares award which the Company will match if the related performance criteria are achieved (see later under Long-Term Incentive Schemes). For 2002, executive directors will be able to voluntarily defer up to 100% of their annual bonus for this purpose. The rights to deferred shares cannot normally be exercised for three years and lapse if not exercised within seven years.

Long-Term Incentive Schemes

There are share schemes for executive directors designed to align the interests of executive directors with those of shareholders:

1. Options are granted under the Alliance & Leicester Approved and Unapproved Company Share Option Schemes. The aggregate value of options to subscribe for new shares (at market value on the day before the grant) granted to each individual cannot exceed a maximum annual award of two times basic salary per annum with a power for the Committee to increase this up to four times basic salary if it considers that this is warranted in exceptional circumstances. Annual grants have normally been up to one times basic salary with the grants being made in two tranches at the time of the final and interim results. Options cannot normally be exercised for three years from the date of grant. The performance condition that has been applied to the schemes to date is that options can only be exercised if the percentage growth in earnings per share over a three year period exceeds the Retail Price Index (RPI) inflation by at least 6% (9% for the 1998 scheme) over the same period. The Committee reviews this condition before each new grant paying due regard to market practice.

2. In addition, the Company will match an award of deferred shares (see under Annual Bonus above) on the basis of up to three matched shares for each deferred share awarded. The maximum matched award is given for upper quartile performance in terms of the Total Shareholder Return measured relative to a peer group of Retail Banks. Awards only begin to vest when median performance relative to the peer group is achieved. The rights to matching shares cannot normally be exercised for three years and lapse if not exercised within seven years.

Employee Share Schemes

Directors may also participate in the Company's existing Employee Share Schemes and Savings Related Share Option Schemes (including the Company's All Employee Share Ownership Plan) on the same basis as all other employees.

Pensions

Executive directors are members of the defined benefit section of the Alliance & Leicester Pension Scheme which has a normal retirement age of 60.

The main features for executive directors based on the standard terms of the Scheme, are:

(a) Pensions from age 60 of 1/60th of basic salary averaged over the last twelve months prior to retirement for each year of pensionable service.
(b) A cash benefit on death in service of 4x annual rate of basic salary at date of death.
(c) Pensions payable in the event of ill-health.
(d) Pensions for dependants on a member's death are generally equal to half the member's prospective retirement pension at 60 on death in service, or half the member's pension entitlement on death in retirement.
(e) Member contributions are 5% of basic salary.

The following executive directors have special benefits:

Mr Pym and Mr Bennett are entitled to a pension of 2/3rd of their final pensionable salary on retirement at age 60 inclusive of retirement benefits from service at other organisations (Mr McNamara was similarly entitled).

Mr Pym is not required to contribute. Mr Windeler contributes 5% of the Earnings Cap and Mr Bennett contributes 15% of the Earnings Cap.

There is an unfunded unapproved pension arrangement to increase the pension/lump sum life assurance benefit to the level promised, where, because of Inland Revenue limitations (including those resulting from the Earnings Cap), these cannot be paid in total from the Scheme. Such arrangements apply to Mr Windeler, Mr Pym and Mr Bennett.

On retirement from service an executive director may, with the consent of the employer, draw his accrued pension under the Pension Scheme at any time after his 50th birthday (subject to a reduction of 3% for each year by which retirement precedes his 60th birthday).

All pensions earned over the year are subject to contractual increases each April in line with the annual percentage rise in the RPI over the previous calendar year, subject to a maximum of 5%.

It is confirmed that there are no discretionary practices which are taken into account in calculating transfer values on leaving service.

Other Benefits

Executive directors are eligible for a range of benefits which include the provision of company cars, payment of operating expenses including fuel and membership of a private medical insurance scheme.

Remuneration for Non-Executive Directors

The fees of the non-executive directors are determined by the Board as a whole in the light of recommendations by the Executive Chairman and within the limits specified in the Articles of Association of the Company.

Other benefits for non-executive directors include the reimbursement of travel and other incidental expenses for attendance at Board meetings.

Service Contracts

The non-executive directors do not have service contracts with the Company, but on appointment are issued with a letter of understanding, which does not have contractual force.

For executive directors the Board has adopted an objective of moving towards contracts with a twelve months' notice period over a period of time, having regard to existing arrangements. Indeed, notice periods were reduced from the three years applicable at the time of conversion to plc status, without payment of compensation. The Board also recognises, as is acknowledged in the Combined Code, that there are circumstances on recruitment where it may be necessary to agree a longer notice period for an initial period.

The service contracts of Mr J R Windeler (Executive Chairman) and Mr D J Bennett are terminable by the Company on twelve months' notice. The service contracts of Mr R A Pym and Mr R L Banks are terminable by the Company on two years' notice.

If the employment of an executive director is terminated by the Company for any reason (other than due cause) without notice being given then Mr Pym and Mr Banks are entitled to receive payment of eighteen months' basic salary (or two years' basic salary if at the time the executive director is 55 or over) and pension benefits. In the case of those directors subject to twelve months' notice, they are entitled to receive payment of twelve months' basic salary, annual bonus and pension benefits (plus an additional three months' basic salary and pension benefits at the discretion of the Committee as 'good leavers', or an additional six months' basic salary and pension benefits where employment is terminated by the Company within six months of a change of control of the Company). No such payments of salary and pension benefits on termination by the Company will in any event exceed a payment based on the number of months from the date of termination of employment to the executive director's normal retirement date.

The Committee believes that these provisions will ensure that the right calibre of directors are recruited and retained and ease an orderly transition from a two year to a twelve month notice period.

The executive directors may terminate their contracts of employment at any time by giving six months' prior notice.

Directors' Remuneration

Year ended 31 December 2001

	Salaries/ Fees £'000	Bonus £'000	Deferred Bonus (i) £'000	Other Benefits £'000	Compensation for loss of Office (ii) £'000	Total 2001 £'000	Total 2000 £'000
Executive Chairman							
J R Windeler	464	215	–	15	–	**694**	808
Executive Directors							
R L Banks	235	75	25	15	–	**350**	392
D J Bennett	261	90	30	17	–	**398**	391
T M Hilliard (to 31.12.00)	–	–	–	–	–	**–**	722
P D McNamara (to 1.10.01)	323	–	–	14	570	**907**	382
R A Pym	350	120	80	15	–	**565**	571
Subtotal	1,633	500	135	76	570	**2,914**	3,266
Non-Executive Directors							
M J Allen	37	–	–	2	–	**39**	33
M P S Barton	88	–	–	–	–	**88**	52
The Hon D Brougham	41	–	–	1	–	**42**	22
F A Cairncross	39	–	–	–	–	**39**	35
G N Corah (iii)	45	–	–	3	–	**48**	40
M McTighe	34	–	–	–	–	**34**	18
Sir Michael Thompson (to 31.12.00)	–	–	–	–	–	**–**	63
E J Watts	33	–	–	–	–	**33**	20
Subtotal	317	–	–	6	–	**323**	283
Total	1,950	500	135	82	570	**3,237**	3,549

Notes:

(i) Maximum aggregate market value at date of grant of shares recommended by the Remuneration Committee to the Trustees of the Alliance & Leicester Share Ownership Trust (awarded in February 2002) in accordance with the deferred bonus arrangements described on page 30 of this report. The director will normally receive the deferred shares after 3 years and the matching shares upon fulfilment of the performance criteria if he is still employed by the Company (or, at the discretion of the Trustees, if he leaves the Group earlier).

(ii) Mr P D McNamara's pension entitlement has been enhanced by the equivalent of eighteen months additional pensionable service in accordance with the provisions of his service contract. Details of his pension are given in the 'Pension Entitlements' section below.

(iii) Mr G N Corah retired as a director of the Company on 23 January 2002.

Pension Entitlements

Executive Director	R L Banks	R A Pym	J R Windeler	P McNamara	D J Bennett
Age attained at 31.12.01	50	52	58	50	39
Normal retirement age	60	60	60	60	60
	£	£	£	£	£
Amount of accrued pension per annum at 31.12.01	56,465	94,478	16,250	34,519*	18,934
(at 31.12.00)	50,872	76,988	8,345	10,089	12,869
Change in amount of accrued pension p.a. net of revaluation during year to 31.12.01	4,729	16,181	7,763	24,258	5,846
(to 31.12.00)	6,514	14,974	7,197	10,089	7,550
Directors contributions payable during year to 31.12.01	11,750	–	4,725	–	14,175

Notes:

* The table above confirms Mr McNamara's entitlement from the Alliance & Leicester Pension Scheme and the Company's unfunded unapproved retirement benefits scheme on leaving as at 1 October 2001 and allowing for eighteen months' additional pensionable service in accordance with his service contract. This amount came into payment as an immediate pension on 1 October 2001 with the usual early retirement factor applying. The corresponding amount as at 31 December 2000 was payable from age 60.

Details of terms and conditions associated with the above pensions are shown on page 31.

Mr Corah (who retired on 23 January 2002) was entitled as a former director of the Company's predecessor Alliance & Leicester Building Society, to an unfunded unapproved arrangement providing for a pension (and to the benefit of private medical insurance) on retirement. This obligation had been transferred to the Company.

Non-Executive Director	G N Corah
Age attained at 31.12.01	69
Normal retirement age	70
	£
Amount of accrued pension p.a. at 31.12.01	16,650
Amount of pension accruing during 2001	–
Director's contributions	–

On the death of Mr Corah a widow's pension of one half of the full pension entitlement is payable.

Directors' Interests in Ordinary Shares

The beneficial interests of directors at the year-end in shares in Alliance & Leicester plc were:

	Fully Paid Shares of 50p each‡	
Directors	As at 1.1.01 (or date of appointment if later)	As at 31.12.01~
M J Allen	500	500
R L Banks	2,443	3,732
M P S Barton	1,500	1,500
D J Bennett	2,025	3,314
The Hon D Brougham	3,000	3,000
F A Cairncross	12,014	12,014
G N Corah	4,217	4,217
M McTighe	500	500
R A Pym	10,269	11,558
E J Watts	500	500
J R Windeler	32,500	33,789

‡ Directors' share interests include the interests of their spouses and infant children, as required by Section 328 of the Companies Act 1985.

~ In addition to the beneficial interests in shares shown as at 31 December 2001, Mr R L Banks, Mr D J Bennett, Mr R A Pym and Mr J R Windeler were each allocated 92 shares in the capital of the Company by the All Employee Share Ownership Plan Trustee on 30 January 2002. There were no further changes in the beneficial interests of the directors in Company shares between 31 December 2001 and 11 February 2002.

Rights to Acquire Shares

In addition, the following directors have options to subscribe for shares of 50p each granted under the terms of the Alliance & Leicester share option schemes:

Directors	Number of options: As at 1.1.01	Granted during the year	As at 31.12.01	Exercise price £	Exercise period
R L Banks	5,628		5,628	5.33#	23/4/00 – 23/4/07
	16,417		16,417	5.33•	23/4/00 – 23/4/04
	3,239		3,239	4.26*	1/8/02 – 1/2/03
	38,589		38,589	9.005•	6/3/01 – 6/3/05
	513		513	6.72*	1/11/03 – 1/5/04
	47,320		47,320	8.77•	17/6/02 – 17/6/06
	3,768		3,768	Nil†	17/6/02 – 17/6/06
	43,137		43,137	5.10•	17/2/03 – 17/2/07
	11,764		11,764	Nil†	17/2/03 – 17/2/07
	Nil	28,731	28,731	6.70•	23/2/04 – 23/2/08
	Nil	14,587	14,587	8.055•	23/7/04 – 23/7/11
	Nil	26,865	26,865	Nil†	23/2/04 – 23/2/08
D J Bennett	3,420		3,420	8.77#	17/6/02 – 17/6/09
	42,189		42,189	8.77•	17/6/02 – 17/6/06
	1,443		1,443	6.712*	1/11/02 – 1/5/03
	45,098		45,098	5.10•	17/2/03 – 17/2/07
	Nil	36,567	36,567	6.70•	23/2/04 – 23/2/08
	Nil	15,518	15,518	8.055•	23/7/04 – 23/7/11
	Nil	22,386	22,386	Nil†	23/2/04 – 23/2/08
R A Pym	5,628		5,628	5.33#	23/4/00 – 23/4/07
	76,923		76,923	5.33•	23/4/00 – 23/4/04
	4,049		4,049	4.26*	1/8/02 – 1/2/03
	31,093		31,093	9.005•	6/3/01 – 6/3/05
	59,293		59,293	8.77•	17/6/02 – 17/6/06
	5,938		5,938	Nil†	17/6/02 – 17/6/06
	60,784		60,784	5.10•	17/2/03 – 17/2/07
	19,606		19,606	Nil†	17/2/03 – 17/2/07
	Nil	47,761	47,761	6.70•	23/2/04 – 23/2/08
	Nil	21,104	21,104	8.055•	23/7/04 – 23/7/11
	Nil	41,193	41,193	Nil†	23/2/04 – 23/2/08
J R Windeler	6,586		6,586	4.555#	27/7/03 – 27/7/10
	190,998		190,998	4.555•	27/7/03 – 27/7/07
	2,658		2,658	3.644*	1/11/03 – 1/5/04
	Nil	67,164	67,164	6.70•	23/2/04 – 23/2/08
	Nil	134,328	134,328	Nil†	23/2/04 – 23/2/08

* Options granted under the Alliance & Leicester ShareSave Scheme.
\# Options granted under the Alliance & Leicester Approved Company Share Option Scheme.
• Options granted under the Alliance & Leicester Unapproved Company Share Option Scheme.
† Options granted over Matching Shares under the Alliance & Leicester Deferred Bonus Scheme.
During the year, no options granted to the above Directors lapsed or were exercised.

On 31 December 2001 the market price of ordinary shares in Alliance & Leicester plc was £8.02 and the range during 2001 was £6.55 to £8.435.

Bonus Awards

The following table shows the directors' interests in options awarded under the deferred bonus scheme (but does not include those awarded in February 2002 as described on page 32 of this report).

Executive Director	Bonus year		Value of award £	Market value at date of grant £	No. of shares under option	Exercise price £	Exercise period
R L Banks	1998	Deferred Shares	16,530	8.77	1,884•	Nil	17/6/02 – 17/6/06
	1999	Deferred Shares	29,998	5.10	5,882•	Nil	17/2/03 – 17/2/07
	2000	Deferred Shares	60,000	6.70	8,955#	Nil	23/2/04 – 23/2/08
D J Bennett	2000	Deferred Shares	50,000	6.70	7,462#	Nil	23/2/04 – 23/2/08
R A Pym	1997	Deferred Shares	22,800	9.005	2,532~	Nil	6/3/01 – 6/3/05
	1997	Matching Shares	22,800	9.005	2,531~	Nil	6/3/01 – 6/3/05
	1998	Deferred shares	26,040	8.77	2,969•	Nil	17/6/02 – 17/6/06
	1999	Deferred Shares	49,995	5.10	9,803•	Nil	17/2/03 – 17/2/07
	2000	Deferred Shares	92,000	6.70	13,731#	Nil	23/2/04 – 23/2/08
J R Windeler	2000	Deferred Shares	300,000	6.70	44,776#	Nil	23/2/04 – 23/2/08

~ The matching share option granted in 1998 in respect of the 1997 bonus year was not subject to a performance objective.

• In the case of the 1998 and 1999 bonus years, a maximum of up to two matching shares for each Deferred Share may be awarded subject to the Company's Total Shareholder Return (TSR) performance ranking greater than 50th percentile against the TSR performance of two comparitor groups namely the FTSE Retail Banks Index and the FTSE 100 Index (with application on a linear basis between zero for the 50th percentile performance and two times for the top 25th percentile performance).

\# For the 2000 bonus year, a maximum of up to three Matching Shares for each Deferred Share may be awarded subject to the Company's TSR performance ranking higher than 50th percentile against the TSR performance of a comparitor group of Retail Banks (with application on a linear basis between zero for the 50th percentile performance and three times for the top 25th percentile performance).

On behalf of the Board
M P S Barton
Chairman of the Remuneration Committee

21 February 2002

Statement of Corporate Governance

Principles of Corporate Governance

The Company's Board appreciates the value of good corporate governance not only in the areas of accountability and risk management but also as a positive contribution to business prosperity. It believes that corporate governance involves more than a simple 'box ticking' approach to establish whether a company has met the requirements of a number of specific rules and regulations. Rather the issue is one of applying corporate governance principles (including those set out in Section 1 of the Principles of Good Governance and Code of Best Practice ('the Combined Code') published by the Stock Exchange in June 1998) in a sensible and pragmatic fashion having regard to the individual circumstances of a particular company's business. The key objective is to enhance and protect shareholder value.

Board Structure

The Company's Board comprises six non-executive directors and four executive directors who have the collective responsibility for ensuring that the affairs of the Company and its subsidiaries are managed competently and with integrity. The Executive Chairman is Mr J R Windeler. The senior independent non-executive director is the Deputy Chairman, Mr M P S Barton. Mr Windeler presently combines the roles of Chairman and Chief Executive.

The non-executive directors are not employees of the Company and the Board considers that all the non-executives are independent of management and free from business or other relationships which could materially interfere with the exercise of their independent judgement.

The non-executive directors provide an independent challenge to executive directors and play a full part as members of the Board 'team'. They bring a diversity of business perspectives and objectivity which complements the 'hands on' expertise of their executive director colleagues. All members of the Board share responsibility for Board decisions.

The composition of the Board is kept under review with the aim of ensuring that there is a proper balance of power and authority between executive and non-executive members of the Board and that the Board collectively possesses the necessary skills and experience for the proper direction for the Group's business activities.

Newly appointed directors submit themselves for election by shareholders at the first opportunity after their appointment and at three yearly intervals thereafter. They receive induction training upon appointment.

Governance Oversight

Following the departure of the Group Managing Director in October the Executive Chairman assumed the Chief Executive role as part of a management restructuring designed to deliver greater focus in the achievement of the Group's strategy.

Whilst the Company has an Executive Chairman who combines the roles of Chairman and Chief Executive, the Deputy Chairman, as senior independent non-executive director, is charged by the Board with the responsibility of ensuring that a suitable balance of power and authority is demonstrated. He exercises this governance oversight role through the non-executive majority on the Board which meets regularly to monitor and review the execution of the Executive Chairman's management responsibilities and the exercise of his devolved powers. The composition of the Board, with a strong independent element, ensures that no one individual has unfettered powers of decision and authority.

Operation of the Board

The Board meets regularly and approves and closely monitors the Alliance & Leicester Group's strategic direction and business strategy. There is a formal schedule of matters specifically reserved to the Board for decision including major capital expenditure, annual budgets and corporate objectives. Procedures are in place which allow directors to take independent professional advice in the course of their duties and all directors have access to the advice and services of the Company Secretary.

The Board receives regular management performance and internal control reports and operates a system of Board reviews of individual business units and their performance against key business targets and objectives.

The Board has established several committees with specified terms of reference which assist the full Board in the exercise of its responsibilities:

Nomination Committee

Under the chairmanship of Mr Windeler this Committee has the task of recommending new appointments to the Board and reviewing re-appointments when they become due. It has formal Terms of Reference and its current membership comprises:

Mr J R Windeler (Chairman)
Mr M P S Barton (non-executive)
Mr M J Allen (non-executive)
Miss F A Cairncross (non-executive)

Remuneration Committee

Under the chairmanship of Mr Barton (non-executive Deputy Chairman) this Committee determines the remuneration and contractual arrangements of individual executive directors having regard to a general policy framework for executive remuneration established by the Board. The Board's Report on Directors' Remuneration appears on pages 30 to 34.

The Committee's Terms of Reference require membership of the Committee to be confined to non-executive directors. The present members of the Committee are:

Mr M P S Barton (Chairman)
Mr M J Allen
The Hon D Brougham
Miss F A Cairncross

Group Audit and Risk Committee

Membership of the Committee comprises Mr Barton (Chairman), The Hon. D Brougham, and Mr M McTighe (all of whom are non-executive directors). Mr Barton succeeded Mr N Corah who was Chairman of the Committee throughout 2001 and until his retirement from the Board in January 2002. Meetings of the Committee are normally attended by the Group Finance Director, the Director of Group Risk, the Head of Internal Audit and the Head of Group Compliance. The Chairman of the Committee has independent access to both internal and external auditors (and to the Group's statutory regulator, the Financial Services Authority).

The duties of the Committee fall into two main areas: internal control and financial reporting.

Internal Control: the Committee reviews the effectiveness of the Group's systems of internal control and risk management and monitors compliance with regulatory requirements. To do this, the Committee approves the annual Internal Audit and Compliance plans, which are based on thorough risk assessments of the full scope of the Group's business activities, and monitors progress against the plans. Each meeting of the Committee receives reports from the Head of Internal Audit and the Head of Group Compliance regarding the state of internal control and compliance within the Group. The salient points of these reports are presented to the next Board meeting.

Financial Reporting: the Committee's role is to review, on behalf of the Board, the Annual Report and Accounts, the Interim Report and internal audit reports. The Committee focuses on reviewing any changes in accounting policy, major areas of judgement and estimates, and compliance with accounting principles and regulatory requirements.

The Committee recognises the importance of maintaining a sound system of internal control to safeguard shareholders' investments and the Group's assets. Further information on the systems of business control appears later in this Statement. The Committee has formal Terms of Reference. The Company's auditors are present at meetings of the Committee and the Committee keeps under review the overall financial relationship between the Company and its auditors in order to ensure a proper balance between the maintenance of objectivity and obtaining value for money.

The Committee also receives on behalf of the Board the Annual Report of the Group Money Laundering Reporting Officer. All authorised firms are required by the Financial Services Authority to commission such a report on an annual basis.

The Board has also established two other committees. The Group Credit Policy Committee reviews all aspects of lending credit and market risk and the Group Assets and Liabilities Committee establishes strategies for, and monitors and controls, the levels of balance sheet risk including liquidity, funding and currency exposures across the Group and the monitoring of interest rate refixing profiles.

Pension Funds

The Group's pension funds are held and controlled by Trustees separately from the Group; in particular no scheme assets are invested in or loaned to the Company or its subsidiaries. Independence is reinforced by strong employee trustee representation.

Relations with Shareholders

The Company values dialogue with its institutional shareholders through meetings and results briefings. The Annual General Meeting and the documents sent to shareholders before that meeting provide an opportunity for the Board to account to shareholders for its stewardship of the Group's business.

Compliance Statement

In the directors' opinion the Company complied with the provisions of Section 1 of the Combined Code throughout the year ended 31 December 2001.

Internal Control

The Group Audit and Risk Committee has regularly reviewed the effectiveness of the Group's system of internal control for the year to 31 December 2001 on behalf of the Board and has taken account of any material developments that may have taken place since the year end.

Systems of Business Control

The Board is responsible for the Group's system of internal controls and for monitoring its effectiveness. The Group's business involves the identification, acceptance and mitigation of risk, and appropriate internal control systems have been implemented and embedded. These systems of internal control are designed to manage rather than eliminate the risk of failure to achieve business objectives and provide reasonable but not absolute assurance as to the effectiveness of the safeguards protecting the business against the risk of material error, loss or fraud, but it must be recognised that they cannot provide absolute assurance.

The directors are required by law to establish systems for the control of the conduct of the business in accordance with the Financial Services and Markets Act 2000 and to conduct the business with prudence and integrity, ensuring that there are adequate reserves and other capital resources and assets in liquid form for the protection of depositors.

There has been in place for the year under review and up to the date of this report a process of identifying, evaluating and managing the significant risks faced by the Group. This process is regularly reviewed by the Board and accords with the Guidance for Directors on the Combined Code issued by the Institute of Chartered Accountants in England and Wales in September 1999.

The Board receives monthly reports from the key executives identifying performance against budget, major business issues and the impact of the external business and economic environment on their areas of responsibility. The Board also receives the minutes of the Group Audit and Risk Committee, and reports from the Chairman of the Group Credit Policy Committee. These identify any significant issues relating to the adequacy of the Group's risk management policies and procedures across the full range of risk to which the Group is exposed.

The Board has delegated oversight of the Group's Internal Control Policy to the Group Audit and Risk Committee. Each regular meeting of this Committee receives a report identifying the effectiveness of internal control together with specific reports on major issues. An annual assessment of the effectiveness of internal control within the Group is submitted by the Head of Internal Audit to this Committee. The Board retains control over this area through the presentation of a regular Group Audit and Risk Committee 'activities' report together with the minutes of the Committee meetings.

The key features of the system of business control established by the Board are:

- a Group Internal Control Policy requiring senior management to identify major risks and monitor the effectiveness of internal controls through key performance indicators and certify to the Board on a twice yearly basis that they are effective. The results of this self certification are subject to internal audit scrutiny and are reported via the Group Audit and Risk Committee;
- a well defined management structure with clear accountabilities and delegations;
- a planning and budget process that delivers detailed annual financial forecasts and targets for Board approval;
- management information systems enabling the Board to receive comprehensive monthly analysis of financial and business performance including variance against budget;
- risk management functions to identify and monitor all major risks to which the Group is exposed;
- an Internal Audit function to report to the Board on the effectiveness of key internal controls in relation to these major risks;
- a Compliance function to manage relationships with the Group's key regulators and to identify and control major compliance risks;
- The appointment of a Money Laundering Reporting Officer and the establishment and maintenance of the anti-money laundering procedures and controls including training programmes for staff; and
- documented procedures and authority levels to ensure that risks involved in major projects are properly assessed and controlled.

The activities of the Group, including the systems of business control, are subject to supervision by the Financial Services Authority. The Group is required on a regular basis to submit detailed prudential and statistical returns covering all areas of its business and meets regularly with its supervisors, conducting the relationship in an open and constructive manner. This includes a specific bilateral meeting between the FSA and the Chairman of the Group Audit and Risk Committee.

Going Concern

The directors confirm that they are satisfied that the Group has adequate resources to continue in business for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

Statement of Directors' Responsibilities

Company law requires the directors to prepare financial accounts for each financial year which give a true and fair view of the state of affairs of the Company and Group as at the end of the financial year and of the profit or loss of the Group for that period. In preparing those financial accounts, the directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- prepare financial accounts on the going concern basis unless it is inappropriate to assume the Group will continue to be in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

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 2001 which comprise the profit and loss account, the balance sheets, the reconciliation of movements in shareholders' funds, the cash flow statement and the related notes 1-42. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information which is specified by the Financial Services Authority to be audited in respect of any directors' remuneration, share options, long-term incentive schemes and pension entitlements and which is set out in the report to shareholders by the Board on directors' remuneration.

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the Company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements, auditing standards, and the Listing Rules of the Financial Services Authority.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions with the Company and other members of the Group is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance or its risk and control procedures.

We read the directors' report and other information contained in the Annual Report for the above year as described in the contents section and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2001 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche

Deloitte & Touche
Chartered Accountants and Registered Auditors
Colmore Gate
2 Colmore Row
Birmingham
B3 2BN

21 February 2002

Consolidated Profit and Loss Account

For the year ended 31 December 2001	Notes	Continuing Operations 2001 £m	2000 (restated) £m
Interest receivable:			
Interest receivable and similar income arising from debt securities		**389.7**	334.9
Other interest receivable and similar income		**1,751.1**	1,855.3
Interest payable		**(1,386.2)**	(1,451.4)
Net interest income		**754.6**	738.8
Fees and commissions receivable		**501.2**	452.3
Fees and commissions payable		**(109.4)**	(84.4)
Other operating income	3	**129.5**	119.9
Total non-interest income		**521.3**	487.8
Operating income		**1,275.9**	1,226.6
Administrative expenses	4	**(731.2)**	(662.3)
Depreciation and amortisation:			
On fixed assets excluding operating lease assets		**(36.9)**	(36.0)
On operating lease assets		**(48.0)**	(39.8)
		(84.9)	(75.8)
Provisions for bad and doubtful debts	17	**(63.4)**	(41.8)
Operating profit on ordinary activities before tax		**396.4**	446.7
Tax on profit on ordinary activities:			
Underlying	9	**(109.1)**	(125.6)
Tax credit in respect of conversion costs	9	**-**	15.2
		(109.1)	(110.4)
Profit on ordinary activities after tax		**287.3**	336.3
Minority interests – non-equity		**(0.3)**	-
Profit attributable to the shareholders of Alliance & Leicester plc	10	**287.0**	336.3
Dividends	11	**(182.5)**	(165.5)
Retained profit for the year	35	**104.5**	170.8
Basic earnings per ordinary share	12	**57.0p**	63.9p
Underlying basic earnings per ordinary share	12	**57.0p**	61.0p
Diluted earnings per ordinary share	12	**56.6p**	63.7p

There were no material gains or losses other than the profit shown above.

In both the current and preceding year the Group had no material acquisitions or discontinued operations.

There is no difference, in the current or previous period, between the consolidated profit and loss account as reported and the profit and loss account which would have been reported on an unmodified historical cost basis.

The restatement of the 2000 results is discussed in Note 2.

Consolidated Balance Sheet

As at 31 December 2001	Notes	2001 £m	2000 (restated) £m
Assets			
Cash and balances at central banks		**219.1**	122.3
Treasury bills and other eligible bills	13	**279.6**	218.5
Loans and advances to banks	14	**1,719.8**	1,347.7
Items in the course of collection from other banks		**171.5**	190.6
Loans and advances to customers	15	**27,412.8**	24,022.4
Securitised assets	16	**204.5**	254.0
Less: non-recourse finance	16	**(199.6)**	(248.7)
		27,417.7	24,027.7
Debt securities	18	**8,210.5**	6,963.3
Intangible fixed assets	20	**2.8**	4.3
Tangible fixed assets	21	**642.3**	584.7
Other assets	22	**219.2**	444.1
Prepayments and accrued income	23	**281.0**	396.8
Long-term assurance business attributable to shareholders	24	**82.8**	75.1
		39,246.3	34,375.1
Long-term assurance assets attributable to policyholders	24	**230.3**	340.7
Total assets		**39,476.6**	34,715.8
Liabilities			
Deposits by banks	25	**1,991.2**	1,402.2
Items in the course of transmission to other banks		**231.0**	215.0
Customer accounts	26	**22,099.8**	21,324.0
Debt securities in issue	27	**11,053.9**	7,852.9
Other liabilities	28	**548.4**	432.8
Accruals and deferred income	29	**771.6**	892.4
Provisions for liabilities and charges	30	**175.5**	137.4
Subordinated liabilities	33	**609.5**	461.8
		37,480.9	32,718.5
Minority interests – non-equity		**0.8**	–
Called up share capital	34	**252.5**	252.2
Share premium account	35	**25.1**	21.9
Capital redemption reserve	35	**40.1**	40.1
Profit and loss account	35	**1,446.9**	1,342.4
Shareholders' funds (equity)		**1,764.6**	1,656.6
		39,246.3	34,375.1
Long-term assurance liabilities to policyholders	24	**230.3**	340.7
Total liabilities		**39,476.6**	34,715.8
Memorandum items			
Contingent liabilities	38	**220.5**	99.1
Commitments	38	**911.7**	681.4

The restatement of the 2000 results is discussed in Notes 16 and 21.

Approved by the Board of directors on 21 February 2002 and signed on its behalf by:
J R Windeler Executive Chairman
D J Bennett Group Finance Director

Company Balance Sheet

As at 31 December 2001	Notes	2001 £m	2000 (restated) £m
Assets			
Cash and balances at central banks		**41.4**	49.2
Treasury bills and other eligible bills	13	**279.6**	218.5
Loans and advances to banks	14	**1,967.9**	1,364.3
Loans and advances to customers	15	**26,740.5**	23,454.5
Securitised assets	16	**204.5**	254.0
Less: non-recourse finance	16	**(199.6)**	(248.7)
		26,745.4	23,459.8
Debt securities	18	**7,519.2**	6,291.0
Shares in group undertakings	19	**750.4**	582.9
Tangible fixed assets	21	**177.8**	253.2
Other assets	22	**104.4**	297.8
Prepayments and accrued income	23	**296.4**	394.9
Total assets		**37,882.5**	32,911.6
Liabilities			
Deposits by banks	25	**4,505.6**	3,673.7
Customer accounts	26	**19,007.4**	18,407.4
Debt securities in issue	27	**11,011.9**	7,852.9
Other liabilities	28	**581.4**	370.1
Accruals and deferred income	29	**670.4**	789.0
Provisions for liabilities and charges	30	**18.6**	17.2
Subordinated liabilities	33	**609.5**	461.8
		36,404.8	31,572.1
Called up share capital	34	**252.5**	252.2
Share premium account	35	**25.1**	21.9
Capital redemption reserve	35	**40.1**	40.1
Profit and loss account	35	**1,160.0**	1,025.3
Shareholders' funds (equity)		**1,477.7**	1,339.5
Total liabilities		**37,882.5**	32,911.6

The restatement of the 2000 results is discussed in Notes 1, 16 and 21.

Approved by the Board of directors on 21 February 2002 and signed on its behalf by:
J R Windeler Executive Chairman
D J Bennett Group Finance Director

Reconciliation of Movements in Shareholders' Funds

For the year ended 31 December 2001	2001 £m	2000 £m
Group profit attributable to the shareholders of Alliance & Leicester plc	**287.0**	336.3
Dividends	**(182.5)**	(165.5)
Retained profit for the financial year	**104.5**	170.8
New shares issued	**0.3**	0.2
Repurchase of share capital	**-**	(260.2)
Share premium on issue of shares under option	**3.2**	2.0
Net increase/(decrease) in shareholders' funds	**108.0**	(87.2)
Opening shareholders' funds	**1,656.6**	1,743.8
Closing shareholders' funds	**1,764.6**	1,656.6

Consolidated Cash Flow Statement

For the year ended 31 December 2001	Notes	2001 £m	2000 £m
Net cash inflow from operating activities	41	**1,368.9**	3,575.1
Returns on investments and servicing of finance:			
Interest paid on loan capital		**(36.3)**	(34.7)
Taxation		**(63.5)**	(74.4)
Capital expenditure and financial investment:			
Purchase of investment securities		**(8,645.5)**	(9,495.6)
Sale and maturity of investment securities		**7,665.3**	6,357.0
Purchase of tangible fixed assets		**(221.9)**	(216.6)
Sale of tangible fixed assets		**86.3**	75.4
Net cash outflow from capital expenditure and financial investment		**(1,115.8)**	(3,279.8)
Acquisitions and disposals		**(0.3)**	1.0
Equity dividends paid		**(171.8)**	(159.2)
Net cash (outflow)/inflow before financing		**(18.8)**	28.0
Financing:			
Proceeds from issue of ordinary share capital		**3.5**	2.2
Repurchase of share capital		**-**	(260.2)
Issue of loan capital	41	**150.0**	188.1
Increase in minority interests		**0.5**	-
Increase/(decrease) in cash	41	**135.2**	(41.9)

1 Principal accounting policies

Basis of presentation
The consolidated accounts are prepared in accordance with the special provisions of Part VII, Chapter II of the Companies Act 1985 applicable to banking companies and banking groups.

Accounting convention
The Group prepares its accounts under the historical cost convention, and in accordance with applicable UK accounting standards.

Basis of consolidation
The Group accounts consolidate the accounts of the bank and all its subsidiaries at the end of the year. Where subsidiaries are acquired during the year, their results are included in the Group accounts from the date of acquisition.

Statements of Recommended Practice (SORPs)
The accounts have been prepared in accordance with British Bankers' Association SORPs on Advances, Securities, Derivatives, Contingent Liabilities and Segmental Reporting by Banks.

Goodwill
Goodwill arising on the acquisition of subsidiary companies, which is represented by the excess of fair value of the purchase consideration over the fair value of assets acquired, is capitalised and shown as an asset in the balance sheet and subsequently amortised over a period of between 3 and 10 years as a charge to the profit and loss account. Goodwill previously written off to reserves amounts to £42.2m.

Deferred taxation
Provision is made using the liability method for taxation which is deferred as a result of timing differences, only to the extent that it is likely that such taxation will become payable or receivable in the foreseeable future. Provision is calculated at rates expected to be applicable when the liability or asset crystallises.

Fixed assets and depreciation
The cost of additions and major alterations to office premises, plant, fixtures, equipment and motor vehicles is capitalised. The cost of fixed assets less estimated residual value is written off on a straight line basis over their estimated useful lives as follows:

Freehold buildings	40 to 75 years
Leasehold buildings	over the remainder of the lease up to 75 years
Plant, fixtures and major alterations	10 to 15 years
Equipment and motor vehicles	3 to 9 years
No depreciation is provided on freehold land	

Software costs and external consultancy costs associated with software development are written off to the profit and loss account as incurred.

Depreciation is provided on operating lease assets acquired for the purposes of renting out at rates calculated to write off the cost of the assets, less estimated residual value, over their useful lives using methods which allocate depreciation charges on a systematic basis to the periods which are expected to benefit from their use.

Finance and rental agreements
The minimum lease payments receivable from finance lease and other finance agreements, less appropriate future income arising from finance charges, are included in loans and advances to customers.

Assets acquired for the purpose of renting out under operating lease agreements are capitalised and depreciated in accordance with the accounting policy set out above. Gross earnings on finance and rental agreements comprise the income component of repayments, after recognising sufficient income to cover initial direct costs, which are credited to the profit and loss account using methods which produce an approximate constant rate of return on the net cash investment.

Operating lease agreements
Rentals under operating leases are charged to administrative expenses on a straight line basis.

Finance lease agreements
Assets acquired under finance leases are capitalised at fair value at the start of the lease, with the corresponding obligations being included in other liabilities. The finance lease costs charged to the profit and loss account are based on a constant periodic rate as applied to the outstanding liabilities.

Wholesale funding issue costs
Premiums or discounts, net of commission costs associated with the issue of fixed and floating rate notes and subordinated liabilities, are amortised over the relevant period to maturity and are included in the profit and loss account within interest payable.

Pensions
The Group operates both defined benefit and defined contribution arrangements. Under the defined benefit sections the cost of providing pensions and related benefits is charged to the profit and loss account so as to spread the costs evenly over the employees' working lives. The difference between the charge to the profit and loss account and the contributions paid to the scheme is shown as an asset or a liability in the balance sheet. The assets of the defined contribution section are held separately in an independently administered fund. Contributions to the scheme are charged to the profit and loss account as they fall due.

Securities
Securities intended for use on a continuing basis in the bank's activities are classified as investment securities and are stated in the balance sheet at cost less any impairment in value. Adjustments are made to cost for premiums and discounts arising on the purchase of investment securities, which are amortised over the period to the maturity date of the security, and for the effect of the annual movement in the retail price index where redemption is so fixed under the terms of the issue.

Securities used in trading activities are carried at fair value, with all gains and losses taken directly to the profit and loss account.

Provisions for bad and doubtful debts
Specific provisions are made in respect of loans and advances where recovery is considered doubtful; a general provision is made for

1 Principal accounting policies *continued*

losses which, although not specifically identified, are known to be inherent in any portfolio of lending. Where the collection of interest is in significant doubt, it is credited to a suspense account and written off when there is no longer any realistic prospect of recovery. The outstanding provisions are deducted from loans and advances, along with the interest on non-performing loans held in suspense. The charge in the profit and loss account represents the net increase (or decrease) in the provisions less recoveries for the year.

Income recognition
Interest is recognised in the profit and loss account on an accruals basis. The costs of mortgage cashbacks, discounts and other incentives to borrowers are charged as incurred to interest receivable. Mortgage arrangement fees are taken to income in the profit and loss account on a received basis. Other fees receivable are credited to income when the related service is performed.

Foreign currencies
Monetary assets and liabilities in foreign currencies, other than those covered by forward contracts which are translated at contracted rates, are translated into sterling using year end exchange rates and any differences charged or credited to the profit and loss account.

Derivative financial instruments
Derivatives used in trading activities are carried at fair value, with all gains and losses taken directly to the profit and loss account.

Gains and losses on non-trading derivatives are taken to the profit and loss account in accordance with the accounting treatment of the underlying transaction being hedged. Accrued income or expense is reported in prepayments and accrued income or accruals and deferred income as appropriate. Profits and losses relating to hedges of commitments and anticipated transactions are deferred and taken to the profit and loss account over the life of the underlying hedge.

Hedging contracts and instruments are used by the Group as part of its overall risk management strategy. Instruments used for hedging purposes include interest rate swaps, interest rate caps, collars and floors, futures, forward rate agreements and spot and forward foreign exchange transactions.

The criteria required for a derivative instrument to be classified as a designated hedge is:

i) the transaction must be reasonably expected to match or eliminate a significant proportion of the risk inherent in the assets, liabilities or positions being hedged which results from potential movements in interest rates and exchange rates;
ii) adequate evidence of the intention to hedge and linkage with the underlying risk inherent in the assets and liabilities being hedged must be established at the outset of the transaction.

Hedge transactions which cease to be effective or are terminated early are measured at fair value. Any profit or loss arising is deferred and amortised over the remaining life of the asset, liability or position being hedged. Where the underlying asset, liability or position no longer exists, the hedging transaction is measured at fair value and any profit or loss arising is recognised in full.

Mortgage guarantee income
The bank charges a fee to reflect the increased risk on high loan to value advances and has established a wholly owned subsidiary, as a captive insurance company, for the purposes of insuring part of the risk upon such secured lending. The insurance fund of the captive is included within accruals and deferred income in the Group balance sheet.

Where such fees are not used to insure the loan, they are deferred and included within other accruals and deferred income. The fees are taken to the profit and loss account over the average anticipated life of the loan.

Long-term life assurance business
The value of long-term assurance business represents an actuarial assessment of the value of the shareholders' interest in the long-term assurance funds, comprising the present value of future surpluses expected to emerge from business currently in force together with the surplus retained in the long-term funds. The value is determined on the advice of a qualified actuary.

Movements in the value of long-term assurance business, grossed up at the effective rate of corporation tax, are included within other operating income in the Group profit and loss account.

Securitisation
Securitisation transactions are reported in accordance with FRS 5, 'Reporting the Substance of Transactions'. Where assets are sold under securitisation, if there is no significant change to the Group's rights and benefits to those assets and its exposure is limited to a fixed monetary ceiling, linked presentation is used. Under linked presentation the finance is shown deducted from the gross amount of the item it finances on the face of the balance sheet within a single asset caption 'Loans and advances to customers'.

Alliance & Leicester Group Treasury plc
On 31 December 2001, the trade, assets and liabilities of Alliance & Leicester Group Treasury plc ('ALGT') were vested in Alliance & Leicester plc by means of an Act of Parliament. The results of ALGT have been included within the results of Alliance & Leicester plc for the year ended 31 December 2001, and the comparative results for the year ended 31 December 2000 have also been restated to include the results of ALGT. There is no impact on the Group results.

2 Change in accounting policy

In accordance with best practice, operating lease income is now reported within the heading 'Other operating income' and depreciation on operating lease assets is reported within the statutory heading 'Depreciation and amortisation'. This represents a change in presentation from previous periods where the net of these items was within 'net interest receivable'. The depreciation on operating lease assets is separately identified in order to differentiate the charge from normal depreciation on fixed assets held for use within the business. The impact on 2001 was an increase in other operating income of £71.2m, offset by a £23.2m reduction in interest receivable and £48.0m of additional depreciation charge. The impact on 2000 was an increase in other operating income of £68.5m, offset by a £28.7m reduction in interest receivable and £39.8m of additional depreciation charge.

3 Other operating income

	2001 £m	2000 (restated) £m
Income from operating leases	**71.2**	68.5
Dealing profits	**1.2**	–
Profits on disposal of investment securities	**1.1**	–
Profit on rationalisation of London premises	**11.6**	–
Other	**44.4**	51.4
Total	**129.5**	119.9

4 Administrative expenses

	2001 £m	2000 £m
Staff costs:		
Wages and salaries	**200.8**	175.7
Social security costs	**17.7**	15.5
Other pension costs	**16.5**	12.7
	235.0	203.9
Other administrative expenses	**496.2**	458.4
Total	**731.2**	662.3

The above expenses exclude those incurred by Alliance & Leicester Life Assurance Company Limited, which are reflected in the movement in the value of long-term assurance business, included within Other operating income.

5 Profit on ordinary activities before tax

	2001 £m	2000 £m
Is stated after:		
(i) Income		
Income from listed investments	**287.5**	221.6
(ii) Charges		
Interest payable on subordinated liabilities	**39.1**	35.6
Rentals under operating leases		
Land and buildings	**12.0**	11.8
Other operating leases	**2.1**	2.7
Finance lease interest charges	**1.8**	1.4
Auditors' remuneration:		
Group		
Deloitte & Touche:		
as auditors	**0.4**	0.3
as reporting accountants and other regulatory reporting	**0.4**	–
other fees paid to the auditors and their associates	**0.9**	0.6
fees earned before appointment as auditors	**–**	0.2
Company		
Deloitte & Touche:		
as auditors	**0.2**	0.2
as reporting accountants and other regulatory reporting	**0.2**	–
other fees paid to the auditors and their associates	**0.5**	0.1
fees earned before appointment as auditors	**–**	0.2

6 Staff numbers

The average number of persons employed by the Group during the year was as follows:

	Full time		Part time	
	2001	2000	**2001**	2000
Total	**6,375**	6,078	**3,001**	2,776

7 Directors' emoluments

	2001 £m	2000 £m
Services as a director	**0.3**	0.3
Other services	**2.3**	2.7
	2.6	3.0
Compensation for loss of office	**0.6**	0.5
Total	**3.2**	3.5

Directors' emoluments include those emoluments received by directors from the Company and its associated bodies. The highest paid director was Mr Windeler. A detailed analysis of directors' emoluments is given on page 32 in the Report on Directors' Remuneration.

8 Directors' loans and transactions

The aggregate amount outstanding at 31 December 2001 in respect of loans in the ordinary course of business from the Company, or a subsidiary company, to directors of the Company and persons connected with the directors of the Company was £16,416 representing loans to 6 persons.

9 Tax on profit on ordinary activities

	2001 £m	2000 £m
UK corporation tax at 30%	**66.5**	80.9
Relief for overseas taxation	**(3.8)**	(3.8)
	62.7	77.1
Deferred tax	**40.8**	40.6
Overseas taxation	**5.6**	7.9
	109.1	125.6
Exceptional adjustments to prior years' tax provisions in respect of conversion costs	**–**	(15.2)
	109.1	110.4

The tax charge for 2001 is 27.5% of profit before tax (2000: 24.7%). The comparative figure is significantly lower than 30% due to a favourable Special Commissioners decision on the tax deductibility of conversion costs which resulted in a tax credit in respect of prior years of £15.2m being reflected in the 2000 results. The underlying tax rate, excluding the tax credit in respect of conversion costs, was 28.1% for 2000.

10 Group profit dealt with in the accounts of Alliance & Leicester plc

£317.2m (2000: £390.6m) of the Group profit attributable to ordinary shareholders has been dealt with in the accounts of Alliance & Leicester plc. This includes £20.0m (2000: £20.8m) of profit from Alliance & Leicester Group Treasury which has previously been a separate legal entity. As permitted by Section 230 of the Companies Act 1985, the profit and loss account of Alliance & Leicester plc has not been presented separately.

11 Dividends

	2001 pence per share	2000 pence per share	2001 £m	2000 £m
Interim	**11.8**	10.7	**59.3**	54.5
Final	**24.5**	22.3	**123.2**	111.0
Total	**36.3**	33.0	**182.5**	165.5

12 Earnings per share

Earnings per ordinary share are calculated by dividing the Group profit attributable to shareholders of £287.0m (2000: £336.3m) by the weighted average number of ordinary shares in issue and ranking for dividend of 503.6m (2000: 526.4m) during the year.

The underlying earnings per share is provided to disclose the trend in earnings excluding the distorting effect of non-recurring items. This is based on the same number of shares and for 2000 the profit after excluding the exceptional tax credit in respect of conversion costs as follows:

	2001 £m	2000 £m
Profit for the financial year as reported	**287.0**	336.3
Adjusted for:		
Exceptional tax credit in respect of conversion costs	**-**	(15.2)
Underlying profit for the year	**287.0**	321.1

The diluted earnings per share is based on the total dilutive potential shares and the Group profit attributable to shareholders. The total dilutive potential shares are the ordinary shares together with all dilutive financial instruments or rights that may entitle the holder to ordinary shares.

	2001 Number m	2000 Number m
Weighted average number of ordinary shares in issue	**503.6**	526.4
Weighted average dilutive options outstanding	**3.7**	1.6
	507.3	528.0

13 Treasury bills and other eligible bills

	Group 2001 £m	Group 2000 £m	Company 2001 £m	Company 2000 (restated) £m
Investment securities				
Treasury bills and similar securities	**91.5**	6.1	**91.5**	6.1
Other eligible bills	**188.1**	212.4	**188.1**	212.4
Total	**279.6**	218.5	**279.6**	218.5
Market value of investment securities	**279.6**	218.5	**279.6**	218.5
Unamortised discounts on investment securities	**(1.3)**	1.6	**(1.3)**	1.6

13 Treasury bills and other eligible bills *continued*

The movement on Treasury bills and similar securities held for investment purposes was as follows:

	Group 2001	Group 2000	Company 2001	Company 2000 (restated)
	£m	£m	£m	£m
At 1 January 2001	**218.5**	279.5	**218.5**	279.5
Exchange adjustments	**(0.1)**	–	**(0.1)**	–
Additions	**1,517.2**	1,238.9	**1,517.2**	1,238.9
Disposals	**(1,456.7)**	(1,301.5)	**(1,456.7)**	(1,301.5)
Amortisation of discounts and premiums	**0.7**	1.6	**0.7**	1.6
At 31 December 2001	**279.6**	218.5	**279.6**	218.5

14 Loans and advances to banks

	Group 2001	Group 2000	Company 2001	Company 2000 (restated)
	£m	£m	£m	£m
Amounts due from subsidiary undertakings	**–**	–	**313.7**	37.0
Sale and repurchase agreements	**250.0**	72.7	**250.0**	72.7
Other loans and advances	**1,469.8**	1,275.0	**1,404.2**	1,254.6
Total	**1,719.8**	1,347.7	**1,967.9**	1,364.3
Repayable on demand	**66.2**	27.8	**81.4**	36.3
Remaining maturity:				
3 months or less	**1,550.2**	1,250.9	**1,699.2**	1,267.1
1 year or less but over 3 months	**33.1**	66.0	**27.1**	60.9
5 years or less but over 1 year	**34.8**	3.0	**–**	–
Over 5 years	**35.6**	–	**160.3**	–
Less: provisions	**(0.1)**	–	**(0.1)**	–
Total	**1,719.8**	1,347.7	**1,967.9**	1,364.3

15 Loans and advances to customers

	Group 2001	Group 2000	Company 2001	Company 2000 (restated)
	£m	£m	£m	£m
Advances secured on residential properties	**21,746.9**	19,120.0	**21,721.5**	19,086.3
Other secured advances	**696.7**	345.6	**98.6**	108.1
Unsecured loans	**3,456.4**	3,168.8	**4,896.3**	4,232.4
Net investment in finance leases and hire purchase contracts	**1,512.8**	1,388.0	**-**	-
Amounts due from subsidiary undertakings	**-**	-	**24.1**	27.7
Total	**27,412.8**	24,022.4	**26,740.5**	23,454.5
Repayable on demand	**173.8**	118.7	**2,191.7**	2,015.6
Remaining maturity:				
3 months or less	**1,551.7**	1,310.7	**2,642.3**	2,178.1
1 year or less but over 3 months	**1,038.7**	834.3	**178.3**	156.4
5 years or less but over 1 year	**1,992.4**	2,118.7	**286.8**	410.1
Over 5 years	**22,813.1**	19,781.9	**21,509.8**	18,772.5
Less: provisions	**(156.9)**	(141.9)	**(68.4)**	(78.2)
Total	**27,412.8**	24,022.4	**26,740.5**	23,454.5

Net investment in finance leases and hire purchase contracts arise from loans and advances to customers by Sovereign Finance plc, a subsidiary undertaking.

The cost of equipment acquired during the year for the purpose of finance lease and hire purchase agreements was £519.3m (2000: £613.6m).

The aggregate amounts receivable, including capital repayments, under finance and hire purchase agreements were £366.8m (2000: £351.2m).

16 Securitisation

On 1 November 2000, the Company sold residential mortgage assets of £250.0m to Fosse Securities No.1 plc ('Fosse'). Fosse issued Mortgage Backed Floating Rate Notes to finance the purchase of the portfolio of loans. These notes are serviceable only from cash flows generated by the mortgage assets together with £3.8m of subordinated finance from the Company. In addition, the Company has a subordinated loan of £1.1m at 31 December 2001 to finance certain issue related expenses.

The Group is not obliged to support any losses in respect of these mortgages other than to the extent of its subordinated loans, nor does it intend to do so. This is clearly stated in the agreements with bondholders. The net exposure of the Group has been reclassified as part of the linked presentation. In the prior year this was included within other assets and the comparative balances have been restated accordingly on the Consolidated Balance Sheet on page 41.

The Company has an option to sell further mortgage loans to Fosse where at the end of any interest period the actual rate of repayment of principal ('ARR') exceeds 20% per annum, so long as the sale price of such loans does not exceed the principal repayments received in the interest period and the ARR after the sale is not less than 20% per annum.

The controlling interest of Fosse is held by a discretionary trust established for charitable purposes. The Group receives administration fees for servicing Fosse's mortgage portfolio together with its residual income arising after the claims of the bondholders and other creditors are met. Fosse is consolidated and included in the Group financial statements as a quasi-subsidiary.

The summary results of Fosse are as follows:

	2001	2000
	£m	£m
Interest receivable	**13.7**	2.9
Interest payable	**(12.7)**	(2.8)
Net interest receivable	**1.0**	0.1
Administrative and other expenses	**(1.0)**	(0.1)
Profit for the financial period	**-**	-

At 31 December 2001, the balances of assets securitised were £204.5m (2000: £254.0m) and subordinated loans from the Group totalled £4.9m (2000: £5.3m). Amounts due on Mortgage Backed Floating Rate Notes were £199.6m (2000: £248.7m).

17 Provisions for bad and doubtful debts

	Advances secured on residential property £m	Advances secured on land £m	Unsecured loans and Leasing £m	Total £m
Group				
At 1 January 2001				
General	7.4	4.3	22.9	34.6
Specific	21.3	5.6	80.4	107.3
Total	28.7	9.9	103.3	141.9
Charge for the year:				
Increase/(decrease) in provision	(3.1)	(3.6)	77.1	70.4
Recoveries of amounts previously written off	(1.6)	(0.6)	(4.8)	(7.0)
	(4.7)	(4.2)	72.3	63.4
Amounts written off in year	(2.9)	2.4	(46.1)	(46.6)
At 31 December 2001				
General	7.1	4.7	22.4	34.2
Specific	14.0	3.4	107.1	124.5
Total	21.1	8.1	129.5	158.7
Company				
At 1 January 2001				
General	16.0	3.0	9.0	28.0
Specific	30.3	5.1	14.8	50.2
Total	46.3	8.1	23.8	78.2
Charge for the year:				
Increase/(decrease) in provision	(8.6)	(4.6)	25.7	12.5
Recoveries of amounts previously written off	(1.6)	(0.6)	(0.2)	(2.4)
	(10.2)	(5.2)	25.5	10.1
Amounts written off in year	(2.9)	2.4	(18.6)	(19.1)
At 31 December 2001				
General	14.7	2.7	8.6	26.0
Specific	18.5	2.6	22.1	43.2
Total	33.2	5.3	30.7	69.2

The total of non-performing loans, being those on which interest is no longer being credited to the profit and loss account, is as follows:

	Group 2001 £m	Company 2001 £m
Non-performing loans before provisions	**4.5**	**3.5**
Non-performing loans after provisions	**2.3**	**1.5**

18 Debt securities

	Group 2001 Book value £m	Group 2001 Market value £m	Group 2000 Book value £m	Group 2000 Market value £m	Company 2001 Book value £m	Company 2001 Market value £m	Company 2000 Book value (restated) £m	Company 2000 Market value (restated) £m
Investment securities								
Issued by public bodies:								
Government securities	**55.8**	**56.0**	210.4	210.9	**–**	**–**	162.1	162.1
Other public sector securities	**3.7**	**3.9**	76.1	75.8	**3.0**	**3.2**	12.5	12.9
	59.5	**59.9**	286.5	286.7	**3.0**	**3.2**	174.6	175.0
Issued by other issuers:								
Bank and building society certificates of deposit	**1,150.9**	**1,150.8**	1,880.2	1,882.6	**1,063.8**	**1,063.7**	1,856.1	1,858.5
Other debt securities	**6,670.9**	**6,667.5**	4,743.9	4,739.8	**6,123.2**	**6,122.3**	4,207.6	4,208.3
	7,821.8	**7,818.3**	6,624.1	6,622.4	**7,187.0**	**7,186.0**	6,063.7	6,066.8
Total investment securities	**7,881.3**	**7,878.2**	6,910.6	6,909.1	**7,190.0**	**7,189.2**	6,238.3	6,241.8
Other debt securities	**329.2**	**329.2**	52.7	52.7	**329.2**	**329.2**	52.7	52.7
Total debt securities	**8,210.5**	**8,207.4**	6,963.3	6,961.8	**7,519.2**	**7,518.4**	6,291.0	6,294.5
Analysed by listing status:								
Debt securities								
Listed in the UK	**2,975.1**	**2,973.3**	2,440.5	2,441.5	**2,883.8**	**2,881.8**	2,286.8	2,287.9
Listed or registered elsewhere	**3,527.3**	**3,527.6**	2,313.2	2,312.5	**3,306.1**	**3,307.3**	2,104.5	2,104.6
Unlisted	**1,708.1**	**1,706.5**	2,209.6	2,207.8	**1,329.3**	**1,329.3**	1,899.7	1,902.0
Total	**8,210.5**	**8,207.4**	6,963.3	6,961.8	**7,519.2**	**7,518.4**	6,291.0	6,294.5

	Group 2001 £m	Group 2000 £m	Company 2001 £m	Company 2000 (restated) £m
Book value				
Analysed by maturity:				
Due within one year	**1,734.1**	2,416.3	**1,578.7**	2,263.1
Due one year and over	**6,476.4**	4,547.0	**5,940.5**	4,027.9
Total	**8,210.5**	6,963.3	**7,519.2**	6,291.0
Unamortised premiums and indexation on investment securities	**(3.4)**	19.0	**(13.3)**	(6.1)

The movement on debt securities held for investment purposes was as follows:	Cost £m	Discounts, premiums and indexation £m	Provisions £m	Net book value £m
Group				
At 1 January 2001	6,891.6	19.0	–	6,910.6
Exchange adjustments	27.9	–	–	27.9
Acquisitions	7,137.7	(9.4)	–	7,128.3
Disposals	(6,171.8)	(36.8)	–	(6,208.6)
Provisions made	–	–	(0.9)	(0.9)
Amounts written off	(0.2)	–	0.2	–
Amortisation of discounts, premiums and indexation	0.2	23.8	–	24.0
At 31 December 2001	7,885.4	(3.4)	(0.7)	7,881.3
Company				
At 1 January 2001 (restated)	6,244.4	(6.1)	–	6,238.3
Exchange adjustments	27.9	–	–	27.9
Acquisitions	6,842.5	(9.4)	–	6,833.1
Disposals	(5,910.6)	(2.8)	–	(5,913.4)
Provisions made	–	–	(0.9)	(0.9)
Amounts written off	(0.2)	–	0.2	–
Amortisation of premiums	–	5.0	–	5.0
At 31 December 2001	7,204.0	(13.3)	(0.7)	7,190.0

19 Shares in group undertakings

	Company Shares £m
At 1 January 2001 (restated)	582.9
Additions	167.5
Repayments	–
At 31 December 2001	750.4
Credit institutions	75.6
Other	674.8
Total	750.4

The principal subsidiary undertakings of Alliance & Leicester plc at 31 December 2001 are listed below. These subsidiary undertakings, which all have 31 December year-ends, are incorporated and all operate in the United Kingdom except Alliance & Leicester International Limited, which is incorporated and operates in the Isle of Man and Alliance & Leicester Mortgage Insurance (Guernsey) Limited which is incorporated in and operates in Guernsey.

Directly held subsidiaries	Nature of business
Girobank plc	Banking
Alliance & Leicester Personal Finance Limited	Unsecured lending
Alliance & Leicester Mortgage Insurance (Guernsey) Limited	Insurance
Alliance & Leicester Life Assurance Company Limited	Ordinary long-term insurance cover
Alliance & Leicester General Insurance Company Limited	General insurance
Alliance & Leicester Investments Limited	Making and holding of investments

Indirectly held subsidiaries	Nature of business
Girobank Investments Ltd	Holding investment securities
Sovereign Finance plc	Asset leasing
Alliance & Leicester International Limited	Offshore deposit taking

All subsidiary undertakings are limited by shares and are unlisted.

The Company holds 100% interest in the ordinary share capital of all its subsidiary undertakings.

The results of all subsidiary undertakings have been included in the consolidated accounts.

20 Intangible fixed assets

Goodwill	Positive Goodwill £m	Negative Goodwill £m	Group £m
Cost			
At 1 January 2001	4.6	–	4.6
Additions	0.1	(1.7)	(1.6)
At 31 December 2001	4.7	(1.7)	3.0
Amortisation			
At 1 January 2001	0.3	–	0.3
Charge in year	0.5	(0.6)	(0.1)
At 31 December 2001	0.8	(0.6)	0.2

20 Intangible fixed assets *continued*

	Positive Goodwill £m	Negative Goodwill £m	Group £m
Net book value			
At 31 December 2001	3.9	(1.1)	2.8
At 31 December 2000	4.3	–	4.3

Negative goodwill is amortised over a period of 3 years.

21 Tangible fixed assets

	Freehold land and buildings £m	Leasehold 50 or more years unexpired £m	Leasehold Under 50 years unexpired £m	Equipment fixtures and vehicles £m	Assets in course of construction £m	Total £m
Group						
Cost						
At 1 January 2001 (restated)	287.8	11.1	53.9	683.9	27.3	1,064.0
Additions	4.5	0.1	3.6	186.7	24.8	219.7
Disposals	(6.5)	–	(5.9)	(128.2)	–	(140.6)
Transfers	1.9	–	–	28.0	(29.9)	–
At 31 December 2001	287.7	11.2	51.6	770.4	22.2	1,143.1
Depreciation and amortisation						
At 1 January 2001	108.1	4.5	40.2	326.5	–	479.3
Charge in year	7.0	0.2	3.0	76.4	–	86.6
Disposals	(3.5)	–	(5.0)	(56.6)	–	(65.1)
At 31 December 2001	111.6	4.7	38.2	346.3	–	500.8
Net book value						
At 31 December 2001	176.1	6.5	13.4	424.1	22.2	642.3
At 31 December 2000 (restated)	179.7	6.6	13.7	357.4	27.3	584.7

Assets in the course of construction have been presented within tangible fixed assets. The prior period amounts for both Group and Company were included within other assets and the comparatives have been restated accordingly.

Freehold land and buildings includes land of £11.4m which is not depreciated. The net book value of land and buildings occupied by the Group for its own activities was £176.2m (2000: £185.8m).

The cost of assets leased to customers under operating leases and included in equipment, fixtures and vehicles above was £419.5m (2000: £372.7m). The related cumulative depreciation of £79.2m (2000: £85.1m) includes £48.0m (2000: £39.8m) charged during the year.

The aggregate rentals receivable in respect of operating leases were £71.2m (2000: £68.5m).

The cost of freehold land and buildings held under finance leases was £100.4m (2000: £nil). The related cumulative depreciation of £27.2m (2000: £nil) includes £0.4m charged during the year (2000: £nil).

The cost of leaseholds over 50 years held under finance leases was £1.8m (2000: £nil). The related cumulative depreciation of £0.8m (2000: £nil) includes £nil charged during the year (2000: £nil).

The cost of equipment, fixtures and vehicles held under finance leases was £20.1m (2000: £13.8m). The related cumulative depreciation of £3.4m (2000: £1.1m) includes £2.2m charged during the year (2000: £1.1m).

21 Tangible fixed assets *continued*

	Freehold land and buildings £m	Leasehold 50 or more years unexpired £m	Leasehold Under 50 years unexpired £m	Equipment fixtures and vehicles £m	Assets in course of construction £m	Total £m
Company						
Cost						
At 1 January 2001 (restated)	235.5	6.5	47.1	216.0	16.1	521.2
Additions	3.2	0.1	3.0	15.0	19.8	41.1
Disposals	(112.0)	(1.8)	(1.7)	(2.1)	–	(117.6)
Transfers	1.3	–	–	14.8	(16.1)	–
At 31 December 2001	128.0	4.8	48.4	243.7	19.8	444.7
Depreciation and amortisation						
At 1 January 2001	78.5	3.8	34.6	151.1	–	268.0
Charge in year	4.8	0.2	2.4	23.1	–	30.5
Disposals	(27.7)	(0.8)	(1.6)	(1.5)	–	(31.6)
At 31 December 2001	55.6	3.2	35.4	172.7	–	266.9
Net book value						
At 31 December 2001	72.4	1.6	13.0	71.0	19.8	177.8
At 31 December 2000 (restated)	157.0	2.7	12.5	64.9	16.1	253.2

Freehold land and buildings includes land of £11.4m which is not depreciated. The net book value of land and buildings occupied by the Company for its own activities was £76.5m (2000: £156.5m).

The cost of equipment, fixtures and vehicles held under finance leases was £19.6m (2000: £13.8m). The related cumulative depreciation of £3.2m (2000: £1.3m) includes £1.9m charged during the year (2000: £1.1m).

	Group 2001 £m	Group 2000 £m	Company 2001 £m	Company 2000 £m
Future capital expenditure:				
Contracted for but not provided in the accounts	–	2.7	–	–

22 Other assets

	Group 2001 £m	Group 2000 (restated) £m	Company 2001 £m	Company 2000 (restated) £m
Trade debtors	**191.0**	410.4	**–**	–
Due from subsidiary undertakings	**–**	–	**82.5**	281.9
Other	**28.2**	33.7	**21.9**	15.9
Total	**219.2**	444.1	**104.4**	297.8
Due within one year	**220.2**	438.8	**80.0**	273.6
Due after more than one year	**–**	5.3	**24.4**	24.2
Provisions	**(1.0)**	–	**–**	–
Total	**219.2**	444.1	**104.4**	297.8

23 Prepayments and accrued income

	Group		Company	
	2001	2000	2001	2000 (restated)
	£m	£m	£m	£m
Accrued interest	**187.7**	330.9	**230.9**	364.9
Prepayments and other accruals	**93.3**	65.9	**65.5**	30.0
Total	**281.0**	396.8	**296.4**	394.9

24 Long-term assurance business

The value of long-term assurance business attributable to shareholders included in the consolidated balance sheet comprises:

	2001 £m	2000 £m
Group		
Net tangible assets of life company including surplus retained within the long-term assurance funds	**50.7**	43.0
Value of policies in force	**32.1**	32.1
Long-term assurance business attributable to shareholders	**82.8**	75.1
The long-term assurance assets attributable to policyholders are:		
Investments	**323.5**	383.8
Value of policies in force	**32.1**	32.1
Net current liabilities	**(42.5)**	(0.1)
	313.1	415.8
Less: Long-term assurance business attributable to shareholders	**(82.8)**	(75.1)
Long-term assurance business attributable to policyholders	**230.3**	340.7

The increase in value of the Group's long-term assurance business included in the profit and loss account amounted to £10.9m before tax (2000: £14.8m) and £7.7m after tax (2000: £10.3m).

Included in net current liabilities were £39.8m of uncashed cheques issued to policyholders on 31 December 2001 on the maturity of a life assurance bond.

The value placed on long-term assurance business is calculated by discounting estimated future flows of statutory profits from in-force business at a discount rate that includes a risk margin. The future flows are based on prudent assumptions about long-term economic and business experience determined with the advice of a qualified actuary. The risk margin is designed to reflect uncertainties in expected future flows.

The key assumptions used are:

	2001	2000
Risk discount rate (net of tax)	**8.5%**	10.0%
Economic assumptions		
Growth of unit-linked funds (pa gross of tax)	**7.0%**	7.5%
Growth of non-linked funds (pa gross of tax)	**5.0%**	6.0%
Policyholder taxation – life	**22%**	20%
Shareholder taxation – life	**30%**	30%
Expense inflation (pa)	**4.5%**	4.5%

25 Deposits by banks

	Group 2001 £m	Group 2000 £m	Company 2001 £m	Company 2000 (restated) £m
Amounts due to subsidiary undertakings	**–**	–	**2,524.5**	2,277.6
Other deposits	**1,991.2**	1,402.2	**1,981.1**	1,396.1
Total	**1,991.2**	1,402.2	**4,505.6**	3,673.7
Repayable on demand	**58.8**	6.3	**194.1**	418.1
Remaining maturity:				
3 months or less	**1,522.4**	765.8	**3,902.4**	2,627.6
1 year or less but over 3 months	**397.7**	628.1	**397.1**	627.0
5 years or less but over 1 year	**12.3**	2.0	**12.0**	1.0
Total	**1,991.2**	1,402.2	**4,505.6**	3,673.7

26 Customer accounts

	Group 2001 £m	Group 2000 £m	Company 2001 £m	Company 2000 (restated) £m
Repayable on demand	**17,352.9**	16,436.6	**14,278.1**	13,767.9
With agreed maturity dates or periods of notice – remaining maturity:				
3 months or less but not repayable on demand	**3,596.2**	3,254.9	**3,591.2**	3,201.7
1 year or less but over 3 months	**911.4**	1,260.7	**906.4**	1,078.1
5 years or less but over 1 year	**196.2**	371.8	**188.6**	359.7
Over 5 years	**43.1**	–	**43.1**	–
Total	**22,099.8**	21,324.0	**19,007.4**	18,407.4

27 Debt securities in issue

	Group 2001	Group 2000	Company 2001	Company 2000 (restated)
	£m	£m	£m	£m
Bonds and medium-term notes – remaining maturity:				
1 year or less or on demand	**1,071.9**	233.0	**1,071.9**	233.0
2 years or less but over 1 year	**911.9**	1,071.3	**911.9**	1,071.3
5 years or less but over 2 years	**2,245.6**	1,741.8	**2,203.6**	1,741.8
Over 5 years	**130.2**	60.4	**130.2**	60.4
	4,359.6	3,106.5	**4,317.6**	3,106.5
Other debt securities in issue – remaining maturity:				
3 months or less or on demand	**5,121.7**	3,436.7	**5,121.7**	3,436.7
1 year or less but over 3 months	**1,396.1**	1,224.2	**1,396.1**	1,224.2
2 years or less but over 1 year	**150.5**	74.0	**150.5**	74.0
5 years or less but over 2 years	**26.0**	11.5	**26.0**	11.5
	6,694.3	4,746.4	**6,694.3**	4,746.4
Total	**11,053.9**	7,852.9	**11,011.9**	7,852.9

Amounts due in more than 5 years mainly consist of £55m floating rate notes due 2009, with an interest rate of LIBOR plus 0.15%, and £75m fixed rate notes due 2015, with an interest rate of 6.50%.

28 Other liabilities

	Group 2001	Group 2000	Company 2001	Company 2000 (restated)
	£m	£m	£m	£m
Falling due within one year:				
Trade creditors	**29.3**	20.2	**7.2**	6.4
Corporation taxation	**66.6**	65.6	**37.5**	42.5
Other taxation	**40.2**	54.8	**39.6**	53.2
Dividends payable	**137.3**	126.6	**137.3**	126.6
Finance leases	**5.8**	7.6	**2.9**	2.2
Other liabilities	**191.5**	144.7	**343.3**	128.5
	470.7	419.5	**567.8**	359.4
Falling due after more than one year:				
Finance leases	**77.7**	13.3	**13.6**	10.7
Total	**548.4**	432.8	**581.4**	370.1
Amounts include:				
Due to subsidiary undertakings	**–**	–	**252.4**	24.3
The maturity of net obligations under finance leases is as follows:				
1 year or less	**5.8**	7.6	**2.9**	2.2
5 years or less but over 1 year	**22.7**	11.2	**11.6**	8.6
Over 5 years	**55.0**	2.1	**2.0**	2.1
Total	**83.5**	20.9	**16.5**	12.9

29 Accruals and deferred income

	Group 2001 £m	Group 2000 £m	Company 2001 £m	Company 2000 (restated) £m
Interest accrued on subordinated liabilities	**10.8**	7.8	**10.8**	7.8
Other accrued interest	**439.4**	585.4	**417.3**	555.5
Captive mortgage indemnity fund	**25.4**	36.1	**–**	–
Other	**296.0**	263.1	**242.3**	225.7
Total	**771.6**	892.4	**670.4**	789.0

30 Provisions for liabilities and charges

	Group 2001 £m	Group 2000 £m	Company 2001 £m	Company 2000 £m
Deferred taxation (note 31)	**156.9**	120.2	**–**	–
Other provisions for liabilities and charges (note 32)	**18.6**	17.2	**18.6**	17.2
Total	**175.5**	137.4	**18.6**	17.2

31 Deferred taxation

The amounts provided for deferred taxation are set out below:

	Group 2001 £m	Group 2000 £m	Company 2001 £m	Company 2000 £m
Difference between accumulated depreciation and capital allowances	**172.6**	135.1	**1.4**	1.4
Other timing differences	**(15.7)**	(14.9)	**(20.8)**	(20.3)
Total	**156.9**	120.2	**(19.4)**	(18.9)
Full potential deferred liability/(asset):				
Difference between accumulated depreciation and capital allowances	**179.5**	140.2	**7.3**	9.6
Other timing differences	**(16.7)**	(17.0)	**(19.8)**	(20.3)
Total	**162.8**	123.2	**(12.5)**	(10.7)

Where there is a liability in respect of deferred taxation it is included in 'provisions for liabilities and charges'; where there is an asset it is included in 'other assets'.

	Group £m	Company £m
Deferred taxation liability/(asset):		
At 1 January 2001	**120.2**	**(18.9)**
Amount charged during year	**40.8**	**(0.5)**
Deferred tax on acquisitions and disposals in the year	**(4.1)**	**-**
At 31 December 2001	**156.9**	**(19.4)**

32 Other provisions for liabilities and charges

	Post retirement medical benefits £m
Group and Company	
At 1 January 2001	17.2
Transfer from profit and loss account	2.0
Provisions utilised	(0.6)
At 31 December 2001	18.6

33 Subordinated liabilities

	Group 2001 £m	Group 2000 £m	Company 2001 £m	Company 2000 £m
Dated loan capital	**613.7**	463.7	**613.7**	463.7
Total subordinated liabilities	**613.7**	463.7	**613.7**	463.7
Less: Unamortised issue costs	**(4.2)**	(1.9)	**(4.2)**	(1.9)
Total	**609.5**	461.8	**609.5**	461.8
Maturing by 2006	**200.0**	200.0	**200.0**	200.0
Maturing by 2008	**75.0**	75.0	**75.0**	75.0
Maturing by 2010	**188.7**	188.7	**188.7**	188.7
Maturing by 2031	**150.0**	–	**150.0**	–
Total	**613.7**	463.7	**613.7**	463.7

The interest rate liabilities of 8.75% on the £200 million Notes due 2006, 9.75% on the £75 million Notes due 2008 and of 5.875% on the £150 million Notes due 2031 have each been swapped into floating rate, with rates of up to 1.25% above 6-month sterling LIBOR. The Notes due 2010 have been swapped, on an unsubordinated basis, into UK Sterling. The subordinated debt was raised in order to widen the capital base of the Company.

The following subordinated loans each exceed 10% of total subordinated liabilities. The Subordinated Notes due 2006, 2008 and 2031 are denominated in UK Sterling. The Subordinated Notes due 2010 are denominated in US Dollars.

	Terms	Group and Company £m
Subordinated Notes due 2006	Fixed interest rate of 8.75%	200.0
Subordinated Notes due 2008	Fixed interest rate of 9.75%	75.0
Subordinated Notes due 2010	Floating rate	188.7
Subordinated Notes due 2031	Fixed interest rate of 5.875%	150.0

The Notes are subordinated to the claims of depositors and all other creditors. During the year £150m Subordinated Notes due 2031 were issued to support the capital management of the Group.

All the Notes may be redeemed at the option of the Group, at the outstanding principal amount plus accrued interest, in the event of certain changes in UK taxation. The Group may also purchase the Notes in the open market. The 2008 Notes can be redeemed at the option of the Group, at the higher of their principal amount and the price at which the gross redemption yield on the Notes is equal to the gross redemption yield on 9% Treasury Stock 2008. The 2010 Notes can be redeemed at the option of the Group at the outstanding principal amount plus accrued interest not before March 2005. For all the Notes, no such purchase or redemption may be made without the consent of the Financial Services Authority.

34 Called up share capital

	2001 Number m	2001 Amount £m	2000 Number m	2000 Amount £m
Authorised share capital:				
Ordinary shares of 50p each	**776.0**	**388.0**	776.0	388.0
Issued, allotted and fully paid	**505.0**	**252.5**	504.4	252.2

During the year 562,751 new shares were issued between 510p and 785p under the Alliance & Leicester Executive Share Option Plan.

At 31 December 2001, there were 7,212,781 options outstanding under the Alliance & Leicester ShareSave Scheme and 3,951,781 options outstanding under the Alliance & Leicester Executive Share Option Plan. The options enable members of staff and executive directors to subscribe for ordinary shares of 50p between 2001 and 2011, at prices ranging from 364.4p to 900.5p. There are also 483,082 options outstanding under the Alliance & Leicester Deferred Share Bonus Scheme. The Group has taken advantage of the exemption from UITF 17 permitted for ShareSave Schemes.

Substantial share interests

In accordance with sections 198 to 208 of the Companies Act 1985, the following shareholders disclosed a major interest in the share capital of the Company as at 11 February 2002.

	%
Alliance & Leicester ShareSafe Limited	13.03
M&G Investment Management Limited	4.30
AXA Investment Managers UK Limited	3.03

35 Reserves

	Group 2001 £m	Group 2000 £m	Company 2001 £m	Company 2000 (restated) £m
Profit and loss account				
At 1 January 2001	**1,342.4**	1,431.8	**1,025.3**	1,060.4
Retained profit for the year	**104.5**	170.8	**134.7**	225.1
Repurchase of share capital	**–**	(260.2)	**–**	(260.2)
At 31 December 2001	**1,446.9**	1,342.4	**1,160.0**	1,025.3
Share premium account				
At 1 January 2001	**21.9**	19.9	**21.9**	19.9
Share premium on issue of shares under option	**3.2**	2.0	**3.2**	2.0
At 31 December 2001	**25.1**	21.9	**25.1**	21.9
Capital redemption reserve				
At 1 January 2001	**40.1**	17.4	**40.1**	17.4
Repurchase of share capital	**–**	22.7	**–**	22.7
At 31 December 2001	**40.1**	40.1	**40.1**	40.1

The cumulative amount of goodwill resulting from acquisitions in earlier financial years, after deducting goodwill relating to disposals made prior to the balance sheet date, which has been written off to Group profit and loss account reserves is £42.2m (2000: £42.2m).

36 Assets and liabilities in foreign currencies

	Group		Company	
	2001	2000	2001	2000 (restated)
	£m	£m	£m	£m
Assets denominated in sterling	**33,734.5**	31,755.5	**32,060.0**	29,925.2
Assets denominated in other currencies	**5,742.1**	2,960.3	**5,822.5**	2,986.4
Total assets	**39,476.6**	34,715.8	**37,882.5**	32,911.6
Liabilities denominated in sterling	**33,590.4**	31,414.3	**31,915.2**	29,610.2
Liabilities denominated in other currencies	**5,886.2**	3,301.5	**5,967.3**	3,301.4
Total liabilities	**39,476.6**	34,715.8	**37,882.5**	32,911.6

The above assets and liabilities denominated in currencies other than sterling do not indicate the Group's exposure to foreign exchange risk. The Group has hedged all material foreign currency exposures by using off balance sheet hedging instruments so that there are no material unmatched exposures at the balance sheet date. All of the subsidiaries owned by Alliance & Leicester plc use sterling as their functional currency. Therefore, the Group is not subject to any structural currency exposures.

37 Pensions

(a) SSAP 24 Disclosures	2001 £m	2000 £m
Regular cost	**18.3**	15.2
Variations from regular cost(i)	**(1.9)**	(2.2)
Notional interest on prepayment	**(1.6)**	(1.6)
Total	**14.8**	11.4

(i) Variations from regular cost arise from the scheme surplus being spread on a basis increasing in line with pensionable payroll over the average expected future working life of the membership (16 years).

The Alliance & Leicester Pension Scheme (the Scheme) comprises funded defined benefit sections which became closed to new entrants on 31 March 1998. New employees on or after 1 April 1998 were eligible to join a defined contribution section of the Scheme.

The principal scheme is an exempt approved pension scheme under which retirement and death benefits are provided for Group employees. The funds of the scheme are administered by trustees independently of the finances of the participating employers.

In addition benefits are provided by the Company on an unfunded unapproved basis to a number of senior staff recruited since June 1989 whose benefits would otherwise be restricted by the Finance Act 1989 earnings cap.

The pension costs are assessed in accordance with the advice of independent qualified actuaries using the projected unit method. The latest actuarial valuation was made as at 31 March 2000. The significant assumptions in these valuations were that salaries increase on average by 1.75% p.a. above inflation, long-term return on investments is 6.5% p.a. in the period before members reach retirement and 5% p.a. in the post-retirement period, and that pensions increase at 2.5% p.a. Assets were valued at their market value as at 31 March 2000.

At 31 March 2000 the market value of the assets of the Scheme was £784.4m and this was sufficient to cover 108% of the liabilities for benefits due to members in respect of service prior to that date. Contributions to the Scheme in 2001 amounted to £11.8m.

The excess of £3.0m of the pension charge over the contributions has reduced the prepayment of £24.8m at the start of the year. An asset of £21.8m representing total net accumulated prepaid contributions is included in the Group balance sheet as at 31 December 2001.

Post-retirement benefits
The Group provides post-retirement medical benefits to certain pensioners and active employees. The liability has been assessed by a qualified actuary as at 31 December 2001, using the projected unit method. The principal actuarial assumptions used in the valuation were a discount rate of 6.5% and medical benefit cost inflation of 8% for 3 years gradually reducing to 4.25% over 5 years and remaining at 4.25% thereafter.

The charge in the year for post-retirement medical benefits in the Group accounts is £1.4m (2000: £1.3m).

37 Pensions *continued*

(b) FRS 17 Retirement Benefits: Group accounts

(i) Defined benefit section

The following disclosures are provided under the transitional arrangements for FRS 17 which requires certain disclosures only for periods ending subsequent to 22 June 2001. The amounts disclosed under these transitional arrangements, which apply to both the funded and unfunded schemes, are not included in the Group's financial statements. If FRS 17 were to be fully adopted, the balance sheet impact would be as set out below.

The valuation used for FRS 17 disclosures has been based on the most recent actuarial valuation at 31 March 2000 and updated to take account of the requirements of FRS 17 in order to assess the liabilities of the scheme at 31 December 2001. Scheme assets are stated at their market value at 31 December 2001.

The financial assumptions used to calculate scheme liabilities under FRS 17 are:

Valuation method	Projected unit
Inflation assumption	2.5%
Salaries rate of increase	4.25% p.a.
Pensions rate of increase	2.5% p.a.
Discount rate for scheme liabilities	5.9%

The assets in the scheme and the expected rate of return were:

	Long-term rate of return expected at 31 December 2001	**Value at 31 December 2001 £m**
Equities	7.0%	527.2
Bonds	5.0%	179.5
Net current assets	–	3.1
Total market value of assets		709.8
Present value of scheme liabilities		(768.9)
Deficit in scheme		(59.1)
Post-retirement medical benefits liability (see below)		(20.2)
Total retirement benefits liability		(79.3)
Related deferred tax asset		23.8
Net retirement benefits liability		(55.5)

Post-retirement benefits

There is a provision of £18.6m in the Group accounts at 31 December 2001 for post-retirement medical benefits (see note 32), which is based on SSAP 24 and assumes a discount rate of 6.5%. Under FRS 17, a discount rate of 6% would be used, increasing the provision to £20.2m. Other assumptions would be unchanged.

	2001 Group £m
Net assets	
Net assets excluding pension liability	1,764.6
less SSAP 24 prepayment	(21.8)
related deferred tax liability	6.5
add back SSAP 24 post-retirement medical benefits provision	18.6
related deferred tax asset	(5.6)
	1,762.3
Pension liability	(59.1)
Provision for post-retirement medical benefits	(20.2)
Related deferred tax asset	23.8
Net assets as adjusted	1,706.8

37 Pensions *continued*

	2001 Group £m
Reserves	
Profit and loss reserve excluding pension liability	1,446.9
less SSAP 24 prepayment	(21.8)
related deferred tax liability	6.5
add back SSAP 24 post-retirement medical benefits provision	18.6
related deferred tax asset	(5.6)
	1,444.6
Pension liability	(59.1)
Provision for post-retirement medical benefits	(20.2)
Related deferred tax asset	23.8
Profit and loss reserve as adjusted	1,389.1

The scheme is closed to new members. Therefore, under the projected unit method the current service cost will increase as the members of the scheme approach retirement.

The Group made contributions of £9.3m during the year (9% of pensionable salary). It has been agreed with the trustees that the contribution rate for 2002 will be 9.25%, plus an additional £0.5m per month.

(ii) Defined contribution section
Employer contributions payable during the year were £2.5m. There were no unpaid contributions at 31 December 2001.

(c) Company accounts
It is not possible to identify the Company's share of the underlying assets and liabilities of the Group's defined benefit section of the scheme and accordingly the Company will account for the scheme as a defined contribution scheme in accordance with paragraph 9(b) of FRS 17.

The Company contributions payable during the year to the defined benefit section were £6.5m. There were no unpaid contributions at 31 December 2001.

The Company contributions payable during the year to the defined contribution section were £1.9m. There were no unpaid contributions at 31 December 2001.

38 Memorandum items

		Group		Company
	2001 £m	2000 £m	**2001 £m**	2000 £m
Contingent liabilities				
Guarantees and irrevocable letters of credit	**140.5**	99.1	**-**	-
Assets pledged as collateral security	**80.0**	-	**-**	-
	220.5	99.1	**-**	-
Commitments				
Irrevocable undrawn loan facilities	**911.7**	681.4	**76.5**	55.2

Litigation
Members of the Group are engaged in litigation, involving claims by and against them which arise in the ordinary course of business. The directors, after reviewing the claims pending and threatened against Group undertakings and taking into account the advice of the relevant legal advisers, are satisfied that the outcome of these claims will not have a material adverse effect on the net assets of the Group.

38 Memorandum items *continued*

Material Contracts
During the year, Post Office Limited ('POL') served notice to terminate its Cash Market contract with Girobank plc with effect from 18 June 2002. The contract covers POL's provision of cash centre and other services for Girobank plc's cash handling business. Negotiations with POL are continuing, aimed at agreeing revised arrangements for the future. In the meantime, after 18 June 2002 Girobank plc's existing cash handling business will continue to be subject to the terms of the Cash Market contract with POL.

On 18 February 2002, Alliance & Leicester Cash Solutions Limited ('ALCS'), a wholly-owned subsidiary of Alliance & Leicester plc, entered into a a ten year contract with Securicor Cash Centres Limited ('Securicor'). From April 2002, new cash handling customers requiring cash centre services will have these services provided by Securicor. ALCS will sell the services and manage these customer contracts.

39 Guarantees and other financial commitments

a) Alliance & Leicester International Limited, a subsidiary licensed under the Isle of Man Banking Acts 1975 to 1986, has a contingent liability to the Isle of Man Depositors Compensation Scheme.

b) The Company does guarantee or give commitments in respect of some of its subsidiary undertakings.

c) Operating lease commitments:

	Group		Company	
	2001	2000	**2001**	2000 (restated)
	£m	£m	**£m**	£m
At 31 December, annual commitments under operating leases are as follows:				
Land and buildings				
Leases which expire:				
Within 1 year	**0.4**	0.1	**0.4**	0.1
1-5 years	**2.7**	3.6	**2.3**	3.5
Over 5 years	**8.9**	8.2	**15.7**	7.7
Total	**12.0**	11.9	**18.4**	11.3

40 Derivatives and other financial instruments

The Group uses financial instruments, including derivatives, to manage its financial risks.

Financial instruments have the potential to reduce, modify or increase the liquidity, credit and market risks arising from normal business activities.

Details of the objectives and policies for managing the risks associated with the Group's use of financial instruments are presented in the Financial Review on pages 22 to 24. These disclosures form part of the audited financial statements.

i) Interest rate repricing analysis
The following table provides a summary of the interest rate repricing profile of the Group's assets and liabilities as at 31 December 2001. Assets and liabilities have been allocated to time bands by reference to the earlier of the next interest rate reset date and the contractual maturity date. The table takes account of derivative financial interests whose effect is to alter the interest basis of Group assets and liabilities.

The trading book and non-interest bearing balances have been included in a separate column; the interest rate risk of the trading book is analysed under ii) below.

Differences between the balance sheet and the totals below arise due to the exclusion of life insurance assets and liabilities from the interest rate repricing analysis.

40 Risk management *continued*

	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Non-interest bearing/ trading book £m	Total £m
Assets							
Treasury bills and other eligible bills	242	38	–	–	–	–	280
Loans and advances to banks	1,653	53	3	1	–	229	1,939
Loans and advances to customers	22,095	565	1,062	3,470	286	(60)	27,418
Debt securities	6,889	477	188	279	27	350	8,210
Other assets	145	20	34	180	28	910	1,317
Total assets	31,024	1,153	1,287	3,930	341	1,429	39,164
Liabilities							
Deposits by banks	1,576	95	302	12	–	6	1,991
Customer accounts	17,810	569	583	670	56	2,412	22,100
Debt securities in issue	8,541	1,258	551	629	75	–	11,054
Other liabilities	168	12	5	31	5	1,506	1,727
Subordinated liabilities	205	–	–	200	205	–	610
Shareholders' funds	–	–	–	–	–	1,682	1,682
Total liabilities	28,300	1,934	1,441	1,542	341	5,606	39,164
Off-balance sheet items	(2,635)	766	751	582	536	–	–
Interest rate sensitivity gap	89	(15)	597	2,970	536	(4,177)	–
Cumulative gap at 31 December 2001	89	74	671	3,641	4,177	–	–

The following table provides a restated summary of the interest rate repricing profile of the Group's assets and liabilities as at 31 December 2000:

	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Non-interest bearing/ trading book £m	Total £m
Assets							
Treasury bills and other eligible bills	212	6	–	–	–	–	218
Loans and advances to banks	1,245	37	1	2	–	185	1,470
Loans and advances to customers	19,066	371	683	3,842	187	(122)	24,027
Debt securities	5,526	576	560	221	20	61	6,964
Other assets	440	27	34	173	16	931	1,621
Total assets	26,489	1,017	1,278	4,238	223	1,055	34,300
Liabilities							
Deposits by banks	754	396	231	–	–	21	1,402
Customer accounts	17,156	469	722	813	–	2,164	21,324
Debt securities in issue	5,950	761	592	475	75	–	7,853
Other liabilities	40	1	2	2	–	1,633	1,678
Subordinated liabilities	188	–	–	–	274	–	462
Shareholders' funds	–	–	–	–	–	1,581	1,581
Total liabilities	24,088	1,627	1,547	1,290	349	5,399	34,300
Off-balance sheet items	(2,054)	716	1,059	116	163	–	–
Interest rate sensitivity gap	347	106	790	3,064	37	(4,344)	–
Cumulative gap at 31 December 2000	347	453	1,243	4,307	4,344	–	–

For the purposes of this analysis, loans and advances to banks includes cash and balances at central banks.

40 Risk management *continued*

ii) Trading book

The Group's trading activities are conducted through the Group's Treasury division. Material trading assets comprise debt securities for which the carrying value is equal to the fair value at 31 December 2001 and 2000. Dealing profits are disclosed in note 3.

The bank uses a variety of techniques to measure market risk in the trading book, including calculating the sensitivity of the market value of positions to hypothetical changes in interest rates. The following table sets out the change in the value of the trading book arising from a 1% change in market interest rates, for the year ended 31 December 2001, with all other variables remaining constant:

		Change in value
	£m	£m
	2001	2000*
Highest exposure	**1.0**	0.5
Lowest exposure	**0.0**	0.0
Average exposure	**0.4**	0.1
Exposure as at 31 December 2001	**0.4**	0.1

*From 31 October 2000 to 31 December 2000.

The sensitivity analysis technique used by the Group measures the change in the fair value of the Group's trading book arising from hypothetical changes in market rates. Actual results in the future could differ from these projected figures if fluctuations in interest rates exceeded the hypothetical 1% shift. The Group's trading book is not materially exposed to other market risks.

iii) Fair values

The table below compares the book and fair values of some of the Group's financial instruments by category at the balance sheet date. Where available, market prices have been used to determine fair values. Where market prices are not available, fair values have been calculated for options by using option-pricing models and for other financial instruments by discounting cash flows at prevailing interest and exchange rates. Minor changes in assumptions used could have a significant impact on the resulting estimated fair values, and, as a result, readers of these financial statements are advised to use caution when using this data to evaluate the Group's financial position.

The concept of fair value assumes realisation of financial instruments by way of sale. However, in many cases, the Group intends to realise assets through collection over time.

	Group 2001 Carrying value £m	Group 2001 Fair value £m	Group 2000 Carrying value £m	Group 2000 Fair value £m
Primary non-trading financial instruments:				
Assets				
Cash and balances at central banks	**219.1**	**219.1**	122.3	122.3
Treasury bills and other eligible bills	**279.6**	**279.6**	218.5	218.5
Debt securities	**7,881.3**	**7,878.2**	6,910.6	6,909.1
Liabilities				
Debt securities in issue	**(11,053.9)**	**(11,080.6)**	(7,852.9)	(7,880.6)
Subordinated liabilities	**(609.5)**	**(656.7)**	(461.8)	(504.5)
Off balance sheet and similar instruments	**47.2‡**	**161.7**	142.8‡	230.1

The table excludes certain financial assets and liabilities which are not listed or publicly traded, or for which a liquid and active market does not exist. Thus it excludes mortgages, leases, personal loans and retail savings accounts whose book and fair values differ.

‡These figures represent accrued interest at the year-end.

40 Risk management *continued*

The table below analyses the Group's derivatives portfolios by type of contract and maturity and shows the contract amount and the replacement cost. Contract amount indicates the volume of business outstanding at the balance sheet date and does not represent amounts at risk. The replacement cost represents the cost of replacing contracts, calculated at market rates current at the balance sheet date and reflects the Group's exposure should counterparties default. No account is taken of offsetting positions with the same counterparty.

	Group 2001 Contract or underlying principal amounts £m	Group 2001 Replacement cost £m	Group 2000 Contract or underlying principal amounts £m	Group 2000 Replacement cost £m
Non-trading derivatives:				
Used to manage foreign exchange risk				
Exchange rate contracts:				
Forward foreign exchange	1,018.3	14.2	485.8	2.3
Cross currency swaps	1,544.1	87.0	1,253.8	60.7
Total	2,562.4	101.2	1,739.6	63.0
With OECD financial institutions	2,515.5	96.0	1,711.3	62.7
With non-financial institutions	46.9	5.2	28.3	0.3
Total	2,562.4	101.2	1,739.6	63.0
In not more than one year	1,443.2	46.9	477.8	2.2
In more than one year but not more than five years	1,081.5	54.2	1,226.7	60.7
In more than five years	37.7	0.1	35.1	0.1
Total	2,562.4	101.2	1,739.6	63.0
Used to manage interest rate risk				
Interest rate contracts:				
Interest rate swaps	17,776.9	264.1	15,049.0	298.6
Caps, collars and floors	1,415.1	1.4	1,649.7	14.8
Futures	-	-	405.0	-
Forward rate agreements	659.4	0.7	223.5	0.4
Total	19,851.4	266.2	17,327.2	313.8
With OECD financial institutions	19,232.4	257.6	17,014.7	310.5
With non-financial institutions	619.0	8.6	312.5	3.3
Total	19,851.4	266.2	17,327.2	313.8
In not more than one year	8,732.0	105.4	6,329.1	149.4
In more than one year but not more than five years	9,520.9	132.2	10,009.2	120.9
In more than five years	1,598.5	28.6	988.9	43.5
Total	19,851.4	266.2	17,327.2	313.8

40 Risk management *continued*

	Group 2001 Contract or underlying principal amounts £m	Group 2001 Positive fair value £m	Group 2001 Negative fair value £m	Group 2000 Contract or underlying principal amounts £m	Group 2000 Positive fair value £m	Group 2000 Negative fair value £m
Trading derivatives						
Foreign exchange derivatives	–	–	–	–	–	–
Interest rate derivatives						
Interest rate contracts:						
Interest rate swaps	185.0	0.9	(0.7)	–	–	–
Futures	–	–	–	50.0	–	–
Total	185.0	0.9	(0.7)	50.0	–	–
With OECD financial institutions	185.0	0.9	(0.7)	50.0	–	–
With non-financial institutions	–	–	–	–	–	–
Total	185.0	0.9	(0.7)	50.0	–	–
In not more than one year	45.0	0.2	(0.2)	50.0	–	–
In more than one year but not more than five years	140.0	0.7	(0.5)	–	–	–
In more than five years	–	–	–	–	–	–
Total	185.0	0.9	(0.7)	50.0	–	–

iv) Hedging

As explained in the Financial Review on pages 23 and 24, the Group's policy is to hedge the following exposures:

- Interest rate risk – using interest rate swaps, caps, collars and floors, futures and forward rate agreements;
- Transactional currency exposures – using spot and forward foreign exchange transactions.

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised gains and losses on instruments used for hedging, and the movements therein, are as follows:

	Gains £m	Losses £m	2001 Total net gains/(losses) £m	Gains £m	Losses £m	2000 Total net gains/(losses) £m
Unrecognised gains/(losses) on hedges at 1 January 2001 (2000)	199.6	(112.3)	87.3	142.8	(92.5)	50.3
(Gains)/losses arising in previous years that were recognised in the year	(80.0)	56.0	(24.0)	(58.9)	42.7	(16.2)
Gains/(losses) arising before 1 January 2001 (2000) that were not recognised in the year	119.6	(56.3)	63.3	83.9	(49.8)	34.1
Gains/(losses) arising in the year that were not recognised in the year	129.5	(78.3)	51.2	115.7	(62.5)	53.2
Unrecognised gains/(losses) on hedges at 31 December 2001 (2000)	249.1	(134.6)	114.5	199.6	(112.3)	87.3
Of which:						
Gains/(losses) expected to be recognised in the next year	74.9	(45.9)	29.0	80.0	(56.0)	24.0
Gains/(losses) expected to be recognised after the next financial year	174.2	(88.7)	85.5	119.6	(56.3)	63.3

The above table shows the gains and losses on off-balance sheet derivative instruments used for hedging by the Group. The gains and losses do not therefore represent absolute gains or losses expected by the Group as they will be substantially offset by corresponding losses or gains from on-balance sheet instruments.

41 Reconciliation of operating profit to net operating cash flows

For the year ended 31 December 2001	2001 £m	2000 (restated) £m
Operating profits	**396.4**	446.7
Decrease/(increase) in accrued income and prepayments	**115.8**	(158.6)
(Decrease)/increase in accruals and deferred income	**(118.1)**	212.1
Provision for bad and doubtful debts	**63.4**	41.8
Loans and advances written off net of recoveries	**(39.6)**	(56.2)
Depreciation and amortisation	**86.5**	78.6
Interest on subordinated loan added back	**36.3**	34.7
Provisions for liabilities and charges	**1.4**	1.3
Increase in shareholders interest in long-term assurance fund	**(7.7)**	(10.3)
Other non-cash movements	**(2.3)**	0.2
Net cash flow from trading activities	**532.1**	590.3
Net decrease/(increase) in collections/transmissions	**35.1**	(71.3)
Net increase in loans and advances to banks and customers	**(3,739.9)**	(403.2)
Net increase in debt securities	**(51.9)**	(18.2)
Net increase in deposits by banks and customer accounts	**1,364.8**	1,592.6
Net increase in debt securities in issue	**3,201.0**	2,101.5
Net increase in non-investment debt and equity	**(276.5)**	–
Net (increase)/decrease in other assets	**225.2**	(287.2)
Net increase in other liabilities	**90.4**	76.1
Other non-cash movements	**(11.4)**	(5.5)
Net cash inflow from operating activities	**1,368.9**	3,575.1

Analysis of the balances of cash as shown in the balance sheet

	At 1/1/01 £m	Cashflow £m	At 31/12/01 £m
Cash and balances at central banks	122.3	96.8	219.1
Loans and advances to other banks repayable on demand	27.8	38.4	66.2
	150.1	135.2	285.3

The Group is required to maintain balances with the Bank of England which at 31 December 2001 amounted to £35.6m (2000: £32.9m).

Analysis of changes in financing during the year

	Share capital £m	Subordinated liabilities £m
Balance at 1 January 2001	252.2	461.8
Issue of loan capital	–	150.0
Other movements	0.3	(2.3)
Balance at 31 December 2001	252.5	609.5

42 Segmental analysis

The Group has three business sectors: Retail Banking, Commercial Banking and Treasury & Group. The information contained within the following table, in a format guided by SSAP 25 and the BBA SORP on segmental reporting, represents an analysis of the Group profit before tax and Group total assets. Further information is provided in the notes below. A more detailed and relevant breakdown is given within the Business and Financial Reviews on pages 8 to 24.

2001	Retail Banking £m	Commercial Banking £m	Treasury & Group £m	Total Group £m
Total income	850.2	355.5	70.2	1,275.9
Profit on ordinary activities before tax	379.7	73.8	(57.1)	396.4

	Retail Banking £m	Commercial Banking £m	Treasury & Group £m	Inter-group eliminations £m	Total Group £m
Gross assets	32,657.7	4,965.1	21,873.1	(20,019.3)	39,476.6
Inter-group eliminations	(7,015.3)	(1,237.2)	(11,766.8)	20,019.3	–
Total assets	25,642.4	3,727.9	10,106.3	–	39,476.6

2000	Retail Banking £m	Commercial Banking £m	Treasury & Group £m	Total Group £m
Total income (restated)	836.6	335.2	54.8	1,226.6
Profit/(loss) on ordinary activities before tax (restated)	403.2	71.9	(28.4)	446.7

	Retail Banking £m	Commercial Banking £m	Treasury & Group £m	Inter-group eliminations £m	Total Group £m
Gross assets	28,670.6	4,318.0	16,935.9	(15,208.7)	34,715.8
Inter-group eliminations	(5,629.6)	(1,184.4)	(8,394.7)	15,208.7	–
Total assets	23,041.0	3,133.6	8,541.2	–	34,715.8

Notes

a) Capital is allocated to business sectors on the basis of 7% equity and 3.5% subordinated debt. Excess capital is held within Treasury & Group.

b) Costs have been assigned to each sector based on resources consumed. Corporate overheads not directly attributable to business units, including strategy costs are included within Treasury & Group.

c) The Group operates entirely within the banking and insurance business, and operations are not managed on the basis of an allocation of net assets. The level of banking assets can fluctuate throughout the year, therefore the information derived from the year end figures does not provide a picture representative of the year as a whole. A more meaningful analysis of average interest-earning assets and average interest-bearing liabilities by business sector is contained within the Business and Financial Reviews on pages 8 to 24.

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

Consolidated Profit and Loss Account 5 Year Summary

	2001 £m	2000 (restated) £m	1999 (restated) £m	1998 (restated) £m	1997 (restated) £m
Interest receivable:					
Interest receivable and similar income arising from debt securities	**389.7**	334.9	196.0	196.4	185.8
Other interest receivable and similar income	**1,751.1**	1,855.3	1,645.6	1,866.1	1,518.8
Interest payable	**(1,386.2)**	(1,451.4)	(1,110.5)	(1,328.6)	(1,017.8)
Net interest income	**754.6**	738.8	731.1	733.9	686.8
Fees and commissions receivable	**501.2**	452.3	457.8	443.9	400.4
Fees and commissions payable	**(109.4)**	(84.4)	(81.4)	(67.1)	(47.5)
Other operating income	**129.5**	119.9	100.6	104.6	92.1
Total non-interest income	**521.3**	487.8	477.0	481.4	445.0
Operating income	**1,275.9**	1,226.6	1,208.1	1,215.3	1,131.8
Administrative expenses:					
Underlying	**(731.2)**	(662.3)	(601.7)	(660.9)	(630.8)
Exceptional costs of conversion	**-**	-	-	-	(28.0)
Depreciation and amortisation:					
On fixed assets excluding operating lease assets	**(36.9)**	(36.0)	(36.8)	(34.2)	(35.0)
On operating lease assets	**(48.0)**	(39.8)	(34.9)	(26.3)	(14.1)
	(84.9)	(75.8)	(71.7)	(60.5)	(49.1)
Provision for bad and doubtful debts	**(63.4)**	(41.8)	(41.2)	(38.7)	(29.3)
Operating profit on ordinary activities before tax	**396.4**	446.7	493.5	455.2	394.6
Tax on profit on ordinary activities:					
Underlying	**(109.1)**	(125.6)	(146.0)	(137.3)	(133.9)
Tax credit in respect of conversion costs	**-**	15.2	-	-	-
	(109.1)	(110.4)	(146.0)	(137.3)	(133.9)
Profit on ordinary activities after tax	**287.3**	336.3	347.5	317.9	260.7
Minority interests – non-equity	**(0.3)**	-	-	-	-
Profit attributable to the shareholders of Alliance & Leicester plc	**287.0**	336.3	347.5	317.9	260.7
Dividends	**(182.5)**	(165.5)	(162.9)	(142.6)	(121.1)
Retained profit for the year	**104.5**	170.8	184.6	175.3	139.6

Basic earnings per ordinary share	**57.0p**	63.9p	60.7p	54.6p	44.8p
Underlying basic earnings per ordinary share	**57.0p**	61.0p	60.7p	54.6p	49.6p
Diluted earnings per ordinary share	**56.6p**	63.7p	60.3p	54.3p	44.7p

Prior year figures have been restated to reflect the new presentation for operating lease depreciation, as explained in Note 2 on page 46.

Consolidated Balance Sheet 5 Year Summary

	2001 £m	2000 (restated) £m	1999 £m	1998 £m	1997 £m
Assets					
Cash and balances at central banks	**219.1**	122.3	155.8	66.5	84.7
Treasury bills and other eligible bills	**279.6**	218.5	279.5	454.9	202.8
Loans and advances to banks	**1,719.8**	1,347.7	1,230.7	2,061.1	1,841.6
Items in the course of collection from other banks	**171.5**	190.6	102.0	128.8	118.0
Loans and advances to customers	**27,412.8**	24,022.4	23,732.0	21,475.1	19,133.6
Securitised advances	**204.5**	254.0	–	–	–
Less: non-recourse finance	**(199.6)**	(248.7)	–	–	–
	27,417.7	24,027.7	23,732.0	21,475.1	19,133.6
Debt securities	**8,210.5**	6,963.3	3,743.9	2,274.8	2,307.1
Intangible fixed assets	**2.8**	4.3	–	–	–
Tangible fixed assets	**642.3**	584.7	516.5	440.5	355.7
Other assets	**219.2**	444.1	163.1	171.9	60.0
Prepayments and accrued income	**281.0**	396.8	238.2	269.2	173.0
Long-term assurance business attributable to shareholders	**82.8**	75.1	64.8	56.2	32.6
	39,246.3	34,375.1	30,226.5	27,399.0	24,309.1
Long-term assurance assets attributable to policyholders	**230.3**	340.7	258.0	179.6	94.6
Total assets	**39,476.6**	34,715.8	30,484.5	27,578.6	24,403.7
Liabilities					
Deposits by banks	**1,991.2**	1,402.2	1,023.8	721.0	89.1
Items in the course of transmission to other banks	**231.0**	215.0	197.7	141.6	200.6
Customer accounts	**22,099.8**	21,324.0	20,125.0	19,892.2	18,948.4
Debt securities in issue	**11,053.9**	7,852.9	5,751.4	3,406.8	1,820.6
Other liabilities	**548.4**	432.8	352.0	345.3	349.9
Accruals and deferred income	**771.6**	892.4	659.2	711.6	629.2
Provisions for liabilities and charges	**175.5**	137.4	100.1	54.0	18.4
Subordinated liabilities					
undated loan capital	**–**	–	–	–	198.9
dated loan capital	**609.5**	461.8	273.5	273.2	376.0
	37,480.9	32,718.5	28,482.7	25,545.7	22,631.1
Minority interests – non-equity	**0.8**	–	–	–	–
Called up share capital	**252.5**	252.2	274.7	292.1	291.0
Share premium account	**25.1**	21.9	19.9	19.7	–
Capital redemption reserve	**40.1**	40.1	17.4	–	–
Profit and loss account	**1,446.9**	1,342.4	1,431.8	1,541.5	1,387.0
Shareholders' funds (equity)	**1,764.6**	1,656.6	1,743.8	1,853.3	1,678.0
	39,246.3	34,375.1	30,226.5	27,399.0	24,309.1
Long-term assurance liabilities to policyholders	**230.3**	340.7	258.0	179.6	94.6
Total liabilities	**39,476.6**	34,715.8	30,484.5	27,578.6	24,403.7

Supplementary Information

1. Profit & Loss Account for Retail Banking Sector

	Mortgage Lending & Investments Year ended 31.12.01 £m	Personal Banking Year ended 31.12.01 £m	Retail Banking Year ended 31.12.01 £m	Retail Banking Year ended 31.12.00 (Restated) £m
Net interest income	355	261	**616**	621
Non-interest income	114	120	**234**	215
Total income	469	381	**850**	836
Administrative expenses	(202)	(212)	**(414)**	(398)
Bad debt provisions	9	(65)	**(56)**	(35)
Profit before tax	276	104	**380**	403

2. Net Interest Margins

The following table includes income and balances from operating lease assets.

	Mortgage Lending & Investments	Personal Banking	Retail Banking	Commercial Banking	Treasury & Group	Total Group
2001						
Net interest £m	355	261	616	104	58	**778**
Mean interest-earning assets £m (Note 2)	21,716	4,906	26,622	4,084	18,698	**34,669**
Net interest margin as % mean IEA (Note 1)	1.63	5.32	2.31	2.55	0.31	**2.24**
2000 (restated)						
Net interest £m	358	263	621	92	55	**768**
Mean interest-earning assets £m (Note 2)	20,828	4,460	25,288	3,310	15,973	**30,778**
Net interest margin as % mean IEA (Note 1)	1.72	5.90	2.46	2.76	0.35	**2.49**

(Note 1) The net interest margin is calculated above, consistent with previous years, as net interest income, including net income from operating lease assets, divided by average interest-earning assets including operating lease assets. Excluding net income from operating lease assets and excluding operating lease assets from average interest-earning assets, the net interest margin for the Commercial Bank and the Group is 2.13% (2000: 2.04%) and 2.20% (2000: 2.42%) respectively.

(Note 2) Included within Commercial Banking and total Group mean interest-earning assets are operating lease assets of £291m (2000: £226m).

3. Analysis of Mortgage Lending & Investments

	Year ended 31.12.01 £m	Year ended 31.12.00 (restated) £m
Net interest income	**355**	358
Average balances:		
Interest-earning assets (IEA)	**21,716**	20,828
Financed by:		
Interest-bearing liabilities	**20,473**	19,688
Interest-free liabilities	**1,243**	1,140
Average rates:	**%**	%
Bank base rate	**5.12**	5.96
Gross yield on average IEA	**5.92**	6.74
Cost of interest-bearing liabilities	**4.55**	5.32
Interest spread	**1.37**	1.42
Contribution of interest-free liabilities	**0.26**	0.30
Net interest margin on average IEA	**1.63**	1.72

4. Mortgage Incentives

The tables below show the analysis of mortgage incentive costs, calculated as both a discount to the appropriate headline mortgage rate, and bank base rate, charged to the profit & loss account:

Against headline mortgage rate	Year ended 31.12.01 £m	Year ended 31.12.00 £m
Cash incentives	**31**	12
Variable rate discounts (including Flexible rate)	**169**	105
Fixed and capped rate discounts	**73**	100
Total	**273**	217

Against bank base rate	Year ended 31.12.01 £m	Year ended 31.12.00 £m
Cash incentives	**31**	12
Variable rate discounts (including Flexible rate)	**15**	10
Fixed and capped rate discounts	**10**	38
Total	**56**	60

4. Mortgage Incentives continued

Mortgage incentive costs, as a discount to the appropriate headline mortgage rate, increased by £56m to £273m. Expressed as a discount to bank base rate, incentives fell £4m from £60m (December 2000) to £56m. The cost of discounts relative to bank base rate provides a close proxy to the actual cost of discounts which impact the profit & loss account. Whilst cash incentives and variable rate discounts have increased by £24m in the year, due to the growth in lending, the cost has been offset by a £28m reduction in fixed and capped rate discounts due to the maturity of previous years fixed rate lending at a lower margin.

The variable rate discounts have an average remaining life of 23 months (December 2000: 20 months). For fixed rate discounts, the average remaining period was 16 months (December 2000: 18 months). At the end of December 2001 61% (December 2000: 70%) of mortgage balances, including fixed and variable rate mortgages, were covered by redemption penalties.

5. Residential Mortgage Arrears

	As at 31.12.01 Value of Arrears £'000	As at 31.12.01 Arrears as a % of Residential Mortgage Balances	As at 31.12.00 Value of Arrears £'000	As at 31.12.00 Arrears as a % of Residential Mortgage Balances
Arrears as a % of mortgage balance				
2.5 – 10%	**7,171**	**0.032**	11,153	0.058
10% +	**5,433**	**0.025**	7,070	0.036
Repossession stock	**634**	**0.003**	976	0.005
Total	**13,238**	**0.060**	19,199	0.099

6. Residential lending by type of borrower (by value)

	Year ended 31.12.01 %	Year ended 31.12.00 %
Borrower type:		
First time buyer	**17**	18
Next time buyer	**43**	58
Remortgage	**40**	24
	100	100

7. Asset finance book

The total asset finance book, net of provisions and intercompany lending, as at December 2001 is £2,116m and is included in the following balance sheet headings:

	As at 31.12.01 £m	As at 31.12.00 £m
Loans and advances to banks	**54**	15
Loans and advances to customers:		
Finance leases and hire purchase	**1,513**	1,323
Unsecured loans	**8**	10
Secured loans	**201**	65
Fixed assets:		
Operating leases	**340**	287
	2,116	1,700

Shareholder Information

Shareholder analysis as at 31 December 2001

	No. of holders*	Percentage of total holders	No. of shares	Percentage of ordinary share capital
Shareholding range:				
1 - 250	698,317	91.31	169,992,329	33.66
251 - 500	51,124	6.69	24,565,114	4.86
501 - 10,000	14,508	1.90	18,584,650	3.68
10,001 - 50,000	342	0.04	8,120,931	1.61
50,001 - 100,000	125	0.02	9,078,920	1.80
100,001 and over	298	0.04	274,635,144	54.39
	764,714	100.00	504,977,088	100.00

Classification of shareholders:		
Personal holders (**)	210.5m	41.7%
Institutional holders	294.5m	58.3%

(*) Including those holders whose shares are held in the 'Alliance & Leicester ShareSafe' nominee account.
(**) Includes private shareholdings, ShareSafe and shares held in Private Client Accounts by institutional investors.

Financial Calendar

Ex dividend date for final dividend	10 April 2002
Record date for final dividend	12 April 2002
Annual General Meeting	7 May 2002
Final dividend for the year to 31 December 2001 payable	13 May 2002
Provisional date for Interim results to be announced	26 July 2002

Dividend History

Interim dividend 2000	10.7p
Final dividend 2000	22.3p
Interim dividend 2001	11.8p
Final dividend 2001	24.5p

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