2017 Annual Report

Santander UK plc

Part of the Banco Santander group

Santander UK plc
Annual Report 2017

Important information for readers

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

This Annual Report contains forward-looking statements that involve inherent risks and uncertainties. Actual results may differ materially from those contained in such forward-looking statements. See Forward-looking statements on page 233.

For more information see www.aboutsantander.co.uk.

Strategic report

Santander UK plc (the Company and together with its subsidiaries, Santander UK or the Santander UK group) is required to set out in this report a fair review of its business and a description of its principal risks and uncertainties, including a balanced and comprehensive analysis of the development and performance of the business in the year and of its position at the end of the year. This information can be found below and in the following sections of this Annual Report, which are incorporated into and form part of this Strategic report.

Under the UK Companies Act 2006, a safe harbour limits the liability of Directors in respect of statements in and omissions from the Directors' Report (for which see page 51), the Strategic report and the Remuneration report. Under English law the Directors would be liable to the company, but not to any third party, if one or more of these reports contained errors as a result of recklessness or knowing misstatement or dishonest concealment of a material fact, but would otherwise not be liable. Pages 51 to 55 inclusive comprise the Directors' Report, pages 2 to 4 inclusive comprise the Strategic report and pages 43 to 46 inclusive comprise the Remuneration report, each of which have been drawn up and presented in accordance with and in reliance upon English company law and the liabilities of the Directors in connection with these reports shall be subject to the limitations and restrictions provided by such law.

The Directors, in preparing this Strategic report, have complied with section 414C of the Companies Act 2006.

Principal activities and business review

Who we are

We are the only UK bank with the scale and breadth of proposition to challenge the big four UK banks. With our omni-channel approach we serve our customers through digital channels, in particular mobile, alongside a network of 806 branches and 64 Corporate Business Centres supported by telephone call centres.

We play an important role in the UK economy and in the communities in which we operate. We help people finance their home, save for the future and support business growth. We employ around 20,000 people and we paid £484m of corporation tax in 2017.

What we do

Most of what we do can be described as lending money to borrowers, taking deposits from savers, providing bank accounts and payment services. We also offer a wide range of investment and insurance products to households and other more specialised services and products to companies.

We are here to help our customers prosper

We are here to help our customers prosper and by doing so we create and protect sustainable value for all our stakeholders.

We do things The Santander Way: Simple, Personal, Fair

– Our customers are at the heart of everything we do.
– We have a culture of personal responsibility.

Development and performance of our business in 2017

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

Our position at 31 December 2017

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

A straightforward ring fence structure

UK legislation establishes new requirements for certain UK banks to ring-fence their retail activities, such as current accounts, savings accounts and payments. The largest UK banking groups, including Santander UK, have to comply with these requirements by 1 January 2019.

Santander UK plc will become the main ring-fenced bank of the Santander UK group. It will serve all our personal customers in the UK and the vast majority of our business customers.

To the extent allowed by the legislation, the ring-fenced bank will also broadly continue to hold and serve our Corporate Banking business in the UK. There will be some instances where products cannot be offered, or customers cannot be served from within the ring-fenced bank. In most of these instances, these products will be provided, or these customers served, by Banco Santander through its London branch. This will include some Global Corporate Banking business and Corporate Banking customers.

Abbey National Treasury Services plc will transfer all of its business to either Santander UK or Banco Santander's London Branch, save for a small portfolio of specific assets that will remain in Abbey National Treasury Services plc and be held until their maturity.

For more information on our ring-fencing plans, see page 225.

Uncertain economic environment
We see uncertainty ahead and with a wide range of projections for key economic indicators, such as GDP and house price growth, it's possible that outcome will be significantly different from the consensus view. The UK economy experienced solid growth in 2017, with record low levels of unemployment. Despite the squeeze on real incomes from rising inflation and muted earnings growth, the Bank of England decided to raise Bank Rate for the first time since July 2007 based, in part, on this solid growth. Business investment has continued to be affected by the ongoing uncertainty in the UK economy, which has impacted corporate borrowing.

We have a track record of consistent profitability, a resilient balance sheet and a relentless focus on customers. We believe that we are well-placed to manage any potential uncertainties and deliver our strategy. In light of the uncertain outlook we continued to control growth in some higher margin business areas where we saw potentially higher risks. We believe that our proactive risk management policies will deliver a resilient performance in the business.

Demanding regulatory change agenda
The regulatory agenda continues to present both risks and opportunities for UK banks. As well as encouraging competition, new entrants and innovation it also focuses on conduct towards customers and financial stability. Digital advances have opened up opportunities for both start-ups and established technology companies. This is set to continue the launch of Open Banking which aims to increase the number of companies that can offer financial services and enable them to develop technology to manage customers' money. We have also received confirmation of two important regulatory items: indicative MREL requirements and the final rules and guidance on Payment Protection Insurance (PPI) from the FCA.

We expect our returns going forward will continue to be impacted by increased regulatory compliance costs and the onerous bank regulation regime. However, we remain confident that we can continue to grow our business and plan to further develop loyal relationships with our personal and corporate customers by living up to our commitment to be Simple, Personal and Fair.

2018 outlook remains uncertain
We anticipate that the UK economy will continue to grow in 2018, although at a slightly subdued pace. Stronger global growth is likely, coming in particular from emerging markets. Nonetheless, for the UK economy, some downside risks could materialise, as a result of higher inflation and low wage growth reducing households' real earnings. This may restrict consumer spending which, when combined with a potentially more challenging macro environment, adds a degree of caution to our outlook.

We expect net interest margin will be lower than in 2017, with continued competitive pressures on new asset margins as well as SVR attrition. Cost management remains a key area of focus, as we work to comply with the demanding regulatory agenda and inflationary pressures. We will continue to invest in strategic projects, including global group initiatives, which over time will further improve our customer experience and operational efficiency.

We anticipate gross mortgage lending growth in line with the market, with continued focus on customer service and retention while delivering operational and digital excellence. Our lending to UK companies is likely to grow in line with the market. Our lending growth to trading business customers will remain strong, partially offset by modest growth in commercial real estate exposures. This will result in slower overall growth than in recent years.

We will continue to purposefully control growth in line with our proactive risk management policies and prudent approach to risk appetite. These actions will help deliver sustainable results while supporting our customers in an uncertain environment.

Our principal risks and uncertainties
Information on our principal risks and uncertainties is set out in the Risk review by type of risk, with more detail by business segment. When reading the Risk review and the other sections of the Annual Report, you should refer to the 'Forward-looking statements' section in the Shareholder information.

Key performance indicators
The directors of the Company's immediate parent, Santander UK Group Holdings plc, manage the operations of the Santander UK Group Holdings plc group (which includes the Santander UK group) on a business division basis. Key performance indicators are not set, monitored or managed at the Santander UK group level. As a result, the Company's Directors believe that analysis using key performance indicators for the Company is not necessary or appropriate for an understanding of the development, performance or position of the Company. The development performance and position of the business of the Santander UK group, mainly at a consolidated level, is set out in the Financial Review. The key performance indicators of the Santander UK Group Holdings plc group can be found on pages 12 and 13 of its 2017 Annual Report, which does not form part of this report.

Managing our environmental impact efficiently
Our Environmental & Energy Management Systems (EMS & EnMS) provide a framework for defining responsibilities and processes in relation to waste, energy, water, travel and supply chain management at our 15 main offices and data centres in the UK. In 2017, we successfully recertified the ISO 14001 & ISO 50001 accreditation across all of these properties.

Managing our supply chain responsibly
We buy goods and services from over 1,600 external suppliers and intra-group companies accounting for £1.7bn of costs in 2017, governed by our Cost Management and Procurement Policy, Third Party Risk Management Policy and Conduct in Supplier Relationships Manual.

We meet the Living Wage requirement for employees of suppliers who work at Santander UK sites, and our supplier contracts include specific requirements to respect human rights and ethical labour practice based on the principles of the UN Global Compact.

We are a signatory to the Business in the Community Access Pledge, a public commitment to a fair and open procurement process for SMEs. In 2017, 80% of our new supplier contracts, worth over £7m, were with businesses with less than £10m annual turnover or 250 employees.

We are committed to high ethical standards
We adhere to laws and regulations, conduct business in a responsible way and treat our stakeholders with honesty and integrity. We review each investment and lending proposal case-by-case, taking account of the potential impact on human rights, public health and the environment. We also consider the ethics of supporting or partnering with particular organisations, governments and projects. Our Code of Ethical Conduct sets out the standards we expect of our people. It supports our commitment to being Simple, Personal and Fair and also helps to protect our reputation by building a culture free from corruption, risk of compromise or conflicts of interest.

See the Director's report for more on our Code of Ethical Conduct and Anti-Bribery and Corruption Policy.

By Order of the Board

Nathan Bostock
Director
27 February 2018

Financial review

Contents

Income statement review

SUMMARISED CONSOLIDATED INCOME STATEMENT

	2017 £m	2016 £m	2015 £m
Net interest income	**3,803**	3,582	3,575
Non-interest income[1]	**1,109**	1,213	998
Total operating income	**4,912**	4,795	4,573
Operating expenses before impairment losses, provisions and charges	**(2,499)**	(2,414)	(2,400)
Impairment losses on loans and advances	**(203)**	(67)	(66)
Provisions for other liabilities and charges	**(393)**	(397)	(762)
Total operating impairment losses, provisions and charges	**(596)**	(464)	(828)
Profit before tax	**1,817**	1,917	1,345
Tax on profit	**(561)**	(598)	(381)
Profit after tax	**1,256**	1,319	964
Attributable to:			
Equity holders of the parent	**1,235**	1,292	939
Non-controlling interests	**21**	27	25
Profit after tax	**1,256**	1,319	964

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

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

2017 compared to 2016

Profit before tax was down 5% at £1,817m, primarily impacted by a large credit impairment charge and higher operating expenses. By income statement line, the movements were:

- Net interest income was up 6%, driven by retail liability margin improvement, partially offset by pressure on new lending margins.
- Non-interest income was down 9%, with the absence of the £119m gain on sale of Visa Europe Limited in Q2 2016 and mark-to-market movements on economic hedges and hedge inefficiencies. There was good momentum in Retail Banking and GCB as well as the £48m gain on sale of Vocalink Holdings Limited in Q2 2017.
- Operating expenses before impairment losses, provisions and charges were up 4%. Higher strategic investment costs in business transformation, regulatory compliance costs and inflationary pressures offset operational and digital efficiencies.
- Impairment losses on loans and advances increased to £203m, primarily relating to GCB exposures to Carillion plc. Impairment charges in the year for other customer loan books were not material and mortgage releases were lower at £40m (2016: £120m).
- Provisions for other liabilities and charges were broadly flat at £393m, including charges for PPI of £109m and other conduct matters of £35m.

  The remaining provision for PPI redress and related costs amounted to £356m, including an additional net provision of £40m in Q4 2017 bringing the total charge for the year to £109m. The Q4 2017 provision relates to an increase in estimated future claims driven by the start of the FCA advertising campaign for PPI, offset by an expected decline pertaining to a specific PPI portfolio review. We continue to monitor our provision levels in respect of recent claims experience.

  The remaining non-PPI related conduct provisions amounted to £47m, including the Q2 2017 provision of £35m outlined above, relating to the sale of interest rate derivatives. This charge followed an ongoing review regarding regulatory classification of certain customers potentially eligible for redress.
- Tax on profit decreased 6% to £561m with lower profits. The effective tax rate was stable at 31%.

2016 compared to 2015
Profit before tax was up 43% at £1,917m, with solid income growth, strong cost discipline and lower conduct costs. By income statement line, the movements were:

- Net interest income was up £7m, driven by strong retail liability margin improvement in Q4 2016 and increased lending that offset continued SVR attrition and asset margin pressure. NIM was 1.48% for the year, compared to 1.53% in 2015.
- Non-interest income at £1,213m, up 22%, benefited from a £119m gain on the sale of our Visa Europe Limited shareholding in Q2 2016 and higher 1I2I3 Current Account fees.
- Operating expenses before impairment losses, provisions and charges were broadly flat at £2,414m, with operational efficiency absorbing investment in business growth, regulatory costs, and the ongoing enhancements to our digital channels. Intangible asset write-downs for the year primarily related to a multi-entity banking platform developed for our non-ring-fenced bank under the original ring-fencing structure.
- Impairment losses on loans and advances were broadly flat at £67m, with a single loan in Global Corporate Banking that moved to non-performance in Q2 2016 offset by lower write-offs and charges. Overall, all loan portfolios continued to perform well.
- Provisions for other liabilities and charges decreased 48%, mainly due to lower PPI, including Plevin, provision charges..

  We made an additional £144m provision charge in the year, which included our best estimate of Plevin related claim costs and a £30m charge for a portfolio under a past business review. With the FCA consultation that was expected to close in the first quarter of 2017, we assessed the adequacy of our provision and applied the principles published in the August 2016 FCA consultation paper to our current assumptions. We continued to review our provision levels in respect of recent claims experience and noted that once the final FCA guidance was published it was possible further PPI-related provision adjustments would be required in future years.

  Monthly utilisation during the year, excluding the impact of past business review activity, was slightly higher than the 2015 average and in line with our assumptions.
- Tax on profit increased 57% to £598m with the effective tax rate up from 28% to 31%. These increases are primarily driven by the 8% bank corporation tax surcharge and higher profits, partially offset by the tax impact of lower conduct provision charges in 2016.

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

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

The rest of this section contains a summary of the results, and commentary thereon, by income statement line item for each segment.

Basis of results presentation
The segmental information in this Annual Report reflects the reporting structure in place at the reporting date in accordance with which the segmental information in Note 2 to the Consolidated Financial Statements has been presented.

The basis of presentation in this Annual Report has been changed, and the prior period restated to reflect a change in the internal transfer of revenues and costs from Corporate Centre to the three customer business segments. This enables a more targeted apportionment of capital and other resources in line with the strategy of each segment.

PROFIT BEFORE TAX BY SEGMENT

2017	Retail Banking £m	Commercial Banking £m	Global Corporate Banking £m	Corporate Centre £m	Total £m
Net interest income	**3,302**	**395**	**74**	**32**	**3,803**
Non-interest income[1]	**615**	**74**	**364**	**56**	**1,109**
Total operating income	**3,917**	**469**	**438**	**88**	**4,912**
Operating expenses before impairment losses, provisions and charges	**(1,871)**	**(223)**	**(304)**	**(101)**	**(2,499)**
Impairment (losses)/releases on loans and advances	**(36)**	**(13)**	**(174)**	**20**	**(203)**
Provisions for other liabilities and (charges)/releases	**(342)**	**(55)**	**(11)**	**15**	**(393)**
Total operating impairment losses, provisions and (charges)/releases	**(378)**	**(68)**	**(185)**	**35**	**(596)**
Profit/(loss) before tax	**1,668**	**178**	**(51)**	**22**	**1,817**
2016					
Net interest income/(expense)	3,140	383	73	(14)	3,582
Non-interest income[1]	562	76	312	263	1,213
Total operating income	3,702	459	385	249	4,795
Operating expenses before impairment losses, provisions and charges	(1,800)	(215)	(280)	(119)	(2,414)
Impairment (losses)/releases on loans and advances	(20)	(29)	(21)	3	(67)
Provisions for other liabilities and charges	(338)	(26)	(12)	(21)	(397)
Total operating impairment losses, provisions and charges	(358)	(55)	(33)	(18)	(464)
Profit before tax	1,544	189	72	112	1,917
2015					
Net interest income	3,097	399	52	27	3,575
Non-interest income[1]	526	91	303	78	998
Total operating income	3,623	490	355	105	4,573
Operating expenses before impairment losses, provisions and (charges)/releases	(1,898)	(217)	(287)	2	(2,400)
Impairment (losses)/releases on loans and advances	(90)	(25)	13	36	(66)
Provisions for other liabilities and (charges)/releases	(728)	(23)	(14)	3	(762)
Total operating impairment (losses)/releases, provisions and (charges)/releases	(818)	(48)	(1)	39	(828)
Profit before tax	907	225	67	146	1,345

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

RETAIL BANKING

Retail Banking offers a wide range of products and financial services to individuals and small businesses through a network of branches and ATMs, as well as through telephony, digital and intermediary channels. Retail Banking includes business banking customers, small businesses with an annual turnover of up to £6.5m, and Santander Consumer Finance, predominantly a vehicle finance business.

Summarised income statement

	2017 £m	2016 £m	2015 £m
Net interest income	**3,302**	3,140	3,097
Non-interest income	**615**	562	526
Total operating income	**3,917**	3,702	3,623
Operating expenses before impairment losses, provisions and charges	**(1,871)**	(1,800)	(1,898)
Impairment losses on loans and advances	**(36)**	(20)	(90)
Provisions for other liabilities and charges	**(342)**	(338)	(728)
Total operating impairment losses, provisions and charges	**(378)**	(358)	(818)
Profit before tax	**1,668**	1,544	907

2017 compared to 2016
Profit before tax increased by £124m to £1,668m in 2017 (2016: £1,544m). By income statement line, the movements were:

- Net interest income increased 5%, driven by liability margin improvement offsetting pressure on new lending margins and SVR attrition.
- Non-interest income increased 9%, due to higher current account and wealth management fees.
- Operating expenses before impairment losses, provisions and charges were up 4%, with investment in business growth, digital enhancements and software write-offs, partially offset by operational efficiency.
- Impairment losses on loans and advances increased to £36m, predominantly driven by lower mortgage impairment releases of £40m in 2017 (2016: £120m). The loan book continues to perform well, supported by the ongoing resilience of the UK economy and our strong risk management practices.
- Provisions for other liabilities and charges were broadly flat at £342m, including charges for PPI and other conduct matters during the year.

  The remaining provision for PPI redress and related costs amounted to £356m, including an additional net provision of £40m in Q4 2017 bringing the total charge for the year to £109m. The Q4 2017 provision relates to an increase in estimated future claims driven by the start of the FCA advertising campaign for PPI, offset by an expected decline pertaining to a specific PPI portfolio review. We continue to monitor our provision levels in respect of recent claims experience.

  The remaining non-PPI related conduct provisions amounted to £47m, including the Q2 2017 provision of £35m, relating to the sale of interest rate derivatives. This charge followed an ongoing review regarding regulatory classification of certain customers potentially eligible for redress.

2016 compared to 2015
Profit before tax increased by £637m to £1,544m in 2016 (2015: £907m). By income statement line, the movements were:

- Net interest income increased 1%, with higher asset volumes and liability margin improvement offsetting continued SVR mortgage attrition and pressure on new lending margins.
- Non-interest income increased 7%, with higher 1I2I3 Current Account fees, partially offset by reduced investment fees and lower credit card interchange income.
- Operating expenses before impairment losses, provisions and charges were down 5% with operational efficiencies, partially offset by continued investment in business growth and digital enhancements.
- Impairment losses on loans and advances decreased 78%, with lower mortgage impairment releases and write-offs. Mortgage releases of £120m (2015: £125m) were driven by the continued rise in house prices and improving quality of the portfolio, as well as an update to our model.
- Provisions for other liabilities and charges decreased 54%, mainly due to lower conduct costs and FSCS charge in 2016.

  We made an additional £144m provision charge in the year, which included our best estimate of Plevin related claim costs and a £30m charge for a specific portfolio under a past business review. With the FCA consultation expected to close in the first quarter of 2017, we have assessed the adequacy of our provision and applied the principles published in the August 2016 FCA consultation paper to our current assumptions. We will continue to review our provision levels in respect of recent claims experience and once the final FCA guidance is published, and it is possible further PPI-related provisions will be required in future years.

  Monthly utilisation during the year, excluding the impact of past business review activity, was slightly higher than the 2015 average and in line with our assumptions. We will continue to review our provision levels in respect of recent claims experience and once the final FCA guidance is published.

Balances

	2017 £bn	2016 £bn
Customer loans	**169.0**	168.6
– of which mortgages	**154.9**	154.3
– of which business banking[1]	**1.9**	2.3
– of which consumer (auto) finance	**7.0**	6.8
– of which other unsecured lending	**5.2**	5.2
Risk-weighted assets (RWAs)	**44.1**	43.6
Customer deposits	**149.3**	148.1
– of which current accounts	**67.3**	64.8
– of which savings	**60.8**	64.7
– of which business banking accounts	**11.1**	10.0
– of which other retail products	**10.1**	8.6

(1) Following a periodic review in Q1 2017, a number of business banking customers were transferred to Commercial Banking, where their ongoing needs can be better served. The balance associated was c£200m. Prior periods have not been amended.

2017 compared to 2016
- Mortgage lending increased £0.6bn, driven by management pricing actions in a competitive environment and an ongoing focus on customer service and retention. In 2017, mortgage gross lending was £25.5bn (2016: £25.8bn) and we retained c78% of mortgages reaching the end of their incentive period.
- Consumer (auto) finance balances increased £0.2bn with higher retail loans, partially offset by a decrease in the stock of new car registrations. In 2017, consumer (auto) finance gross lending was £3,133m (2016: £3,111m).
- Other unsecured lending was steady as a result of controlled management actions.
- RWAs were up, broadly in line with an increase in customer loans and average mortgage risk-weights.
- Customer deposits increased, primarily due to ongoing demand for current accounts, up £2.5bn, other retail products, up £1.5bn, and business banking deposits, up £1.1bn. This was partially offset by a £3.9bn decline in savings balances.
- Retail Banking deposit spread narrowed to (0.23)% from (0.57)% in 2016.

COMMERCIAL BANKING

Commercial Banking offers a wide range of products and financial services provided by relationship teams that are based in a network of regional Corporate Business Centres (CBCs) and through telephony and digital channels. The management of our customers is organised across two relationship teams - the Regional Corporate Bank (RCB) that covers non-property backed trading businesses that are UK domiciled with annual turnover above £6.5m and Specialist Sector Groups (SSG) that cover real estate, social housing, education, healthcare, and hotels.

Summarised income statement

	2017 £m	2016 £m	2015 £m
Net interest income	**395**	383	399
Non-interest income	**74**	76	91
Total operating income	**469**	459	490
Operating expenses before impairment losses, provisions and charges	**(223)**	(215)	(217)
Impairment losses on loans and advances	**(13)**	(29)	(25)
Provisions for other liabilities and charges	**(55)**	(26)	(23)
Total operating impairment losses, provisions and charges	**(68)**	(55)	(48)
Profit before tax	**178**	189	225

2017 compared to 2016

Profit before tax decreased by £11m to £178m in 2017 (2016: £189m). By income statement line, the movements were:

- Net interest income increased 3%, driven by an increase in customer deposits as we continued to focus on deepening customer relationships.
- Non-interest income was down £2m, with lower rates management fees, partially offset by growth in asset restructuring, up 4%, international, up 20%, and digital and payment fees, up 16%.
- Operating expenses before impairment losses, provisions and charges were up 4%, driven by enhancements to our digital channels.
- Impairment losses on loans and advances were lower at £13m. The loan book continues to perform well and is supported by our prudent lending policy.
- Provisions for other liabilities and charges increased to £55m, mainly due to conduct charges in Q2 2017.

2016 compared to 2015

Profit before tax decreased by £36m to £189m in 2016 (2015: £225m). By income statement line, the movements were:

- Net interest income decreased 4%, with continued growth in customer lending and improved cost of funding from higher deposits that were driven by the enhanced franchise and broader range of services.
- Non-interest income decreased 16%, with lower asset restructuring and rates management fees partially offset by growth in international fees, up 9%, and digital and payment fees, up 26%, the latter two driven by more loyal customer relationships.
- Operating expenses before impairment losses, provisions and charges decreased 1%, demonstrating our strong cost management focus.
- Impairment losses on loans and advances increased £4m, with the loan book continuing to perform well, supported by our prudent lending policy.
- Provisions for other liabilities and charges increased by £3m and include restructuring costs.

Balances

	2017 £bn	2016 £bn
Customer loans[1]	**19.4**	19.4
– of which Commercial Real Estate[2]	**8.1**	9.0
RWAs	**19.4**	20.4
Customer deposits	**18.7**	17.2

(1) Following a periodic review in Q1 2017, a number of business banking customers were transferred to Commercial Banking, where their ongoing needs can be better served. The balance associated was c£200m. Prior periods have not been amended.
(2) Includes CRE loans to small business customers managed by business banking in the Retail Banking business segment.

- Customer loans were flat at £19.4bn, with strong lending growth to other corporate businesses customers, reversed by £0.9bn reduction in CRE lending.
- RWAs decreased 5%, with RWA management, including securitisations, and lower CRE exposures.
- Customer deposits were up £1.5bn, as we continue to focus on growing primacy through our strong customer relationships and a comprehensive product range.

Business volumes

	2017	2016	2015
New facilities (£m)	**7,980**	7,400	8,500
Bank account openings (No.)	**3,150**	2,470	3,160
Online banking (Connect) active users[1] (No.)	**31,670**	26,970	25,120

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

2017 compared to 2016
- We continue to attract new clients and deepen existing relationships, resulting in higher new facilities to customers and bank account openings, up 8% and 28%, respectively. Our Relationship Managers are also building their portfolios by leveraging our comprehensive suite of products and services.
- Active users of our corporate banking platform 'Connect' continued to increase, up 17%, driven by enhancements to the online platform, including expanded services and access to our international product suite.

2016 compared to 2015
- We continue to open bank accounts and extend new facilities, although at a slower pace, in an increasingly competitive environment and amid economic uncertainty. Our Relationship Managers (RMs) continue to build their portfolios by leveraging our comprehensive suite of products and services. We will continue to focus on growing more loyal customer relationships and on better diversification across the sectors, driving primacy through more capital efficient growth whilst utilising international expertise and economic corridors via Banco Santander.
- There was a continuation in the pickup of our corporate banking platform 'Connect', with active users increasing 7% year-on-year.

Strategic report
Financial review
Governance
Risk review
Financial statements
Shareholder information

GLOBAL CORPORATE BANKING

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

Summarised income statement

	2017 £m	2016 £m	2015 £m
Net interest income	**74**	73	52
Non-interest income	**364**	312	303
Total operating income	**438**	385	355
Operating expenses before impairment losses, provisions and charges	**(304)**	(280)	(287)
Impairment (losses)/releases on loans and advances	**(174)**	(21)	13
Provisions for other liabilities and charges	**(11)**	(12)	(14)
Total operating impairment (losses)/releases, provisions and charges	**(185)**	(33)	(1)
(Loss)/profit before tax	**(51)**	72	67

2017 compared to 2016
Profit before tax decreased by £123m to a loss of £51m in 2017 (2016: £72m). By income statement line, the movements were:

- Net interest income was up £1m, due to lending growth in project and acquisition finance, securitisation and transactional services, offset by continued asset margin pressures.
- Non-interest income increased 17% to £364m, driven by security financing, derivative sales, and market making.
- Operating expenses before impairment losses, provisions and charges increased 9% to £304m, due to a one-off charge for services provided by Banco Santander S.A. Going forward, the majority of these charges will be allocated to the London branch of Banco Santander under our new ring-fence structure.
- Impairment losses on loans and advances increased to £174m, primarily relating to Carillion plc exposures.
- Provisions for other liabilities and charges were down £1m to £11m.

2016 compared to 2015
Profit before tax increased by £5m to £72m in 2016 (2015: £67m). By income statement line, the movements were:

- Net interest income increased to £73m, with ongoing demand for project and acquisition finance, transactional services and factoring products offsetting continued asset margin compression.
- Non-interest income increased 3% to £312m, underpinned by ongoing demand for derivative and cash sales activities as well as market making activities.
- Operating expenses before impairment losses, provisions and charges decreased 2% to £280m, as we continue to improve the efficiency of our operating model.
- Impairment losses on loans and advances increased due to the impairment of a single loan that moved to non-performance in the second quarter of 2016 and the absence of releases in the year.
- Provisions for other liabilities and charges decreased by £2m to £12m.

Balances

	2017 £bn	2016 £bn
Customer loans	**6.0**	5.7
Other assets	**45.1**	34.1
RWAs	**16.5**	16.9
Customer deposits	**4.5**	4.1

2017 compared to 2016
- Customer loans increased £0.3bn, primarily due to higher syndicated lending, project and acquisition finance and lending to financial institutions, partially offset by a decrease in client drawdowns.
- An increase in Carillion plc provisions has reduced our exposure and therefore reduced RWAs. We have also recalibrated some of our models. RWAs attributable to customer loans were £7.2bn (2016: £7.5bn).
- Customer deposits were higher at £4.5bn, resulting from growth in cash management products.

CORPORATE CENTRE

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

Summarised income statement

	2017 £m	2016 £m	2015 £m
Net interest income/(expense)	**32**	(14)	27
Non-interest income	**56**	263	78
Total operating income	**88**	249	105
Operating (expenses)/income before impairment losses, provisions and charges	**(101)**	(119)	2
Impairment releases on loans and advances	**20**	3	36
Provisions for other liabilities and releases/(charges)	**15**	(21)	3
Total operating impairment releases/(losses), provisions and charges	**35**	(18)	39
Profit before tax	**22**	112	146

2017 compared to 2016

Profit before tax decreased by £90m to £22m in 2017 (2016: £112m). By income statement line, the movements were:

- Net interest income increase was primarily due to a £39m release of accrued interest on a foreign tax liability no longer payable after Q2 2017. Net interest income from the structural hedge was broadly in line with 2016, with a hedge position of c£80bn and average duration of c2.5years. The majority of new mortgage flows were left un-hedged.
- Non-interest income was impacted by the absence of the £119m gain on sale of Visa Europe Limited in 2016 and mark-to-market movements on economic hedges and hedge inefficiencies in 2017. This was partially offset by the £48m gain on sale of Vocalink Holdings Limited in Q2 2017.
- Operating expenses before impairment losses, provisions and charges, represent regulatory compliance and project costs relating to ring-fencing of £81m as well as costs pertaining to strategic investment in business growth.
- Impairment releases on loans and advances increased to £20m, driven by our exit strategy from non-core customer loans.
- Provisions for other liabilities and charges improved to £15m, predominantly due to a provision release for a historical operational risk closure.

2016 compared to 2015

Profit before tax decreased by £34m to £112m in 2016 (2015: £146m). By income statement line, the movements were:

- Net interest expense of £14m down from £27m income in 2015, reflects changes in the commercial balance sheet profile and in part an increase in wholesale funding cost. This cost increased with the commencement of senior unsecured issuance from the holding company to meet our MREL recapitalisation requirements.
  Due to the lower interest rate environment, we envisage that net interest income from the structural hedge will decrease as a result of maturing positions being reinvested at lower prevailing rates. The majority of new mortgage flows are left un-hedged to provide stable returns on equity and current accounts. The average term of our new mortgage flows is about 2.5 years, with a total structural hedge position of c. £80bn.
- Non-interest income benefited from a £119m gain on the sale of our Visa Europe Limited shareholding in Q2 2016, and mark-to-market movements on economic hedges.
- Operating expenses before impairment losses, provisions and charges mainly represent £122m of regulatory compliance and project costs relating to ring-fencing, including intangible asset write-downs.
- Impairment releases on loans and advances decreased to £3m, with lower releases from asset disposals than in 2015.
- Provisions for other liabilities include employee restructuring costs and related provisions.

Balances

	2017 £bn	2016 £bn
Non-core customer loans	**5.9**	6.5
- of which Social Housing	**5.1**	5.4
RWAs	**7.0**	6.7
Customer deposits	**3.4**	3.0

2017 compared to 2016

- Non-core customer loans decreased £0.6bn, as we continue to implement our exit strategy from individual loans and leases.
- RWAs increased to £7.0bn, with higher market and counterparty credit risk, partially offset by a reduction in non-core customer loans. RWAs attributable to non-core customer loans amounted to £1.0bn (2016: £1.3bn).
- Customer deposits increased £0.4bn, as we continue to rebalance the deposit base tenor.

Strategic report
Financial review
Governance
Risk review
Financial statements
Shareholder information

Balance sheet review

SUMMARISED CONSOLIDATED BALANCE SHEET

	2017 £m	2016[(1)] £m
Assets		
Cash and balances at central banks	**32,771**	17,107
Trading assets	**30,555**	30,035
Derivative financial instruments	**19,942**	25,471
Financial assets designated at fair value	**2,096**	2,140
Loans and advances to banks	**5,927**	4,348
Loans and advances to customers	**199,490**	199,738
Financial investments	**17,611**	17,466
Interest in other entities	**73**	61
Property, plant and equipment	**1,598**	1,491
Retirement benefit assets	**449**	398
Tax, intangibles and other assets	**4,253**	4,256
Total assets	**314,765**	302,511
Liabilities		
Deposits by banks	**13,784**	9,769
Deposits by customers	**183,648**	177,172
Trading liabilities	**31,109**	15,560
Derivative financial instruments	**17,613**	23,103
Financial liabilities designated at fair value	**2,315**	2,440
Debt securities in issue	**42,633**	50,346
Subordinated liabilities	**3,793**	4,303
Retirement benefit obligations	**286**	262
Tax, other liabilities and provisions	**3,379**	4,103
Total liabilities	**298,560**	287,058
Equity		
Total shareholders' equity	**16,053**	15,303
Non-controlling interests	**152**	150
Total equity	**16,205**	15,453
Total liabilities and equity	**314,765**	302,511

(1) Restated to reflect the change in accounting policy relating to business combinations between entities under common control, as described in Note 1 to the Consolidated Financial Statements.

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

2017 compared to 2016

Assets

Cash and balances at central banks

Cash and balances at central banks increased by 92% to £32,771m at 31 December 2017 (2016: £17,107m). The increase was mainly due to an increase in securities sold under resale agreements as part of ongoing operational liquidity management activity which resulted in the mix of our eligible liquidity pool being weighted more towards cash in 2017 than in 2016.

Derivative financial instruments

Derivative assets decreased by 22% to £19,942m at 31 December 2017 (2016: £25,471m). The decrease was mainly due to volatility in the fair value of interest rate and cross currency derivative assets principally driven by movements in yield curves and foreign exchange rates.

Loans and advances to banks

Loans and advances to banks increased 36% to £5,927m at 31 December 2017 (2016: £4,348m). The increase was driven by a higher volume of securities purchased under resale agreements and placements with other banks.

Loans and advances to customers

Loans and advances to customers were broadly flat at £199,490m at 31 December 2017 (2016: £199,738m), with solid lending growth in mortgages and to trading businesses, offset by a decrease in Commercial Real Estate and non-core loans as we actively manage our exposure in line with proactive risk management policies.

Liabilities

Deposits by banks

Deposits by banks increased by 41% to £13,784m at 31 December 2017 (2016: £9,769m) mainly driven by further drawdowns of the Term Funding Scheme with the Bank of England.

Deposits by customers

Deposits by customers increased by 4% to £183,648m at 31 December 2017 (2016: £177,172m) as we focused on retaining and originating accounts held by more loyal customers, with continued net positive inflows to retail banking current accounts as well as corporate accounts.

Trading liabilities
Trading liabilities doubled to £31,109m at 31 December 2017 (2016: £15,560m) mainly as a result of an increase in securities sold under resale agreements, partially offset by a reduction in cash collateral and short-term deposits.

Derivative financial instruments
Derivative liabilities decreased by 24% to £17,613m at 31 December 2017 (2016: £23,103m). The decrease was mainly due to volatility in the fair value of interest rate and cross currency derivative liabilities principally driven by movements in yield curves and foreign exchange rates.

Debt securities in issue
Debt securities in issue decreased by 15% to £42,633m at 31 December 2017 (2016: £50,346m) as Term Funding Scheme drawdowns replaced some matured funding, including securitisations.

Tax, other liabilities and provisions
Tax, other liabilities and provisions decreased by 18% to £3,379m at 31 December 2017 (2016: £4,103m). This was mainly due to a reduction in other liabilities, as well as a decrease in provisions as utilisations exceeded provision charges in the year.

Equity
Total shareholders' equity
Total shareholders' equity increased by 5% to £16,053m at 31 December 2017 (2016: £15,303m). The increase was mainly due to retained profits for the year and the issuance of AT1 capital, partially offset by the impact of cash flow hedges.

Cash flows

	2017 £m	2016 £m	2015 £m
Net cash flows from operating activities	**23,976**	18,005	(3,897)
Net cash flows from investing activities	**816**	(7,340)	(518)
Net cash flows from financing activities	**(7,637)**	(6,388)	(2,914)
Change in cash and cash equivalents	**17,155**	4,277	(7,329)

The major activities and transactions that affected Santander UK's cash flows during 2017, 2016 and 2015 were as follows:

In 2017, the net cash flows from operating activities of £23,976m resulted from the increase in trading balances, increased customer lending and customer savings and deposits from other banks. The net cash flows from investing activities of £816m mainly reflected sale and redemption of financial investments offset by purchases of property, plant and equipment and intangible assets. The net cash flows from financing activities of £7,637m principally reflected the repayment of debt securities maturing in the year of £13,763m offset by new issues of debt securities of £6,645m, the payment of interim dividends on ordinary shares, preference shares, other equity instruments and non-controlling interests of £1,000m. Cash and cash equivalents increased by £17,155m principally from the increase in cash and balances at central banks, which is held as part of the liquidity pool. This increase was mainly due to a change in the mix of assets held for liquidity purposes as part of normal portfolio management activity.

In 2016, the net cash flows from operating activities of £18,005m resulted from the increase in trading balances, increased customer lending and customer savings and deposits from other banks. The net cash flows from investing activities of £7,340m principally reflected the purchase of held-to-maturity investments. The net cash flows from financing activities of £6,388m principally reflected the repayment of debt securities maturing in the year of £11,352m offset by new issues of debt securities of £5,547m, the payment of interim dividends on ordinary shares, preference shares, other equity instruments and non-controlling interests of £559m. Cash and cash equivalents increased by £4,277m principally from the increase in cash held at central banks and also debt securities, both of which are held as part of the liquidity pool. This has increased due to an increase in wholesale funding with a maturity of less than 30 days.

In 2015, the net cash flows from operating activities of £3,897m resulted from the increase in trading balances, increased customer lending partially offset by an increase in customer savings and deposits from other banks. The net cash flows from investing activities of £518m principally reflected the purchase and sale of available-for-sale securities, purchase of property, plant and equipment and the acquisition of PSA Finance UK Limited. The net cash flows from financing activities of £2,914m principally reflected the repayment of debt securities maturing in the year of £16,098m offset by new issues of debt securities of £13,267m, the issuance of £750m Perpetual Capital Securities and the payment of interim dividends on ordinary shares, preference shares, other equity instruments and non-controlling interests of £701m. Cash and cash equivalents decreased by £7,329m principally from the decrease in cash held at central banks and also debt securities both of which are held as part of the liquidity pool. This has decreased due to a reduction in wholesale funding with a maturity of less than 30 days.

2017 business development highlights

Retail Banking

- In 2017, we introduced a new set of tools that aim to improve customer experience across all channels. In January 2017, we launched the new NeoCRM tool, now used by 14,000 colleagues, to enable more meaningful and relevant conversations with customers by utilising information from connected systems. We also introduced a 'Machine Learning' capability, which is helping us to better identify individual customer needs and inform how we personalise our customer communication. In addition, we simplified the process for opening current accounts, including instant decisions, document upload, and made the process paper free.
- We continued to improve our online mortgage retention tool, where transaction volumes in 2017 increased substantially. In June 2017, we also launched a new service that allows customers to apply for their mortgage via a video link to an advisor, hence enhancing the omni-channel experience and providing them with more choice and flexibility.
- Protecting our customers, systems and information is a top priority and in 2017, we undertook a large programme of staff training, customer education and technology improvements. This also included enhanced technical measures to ensure our technology continues to be resilient to online cyber-disruption. Our Cyber Resilience programme continued to operate with a layered defence approach, constantly evolving and adapting to cyber threats. We also launched a successful 'Phish and Chips' campaign designed to raise awareness and equip customers with the knowledge they need to prevent themselves becoming a victim of fraud.
- We are committed to enabling our customers to use third party providers (TPP) through Open Banking. We intend to work with regulators to ensure that the Open Banking ecosystem develops quickly to meet the challenges of cyber security, fraud and wider financial crime. We will also proactively monitor customer transactions and will work to protect our customers by inhibiting TPPs when we establish a clear instance of fraud or likely risk of fraud.
- We continued to make investments accessible to all customers by expanding our wealth management business. We have grown our Private Banking and Financial Planning advisory teams and have c220,000 customers registered on Investment Hub, our online platform. In 2017, we also improved our Select & Private Banking offering by launching a new current account and the World Elite Mastercard, the latter offering extensive travel and lifestyle benefits while also providing cashback on purchases. These products also offer customers access to our services in 11 countries worldwide, a unique feature of Santander Select.
- We continued to make improvements to our banking services for smaller SME customers by growing the Santander Business franchise. We embedded a new operating model and streamlined our portfolio to provide more capacity and enable greater support to our clients. We also introduced a fast track process for asset finance up to £150,000 and simplified the credit application process for smaller exposures to facilitate quicker lending decisions.

Commercial Banking

- We are focused on leveraging investments and on meeting our customers' full financial needs through banking and transactional services, in addition to lending. We are building primacy through our collaboration with Banco Santander S.A. and key strategic partners to develop international trade initiatives, which complement existing services like the Santander Trade Club. In 2017, we announced trade corridors with Spain, US, Poland, Brazil, and South East Asia to facilitate introductions to support trade and offer our customers new business opportunities in the respective markets. We also formalised an alliance with YES bank, India's fourth largest private sector bank and a partnership with JD.com Worldwide, the cross-border e-commerce arm of China's largest retailer.
- Growth Capital provides high growth SMEs with innovative funding solutions to support investment and help accelerate the development of our clients' business. Since inception, we have supported over 120 businesses and lent more than £500m, of which c£200m was this year having completed 50 deals.
- Our innovative offering was once again recognised at the 2017 Business Moneyfacts Awards, winning a number of prestigious awards including: 'Business Bank of the Year' and the 'Best International Solutions Provider', both for the third consecutive years. The industry recognition is a testament to Santander UK's commitment to become the bank of choice for UK companies and shows the strength of our value proposition, built on our relationship banking approach.

Global corporate banking

- We continue to develop our global franchise by improving client coverage and products. In 2017, we funded more than 25 infrastructure and energy projects in the UK, topping the UK infrastructure league tables as the overall sector leader. There was also increased demand for our Debt Capital Markets services on €170bn of bond issuance. In addition, our recently established M&A team delivered its first advisory mandate for a cross-border transaction and our markets business saw a substantial increase in client flows.
- We also continued to enhance our compliance and risk frameworks, with improvements to our internal processes. We integrated the financial crime management operations of GCB and Commercial Banking, by investing in additional resources and an upgrade to systems and processes. We also made progress in rolling out our client management service to all our customers, to simplify the client on-boarding process and improve customer experience. Furthermore, we embedded our operational risk framework in Santander London Branch in preparation for ring-fencing.

Governance

Contents

Board of Directors

Shriti Vadera
Chair

Chair since 30 March 2015, previously Independent Non-Executive Director and Deputy Chair from 1 January 2015.

Skills and experience

Shriti Vadera was an investment banker with SG Warburg/UBS from 1984 to 1999, on the Council of Economic Advisers, HM Treasury from 1999 to 2007, Minister in the UK Government from 2007 to 2009 (Cabinet Office, Business Department and International Development department), G20 Adviser from 2009 to 2010, and advised governments, banks and investors on the eurozone crisis, banking sector, debt restructuring and markets from 2010 to 2014.

Other principal appointments

Chair of Santander UK Group Holdings plc* since 30 March 2015.

Senior Independent Director of BHP Billiton plc since 2015 and Non-Executive Director of BHP Billiton plc and BHP Billiton Ltd since 2011. Non-Executive Director of AstraZeneca plc since 2011.

Board committee membership

Nomination Committee since 1 January 2015 and Chair since 30 March 2015.

Alain Dromer
Independent Non-Executive Director

Appointed Independent Non-Executive Director on 1 October 2013.

Skills and experience

Alain Dromer is an experienced financial services executive director with 25 years' experience in asset management and capital markets in the UK and Europe, together with nearly 10 years' experience with the French Treasury.

He was previously CEO of Aviva Investors; Global Head of Group Investment Business of HSBC Investments; Head of Asset Management at CCF Crédit Commercial de France and Head of Capital Markets of La Compagnie Financière Edmond de Rothschild Banque. Prior to that, Alain held various roles in the Government of France, French Treasury including Section Head, World Monetary Affairs and IMF, and Deputy Head/Office of Financial Markets.

Other principal appointments

Independent Non-Executive Director of Santander UK Group Holdings plc* since 2014. Director of Moody's Investors Service Ltd since 2013. Director of Moody's Investors Service EMEA Ltd since 2014. Independent Member of the Advisory Board of Moody's Deutschland GmbH since 2013. Independent Member of the Supervisory Board of Moody's France SAS since 2013. Non-Executive Director of Majid Al Futtaim Trust LLC since 2013. Non-Executive Director of Henderson European Focus Trust plc since 2014.

Board committee membership

Audit Committee since 1 January 2014. Remuneration Committee since 1 January 2014. Risk Committee since 15 December 2015.

Annemarie Durbin
Independent Non-Executive Director
Chair of Board Remuneration Committee

Appointed Independent Non-Executive Director on 13 January 2016.

Skills and experience

Annemarie Durbin has 30 years' international retail, commercial, corporate and institutional banking experience culminating in being a member of Standard Chartered's Group Executive Committee. In addition, she was Group Company Secretary at Standard Chartered for a number of years and an independent non-executive director on the board of Fleming Family and Partners Limited. Annemarie is an executive leadership coach and a Board governance consultant.

Annemarie brings broad based international banking, leadership, talent development, executive remuneration, property, internal audit, crisis management, business continuity, operational excellence and governance capabilities to the Board.

Other principal appointments

Independent Non-Executive Director of Santander UK Group Holdings plc* since 13 January 2016. Non-Executive Director of Ladbrokes Coral Group plc since 24 January 2017. Non-Executive Director of WH Smith PLC since 2012. Member of the Listing Authority Advisory Panel since 2015 and Chair since 1 April 2016.

Board committee membership

Remuneration Committee since 13 January 2016 and Chair since 4 August 2017. Responsible Banking Committee since 1 July 2017. Risk Committee since 13 January 2016.

Board of Directors continued

Ed Giera
Independent Non-Executive Director
Chair of Board Risk Committee

Appointed Independent Non-Executive Director on 19 August 2015.

Skills and experience
Ed Giera is an experienced Non-Executive Director, having held a number of Board roles following his career with JP Morgan Securities, the investment banking affiliate of JP Morgan Chase & Co. He provided corporate finance advisory and fiduciary services as Principal of EJ Giera LLC and was formerly a Non-Executive Director for the Renshaw Bay Structured Finance Opportunity Fund, NovaTech LLC, and the Life and Longevity Markets Association. Ed was also a director of Pension Corporation Group Ltd from 2012 to 2015, and Pension Insurance Corporation Holdings Ltd from 2008 to 2012.

Other principal appointments
Independent Non-Executive Director of Santander UK Group Holdings plc* since 19 August 2015. Non-Executive Director of ICBC Standard Bank Plc since 2015. Non-Executive Director of Pension Insurance Corporation Group Limited since 2015. Non-Executive Director of the Renshaw Bay Real Estate Finance Fund since 2012.

Board committee membership
Audit Committee since 19 August 2015.
Risk Committee member since 19 August 2015 and Chair since 1 November 2015. Responsible Banking Committee since 1 July 2017.

Chris Jones
Independent Non-Executive Director
Chair of Board Audit Committee

Appointed Independent Non-Executive Director on 30 March 2015.

Skills and experience
Chris Jones was a partner at PwC from 1989 to 2014. He focused on the financial services industry from the mid-1980s and was a Senior Audit Partner specialising in the audit of banks and other financial services companies. He also led PwC's EMEA Financial Services practice and was a member of their Financial Services global leadership team.

Chris is a past president of the Association of Corporate Treasurers.

Other principal appointments
Independent Non-Executive Director of Santander UK Group Holdings plc* since 30 March 2015. Audit Committee member of the Wellcome Trust since 1 September 2016. Non-Executive Director of Redburn (Europe) Ltd since 2014. Chairman of the Advisory Board of the Association of Corporate Treasurers since 2010. Investment Trustee of the Civil Service Benevolent Fund since 2015.

Board committee membership
Audit Committee since 30 March 2015 and Chair since 30 June 2015. Remuneration Committee since 1 September 2015.
Risk Committee since 30 March 2015. Chris is also Santander UK's Whistleblowers' Champion.

Genevieve Shore
Independent Non-Executive Director

Appointed Independent Non-Executive Director on 18 May 2015.

Skills and experience
Genevieve Shore brings digital, technology and commercial expertise to Santander UK from a career in the media, publishing and technology sectors, most recently as Chief Product and Marketing Officer of Pearson plc, and previously as Director of Digital Strategy and Chief Information Officer.

Genevieve has also advised and invested in Education Technology start-ups and works with female executives as a coach and mentor.

Other principal appointments
Independent Non-Executive Director of Santander UK Group Holdings plc* since 18 May 2015. Non-Executive Director of Next Fifteen Communications Group plc since 2015. Non-Executive Director of Moneysupermarket.com Group plc since 2014. Non-Executive Director of Arup Group Limited since 2017. Independent Non-Executive Director of the Rugby Football Union since 2017.

Board committee membership
Audit Committee since 1 September 2015.
Risk Committee since 1 September 2015.
Responsible Banking Committee since 1 July 2017.

* Part of the Banco Santander group.

Scott Wheway
Independent Non-Executive Director
Senior Independent Director
Chair of Board Responsible Banking Committee

Appointed Senior Independent Director on 18 May 2015 and Independent Non-Executive Director on 1 October 2013.

Skills and experience
Scott Wheway brings extensive retail and consumer knowledge to the Board, having formerly held various senior roles at Tesco plc, including Operations Director and CEO, Tesco Japan. Following this, he was CEO of Best Buy Europe and Managing Director and Retail Director of Boots Company plc (now known as The Boots Company Ltd) and Managing Director of Boots the Chemist at Alliance Boots plc. Scott also has experience of the financial services sector through his past roles at Aviva plc (NED from 2007 to 2016) and Aviva Insurance Limited (Chairman from 2015 to 2017).

Other principal appointments
Independent Non-Executive Director of Santander UK Group Holdings plc* since 2014. Non-Executive Director of Centrica plc since 1 May 2016. Chairman of AXA UK plc since 12 December 2017.

Board committee membership
Nomination Committee since 1 January 2014. Remuneration Committee since 1 January 2014 and Chair (September,2015 to July 2017). Risk Committee since 1 January 2014. Responsible Banking Committee, Chair since 1 July 2017.

Ana Botín
Banco Santander Nominated Non-Executive Director

Appointed Non-Executive Director on 29 September 2014.

Skills and experience
Ana Botín joined the Banco Santander group in 1988 and was appointed Executive Chair of Banco Santander SA in September 2014. Ana has been a member of Banco Santander SA's Board and Executive Committee since 1989 and previously served as Chief Executive Officer and Executive Director of Santander UK plc from December 2010 to September 2014. She has extensive financial services experience. She directed Banco Santander SA's Latin American expansion in the 1990s and was responsible for the Latin American Corporate Banking, Asset Management and Treasury divisions.

Other principal appointments
Previously Exective Director of Santander UK plc* from 1 December 2010 to 29 September 2014. Non-Executive Director of Santander UK Group Holdings plc* since 29 September 2014. Executive Chair of Banco Santander SA* since 2014 and Director since 1989. Non-Executive Director of The Coca-Cola Company since 2013. Vice-Chair of the Empresa y Crecimiento Foundation since 2000. Vice-Chair of the World Business Council for Sustainable Development since 11 January 2016. Member of the MIT's CEO Advisory Board since 2015.

Board committee membership
Nomination Committee since 27 July 2015.

Juan Rodríguez Inciarte
Banco Santander Nominated Non-Executive Director
Deputy Chair

Appointed Non-Executive Director on 1 December 2004.

Skills and experience
Juan Rodríguez Inciarte joined Banco Santander SA in 1985. After holding various positions, he was appointed to the Board of Directors in 1991, holding this office until 1999. Juan was also an Executive Director of Banco Santander SA from 2008 to 2015.

Juan has also held directorships at the Royal Bank of Scotland plc (RBS) and National Westminster Bank plc from 1998 to 2004, ABN Amro, First Fidelity Bancorp, First Union Corporation (now part of Wells Fargo), and at NIBC Bank NV.

Other principal appointments
Non-Executive Director of Santander UK Group Holdings plc* since 2014. Director Santander Consumer Finance SA* since 2003. Director of SAM Investment Holdings Limited* since 2013. Director of Vista Capital de Expansion SA SGECR since 2007. Chairman of Saarema Inversiones SA since 2005.

Board committee membership
Risk Committee since 1 September 2015.

Board of Directors continued

Gerry Byrne
Banco Santander Nominated Non-Executive Director

Appointed Non-Executive Director on 1 December 2017.

Skills and experience
Gerry Byrne has been the Chairman of the Supervisory Board of Bank Zachodni WBK SA* (BZWBK), since 2011 having originally joined the BZWBK Board as Deputy Chairman in 2001.

Previously, he held several senior management roles at AIB Group, both in Ireland (from 1973 to 2000) and in Poland (from 2001 to 2010), latterly as Managing Director of the Central Eastern Europe Division in 2009-2010. He is a member of the Irish Institute of Bankers, Irish Management Institute and an Alumni of Harvard Business School.

Other principal appointments
Non-Executive Director of Santander UK Group Holdings plc* since 1 December 2017. Chairman of the Supervisory Board of Bank Zachodni WBK SA since 2011.

Lindsey Argalas
Banco Santander Nominated Non-Executive Director

Appointed Non-Executive Director on 1 January 2018.

Skills and experience
Lindsey Argalas joined Banco Santander SA in September 2017 as Chief Digital and Innovation Officer where she is responsible for leading the Bank's digital transformation and innovation efforts throughout the Banco Santander group. Lindsey joined Banco Santander from the Silicon Valley-based software company Intuit Inc, where she held a number of senior positions from 2008 to 2017, most recently as Senior Vice President, Chief of Staff to the CEO. Prior to that, Lindsey worked as a Principal at the Boston Consulting Group for 10 years with world renowned retail and customer products companies in Europe, Australia and the USA. Lindsey brings extensive international experience of driving growth and leading transformational change with particular expertise in new market entry, customer-driven innovation and digital experiences.

Other principal appointments
Non-Executive Director of Santander UK Group Holdings plc* since 1 January 2018.

* Part of the Banco Santander group.

Nathan Bostock
Executive Director
Chief Executive Officer

Chief Executive Officer since 29 September 2014, previously Executive Director and Deputy Chief Executive Officer from 19 August 2014.

Skills and experience
Nathan Bostock joined Santander UK from RBS, where he was an Executive Director and Group Finance Director. He joined RBS in 2009 as Head of Restructuring and Risk, and Group Chief Risk Officer. Nathan previously spent eight years with Abbey National plc (now Santander UK plc) from 2001 to 2009 and served on the Board as an Executive Director from 2005. During his time with Abbey National plc, he held various senior positions including Chief Financial Officer and Executive Director. Nathan was also previously at RBS from 1991 to 2001 in a number of senior positions and spent seven years before that with Chase Manhattan Bank, having previously qualified as a Chartered Accountant with Coopers & Lybrand (now PwC).

Other principal appointments
Chief Executive Officer of Santander UK Group Holdings plc* since 29 September 2014. Director of Santander Fintech Limited* since 2015. Director of SAM Investment Holdings Limited* since 2014. Member of the PRA Practitioner Panel since 2014. Member of the Financial Services Trade and Investment Board (FSTIB) since 2015.

Antonio Roman
Executive Director
Chief Financial Officer

Appointed Chief Financial Officer on 30 October 2015 and Executive Director from 1 August 2017.

Skills and experience
Antonio Roman has extensive financial services experience across a wide range of areas including Finance, Investor Relations and Retail Banking. He was appointed Treasurer of Santander UK plc in 2014, with responsibility for the management of interest risk, liquidity, funding, economics and investor relations.

Antonio joined Santander UK plc in 2013 as Deputy Treasurer and prior to that held the position of Head of Financial Management at Banco Español de Credito SA*.

Antonio also worked for Grupo Caja Madrid where he served as Financial Controller from 2007 to 2010.

Other principal appointments
Chief Financial Officer of Santander UK Group Holdings plc* since 30 October 2015. Executive Director of Santander UK Group Holdings plc* since 1 August 2017. Director of Abbey National Treasury Services plc* since 2014. Management Board Member of Abbey Covered Bonds LLP* since 2014. Member of UK Finance's (previously the British Bankers' Association) Financial and Risk Policy Committee since 2015.

Javier San Felix
Executive Director
Head of Retail & Business Banking,
Deputy Chief Executive Officer

Appointed Head of Retail & Business Banking, Deputy Chief Executive Officer on 1 August 2015 and Executive Director from 1 August 2017.

Skills and experience
Javier has significant retail and commercial international banking experience. He has held a number of senior positions within the Banco Santander group since he joined in 2004, including more recently Senior Executive Vice President, Global Retail and Commercial Banking, Senior Executive Vice President, Latin America (excluding Brazil) and CEO, Banco Español de Crédito, Banesto.
He was Chairman of the European Financial Management Association (EFMA) from 2014 to 2017. Javier also worked for McKinsey & Company for 13 years in Spain, latterly as a partner.

Other principal appointments
Head of Retail & Business Banking, Deputy Chief Executive Officer of Santander UK Group Holdings plc* since 1 August 2015. Executive Director of Santander UK Group Holdings plc* since 1 August 2017. Director of SAM Investment Holdings Limited* since 12 September 2016. Director of Santander Consumer (UK) plc* since 2016. Director of Santander UK Technology Limited* since 2017.

* Part of the Banco Santander group.

Chair's report on corporate governance

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

Our governance

As a non-listed subsidiary of a European banking group, we are not required to comply with the UK Corporate Governance Code (the Code). However, we choose to voluntarily comply with the Code, wherever applicable, to practice best corporate practice.

In addition to the Code, our governance is set out in a number of key documents, these are:

- the UK Group Framework, which defines clearly our responsibilities and relationship with Banco Santander SA, our sole shareholder. This provides Banco Santander SA with the oversight and controls it needs while providing us with the autonomy to discharge our responsibilities in the UK in line with best practice as an independent board. Clarity of roles and responsibilities is key to ensuring proper accountability for decisions and outcomes; and
- the Corporate Governance Framework, which outlines the various constitutional documents underpinning the operation of the Board and its Committees as well as Executive Governance and Delegated Authorities.

Board membership

During the year, three of the Banco Santander nominated Non-Executive Directors (Group NEDs), Peter Jackson, Bruce Carnegie-Brown and Manuel Soto, stepped down. I should like to thank Peter, Bruce and Manuel for their invaluable service to the Board and the Company. During the year, we appointed Antonio Roman, Chief Financial Officer, and Javier San Felix, Deputy CEO and Head of Retail & Business Banking, as Executive Directors on 1 August 2017 and appointed Gerry Byrne and Lindsey Argalas on 1 December 2017 and 1 January 2018 respectively as Group NEDs. These appointments have provided the Board with skills and experience in retail and corporate banking, finance, strategy, digital and innovation.

Following these changes, the Board's composition continues to align with the UK Group Framework principles of at least 50% INED membership, including the Chairman, appropriate breadth and depth of skills and experience, and gender diversity. There are one-year rolling terms in place for all NEDs.

Board committees

The Board delegates certain responsibilities to Committees to assist in discharging its duties, as set out on page 27. The Committees play an essential role in supporting the Board in these duties, providing focused oversight of key areas and aspects of the business.

The role and responsibilities of the Board and each Board Committee are set out in formal Terms of Reference. These are reviewed at least annually as part of the Corporate Governance Framework review.

In Q3 2017, we have further strengthened the Company's connection between culture, conduct and customer outcomes by establishing the Responsible Banking Committee. The purpose of this Committee is to assist the Board in shaping the culture, reputation and customer propositions of Santander UK through overseeing and advising management on conduct, people, community, brand and compliance issues.

The Responsible Banking Committee is chaired by our Senior Independent Director Scott Wheway. Its first report on its activities will be provided in the 2018 corporate governance review.

> "The purpose of the Responsible Banking Committee is to assist in shaping the culture, reputation and customer propositions of Santander UK."

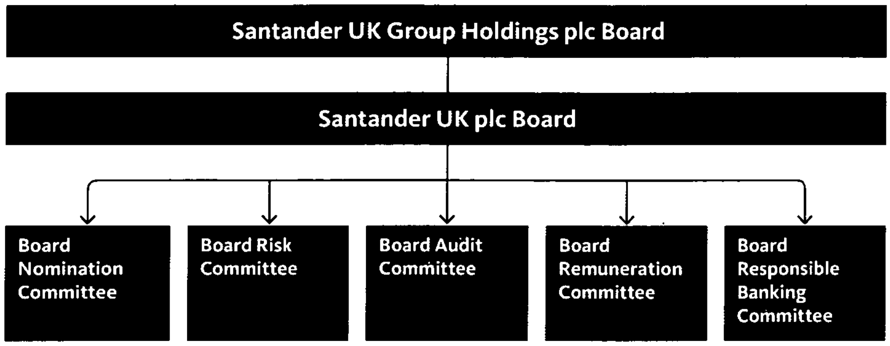
Shriti Vadera

Shriti Vadera
Chair
27 February 2018

(1) In this Annual Report, the terms 'independence' and 'Independent' are, unless otherwise stated, defined in accordance with our UK Group Framework. For further details see page 51.

Board membership, tenure and attendance
Read more on **p49**

Board responsibilities
Read more on **p27**



The Board Committees make recommendations to the Board in accordance with their Terms of Reference. The Chair of each Committee reports to the Board at each meeting on the matters discussed and significant developments within their remit that warrant further consideration by the Board. The minutes of each meeting, except for the Board Nomination Committee, are provided to the Board members for information.

All Committees are chaired by INEDs and have only INEDs as members, other than the Board Risk Committee and the Board Nomination Committee. Following Manuel Soto's retirement from the Board in December 2017, the Board Audit Committee is also comprised of INEDs only and this is our policy going forward. All INEDs are members of the Board Risk Committee in order to provide efficient working and effective oversight of risks. The activities undertaken by each of the Board Committees are set out in the Board Committee Chairs' reports on pages 28 to 44. A report on the activities of the Responsible Banking Committee will be provided in the 2018 Annual Report. The full Terms of Reference for each Committee are available on Santander UK's website www.santander.co.uk and from the Company Secretary upon request.

Board fees

We reviewed all Board and Board Committee fees during the year and made no changes to the existing fee structure. It was agreed that the fees for the Chair and members of the Responsible Banking Committee would align with those of the Board Audit Committee, Board Remuneration Committee and Board Risk Committee.

In consideration of the time commitment required, it was agreed that a fee of £30,000 per annum would be paid to Genevieve Shore as the Independent Chair of the Customer & Innovation Forum. This is a non-Board forum providing advice and guidance to assist the Company in being well placed to meet emerging customer preferences through our digital and innovation capability. The Customer & Innovation Forum is scheduled to meet eight times per year.

Board fees are set out on page 48 in the Directors' Remuneration Report.

Conflicts of interest

Santander UK's Articles of Association contain provisions that allow the Board to consider and, if it sees fit, to authorise situational conflicts. The Board confirms that such powers have been operated effectively and that a formal system for Directors to declare their interest and for the non-conflicted Directors to authorise situational conflicts continues to be in place. Any authorisations given are recorded by the Company Secretary.

Board effectiveness review

In 2017 we maintained our focus on our strategic priorities for the Board. The Board discussed and refreshed its strategic priorities during the year. The existing priorities were reaffirmed and updated and a new priority on systems and capabilities was added. The existing six priorties are in the areas of long-term strategy; regulatory trust; customer focus; embedding culture; talent and succession planning, and systems and capabilities. These were not intended to set the strategy or the priorities of the business but have been invaluable in setting the Board agenda and guiding the Board's deliberations and discussions.

This year we reviewed the progress made on implementing the recommendations from last year's extensive external evaluation of Board effectiveness and carried out an internal assessment of effectiveness. The internal review concluded that the Board, the Chair and each of its Directors continue to be effective.

The Board is satisfied that the Chair and those Directors who have external directorships have sufficient time available to discharge their responsibilities and to be effective members of the Board.

Board activities

The Chair, together with the CEO and Company Secretary, ensure that the Board has an appropriate schedule so that its time is focused on matters of strategic importance to the business and appropriate monitoring of risks and controls. We keep under review the items considered by the Board and their appropriate frequency and the balance of issues in order to ensure that the Board adequately discharges its responsibility. In line with an assessment of the forward looking agenda, we reconfirmed that the total number of scheduled Board meetings held in 2018 will remain at eight. We will keep this under review as we continue to enhance our operating efficiency.

The Board held its annual Strategy Offsite in June, where we considered the competitive landscape, the Company's Digital Strategy and innovation, as well as the opportunities and risks facing the banking sector and their implications for our long-term strategy. As a result we refined our focus in relation to strategic initiatives, and progress on these are reported to the Board at appropriate frequencies.

Board strategic priorities

- Long-term strategy
- Regulatory trust
- Customer focus
- Embedding culture
- Talent and succession planning
- Systems and capabilities

Chair's report on corporate governance continued

To ensure the most effective use of time at Board meetings, in addition to the delegation of certain responsibilities to the Board Committees, the Board has Board dinners, external speaker lunches and workshops.

The Board ensures regular contact with the senior leadership through a number of means. These include: inviting relevant business and function heads to present to the Board or its Committees on current internal and external developments; permitting observers as part of individual senior managers' development plans; scheduling regular meetings for Committee Chairs to meet with relevant senior managers; site visits by one or more Directors; and topical or technical workshops.

In addition, senior leaders make themeselves available to meet with the NEDs throughout the year.

Non-Executive Director inductions and training

The delivery of our tailored NED induction programmes for our new appointments continued through 2017, and other NEDs also have ongoing development plans. The external Board effectiveness review conducted in 2016 included individual evaluation of all Board members, and the feedback from those reports was included in individual development plans for 2017. This assists the NEDs in having the necessary understanding of the business, its activities, core markets, and operating environment. The Company Secretary supports the Chair in designing individual inductions for NEDs, which include site visits and cover topics such as strategy, key risks and current issues including the legal and regulatory landscape.

Throughout 2017 we continued to deliver regular workshops for all NEDs to further develop their knowledge and understanding of key business issues such as payments and clearing systems, financial crime and IFRS 9. This has been supplemented with visits to corporate sites and branches. A summary of the Board's activities in 2017 is set out below.

Summary of Board activities in 2017

The Board's activities during 2017 related to the following themes:

Theme	Actions taken by the Board and outcomes
Business and customer	– Reviewed, challenged and remained apprised in respect of various items, including strategic business opportunities; developments with customer experience and complaints; and the performance and strategy of the Retail Banking, Commercial Banking and Global Corporate Banking divisions. The Board also reviewed, challenged and approved the 3-year business plan (2018-2020) and the Budget for 2018, including associated risk assessments and UK-relevant material presented at the Banco Santander Investor Day. The Board received an update on the competitor environment.
Strategy	– The Board held its annual Strategy Day offsite in June 2017. Discussions included 2018 targets, banking trends and competitors, digital innovation and transformation, M&A market opportunities, the three year business plan and the evolution of the Retail & Business Banking model.
Regulation, Balance Sheet and capital	– Reviewed, challenged and approved the ICAAP, RFB ICAAP, ILAAP and Santander UK's Recovery and Resolution Plan; adequacy and effectiveness of stress-testing and capital management; tax strategy statement; structured notes and short-term funding programmes; Ring-Fencing Programme; Dividends and AT1 Payments. The Board also reviewed the asset and liability management activities and was appraised of regulatory developments. The Board received an update on pensions.
Risk and control	– Reviewed, challenged and approved the update to the Risk Appetite and monitored performance across all risk types. Received regular enterprise wide risk updates from the CRO; and updates on Technology and Operations (T&O), IT risk, cyber risk including the Group Ransom Policy, fraud policy and financial crime management plans.
People	– Received updates on people issues including HR strategy, talent management and succession planning as well as culture, diversity and inclusion; assessed the performance of the CEO; and participated in the Banking Standards assessment process and approved Santander UK's response to the Banking Standards Board survey.
Governance	– Reviewed, revised and approved the Board's Strategic Priorities; the appointment of two EDs, two Group NEDs and the Chief Risk Officer; revisions to the UK and Group Corporate Governance Frameworks; and the annual whistleblowing report. The Board also reviewed its Terms of Reference, together with the Terms of Reference of the Board Committees. – Approved the establishment of the Responsible Banking Committee to assist the Board in shaping the culture, reputation and customer propositions of Santander UK through overseeing and advising on conduct, people, community, brand and compliance issues. – Reviewed, challenged and approved Santander UK's Annual Report. – Assessed the performance of the Board Chair.

Strategic report
Financial review
Governance
Risk review
Financial statements
Shareholder information

Board and Board Committee responsibilities

	Key responsibilities
Board	- Review, approve and monitor performance in respect of corporate strategy, major plans of action, Risk Appetite and policies, annual budgets and business plans. - Monitor the effectiveness of Santander UK's governance arrangements including appointments to the Board and its Committees and managing conflicts of interest. - Monitor the performance of the CEO and Senior Executives. - Ensure that appointments to the Board or its Committees are effected in accordance with the appropriate governance process. - Monitor and manage potential conflicts of interest of management, Board members, shareholders, external advisers and other service providers.
Board Nomination Committee	- Review the structure, size and composition of the Board, including skills, knowledge, experience and diversity. - Consider succession planning for Directors and senior executives. - Identify and nominate candidates to fill Board vacancies as and when they arise. - Assess the performance of the Board. - Review annually whether NEDs have dedicated sufficient time to their duties to have been effective in their role. - Oversee Santander UK's governance arrangements.
Board Risk Committee	- Advise the Board on the enterprise wide risk profile, Risk Appetite and strategy. - Review the enterprise wide risk profile by way of business updates provided by the First Line of Defence and regular reports and updates on each key risk type provided by the Second Line of Defence. - Provide advice, oversight and challenge to embed and maintain a supportive risk culture throughout Santander UK. - Review the Risk Framework and recommend it to the Board for approval. - Review and approve the key risk type and risk activity frameworks identified in the Santander UK Risk Framework. - Review the capability to identify and manage new risks and risk types. - Oversee and challenge the day-to-day risk management actions and oversight arrangements and adherence to Santander UK's risk frameworks and policies.
Board Audit Committee	- Monitor and review the integrity of the financial statements of Santander UK. - Keep under review the adequacy and effectiveness of the internal financial controls. - Review the adequacy of Whistleblowing arrangements. - Monitor and review the effectiveness of the Internal Audit function. - Assess the performance of the External Auditors and oversight of their independence.
Board Remuneration Committee	- Consider, agree and recommend to the Board the principles and parameters of Santander UK's remuneration and reward policies and frameworks. - Consider and approve specific remuneration packages for EDs and other senior management. - Oversee the implementation of remuneration policies, ensuring they promote sound and effective risk management. - Determine and oversee the remuneration governance framework. - Review and approve regulatory submissions in relation to remuneration.
Board Responsible Banking Committee	- Oversee culture and operational risks relating to conduct, compliance, competition, financial crime and legal matters set within the Risk Appetites and Risk Framework. - Ensure adequate and effective control processes and policies for conduct and compliance risk, fair customer treatment and customer outcomes. - Oversee the reputation of Santander UK and how this impacts its brand and market positioning, and the Corporate and Social Responsibility Programme. - Monitor, challenge and support management in its efforts to evolve Santander UK's conduct, culture and ethical standards through sustained effectiveness of Santander UK's values and nine behaviours.

Board Nomination Committee Chair's report
Read more on **p28**

Board Risk Committee Chair's report
Read more on **p30**

Board Audit Committee Chair's report
Read more on **p37**

Board Remuneration Committee Chair's report
Read more on **p43**

Board Nomination Committee Chair's report

The Committee has overseen changes to the Board and recommended the establishment of the Board Responsible Banking Committee.

Overview of the year
The Committee oversaw a number of changes in the membership of the Board and Committees since last year's report, with the departure of three Banco Santander nominated NEDs (Group NEDs) and the appointment of four new Directors. The Committee also focused on reviewing the skills matrix of the Board to ensure that we had the right balance and breadth of skills and experience, changes to the membership of the Board Committees and succession planning both for the Board and senior management. The Committee met on three occasions during the year.

In 2017, the Committee recommended to the Board the establishment of the Board Responsible Banking Committee and the recommendation of its Terms of Reference, and consequent changes to the Board Risk Committee Terms of Reference. The purpose of the Board Responsible Banking Committee is to assist the Board in shaping the culture, reputation and customer propositions of Santander UK through overseeing and advising on conduct, people, community, brand and compliance issues.

Board and Committee membership
During the year, three of the Group NEDs, Peter Jackson, Bruce Carnegie-Brown and Manuel Soto, stepped down from the Board. I would like to thank them for their commitment and contribution to the Board during their tenure. The Committee has been actively engaged in the Board appointments process of identifying, assessing and recommending new members to the Board in alignment with the UK Group Framework principles (see page 51) and ensuring appropriate breadth and depth of skills and experience, and diversity. In replacing members who have stepped down, we took into consideration the overall Board composition in order to ensure that we had the right skill sets to meet our fiduciary duties.

In line with the process set out in the UK Group Framework, and following an assessment by the Committee as to suitability, the Committee recommended the appointments of Gerry Byrne and Lindsey Argalas to the Board as Group NEDs. Gerry Byrne brings a wealth of experience in the international banking sector most recently through his experience gained as Deputy Chairman and Chairman of the Supervisory Board of Bank Zachodni WBK SA and prior to that through his experience at the AIB Group, both in Ireland and in Poland. Recognising the importance of the digital agenda in the bank's strategy, Lindsey Argalas, as Banco Santander SA's Chief Digital and Innovation Officer brings a depth of experience in digital technology and innovation and an important connectivity with Banco Santander's innovation and digital strategy businesses.

In August 2017, Antonio Roman and Javier San Felix were appointed to the Board. As EDs, Antonio is our Chief Financial Officer and Javier our Deputy CEO and Head of Retail & Business Banking.

We streamlined the membership of the Committee, which previously had six members, to comprise in addition to myself as the Chair, the Senior Independent Director and the Banco Santander Group Executive Chairman as the Group NED representative on the Committee. This aligns with revisions to our UK Group Framework by reducing the required number of Group NEDs to one.

“ We will continue to work on talent and succession planning”

Responsibilities of the Committee
Read more on **p27**

Committee membership, tenure and attendance
Read more on **p49**

Shriti Vadera

Shriti Vadera
Chair
27 February 2018

We also reviewed other Committee memberships in order to provide efficient working and effective oversight and decided membership of the Board Responsible Banking Committee. This resulted in reducing the size and composition of the Board Audit and Board Remuneration Committee memberships as explained in the respective reports on pages 37 and 43, Scott Wheway becoming the Chair of the newly-established Board Responsible Banking Committee and stepping down as Chair of the Board Remuneration Committee, and Annemarie Durbin taking his place as the Chair.

All Committees are chaired by INEDs and have only INEDs as members, other than the Board Risk Committee and Board Nomination Committee. Following Manuel Soto's retirement from the Board in December 2017, the Board Audit Committee is also comprised of INEDs only and this is our policy going forward. The membership of the Committees is set out on pages 49 and 50.

Evaluation of Board effectiveness
In 2016, we engaged an independent consultant, Ffion Hague of Independent Board Evaluation, to evaluate the effectiveness of the Board and its Committees. Following the comprehensive nature of the review in 2016, the Board on the recommendation of the Committee agreed to carry out an internal review in 2017 focused primarily on progress against the actions from the 2016 evaluation. The review concluded that the performance of the Board, its Committees, the Chair, and each of the Directors continues to be effective.

Skills and experience
The Committee continued to monitor NED skills, experience and time commitment through the year. This has informed the selection process during the recruitment of new NEDs and enabled us to assess their ongoing development and training needs.

A tailored plan has been developed for each of the new NEDs, including visits to corporate sites and branches, as appropriate to their experience, which are also well attended by existing NEDs. We have continued regular workshops for all NEDs to deepen and refresh our understanding of key business issues. For more information see page 26.

Diversity
Last year, we set an aspirational target of having 33% women on the Board by 2020. Following the appointment of Lindsey Argalas in January 2018, I am pleased that we achieved a ratio of 36%, ahead of target. We will continue to strive toward gender balance and broader diversity.

Santander UK has committed to gender targets for our senior female management population, and we have embedded these into our Executive Committee annual performance objectives. We will continue to ensure that gender and broader diversity remains front of mind in our succession planning.

Succession Planning
The Committee is responsible for overseeing the process of succession for Board Directors and is satisfied that a robust plan is in place to meet planned as well as emergency requirements. The Committee has also been working to ensure that a robust succession planning framework is in place for senior management and will continue to review the adequacy of our succession planning. As a very important part of the responsibility of all Directors, this is regularly discussed as part of the Board agenda.

Annual review of director interests, time commitment and fees
Consistent with its terms of reference, the Committee completed its annual review of the Directors' interests to ensure any conflicts are managed appropriately and in compliance with CRD IV requirements. The time commitments of the Directors were also reviewed to ensure Directors have sufficient time available to discharge their responsibilities and to be effective members of the Board.

The review of time commitment of the Directors showed that Directors are able to dedicate sufficient time to their commitments on the Board and Board Committees.

Priorities for 2018
Over the next year we will continue to work on talent and succession planning, in particular on senior management succession and NEDs' continuing development.

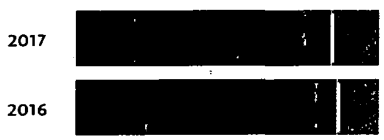
Board Risk Committee Chair's report

The Committee supports the Board in ensuring that the business operates within agreed Risk Appetite while taking account of emerging risks.

Overview of the year
The Committee considered a wide range of risks during 2017, from the perspective both of their potential impact on our business and on our customers. These risks included the execution of the ring-fencing programme as we approach the legislative deadline of January 2019; the macro-economic environment, particularly in the context of the ongoing uncertainty following the result of the UK referendum on EU membership in June 2016; the resilience of our systems to fraud, data and cyber risks; and financial crime risks.

How we spent our time (%)

	2017	2016
Operational risk	20	24
Risk appetite and internal controls	13	15
Credit risk	14	14
Reporting	6	10
Regulatory risk	22	16
Other risks	9	7
Specific risks	16	14



We have also continued to receive regular updates on the single name credit exposures that are non-performing or on the Watchlist, including Carillion, and on matters such as stress testing; capital and liquidity; and pension risk appetite.

Following the establishment of the Board Responsible Banking Committee in July 2017, we agreed that certain risk types previously considered by the Board Risk Committee would in future be considered by that Committee. These include: financial crime; reputational risk; conduct and compliance; and risk culture.

The Board Risk Committee will, however, maintain a holistic view of Enterprise-Wide risks and, to help achieve this, there is appropriate cross-membership between the two committees.

Membership
The only change to the membership during the year was the departure of Bruce Carnegie-Brown with effect from 1 June 2017. Bruce made a valuable contribution to the Committee, both as a member and as a former Chair, and I would like to take this opportunity to thank him on behalf of the Committee.

Otherwise, the Committee has again benefited from a period of consistency as members' familiarity with the matters considered by the Committee has continued to grow. I believe that the Committee retains an appropriate balance of skills and expertise to carry out its role effectively.

The Terms of Reference require the majority of the members to be Independent Non-Executive Directors. This criterion was met throughout the year.

"We receive regular reports on enterprise wide risk and we have called risk owners to our meetings to account for their progress."

Edward J. Giera

Ed Giera
Board Risk Committee Chair
27 February 2018

Responsibilities of the Committee
Read more on **p27**

Committee membership, tenure and attendance
Read more on **p49**

Meeting our key responsibilities in 2017

How we addressed our key responsibilities relating to Risk Appetite and the Risk Framework, together with a representative selection of matters where we raised challenges and other related outcomes, as well as our work on stress testing and individually significant matters, is shown below. For information on our responsibilities relating to risk management and internal controls **see page 36**.

Significant areas of focus

Area of focus	Action taken by the Board Risk Committee	Outcome
Risk Appetite	- Following the Annual Risk Appetite Review at the beginning of the year, we also reviewed some proposed amendments to Risk Appetite in June. - We monitored Pension Risk appetite metrics closely, in part due to the increase in the absolute size of the pension fund due to market movements. When considering possible changes, we noted that a strategic asset allocation and hedging programme were underway. We reviewed the pension risk appetite position again in detail in the second half of the year. - Whilst responsibility for oversight of financial crime risk transitioned to the Board Responsible Banking Committee in Q3 2017, the Board Risk Committee retains ultimate oversight. During the first half of 2017, we spent considerable time considering the financial crime transformation programme and financial crime risk appetite.	- We recommended management's proposed amendments to Risk Appetite to the Board for approval. - We noted in the second half of the year that equity hedging had been transacted by the Common Investment Fund Trustee which materially reduced the risk. For more on Risk Appetite **see page 65**
Risk Framework	- We received an update on the annual certification process in respect of compliance with management of risk within the Risk Framework. - We carried out our annual review of the Risk Framework and noted a number of changes, including the introduction of the Board Responsible Banking Committee; the separation from operational risk of legal risk and its creation as its own risk type.	- We noted that the outcomes reflected what had been considered by the Committee during the year. - We noted that the Framework would be revisited in the coming months to consider what further changes might be necessary to reflect ring-fencing, and new regulatory guidelines. We recommended the Risk Framework to the Board for approval. For more on Risk Framework **see pages 58 to 64**
Stress testing	- As in previous years, in 2017 the Committee monitored the annual stress test exercise, and received updates throughout the process, including with respect to proposed enhancements following the 2016 exercise. We also considered the comparison of key metrics and results with prior years and questioned management on material drivers. - We also noted the context and results of the IFRS 9 stress test submitted to the Bank of England in September 2017 and considered the implications of the change in accounting standard for managing and monitoring credit, capital and model risk respectively.	- We recommended the governance arrangements, process, controls and stress test results to the Board for approval and onward submission to the PRA. - We noted the need to be cognisant of the impact on capital of the adoption of IFRS 9 in the context of the stress tests. For more on stress testing **see page 66**
Macroeconomic environment	- We received an update on an internal stress scenario, centred on a material confidence shock to the UK economy. The results supported the conclusions of previous PRA stress tests which showed that Santander UK had a resilient capital position. - We considered, from a credit perspective, certain vulnerable industry sectors in the context of the changing macro-economic environment, and considered the effectiveness of early warning indicators in identifying deteriorating performance.	- We requested management to inform the Committee further around the impact of stress scenarios for the medium term outlook for the UK, with a focus on the potential dislocation in the second half of 2019, including the development of possible scenarios. - We asked for assurance around the efficacy of monitoring, as well as the potential impact from the transfer of credit assets to the London branch of Banco Santander SA as part of the ring-fencing programme.

Board Risk Committee Chair's report continued

Area of focus	Action taken by the Board Risk Committee	Outcome
Ring-fencing	- We received frequent updates on the ring-fencing programme both as part of the Enterprise-Wide Risk Management Reports and separately. The updates focused on the ring-fencing programme's top risks and mitigating actions. - Following changes to the original ring-fencing model, we agreed to recommend that the Board approve management's revised proposals. - We noted the confirmation from management that there was alignment between the views of the Company and the Independent Expert that the implementation of the Part VII Ring-Fence Transfer Scheme (RFTS) does not create any adverse effects to customers that are likely to be greater than reasonably necessary in order to achieve ring-fencing. - We also noted the reliance on completion of the Part VII FSMA process in time to effect the ring-fencing programme in accordance with the legislation.	- We continue to monitor developments relating to ring-fencing. For more on ring-fencing **see page 225**
Technology & Operations (T&O)	- During the year, we received a number of updates on T&O's risk management priorities and, at 31 January 2017, were advised that, following the completion of mitigation activity, all firm threatening risks have extensive control sets which ensures the likelihood of a major impact to the bank is low. However, cyber, in particular, continues to be subject to close monitoring. - Updates included a review of the fraud prevention and detection strategy including client communication strategies and staff training; cyber risk and progress in respect of the Cyber Security plan; the work of the Cyber Defence Alliance; and the implementation of a software package to control and reduce risk associated with end user computing. We noted that recruiting cyber defence resource remained challenging, and we agreed that management would look at this issue thoughtfully in an effort to reduce the dependency on third party expertise. - In respect of IT obsolescence, we noted the increasing risk profile and pace of IT change. We considered management's assessment of high impact, high priority systems, together with a programmatic approach for prioritisation and risk mitigation.	- We requested further updates on end user computing and third party risk management once these had been discussed by management. - We supported management's plans for continued investment in fraud prevention and detection. - We challenged the scope of management's assessment, which excluded third party technology risks, and the appropriateness of the risk-based methodology to allocate budget. - We requested management to consider proposals to refine the communication process with Board members in the event of larger scale, systemic cyber-attacks. For more on operational risk **see page 128**
European Union	- Following the result of the UK referendum on EU membership in June 2016, we continued to monitor the risks and potential impact to Santander UK of the negotiation of terms for the UK to leave the EU, and for future agreements covering trade in both goods and services. - We had early sight of Santander UK's draft response to the PRA following the regulator's request for firms to undertake appropriate contingency planning for the UK's withdrawal from the EU. We expressed support for the sentiment set out in the draft letter, but considered that the dangers of continuing uncertainty should be expressed more strongly. - We received an update on the impact of the UK's decision to leave the EU on the continuity of contracts, including with respect to derivatives, insurance policies, central counterparty clearing, and contracts pertaining to personal data and cross-border services. - We also considered an analysis outlining potential impacts from the outcome of the French Presidential election in respect of potential funding, liquidity, and credit risks.	- We are monitoring closely political developments as they progress. - We noted the risks in respect of a lack of any legislative solutions, and requested that management continue to monitor the position closely and to develop contingency arrangements. - We agreed with management's assessment and planning for potential tail risks.

Oversight and advice to the Board on Santander UK's current risk exposure and future risk strategy
During 2017, we reviewed Santander UK's exposure to the risks outlined below and analysed emerging themes, including regulatory, macro-economic and global risks, which could affect Santander UK's ability to achieve its strategic goals.

Risk	Action taken by the Board Risk Committee	Outcome
Pension risk	- We challenged management with respect to the need to manage capital impact, principally through hedging of market risks, and the related impact on the overall performance of the pension fund in the context of the current funding target agreed with the Trustee. - We requested that management confirm whether, given the inflation hedging in place within the Santander (UK) Group Pension Scheme, there were scenarios where there would be significant exposure in a rising inflation scenario.	- We considered the level of certain triggers proposed as part of the pension risk appetite and asked management to provide additional support. - We requested further detail of the individual elements of the pension risk appetite be submitted for consideration before the Committee was asked to approve the risk appetite in early 2018. - Management undertook analysis to assess the impact of four different inflation scenarios on the Pension Scheme's forecast IAS 19 accounting position at the end of the forecast period in 2026. Following consideration, the Committee concurred that the exposure was manageable. For more **see page 122** See page **124** for a case study on our pension hedging strategy.
Financial Crime risk	- In Q3 2017, oversight of financial crime risk transitioned to the Board Responsible Banking Committee. Prior to that, we received regular updates from both Line 1 and Line 2, as defined on page 63, on the mitigation of financial crime risks. We debated the challenges in relation to recruitment of experienced resource, systems limitations, and the pace of improvement, across the organisation, relative to risk appetite.	- We noted the importance of coordination between HR and critical functions in the recruitment, training and retention of internal expertise and requested regular updates going forward to monitor progress. - We agreed that management would re-set its plans for addressing financial crime risk, including the establishment of a Financial Crime Steering Committee (supported by external consultants), to oversee progress in respect of the various financial crime initiatives. The CEO and CLRO jointly chair the Steering Committee.

Board Risk Committee Chair's report continued

Risk	Action taken by the Board Risk Committee	Outcome
Credit risk	- We received updates on various corporate exposures, including to Carillion plc. - We challenged management as to whether appropriate management information (MI) was generated to enable them to review the development of significant credit risk exposures on a real time basis. - In the context of regular updates on Retail Credit risks, we also noted the Retail Risk Playbook tolerance framework, which set out the approach that the Risk function proposed to adopt to manage retail credit risks in the event that the economy deviated materially from forecast. - In addition to monitoring the increase in corporate non-performing loans in GCB, we considered management's review into Corporate Banking Economic Headwinds across vulnerable sectors, including a detailed overview of exposure and credit performance, as well as the adequacy of dedicated restructuring and recovery resource. - We received an update on the Consumer (auto) finance risk profile.	- We noted that exposures to each sector had been reviewed during 2017 and a series of reduction plans had been implemented. We were advised by management that these would now be revisited and consideration given to whether any further actions would be appropriate to de-risk the portfolio. - We were advised that information provided was suitable from a monitoring perspective, but the architecture of the existing systems posed challenges to fully utilising all available data, pending further investment in credit bureau and internal customer data. - We recognised the need to monitor model calibration based on potential changes to the underlying dynamics in the UK economy. - We supported management's plans for exposure management across economically sensitive sectors, and preparations for a potential change in the credit cycle. We requested that counterparty risk ratings were updated more regularly. - We noted that management was reviewing its incident management processes to ensure that there could be a quick and effective reaction to idiosyncratic and industry events. For more **see pages 68 to 99**
Market risk	- We considered the annual traded market risk review and noted that market risk on the trading book continued to be low, with the main source of profit and loss volatility continuing to be valuation adjustments in relation to derivatives. - The three year Net Interest Margin (NIM) metric moved materially due to the increase in market rates in June. We noted that the three year NIM had previously been identified as a very sensitive metric.	- We supported management's ongoing plans to adopt systems and processes required to deliver traded risk stress analyses annually. - We agreed to recommend to the Board that the three year NIM should be operated as a trigger rather than as a limit, since an excess should not necessarily force immediate action, but rather prompt management to consider potential strategies. For more **see page 100**
Liquidity risk	- We considered the 2017 Internal Liquidity Adequacy Assessment Process (ILAAP) and noted the changes since the previous year. These included refreshing and enhancing the Liquidity Risk Appetite (LRA) and enhancing the control and governance around the business approach to, and assessment of, the LRA scenarios.	- We noted the reduction in the LRA. This was due to the increased severity of the new stress scenarios, and therefore, going forward the LRA will become a more prudent measure of liquidity. We requested a more detailed review of the changes be scheduled for Q1 2018 to ensure that members of the Committee had appropriate oversight of the component parts of the LRA. - We agreed to recommend the 2017 ILAAP to the Board for approval, noting that a number of challenges raised during the meeting, but not critical prior to approval, would be addressed through on-going review. For more **see page 108**

Risk	Action taken by the Board Risk Committee	Outcome
Capital risk	- We considered, from a capital risk perspective, dividends payable on AT1 securities, and the ordinary dividends proposed to be paid by Santander UK plc. - We reviewed the Internal Capital Adequacy Assessment Process (ICAAP) and agreed to recommend it to the Board.	- We recommended the payment of dividends to the Board for approval, and requested that, during 2018, management prepares potential actions and available options for managing headroom relative to key capital levels for the horizon of the Three Year business plan. For more **see page 119**
Operational risk	- We noted a number of adverse trends, including unavailability rates of ATMs and fraud relating to telephone banking, mitigated by the roll out of voice biometrics capability. - In respect of third party supplier risk, we noted that, while there were currently no trends that were causing concern, management added third party risk to the list of top risks, and was continuing to monitor each sector for any negative signs. We challenged management on the adequacy of resource around third party risk management capability. - With respect to horizon scanning, we considered key challenges such as the potential risk arising from the transition to Open Banking under PSDII. - We requested and received an update on the key risks and issues arising from, and being managed by, the General Data Protection Regulation (GDPR) Programme ahead of its introduction in May 2018.	- We were advised that new metrics which had been introduced were flagging issues more effectively, and did not necessarily indicate a trend of decline. - We requested more information on the status and degree of reliance on obsolete systems in future updates, and noted that management actions to reduce obsolescence were progressing in accordance with plans to address the risk exposure. - We were advised that management did not consider there was sufficient resource for managing third party supplier risk, but that an adviser had been engaged to deliver analysis and the position would be considered further once the analysis had been completed. The review also would consider the target operating model for managing third party risk. For more **see page 128**
Conduct and regulatory risk	- We received an update on Conduct Risk Strategy Programme activity. - We noted the identification of a number of emerging issues and, whilst their identification was positive, we expressed concern over whether the systems and processes were sufficiently capable. We also stressed the need for simplification and prioritisation of areas of high risk. We discussed the confluence of conduct, operational issues and regulatory constraints. - We provided oversight in connection with review and enhancement of certain key processes, including in relation to probate and bereavement. - Following delegation of an action from the Board, we requested and received regular updates on the main risks faced by the MiFID II Programme, mitigating actions and contingency plans ahead of the effective date of 3 January 2018. - We noted the merging of the management of conduct risk and regulatory risk.	- We noted that, whilst more work remained to be done, the degree and nature of the progress was appropriate. - We noted the importance of assessing performance in the content of management's priorities, as well as industry wide challenges. For more **see page 125** For more on how we have been supporting vulnerable customers **see page 127**
Model risk	- We noted the increased reliance being placed on models and the ongoing work within Santander UK to ensure effective management and control of models across the organisation. We noted that recruitment of sufficient resource with the necessary expertise was challenging. - We noted that from January 2018 all material models would be risk assessed at least every 14 months.	- We questioned the process to identify the universe of models and noted the introduction of specialist software by the Risk function for a range of applications.

Board Risk Committee Chair's report continued

During the year, we also considered a number of other areas of risk, including reputational risk; strategic risk; regulatory risk; and legal risk.

Effectiveness of risk management system and internal controls
During the year, we continued to receive updates on the completion by all business units of their Risk and Control Self Assessments (RCSA). Following the latest half-yearly assessment, we were advised that no additional major risks were identified. The highest individual residual risk exposures each had an executive owner and remediation plans, and the RCSA will be used and updated by the business on a regular basis.

We also received regular reports on the implementation of key risk control programmes during the course of the year, including the model risk framework. We noted that budget allocations aligned with the CRO's views on appropriate resourcing for the Risk function.

We also noted the introduction of Principal Operational Risk Dashboards (PORD) by the organisation to assess across a range of operational risks by high level Principal Operational Risk Categories. This is influenced by the underlying Risk MI, and overlaid with senior management judgement, to identify business-wide thematic trends.

Change Programme
The scale, scope and critical nature of the various change initiatives undertaken by Santander UK to meet regulatory and other requirements continued to pose significant risk. We received updates on actions being taken to mitigate change risk and noted that a significant proportion of total expenditure continued to relate to regulatory and compliance projects. We also noted the ongoing efforts to increase permanent in-house project management skills and noted that the development of an agile work environment was enhancing the organisation's capacity to adapt.

Six months on from the previous update to the Committee, we requested an update from an external consultant on the progress of the work undertaken by the business in respect of the controls and strategic operating model of our Global Corporate Banking business segment. We were advised that material progress had been made and the remaining observations from the original report could be managed on a business as usual basis. We also noted the need for the organisation to continue to develop to meet evolving new challenges.

Effectiveness of the Committee
As referenced above, the Committee membership has only seen one change during the year. I believe that the Committee has an appropriate mix of skills to enable it to operate effectively and to offer appropriate challenge and support to management.

We reviewed the Committee's responsibilities as set out in the Terms of Reference and confirmed that the Committee had discharged its responsibilities in full in 2017.

Full terms of reference can be found on our website at www.santander.co.uk and a summary is given on page 27.

We receive regular reports on enterprise wide risk and we have called risk owners to our meetings to account for their progress. Where appropriate, we have also called upon the resources of leading external organisations to provide confirmation of progress in respect of change initiatives.

These actions are examples of how we have looked to inform our debate and decision-making during the course of the year and contribute to our effectiveness as a Committee.

Priorities for 2018
As we move closer to the implementation of ring-fencing and the UK's departure from the EU, we will consider capital stress testing following the adoption of IFRS 9, and regularly assess our capital adequacy relative to internal and regulatory benchmarks.

Credit risk, both retail and corporate and commercial, will remain central to our business and sensitive to changing economic conditions, and will be the focus of our continued attention.

Cyber risk will continue to be a priority. We will monitor the outcomes of the technology architecture review and especially the appropriate adoption of cloud services, ongoing data architecture review and increasing use of Application Program Interfaces (APIs) and micro-services. This major change will bring new technologies into play and is essential for our strategy and customer outcomes, but presents new operational risks.

We also expect to monitor key structural risks, banking market and pension risk, in accordance with the development of interest rates and the overall macro-economic environment.

Strategic report
Financial review
Governance
Risk review
Financial statements
Shareholder information

Board Audit Committee Chair's report

Our responsibilities include oversight of the integrity of financial reporting and controls, the effectiveness of our internal audit function, the relationship with the external auditors and the adequacy of our whistleblowing arrangements.

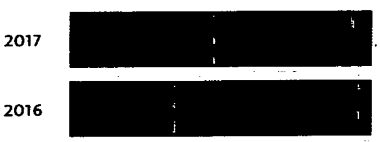
Overview of the year
During 2017, the principal activities of the Committee included:

- Assessing the appropriateness of key management judgements, including the consideration of the exposure to PPI in the context of the publication of the FCA's final rules and guidance and the FCA's advertising campaign on PPI, as well as a review of the corporate credit provisioning, including our exposure to Carillion plc.
- Overseeing the IFRS 9 planning and its transitional impact.
- Providing oversight on the effectiveness of financial reporting and controls.
- Overseeing the performance of the Internal Audit function, reinforcing accountability amongst management for addressing Internal Audit recommendations, assuming lead responsibility for objective setting and performance evaluation of the Head of Internal Audit and supporting an increase in Internal Audit resources.
- Continued development and oversight of interaction with our External Auditors.
- Continued improvement of interaction between the Committee and the Banco Santander Audit Committee (the Audit Committee of our parent company), including participation in the Santander Chairs of Audit Committee Meeting, and
- Overseeing Santander UK's whistleblowing arrangements, including an increase in specialist whistleblowing resources and further enhancements in accordance with the FCA's whistleblowing rules.

We also addressed other responsibilities delegated to the Committee by the Board.

How we spent our time (%)

	2017	2016
Financial reporting	48	35
Internal audit and internal controls	22	30
External audit	13	15
Legal and compliance including whistleblowing	10	15
Other	7	5



Membership
Following a regular review of the size and composition of the Board and its committees, Scott Wheway and Annemarie Durbin stepped down from the Committee on 30 June 2017. Manuel Soto resigned from the Board and Committee on 15 December 2017. Manuel made a valuable contribution to the Committee during his tenure and I would like to take this opportunity to thank him on behalf of the Committee.

In respect of the Revised Statutory Audit Directive, the Board satisfied itself that at least one member of the Committee had competence in accounting and auditing, and the members of the Committee as a whole had competence in the banking sector, in which we are operating.

At 31 December 2017, all four members of the Committee were Independent Non-Executive Directors.

The Committee met the necessary requirements of independence throughout the year, in accordance with the requirements of Rule 10A-3 under the US Securities Exchange Act of 1934.

> "In 2017, we considered the exposure to PPI in the context of the FCA's advertising campaign, reviewed corporate credit provisioning including our exposure to Carillion plc and oversaw planning for IFRS 9 and its transitional impact."

Chris Jones
Board Audit Committee Chair
27 February 2018

Responsibilities of the Committee
Read more on **p27**

Committee membership, tenure and attendance
Read more on **p49**

Board Audit Committee Chair's report continued

Significant financial reporting issues and judgements

The use of assumptions or estimates and the application of management judgement is an essential part of financial reporting. In 2017, we focused on the following significant reporting matters in relation to financial accounting and disclosures:

Financial reporting issue or judgement	Action taken by the Board Audit Committee	Outcome

Conduct provisions
The provision for conduct remediation activities for PPI and other products continues to be highly judgemental and requires significant assumptions including claim volumes, uphold rates and redress costs.
	- Continued to scrutinise the level and adequacy of conduct remediation provisions and challenged the reasonableness of management's assumptions throughout the year.
	- In respect of PPI, the Committee:
	  - Reviewed the judgements and estimates in respect of the provision considering management's assumptions in relation to changes in claim volumes, uphold rates and average cost of redress. This was in the context of key developments in the year, including:
	    - The FCA's publication in March 2017 of final rules and guidelines in respect of PPI complaints. This provided further clarification on the application of the Supreme Court judgement in Plevin v Paragon Personal Finance Limited, and extended the consumer complaint deadline to August 2019.
	    - The completion of a review of claims handling procedures in Q2 2017 by management in relation to a specific PPI portfolio.
	    - The FCA's first advertising campaign on PPI.
	  - Benchmarked PPI provisioning disclosures in light of those adopted by peers.
	  - Reviewed updates to the provisioning model in light of increased PPI enquiries and complaint inflow levels driven by the media advertising campaign and proactive mailings to customers potentially eligible to make a further complaint.
	  - Reviewed the appropriateness of provision releases pertaining to a specific PPI portfolio review.
	- In respect of other products, the Committee evaluated management's judgements and estimates in respect of additional provisions relating to the sale of interest rate derivatives, regarding the regulatory classification of certain customers eligible for redress.
		- Requested and received from management benchmarking analysis against other banks on the level of PPI disclosures, to satisfy ourselves on the adequacy of Santander UK's disclosures.
		- Requested and received from management details of the enquiries received through all channels, including social media, following the launch of the FCA's advertising campaign on PPI, and conversion of those enquiries into complaints.
		- Endorsed management's recommendation that an additional net charge of £109m in the year should be made for PPI.
		- Agreed with management's judgement on the level of conduct remediation provisions, including PPI and other products.
		- We will continue to monitor the provisioning levels in light of any changes to claims volumes, inflows and average redress costs.
		
		See 'Critical accounting policies' in Note 1 to the Consolidated Financial Statements.
		
		For more, see Note 27 to the Consolidated Financial Statements.

Credit provisions – corporate Determining the appropriateness of corporate credit provisions is highly judgemental, requiring management to make a number of assumptions.	- Reviewed detailed reports from management on credit provisions relating to corporate lending portfolios throughout the year to satisfy ourselves that any impairment triggers had been correctly identified. - Considered reports on specific cases in the construction sector, including Carillion plc, as well as a review of the rest of the construction portfolio to identify other cases that could potentially be at risk. - Discussed other exposures and satisfied ourselves that there had been no impairment triggers during the year that warranted any significant adjustment to provision levels.	- Agreed with management's judgement on the level of corporate credit provisions, concluding that provisions remain robust and assumptions were appropriate. - We will continue to monitor closely corporate credit provisions. See 'Critical accounting policies' in Note 1 to the Consolidated Financial Statements. For more, see Note 15 to the Consolidated Financial Statements.

Financial reporting issue or judgement	Action taken by the Board Audit Committee	Outcome
Credit provisions – retail Determining the appropriateness of retail credit provisions, especially those relating to the mortgage portfolio, remains one of the most significant areas of management judgement.	– Reviewed detailed reports from management throughout the year analysing the proposed provisions. – Considered proposals on refinements to the assumptions underpinning the mortgage provision models and the impacts on the level of provisions required.	– Agreed with management's judgement on the level of retail credit provisions, concluding that provisions remain robust and assumptions were appropriate. – Endorsed management's recommendation to make a provision release in relation to unsecured write-offs as a result of an enhancement of the methodology. – We will continue to monitor retail credit provisions. See 'Critical accounting policies' in Note 1 to the Consolidated Financial Statements. For more, see Note 15 to the Consolidated Financial Statements.
Implementation of IFRS 9 Ensuring the appropriate application of IFRS 9 is a significant area of management judgement given its technical complexity, the number of key decisions and judgements needed, and their potential impact on transition.	– Monitored the implementation of IFRS 9 throughout the year, reviewed key management decisions and challenged the most significant assumptions. – Reviewed key decisions and judgements and their impacts, considering sensitivity analysis to the different options presented. We placed special focus on post model adjustments, the criteria to trigger a 'significant increase in credit risk' and the internal governance around forward-looking macroeconomic scenarios and weights, as well as the approach to setting them. – Reviewed the results from parallel runs, including variances to IAS 39 numbers. – Challenged management's implementation strategy and plan, including models and their level of sophistication, data requirements and IT infrastructure. – Reviewed changes to processes, internal controls and governance to ensure they are appropriate for use. – Reviewed the proposed approach to year-end disclosures and publication of transitional impacts.	– Requested and received two deep-dive sessions on key decisions and judgements as well as quarterly updates on their impact and progress on implementation. – Agreed with management's key decisions and judgements and noted the results from parallel runs. – Endorsed the implementation strategy and plan. – Endorsed the proposed year-end disclosures and content of the transitional document. – We will continue to monitor closely how adoption of the new standard is embedded in internal governance and business processes. – We will monitor the PRA's expected credit loss (ECL) consistency agenda, including the output of the Taskforce on Disclosures about ECL and, in particular, recommendations around the disclosure of ECL measurement uncertainty and sensitivity which are expected to develop during 2018. See 'Accounting policies – future accounting developments' in Note 1 to the Consolidated Financial Statements.
Pension obligations Significant management judgement is required on financial and demographic assumptions such as mortality, discount rates, inflation rates and pension increases. Actuaries are engaged to help assess pension obligations because of the complex nature of the calculations, but outcomes remain inherently uncertain.	– Reviewed detailed reports throughout the year on the key assumptions underlying the defined benefit pension obligation calculations. We noted that the calculations continue to be prepared with the assistance of actuarial advisers and when assessing our pension obligations recognised that, although some of the assumptions were based on observable data, there remained others that require significant management judgement. – Debated changes in methodology to derive the inflation risk premium to better reflect management's view of inflation expectations, and updated mortality rate assumptions appropriate for the Scheme mortality experience and latest data. – Noted that no changes were proposed in respect of the discount rate assumption methodology. – Noted that the revised inputs and related models had been subject to our pensions governance framework. – Noted the appointment of new actuarial experts. – Monitored the continued appropriateness of the methodology and reviewed the inflation, discount and mortality rates applied at the year-end.	– Sought and was provided with clarification on the rationale for, and regulatory capital impact of, the changes to the methodology to derive the discount and inflation rate assumptions. – Agreed with management's approach to the assumptions applied, including changes made to assumptions during the year. – Endorsed the proposed quantitative and qualitative disclosures in respect of pension obligations, including disclosures around the methodology changes at the end of the year. See 'Critical accounting policies' in Note 1 to the Consolidated Financial Statements. For more, see Note 28 to the Consolidated Financial Statements.

Board Audit Committee Chair's report continued

The Committee's focus continues to be on areas of significant judgement, being those which pose the greatest risk of a material misstatement to the financial statements. In addition to the areas of significant judgement set out in the table on the preceding pages, the Committee also considers other higher risk items. During the 2017 year end process, these included the identification and assessment of risks of material misstatement due to fraud or error, the change in accounting policy for common control transactions, impairment of intangible assets, and disclosures related to operations which are currently expected to be transferred out of the Santander UK group as part of ring-fencing, subject to regulatory approval. We have also received regular reports on any material litigation cases and their progress, as part of our consideration of provisions and contingent liabilities.

External Auditors

Following their appointment in 2016 as a result of the re-tendering of the global external audit, the Committee continued to develop and oversee the interaction with PwC with Jon Holloway in his second year as the audit partner, after the global re-tender. The independence of PwC was considered and monitored throughout the year.

Oversight of the relationship with our External Auditors

As part of our review of our relationship with our External Auditors, PwC, our activities included:

- Consideration of their work and opinion relating to management judgements;
- Review of the summary of misstatements not corrected by management; the Committee was satisfied that they were not quantitatively or qualitatively material, both individually and in the aggregate;
- Discussion regarding the level of disclosure in the Annual Report and Half Yearly Financial Report to satisfy ourselves that it is appropriate;
- Discussion of developments in financial reporting including changes to accounting standards, statute and best practice;
- A review of reports received from PwC on findings and recommendations on internal control and financial reporting matters identified during the course of their audit and their view of management's progress in resolving them; and
- Interactions, including meetings in private session during each Committee meeting, and at other times throughout the year.

Based on the above inputs, which were captured in a formalised assessment, the Committee satisfied itself as to the rigour and quality of PwC's audit process. The Committee also reviewed the latest results of the FRC's quality inspections and our auditors' response to the FRC's challenge on the general quality of banking audits.

Non-audit fees

We have a policy on non-audit services provided by our External Auditors, which was updated in 2016 in the context of the Revised Ethical Standard issued by the FRC on auditor independence requirements resulting from the new European Audit Regulation and Directive.

Non-audit services were under continuous review throughout 2017 to determine whether they were permitted by reference to their nature, assessing potential threats and safeguards to auditor independence as well as the overall ratio of audit to non-audit fees.

All individual assignments require advance approval, either by the Chair (or in his absence his delegate), under delegated authority for amounts under £250,000 plus VAT or, if larger, by the full Committee. This process is in addition to the requirement for all non-audit fees to be approved by the Banco Santander Audit Committee.

The fees for non-audit work performed by PwC during the year, other than audit-related assurance services, primarily comprised services performed in respect of the GCB remediation programme of £0.4m. We ensured that this met both the external and internal tests for maintaining their independence, including evidence of their professional scepticism.

We also monitored:

- The non-audit fees and independence of Deloitte LLP, our auditors for the 2015 year-end process, until they achieved independence. This was confirmed with effect from 5 May 2017 and thus proposed engagements up until that date remained subject to approval prior to appointment; and
- Other fees in respect of work performed by Ernst & Young, in their role as our appointed Independent Expert in relation to the ring-fencing requirements.

Internal control

The Board Risk Committee has overall responsibility for the effectiveness of the internal control systems. However, due to the nature of internal control matters, there is a natural overlap in responsibilities with those of this Committee. We recognise that a robust framework of internal control is essential for a complex and changing business environment.

We have a comprehensive internal control framework in place and during the course of the year, we received and considered regular reports regarding the operation of, and continued enhancement to this framework. This comprised reports from Internal Audit and the External Auditors as well as the related plans and actions taken by management to successfully remediate control recommendations raised in those reports, including addressing IT user access control weaknesses. Finance has provided regular updates to this Committee on internal control over financial reporting (ICFR).

Internal control over financial reporting

Section 404 of the Sarbanes-Oxley Act requires management to report on the design and effectiveness of its ICFR framework. Further enhancements have been introduced to the ICFR framework, in order to better align to Public Company Accounting Oversight Board (PCAOB) standards. Work is also progressing to further embed the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework following its adoption in December 2014.

We considered the financial control environment during the year. The Committee received regular reports on ICFR, including key systems, and provided feedback on remediation and overall improvements required to ensure that the relevant controls were appropriately designed and operating effectively. This included special focus on management actions aimed at addressing control deficiencies identified through the assessment of the effectiveness of the ICFR framework.

Disclosure in the Annual Report
We received regular reports from the Disclosure Committee, a senior executive committee chaired by the Chief Financial Officer. Its remit is to advise the Committee on the completeness and accuracy of disclosures made by Santander UK in its external reporting. This, together with other reports received during the year, and a review of best practice and the approach of our peers, enabled us to conclude that we were satisfied with the level of disclosure made in this 2017 Annual Report.

Management also engaged the Board and Committee early on the approach to the report which enabled them to provide input into the overall tone and messaging in a timely manner.

The Committee also reviewed and approved streamlined disclosures in the Quarterly Management Statements and Investor Updates following a benchmarking exercise to bring our disclosures more in line with our peers and to highlight areas of market interest, such as Consumer Finance and Commercial Real Estate. The disclosures in these areas have also been enhanced in the Annual Report.

Fair, balanced and understandable
The Disclosure Committee also reports on whether the Annual Report is fair, balanced, and understandable and whether it provides the information necessary for readers to assess Santander UK's position and performance, business model and strategy.

In this context, the Disclosure Committee considered and advised us whether:

- Key messages remained consistent throughout the document, relating both to financial performance and progress against strategic objectives;
- All key judgements, significant risks and issues are reported and explained clearly and adequately; and
- There is a clear framework to the document with good signposting and a complete picture of performance and events.

We have worked to further improve our external reporting to align more closely with our peers. We have also had due regard to best practice, our relationship with our ultimate parent company, and the requirements of our debt and capital investors.

In addition to the above review process, the Committee's assessment of fair, balanced and understandable is underpinned by the understanding it gains through the reporting of management judgements, internal control matters, Internal Audit activities and the reports of the External Auditors made to the Committee throughout the year.

The Committee's assessment also considers the robustness and outcomes of the assurance, review and verification processes conducted by management and considers whether the key risks reflected those that were of a concern to the Committee and were consistent with those reported by management.

Following our assessment we concluded that the 2017 Annual Report is fair, balanced and understandable.

Financial Reporting Council (FRC) Annual Review of Corporate Reporting 2016/2017
In October 2017, the FRC issued a report entitled 'Annual Review of Corporate Reporting 2016/2017' which sets out its assessment of corporate reporting in the UK based on outreach and evidence from the FRC's monitoring work and thematic reviews. The report outlines the characteristics of corporate reporting which the FRC believe make for a good annual report, beyond basic compliance with laws and accounting standards.

As part of our oversight of this area, we received and reviewed a report from management on its work in respect of the areas of interest to the FRC. We are satisfied that management adhered to the characteristics identified by the FRC in the preparation of this Annual Report to the extent appropriate to our ownership structure.

Going Concern and Viability
We satisfied ourselves that it is appropriate to use the going concern basis of accounting in preparing the financial statements, supported by a detailed analysis provided to the Committee by senior finance management.

As part of the assessment, we considered whether there are sufficient financial resources, including liquidity and capital, available to continue the operations of Santander UK. We considered Santander UK's resilience in the face of potential stress and prominent events. In making our assessment, we took into account all information of which we were aware about the future, which was at least, but not limited to, 12 months from the date that the balance sheet was signed.

The going concern assessment is further enhanced by the Viability Statement. This is a requirement of the UK 2014 Corporate Governance Code, which we have chosen to adopt to the extent appropriate to our ownership structure. This statement requires the Directors to explain how they have assessed Santander UK's prospects, over what period they have done so and why they consider that period appropriate.

Whilst the full disclosures are included in the Directors' report, we have satisfied ourselves that a three-year time period for the viability statement remains appropriate. Although the determination of longer-term viability for banks is of greater inherent uncertainty, banks are already subject to extensive regulatory measures including having to meet minimum capital and liquidity requirements as well as having to carry out stress tests. A time period of three years remains consistent with our planning horizon and that covered by regulatory monitoring.

Board Audit Committee Chair's report continued

Internal Audit
The Internal Audit plan, based on a comprehensive risk assessment, was presented in draft and then final form for challenge and approval by the Committee. The plan has been updated at regular intervals throughout the year, in response to changes in the business and the regulatory environment, and at the request of the Committee.

A recalibration of audit ratings was overseen by the Committee in 2016 to ensure that the full rating scale was applied more consistently and to highlight areas that require immediate attention. This has resulted in an increase in unsatisfactory audit reports being issued. These reports are subject to additional scrutiny by the Committee with the relevant business areas being required to present their action plans to the Committee.

The Committee also chose to invite key members of management with any past due recommendations to present on progress with the implementation of Internal Audit's recommendations, issues encountered with closing them, key milestones and key dependencies including those relating to Banco Santander.

We received regular reports on audit recommendations from our Head of Internal Audit (Quarterly Internal Audit Reports) and monitored findings as part of our oversight. We considered the aggregate number of recommendations, the rationale for any recommendations becoming overdue, and broader root cause analyses. The Committee also requested that the Head of Internal Audit highlight recommendations becoming due.

The Committee continued to review the remainder of conclusions and recommendations of an external Quality Assurance assessment of a sample of internal audits that had been completed during the second half of 2016 at the request of the Committee. Structured feedback was obtained directly from those who had been audited, which was supplemented by periodic external reviews.

We considered the recommendations made as part of our continuous improvement programme, and supported the further strengthening of the Internal Audit resource base.

A strong engagement between the Internal Audit function and the business during 2017 was noted.

The Chartered Institute of Internal Auditors published in 2017 an updated Guidance on Effective Internal Audit in Financial Services – Second Edition (the Code), and a self-assessment exercise was performed by the Head of Internal Audit against the expectations of the revised code and concluded that the function is generally compliant with the Code. Whilst there were no material gaps, improvement opportunities were identified, which have been included in the function's Continuous Improvement Plan.

We also assumed lead responsibility for and oversaw the objective setting and performance evaluation of the Head of Internal Audit.

Whistleblowing
The Committee received biannual reports on Santander UK's whistleblowing activities. The reporting includes oversight of progress reports and outcomes, as well as root cause analysis and information on identifiable trends, hot spots and any observable risks. The reporting also covers developments in the regulatory environment and activities to promote enhancements to Santander UK's whistleblowing arrangements. The Committee is satisfied that Santander UK has complied with the FCA and PRA regulations on whistleblowing during the year.

The Committee considers that the Whistleblowing Policy and training, both enhanced during 2017, play a key role in supporting our culture and behaviours at all levels in the business. Santander UK has, as part of the continuous process of improving its whistleblowing arrangements, recruited two new full time members of staff to the Central Whistleblowing Team. Both staff members have whistleblowing and investigations experience across a range of industries. These appointments are considered a positive step in the right direction as well as demonstrating the ambition of Santander UK in developing and enhancing its whistleblowing arrangements. The Committee also sees the annual report on whistleblowing which the Board receives and considers.

During the year, I continued to act as the Whistleblowers' Champion. The purpose of this role is to oversee the integrity, independence and effectiveness of the policies and procedures in this area including ensuring procedures are in place to prevent victimisation of those employees who have raised a whistleblowing concern.

I continued to work closely with management, receiving monthly updates on key areas of whistleblowing activity including trends, communications, awareness, training and testing. I supported management's continuing education and awareness campaign for whistleblowing by recording personal messages for inclusion in the all staff and manager videos.

Effectiveness
The Board has determined that I have the necessary qualifications and skills to qualify as a Board Audit Committee financial expert as defined in Item 16A of Form 20-F and by reference to the NYSE listing standards, based on my professional background as a former senior audit partner at PwC.

In my capacity as Committee Chair, I meet with key members of the management team and the External Auditor in advance of each Committee meeting. I ensure that the Committee meets with management, the Internal Auditors and the External Auditors in private sessions. I also attend meetings with the PRA, the FCA, the FRC and UK Finance, both on an individual basis and together with the Chairs of audit committees of other major UK banks and other financial institutions.

In line with the Committee's forward-looking agenda and the Board programme, the Committee will continue to meet eight times a year.

Planned activities for 2018
The specific areas of focus for the Committee for 2018 will be the continuous monitoring and reviewing of the implementation of IFRS 9, the level and adequacy of conduct remediation and corporate credit provisions, the financial control and reporting implications of any change in the economy, and ring-fencing.

Board Remuneration Committee Chair's report

The Committee reviews remuneration policies and their implementation for the long-term sustainability of Santander UK.

Chair's Welcome
I am pleased to present the 2017 Directors' Remuneration Report. This is comprised of:

- My report as Chair of the Committee;
- The Remuneration report which summarises our remuneration policies; and
- The Remuneration implementation report, which shows how these policies have been applied during 2017.

Overview of the year
I succeeded Scott Wheway as Committee Chair in July 2017. Scott stepped down to become Chair of the Responsible Banking Committee whilst remaining a member of this Committee. Prior to my appointment as Committee Chair, I served as a Committee member for eighteen months and have been a member of other remuneration committees for over five years. In my time as a member, I observed how Scott presided over the Committee, driving high standards in remuneration governance. I would like to thank Scott for his contribution and I value his continued his Committee membership.

In 2017 we continued to build, strengthen and improve upon the solid foundations established in previous years.

We maintained our focus on ensuring that our remuneration policy and outcomes were aligned with and supported Santander UK's strategic objectives, to drive the Company's long-term success and promote sound and effective risk management.

We enhanced our approach to Material Risk Takers (MRT) identification and the increased governance and controls over risk adjustment both at the Company level and for individuals.

We spent considerable time as a Committee reviewing our Regulated Remuneration Governance Framework. This provides the over-arching framework for remuneration policies, standards and decisions. We satisfied ourselves that this meets all regulatory requirements and remains fit for purpose.

The Committee annually approves the operation of all our variable reward schemes for our customer facing colleagues. This ensures that all of our incentive plans reward appropriate conduct and do not reward behaviours that could lead to unnecessary risk taking.

We approved the remuneration packages for a number of key MRT appointments including reviewing the packages of the two new Executive Directors to the Board.

Underlying our approach to remuneration is the Company's aspiration to be Simple, Personal and Fair in all that we do. We therefore focus on delivering a reward framework that is simple to understand, tailored to individual roles and is competitive to attract, retain and motivate employees of the highest calibre.

Whilst encouraging a high performance culture, we also focus on employees displaying conduct and behaviours aligned to Santander UK's stated strategic objectives, culture and values, The Santander Way.

A significant proportion of our performance-related pay is deferred over the long-term and remains 'at risk'. Provisions within our Regulated Remuneration Governance Framework allow Santander UK to reduce or cancel variable pay awards for up to ten years and seven years after they are awarded for Senior Management Functions (SMFs) and MRTs respectively.

The following pages explain how our existing remuneration policy was implemented for 2017 and our priorities for 2018.

"We maintained our focus on ensuring that our remuneration policy and outcomes were aligned with and supported Santander UK's strategic objectives."

Responsibilities of the Committee
Read more on **p27**

Committee membership, tenure and attendance
Read more on **p49**

Annemarie Durbin
Board Remuneration Committee Chair
27 February 2018

Board Remuneration Committee Chair's report continued

2017 Business Performance and Impact on Remuneration

Our management team has delivered a solid business performance this year and during 2017, Santander UK continued to deliver on its mission to provide a long-term, sustainable return for our shareholders while helping people and businesses prosper. Profit before tax was £1,817m, down from £1,917m in 2016. Our 2017 financial results were impacted by a credit impairment charge for Carillion plc, which offset otherwise good profit growth. Customer satisfaction has improved in the last three years to 63%. This has been a year of solid business performance and payments under our single variable pay plan reflect that. Details of the payments to Executive Directors are set out in the Remuneration Implementation Report on page 47.

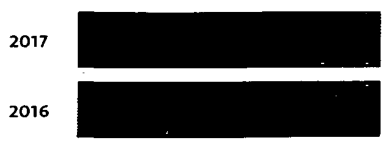
Key activities in 2017

The Committee's activities in 2017 included:

- Receiving reports on cultural change and challenging management to ensure that performance management outcomes and incentives and were directly linked to the Santander values and positive behaviours. Time spent on culture reduced as a result of such matters transferring to the Responsible Banking Committee.
- Overseeing enhancement of our governance in respect of ex-ante and ex-post risk adjustment through the establishment of the Individual Accountability Committee (IAC). This management committee oversees the various business accountability forums (BAFs) that investigate, and make recommendations on, individual accountability. The IAC provides the Remuneration Committee with regular updates and recommendations for adjustments to variable remuneration based on individual accountability.
- Enhancing our framework for identifying MRTs.

How we spent our time (%)

	2017	2016
People	30	30
Regulation	35	20
Culture	5	20
Risk and control	10	15
Governance	15	10
Conduct	5	5



- Refreshing the variable remuneration risk adjustment process, and applying this to the aggregate bonus pool for MRTs.
- Proactively engaging with the PRA and FCA.
- Considering, and, where relevant, approving various remuneration-related regulatory submissions in relation to Pillar III disclosures, MiFID II and the Remuneration Code.
- Approval of a new forward-looking pensions strategy, to ensure that the employee value proposition with respect to pensions is appropriately aligned to our objectives and competitive to attract, retain and motivate employees of the highest calibre.
- Reviewing and approving revisions to the Regulated Remuneration Governance Framework, which sets out the framework for remuneration policies, standards and decisions. This included updates covering buy-outs, termination payments and incentive plans.
- Considering the content and outcomes of the 2017 Gender Pay Gap report.
- Receiving updates from our advisors on proposed changes to the UK Corporate Governance Code as they pertain to remuneration as well as other regulatory developments during the year.
- Approving the remuneration packages for a number of key MRT appointments.
- Approving of the variable reward schemes for our customer facing colleagues.

Membership

During the year the composition of the Board Committees was reviewed following the establishment of the Responsible Banking Committee. The membership of the Committee was reduced from six to four. All four members of the Committee including the Committee Chair are Independent Non-Executive Directors (INEDs).

Remuneration Committee meetings are regularly attended by the Board Chair, Chief Executive Officer, HR Director, Reward Director, Company Secretary, Chief Risk Officer, Chief Legal and Regulatory Officer and Deloitte LLP, as appointed independent Remuneration Committee advisors. The Committee satisfied itself that Deloitte do not have connections with the Company that may impair their independence.

Effectiveness of the Committee

In accordance with good governance, the Committee's effectiveness was considered as part of the overall review of the progress made on the actions arising from the evaluation of Board effectiveness. I believe that the Committee retains an appropriate balance of skills and expertise to carry out its role effectively.

Terms of reference

The terms of reference were reviewed and revised to reflect changes that had taken place in the year to membership as well as with respect to the IAC and BAFs. In addition, we clarified the delegated authority of the Committee Chair between meetings.

Full terms of reference are available at www.santander.co.uk

Priorities for 2018

In 2018, we will:

- Undertake a market review of the Company's reward package to ensure that our remuneration arrangements continue to support our business transformation. We will continue to review the balanced scorecard of quantifiable measures focusing on the people and communities metrics.
- Continue to focus on driving the right culture and behaviours balancing the needs of our people, customers, communities and shareholders.
- Review the end-to-end performance management process for MRTs.
- Oversee the alignment of remuneration practices for the expanded workforce following integration of certain Banco Santander group subsidiaries into the Santander UK perimeter.
- Focus on the remuneration implications of the ongoing transformation agenda to achieve the strategic objectives we have set for the three years from 2017 to 2020.
- Continue to monitor gender pay reporting analysis. The Committee is cognisant of addressing any gender profile imbalances within the organisation and this is at the centre of the approach to address any gender pay gap.
- Continue to monitor changes to the UK Corporate Governance Code and ensure that our remuneration structures and governance remain appropriate for our ownership structure.

Remuneration report and remuneration policies

Basis of preparation
The Committee presents this report on behalf of the Board. We follow UK corporate governance regulations, guidelines and codes to the extent they are appropriate to our ownership structure. Accordingly, a number of voluntary disclosures relating to remuneration have been presented in this report.

Executive remuneration policies and principles
Our core values of Simple, Personal and Fair drive our remuneration policy which is designed with the long-term success of the business in mind, to deliver our business strategy and reinforce our values. We apply a consistent approach to the reward of all our employees which upholds our prudent approach to Risk Appetite which is set as part of a Santander UK-wide Risk Management Framework.

The structure of our variable pay plan for our Executive Directors ensures that there is a clear link between the Company's strategy and remuneration. Awards under the variable pay plan are based on a balanced scorecard of quantitative and qualitative metrics which are aligned to the Santander Compass. The Compass sets out the Company's KPIs across four quadrants covering each of the main stakeholder groups; Customers, Shareholders, Communities and People. The Compass ensures that our day-to-day activities align with the overarching strategy of the bank and helps us to measure progress towards our strategic priorities and our aim of being the best bank.

The allocation of awards under the variable pay plan takes into account an assessment of the Executive Director's performance against a performance management framework set at the start of the year covering a range of financial, non-financial, quantitative and qualitative criteria.

Forward-looking remuneration policies for Executive Directors
Our forward looking remuneration policies are outlined in the table below.

Our remuneration is structured into two main elements: *fixed pay and our variable pay plan.*

Our aim is to set fixed pay at market competitive levels appropriate for the role. The level of fixed pay aims to be sufficient so that inappropriate risk taking is not encouraged.

Executive Directors' remuneration structure
Fixed Pay

	Principle and description	Policy
Base salary	- Reviewed annually to ensure market competitive pay appropriate for the role. - Set at an appropriate level so that inappropriate risk taking is not encouraged. - Reflects the complexity of each role and the responsibilities and experience of each individual.	- Salaries are set to reflect prevailing market and economic conditions and the approach to pay for all other employees.
Pension arrangements	- Post-retirement benefits for participants are offered in a cost-efficient manner.	- All Executive Directors receive a cash allowance in lieu of pension.
Other benefits	- Benefits are offered to Executive Directors as part of a competitive remuneration package.	- Includes private medical insurance for Executive Directors and their dependants, life assurance, health screening, relocation allowances and expatriate allowances where relevant. - Access to the Company's all-employee share schemes on the same terms as all UK employees.

Variable Pay

	Principle and description	Policy
Variable pay plan	- To motivate Executive Directors to achieve and exceed annual financial and strategic targets within the Company's Risk Appetite and in alignment with our business strategy and Company values. - Multi-year deferral, further performance testing and delivery in Banco Santander SA shares aligns Executive Directors' interests to the long-term interest of the Company and the Group. - Deferral of part of the award is applied in accordance with the requirements of the Remuneration Code.	- Awards are discretionary and determined by reference to performance against a scorecard of financial and strategic goals. - 40% of the bonus awarded is paid upfront in the year following the performance year (year one), delivered half in cash and half in shares. - 60% of the bonus awarded is deferred and delivered in equal tranches over years three to seven, with each tranche delivered half in cash and half in shares. - The final three tranches of the award are paid subject to further performance testing, which may reduce the level of deferred payout. - Share-based awards are subject to a minimum twelve month retention period following the relevant vesting date. - Malus and clawback provisions apply to all elements of variable pay up to ten years following the grant of an award.

Remuneration report and remuneration policies continued

Our variable pay plan rewards financial and non-financial performance over the year with additional long-term metrics applied to the deferred element which can reduce, but not increase, the deferred award.

Our remuneration structures, which incorporate significant long-term deferral, align the interests of Executive Directors with shareholders and encourage the building of a long-term shareholding in Banco Santander SA.

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

On recruitment
When appointing a new Executive Director, base salary is set at a market competitive level appropriate for the role. The appropriate level is determined taking into consideration a range of factors including the individual's previous remuneration, relevant experience, an assessment against relevant comparator groups and cost. Other elements of remuneration will be established in line with the Remuneration Policy set out in the Executive Directors' remuneration structure table below. Relocation support and international mobility benefits may also be provided.

Buy-out awards
Compensation may be provided to Executive Directors recruited externally for the forfeiture of any award on leaving their previous employer. The Committee retains discretion to make such compensation as it deems necessary and appropriate to secure the relevant Executive Director's employment, and ensure any such payments align with the long-term interests of Santander UK and the prevailing regulatory framework.

Service agreements
Terms and conditions of employment are set out in individual service agreements which include a notice period of six months from both the Executive Director and the Company. The agreements may be terminated immediately with payment of fixed pay in lieu of notice. In the event of termination for gross misconduct neither notice nor payment in lieu of notice is required and any deferred awards are forfeited.

Termination payments
The impact of an Executive Director leaving the Company on remuneration under various scenarios reflects the service agreements, the relevant scheme rules, and the Committee's policy in this area. The Committee determines whether an Executive Director is a 'good leaver' should their employment end due to injury, ill-health, disability, redundancy, retirement, death, or any other reason at the Committee's discretion. Other than a payment in the event of redundancy, Santander UK provides no other compensation upon termination of employment for Executive Directors.

Risk and Performance adjustment
We will continue to ensure that the requirements of the Remuneration Code on risk and performance adjustment are met for our employees. All variable remuneration is subject to adjustment for all current and future risks through our Additional Risk Adjustment Standard (ARAS) which is linked to Santander UK's Risk Appetite and our Individual Remuneration Adjustment Standard (IRAS).

Our ARAS provides both a formula-based assessment against Santander UK's Risk Appetite and an additional qualitative risk event assessment overlay that can result in a downward risk adjustment of up to 100% of the bonus pool or individual awards at the discretion of the Committee.

Our IRAS provides a framework for the process, governance and standards relevant for making decisions in relation to individual performance adjustments following an Incident, including malus and clawback. In 2017, we enhanced the Standard, establishing the Individual Accountability Committee (IAC) which is a management committee which considers and makes recommendations on accountability following investigations.

Performance adjustments may include, but are not limited to:

- Reducing a bonus outcome for the current year
- Reducing the amount of any unvested deferred variable remuneration (including historic LTIP awards)
- Requiring repayment on demand (on a net basis) of any cash and share awards received at any time during the ten year period after the date of award
- Requiring a bonus which has been awarded (but not yet paid) to be forfeited.

The Committee has full discretion to prevent vesting of all or part of an amount of deferred remuneration and/or to freeze an award during an ongoing investigation in any of the following circumstances:

- Evidence of employee misbehaviour or material error
- Material downturn in the performance of Santander UK or a relevant business unit's performance
- Santander UK or a relevant business unit suffers a material failure of risk management
- Significant changes in the Banco Santander SA group's or the Santander UK's economic or regulatory capital base and the qualitative assessment of risk.
- A material restatement of Banco Santander's or Santander UK's financial statements (except when required due to modification of the accounting rules).

The Committee seeks input from the Board Risk Committee, the CRO and the CLRO when determining whether any performance or risk adjustments are required particularly in relation to the application of risk adjustment to the bonus pool. Furthermore, members of the Board Risk Committee (along with the Audit Committee Chair and Whistleblowing Champion, and another member of the Audit Committee) sit on this Committee. The Committee Chair also engages with the Chair of the Board Risk Committee given that he is no longer a formal member of this Committee.

Policy for all employees
Our performance, reward and benefits approach across the Company supports our business strategy and reinforces our values in the context of a clearly articulated Risk Appetite. We apply a consistent approach to reward for all employees. Employees are entitled to a base salary and benefits and have the opportunity to receive an element of performance-related compensation, subject to their role and grade. The Remuneration Committee annually approves the operation of all of our variable reward schemes for our customer facing colleagues to ensure that plans reward appropriate behaviour and do not incentivise unnecessary risk taking.

Remuneration implementation report

Introduction
This report outlines how we implemented Remuneration Policy in 2017. The composition and total remuneration received by each Executive Director in office during the year is shown in the table below. This includes the two Executive Directors appointed to the Board on 1 August 2017; Antonio Roman (Chief Financial Officer) and Javier San Felix (Head of Retail and Business Banking and Deputy CEO of Santander UK).

Variable Pay Plan
Our Executive Directors participate in a variable pay plan. The purpose of the plan is to align participants' reward with the financial and non-financial performance of Santander UK as measured over the financial year. Multi-year deferral, further performance testing and delivery in Banco Santander SA shares ensure that Executive Directors' interests align to the long-term interest of the Company and the Group. Payments half in cash and half in shares, spread over seven years, with the final three tranches of awards subject to further long term metrics which can reduce the level of awards. Awards delivered in shares are subject to an additional one-year retention period from the point of delivery.

The 2017 Variable Pay Plan pool was determined based on a range of metrics using a balanced scorecard approach (explained further below):

- A **quantitative assessment** – Measured at UK level using a balanced scorecard approach of financial and non-financial measures. The measures are based on Santander UK's strategy (the Compass) and for 2017 were:
  - Customers (Customer Satisfaction and loyal customers)
  - Employees (Employee Engagement and Enablement Scores)
  - Communities (number of scholarships and number of people supported)
  - Risk (Cost of Credit Ratio and Non-performing loan ratio)
  - Capital (Contribution to Group Capital)
  - Profitability (Net Profit and Return on Risk-Weighted Assets)
- A **qualitative assessment** – This adds context to the quantitative assessment to ensure a balanced assessment of performance has been made.
- A **group multiplier** adjusts the pool upwards or downwards to reflect overall group performance.
- **Exceptional adjustment** – Intended to cover unexpected factors or additional targets not covered by the quantitative or qualitative assessments. This may also include adjustments not covered in the qualitative assessments, including major risk events. This may be requested at a Banco Santander group or Santander UK level.

Finally, an overall **UK-focused risk adjustment** linked to Santander UK's Risk Appetite is applied. This provides both a formula-based assessment against Risk Appetite and an additional qualitative risk event assessment overlay that can result in a downward risk adjustment of up to 100% of the bonus pool or individual awards at the discretion of the Committee.

2017 Business Performance and Impact on Remuneration
Our management team has delivered solid Company performance this year, delivering for our shareholders, people, customers and communities.

- Our financial results were impacted by a credit impairment charge for Carillion plc which offset otherwise good profit growth and we maintained a strong capital position
- Loyal retail customers and loyal SME and corporate customers increased in 2017
- Customer satisfaction improved in the last three years to 63%
- More than 281,000 people were supported in 2017 through our skills, knowledge and innovation projects, exceeding our target. Over £1m was raised for our charity partners.

Payments under our variable pay plan reflect a year of solid performance. Details of the payments to Executive Directors are set out in the table below.

Rewarding Executives appropriately
We ensure that broader remuneration policies and practices for employees across Santander UK are taken into account when setting the policy for Executive Director remuneration. The Committee annually reviews remuneration trends across Santander UK including the relationship between executive remuneration and the remuneration of other Santander UK employees, as well as remuneration in the wider UK market when making decisions on executive pay.

We oversee the broader workforce remuneration policies and practices, the implementation of remuneration and related employment policies across Santander UK and the salary and variable pay awards for all MRTs. We also approve the design of any material performance related pay plans operated by Santander UK.

As part of our monitoring of pay across the Company, the following is considered:

- Santander UK's engagement with its recognised trade unions on matters relating to pay and benefits for all employees
- Annual pay reviews for the general employee population
- Santander UK benefit provision
- The design of and the overall spend on variable pay arrangements
- An assessment of conduct across the Company.

Executive Directors' remuneration (audited)
Total remuneration of each Executive Director for the years ended 31 December 2017 and 2016.

Executive rewards	Nathan Bostock[1]		Antonio Roman[2]		Javier San Felix		Total	
	2017 £000	2016 £000	**2017 £000**	2016 £000	**2017 £000**	2016 £000	**2017 £000**	2016 £000
Salary and fees	**1,653**	1,600	**243**	–	**302**	–	**2,198**	1,600
Taxable benefits (cash and non-cash)	**55**	46	**17**	–	**329**	–	**401**	46
Pension	**581**	560	**61**	–	**–**	–	**642**	560
Bonus (paid and deferred)	**2,425**	2,330	**400**	–	**861**	–	**3,686**	2,330
Total remuneration	**4,714**	4,536	**721**	–	**1,492**	–	**6,927**	4,536

(1) The remuneration figure for Nathan Bostock does not include £1,800,000 (2016: £1,800,000) relating to a share based buy-out of deferred awards in respect of his previous employment.
(2) This figure represents an allocation of 90% of Antonio Roman's remuneration (for his time spent as a director of the Company in 2017) given that he spends 90% of his time on Company business. An additional 10% (£175,866) has been allocated to Abbey National Treasury Services plc, which results in a total remuneration of £896,115.

Remuneration implementation report continued

Stakeholder views
Santander UK engages with key stakeholders. During 2017, Management and the Committee Chair increased ongoing engagement with the PRA and FCA. Employee opinion surveys are undertaken annually, and discussions take place with union representatives during the annual pay review cycle and on relevant employee reward matters.

During 2018, the Committee will review its approach to engaging with stakeholders on executive remuneration in light of the outcomes of the consultation on the revised UK Corporate Governance Code.

Advice and support provided to the Remuneration Committee
As permitted by its Terms of Reference, the Committee has engaged the advice and support of Deloitte LLP (Deloitte) as independent remuneration consultants at the expense of the Company. Total fees (exclusive of VAT) for advice and support provided to the Remuneration Committee during the financial year were £185,250. Deloitte is a founding member of the Remuneration Consultants Group and voluntarily operates under the Code of Conduct in relation to executive remuneration consulting in the UK. We are comfortable that the Deloitte engagement partner and team that provides remuneration advice to the Committee do not have connections with the Company that may impair their independence. During the year, Deloitte also provided tax, financial and advisory, risk, assurance and consulting services to Santander UK.

The Board Chair, Chief Executive Officer, HR Director, Reward Director, Company Secretary, CLRO and CRO attended Committee meetings by invitation in order to support the discussion of the agenda items as appropriate. The Committee Chair also engages with the Chair of the Board Risk Committee given that he is no longer a formal member of the Committee.

No individual participates in discussions regarding their own remuneration.

Chair and Non-Executive Directors' remuneration
The Chair's fee is reviewed and approved by the Committee. The fees paid to Non-Executive Directors are reviewed and approved by the Executive Directors and the Chair. Fees are reviewed annually taking into account information on fees paid in similar companies, as well as the time commitment for the role. The Chair is paid an all-inclusive base fee. Non-Executive Directors are paid a base fee, with an additional supplement for serving on or chairing a Board Committee, save for two of the Group NEDs of Santander UK who receive no fees in respect of their Santander UK duties.

The Responsible Banking Committee was formed in 2017 and the fee levels approved in April 2017 for chairing/membership of this Committee were £60,000 and £25,000 respectively. This is in line with the fee levels for the other committees. Genevieve Shore receives £30,000 as the Independent Chair of the Customer Innovation Forum, a non-Board forum. No other changes were made to Non-Executive Directors' remuneration in 2017. The 2017 fee structure is shown in the table below.

All Non-Executive Directors and the Chair serve under letters of appointment and either party can terminate on three months' written notice, except in the case of the Chair where twelve months' written notice is required. Neither the Chair nor the Non-Executive Directors are eligible for pension scheme membership, bonus or incentive arrangements, nor do they have the right to compensation on the early termination of their appointment beyond payments in lieu of notice at the option of the Company.

Relative importance of spend on pay

	2017 £m	2016 £m	Change %
Profit before tax	**1,817**	1,917	(5.22%)
Total employee costs	**1,134**	1,122	1.07%

Highest paid senior executives
The remuneration of the eight highest paid senior executives for the year ended 31 December 2017 is detailed below. Senior executives are defined as members of the Executive Committee (excluding Executive Directors).

Individuals	1 £000	2 £000	3 £000	4 £000	5 £000	6 £000	7 £000	8 £000
Fixed remuneration (including any non-cash and taxable benefits)	881	707	949	693	740	606	590	410
Variable remuneration (cash – paid)	349	261	192	220	144	139	124	105
Variable remuneration (cash – deferred)	523	392	287	330	216	209	186	158
Variable remuneration (shares – paid)	349	261	192	220	144	139	124	105
Variable remuneration (shares – deferred)	523	392	287	330	216	209	186	158
2017 remuneration	**2,625**	**2,013**	**1,907**	**1,793**	**1,460**	**1,302**	**1,210**	**936**

Chair and Board Committee member fees	Board £000	Board Nomination Committee £000	Board Risk Committee £000	Board Audit Committee £000	Board Remuneration Committee £000	Board Responsible Banking Committee £000
Chair (inclusive of membership fee)	650	60	60	60	60	60
Senior Independent Director	30	–	–	–	–	–
Member	90	25	25	25	25	25

Board and Committee membership, tenure, attendance and remuneration

		Independent Chair	Independent Non-Executive Directors					
	Name	**Shriti Vadera[1]**	**Scott Wheway[2]**	**Alain Dromer**	**Annemarie Durbin**	**Ed Giera**	**Chris Jones[3]**	**Genevieve Shore**
Board	Scheduled meetings attended	8/8	8/8	8/8	7/8	7/8	8/8	8/8
	Ad hoc meetings attended	1/1	1/1	1/1	1/1	1/1	1/1	1/1
Nomination Committee	Scheduled meetings attended	3/3	3/3	-	-	1/1[5]	1/1[5]	
	Ad hoc meetings attended	-	-	-	-	-	-	-
Risk Committee	Scheduled meetings attended	-	10/10	10/10	9/10	10/10	10/10	9/10
	Ad hoc meetings attended	-	-	-	-	-	-	-
Audit Committee	Scheduled meetings attended	-	4/4[5]	9/9	4/4[5]	9/9	9/9	9/9
	Ad hoc meetings attended	-	-	-	-	-	-	-
Remuneration Committee	Scheduled meetings attended	-	7/7[5][6]	7/7	7/7[7]	5/5[8]	7/7	4/4[5]
	Ad hoc meetings attended	-	1/1	1/1	1/1	1/1	1/1	1/1
Responsible Banking Committee	Scheduled meetings attended	-	3/3	-	3/3	3/3	3/3	3/3
	Ad hoc meetings attended	-	-	-	-	-	-	-

(1) Appointed Chair on 30 March 2015.
(2) Senior Independent Director since 18 May 2015.
(3) Deemed financial expert.
(4) Deputy Chair.
(5) Ceased to be a member of the Committee on 30 June 2017.
(6) Ceased to be Chair of the Remuneration Committee on 3 August 2017. Remained a member of the Committee.
(7) Appointed Chair of the Remuneration Committee on 3 August 2017.
(8) Ceased to be a member of the Committee on 30 July 2017 but attended the July 2017 meeting as an observer.
(9) Ceased to be a member of the Board, Nomination Committee, Remuneration Committee and Risk Committee on 1 June 2017; and became an observer at Board Meetings for the remainder of 2017.
(10) Ceased to be a member of the Board on 28 February 2017.

Board and Committee membership, tenure, attendance and remuneration continued

		Banco Santander nominated Non-Executive Directors							Executive Directors		
	Name	Ana Botín	Lindsey Argalas	Gerry Byrne	Juan Rodríguez Inciarte[4]	Bruce Carnegie-Brown[9]	Peter Jackson[10]	Manuel Soto	Nathan Bostock	Antonio Roman	Javier San Felix
Board	Scheduled meetings attended	7/8	-	1/1	8/8	3/3	2/2	8/8	8/8	3/3	3/3
Board	Ad hoc meetings attended	1/1	-	-	1/1	1/1	-	1/1	1/1	n/a	n/a
Nomination Committee	Scheduled meetings attended	2/2	-	-	-	1/1	-	-	-	-	-
Nomination Committee	Ad hoc meetings attended	-	-	-	-	-	-	-	-	-	-
Risk Committee	Scheduled meetings attended	-	-	-	9/10	3/3	-	-	-	-	-
Risk Committee	Ad hoc meetings attended	-	-	-	-	-	-	-	-	-	-
Audit Committee	Scheduled meetings attended	-	-	-	-	-	-	9/9	-	-	-
Audit Committee	Ad hoc meetings attended	-	-	-	-	-	-	-	-	-	-
Remuneration Committee	Scheduled meetings attended	-	-	-	-	3/3	-	-	-	-	-
Remuneration Committee	Ad hoc meetings attended	-	-	-	-	-	-	-	-	-	-
Responsible Banking Committee	Scheduled meetings attended	-	-	-	-	-	-	-	-	-	-
Responsible Banking Committee	Ad hoc meetings attended	-	-	-	-	-	-	-	-	-	-

	2017 Fees £000	2016 Fees £000	**2017 Expenses £000**	2016 Expenses £000	**2017 Total £000**	2016 Total £000
Chair						
Shriti Vadera	650	650	-*	-	650	650
Independent Non-Executive Directors						
Scott Wheway	248	230	25	14	273	244
Alain Dromer	165	165	17	19	182	184
Annemarie Durbin	165	165	-	-	165	165
Ed Giera	202	200	3	-	205	200
Chris Jones	200	200	1	30	201	230
Genevieve Shore	180	165	1	1	181	166
Banco Santander nominated Non-Executive Directors						
Ana Botín	-	-	-	-	-	-
Lindsey Argalas	-	-	-	-	-	-
Gerry Byrne	-	-	-	-	-	-
Juan Rodríguez Inciarte	115	115	38	33	153	148
Bruce Carnegie-Brown	-	-	-	-	-	-
Peter Jackson	-	-	-	-	-	-
Manuel Soto	111	115	11	22	122	137
Total	**2,036**	**2,005**	**96**	**119**	**2,132**	**2,124**

* In addition to the above fees, Shriti Vadera was entitled to taxable benefits as follows: private medical cover of £564 (2016: £588) and transportation of £24,227 (2016: £29,149).

Directors' report

Introduction
The Directors have pleasure in submitting their report together with the financial statements for the year ended 31 December 2017. The information in the Directors' Report is unaudited, except where marked.

History and corporate structure
Santander UK plc (incorporated on 12 September 1988) is a subsidiary of Banco Santander SA, a Spanish retail and commercial bank with a meaningful market share in nine core countries in Europe and the Americas. Santander UK was formed from the acquisition of three former building societies, Abbey National, Alliance & Leicester and Bradford & Bingley, and has been operating under a single brand since 2010. The ordinary shares of the Company are not traded. A list of the subsidiaries of the Company, where they are incorporated, their registered office and details of branches is provided in the Shareholder information section of the Consolidated Financial Statements. Note 30 provides details of the Company's share capital.

Structural relationship of Santander UK with Banco Santander – the 'subsidiary model'
Banco Santander operates a 'subsidiary model'. This involves autonomous units, such as Santander UK, operating in core markets, with each unit being responsible for its own liquidity, funding and capital management on an ongoing basis. The model is designed to minimise the risk to Banco Santander, and all its units, from problems arising elsewhere in Banco Santander. The subsidiary model means that Banco Santander SA has no obligation to provide any liquidity, funding or capital assistance, to any of these units, although it enables Banco Santander SA to take advantage selectively of opportunities.

Under the subsidiary model, Santander UK plc generates funding and liquidity through retail and corporate deposits, as well as its own debt programmes and facilities. Santander UK plc does this by relying on the strength of its own balance sheet and profitability. It does not rely on any guarantees from Banco Santander SA or any subsidiaries of the Banco Santander group outside the Santander UK group.

Related party transactions with companies in the Banco Santander group are managed on an arm's length commercial basis. Transactions which are not in the ordinary course of business must be approved in advance by the Santander UK Board.

The subsidiary model gives Santander UK considerable financial flexibility, yet enables it to continue to take advantage of significant synergies and strengths that come from being part of the global Banco Santander group, in brand, products, systems, platforms, development capacity and management capability. In the subsidiary model, Banco Santander facilitates the sharing of best practice and provides common technology, operations and support services to all of its subsidiaries via independent operating entities, themselves established by Banco Santander SA so as to be able to continue operating as viable standalone businesses.

Whilst the Company is a subsidiary of Banco Santander SA, the Company's corporate governance model ensures that the Board and management make their own decisions on funding, capital and liquidity having regard to what is appropriate for Santander UK's business and strategy.

UK Group Framework
Santander UK operates a UK Group Framework of corporate governance which defines our responsibilities and relationship with Banco Santander SA, our sole shareholder. This provides Banco Santander with the oversight and controls they need whilst discharging our responsibilities in the UK. The UK Group Framework sets out, amongst other elements:

- The principle that at least 50% of the Board should be INEDs and the other 50% either Executive Directors or Banco Santander nominated Non-Executive Directors
- The definition of independence, in recognition of our ownership, is a Director who has no current or recent relationship with Banco Santander and Santander UK, other than through the UK Board role. Under this definition the Chair is considered independent
- The manner in which the Chair, Chief Executive Officer, other Executive Directors, INEDs and Banco Santander nominated Non-Executive Directors will be appointed
- The iterative process by which strategy and annual budgets will be approved by Banco Santander and the Santander UK Board
- How remuneration of key executives will be determined.

Result and dividends
The consolidated profit after tax for the year was £1,256m (2016: £1,319m). The Directors do not recommend the payment of a final dividend for 2017 (2016: £nil). Two interim dividends were declared on the Company's ordinary shares in issue during the year. The first dividend of £323m was declared on 27 June 2017 and the second dividend of £230m was declared on 15 December 2017. Both dividends were paid in 2017.

Details of Santander UK's activities and business performance during 2017, together with an indication of future outlook, are set out in the Strategic report on pages 2 to 4 and the Financial review on pages 5 to 17.

Events after the balance sheet date
There have been no material post balance sheet events.

Directors
The names and biographical details of the current Directors are shown on pages 19 to 23. Particulars of their emoluments and interests in shares can be found in the Directors' Remuneration implementation report on pages 47 and 48. Changes to the composition of the Board can be found on pages 49 and 50, with further details in the Chair's report on Corporate Governance, on pages 24 to 27, and each of the Committee Chair's reports on pages 28, 30, 37 and 43.

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

The Company does not require the Directors to offer themselves for re-election every year, or that new Directors appointed by the Board offer themselves for election at the next Annual General Meeting. The appointment of Gerry Byrne was proposed by Banco Santander.

Directors' report continued

Directors' indemnities
In addition to Directors' and Officers' liability insurance cover in place throughout 2017, individual deeds of indemnity were also in place to provide cover to the Directors for liabilities to the maximum extent permitted by law. These remain in force for the duration of the Directors' period of office from the date of appointment. The Directors of the Company, including former Directors who resigned during the year, benefit from these deeds of indemnity. They constitute qualifying third party indemnity provisions for the purposes of the Companies Act 2006.

Deeds for existing Directors are available for inspection at the Company's registered office.

The Company has also granted an indemnity which constitutes 'qualifying third party indemnity provisions' to the Directors of its subsidiary and associated companies, including former Directors who resigned during the year and since the year-end.

Qualifying pension scheme indemnities were also granted to the Trustees of the Santander UK group's pension schemes.

Employees
We continue to ensure that our remuneration policies are consistent with our strategic objectives and are designed with the long-term success of the Company in mind. In doing so we aim to attract and retain the most talented and committed people with first class development schemes and a customer-focused culture that empowers people, values individuality and encourages collaboration. A highly motivated and engaged workforce provides the best service for our customers.

Communication
Santander UK wants to involve and inform employees on matters that affect them. The intranet is a focal point for communications with daily updates on what is happening across Santander. The 'We are Santander' website connects staff to all the information they need about working for Santander UK. Santander UK also uses face-to-face communication, such as team meetings, regional roadshows and annual staff conventions for strategic updates.

All these channels are designed to keep employees fully informed of news and developments which may have an impact on them, and to keep them up to date on financial, economic and other factors which affect Santander UK's performance. Santander UK considers employees' opinions and asks for their views on a range of issues through regular Company-wide surveys.

Consultation
Santander UK has a successful history of working in partnership with its recognised trade unions, Advance and the Communication Workers Union (CWU). Both trade unions are affiliated to the Trades Union Congress. We consult Advance and the CWU on significant proposals and change initiatives within the business at both national and local levels.

Employee share ownership
Santander UK continues to operate two all-employee, HMRC-approved share schemes: a Save-As-You-Earn (Sharesave) Scheme and a Share Incentive Plan (SIP), the latter of which allows employees to purchase Banco Santander SA shares from gross salary. Eligible senior management can participate in a Banco Santander long-term incentive plan. See Note 34 to the Consolidated Financial Statements for a description of the plans and the related costs and obligations.

Disability
Santander UK is committed to equality of access and quality of service for disabled people and embraces the spirit of the UK Equality Act 2010 throughout its business operations.

Santander UK has processes in place to help train, develop, retain and promote employees with disabilities. It is committed to giving full and fair consideration to applications for employment made by disabled people, having particular regard to their particular aptitudes and abilities, and for continuing the employment of employees who have become disabled by arranging appropriate training and making reasonable adjustment within the workplace.

CO_2 emissions
This year CO_2 emissions, measured in CO_2 equivalent tonnes, have decreased by 7.94% year on year to 11,485 tonnes. CO_2 from fuel has decreased by 5.79% to 5,488 tonnes in 2017, CO_2 from business travel has decreased by 9.82% to 5,997 tonnes in 2017 and output per employee tonne has reduced by 9.62% to 0.47 tonnes in 2017.

Code of Ethical Conduct
Santander UK is committed to maintaining high ethical standards – adhering to laws and regulations, conducting business in a responsible way, and treating all stakeholders with honesty and integrity. These principles are further reflected in Santander UK's Ethical Code of Conduct as updated in December 2015. This sets out the standards expected of all employees, and supports The Santander Way and Santander UK's commitment to being Simple, Personal and Fair. Under their terms and conditions of employment, staff are required to act at all times with the highest standards of business conduct in order to protect Santander UK's reputation and ensure a Company culture which is free from any risk of corruption, compromise or conflicts of interest. Staff are also required to comply with all Company policies.

These require employees to:

- Abide by all relevant laws and regulations
- Act with integrity in all their business actions on behalf of Santander UK
- Not use their authority or office for personal gain
- Conduct business relationships in a transparent manner
- Reject all improper practices or dealings to which they may be exposed.

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

Santander UK meets these requirements through its Code of Ethical Conduct, the Anti-Bribery and Corruption Policy, the Whistleblowing Policy, the FCA's Principles for Business, and the FCA's Principles and Code of Practice for Approved Persons, with which the CEO and senior financial officers must comply. These include requirements to manage conflicts of interest appropriately and to disclose any information the FCA may want to know about.

Santander UK provides a copy of these documents to anyone, free of charge, on application to Santander UK plc, 2 Triton Square, Regent's Place, London NW1 3AN.

Political contributions

In 2017 and 2016, no contributions were made for political purposes and no political expenditure was incurred.

Share capital

Details about the structure of the Company's capital, including the rights and obligations attaching to each class of share in the Company, can be found in Note 30 to the Consolidated Financial Statements.

Details of employee share schemes and how rights are exercisable can be found in Note 34 to the Consolidated Financial Statements.

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

Subsidiaries and branches

The Santander UK group consists of a parent company, Santander UK plc, incorporated in England and Wales, and a number of directly and indirectly held subsidiaries and associates. Santander UK directly or indirectly holds 100% of the issued ordinary share capital of its principal subsidiaries.

All companies operate principally in their country of incorporation or registration. Abbey National Treasury Services plc, a subsidiary of Santander UK plc, also has a branch office in the United States and until October 2017 had a branch office in the Cayman Islands. Santander UK plc has branches in the Isle of Man and in Jersey.

For further information see Note 19 to the Consolidated Financial Statements and 'Subsidiaries, joint ventures and associates' in the Shareholder information section of this Annual Report.

Financial instruments

The financial risk management objectives and policies of Santander UK, the policy for hedging, and the exposure of Santander UK to credit risk, market risk, and liquidity risk are outlined in the Risk review.

Research and development

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

Supervision and regulation

Santander UK is authorised by the PRA and regulated by the FCA and the PRA. Some of its subsidiaries and associates are also authorised by the PRA or the FCA, and regulated by the FCA or both the FCA and the PRA.

While Santander UK operates primarily in the UK, it is also subject to the laws and regulations of the other jurisdictions in which it operates, such as the requirements of the SEC for its activities in the US.

Internal controls

Risk management and internal controls

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

We have carried out a robust assessment of the principal risks facing Santander UK (as set out in 'How we define our risks' on page 59 of the Risk review) including those that would threaten its business model, future performance, solvency or liquidity.

Management's report on internal control over financial reporting

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

Santander UK's internal control over financial reporting includes:

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

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

Directors' report continued

Management is responsible for establishing and maintaining adequate internal control over the financial reporting of Santander UK. Management assessed the effectiveness of Santander UK's internal control over financial reporting at 31 December 2017 based on the criteria established in the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in May 2013 (the 2013 Framework).

Based on this assessment, management concluded, at 31 December 2017, that Santander UK's internal control over financial reporting was effective.

Disclosure controls and procedures over financial reporting
Santander UK has evaluated, with the participation of its CEO and CFO, the effectiveness of Santander UK's disclosure controls at 31 December 2017. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error, and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Based upon Santander UK's evaluation, the CEO and the CFO have concluded that, at 31 December 2017, Santander UK's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by Santander UK in the reports that it files and submits under the US Securities Exchange Act of 1934 is recorded, processed, summarised and reported within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to Santander UK's management, including the CEO and CFO, as appropriate, to allow timely decisions regarding disclosure.

Changes in internal control over financial reporting
There were no changes to our internal control over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. However, the Directors are overseeing the IFRS 9 planning and its transitional impact including reviewing changes to processes, internal controls and governance to ensure they are appropriate for use.

Going concern and viability
The going concern and viability of Santander UK are reliant on preserving a sufficient level of capital and adequately funding the balance sheet. Santander UK's business activities and financial position, together with the factors likely to affect its future development and performance, are set out in the Financial review on pages 5 to 17. Santander UK's objectives, policies and processes for managing the financial risks to which it is exposed, including capital, funding and liquidity, are described in the Risk review.

In assessing going concern, the Directors take account of all information of which they are aware about the future, which is at least, but is not limited to, 12 months from the date that the balance sheet is signed. In making their assessment of viability, the Directors, after taking account of the Company's current position and principal risks, consider that a period of three years from the balance sheet date is appropriate, as this is consistent with both the period covered by Santander UK's three year plan and the minimum time horizon over which regulatory stress testing is carried out.

In making their going concern and viability assessments, the information considered by the Directors includes Santander UK's forecasts and projections, estimated capital, funding and liquidity requirements, contingent liabilities, ring-fencing, and possible economic, market and product developments, taking account of reasonably possible changes in trading performance. For capital, funding and liquidity purposes, Santander UK operates on a standalone basis and is subject to regular and rigorous monitoring by external parties. The Directors review the outputs of stress testing as part of the approval processes for the ICAAP, the ILAAP, our Risk Appetite and regulatory stress tests. We exceeded the Bank of England's 2017 stress test threshold requirement.

The Directors have a reasonable expectation that Santander UK will be able to continue in operation and meet its liabilities as they fall due over the next three years.

Having assessed the principal risks and the other matters discussed in connection with the viability statement, the Directors consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

Statement of Compliance
The UK Corporate Governance Code
The Board confirms that, for the year ended 31 December 2017, Santander UK has applied those principles and provisions of the UK Corporate Governance Code 2016, as appropriate, given its ownership structure.

BBA Code for Financial Reporting Disclosure
Santander UK's financial statements for the year ended 31 December 2017 have been prepared in compliance with the principles of the BBA Code for Financial Reporting Disclosure.

Directors' responsibilities
The Directors are responsible for preparing the Annual Report, including the financial statements, in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. The Directors are required by the International Accounting Standards (IAS) Regulation to prepare the group financial statements under IFRS, as adopted by the EU, and have also elected to prepare the parent company financial statements in accordance with IFRS, as adopted by the EU. The financial statements are also required by law to be properly prepared in accordance with the UK Companies Act 2006 and Article 4 of the IAS Regulation. In addition, in order to meet certain US requirements, the Directors are required to prepare Santander UK's financial statements in accordance with IFRS, as issued by the International Accounting Standards Board (IASB).

The Directors are responsible for ensuring the financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss presented, and that the management report (which is incorporated into the Strategic report and the Directors' Report), includes a fair review of the development and performance of the business and a description of the principal risks and uncertainties the business faces.

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

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

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

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on our website.

Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Disclosure of information to Auditors
Each of the Directors at the date of approval of this report confirms that:

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

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

Auditor
PricewaterhouseCoopers LLP have expressed their willingness to continue in the office of auditor and a resolution to reappoint them will be proposed at the Company's forthcoming Annual General Meeting.

By Order of the Board

Marc Boston
Company Secretary
27 February 2018
2 Triton Square, Regent's Place,
London NW1 3AN

Directors' responsibilities statement

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

We confirm to the best of our knowledge that:

- The financial statements, prepared in accordance with International Financial Reporting Standards, as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole
- The management report, which is incorporated into the Directors' Report, includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face.

By Order of the Board

Nathan Bostock
Chief Executive Officer
27 February 2018

Risk review

This Risk review consists of audited financial information except where it is marked as unaudited. The audited financial information is an integral part of our Consolidated Financial Statements.

Contents

Risk governance

INTRODUCTION (unaudited)

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

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

RISK FRAMEWORK

Key elements (unaudited)
Our Risk Framework sets out how we manage and control risk. It is based on the following key elements which we describe in more detail in the next pages:

Section	Content
How we define risk	We describe each of our key risk types.
How we approach risk – our culture and principles	We describe our risk culture and explain how we make it a day-to-day reality across our business.
Our risk governance structure	We describe how we consider risk in all our business decisions as part of our organisational structure, and the responsibilities of our people and our committees.
Our internal control system	We describe our internal control system and how it helps us manage and control risk.

In 2017, we updated our Risk Framework to ensure it remains comprehensive and to improve our focus on key risk issues:

- We introduced two new committees:
  - The Board Responsible Banking Committee, which reviews risks relating to conduct, compliance, competition, financial crime and legal matters. It also provides advice, oversight and challenge to maintain a supportive risk culture throughout the business.
  - The Incident Accountability Committee, which considers, calibrates and agrees any appropriate individual remuneration adjustments recommended by the Business Accountability Forum and presents recommendations to the Board Remuneration Committee.
- We now include legal risk as a risk type on its own. This reflects its importance and enables us to give it a higher level of focus.
- We transferred responsibility for reputational risk to the Chief Legal and Regulatory Officer (CLRO) from the Chief Risk Officer (CRO).
- We merged the management of conduct and regulatory risk to take advantage of the synergies between these risk types. This is aligned to the approach used by Banco Santander.

How we define risk (unaudited)

Risk is any uncertainty about us being able to achieve our business objectives. It can be split into a set of key risk types, each of which could affect our results and our financial resources. Our risk types are:

Key risk types	Description
Credit	The risk of loss due to the default or credit quality deterioration of a customer or counterparty to which we have provided credit, or for which we have assumed a financial obligation.
Market	Trading market risk – the risk incurred as a result of changes in market factors that affect the value of positions in the trading book. Banking market risk – the risk of loss of income or economic value due to changes to interest rates in the banking book or to changes in exchange rates, where such changes would affect our net worth through an adjustment to revenues, assets, liabilities and off-balance sheet exposures in the banking book.
Liquidity	The risk that we do not have sufficient liquid financial resources available to meet our obligations as they fall due, or we can only secure such resources at excessive cost. It is split into three types of risk: – Funding or structural liquidity risk – the risk that we may not have sufficient liquid assets to meet the payments required at a given time due to maturity transformation. – Contingent liquidity risk – the risk that future events may require a larger than expected amount of liquidity, that is the risk of not having sufficient liquid assets to meet sudden and unexpected short-term obligations. – Market liquidity risk – the risk that assets we hold to mitigate the risk of failing to meet our obligations as they fall due, which are normally liquid, become illiquid when they are needed.
Capital	The risk that we do not have an adequate amount or quality of capital to meet our internal business objectives, regulatory requirements, market expectations and dividend payments, including AT1 coupons.
Pension	The risk caused by our contractual or other liabilities with respect to a pension scheme (whether established for our employees or those of a related company or otherwise). It also refers to the risk that we will need to make payments or other contributions with respect to a pension scheme due to a moral obligation or for some other reason.
Conduct and regulatory	Conduct risk – the risk that our decisions and behaviours lead to a detriment or poor outcome for our customers. It also refers to the risk that we fail to maintain high standards of market behaviour and integrity. Regulatory risk – the risk of financial or reputational loss, or imposition or conditions on regulatory permission, as a result of failing to comply with applicable codes, regulator's rules, guidance and regulatory expectations.
Other key risk types	Operational risk – the risk of loss due to inadequate or failed internal processes, people and systems, or external events. Our top three key operational risks are: – Cyber risk – Third party supplier management – Process and change management. Financial crime risk - the risk that we are used to further financial crime, including money laundering, sanctions evasion, terrorist financing, bribery and corruption. Failure to meet our legal and regulatory obligations could result in criminal or civil penalties against Santander UK or individuals, as well as negatively affecting our customers and the communities we serve. Legal risk – the risk of an impact arising from legal deficiencies in contracts; failure to take appropriate measures to protect assets; failure to manage legal disputes appropriately; failure to assess or implement the requirements of a change of law; or failure to comply with law or regulation or to discharge duties or responsibilities created by law or regulation. Model risk – the risk that the results of our models may be inaccurate, causing us to make sub-optimal decisions, or that a model may be used inappropriately. Strategic risk – the risk of significant loss or damage arising from strategic decisions that impact the long-term interests of our key stakeholders or from an inability to adapt to external developments. Reputational risk – the risk of damage to the way our reputation and brand are perceived by the public, clients, government, colleagues, investors or any other interested party.

Enterprise wide risk is the aggregate view of all the key risk types described above.

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

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

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

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

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

Making change happen: I AM Risk – everyone's personal responsibility for managing risk
I AM Risk continues to play a key part in our aim to be the best bank for our people, customers, shareholders and communities. Our I AM Risk approach aims to make sure our people:

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

We use I AM Risk in our risk certifications, policies, frameworks and governance, and in all our risk-related communications. We also include it in mandatory training and induction courses for our staff, in our codes of conduct and in rewards and incentives. We embed the behaviours we want to encourage in key processes and documents.

I AM Risk is how we make risk management part of everyone's life as a Santander employee, from how we recruit them and manage their performance to how we develop and reward them. It is also how we encourage people to take personal responsibility for risk, speak up and come up with ideas that help us change. To support this, our learning website includes short films, factsheets and discussion boards.

As part of I AM Risk, we include mandatory risk objectives for all our people – from our Executive Risk Control Committee to branch staff. The Santander Way Steering Committee coordinates all our culture initiatives under the sponsorship of the CEO.

In 2017, we made good progress with continuing to embed personal accountability for managing risk across the business. For all new and existing employees, we enhanced our mandatory risk training and we ensured that the updated performance management risk objectives were used across the business. In our most recent employment engagement survey, 94% of employees acknowledged their personal responsibility for risk management and 97% of employees confirmed that they are aware of how to escalate and report potential risks. This demonstrates how we are successfully embedding risk management in our culture.

Our risk governance structure
We are committed to the highest standards of corporate governance in every part of our business. This includes risk management. For details of our governance, including the Board and its Committees, see the 'Governance' section of this Annual Report.

The Board delegates certain responsibilities to Board Level Committees as needed and where appropriate. Our risk governance structure strengthens our ability to identify, assess, manage and report risks, as follows:

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

Committees
The Board Level Committee responsibilities for risk are:

Board Level Committee	Main risk responsibilities
The Board	– Has overall responsibility for business execution and for managing risk – Reviews and approves the Risk Framework and Risk Appetite.
Board Risk Committee	– Assesses the Risk Framework and recommends it to the Board for approval – Advises the Board on our overall Risk Appetite, tolerance and strategy – Oversees our exposure to risk and our strategy and advises the Board on both – Reviews the effectiveness of our risk management systems and internal controls.
Board Responsible Banking Committee	– Responsible for culture and operational risks relating to conduct, compliance, competition, financial crime and legal matters – Reviews reports from the CLRO on the adequacy and effectiveness of the compliance function – Ensures that adequate and effective control processes are in place to identify and manage reputational risks – Oversees our reputation and how this impacts our brand and market positioning.

The Executive Level Committee responsibilities for risk are:

Executive Level Committee	Main risk responsibilities
Executive Committee	– Reviews and approves business plans in line with our Risk Framework and Risk Appetite before they are sent to the Board to approve – Receives updates on key risk issues managed by CEO-level committees and monitors the actions taken.
Executive Risk Control Committee	– Reviews Risk Appetite proposals before they are sent to the Board Risk Committee and the Board to approve – Ensures that we comply with our Risk Framework, Risk Appetite and risk policies – Reviews and monitors our risk exposures and approves any corrective steps we need to take.
Asset and Liability Committee (ALCO)	– Reviews liquidity risk appetite proposals before they are sent to the Board to approve – Ensures we measure and control structural balance sheet risks, including capital, funding and liquidity, in line with the policies, strategies and plans set by the Board – Reviews and monitors the key asset and liability management activities of the business to ensure we keep our exposure in line with our Risk Appetite.
Pensions Committee	– Reviews pension risk appetite proposals before they are sent to the Board to approve – Approves actuarial valuations and reviews the impact they may have on our contributions, capital and funding – Consults with the pension scheme trustees on the scheme's investment strategy.
Capital Committee	– Puts in place risk control processes, reporting systems and processes to make sure capital risks are managed within our Risk Framework – Reviews capital adequacy and capital plans, including the Internal Capital Adequacy Assessment Process (ICAAP), before they are sent to the Board to approve.
Incident Accountability Committee	– Considers, calibrates, challenges and agrees any appropriate individual remuneration adjustments recommended by the Business Accountability Forums – Presents recommendations to the Board Remuneration Committee.
Executive Credit Approval Committee	– Approves corporate and wholesale credit transactions which exceed levels delegated to lower level approval forums or individuals.
Executive Investment Approval Committee	– Approves equity type investment transactions which exceed levels delegated to lower level approval forums or individuals.

Roles with risk management responsibilities

Chief Executive Officer

The Board delegates responsibility for our business activities and managing risk on a day-to-day basis to the CEO. The main risk responsibilities of the CEO are to:

- Propose our strategy and business plan, put them into practice and manage the risks involved
- Ensure we have a suitable system of controls to manage risk and report to the Board on it
- Foster a culture that promotes ethical practices and social responsibility
- Ensure all our staff are aware of the policies and corporate values approved by the Board.

Chief Risk Officer

As the leader of the Risk Division, the CRO oversees and challenges risk activities, and ensures new lending decisions are made within our Risk Appetite. The CRO reports to the Board through the Board Risk Committee, and also reports to the CEO for operational purposes. The CRO also reports functionally to the global CRO for the Banco Santander group. The main responsibilities of the CRO are to:

- Propose a Risk Framework to the Board (through the Board Risk Committee) that sets out how we manage the risks from our business activities within our approved Risk Appetite
- Advise the CEO, the Board Risk Committee and Board on our Risk Appetite linked to our strategic business plan and why it is appropriate
- Reassure the Board and our regulators that we identify, assess and measure risk and that our systems, controls and delegated authorities to manage risk are adequate and effective
- Advise the CEO, Board Risk Committee, the Board and our regulators on how we manage key risks and escalate issues or breaches of Risk Appetite
- Ensure that our culture promotes ethical practices and social responsibility
- Ensure that our policies and corporate values approved by the Board are communicated so that our culture, values and ethics are aligned to our strategic objectives
- Ensure an appropriate governance structure is in place to make effective credit decisions.

The CRO is accountable for the control and oversight of credit, market, liquidity, capital, pension, strategic, operational and model risk. The CLRO is accountable for the control and oversight of legal, conduct and regulatory, reputational and financial crime risk, and is responsible for reporting on these risks to the CRO to provide them with a holistic enterprise wide view of all risks.

Chief Legal and Regulatory Officer

The CLRO is accountable for the control and oversight of legal, conduct and regulatory, reputational and financial crime risk. The CLRO reports relevant matters to the Board Responsible Banking Committee (BRBC), the Board Risk Committee and the Board. The main responsibilities of the CLRO are to:

- Propose a Risk Framework for legal, conduct and regulatory, reputational and financial crime risk to the Board (through the Board Risk Committee and the CRO) that sets out how we manage these risks in line with our Risk Appetite
- Advise the CRO, CEO, the Board Risk Committee and the Board on our risk appetite for legal, conduct and regulatory, reputational and financial crime risk, linked to our strategic business plan and why it is approved
- Reassure the CRO, the BRBC, the Board and our regulators that we identify, assess and measure legal, conduct and regulatory, reputational and financial crime risk appropriately and that our systems, controls and delegated authorities to manage risk are adequate and effective
- Advise the CRO, CEO, the Board Risk Committee, the BRBC, the Board and our regulators on how we manage key legal, conduct and regulatory, reputational and financial crime risks and escalate any issues or breaches of our Risk Appetite
- Ensure that our culture promotes ethical practices and social responsibility and contributes to the management of reputational risk
- Ensure that our policies and corporate values approved by the Board are communicated so that our culture, values and ethics are aligned to our strategic objectives.
- Provide an assessment on Legal, Conduct & Regulatory, Reputational and Financial Crime risks to the CEO, CRO, BRC, BRBC, Board and our regulators on how these risks are being managed in the Santander UK Group and escalate to the CRO, BRC and Board any issue or breach of appetite.

Chief Financial Officer

The main risk responsibilities of the CFO are to:

- Deliver the strategy approved by the Board, in line with the authority delegated to him by the CEO
- Manage the day-to-day operations of their business division, in line with agreed business plans, delegating appropriate authority prudently
- Manage and control effectively in line with the relevant risk types and activity framework relevant to the CFO Division
- Demonstrate an awareness and understanding of the main risks facing the CFO Division and how to manage the risks involved. The key risk types being:
  - Interest Rate Risk and Forex Risk in the banking book: these risks are managed within the Risk Appetite and limits approved by the Board
  - Liquidity Risk: these risks are managed within the Risk Appetite and limits approved by the Board
  - Pension Risk: oversight of the management of the Pension Scheme by the Trustee and agreement with them to manage Pension Scheme assets and liabilities to minimise volatility in IAS19 funding levels and negative impact on capital. To agree investment strategy with the Trustee to manage risk of additional cash contributions being required because of poor investment performance
  - Capital Risk: the capital position of the UK group and legal entities is managed in accordance with the Capital Risk Appetite and regulatory requirements
- Carries out appropriate contingency planning and balances risk impact with delivery of business as usual
- Promotes and embeds a risk awareness culture within CFO Division and actively encourages people to speak up and challenge without fear.

Chief Internal Auditor
The Chief Internal Auditor (CIA) reports to the Board through the Board Audit Committee, and also reports to the CEO for operational purposes. The CIA also reports functionally to the CIA of Banco Santander SA. The main responsibilities of the CIA are to:

- Ensure the scope of Internal Audit covers all activities (including outsourced activities) at a legal entity level
- Design and use an audit system that identifies key risks and evaluates controls
- Develop an audit plan to assess existing risks that involves producing audit, assurance and monitoring reports
- Carry out all audits, special reviews, reports and commissions that the Board Audit Committee asks for
- Monitor business activities regularly by consulting with internal control teams and our External Auditors
- Develop and run internal auditor training that includes regular skills assessments.

Risk organisational structure (unaudited)
We use the 'three lines of defence' model to manage risk. This model is widely used in the banking industry and has a clear set of principles to put in place a cohesive operating model across an organisation. It does this by separating risk management, risk control and risk assurance.

The diagram below shows the reporting lines to the Board with respect to risk:

Line 1
Risk management
Business Units and Business Support Units are accountable for identifying, assessing and managing the risks which originate and exist in their area, within our Risk Appetite.

Line 2
Risk control
Risk Control Units are independent monitoring and control functions. They are under the executive responsibility of the CEO, but responsible to the CRO for overseeing the first line of defence. They make sure Business Units and Business Support Units manage risks effectively and within our Risk Appetite. The Risk Control Units are:

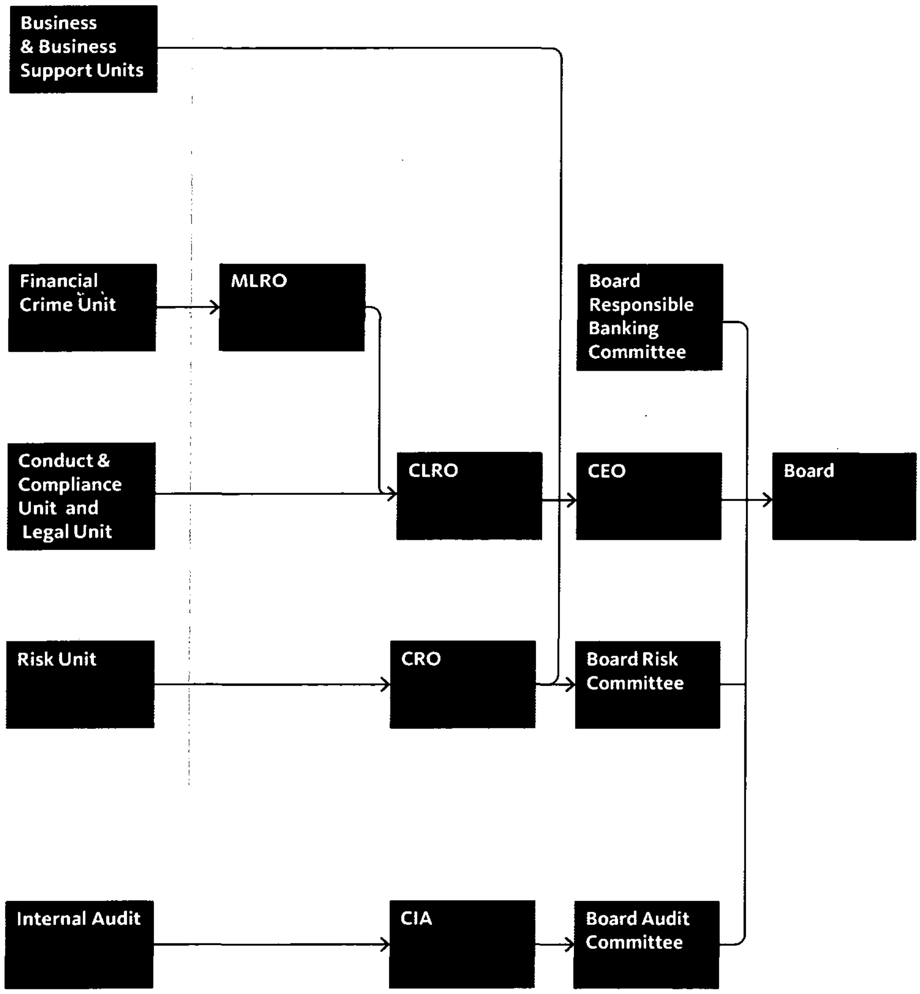
Financial Crime Unit is responsible for controlling financial crime risks.

Conduct & Compliance Unit is responsible for controlling reputational and conduct & regulatory risks.

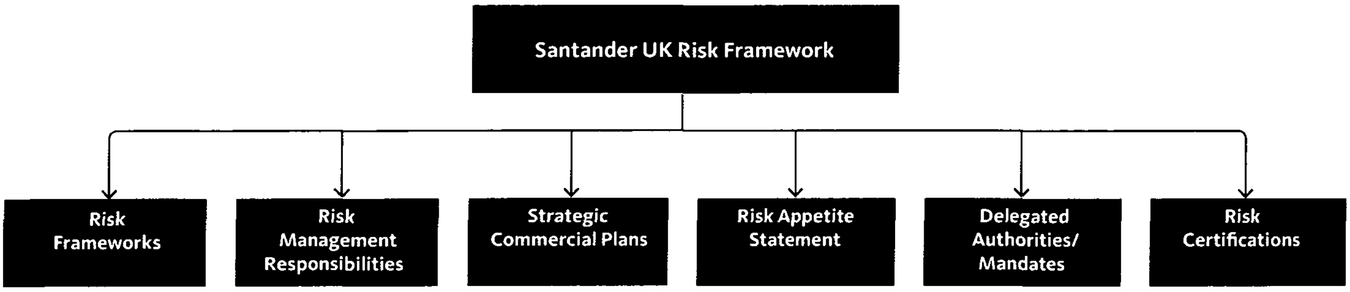
Legal Unit is responsible for controlling legal risks.

Risk Unit is responsible for controlling credit, market, liquidity, capital, pension, strategic, operational and model risks.

Line 3
Risk assurance
Internal Audit is a permanent corporate function, independent of any other unit. Its role is to give assurance on how well-designed and effective our risk management and internal control processes are.



Internal control system *(unaudited)*
Our Risk Framework is an overarching view of our internal control system that helps us manage risk across the business. It sets out at a high level the principles, minimum standards, roles and responsibilities, and governance for internal control.



Category	Description
Risk Frameworks	Set out how we should manage and control risk for: – The Santander UK group (overall framework) – Our key risk types (risk type frameworks) – Our key risk activities (risk activity frameworks).
Risk Management Responsibilities	Set out the Line 1 risk management responsibilities for Business Units and Business Support Units.
Strategic Commercial Plans	Plans produced by business area at least annually that describe the forecasted objectives, volumes and risk profile of new and existing business, within the limits defined in our Risk Appetite and policies in place.
Risk Appetite Statement	Defines the type and the level of risk that we are willing and able to take on to achieve our business plans. The policies set out what action we must (or must not) take to make sure we stay within our Risk Appetite. Risk Control Units set overarching policies. Business and Business Support Units have operational policies, standards and procedures that put these policies into practice. We expect all our people to manage risk within their own work by complying with these policies, standards and procedures.
Delegated Authorities/Mandates	Define who can do what under the authority delegated to the CEO by the Board.
Risk Certifications	Business Units, Business Support Units or Risk Control Units set out how they have managed and/or controlled risks in line with the risk frameworks and within Risk Appetite. They are completed at least once a year. They also explain any action taken. This process helps ensure people can be held personally accountable.

RISK APPETITE (unaudited)

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

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

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

How we describe the limits in our Risk Appetite
Our Risk Appetite sets out detailed limits for different types of risk, using metrics and qualitative statements.

Metrics
We use metrics to set limits on losses, capital liquidity, and concentration. We set:

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

These limits apply in normal business conditions, but also when we might be experiencing a far more difficult economic environment. A good example of this might be when the UK economy is performing much worse than we expected. We refer to conditions such as this as being under stress.

There is more on economic capital and stress scenarios later in this section.

Qualitative statements
For some risks we also use qualitative statements that describe in words the appetite we want to set. For example, in conduct risk, we use them to describe our Risk Appetite for products, sales, after-sales service, and culture. We also use them to prohibit or restrict exposure to certain sectors, types of customer and activities.

How we set our Risk Appetite, and stay within it
We control our Risk Appetite through our Risk Appetite Framework. Our Board approves and oversees our Risk Appetite Statement every year. This ensures it is consistent with our strategy and reflects the markets in which we operate. Our Executive Risk Control Committee is responsible for ensuring that our risk profile (the level of risk we are prepared to accept) is consistent with our Risk Appetite Statement. To do this they monitor our performance against our Risk Appetite, business plans and budgets each month. We also use stress testing to review how our business plan performs against our Risk Appetite Statement. This shows us if we would stay within our Risk Appetite under stress conditions. It also helps us to identify any adverse trends or inconsistencies.

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

We provide a programme of communication and training for our staff which helps ensure that Risk Appetite is well understood.

STRESS TESTING (unaudited)

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

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

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

We describe each scenario using a narrative setting out how events might unfold, as well as a market and/or economic context. For example the key economic factors we reflect in our ICAAP scenarios include house prices, interest rates, unemployment levels and the size of the UK economy. One scenario looks at what might happen in a recession where the output of the economy shrinks by around 5%, unemployment reaches over 9%, and house prices fall by around 30% in a context of high inflation and interest rates rising rapidly. We use a comprehensive suite of stress scenarios to explore sensitivities to market risk, including those based on historic market events.

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

- Our business plan, and its assessment against our Risk Appetite
- Our capital strength, through our ICAAP
- Our liquidity position, through our Internal Liquidity Adequacy Assessment Process (ILAAP)
- Impacts on other risk types.

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

Our stress testing models are subject to a formal review, independent validation and approval process. We highlight the key weaknesses and related model assumptions in the approval process for each stress test. In some cases, we overlay expert judgement onto the results of our models. Where this is material to the outcome of the stress test, the approving governance committee reviews it.

We take a multi-layered approach to stress testing to capture risks at various levels. This ranges from sensitivity analysis of a single factor to a portfolio, to wider exercises that cover all risks across our entire business. We use stress testing outputs to design action plans that aim to mitigate damaging effects.

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

Board oversight of stress testing
The Executive Risk Control Committee approves the design of the scenarios in our ICAAP. The Board Risk Committee approves the stress testing framework. The Board reviews the outputs of stress testing as part of the approval processes for the ICAAP, the ILAAP, our Risk Appetite and regulatory stress tests.

Regulatory stress tests
We take part in a number of external stress testing exercises. These can include stress tests of the UK banking system conducted by the PRA. We also contribute to stress tests of Banco Santander.

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

HOW RISK IS DISTRIBUTED ACROSS OUR BUSINESS (unaudited)

Economic capital
As well as assessing how much regulatory capital we are required to hold, we use an internal Economic Capital (EC) model to measure our risk.

We use EC to get a consistent measure across different risk types. EC also takes account of how concentrated our portfolios are, and how much diversification there is between our various businesses.

As a consequence we can use EC for a range of risk management activities. For example, we can use it to help us compare requirements in our ICAAP or to get a risk-adjusted comparison of income from different activities.

Regulatory capital – risk-weighted assets
The table below shows the proportion of our regulatory capital risk-weighted assets we held in different parts of our business at 31 December 2017 and 2016. It is split between credit, market and operational risk against which we hold regulatory capital.

Santander UK

	2017 %	2016 %
Credit risk	**87**	88
Market risk	**4**	4
Operational risk	**9**	8

Retail Banking

	2017 %	2016 %
Credit risk	**44**	44
Market risk	**–**	–
Operational risk	**7**	6

Commercial Banking

	2017 %	2016 %
Credit risk	**21**	22
Market risk	**–**	–
Operational risk	**1**	1

Global Corporate Banking

	2017 %	2016 %
Credit risk	**14**	14
Market risk	**4**	4
Operational risk	**1**	1

Corporate Centre

	2017 %	2016 %
Credit risk	**8**	8
Market risk	**–**	–
Operational risk	**–**	–

2017 compared to 2016
The distribution of risk across our business was broadly unchanged in the year. The largest category continued to be credit risk in Retail Banking, which accounted for most of our risk-weighted assets. This reflects our business strategy and balance sheet. Market risk arises primarily as part of our trading book activities in Global Corporate Banking. Our operational risk capital requirements remained small and were concentrated in our Retail Banking activities.

Credit risk

Overview (unaudited)

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

Santander UK group level
We start by discussing credit risk at a Santander UK group level. We set out how our exposures arise, our types of customer and how we manage them, and our approach to credit risk across the credit risk lifecycle.

We then analyse our key metrics, including maximum and net exposures, credit quality, risk concentrations, credit performance and forbearance.

Business segments
Then we cover Retail Banking separately from our other segments in more detail in the sections that follow. Our other segments are Commercial Banking, Global Corporate Banking and Corporate Centre.

Key metrics (unaudited)

NPL ratio improved to 1.42% (2016: 1.50%)

NPL coverage ratio increased to 33% (2016: 31%)

Impairment loss allowances increased to £940m (2016: £921m)

Average LTV of 62% (2016: 65%) on new mortgage lending

Credit risk – Santander UK group level

SANTANDER UK GROUP LEVEL – CREDIT RISK MANAGEMENT

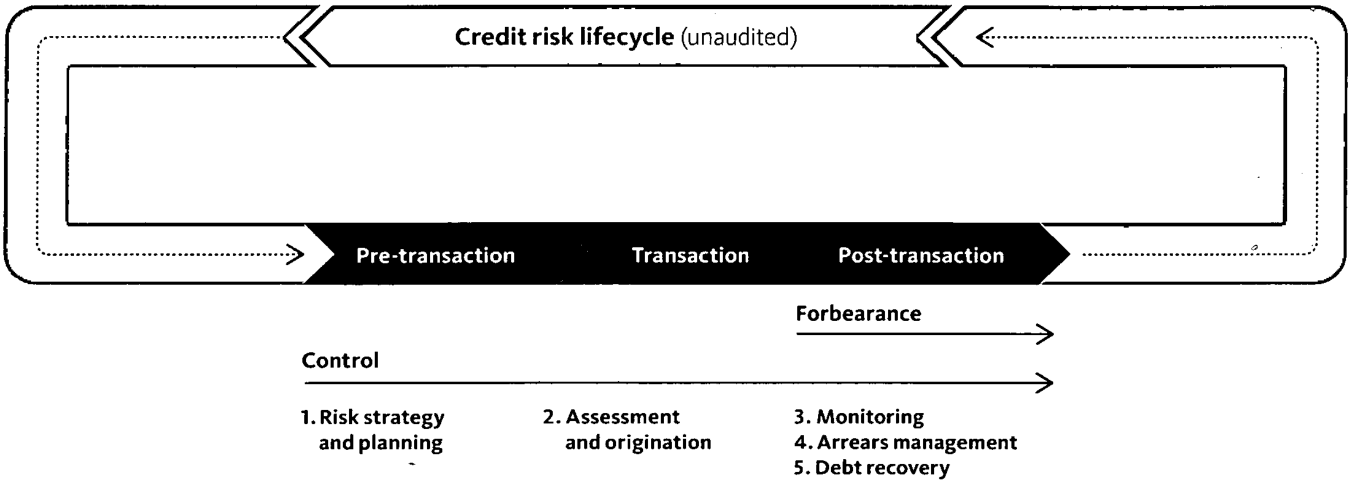
Exposures
Exposures to credit risk arise in our business segments from:

Retail Banking	Commercial Banking	Global Corporate Banking	Corporate Centre
– Residential mortgages, business banking, consumer (auto) finance and other unsecured lending (personal loans, credit cards, and overdrafts).	– Loans, bank accounts, treasury services, invoice discounting, cash transmission, trade finance and asset finance.	– Loans, treasury products, and treasury markets activities.	– Asset and liability management of our balance sheet, as well as our non-core and Legacy Portfolios being run down.
– We provide these to individuals and small businesses.	– We provide these to SMEs and mid corporates, as well as Commercial Real Estate customers and Social Housing associations.	– We provide these to large corporates, and financial institutions, as well as sovereigns and other international organisations.	– Exposures include sovereign and other international organisation assets that we hold for liquidity.

Our types of customers and how we manage them
We manage credit risk across all our business segments in line with the credit risk lifecycle that we show in the next section. We tailor the way we manage risk across the lifecycle to the type of customer. We classify our customers as standardised or non-standardised:

Standardised	Non-standardised
– Mainly individuals and small businesses. Their transactions are for relatively small amounts of money, and share similar credit characteristics.	– Mainly medium and large corporate customers and financial institutions. Their transactions are for larger amounts of money, and have more diverse credit characteristics.
– In Retail Banking, Commercial Banking (for some small, non-complex corporate clients) and Corporate Centre (for our non-core portfolios).	– In Retail Banking (for some business banking transactions), Commercial Banking, Global Corporate Banking and Corporate Centre.
– We manage risk using automated decision-making tools. These are backed by teams of analysts who specialise in this type of risk.	– We manage risk through expert analysis. We support this with decision-making tools based on internal risk assessment models.

Our approach to credit risk



We manage our portfolios across the credit risk lifecycle, from drawing up our risk strategy, plans, budgets and limits to making sure the actual risk profile of our exposures stays in line with our plans and within our Risk Appetite. We further tailor the way we manage risk across the life cycle to the type of product. We say more on this in the Credit risk – Retail Banking and the Credit risk – other segments sections.

1. Risk strategy and planning
All relevant areas of the business work together to create our business plans. This includes Risk, Marketing, Products and Finance. We aim to balance our strategy, business goals, and financial and technical resources with our attitude to risk (our Risk Appetite). To do this, we focus particularly on economic and market conditions and forecasts, regulations, conduct considerations, profitability, returns and market share. The result is an agreed set of targets and limits that help us direct our business.

2. Assessment and origination
Managing credit risk begins with lending responsibly. That means only lending to customers who can afford to pay us back, even if things get tighter for them, and are committed to paying us back. We undertake a thorough risk assessment to make sure customers can meet their obligations before we approve a credit application. We make these decisions with authority from the Board and we consider:

- The credit quality of the customer
- The underlying risk – and anything that mitigates it, such as netting or collateral
- Our risk policy, limits and appetite
- Whether we can balance the amount of risk we face with the returns we expect

We also use stress testing, for example to estimate how a customer might be able to cope if interest rates increase.

3. Monitoring
We measure and monitor changes in our credit risk profile on a regular and systematic basis against budgets, limits and benchmarks. We monitor credit performance by portfolio, segment, customer or transaction. If our portfolios do not perform as we expect, we investigate to understand the reasons. Then we take action to mitigate it as far as possible and bring performance back on track.

We monitor and review our risk profile through a formal structure of governance and forums/committees across our business segments. These agree and track any steps we need to take to manage our portfolios, to make sure the impact is prompt and effective. This structure is a vital feedback tool to co-ordinate issues, trends and developments across each part of the credit risk lifecycle.

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

Managing concentrations of credit risk exposures is a key part of risk management. We track how concentrated our credit risk portfolios are using various criteria. These include geographical areas, economic sectors, products and groups of customers.

Geographical concentrations
As part of our approach to credit risk management and Risk Appetite, we set exposure limits to countries and geographical areas. We set our limits with reference to the country limits set by Banco Santander SA. These are determined according to how the country is classified (whether it is a developed OECD country or not), its credit rating, its gross domestic product, and the types of products and services Banco Santander wants to offer in that country.

For more geographical information, see the 'Country risk exposures' section.

Industry concentrations
As part of our approach to credit risk management and Risk Appetite, we set concentration limits by industry sector. These limits are set based on the industry outlook, our strategic aims and desired level of concentration, but also take into account any relevant limit set by Banco Santander SA.

We provide further portfolio analyses on committed exposures, which are typically higher than the balance sheet value, in the following 'Credit risk review' sections.

4. Arrears management
Sometimes our customers face financial difficulty and they may fall into payment arrears or breach conditions of their credit facility. If this happens, we work with them to get their account back on track. We aim to support our customers and keep our relationship with them. We do this by:

- Finding affordable and sustainable ways of repaying to fit their circumstances
- Monitoring their finances and using models to predict how we think they will cope financially. This helps us design and put in place the right strategy to manage their debt
- Working with them to get their account back to normal as soon as possible in a way that works for them and us
- Monitoring agreements we make to manage their debt so we know they are working.

Forbearance
When a customer gets into financial difficulties, we can change the terms of their loan, either temporarily or permanently. We do this to help customers through temporary periods of financial difficulty so they can get back on to sustainable terms and fully pay off the loan over its lifetime, with support if needed. This is known as forbearance. We try to do this before the customer defaults. Whatever we offer, we assess it to make sure the customer can afford the repayments.

Forbearance improves our customer relationships and our credit risk profile. We only use foreclosure or repossession as a last resort. We review our approach regularly to make sure it is still effective. In a few cases, we can help a customer in this way more than once. This can happen if the plan to repay their debt doesn't work and we have to draw up another one. When this happens more than once in a year, or more than three times in five years, we call it multiple forbearance.

For a loan to exit forbearance all the following conditions must be met:

- The loan has been forborne at least two years ago or, where the forbearance was temporary, must have returned to performing under normal contractual terms for at least two years
- The loan has been performing under the forborne terms for at least two years
- The account is no longer in arrears
- The customer does not have any other debts with us which are more than 30 days in arrears.

5. Debt recovery
Sometimes, even when we have taken all reasonable and responsible steps we can to manage arrears, they prove ineffective. If this happens, we have to end our relationship with the customer and try to recover the whole debt, or as much of it as we can.

Risk measurement and control

We measure and control credit risk at all stages across the credit risk lifecycle. We have a range of tools, processes and approaches, but we rely mainly on:

- **Credit control:** as a core part of risk management we generate, extract and store accurate, comprehensive and timely data to monitor credit limits. We do this using internal data and data from third parties like credit bureaux
- **Models:** we use models widely to measure credit risk and capital needs. They range from statistical and expert models to benchmarks
- **Review:** we use formal and informal forums across the business to approve, validate, review and challenge our risk management. We do this to help us predict if our credit risk will worsen.

We use two key metrics to measure and control credit risk: Expected Loss (EL) and Non-Performing Loans (NPLs).

Metric	Description
EL	EL tells us what credit risk is likely to cost us. It is the product of: – Probability of default (PD) – how likely customers are to default. We estimate this using customer ratings or the transaction credit scores – Exposure at default (EAD) – how much customers will owe us if they default. We calculate this by comparing how much of their agreed credit (such as an overdraft) customers have used when they default with how much they normally use. This allows us to estimate the final extent of use of credit in the event of default – Loss given default (LGD) – how much we lose when customers actually default. We work this out using the actual losses on loans that default. We take into account the income we receive, including the collateral we held, the costs we incur and the recovery process timing. PD, EAD and LGD are calculated in accordance with CRD IV, and include direct and indirect costs. We base them on our own risk models and our assessment of each customer's credit quality. For the rest of our Risk review, impairments, impairment losses and impairment loss allowances refer to calculations in accordance with IFRS, unless we specifically say they relate to CRD IV. For our IFRS accounting policy on impairment, see Note 1 to the Consolidated Financial Statements. The way we calculate impairment under IFRS changed from 1 January 2018 when IFRS 9 took effect. It uses an expected credit loss (ECL) model rather than an incurred loss model used by IAS 39. There are also differences between the ECL approach used by IFRS 9 and the EL approach used by CRD IV. For more, see 'Future accounting developments' in Note 1 to the Consolidated Financial Statements.
NPLs	We use NPLs – and related write-offs and recoveries – to monitor how our portfolios behave. We classify loans as NPLs where customers do not make a payment for three months or more, or if we have data to make us doubt they can keep up with their payments. The data we have on customers varies across our business segments. It typically includes where: Retail Banking – They have been reported bankrupt or insolvent – Their loan term has ended, but they still owe us money more than three months later – They have had forbearance as an NPL, but have not caught up with the payments they had missed before that – They have had multiple forbearance – We have suspended their fees and interest because they are in financial difficulties – We have repossessed the property. *Other segments: Commercial Banking, Global Corporate Banking and Corporate Centre* – They have had a winding up notice issued, or something happens that is likely to trigger insolvency – such as, another lender calls in a loan – Something happens that makes them less likely to be able to pay us – such as they lose an important client or contract – They have regularly missed or delayed payments, even though they have not gone over the three-month limit for NPLs – Their loan is unlikely to be refinanced or repaid in full on maturity – Their loan has an excessive LTV and it is unlikely that it will be resolved, such as by a change in planning policy, pay-downs from rental income, or increases in market values.

We also assess risks from other perspectives. These comprise internal rating deterioration, geographical location, business area, product and process. We do this to identify specific areas we need to focus on. We also use stress testing to establish vulnerabilities to economic deterioration. Our business segments tailor their approach to credit risk to their own customers. We explain their approaches in the business segment sections later on.

SANTANDER UK GROUP LEVEL – CREDIT RISK REVIEW

Our maximum and net exposure to credit risk

The tables below show the main differences between our maximum and net exposure to credit risk. They show the effects of collateral, netting, and risk transfer to mitigate our exposure. The tables only show the financial assets that credit risk affects.

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

	Maximum exposure				Collateral[1]			
	Balance sheet asset							
2017	Gross amounts £bn	Impairment loss allowances and RV & VT[2] provisions £bn	Net amounts £bn	Off-balance sheet £bn	Cash £bn	Non-cash £bn	Netting[3] £bn	Net exposure £bn
Cash and balances at central banks	32.8	–	32.8	–	–	–	–	32.8
Trading assets:								
– Securities repurchased under resale agreements	8.9	–	8.9	–	–	(8.5)	(0.4)	–
– Debt securities	5.2	–	5.2	–	–	–	–	5.2
– Cash collateral	6.2	–	6.2	–	–	–	–	6.2
– Short-term loans	0.7	–	0.7	–	–	–	–	0.7
Total trading assets	21.0	–	21.0	–	–	(8.5)	(0.4)	12.1
Derivative financial instruments	19.9	–	19.9	–	(2.8)	–	(14.8)	2.3
Financial assets designated at fair value:								
– Loans and advances to customers	1.6	–	1.6	–	–	(1.6)	–	–
– Debt securities	0.5	–	0.5	–	–	–	–	0.5
Total financial assets designated at fair value	2.1	–	2.1	–	–	(1.6)	–	0.5
Loans and advances to banks	5.9	–	5.9	1.6	–	(2.5)	–	5.0
Loans and advances to customers:[4]								
– Advances secured on residential property	155.4	(0.2)	155.2	12.4	–	(167.4)[5]	–	0.2
– Corporate loans	31.0	(0.5)	30.5	17.1	–	(21.8)	–	25.8
– Finance leases	6.7	(0.1)	6.6	0.6	(0.1)	(5.8)	–	1.3
– Other unsecured loans	6.2	(0.2)	6.0	11.1	–	(0.1)	–	17.0
– Amounts due from fellow Banco Santander group subsidiaries and joint ventures	1.2	–	1.2	–	–	–	–	1.2
Total loans and advances to customers	200.5	(1.0)	199.5	41.2	(0.1)	(195.1)	–	45.5
Financial investments:								
– Loans and receivables securities[4]	2.2	–	2.2	0.7	–	–	–	2.9
– Available-for-sale debt securities	8.8	–	8.8	–	–	–	–	8.8
– Held-to-maturity debt securities	6.5	–	6.5	–	–	–	–	6.5
Total financial investments	17.5	–	17.5	0.7	–	–	–	18.2
Total	299.7	(1.0)	298.7	43.5	(2.9)	(207.7)	(15.2)	116.4

(1) The forms of collateral we take to reduce credit risk include: residential and commercial property; other physical assets, including motor vehicles; liquid securities, including those transferred under reverse repurchase agreements; cash, including cash used as collateral for derivative transactions; and receivables. Charges on residential property are most of the collateral we take.
(2) Residual Value (RV) and Voluntary Termination (VT) provisions.
(3) We can reduce credit risk exposures by applying netting. We do this mainly for derivative and repurchase transactions with financial institutions. For derivatives, we use standard master netting agreements. They allow us to set off our credit risk exposure to a counterparty from a derivative against our obligations to the counterparty in the event of default. This gives us a lower net credit exposure. They may also reduce settlement exposure. For more on this, see 'Credit risk mitigation' in the 'Other segments – credit risk management' section.
(4) Balances include interest we have charged to the customer's account and accrued interest that we have not charged to the account yet.
(5) The collateral value we have shown is limited to the balance of each associated individual loan. It does not include the impact of over-collateralisation (where the collateral has a higher value than the loan balance) and includes collateral we would receive on draw down of certain off-balance sheet commitments.

2016	Maximum exposure Balance sheet asset Gross amounts £bn	Impairment loss allowances and RV & VT[2] provisions £bn	Net amounts £bn	Off-balance sheet £bn	Collateral[1] Cash £bn	Non-cash £bn	Netting[3] £bn	Net exposure £bn
Cash and balances at central banks	17.1	–	17.1	–	–	–	–	17.1
Trading assets:								
– Securities repurchased under resale agreements	10.7	–	10.7	–	–	(8.6)	(2.1)	–
– Debt securities	6.2	–	6.2	–	–	–	–	6.2
– Cash collateral	6.2	–	6.2	–	–	–	–	6.2
– Short-term loans	0.9	–	0.9	–	–	–	–	0.9
Total trading assets	24.0	–	24.0	–	–	(8.6)	(2.1)	13.3
Derivative financial instruments	25.5	–	25.5	–	(2.4)	–	(17.4)	5.7
Financial assets designated at fair value:								
– Loans and advances to customers	1.7	–	1.7	0.2	–	(1.8)	–	0.1
– Debt securities	0.4	–	0.4	–	–	–	–	0.4
Total financial assets designated at fair value	2.1	–	2.1	0.2	–	(1.8)	–	0.5
Loans and advances to banks	4.4	–	4.4	1.9	–	(1.5)	–	4.8
Loans and advances to customers:[4]								
– Advances secured on residential property	154.7	(0.3)	154.4	10.8	–	(164.9)[5]	–	0.3
– Corporate loans	32.0	(0.4)	31.6	17.1	–	(23.1)	–	25.6
– Finance leases	6.7	(0.1)	6.6	0.4	(0.1)	(5.7)	–	1.2
– Other unsecured loans	6.2	(0.2)	6.0	11.5	–	–	–	17.5
– Amounts due from fellow Banco Santander group subsidiaries and joint ventures	1.1	–	1.1	–	–	–	–	1.1
Total loans and advances to customers	200.7	(1.0)	199.7	39.8	(0.1)	(193.7)	–	45.7
Financial investments:								
– Loans and receivables securities[4]	0.3	–	0.3	1.6	–	–	–	1.9
– Available-for-sale debt securities	10.4	–	10.4	–	–	–	–	10.4
– Held-to-maturity debt securities	6.6	–	6.6	–	–	–	–	6.6
Total financial investments	17.3	–	17.3	1.6	–	–	–	18.9
Total	291.1	(1.0)	290.1	43.5	(2.5)	(205.6)	(19.5)	106.0

(1) The forms of collateral we take to reduce credit risk include: residential and commercial property; other physical assets, including motor vehicles; liquid securities, including those transferred under reverse repurchase agreements; cash, including cash used as collateral for derivative transactions; and receivables. Charges on residential property are most of the collateral we take.
(2) Residual Value (RV) and Voluntary Termination (VT) provisions.
(3) We can reduce credit risk exposures by applying netting. We do this mainly for derivative and repurchase transactions with financial institutions. For derivatives, we use standard master netting agreements. They allow us to set off our credit risk exposure to a counterparty from a derivative against our obligations to the counterparty in the event of default. This gives us a lower net credit exposure. They may also reduce settlement exposure. For more on this, see 'Credit risk mitigation' in the 'Other segments – credit risk management' section.
(4) Balances include interest we have charged to the customer's account and accrued interest that we have not charged to the account yet.
(5) The collateral value we have shown is limited to the balance of each associated individual loan. It does not include the impact of over-collateralisation (where the collateral has a higher value than the loan balance) and includes collateral we would receive on draw down of certain off-balance sheet commitments.

Credit quality

Single rating scale (unaudited)

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

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

Rating distribution

The tables below show the credit rating of our financial assets subject to credit risk. For more on the credit rating profiles of key portfolios, see the 'Credit Risk – Retail Banking' and 'Credit Risk – other segments' sections.

	Santander UK risk grade								
2017	**9 £bn**	**8 £bn**	**7 £bn**	**6 £bn**	**5 £bn**	**4 £bn**	**3 to 1 £bn**	**Other[1] £bn**	**Total £bn**
Cash and balances at central banks	**31.8**	–	–	–	–	–	–	**1.0**	**32.8**
Trading assets:									
– Securities repurchased under resale agreements	–	**5.7**	**1.5**	**1.7**	–	–	–	–	**8.9**
– Debt securities	**1.2**	**3.1**	**0.9**	–	–	–	–	–	**5.2**
– Cash collateral	**0.1**	**0.9**	**5.1**	**0.1**	–	–	–	–	**6.2**
– Short-term loans	**0.7**	–	–	–	–	–	–	–	**0.7**
Total trading assets	**2.0**	**9.7**	**7.5**	**1.8**	–	–	–	–	**21.0**
Derivative financial instruments	**0.4**	**9.9**	**7.6**	**1.5**	**0.4**	–	–	**0.1**	**19.9**
Financial assets designated at fair value:									
– Loans and advances to customers	**0.3**	**1.2**	**0.1**	–	–	–	–	–	**1.6**
– Debt securities	**0.4**	**0.1**	–	–	–	–	–	–	**0.5**
Total financial assets designated at fair value	**0.7**	**1.3**	**0.1**	–	–	–	–	–	**2.1**
Loans and advances to banks	**1.3**	**1.7**	**1.1**	**0.4**	–	–	–	**1.4**	**5.9**
Loans and advances to customers[2]									
– Advances secured on residential property	**3.2**	**26.7**	**75.2**	**35.2**	**6.2**	**4.5**	**4.4**	–	**155.4**
– Corporate loans	**1.7**	**5.1**	**2.1**	**4.6**	**9.6**	**5.1**	**1.5**	**1.3**	**31.0**
– Finance leases	–	–	**0.4**	**1.3**	**2.0**	**1.8**	**1.1**	**0.1**	**6.7**
– Other unsecured loans	–	**0.1**	**0.8**	**1.6**	**1.6**	**0.7**	**0.5**	**0.9**	**6.2**
– Amounts due from fellow Banco Santander group subsidiaries and joint ventures	–	–	–	–	–	–	–	**1.2**	**1.2**
Total loans and advances to customers	**4.9**	**31.9**	**78.5**	**42.7**	**19.4**	**12.1**	**7.5**	**3.5**	**200.5**
Financial investments:									
– Loans and receivables securities[2]	**1.9**	**0.1**	**0.2**	–	–	–	–	–	**2.2**
– Available-for-sale debt securities	**6.5**	**1.9**	**0.4**	–	–	–	–	–	**8.8**
– Held-to-maturity debt securities	**6.5**	–	–	–	–	–	–	–	**6.5**
Total financial investments	**14.9**	**2.0**	**0.6**	–	–	–	–	–	**17.5**
	56.0	**56.5**	**95.4**	**46.4**	**19.8**	**12.1**	**7.5**	**6.0**	**299.7**
Impairment loss allowances and RV & VT provisions[5]									**(1.0)**
Total									**298.7**
Of which:									
Neither past due nor impaired:									
– Cash and balances at central banks	**31.8**	–	–	–	–	–	–	**1.0**	**32.8**
– Trading assets	**2.0**	**9.7**	**7.5**	**1.8**	–	–	–	–	**21.0**
– Derivative financial instruments	**0.4**	**9.9**	**7.6**	**1.5**	**0.4**	–	–	**0.1**	**19.9**
– Financial assets designated at fair value	**0.7**	**1.3**	**0.1**	–	–	–	–	–	**2.1**
– Loans and advances to banks	**1.3**	**1.7**	**1.1**	**0.4**	–	–	–	**1.4**	**5.9**
– Loans and advances to customers	**4.9**	**31.9**	**78.5**	**42.7**	**19.3**	**12.1**	**3.8**	**3.5**	**196.7**
– Financial investments	**14.9**	**2.0**	**0.6**	–	–	–	–	–	**17.5**
Total neither past due nor impaired	**56.0**	**56.5**	**95.4**	**46.4**	**19.7**	**12.1**	**3.8**	**6.0**	**295.9**
Past due but not impaired[3]	–	–	–	–	**0.1**	–	**2.4**	–	**2.5**
Impaired[4]	–	–	–	–	–	–	**1.3**	–	**1.3**
	56.0	**56.5**	**95.4**	**46.4**	**19.8**	**12.1**	**7.5**	**6.0**	**299.7**
Impairment loss allowances and RV & VT provisions[5]									**(1.0)**
Total									**298.7**

(1) Other items include cash at hand and smaller cases mainly in the consumer (auto) finance and commercial mortgages portfolios. We use scorecards for these items, rather than rating models.
(2) Balances include interest we have charged to the customer's account and accrued interest we have not charged to the account yet.
(3) Balances include mortgage loans in arrears which have been assessed for incurred but not observed (IBNO) losses as described in Note 1 to the Consolidated Financial Statements.
(4) Impaired loans are loans we have assessed for observed impairment loss allowances. This included loans individually assessed for impairment of £713m.
(5) Residual Value (RV) and Voluntary Termination (VT) provisions.

2016	Santander UK risk grade 9 £bn	8 £bn	7 £bn	6 £bn	5 £bn	4 £bn	3 to 1 £bn	Other[1] £bn	Total £bn
Cash and balances at central banks	15.9	–	–	–	–	–	–	1.2	17.1
Trading assets:									
– Securities repurchased under resale agreements	–	5.4	4.2	0.9	0.2	–	–	–	10.7
– Debt securities	2.8	1.5	0.3	1.6	–	–	–	–	6.2
– Cash collateral	–	1.5	4.3	0.4	–	–	–	–	6.2
– Short-term loans	0.8	–	–	–	0.1	–	–	–	0.9
Total trading assets	3.6	8.4	8.8	2.9	0.3	–	–	–	24.0
Derivative financial instruments	1.1	10.4	9.9	3.4	0.6	–	–	0.1	25.5
Financial assets designated at fair value:						–	–		
– Loans and advances to customers	0.6	0.5	0.6	–	–	–	–	–	1.7
– Debt securities	–	0.1	–	0.3	–	–	–	–	0.4
Total financial assets designated at fair value	0.6	0.6	0.6	0.3	–	–	–	–	2.1
Loans and advances to banks	1.7	1.5	0.5	0.2	–	–	–	0.5	4.4
Loans and advances to customers:[2]									
– Advances secured on residential property	2.1	23.8	74.0	37.8	6.8	5.3	4.9	–	154.7
– Corporate loans	3.3	3.2	1.6	10.5	7.4	3.7	0.9	1.4	32.0
– Finance leases	–	–	0.4	1.3	2.0	1.9	1.0	0.1	6.7
– Other unsecured loans	–	–	0.2	1.5	2.4	0.9	0.4	0.8	6.2
– Amounts due from fellow Banco Santander group subsidiaries and joint ventures	1.1	–	–	–	–	–	–	–	1.1
Total loans and advances to customers	6.5	27.0	76.2	51.1	18.6	11.8	7.2	2.3	200.7
Financial investments:									
– Loans and receivables securities[2]	0.1	–	0.2	–	–	–	–	–	0.3
– Available-for-sale debt securities	7.8	1.8	0.7	–	–	–	–	0.1	10.4
– Held-to-maturity debt securities	6.6	–	–	–	–	–	–	–	6.6
Total financial investments	14.5	1.8	0.9	–	–	–	–	0.1	17.3
	43.9	49.7	96.9	57.9	19.5	11.8	7.2	4.2	291.1
Impairment loss allowances and RV & VT provisions[5]									(1.0)
Total									290.1
Of which:									
Neither past due nor impaired:									
– Cash and balances at central banks	15.9	–	–	–	–	–	–	1.2	17.1
– Trading assets	3.6	8.4	8.8	2.9	0.3	–	–	–	24.0
– Derivative financial instruments	1.1	10.4	9.9	3.4	0.6	–	–	0.1	25.5
– Financial assets designated at fair value	0.6	0.6	0.6	0.3	–	–	–	–	2.1
– Loans and advances to banks	1.7	1.5	0.5	0.2	–	–	–	0.5	4.4
– Loans and advances to customers	6.5	27.0	76.2	51.1	18.5	11.7	3.3	2.3	196.6
– Financial investments	14.5	1.8	0.9	–	–	–	–	0.1	17.3
Total neither past due nor impaired	43.9	49.7	96.9	57.9	19.4	11.7	3.3	4.2	287.0
Past due but not impaired[3]	–	–	–	–	0.1	0.1	2.5	–	2.7
Impaired[4]	–	–	–	–	–	–	1.4	–	1.4
	43.9	49.7	96.9	57.9	19.5	11.8	7.2	4.2	291.1
Impairment loss allowances and RV & VT provisions[5]									(1.0)
Total									290.1

(1) Other items include cash at hand and smaller cases mainly in the consumer (auto) finance and commercial mortgages portfolios. We use scorecards for these items, rather than rating models.
(2) Balances include interest we have charged to the customer's account and accrued interest we have not charged to the account yet.
(3) Balances include mortgage loans in arrears which have been assessed for IBNO losses as described in Note 1 to the Consolidated Financial Statements.
(4) Impaired loans are loans we have assessed for observed impairment loss allowances. This included loans individually assessed for impairment of £578m.
(5) Residual Value (RV) and Voluntary Termination (VT) provisions.

Age of loans and advances that are past due but not impaired

At 31 December 2017, loans and advances of £2.5bn (2016: £2.7bn) were past due but not impaired. Of these balances, £0.1bn (2016: £0.1bn) were less than 1 month overdue, £0.7bn (2016: £0.8bn) were 1 to 2 months overdue, £0.4bn (2016: £0.5bn) were 2 to 3 months overdue, £0.7bn (2016: £0.7bn) were 3 to 6 months overdue, and £0.6bn (2016: £0.6bn) were greater than 6 months overdue.

Credit performance

The customer loans in the tables below and in the remainder of the 'Credit risk' section are presented differently from the balances in the Consolidated Balance Sheet. The main difference is that the customer loans below exclude inter-company balances. We disclose transactions with related parties in Note 36 to the Consolidated Financial Statements. In addition, customer loans are presented on an amortised cost basis and exclude interest we have accrued but not charged to customers' accounts yet.

2017	Customer loans £bn	NPLs[1][2] £m	NPL ratio[3] %	NPL coverage[4] %	Gross write-offs £m	Impairment loss allowances £m
Retail Banking:	**169.0**	**2,105**	**1.25**	**23**	**195**	**491**
– of which mortgages	**154.9**	**1,868**	**1.21**	**12**	**22**	**225**
Commercial Banking	**19.4**	**383**	**1.97**	**51**	**35**	**195**
Global Corporate Banking	**6.0**	**340**	**5.67**	**69**	**–**	**236**
Corporate Centre	**5.9**	**20**	**0.34**	**90**	**23**	**18**
	200.3	**2,848**	**1.42**	**33**	**253**	**940**
2016						
Retail Banking:	168.6	2,340	1.39	25[5]	210	583[5]
– of which mortgages	154.3	2,110	1.37	13	33	279
Commercial Banking	19.4	518	2.67	42	10	220
Global Corporate Banking	5.7	63	1.11	90	–	57
Corporate Centre	6.5	73	1.12	84	51	61
	200.2	2,994	1.50	31[5]	271	921[5]
Of which: Corporate lending						
2017	**27.3**	**838**	**3.07**	**58**	**56**	**485**
2016	27.4	689	2.51	48	34	334

(1) We define NPLs in the 'Credit risk management' section.
(2) All NPLs continue accruing interest.
(3) NPLs as a percentage of customer loans.
(4) Impairment loss allowances as a percentage of NPLs. Impairment loss allowances relate to early arrears and performing assets (i.e. the incurred but not observed provision) as well as NPLs, so the ratio can exceed 100%.
(5) In the first half of 2017, we reclassified our provisions for residual value and voluntary termination from the consumer (auto) finance impairment loss allowance. In order to facilitate comparison with the current period, the 31 December 2016 consumer (auto) finance loan loss allowance and NPL coverage ratio were amended. This reclassification was also reflected in the Retail Banking loan loss allowance and NPL coverage ratios.

Corporate lending comprises the business banking portfolio of our Retail Banking segment, and our Commercial Banking and Global Corporate Banking segments.

2017 compared to 2016 (unaudited)

The NPL ratio improved 8bps to 1.42%, supported by our predictable medium-low risk profile, proactive management actions and the ongoing resilience of the UK economy.

- The Retail Banking NPL ratio improved to 1.25%, with a decrease in mortgage NPLs as a result of the ongoing resilience of the UK economy and our strong risk management practices. The loan loss rate remained low at 0.02% (2016: 0.01%).
- The NPL ratio for Commercial Banking improved to 1.97%, primarily due to the full repayment of three impaired loans and the write-off of some pre-2009 vintages. The loan loss rate improved to 0.07% (2016: 0.15%).
- The Global Corporate Banking NPL ratio of 5.67% was severely impacted by the Carillion plc loans that moved to non-performance in the year.
- The Corporate Centre NPL ratio decreased to 0.34%, reflecting management of non-core corporate and legacy portfolios.

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

COUNTRY RISK EXPOSURES

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

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

	2017							2016						
			Financial institutions							Financial institutions				
	Governments £bn	Government guaranteed £bn	Banks[1] £bn	Other £bn	Retail £bn	Corporate £bn	Total[2] £bn	Governments £bn	Government guaranteed £bn	Banks[1] £bn	Other £bn	Retail £bn	Corporate £bn	Total[2] £bn
Eurozone														
Ireland	–	–	0.2	1.1	–	0.8	2.1	–	–	0.5	0.4	–	0.5	1.4
Italy	0.4	–	–	0.1	–	0.1	0.6	1.0	–	–	0.1	–	0.2	1.3
Spain (excl. Santander)	–	–	0.3	0.1	–	0.1	0.5	–	–	0.3	0.1	–	0.2	0.6
Portugal	–	–	0.1	–	–	–	0.1	–	–	0.1	–	–	–	0.1
France	–	0.3	2.0	0.2	–	2.2	4.7	0.1	0.3	1.8	0.2	–	0.1	2.5
Germany	–	–	2.8	–	–	0.1	2.9	–	–	2.5	–	–	–	2.5
Luxembourg	–	–	–	1.3	–	0.4	1.7	–	–	–	2.3	–	0.3	2.6
Other[3]	0.3	–	1.1	0.2	–	1.4	3.0	0.3	–	1.1	0.3	–	1.1	2.8
	0.7	0.3	6.5	3.0	–	5.1	15.6	1.4	0.3	6.3	3.4	–	2.4	13.8
Other countries														
UK	44.7	–	9.1	13.0	191.3	42.9	301.0	33.6	0.4	12.0	13.5	189.1	41.3	289.9
US	6.3	0.1	8.2	2.3	–	0.1	17.0	4.8	0.2	10.6	2.5	–	0.1	18.2
Japan[4]	3.0	–	2.6	0.2	–	0.8	6.6	2.8	–	3.2	0.1	–	1.4	7.5
Switzerland	0.2	–	0.2	–	–	0.2	0.6	0.2	–	0.1	–	–	0.2	0.5
Denmark	–	–	0.1	–	–	0.4	0.5	–	–	0.1	–	–	0.4	0.5
Russia	–	–	–	–	–	–	–	–	–	–	0.1	–	–	0.1
Other	0.1	–	2.3	0.9	–	1.9	5.2	0.1	–	2.6	0.6	–	2.3	5.6
	54.3	0.1	22.5	16.4	191.3	46.3	330.9	41.5	0.6	28.6	16.8	189.1	45.7	322.3
Total	55.0	0.4	29.0	19.4	191.3	51.4	346.5	42.9	0.9	34.9	20.2	189.1	48.1	336.1

(1) Excludes balances with central banks.
(2) Excludes cash at hand, interests in other entities, intangible assets, property, plant and equipment, tax assets, retirement benefit assets and other assets. Loans are included gross of credit provisions.
(3) Includes The Netherlands of £1.8bn (2016: £1.4bn), Cyprus of £nil (2016: £28m), Greece of £nil (2016: £nil).
(4) Balances are mainly equity instruments listed in Japan and reverse repos with Japanese banks, held as part of our Short Term Markets business. The equity exposures are hedged using derivatives and the additional reverse repos are fully collateralised.

Balances with other Banco Santander companies

We deal with other Banco Santander companies in the ordinary course of business. We do this where we have a particular business advantage or expertise and where they can offer us commercial opportunities. This is done on the same terms as for similar transactions with third parties. These transactions also arise where we support the activities of, or with, larger multinational corporate clients and financial institutions which may deal with other Banco Santander companies. We conduct these activities in a way that manages the credit risk within limits acceptable to the PRA.
At 31 December 2017 and 2016, we had gross balances with other Banco Santander companies as follows:

	2017				2016			
	Financial institutions				Financial institutions			
	Banks £bn	Other £bn	Corporate £bn	Total £bn	Banks £bn	Other £bn	Corporate £bn	Total £bn
Assets								
Spain	4.4	–	–	4.4	2.1	–	–	2.1
UK	–	1.3	–	1.3	–	1.1	–	1.1
Chile	–	–	–	–	0.1	–	–	0.1
Other <£100m	–	–	–	–	0.2	–	–	0.2
	4.4	1.3	–	5.7	2.4	1.1	–	3.5
Liabilities								
Spain	5.1	0.3	0.1	5.5	2.9	0.2	0.1	3.2
UK	0.1	7.6	0.1	7.8	–	6.2	0.1	6.3
Uruguay	0.1	–	–	0.1	0.2	–	–	0.2
Chile	–	–	–	–	0.1	–	–	0.1
Other <£100m	–	0.1	–	0.1	0.2	0.1	–	0.3
	5.3	8.0	0.2	13.5	3.4	6.5	0.2	10.1

We consider the dissolution of the eurozone and widespread redenomination of our euro-denominated assets and liabilities to be highly improbable. However, we have analysed the redenomination risk that might arise from an exit of a member state from the euro or a total dissolution of the euro and how that would be implemented. It is not possible to predict what the total financial impact on us might be. Determining which balances would be legally redenominated is complex and depends on a number of factors, including the precise exit scenario. This is because the effects on contracts of a disorderly exit or one sanctioned under EU law may differ. We monitor these risks and have taken steps to mitigate them.

Credit risk – Retail Banking

Overview

We offer a full range of retail products and services through our branches, the internet, digital devices and over the phone, as well as through intermediaries.

Credit risk management
In this section, we explain how we manage and mitigate credit risk.

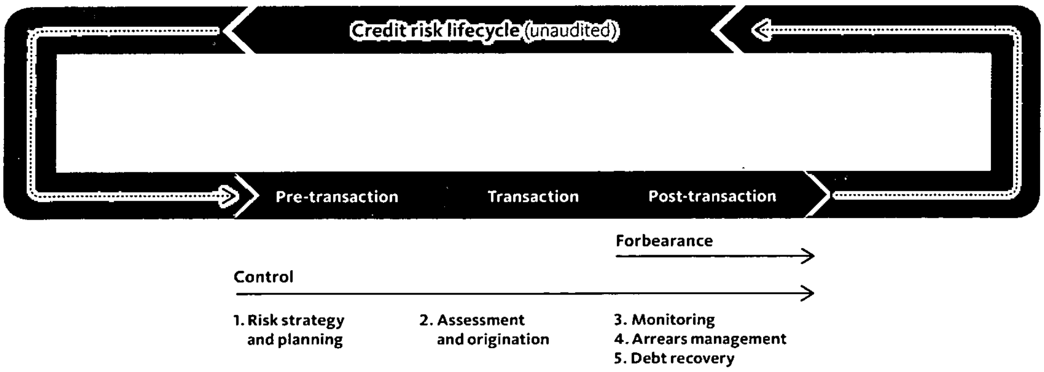
Credit risk review
In this section, we analyse our credit risk exposures and how they are performing. We also focus on forbearance and portfolios of particular interest. Our main portfolios are:

Residential mortgages – This is our largest portfolio. We lend to customers of good credit quality (prime lending). Most of our mortgages are for owner-occupied homes. We also have some buy-to-let mortgages where we focus on non-professional landlords with small portfolios.

Business banking – This portfolio is comprised of small businesses with an annual turnover of up to £6.5m per annum.

Consumer (auto) finance and other unsecured lending – Consumer (auto) finance includes financing for cars, vans, motorbikes and caravans – so long as they are privately bought. Other unsecured lending includes personal loans, credit cards and bank account overdrafts.

RETAIL BANKING – CREDIT RISK MANAGEMENT



For more on our approach to credit risk at a Santander UK group level
See **pages 68 to 71**

In Retail Banking, our customers are individuals and small businesses. We have a high volume of customers and transactions and they share similar credit characteristics, like their credit score or LTV. As a result, we manage our overall credit risk by looking at portfolios or groups of customers who share similar credit characteristics. Where we take this approach, we call them 'standardised' customers.

Exactly how we group customers into segments depends on the portfolio and the stage of the credit risk lifecycle. For example, we may segment customers at origination by their credit score. For accounts in arrears, we may segment them by how fast they improve or worsen. We regularly review each segment compared with our expectations for its performance, budget or limit.

1. Risk strategy and planning
For more on how we set our risk strategy and plans for Retail Banking, see the 'Santander UK group level – credit risk management' section.

2. Assessment and origination
We undertake a thorough risk assessment to make sure customers can meet their obligations before we approve a credit application. We do this mainly by looking at affordability and the customer's credit profile:

Affordability
We take proportionate steps to establish that the customer will be able to make all the repayments on the loan over its full term. As part of this, we assess the risk that they will not pay us back. We do this by a series of initial affordability and credit risk assessments. If the loan is secured, we assess affordability by reviewing the customer's income and spending, their other credit commitments, and what would happen if interest rates went up. For unsecured products that have fixed interest rates, affordability reviews for these products do not consider the impact of increases in interest rates. We regularly review the way we calculate affordability and refine it when we need to. This can be due to changes in regulations, the economy or our risk profile.

Credit profile

We look at each customer's credit profile and signs of how reliable they are at repaying credit. When they apply, we use the data they give us, and:

- **Credit policy:** these are our rules and guidelines. We review them regularly to make sure our decisions are consistent and fair, and align to the risk profile we want. For secured lending, we look at the property and the LTV as well as the borrower
- **Credit scores:** based on statistics about the factors that make people fail to pay off debt. We use them to build models of what is likely to happen in the future. These models give a credit score to the customer or the loan they want, to show how likely it is to be repaid. We regularly review them
- **Credit reference agencies:** data from credit reference agencies about how the borrower has handled credit in the past
- **Other Santander accounts:** we look at how the customer is using their other accounts with us.

How we make the decision

Many of our decisions are automated as our risk systems contain data about affordability and credit history. We tailor the process and how we assess the application based on the type of product being taken. More complex transactions often need greater manual assessment. This means we have to rely more on our credit underwriters' skill and experience in making the decision. This is particularly true for secured lending, where we might need to do more checks on the customer's income, or get a property valuation from an approved surveyor, for example.

Credit risk mitigation

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

Portfolio	Description
Residential mortgages	Collateral is in the form of a first legal charge over the property. Before we grant a mortgage, we get an approved surveyor to value the property. We have our own guidelines for valuations, which build on guidance from the Royal Institution of Chartered Surveyors (RICS). For remortgages and some loans where the LTV is 75% or less, we might use an automated valuation instead.
Business banking	Includes secured and unsecured lending. We can take mortgage debentures as collateral if the business is incorporated. These are charges over a company's assets. We can also take guarantees, but we do not treat them as collateral, and we do not put a cash value on them unless they are secured against a tangible asset. We base our lending decision on the customer's trading cash flow. If a customer defaults, we work with them to consider debt restructuring options. We generally do not enforce our security over their assets except as a last resort. In which case we might appoint an administrator or receiver.
Consumer (auto) finance	Collateral is in the form of legal ownership of the vehicle for most consumer (auto) finance loans, with the customer being the registered keeper. Only a very small proportion of the consumer (auto) finance business is underwritten as a personal loan. In these cases there is no collateral or security tied to the loan. We use a leading vehicle valuation company to assess the LTV at the proposal stage.
Unsecured lending	Unsecured lending means there is no collateral or security tied to the loan that can be used to mitigate any potential loss if the customer does not pay us back.

3. Monitoring

Our risk assessment does not end once we have made the decision to lend. We monitor credit risk across the credit risk lifecycle, mainly using IT systems. There are three main parts:

- **Behaviour scoring:** we use statistical models that help to predict whether the customer will have problems repaying, based on data about how they use their accounts
- **Credit reference agencies:** we often use data from agencies on how the borrower is handling credit from other lenders in our behaviour scoring models. We also buy services like proprietary scorecards or account alerts, which tell us as soon as the customer does something that concerns us (such as missing a payment to another bank)
- **Other Santander accounts:** every month, we also look at how the customer is using their other accounts with us, so we can identify problems early.

For secured lending, our monitoring also needs to take account of changes in property prices. We estimate the property's current value every three months. We use statistical models based on recent sales prices and valuations in that local area. A lack of data can mean our confidence in the model's valuation drops below a certain minimum level, and in that case we use the House Price Index (HPI) instead. The way we use this monitoring to manage risk varies by product. For revolving credit facilities like credit cards and overdrafts, it might lead us to raise or lower credit limits. Our monitoring can also mean we change our minds about whether a product is still right for a customer. This can influence whether we approve an application for refinancing. In these ways we can balance our customers' needs and their ability to manage credit. If we find evidence that a customer is in financial difficulties, we contact them about arrears management including forbearance, which we explain in more detail below.

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

4. Arrears management

We have several strategies for managing arrears and these can be used before the customer has formally defaulted, or as early as the day after a missed payment. We assess the problems a customer is having, so we can offer them the right help to bring their account up-to-date as soon as possible.

The strategy we use depends on the risk and the customer's circumstances. We provide a range of tools to assist customers in reaching an affordable and acceptable solution. That could mean visiting the customer, offering debt counselling by a third party, or paying off the debt using money from their other accounts with us (where we have the right to do so).

Forbearance
If a customer lets us know they are having financial difficulty, we aim to come to an arrangement with them before they actually default. Their problems can be the result of losing their job, falling ill, a relationship breaking down, or the death of someone close to them.

Forbearance is mainly for mortgages and unsecured loans. We offer forbearance in line with our risk policies, and on a case by case basis to ensure we continue to lend responsibly and help customers be able to continue to afford their payments. We may offer the following types of forbearance, but only if our assessments show the customer can meet the revised payments:

Action	Description
Capitalisation	We offer two main types, which are often combined with term extensions and, in the past, interest-only concessions: – If the customer cannot afford to increase their monthly payment enough to pay off their arrears in a reasonable time, but has been making their monthly payments (usually for at least six months), then we can add the arrears to the mortgage balance. – We can also add to the mortgage balance at the time of forbearance unpaid property charges which are due to a landlord and which we pay on behalf of the customer to avoid the lease being forfeited.
Term extension	We can extend the term of the loan, making each monthly payment smaller. At a minimum, we expect the customer to pay the interest in the short-term and have a realistic chance of repaying the full balance in the long-term. We may offer this option if the customer is up-to-date with their payments, but showing signs of financial difficulties. For mortgages, the customer must also meet our policies for maximum loan term and age when they finish repaying (usually no more than 75).
Interest-only	In the past, if it was not possible or affordable for a customer to have a term extension, we may have agreed to let them pay only the interest on the loan for a short time – usually less than a year. We only agreed to this where we believed their financial problems were temporary and they were likely to recover. Since March 2015 we no longer provide this option as a concession. Instead, interest-only is only offered as a short-term standard collections arrangement. We now record any related shortfall in monthly payments as arrears and report them to the credit reference agencies. As a result, we no longer classify new interest-only arrangements agreed since March 2015 as forbearance. We continue to manage and report all interest-only arrangements offered before this date as forbearance.
Reduced payment arrangements	We can suspend overdraft fees and charges while the customer keeps to a plan to reduce their overdraft each month.

When we agree to any forbearance, we review our impairment loss allowances for them. These accounts may stay in our performing portfolio but we report them separately as forborne. If an account is performing when we agree forbearance, we automatically classify it as forborne. We only classify it as NPL once it meets our standard criteria for NPL. If an account is in NPL when we agree forbearance, we keep it in the NPL category until the customer repays all the arrears, including those that existed before forbearance started.

Other changes in contract terms
Apart from forbearance, we have sometimes changed the contract terms to keep a good relationship with a customer. These customers showed no signs of financial difficulties at the time, so we do not classify the contract changes as forbearance, and most of the loans were repaid without any problems. We do not classify insolvency solutions for any unsecured retail customers as forbearance. This is in line with industry guidelines on the treatment of customers experiencing insolvency or bankruptcy.

5. Debt recovery
When a customer cannot or will not keep to an agreement for paying off their arrears, we consider recovery options. We only do this once we have tried to get the account back in order. To recover what we are owed, we may use a debt collection agency, sell the debt to another company, or take the customer to court.

For secured retail loans (most of which are mortgages), we can delay legal action. That can happen if the customer shows evidence that they will be able to pay off the mortgage or pay back the arrears. We aim to repossess only as a last resort when other options have been exhausted or if necessary to protect the property from damage or third party claims.

We make sure our estimated losses from repossessed properties are realistic by getting two independent valuations on each property, as well as the estimated cost of selling it. These form the basis of our impairment loss allowance calculations. Where we do enforce the possession of properties held as collateral, we use external agents to realise the value and settle the debt. During this process we do not own the property but we do administer the sale process. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with insolvency regulations.

Risk measurement and control
Retail Banking involves managing large numbers of accounts, so it produces a huge amount of data. This allows us to take a more analytical and data intense approach to measuring risk. This is reflected in the wide range of statistical models we use across the credit risk lifecycle. We use:

- **Risk strategy and planning:** econometric models
- **Assessment and origination:** application scorecards, and attrition, pricing, impairment and capital models
- **Monitoring:** behavioural scorecards and profitability models
- **Arrears management:** models to estimate the proportion of cases that will result in possession (known as roll rates)
- **Debt recovery:** recovery models.

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

RETAIL BANKING – CREDIT RISK REVIEW

RESIDENTIAL MORTGAGES

We offer mortgages to people who want to buy a property, and offer additional borrowing (known as further advances) to existing mortgage customers. The property must be in the UK, except for a small amount of lending in the Isle of Man and Jersey.

2017 compared to 2016 (unaudited)
Credit risk is at very low levels historically. The benign credit environment has supported our customers and helped to reduce credit risk. In particular, unemployment has been below 5% for 2 years. From our experience we know that unemployment is one of the most important factors in defaults on mortgages, our biggest loan book. Whilst the UK market continues to show resilience, we are cautious on the outlook in light of recent economic uncertainty.

Mortgage lending increased £0.6bn in 2017 (2016: £1.5bn), driven by management pricing actions in a competitive environment and an ongoing focus on customer service and retention. Mortgage gross lending was £25.5bn (2016: £25.8bn) and we retained 78% of mortgages reaching the end of their incentive period.

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

	Stock				New business			
	2017		2016		2017		2016	
	£m	%	£m	%	£m	%	£m	%
First-time buyers	**28,768**	**19**	29,143	19	**4,046**	**17**	4,193	17
Home movers	**68,901**	**44**	68,158	44	**10,730**	**44**	11,072	45
Remortgagers	**50,473**	**33**	50,325	33	**8,071**	**33**	7,092	29
Buy-to-let	**6,802**	**4**	6,648	4	**1,371**	**6**	2,212	9
	154,944	**100**	154,274	100	**24,218**	**100**	24,569	100

In addition to the new business included in the table above, there were £26.0bn (2016: £18.1bn) of internal remortgages where we kept existing customers with maturing products on new mortgages. We also provided £1.3bn (2016: £1.2bn) of further advances and flexible mortgage drawdowns.

2017 compared to 2016 (unaudited)
The mortgage borrower mix remained broadly unchanged, reflecting underlying stability in target market segments, product pricing and distribution strategy. We helped 24,000 first-time buyers (£4.0bn of gross lending) purchase their new home.

Interest rate profile
The interest rate profile of our mortgage asset stock was:

	2017		2016	
	£m	%	£m	%
Fixed rate	**102,268**	**66**	91,817	59
Variable rate	**29,370**	**19**	33,627	22
Standard Variable Rate (SVR)	**23,306**	**15**	28,830	19
	154,944	**100**	154,274	100

2017 compared to 2016 (unaudited)
The proportion of SVR loan balances decreased to 15%, including attrition of £5.5bn (2016: £7.0bn). This was driven by customer refinancing and sentiment over expected future interest rate movements.

Geographical distribution
The geographical distribution of our mortgage asset stock was:

	Stock		New business	
UK region	2017 £bn	2016 £bn	2017 £bn	2016 £bn
London	**37.6**	37.2	**5.8**	6.7
Midlands and East Anglia	**20.6**	20.6	**3.4**	3.2
North	**22.2**	22.8	**3.0**	3.0
Northern Ireland	**3.6**	3.8	**0.2**	0.2
Scotland	**6.8**	7.0	**1.0**	0.9
South East excluding London	**47.2**	46.1	**8.2**	8.1
South West, Wales and other	**16.9**	16.8	**2.6**	2.5
	154.9	154.3	**24.2**	24.6

2017 compared to 2016 (unaudited)
The geographical distribution of the lending profile of the portfolio continued to represent a broad footprint across the UK, whilst maintaining a concentration around London and the South East.

Larger loans

The mortgage asset stock of larger loans was:

	South East including London		UK	
Stock – individual mortgage loan size	2017 £m	2016 £m	2017 £m	2016 £m
<£0.25m	**46,766**	48,355	**107,050**	110,415
£0.25m to £0.50m	**27,562**	25,040	**36,083**	32,871
£0.50m to £1.0m	**9,214**	8,438	**10,535**	9,668
£1.0m to £2.0m	**1,046**	1,099	**1,111**	1,161
>£2.0m	**163**	157	**165**	159
	84,751	83,089	**154,944**	154,274

At 31 December 2017, there were 64 (2016: 65) individual mortgages greater than £2.0m. In 2017, there were 13 (2016: 13) new mortgages over £2.0m.

Average loan size for new business

The average loan size for new business in 2017 and 2016 was:

UK region	2017 £000	2016 £000
South East including London	**260**	264
Rest of the UK	**146**	144
UK as a whole	**196**	198

The loan-to-income multiple of mortgage lending during the year, representing average earnings of new business at inception, was 3.16 (2016: 3.16).

Loan-to-value analysis

This table shows the LTV distribution for our mortgage stock, NPL stock and new business. We use our estimate of the property value at the balance sheet date. We include fees added to the loan in the calculation. For flexible products, we only include the drawn amount, not undrawn limits.

	2017			2016		
		Of which:			Of which:	
LTV	Stock %	NPL stock %	New business %	Stock %	NPL stock %	New business %
Up to 50%	**48**	**44**	**19**	46	39	17
>50-75%	**39**	**34**	**43**	41	36	43
>75-85%	**8**	**8**	**19**	8	9	23
>85-100%	**4**	**7**	**19**	4	8	17
>100%	**1**	**7**	**-**	1	8	-
	100	**100**	**100**	100	100	100
Collateral value of residential properties(1)(2)	**£154,721m**	**£1,824m**	**£24,218m**	£153,989m	£2,043m	£24,569m
	%	**%**	**%**	%	%	%
Simple average(3) LTV (indexed)	**42**	**44**	**62**	43	46	65
Valuation weighted average(4) LTV (indexed)	**38**	**38**	**58**	39	40	60

(1) Includes collateral against loans in negative equity of £1,248m at 31 December 2017 (2016: £1,588m).
(2) The collateral value we have shown is limited to the balance of each associated individual loan. It does not include the impact of over-collateralisation (where the collateral has a higher value than the loan balance).
(3) Total of all LTV% divided by the total of all accounts.
(4) Total of all loan values divided by the total of all valuations.

At 31 December 2017, the parts of the loans in negative equity which were effectively uncollateralised before taking account of impairment loss allowances reduced to £223m (2016: £285m).

Credit performance

	2017 £m	2016 £m
Mortgage loans and advances to customers of which:	**154,944**	154,274
Performing(1)	**151,948**	150,895
Early arrears:	**1,128**	1,269
– 31 to 60 days	**702**	793
– 61 to 90 days	**426**	476
NPLs:(2)	**1,868**	2,110
– By arrears	**1,427**	1,578
– By bankruptcy	**14**	21
– By maturity default	**303**	316
– By forbearance	**95**	160
– By properties in possession (PIPs)	**29**	35
Impairment loss allowances	**225**	279
Early arrears ratio(3)	**0.73%**	0.82%
NPL ratio(4)	**1.21%**	1.37%
Coverage ratio(5)	**12%**	13%

(1) Excludes mortgages where the customer did not pay for between 31 and 90 days, arrears, bankruptcy, maturity default, forbearance and PIPs NPLs. Includes £2,661m of mortgages (2016: £2,959m) where the customer did not pay for 30 days or less.
(2) We define NPLs in the 'Credit risk management' section. All NPLs are in the UK and continue accruing interest.
(3) Mortgages in early arrears as a percentage of mortgages.
(4) Mortgage NPLs as a percentage of mortgages.
(5) Impairment loss allowances as a percentage of NPLs.

NPL movements in 2017

We analyse NPL movements in 2017 in the table below. 'Entries' are loans which we have classified as NPL in the year and exclude 'Policy entries' that are due to definition changes. 'PIP sales' are loans that have been legally discharged when we have sold the property, and include any written-off portion. 'Exits' are loans that have been repaid (in full or in part), and loans that have returned to performing status. Forbearance activity does not change the NPL status.

	£m
At 1 January 2017	**2,110**
Entries	**817**
PIP sales	**(66)**
Exits	**(993)**
At 31 December 2017	**1,868**

2017 compared to 2016 (unaudited)

Mortgage NPLs decreased to £1,868m (2016: £2,110m) and the NPL ratio decreased to 1.21% (2016: 1.37%). Lower NPL and coverage ratios were driven by the ongoing resilience of the UK economy and our strong risk management practices.

Forbearance(1)

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

2017	Capitalisation £m	Term extension £m	Interest-only £m	Total £m	Impairment loss allowances £m
In arrears	**260**	**63**	**175**	**498**	**22**
Performing	**392**	**178**	**407**	**977**	**5**
	652	**241**	**582**	**1,475**	**27**
Proportion of portfolio	**0.4%**	**0.2%**	**0.4%**	**1.0%**	
2016					
In arrears	293	78	226	597	24
Performing	466	222	481	1,169	7
	759	300	707	1,766	31
Proportion of portfolio	0.5%	0.2%	0.4%	1.1%	

(1) We base forbearance type on the first forbearance on the accounts.

2017 compared to 2016 (unaudited)

In 2017, the accounts in forbearance decreased, with the proportion of the mortgage portfolio in forbearance reducing slightly to 1.0% (2016: 1.1%).

- At 31 December 2017, the proportion of accounts in forbearance for more than six months that had made their last six months' contractual payments increased slightly to 78% (2016: 74%).
- The weighted average LTV of all accounts in forbearance was 35% (2016: 36%) compared to the weighted average portfolio LTV of 38% (2016: 39%).
- At 31 December 2017, the carrying value of mortgages classified as multiple forbearance decreased to £123m (2016: £128m)
- At 31 December 2017, impairment loss allowances as a percentage of the overall mortgage portfolio were 0.15% (2016: 0.18%). The equivalent ratio for performing accounts in forbearance was 0.50% (2016: 0.60%), and for accounts in arrears in forbearance was 4.40% (2016: 4.02%). The higher ratios for accounts in forbearance reflect the higher levels of impairment loss allowances we hold on these accounts. This reflects the higher risk on them.

Other changes in contract terms

At 31 December 2017, there were £4.7bn (2016: £5.1bn) of other mortgages on the balance sheet that we had modified since January 2008. We agreed these modifications in order to keep a good relationship with the customer. The customers were not showing any signs of financial difficulty at the time, so did not classify these changes as forbearance.

We keep the performance and profile of the accounts under review. At 31 December 2017:

- The average LTV was 33% (2016: 35%) and 95% (2016: 94%) of accounts had made their last six months' contractual payments
- The proportion of accounts that were 90 days or more in arrears was 1.52% (2016: 1.57%).

RESIDENTIAL MORTGAGES - PORTFOLIOS OF PARTICULAR INTEREST

Introduction (unaudited)
We are mainly a residential prime lender and we do not originate sub-prime or second charge mortgages. Despite that, some types of mortgages have higher risks and others stand out for different reasons. These are:

Product	Description
Interest-only loans and part interest-only, part repayment loans	With an interest-only mortgage, the customer pays the interest every month but does not repay the money borrowed (the principal) until the end of the mortgage. Some mortgages have a part that is interest-only, with the rest being a normal repayment mortgage. Customers with part interest-only, part repayment mortgages still have to pay back a lump sum at the end of their mortgage for the interest-only part. This means there is a higher credit risk on these loans as we depend on the customers to pay back a lump sum. We design new account LTV maximums to mitigate this credit risk. We also make sure the customer has a plausible repayment plan before we lend to them, and remains on track for the life of the loan. Since 2009, we have reduced the risk from new interest-only mortgages by lowering the maximum LTV (it has been 50% since 2012). When a customer plans to repay their mortgage by selling the property, we now only allow that if they own more than a set proportion of the equity. Customers with interest-only mortgages have to make arrangements to repay the principal at the end of the mortgage. We have a strategy to make sure that we tell these customers that they have to do this. We send them messages with their annual mortgage statements, and we run contact campaigns to encourage them to tell us how they plan to repay. In 2013, we contacted all our customers whose mortgages were due to mature before 2020. Since 2016, we have extended these campaigns to periodically contact all interest-only customers. We increase our contact frequency as customers approach term maturity. Outside of sending out annual mortgage statements, we contact more than 100,000 interest-only customers per year. If customers know they will not be able to repay their mortgage in full when it ends, or if their mortgage has already passed the date when it should have ended, we talk to them. If we think it is in the customer's interests (and they can afford it), we look at other ways of managing it. That can mean turning the mortgage into a standard repayment one, and extending it. Or, if the customer is waiting for their means of repaying it (an investment plan or bonds, for example) to mature, it can just mean extending it.
Flexible loans	Flexible mortgages allow customers to pay more or less than their usual amount each month, or even to take 'payment holidays' when they pay nothing at all. Customers do not have to take (or draw down) the whole loan all at once – so if they took out a mortgage big enough to allow them to build a home extension after three years, they do not have to start paying interest on that extra money until they are ready to spend it. There are conditions on when and how much customers can draw down: - There are often limits on how much can be drawn down in any month - The customer cannot be in payment arrears - The customer cannot have insolvency problems, such as a county court judgement, bankruptcy, an individual voluntary arrangement, an administration order or a debt relief order. A customer can ask us to increase their credit limit (the total amount they are allowed to borrow on their mortgage), but that means we will go through our full standard credit approval process. We can also lower the customer's credit limit at any time, so it never goes above 90% of the property's current market value. We no longer offer flexible loan products for new mortgages. This is an area of interest in order to identify customers who might be using these facilities to self-forbear (such as regularly drawing down small amounts). If there is any sign that the credit risk has significantly increased, we reflect this in our provision calculations.
Loans with an LTV >100%	Where the mortgage balance is more than the property is now worth, we cannot recover the full value of the loan by repossessing and selling the property. This means there is a higher credit risk on these loans. In some cases, property prices have fallen, so mortgages we gave in the past with lower LTVs now have LTVs greater than 100%. Before 2009, we sometimes allowed customers to borrow more than the price of the property. We monitor existing accounts with LTVs >100% as part of our assessment of ongoing portfolio performance. We design new account LTV maximums to mitigate an increase in the volume of accounts with an LTV >100%.
Buy-to-Let (BTL) loans	Given that we have a relatively small share of the BTL market, we believe that we still have an opportunity to grow our presence in a controlled manner. We focus on non-professional landlords (landlords with a small number of properties), as this segment is more closely aligned with residential mortgages and covers most of the BTL market. Our policy is that BTL mortgages should finance themselves, with the rent covering the mortgage payments and other costs. Even so, there is always the risk that income from the property may not cover the costs, for example, if the landlord cannot find tenants for a while. In recent years, we have refined our BTL proposition to appeal to a wider catchment, and we have improved our systems to cater for this segment. We have prudent lending criteria, and specific policies for BTL. We only lend to non-professional landlords, to a maximum 75% LTV. The first applicant must earn a minimum income of £25,000 per year, and we require evidence of income in all cases. We also use a BTL affordability rate as part of our assessment about whether or not to lend. This means that the rental income must cover the monthly mortgage interest payments by a prescribed amount when calculated using a stressed interest rate. The prescribed amount is regularly reviewed and adjusted as necessary.

Credit performance

2017	Total £m	Interest-only £m	Part interest-only, part repayment £m	Flexible[2] £m	LTV >100% £m	Buy-to-let £m	Other portfolio £m
		Segment of particular interest[1]					
Mortgage portfolio	**154,944**	**38,893**	**13,794[3]**	**14,787**	**1,472**	**6,802**	**95,779**
Performing	**151,948**	**37,505**	**13,379**	**14,440**	**1,303**	**6,768**	**94,772**
Early arrears:							
– 31 to 60 days	**702**	**317**	**94**	**67**	**22**	**9**	**296**
– 61 to 90 days	**426**	**203**	**58**	**35**	**15**	**4**	**168**
NPLs	**1,868**	**868**	**263**	**245**	**132**	**21**	**543**
NPL ratio	**1.21%**	**2.23%**	**1.91%**	**1.66%**	**8.97%**	**0.31%**	**0.57%**
PIPs	**29**	**17**	**5**	**3**	**10**	**1**	**6**
2016							
Mortgage portfolio	154,274	41,707	14,535[3]	16,853	1,873	6,648	90,570
Performing	150,895	40,185	14,066	16,472	1,661	6,621	89,483
Early arrears:							
– 31 to 60 days	793	360	111	71	33	7	314
– 61 to 90 days	476	224	70	45	22	2	191
NPLs	2,110	938	288	265	157	18	582
NPL ratio	1.37%	2.25%	1.98%	1.57%	8.38%	0.27%	0.64%
PIPs	35	15	7	4	13	1	9

(1) Where a loan falls into more than one category, we have included it in all the categories that apply. As a result, the sum of the mortgages in the segments of particular interest and the other portfolio does not agree to the total mortgage portfolio.
(2) Includes legacy Alliance & Leicester flexible loans that work in a more limited way than our current Flexi loan product.
(3) Mortgage balance includes both the interest-only part of £10,121m (2016: £10,560m) and the non-interest-only part of the loan.

2017 compared to 2016 (unaudited)

– In 2017, the value and proportion of interest-only loans together with part interest-only, part repayment loans and flexible loans reduced, reflecting our strategy to manage down the overall exposure to these lending profiles.
– BTL mortgage balances increased £0.2bn to £6.8bn (2016: £6.6bn). We continue to focus our BTL book on non-professional landlords, as this segment is closely aligned with mortgages and accounts for the majority of the volume in the BTL market. In 2017, we completed 7,500 BTL mortgages, representing 6% of the value of our new business flow, at an average LTV of 61%.

Interest-only sub analysis (unaudited)

Full interest-only new business in the year

	2017 £m	2016 £m
Full interest-only loans	**2,698**	3,404

Full interest-only maturity profile

2017	Term expired £m	Within 2 years £m	Between 2 - 5 years £m	Between 5 - 15 years £m	Greater than 15 years £m	Total £m
Full interest-only portfolio	**509**	**1,585**	**3,508**	**21,803**	**11,488**	**38,893**
of which value weighted average LTV (indexed) is >75%	**47**	**147**	**255**	**2,318**	**948**	**3,715**
2016						
Full interest-only portfolio	506	1,884	3,308	21,154	14,855	41,707
of which value weighted average LTV (indexed) is >75%	36	241	239	2,483	1,957	4,956

2017 compared to 2016 (unaudited)

For full interest-only mortgages, of the total £509m that was term expired at 31 December 2017, 90% continued to pay the interest due under the expired contract terms. Interest-only mortgages that matured in 2017 totalled £859m, of which:

– £466m was subsequently repaid
– £nil was refinanced under normal credit terms
– £28m was refinanced under forbearance arrangements
– £365m remained unpaid and was classified as term expired at 31 December 2017.

At 31 December 2017, there were 93,779 (2016: 103,213) flexible mortgage customers, with undrawn facilities of £6,192m (2016: £6,373m). The portfolio's value weighted LTV (indexed) was 31% (2016: 31%).

Forbearance[1][2]

The balances at 21 December 2017 and 2016 were:

	Interest-only[3] £m	Flexible £m	LTV >100% £m	Buy-to-Let £m
2017	**208**	**34**	**–**	**8**
2016	322	56	–	9

(1) The figures reflect the amount of forbearance in the year, regardless of whether any forbearance on the accounts before.
(2) Where a loan falls into more than one category, we have included it in all the categories that apply.
(3) Comprises full interest-only loans and part interest-only, part repayment loans.

BUSINESS BANKING

2017 compared to 2016 (unaudited)
- NPLs increased by 6% to £115m (2016: £108m) with a NPL ratio of 6.01% (2016: 4.64%).
- Following a periodic review in 2017, a number of business banking customers were transferred to Commercial Banking, where their ongoing needs can be better served. The balance associated was £200m and prior periods have not been amended.

Within our Retail Banking segment we provide business banking services through the Santander Business franchise to small businesses with a turnover of up to £6.5m per annum. We offer current accounts, savings accounts, card acceptance services, insurance and loans.

In 2017, we embedded a new operating model and streamlined our portfolio to provide more capacity and enable greater support to our customers. We also introduced a fast track process for asset finance up to £150,000 and simplified the credit application process for smaller exposures to facilitate quicker lending decisions.

Our business banking customers are an integral part of the UK economy and our dedication to meeting their everyday banking needs has seen us recognised as Best Business Current Account Provider by Moneyfacts for the last 15 years.

We have also been recognised as the Business Bank of the Year for three years running by Moneyfacts and Most Trusted Bank for Small Businesses 2016 by Moneywise, demonstrating our commitment to becoming the bank of choice for UK companies. We are also working to make our award-winning accounts even better by adapting to changing trends.

Credit performance

2017	2017 £m	2016 £m
Loans and advances to customers of which:	**1,912**	2,327
– Performing[1]	**1,793**	2,216
– Early arrears	**4**	3
– NPLs[2]	**115**	108
Impairment loss allowances	**54**	57
NPL ratio[3]	**6.01%**	4.64%
Coverage ratio[4]	**47%**	53%
Gross write-offs	**21**	24

(1) Excludes loans and advances to customers where the customer did not pay for between 0 and 90 days and NPLs.
(2) We define NPLs in the 'Credit risk management' section.
(3) NPLs as a percentage of loans and advances to customers.
(4) Impairment loss allowances as a percentage of NPLs. Impairment loss allowances relate to early arrears and performing assets (i.e the IBNO provision) as well as NPLs, so the ratio can exceed 100%.

Forbearance
The balances at 31 December 2017 and 2016 were:

	£m
2017	**85**
2016	94

In 2017, we enhanced our risk management function, to tailor it specifically to business banking due to our enhanced strategic focus. In line with our risk governance framework, and our three lines of defence model, this included independent assurance support.

This new model will move away from the local management of risk and controls by both the branch network (for Business Relationship Managers) and corporate banking (for Business Relationship Directors) into a centralised Business Assurance and Control Model. Our Business Assurance and Control Model is important to helping us achieve the commercial objectives of our business strategy by providing an enhanced framework for more robust and well-defined controls. We plan to support this with more training for staff in customer-facing roles.

Financial crime continues to be an area of focus within business banking, and identifying and implementing appropriate enhancement remains a priority for us. This focus has highlighted the need to strengthen and enhance systems (both short and long term) to reduce our risk exposure.

At the same time, we have begun a programme to focus on minimising any potential emerging risks.

The training around financial crime and other operational risks provided to our people in 2017 enables them to understand and manage all risk types more effectively. This will continue as a central feature in 2018.

CONSUMER (AUTO) FINANCE AND OTHER UNSECURED LENDING

2017 compared to 2016 (unaudited)
- Consumer (auto) finance balances increased £0.2bn with higher retail loans, partially offset by a decrease in the stock of new car registrations. In 2017, consumer (auto) finance gross lending was £3,133m (2016: £3,111m). NPLs increased slightly to £34m (2016: £32m).
- Other unsecured lending was steady as a result of controlled management actions.
- Forbearance levels were broadly similar to last year with balances at 31 December 2017 of £77m (2016: £75m).

Consumer (auto) finance

We provide auto finance through Santander Consumer (UK) plc (SCUK), which is part of our Retail Banking segment. SCUK provides a range of products designed for the purchase of both new and used personal, business and commercial vehicles, motorcycles and caravans through an extensive network of motor dealers and manufacturer partners. SCUK's products are predominantly distributed via intermediary introducers at the point of sale, and through partnerships with selected car and motorcycle manufacturers. At 31 December 2017, the business operated with seven Original Equipment Manufacturer partners which includes two joint venture arrangements.

Through SCUK's Hyundai Capital UK Ltd (HCUK) and PSA Finance UK Ltd (PSAF) joint ventures, we provide retail point of sale customer finance as well as wholesale finance facilities for Hyundai and Kia, managed by HCUK, as well as Peugeot, Citroën and DS, managed by PSAF. We equity account for HCUK and consolidate PSAF.

SCUK, including PSAF, with total outstanding lending of £7.0bn at 31 December 2017 represented 4% of our total Retail Banking loans and 3% of total customer loans. Conditional sale and Personal Contract Purchase (PCP) lending was approximately 35% and 45%, respectively, of our lending. Wholesale loans to car dealerships at 31 December 2017 were approximately 15% of the loan book.

We maintained our prudent underwriting criteria through the year. The product mix was broadly unchanged in the year. This reflected underlying stability in target market segments, product pricing and distribution strategy. There was a slight shift in the year from new car loans into second hand car loans, both reflecting reduced consumer confidence linked to the underlying economic uncertainty in the UK.

The top risk to SCUK continues to be Residual Value (RV) risk. SCUK remains conservative in setting future asset values, and has embedded a prudent provisioning model as well as robust monitoring processes. The RV portfolio is monitored on a monthly basis, with key risk triggers in place to identify any material change in trends. SCUK's conservative approach to setting Guaranteed Minimum Future Values (GMFV) also protects the customer and the business, by creating projected equity in the vehicle at the end of the loan agreement for the customer to use as a deposit on their next vehicle. SCUK typically sets the GMFV of the asset at 85% of the future value provided by CapHPI (valuation specialists). This creates equity in the asset from day one. In addition to this, SCUK takes an upfront RV provision of the GMFV value, based on a potential fall in car prices and an estimated percentage of hand-backs.

Other unsecured lending

Our other unsecured lending business consists of personal loans, credit cards and overdrafts, which is also part of our Retail Banking business segment:

- personal loans: we offer personal loans for most purposes, such as debt consolidation, home improvement, and to support significant life events such as weddings
- credit cards: we offer a wide range of credit cards designed to suit a variety of customers, including balance transfer cards and cards that offer rewards
- overdrafts: we also offer arranged overdrafts for customers who have a bank account with us. We evaluate our customers' circumstances to decide how much they can borrow. In other cases, a customer may have overdrawn their bank account without arranging it with us first.

Credit performance

		Other unsecured				
2017	Consumer (auto) finance £m	Personal loans £m	Credit cards £m	Overdrafts £m	Total other unsecured £m	Total £m
Loans and advances to customers of which:	6,957	2,169	2,444	565	5,178	12,135
– Performing(1)	6,861	2,129	2,377	516	5,022	11,883
– Early arrears	62	24	19	25	68	130
– NPLs(2)	34	16	48	24	88	122
Impairment loss allowances	77	44	62	29	135	212
NPL ratio(3)	0.49%				1.69%	1.00%
Coverage ratio(4)	226%				153%	174%
Gross write-offs	32				120	152

(1) Excludes loans and advances to customers where the customer did not pay for between 0 and 90 days and NPLs.
(2) We define NPLs in the 'Credit risk management' section.
(3) NPLs as a percentage of loans and advances to customers.
(4) Impairment loss allowances as a percentage of NPLs. Impairment loss allowances relate to early arrears and performing assets (i.e. the IBNO provision) as well as NPLs, so the ratio exceeds 100%.

2016	Consumer (auto) finance £m	Other unsecured: Personal loans £m	Credit cards £m	Overdrafts £m	Total other unsecured £m	Total £m
Loans and advances to customers of which:	6,764	2,229	2,493	551	5,273	12,037
– Performing[1]	6,682	2,188	2,422	501	5,111	11,793
– Early arrears	50	24	23	25	72	122
– NPLs[2]	32	17	48	25	90	122
Impairment loss allowances	78[5]	55	77	37	169	315
NPL ratio[3]	0.47%				1.71%	1.01%
Coverage ratio[4]	244%[5]				188%	258%
Gross write-offs	30				123	153

(1) Excludes loans and advances to customers where the customer did not pay for between 0 and 90 days and NPLs.
(2) We define NPLs in the 'Credit risk management' section.
(3) NPLs as a percentage of loans and advances to customers.
(4) Impairment loss allowances as a percentage of NPLs. Impairment loss allowances relate to early arrears and performing assets (i.e. the IBNO provision) as well as NPLs, so the ratio exceeds 100%.
(5) In 2017, we reclassified our provisions for residual value and voluntary termination from the consumer finance loan loss allowance. In order to facilitate comparison with the current period, December 2016 consumer finance loan loss allowance and NPL coverage ratio were amended. This reclassification is reflected in the Retail Banking loan loss allowance and NPL coverage ratio.

At 31 December 2017, the average retail loan size was £12,500 (2016: £12,000) and the NPL ratio was broadly stable at 0.49% (2016: 0.47%). The average unsecured loan and credit card balances in 2017 were broadly stable at £9,300 (2016: £9,400) and £1,200 (2016: £1,300), respectively.

Forbearance

The balances at 31 December 2017 and 2016 were:

	Consumer (auto) finance £m	**Other unsecured: Personal loans £m**	**Credit cards £m**	**Overdrafts £m**	**Total other unsecured £m**	**Total £m**
2017	**–**	**1**	**48**	**28**	**77**	**77**
2016	–	1	46	28	75	75

The UK consumer credit market continued to grow strongly in 2017. Dealership car finance saw the biggest growth in the year, although credit cards and personal loans also saw significant increases. This growth was much faster than the growth in household incomes. This prompted some discussions across the industry and amongst regulators around the possibility that customer affordability may become more stretched, particularly in a stress, and lead to higher losses to lenders in future.

At Santander UK, we did not see the same levels of consumer credit growth. Vehicle finance increased by 3% in 2017, and credit card and personal loan assets decreased slightly by 2.5% and 1%, respectively.

We maintain rigorous credit scoring and affordability assessment criteria that we monitor and report continuously. For our consumer credit portfolios there were no significant changes to our risk policy or appetite in 2017. This approach resulted in stable, good credit quality consumer credit portfolios.

Our credit assessments use a combination of internal, Credit Reference Agency and application data. Scorecards supported by policy rules give us confidence that customers are creditworthy and can afford their repayments.

We closely monitor and manage the performance of our consumer credit portfolios using a range of information that includes portfolio and key segments performance, macroeconomic indicators and customer risk data.

For these reasons, we are confident that the below market growth in our consumer credit portfolios is the result of our prudent approach to risk management and control. Nonetheless, we are not complacent about the prospect for future risk events and are always looking at ways in which we can strengthen our approach.

Credit risk – other segments

Overview

In Commercial Banking, we are exposed to credit risk through providing overdraft, loan, invoice discounting, trade finance, asset finance and treasury products. We offer bank accounts and cash transmission services to further support clients.

In Global Corporate Banking, we are exposed to credit risk through lending and selling treasury products to large corporates, and through our treasury market activities.

In Corporate Centre, our exposures come from asset and liability management of our balance sheet and our non-core and Legacy Portfolios in run-off.

Credit risk management
In this section, we explain how we manage and mitigate credit risk.

Credit risk review
In this section, we analyse our credit risk exposures and how they are performing. We also focus on forbearance and portfolios of particular interest.

Our main portfolios are:

Commercial Banking

- **SME and mid corporate** – banking, lending and treasury services mainly to enterprises with an annual turnover of up to £500m.
- **Commercial Real Estate** – lending to UK customers, mainly on tenanted property. We focus on the office, retail, industrial and residential sectors.
- **Social Housing** – lending and treasury services for UK Housing Associations who own residential real estate for rent.

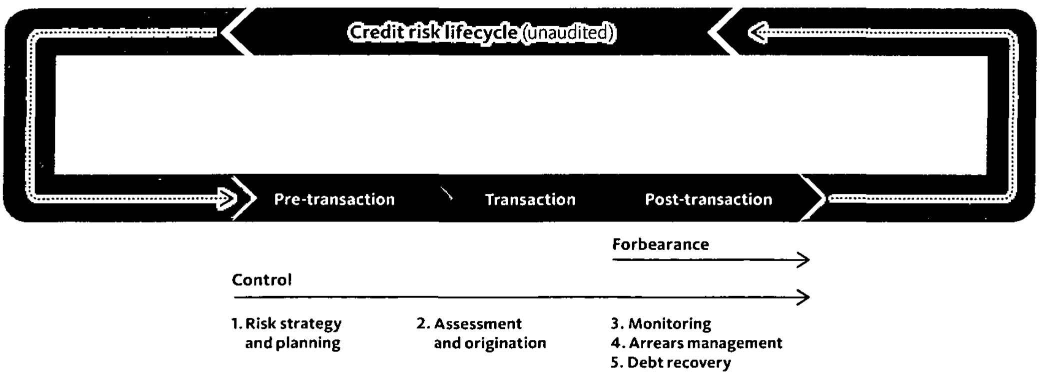
Global Corporate Banking

- **Sovereign and Supranational** – securities issued by local and central governments, and government guaranteed counterparties. We hold them to help meet our liquidity needs and for short-term trading.
- **Large Corporate** – loans and treasury products for large corporates to support their working capital and liquidity needs.
- **Financial Institutions** – mainly derivatives, repurchase and reverse repurchase transactions (known as repos and reverse repos), and stock borrowing/lending.

Corporate Centre

- **Sovereign and Supranational** – securities issued by local and central governments, and government guaranteed counterparties. We hold them to help meet our liquidity needs.
- **Structured Products** – we have two portfolios. The ALCO portfolio is high quality assets. We chose them for diversification and liquidity. The Legacy Treasury asset portfolio is mainly asset-backed securities.
- **Derivatives** – older total return swaps we held for liquidity, that we are running down.
- **Legacy Portfolios in run-off** – assets from acquisitions that do not fit with our strategy. These include some commercial mortgages.
- **Social Housing** – legacy Social Housing loans that do not fit with our strategy.

OTHER SEGMENTS – CREDIT RISK MANAGEMENT



For more on our approach to credit risk at a Santander UK group level
See **pages 68 to 77**

In Commercial Banking, we classify most of our customers as non-standardised. We also have SME customers, which we mainly classify as standardised as it is a high volume portfolio with smaller exposures. In Global Corporate Banking and Corporate Centre, we classify all our customers as non-standardised, except for the commercial mortgages in our Legacy Portfolios in run-off.

We set out how we manage the credit risk on our standardised customers in the previous section 'Credit risk – Retail Banking'. We manage the credit risk on our standardised customers in Commercial Banking and Corporate Centre in the same way, except that we do not use scorecards or credit reference agencies. In the rest of this section, we explain how we manage the credit risk on our non-standardised customers.

1. Risk strategy and planning
For details of how we set risk strategy and plans, see the 'Santander UK group level – credit risk management' section. For treasury products, we take credit risk up to limits for each client. We control, manage and report risks on a counterparty basis, regardless of which part of our business takes the risk.

2. Assessment and origination
We do a thorough risk assessment to make sure customers can meet their obligations before we approve a credit application. We do this mainly by assigning each customer a credit rating, using our internal rating scale (see 'Credit quality' in 'Santander UK group level – credit risk review' section). To do this, we look at the customer's financial history and trends in the economy – backed up by the expert judgement of a risk analyst. We review our internal ratings at least every year. We also assess the underlying risk of the transaction, taking into account any mitigating factors (see the following tables) – and how it fits with our risk policies, limits and Risk Appetite, as set by the Board. We consider transactions in line with credit limits approved by the relevant credit authority. Our Executive Risk Control Committee is responsible for setting those limits. In Global Corporate Banking and Corporate Centre, a specialist analyst usually reviews a transaction at the start and over its life. They base their review on the financial strength of the client, its position in its industry, and its management strengths.

Credit risk mitigation

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

Commercial Banking:

Portfolio	Description
SME and mid corporate	Includes secured and unsecured lending. We can use covenants (financial or non-financial) to support a customer's credit rating. For example, we can set limits on how much they can spend or borrow, or how they operate as a business. We can take mortgage debentures as collateral. These are charges over a company's assets. We can also take guarantees, but we do not treat them as collateral, and we do not put a cash value on them unless they are secured against a tangible asset. We base our lending decision on the customer's trading cash flow. If they default, we will work with defaulted customers to consider debt restructuring options. We generally do not take control of their assets except when restructuring options have been exhausted or to protect our position in relation to third party claims. In this case, we might appoint an administrator. We also lend against assets (like vehicles and equipment) and invoices for some customers. For assets, we value them before we lend. For invoices, we review the customer's ledgers regularly and lend against debtors that meet agreed criteria. If the customer defaults, we repossess and sell their assets or collect on their invoices.
Commercial Real Estate	We take a first legal charge on commercial property as collateral. The loan is subject to strict criteria, including the property condition, age and location, tenant quality, lease terms and length, and the sponsor's experience and creditworthiness. Before agreeing the loan, we visit the property and get an independent professional valuation which assesses the property, the tenant and future demand (such as comparing market rent to current rent). Loan agreements typically allow us to get revaluations every two to three years, or more often if it is likely covenants may be breached, and to view the property each year.
Social Housing	We take a first legal charge on portfolios of residential real estate owned and let by UK Housing Associations as collateral. We revalue this every three to five years (in line with industry practice), using the standard methods for property used for Social Housing. The value would be considerably higher if we based it on normal residential use. The value of the collateral is in all cases more than the loan balance. On average, the loan balance is 25% to 50% of the implied market value, using our LGD methodology. We have not had a default, loss or repossession on Social Housing. Older Social Housing loans that do not fit our current business strategy are managed and reported in Corporate Centre.

Global Corporate Banking:

Portfolio	Description
Sovereign and Supranational	In line with market practice, there is no collateral against these assets.
Large Corporate	Most of these loans and products are unsecured, but we attach covenants to our credit agreements. We monitor whether borrowers keep in line with them so we detect any financial distress early. We also have a small structured finance portfolio, where we hold legal charges over the assets we finance.
Financial Institutions	We use standard legal agreements to reduce credit risk on derivatives, repos and reverse repos, and stock borrowing/lending. We also hold collateral and trade through central counterparties (CCPs) to reduce risk. **Netting** – We use netting agreements where they have legal force – mainly in the UK, the rest of Europe and the US. This means that if a counterparty defaults, we can legally offset what we owe them and what they owe us, and settle the net amount. However, netting arrangements often do not mean we can offset assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis. In line with market practice, we use standard legal agreements. For derivatives, we use ISDA Master Agreements; for repos and reverse repos, we use Global Master Repurchase Agreements; and for stock borrowing/lending and other securities financing, we use Global Master Securities Lending Agreements. **Collateral** – We use the Credit Support Annex with the ISDA Master Agreement. This gives us collateral for our net exposures. The collateral can be cash, securities or equities. For stock borrowing/lending and repos and reverse repos, it includes high quality liquid debt securities and highly liquid equities listed on major developed markets. We revalue our exposures and collateral daily, adjusting the collateral to reflect deficits or surpluses. We have processes to control how we value and manage collateral, including documentation reviews and reporting. Collateral has to meet our 'eligible collateral, haircuts and margining' policy which controls the quality and how much of any one kind of collateral we can hold. That gives us confidence we will be able to cash in the collateral if a client defaults. We have these controls for equities and debt securities. The collateral held for reverse repos is worth at least 100% of our exposure. **CCPs** – These are intermediaries between a buyer and a seller – generally a clearing house. We use CCPs as a way to reduce counterparty credit risk in derivatives.

Corporate Centre:

Portfolio	Description
Sovereign and Supranational	In line with market practice, there is no collateral against these assets.
Structured Products	These are our ALCO and Legacy Treasury asset portfolios. These assets are unsecured, but benefit from senior positions in the creditor hierarchy. Their credit rating reflects the over-collateralisation in the structure, and the assets that underpin their cash flows and repayment schedules. We use a detailed expected cash flow analysis to assess if there is any impairment. We take into account the structure and assets backing each individual security. We set up an impairment loss allowance if we know an issuer has financial difficulties or they are not keeping to the terms of the contract.
Derivatives	We manage the risk on this portfolio in the same way as for the derivatives in Global Corporate Banking.
Legacy Portfolios in run-off	We often hold collateral through a first legal charge over the underlying asset or cash. We get independent third party valuations on fixed charge security like aircraft or ships in line with industry guidelines. We then decide if we need to set up an impairment loss allowance. To do that, we bear in mind: – The borrower's ability to generate cash flow – The age of the assets – Whether the loan is still performing satisfactorily – Whether or not the reduction in value is likely to be temporary – Whether there are other ways to solve the problem. Where a borrower gets into difficulty we look to dispose of the collateral, either with agreement or through the insolvency process. We do this as early as possible, to minimise any loss. We rarely take ownership of collateral.
Social Housing	We manage the risk on this portfolio in the same way as for the Social Housing portfolio in Commercial Banking.

3. Monitoring

We regularly monitor and report our credit risk by portfolio, segment, industry, location and customer. We give our Executive Risk Control Committee a detailed analysis of our credit exposures and risk trends every month. We also report our larger exposures and risks to the Board Risk Committee every month.

Our Watchlist

For non-standardised customers, we also use a Watchlist to help us identify potential problem debt early. Just because a customer is on our Watchlist does not mean they have defaulted. It just means that something has happened that has increased the probability of default. There are several reasons we might put customers on this list. For example, if they suffer a downturn in trade, breach a covenant, lose a major contract, slip into early arrears, or their key management resign. Whatever the trigger, we review the case to assess the potential financial impact.

We classify Watchlist cases as:

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

We assess cases on the Watchlist for impairment collectively, unless they are in the hands of our Restructuring & Recoveries team at which point we assess them individually. If a case becomes NPL, we take it off the Watchlist and assess it for impairment individually.

When a customer is included in proactive management, we usually review the value of any collateral as part of working out what to do next. We also assess whether we need to set up an impairment loss allowance. This is based on the expected future cash flows and the value of the collateral compared to the loan balance. We also take into account any forbearance we offer (which we describe later on). This includes whether any extra security or guarantees are available, the likelihood of more equity and the potential to enhance value through asset management.

In Global Corporate Banking and Corporate Centre we monitor the credit quality of our portfolios of treasury products daily. We use both internal and third-party data to detect any potential credit deterioration.

4. Arrears management

We identify problem debt by close monitoring, supported by our Watchlist process. When there is a problem, our relationship managers are the first to act, supported by the relevant credit risk expert. If a case becomes more urgent or needs specialist attention, and if it becomes NPL, we transfer it to our Restructuring & Recoveries team.

We aim to act before a customer actually defaults (to prevent it, if possible). The strategy we use depends on the type of customer, their circumstances and the level of risk. We use restructuring and rehabilitation tools to try to help our customers find their own way out of financial difficulty and agree on a plan that works for both of us.

We aim to identify warning signs early by monitoring customers' financial and trading data, checking to make sure they are not breaching any covenants, and by having regular dialogue with them. Once a month, we hold Watchlist meetings to agree a strategy for each portfolio. Our Restructuring & Recoveries team attend these meetings, and we may hand over more serious cases to them.

Forbearance
If a customer is having financial difficulty, we will work with them before they actually default to see if the difficulty can be addressed through forbearance. Their problems might be clear from the results of covenant testing, reviews of trading and other data they give us under the terms of their loan or as part of our ongoing conversations with them.

We may offer the following types of forbearance. We only do this if our assessments indicate the customer can meet the revised payments:

Action	Description
Term extension	We can extend the term of the loan. At a minimum, we expect the customer to be able to pay the interest in the short-term and have a realistic chance of repaying the full balance in the long-term. We may offer this option if the customer is up-to-date with their payments, but showing signs of financial difficulties. We may also offer this option where the loan is about to mature and near-term refinancing is not possible on market terms.
Interest-only	We can agree to let a customer pay only the interest on the loan for a short time – usually less than a year. We only agree to this if we believe their financial problems are temporary and they are going to recover. After the interest-only period, we expect the customer to go back to making full payments of interest and capital once they are in a stronger financial position. We regularly look at the customer's financial situation to see when they can afford to do that.
Other payment rescheduling (including capitalisation)	If a customer is having cash flow issues, we may agree to lower or stop their payments until they have had time to recover. We may: – Reschedule payments to better match the customer's cash flow – for example if the business is seasonal – Provide a temporary increase in facilities to cover peak demand ahead of the customer's trading improving. We might do this by adding their arrears to their loan balance (we call this arrears capitalisation) or drawing from an overdraft. We may also offer other types of forbearance, including providing new facilities, interest rate concessions, seasonal profiling and interest roll-up. In rare cases, we agree to forgive or reduce part of the debt.

When we agree to any forbearance, we review our impairment loss allowances for them. These accounts may stay in our performing portfolio but we report them separately as forborne. If an account is performing when we agree forbearance and there is clear evidence that the customer is consistently meeting their new terms and the risk profile is improving, we classify the loan as fully performing. If an account is in NPL when we agree forbearance, we keep it in the NPL category. Once we see that the customer is consistently meeting the new terms we reclassify the loan as performing.

Other forms of debt management
When customers are in financial difficulty we can also manage debt in other ways, depending on the facts of the specific case:

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

5. Debt recovery
Consensual arrangements
Where we cannot find a solution like any of the ones we describe above, we look for an exit. If circumstances permit, we aim to do this by agreeing with the borrower that they will sell some or all of their assets on a voluntary basis or agreeing to give them time to refinance their debt with another lender.

Enforcement and recovery
Where we cannot find a way forward or reach a consensual arrangement, we consider recovery options. This can be through:

- The insolvency process
- Enforcing over any collateral
- Selling the debt on the secondary market
- Considering other legal action available to recover what we are owed from debtors and guarantors.

If there is a shortfall, we write it off against the impairment loss allowance held, once the sale has gone through. In certain very rare instances we may act as mortgagee in possession of assets held as collateral against non-performing commercial lending. In such cases the assets are carried on our balance sheet and are classified according to our accounting policies.

Risk measurement and control
We measure the credit risk on treasury products by adding their potential future exposure to market movements over their lives to their fair value. Then we add it to any other exposure and measure the total against our credit limits for each client.

We assess our impairment loss allowances regularly and have them independently reviewed. We look at a number of factors, including the:

- Cash flow available to service debt
- Value of collateral, based on third-party professional valuations.

OTHER SEGMENTS – CREDIT RISK REVIEW

2017 compared to 2016 (unaudited)
Corporate lending growth has been impacted by uncertainty in the UK economy in relation to the UK's future relationship with the EU. UK businesses face ongoing uncertainty over future trade arrangements, and how the transition to these new rules will be managed. This has impacted business investment, although this is still forecasted to grow. In 2017, there were signs certain vulnerable sectors could be impacted in the context of the changing macro-economic environment.

Committed exposures
Credit risk arises on asset balances and off-balance sheet transactions such as credit facilities or guarantees. As a result, committed exposures are typically higher than asset balances. However, committed exposures can be smaller than the asset balances on the balance sheet due to netting. We show Sovereigns and Supranationals net of short positions and Large Corporate reverse repurchase agreement exposures are shown net of repurchase agreement liabilities and include OTC derivatives. In addition, the derivative and other treasury product exposures (which are classified as 'Financial Institutions') shown are also typically lower than the asset balances. This is because we show our overall risk exposure which takes into account our procedures to mitigate credit risk. The asset balances on our balance sheet only reflect the more restrictive netting permitted by IAS 32.

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

Underlying credit quality has remained stable within our Commercial Banking, Global Corporate Banking and Corporate Centre portfolios. In the second half of 2017 a number of enhancements were made to better harmonise treatments across our reporting classifications. This has resulted in some migrations as shown in the tables below, but on a like for like basis, no deterioration in credit quality has been observed. An exception to this resides in the Large Corporate portfolio where the increase in band 1-3 is driven by 3 new NPL cases in 2017.

	Santander UK risk grade								
2017	9 £m	8 £m	7 £m	6 £m	5 £m	4 £m	3 to 1 £m	Other[1] £m	Total £m
Commercial Banking									
SME and mid corporate	–	–	259	2,183	5,402	3,574	998	214	12,630
Commercial Real Estate	–	–	–	395	6,135	2,014	60	2	8,606
Social Housing	499	2,600	171	–	–	–	4	–	3,274
	499	2,600	430	2,578	11,537	5,588	1,062	216	24,510
Global Corporate Banking									
Sovereign and Supranational	590	3,321	444	–	–	–	–	–	4,355
Large Corporate	260	2,979	8,391	8,879	573	2	355	–	21,439
Financial Institutions	2,362	1,463	2,494	33	103	–	–	–	6,455
	3,212	7,763	11,329	8,912	676	2	355	–	32,249
Corporate Centre									
Sovereign and Supranational	44,477	18	–	–	–	–	–	–	44,495
Structured Products	2,487	1,560	300	32	–	–	–	–	4,379
Derivatives	–	212	–	–	–	–	–	–	212
Legacy Portfolios in run-off[2]	–	–	1	359	104	124	37	400	1,025
Social Housing	1,841	3,641	451	43	–	–	–	–	5,976
	48,805	5,431	752	434	104	124	37	400	56,087
2016									
Commercial Banking									
SME and mid corporate	22	112	344	2,826	4,219	3,142	533	130	11,328
Commercial Real Estate	–	–	302	5,852	2,754	498	118	1	9,525
Social Housing	1,355	1,499	215	–	–	–	–	–	3,069
	1,377	1,611	861	8,678	6,973	3,640	651	131	23,922
Global Corporate Banking									
Sovereign and Supranational	1,025	3,111	977	–	–	–	–	–	5,113
Large Corporate	204	2,028	5,347	9,493	4,296	56	75	1	21,500
Financial Institutions	439	3,877	2,913	597	49	–	–	–	7,875
	1,668	9,016	9,237	10,090	4,345	56	75	1	34,488
Corporate Centre									
Sovereign and Supranational	34,474	–	–	–	–	–	–	–	34,474
Structured Products	1,597	1,755	654	–	–	–	–	–	4,006
Derivatives	–	175	312	–	–	–	–	–	487
Legacy Portfolios in run-off[2]	2	1	5	540	215	69	63	480	1,375
Social Housing	3,313	2,707	548	43	–	–	–	–	6,611
	39,386	4,638	1,519	583	215	69	63	480	46,953

(1) Consists of smaller exposures mainly in the commercial mortgage portfolio. We use scorecards for them, instead of a rating model.
(2) Consists of commercial mortgages and residual structured and asset finance loans (shipping, aviation, and structured finance).

Geographical distribution

We typically classify geographical location according to the counterparty's country of domicile unless there is a full risk transfer guarantee in place, in which case we use the guarantor's country of domicile instead.

2017	UK £m	Europe £m	US £m	Rest of World £m	Total £m
Commercial Banking					
SME and mid corporate	12,513	116	1	–	12,630
Commercial Real Estate	8,606	–	–	–	8,606
Social Housing	3,274	–	–	–	3,274
	24,393	116	1	–	24,510
Global Corporate Banking					
Sovereign and Supranational	–	1,032	1	3,322	4,355
Large Corporate	17,430	3,699	111	199	21,439
Financial Institutions	3,102	2,121	614	618	6,455
	20,532	6,852	726	4,139	32,249
Corporate Centre					
Sovereign and Supranational	35,659	1,514	6,091	1,231	44,495
Structured Products	2,086	1,217	–	1,076	4,379
Derivatives	–	63	149	–	212
Legacy Portfolios in run-off	909	–	–	116	1,025
Social Housing	5,976	–	–	–	5,976
	44,630	2,794	6,240	2,423	56,087
2016					
Commercial Banking					
SME and mid corporate	11,188	83	57	–	11,328
Commercial Real Estate	9,525	–	–	–	9,525
Social Housing	3,069	–	–	–	3,069
	23,782	83	57	–	23,922
Global Corporate Banking					
Sovereign and Supranational	332	1,643	–	3,138	5,113
Large Corporate	17,793	3,356	73	278	21,500
Financial Institutions	4,282	1,629	1,175	789	7,875
	22,407	6,628	1,248	4,205	34,488
Corporate Centre					
Sovereign and Supranational	26,693	1,569	4,770	1,442	34,474
Structured Products	1,352	1,529	–	1,125	4,006
Derivatives	312	12	163	–	487
Legacy Portfolios in run-off	1,205	–	–	170	1,375
Social Housing	6,611	–	–	–	6,611
	36,173	3,110	4,933	2,737	46,953

2017 compared to 2016 (unaudited)

Commercial Banking

In 2017, we saw solid lending growth to trading business customers, offset by active management of our Commercial Real Estate portfolio. Committed exposures increased, despite the uncertain operating environment after the UK's decision to leave the EU and the resulting slowdown in SME activity.

- Our SME and mid corporate exposures increased by 12% as growth in the Mid Corporate portfolio more than offset a reduction in SME exposures.
- Our Commercial Real Estate portfolio decreased by 10% as we continue to actively manage exposures in line with our proactive risk management practices and strive to maintain portfolio quality.
- Our Social Housing portfolio increased by 7%, driven by refinancing of longer-dated loans, previously managed in Corporate Centre, onto shorter maturities and current market terms.

Global Corporate Banking

Our committed exposures decreased by 7% mainly due to decreases in our Sovereign and Supranational and Financial Institutions portfolios.

- Sovereign and Supranational exposures decreased by 15%. The portfolio profile stayed mainly short-term, reflecting the purpose of the holdings.
- Large Corporate exposures decreased slightly. Credit quality was relatively stable overall, except for the impairment of three customers that moved to non-performance, including Carillion plc.
- Financial Institutions exposures decreased by 18%, largely driven by the transfer of prohibited activity to Banco Santander as part of ring-fencing.

Corporate Centre

In 2017, committed exposures increased by 19% mainly driven by our Sovereign and Supranational portfolio.

- Sovereign and Supranational exposures are mainly cash at central banks and highly-rated liquid assets we hold as part of normal liquid asset portfolio management. The increase of 29% in the overall exposure was driven by an increase in deposits in the UK.
- Legacy Portfolios in run-off reduced by 24% in 2017. The disposal of all aviation deals within this portfolio is now complete.
- Social Housing exposures reduced in 2017 to £6.0bn (2016: £6.6bn) as we continue to refinance longer-dated loans onto shorter maturities and current market terms that are then managed in Commercial Banking.

Credit risk mitigation

Commercial Banking

As discussed above, we only hold collateral on Commercial Real Estate loans within our Commercial Banking portfolio. Impaired loans in the Commercial Real Estate portfolio reduced from 2016, resulting in a decrease in the collateral we held against impaired loans. At 31 December 2017, the collateral we held against impaired loans was 15% (2016: 42%) of the carrying amount of the impaired loan balances.

Global Corporate Banking

At 31 December 2017, the top 20 clients with derivative exposure made up 65% (2016: 69%) of our total derivative exposure, all of which were banks and CCPs. The weighted-average credit rating was 7.2 (2016: 7.3). At 31 December 2017 and 2016, we held no collateral against impaired loans in the Large Corporate portfolio.

Corporate Centre

We reduce credit risk in derivatives with netting agreements, collateralisation and the use of CCPs. At 31 December 2017, we had cash collateral of £348m (2016: £457m) held against our Legacy Portfolios in run-off. The collateral we held against impaired loans was 100% (2016: 100%) of the carrying amount of the impaired loan balances.

Credit performance

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

	Committed exposure					
		Watchlist				
2017	Fully performing £m	Enhanced monitoring £m	Proactive management £m	Non-performing exposure[1] £m	Total[2] £m	Observed impairment loss allowances £m
Commercial Banking						
SME and mid corporate	11,185	815	296	334	12,630	128
Commercial Real Estate	8,254	160	133	59	8,606	27
Social Housing	3,274	–	–	–	3,274	–
	22,713	975	429	393	24,510	155
Global Corporate Banking						
Sovereign and Supranational	4,355	–	–	–	4,355	–
Large Corporate	20,757	284	8	390	21,439	236
Financial Institutions	6,354	1	100	–	6,455	–
	31,466	285	108	390	32,249	236
Corporate Centre						
Sovereign and Supranational	44,495	–	–	–	44,495	–
Structured Products	4,379	–	–	–	4,379	–
Derivatives	212	–	–	–	212	–
Legacy Portfolios in run-off	977	22	6	20	1,025	6
Social Housing	5,972	4	–	–	5,976	–
	56,035	26	6	20	56,087	6
Total observed impairment loss allowances						397
Allowance for IBNO[3]						52
Total impairment loss allowances						449

(1) Non-performing exposure includes committed facilities and derivative exposures. So it can exceed the NPLs in the table on page 96 which only include drawn balances.
(2) Includes committed facilities and derivatives. We define 'Enhanced Monitoring' and 'Proactive Management' in the 'Monitoring' section.
(3) Allowance for IBNO losses as described in Note 1 to the Consolidated Financial Statements.

2016	Committed exposure: Fully performing £m	Watchlist: Enhanced monitoring £m	Watchlist: Proactive management £m	Non-performing exposure[1] £m	Total[2] £m	Observed impairment loss allowances £m
Commercial Banking						
SME and mid corporate	9,744	892	331	361	11,328	139
Commercial Real Estate	9,136	161	49	179	9,525	44
Social Housing	2,930	139	–	–	3,069	–
	21,810	1,192	380	540	23,922	183
Global Corporate Banking						
Sovereign and Supranational	5,113	–	–	–	5,113	–
Large Corporate	20,702	659	70	69	21,500	33
Financial Institutions	7,671	202	2	–	7,875	–
	33,486	861	72	69	34,488	33
Corporate Centre						
Sovereign and Supranational	34,474	–	–	–	34,474	–
Structured Products	4,006	–	–	–	4,006	–
Derivatives	487	–	–	–	487	–
Legacy Portfolios in run-off	1,273	20	9	73	1,375	31
Social Housing	6,447	164	–	–	6,611	–
	46,687	184	9	73	46,953	31
Total observed impairment loss allowances						247
Allowance for IBNO[3]						91
Total impairment loss allowances						338

(1) Non-performing exposure includes committed facilities and derivative exposures. So it can exceed the NPLs in the table below which only include drawn balances.
(2) Includes committed facilities and derivatives. We define 'Enhanced Monitoring' and 'Proactive Management' in the 'Monitoring' section.
(3) Allowance for IBNO losses as described in Note 1 to the Consolidated Financial Statements.

2017 compared to 2016 (unaudited)

Commercial Banking

Our SME and mid corporate portfolio improved across all categories as a result of a number of successful exits and the write off of some pre-2009 vintages. In our Commercial Real Estate portfolio, non-performing exposures (NPEs) reduced by 67% to £59m (2016: £179m) driven by a number of successful exits. A single legacy case, where the collateral exceeded the value of the loan, was downgraded to NPE in 2016. The asset was sold and the loan repaid in full in 2017.

Global Corporate Banking

Large Corporate exposures subject to enhanced monitoring decreased by 57% driven by the return of a number of cases to performing as a result of improved trading. However, NPEs increased to £390m (2016: £69m) due to the impairment of three customers that moved to non-performance, including Carillion plc. Financial Institutions exposures subject to enhanced monitoring decreased to £1m (2016: £202m) driven by two cases returning to performing status.

Corporate Centre

In our Legacy Portfolios in run-off portfolio, exposures subject to enhanced monitoring and proactive management remained stable. NPE reduced to £20m (2016: £73m) driven by sales of aviation and shipping assets. In our Social Housing portfolio, exposures subject to enhanced monitoring decreased to £4m (2016: £164m), two large cases that were added in 2016 due to governance issues returned to performing in Q2 2017.

Non-performing loans and advances[1][2]

	2017 Commercial Banking £m	2017 Global Corporate Banking £m	2017 Corporate Centre £m	2016 Commercial Banking £m	2016 Global Corporate Banking £m	2016 Corporate Centre £m
Loans and advances to customers of which:[2]	**19,391**	**6,037**	**5,905**	19,381	5,659	6,478
NPLs[3]	**383**	**340**	**20**	518	63	73
Impairment loss allowances	**195**	**236**	**18**	220	57	61
	%	%	%	%	%	%
NPL ratio[4]	**1.98**	**5.63**	**0.34**	2.67	1.11	1.12
Coverage ratio[5]	**51**	**69**	**90**	42	90	84

(1) We define NPLs in the 'Credit risk management' section.
(2) Includes Social Housing loans and finance leases.
(3) All NPLs continue accruing interest.
(4) NPLs as a percentage of loans and advances to customers.
(5) Impairment loss allowances as a percentage of NPLs. Impairment loss allowances relate to early arrears and performing assets (i.e. the IBNO provision) as well as NPLs, so the ratio can exceed 100%.

NPL movements in 2017

We analyse NPL movements in 2017 below. 'Entries' are loans which we have classified as NPLs in 2017. 'Exits' are the part of loans that has been repaid (in full or in part), and loans that returned to performing status. 'Write-offs' are the unrecovered part of loans where we have exhausted recovery options, including realising any collateral. Forbearance does not change the NPL status.

	Drawn balances		
	Commercial Banking £m	Global Corporate Banking £m	Corporate Centre £m
At 1 January 2017	518	63	73
Entries	194	328	18
Exits	(294)	(51)	(48)
Write offs	(35)	–	(23)
At 31 December 2017	383	340	20

2017 compared to 2016 (unaudited)

Commercial Banking

The Commercial Banking NPL ratio improved to 1.98%, primarily due to the full repayment of three impaired loans and the write-off of some pre-2009 vintages in Q1 2017.

Global Corporate Banking

The Global Corporate Banking NPL ratio of 5.63% was severely impacted by the Carillion plc loans that moved to non-performance in 2017. Impairment losses on loans and advances increased to £236m, primarily relating to Carillion plc exposures.

Corporate Centre

The Corporate Centre NPL ratio decreased to 0.34%, reflecting management of non-core corporate and legacy portfolios.

Forbearance

We only make forbearance arrangements for lending to customers. The balances at 31 December 2017 and 2016, analysed by their payment status at the year-end and the forbearance we applied, were:

	2017			2016		
	Commercial Banking £m	Global Corporate Banking £m	Corporate Centre(2) £m	Commercial Banking £m	Global Corporate Banking £m	Corporate Centre(2) £m
Stock(1)						
– Term extension	136	55	–	168	11	1
– Interest-only	152	–	14	158	–	20
– Other payment rescheduling	127	299	13	208	10	16
	415	354	27	534	21	37
Of which:						
– Non-performing	273	347	11	344	10	15
– Performing	142	7	16	190	11	22
	415	354	27	534	21	37
Proportion of portfolio	1.7%	1.1%	2.6%	2.2%	0.1%	2.7%

(1) We base forbearance type on the first forbearance we applied. Tables only show accounts open at the year-end. Amounts are drawn balances and include off balance sheet balances.
(2) Exposure within the Legacy Portfolios in run-off only.

2017 compared to 2016 (unaudited)

In Commercial Banking, the cumulative forbearance stock reduced by 22% to £415m at 31 December 2017 (2016: £534m). This decrease was mainly due to the successful resolution of NPL cases, and performing cases exiting forbearance according to defined criteria. This impact was offset by an increase in the stock position of forbearance due to the inflows in the year in Global Corporate Banking, where the Carillion plc loans that moved to non-performance in 2017 had a severe impact. At 31 December 2017, there were five forborne cases (2016: two cases) in Global Corporate Banking.

PORTFOLIOS OF PARTICULAR INTEREST

Introduction (unaudited)
Some types of lending have higher risk and others stand out for different reasons. In the section below we provide further details of our Commercial Real Estate and Social Housing portfolios.

Product	Description
Commercial Real Estate	The Commercial Real Estate market experienced a challenging environment in the immediate years after the last financial crisis and has previously seen regular cyclical downturns. In addition to the disclosures on the Commercial Real Estate portfolio earlier in this section, we include below more detail on credit management, credit performance, and LTV and sector analysis.
Social Housing	The Social Housing sector in the UK is critical in ensuring the supply of affordable housing across the country. Housing associations now play a prominent role in addressing the UK's shortage of housing stock across all tenures. The sector benefits from a zero-loss default history aided by its regulated nature. We hold a significant position in this market. Continued investment in this sector is seen as a direct way to support the UK and, indirectly, the wider community initiatives undertaken by our customers.

Commercial Real Estate
Credit performance
The table below shows the main Commercial Real Estate credit performance metrics at 31 December 2017 and 2016.

	Customer loans(1) £bn	NPLs(2)(3) £m	NPL ratio(4) %	NPL coverage(5) %	Gross write-offs £m	Impairment loss allowances £m
2017	**8.1**	**69**	**0.85**	**78**	**11**	**54**
2016	9.0	180	2.00	32	1	58

(1) Comprises commercial real estate drawn loans in the business banking portfolio of our Retail Banking segment of £257m (2016: £365m) and in the Commercial Real Estate portfolio of our Commercial Banking segment of £7,886m (2016: £8,678m).
(2) We define NPLs in the 'Credit risk management' section.
(3) All NPLs continue accruing interest.
(4) NPLs as a percentage of customer loans.
(5) Impairment loss allowances as a percentage of NPLs. Impairment loss allowances relate to early arrears and performing assets (i.e. the IBNO provision) as well as NPLs, so the ratio can exceed 100%.

Commercial Real Estate loans written before 2009 totalled £380m (2016: £543m). The pre-2009 loans were written on market terms which, compared with more recent times and following a significant tightening in our lending criteria, included higher original LTVs, lower interest coverage and exposure to development risk.

LTV analysis
This table shows the LTV distribution for our Commercial Real Estate loan stock and NPL stock (based on the drawn balance and our latest estimate of the property's current value) of the portfolio at 31 December 2017 and 2016.

	2017		2016	
Loans and advances to customers	£m	%	£m	%
<=50%	**4,146**	**51**	3,879	44
>50-70%	**3,035**	**37**	4,007	44
>70-100%	**36**	**–**	194	2
>100% i.e. negative equity	**52**	**1**	88	1
Standardised portfolio(1)	**629**	**8**	652	7
Total with collateral	**7,898**	**97**	8,820	98
Development loans	**246**	**3**	223	2
	8,144	**100**	9,043	100

	2017		2016	
NPLs	£m	%	£m	%
<=50%	**6**	**9**	7	4
>50-70%	**2**	**3**	2	1
>70-100%	**1**	**1**	74	41
>100% i.e. negative equity	**48**	**70**	74	41
Standardised portfolio(1)	**12**	**17**	5	3
Total with collateral	**69**	**100**	162	90
Development loans	**–**	**–**	18	10
	69	**100**	180	100

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

Sector analysis
The table below shows the sector analysis of the portfolio at 31 December 2017 and 2016.

	2017		2016	
Sector	£m	%	£m	%
Office	**2,181**	**27**	2,359	26
Retail	**1,389**	**17**	1,739	19
Industrial	**1,176**	**14**	1,274	14
Residential	**1,001**	**12**	1,016	11
Mixed use	**1,146**	**14**	1,184	13
Student accommodation	**133**	**2**	224	3
Hotels and leisure	**304**	**4**	389	5
Other	**185**	**2**	206	2
Standardised portfolio[1]	**629**	**8**	652	7
	8,144	**100**	9,043	100

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

The Commercial Real Estate portfolio of £8,144m (2016: £9,043m) is well diversified across sectors, with no significant regional or single name concentration, representing 30% (2016: 33%) of our total lending to corporates and 4% (2016: 4%) of total customer loans.

At 31 December 2017, the LTV profile of the portfolio remained conservative with £7,181m (2016: £7,886m) of the non-standardised portfolio assets at or below 70% LTV.

Loans with development risk were only 3% (2016: 2%) of the total Commercial Real Estate portfolio. Development lending is typically on a non-speculative basis with significant pre-lets in place and/or pre-sales in place.

The average loan balance at 31 December 2017 was £4.7m (2016: £4.8m) and the top ten exposures made up 10% (2016: 8%) of the total Commercial Real Estate portfolio exposure.

Refinancing risk
As part of our annual review process, for Commercial Real Estate loans approaching maturity, we look at the prospects of refinancing the loan on current market terms and applicable credit policy. Where this seems unlikely we put the case on our Watchlist.

At 31 December 2017, Commercial Real Estate loans of £1,090m (2016: £1,408m) were due to mature within 12 months. Of these, £59m, i.e. 5% (2016: £161m, i.e. 11%) had an LTV ratio higher than is acceptable under our current credit policy. At 31 December 2017, £53m of this (2016: £149m) had been put on our Watchlist or recorded as NPL and had an impairment loss allowance of £27m (2016: £31m).

2017 compared to 2016 (unaudited)
In our Commercial Real Estate portfolio, customer loans decreased by 10% as we actively manage exposures to certain segments in line with our proactive risk management practices. In 2017, we maintained a prudent lending approach, with no new business written above 70% LTV (2016: nil) and 91% of new business written at or below 60% LTV (2016: 95%). The weighted average LTV on the CRE portfolio was 48% (2016: 50%) and the average loan size was £4.7m (2016: £4.8m).

Exposures subject to enhanced monitoring remained stable at £160m (2016: £161m). Exposures subject to proactive management increased by 171% to £133m (2016: £49m) largely driven by the downgrade of one customer in Q4 2017 following protracted lease re-negotiations. Non-performing exposures reduced by 67% to £59m (2016: £179m) driven by a number of successful exits. Our non-performing loan ratio was 0.85% (2016: 2.00%). A single legacy case, where the collateral exceeded the value of the loan, was downgraded to NPL in 2016. The asset was sold and the loan repaid in full in 2017.

Social Housing
At 31 December 2017 and 2016, our total Social Housing exposure in Commercial Banking and Corporate Centre was:

	2017		2016	
	Drawn £m	Total £m	Drawn £m	Total £m
Commercial Banking	**2,118**	**3,274**	1,897	3,069
Corporate Centre	**5,060**	**5,976**	5,442	6,611
	7,178	**9,250**	7,339	9,680

Market risk

Overview (unaudited)

Market risk comprises trading market risk and banking market risk.

Trading market risk is the risk of losses in trading positions, both on and off-balance sheet, due to movements in market prices or other external factors.

Banking market risk is the risk of loss of income or economic value due to changes to interest rates in the banking book or to changes in exchange rates, where such changes would affect our net worth through an adjustment to revenues, assets, liabilities and off-balance sheet exposures in the banking book.

In this section, we set out which of our assets and liabilities are exposed to trading and banking market risk. Then we explain how we manage these risks and discuss our key market risk metrics.

Key metrics (unaudited)

Net Interest Margin (NIM) sensitivity to +50bps decreased to £212m and to -50bps increased to £(125)m (2016: £240m and £(82)m)

Economic Value of Equity (EVE) sensitivity to +50bps increased to £95m and to -50bps increased to £(213)m (2016: £54m and £(30)m)

Available-for-sale securities three month stressed loss decreased to £193m (2016: £280m)

BALANCE SHEET ALLOCATION BY MARKET RISK CLASSIFICATION

We analyse our assets and liabilities exposed to market risk between trading and banking market risk as follows:

	2017			2016			
	Trading £m	Banking £m	Total £m	Trading £m	Banking £m	Total £m	Key risk factors
Assets subject to market risk							
Cash and balances at central banks	**–**	**32,771**	**32,771**	–	17,107	17,107	FX, Interest rate
Trading assets	**30,555**	**–**	**30,555**	30,035	–	30,035	Equity, FX, interest rate
Derivative financial instruments	**14,744**	**5,198**	**19,942**	18,101	7,370	25,471	Equity, FX, interest rate
Financial assets designated at fair value	**–**	**2,096**	**2,096**	516	1,624	2,140	Interest rate, credit spread
Loans and advances to banks	**–**	**5,927**	**5,927**	–	4,348	4,348	FX, interest rate
Loans and advances to customers	**–**	**199,490**	**199,490**	–	199,738	199,738	Interest rate
Financial investments	**–**	**17,611**	**17,611**	–	17,466	17,466	FX, interest rate, inflation, credit spread
Macro hedge of interest rate risk(1)	**–**	**833**	**833**	–	1,098	1,098	Interest rate
Retirement benefit assets	**–**	**449**	**449**	–	398	398	Equity, FX, interest rate, inflation, credit spread
	45,299	**264,375**	**309,674**	48,652	249,149	297,801	
Liabilities subject to market risk							
Deposits by banks	**–**	**13,784**	**13,784**	–	9,769	9,769	FX, interest rate
Deposits by customers	**–**	**183,648**	**183,648**	–	177,172	177,172	Interest rate
Trading liabilities	**31,109**	**–**	**31,109**	15,560	–	15,560	Equity, FX, interest rate
Derivative financial instruments	**16,891**	**722**	**17,613**	20,018	3,085	23,103	Equity, FX, interest rate
Financial liabilities designated at fair value	**1,612**	**703**	**2,315**	1,665	775	2,440	Interest rate, credit spread
Debt securities in issue	**–**	**42,633**	**42,633**	–	50,346	50,346	FX, interest rate
Subordinated liabilities	**–**	**3,793**	**3,793**	–	4,303	4,303	FX, interest rate
Macro hedge of interest rate risk(2)	**–**	**–**	**–**	–	350	350	Interest rate
Retirement benefit obligations	**–**	**286**	**286**	–	262	262	Equity, FX, interest rate, inflation, credit spread
	49,612	**245,569**	**295,181**	37,243	246,062	283,305	

(1) This is included in Other assets of £2,511m (2016: £2,571m).
(2) This is included in Other liabilities of £2,730m (2016: £3,221m).

We classify assets or liabilities as trading market risk (in total or just in part) as follows:

Balance sheet classification	Market risk classification
Trading assets and liabilities	We classify all our trading portfolios as trading market risk. This is mainly because we are planning to sell or repurchase them in the near future. For more, see Notes 11 and 23 to the Consolidated Financial Statements.
Financial assets and liabilities designated at fair value	We classify all our financial assets designated at fair value as banking market risk. We classify our warrant programmes, our Global Structured Solutions Programme and structured customer deposits as trading market risk. This is because we manage them on a fair value basis. We classify all our other financial liabilities designated at fair value as banking market risk. For more, see Notes 13 and 24 to the Consolidated Financial Statements.
Derivative financial instruments	For accounting purposes, we classify derivatives as held for trading unless they are designated as being in a hedging relationship. Most of our derivatives arise from sales and trading activities and are treated as trading market risk. We treat derivatives that we do not manage on a trading intent basis as banking market risk. For more, see Note 12 to the Consolidated Financial Statements.

TRADING MARKET RISK

OUR KEY TRADING MARKET RISKS (unaudited)

Our main exposure to trading market risk is in Global Corporate Banking and it is an inherent part of providing financial services for our customers. It comes from providing derivative products and services to corporate, business and financial institution customers. It also comes from our short-term market activities and the hedging of structured products that are designed for onward sale to retail and wholesale investors. Our exposures are mainly affected by market movements in interest rates, equities, credit spreads, and foreign exchange. We have no exposures in Retail Banking, Commercial Banking or Corporate Centre.

Trading market risk can reduce our net income. Its effect can be seen in our Consolidated Income Statement, where it appears in the 'Net trading and other income' line, under 'Net trading and funding of other items by the trading book'.

TRADING MARKET RISK MANAGEMENT

Risk appetite
Our framework for dealing with market risk is part of our overall Risk Framework. The market risk Framework sets out our high-level arrangements and minimum standards for managing, controlling and overseeing trading market risk. Our Risk Appetite sets the controls, risk limits and key risk metrics for trading market risk. The key risk metrics include a stress economic loss limit and risk-factor stress scenarios. We report these key metrics to the Board Risk Committee and the Executive Risk Control Committee (ERCC) each month. A specific stress scenario has been created to report the XVA related risks in a comprehensive way. The stressed scenario will be monitored against the specific trigger that was set by ERCC during the annual limits review for 2018 and will be reported to both the BRC and ERCC periodically.

Risk measurement (unaudited)
We have a range of ways of measuring trading market risk, but one of the most important is a statistical measure based on a historical simulation of events called 'Value at Risk' (VaR).

VaR

VaR

- VaR estimates the maximum losses that we might suffer because of unfavourable changes in the markets under normal non-stressed market conditions.
- To calculate VaR we run a historical simulation, at a given confidence level, over a specified time period. We use one or two years of daily price history, with each day given equal weighting.
- This means we include most market risk factors that could make a difference, and it gives us a consistent way of assessing risk for all these factors in all our portfolios.
- We work with three main types of VaR, which all use the same calculation models. They are Internal VaR, Regulatory VaR and Stressed VaR. We have governance and controls for all forms of VaR, and we regularly review and assess them.

Internal VaR

- We use this to calculate the total VaR in our trading book. It covers all the risk asset classes: interest rate, equity, credit (spread) and foreign exchange. We use two years of data for this simulation.
- Like the rest of Banco Santander, we use a time horizon of one day and a confidence level of 99%. For any given day's trading position, we would expect to suffer losses greater than the VaR estimate 1% of the time – once every 100 trading days, or two to three times a year.
- For Internal VaR, we also calculate a time-weighted VaR using Banco Santander's method. This gives more weight to the most recent days in the last two years, which means VaR changes more quickly in line with current market volatility. That gives us a better indication of how the market's behaviour is changing, mitigating some limitations of VaR.
- We measure Internal VaR every day, comparing the equally-weighted result with the time-weighted result and report the higher against the Santander UK and business unit level limits. The Santander UK limits are approved by the Executive Risk Control Committee. We also report our equally weighted VaR against asset class and individual desk level limits. Whenever we find a limit has been exceeded, we report it, following the market risk framework. The main classes of risk that we measure Internal VaR on are:
  - **Interest rate risks:** this measures the effect of changes in interest rates and how volatile they are. The effects are on cash instruments, securities and derivatives. This includes swap spread risk (the difference between swap rates and government bond rates), basis risk (changes in interest rate tenor basis) and inflation risk (changes in inflation rates).
  - **Equity risks:** this measures the effect of changes in equity prices, volatility and dividends on stock and derivatives.
  - **Credit (spread) risks:** this measures the effect of changes in the credit spread of corporate bonds and credit derivatives.

Regulatory VaR and Stressed VaR

- We use these VaR models to calculate how much capital we need to hold for trading market risk. For these calculations, we only look at the factors for which we hold approval from the PRA. For credit and foreign exchange – factors which are not approved by the PRA for our VaR capital models – we use the standardised approach to calculate how much capital to hold. For more on this, see the 'Capital requirement measures' section.
- For Regulatory VaR, we use a time horizon of ten days and a confidence level of 99%. To calculate the ten-day time horizon, we use the one-day VaR multiplied by the square root of ten. This is the industry standard approach to scaling known as the 'square root of time' approach. We use the same two years of history as with Internal VaR. Stressed VaR is the same, except that we use only one year of history, from a time when markets were stressed relative to our current portfolio.
- The PRA also assesses Regulatory VaR and Stressed VaR.

The limitations of VaR

The main limitation of VaR is that it assumes what happened in the past is a reliable way to predict what will happen in the future. If something that affected the markets over the past two years is no longer relevant, then the actual value at risk could be much more or less than the VaR predicts. Sometimes it is obvious that the past data will not predict the future: there is unlikely to be enough data on the history of the market if a product is brand new, for example. In that case, we use proxy data – calculations of what might have happened if the product had existed. That helps make VaR data more complete, but it makes it less accurate. We control and keep a record of how we use proxy data.

Another limitation is that VaR is based on positions at the end of the business day. So the actual value at risk at 1pm could be higher than that at the end of the day. And, when we are calculating a ten-day time horizon using the 'square root of time' approach, it means we do not capture the actual ten-day price movements. This can lead to under or over estimating the ten-day result. But we analyse this every quarter and the analysis is also sent to the PRA.

There is also the fact that VaR gives no guide to how big the loss could be on the 1% of trading days that it is greater than the VaR. To make up for that (and for other reasons), we use stress testing and expected shortfall analysis, which we explain later in this section.

Using a time horizon of one day means VaR does not tell us everything about exposures that we cannot liquidate or hedge within a day, or products with infrequent pricing or whose structures are more complex. We monitor those exposures using illiquid risks metrics (explained in 'Other ways of measuring risk') and stress testing. In addition to using the illiquid risks metrics, to ensure such exposures are adequately included in our regulatory capital requirements, we have developed the Risks Not in VaR (RNIV) framework, in line with the regulatory requirement.

In general, VaR takes account of the main ways risk factors affect each other, and the way most market movements affect valuations. But the more complex the products, and the larger the markets' current movements, the less well the model is likely to fare.

Back-testing – comparing VaR estimates with reality

Every day, we back-test the one day 99% Internal and Regulatory VaR. That means looking at the VaR estimates for the last year (250 working days) and seeing how they compare to the actual profits and losses. Or, to be more precise, how they compare to the market risk-related revenue, as the CRR and PRA define it. It is not normally possible to back-test the Stressed VaR model, because it is not intended to tell us anything about our performance in normal conditions.

To back-test VaR, we use a one-day time horizon. Our back-testing looks at two different types of profit and loss metrics:

- **Actual:** trading profit and loss, less fees, commissions, brokerage, reserves that are not related to market risk, and Day One sales profits
- **Hypothetical:** like the 'Actual' type but also excluding intra-day figures and the effects of the passage of time. It is, in effect, just leaving the pure market risk driven effects on the profit and loss.

Exceptions

Back-testing allows us to identify exceptions – times when the predictions were out of line with what happened. We can then look for trends in these exceptions, which can help us decide whether we need to recalibrate our VaR model. The CRR sets out criteria for how many exceptions are acceptable in the Regulatory VaR model. The PRA's Supervisory Statements clarify the requirements further. If there are five or more exceptions in 250 days, then points are added to our capital requirement multiplier. In 2017, as in 2016, no points were added to our multiplier, and we did not find any trends in the exceptions we experienced.

Other ways of measuring risk

As well as VaR, we use the following methods to measure risk:

Method	Description
Profit and loss	The value of our tradeable instruments, such as shares and bonds, changes constantly. We report our profits and losses from them every day.
Non-statistical measures	We also have ways of measuring risk that do not depend on statistics. That includes looking at how sensitive we are to the variables we use to value our market risk positions. We record all our market risk exposures, set limits to the sensitivities for each, and then check every day whether we are staying within those limits.
Illiquid risks	The financial instruments that we cannot sell or hedge in a day are classified as 'illiquid risks'. We measure and monitor those differently depending on how long they would take to sell or hedge. There are three categories: less than a month, one to six months, or greater than six months. We check each category every day against our limits.
Expected shortfall (ES) analysis	We also use a measurement called ES analysis. It goes some way to mitigate the limitations of the VaR model. ES allows us to better measure how big the loss could be on the 1% of the trading days that it is greater than VaR.

Stress testing
The Basel Capital Accord underlined that stress testing is an essential part of risk management. It helps us to measure and control the risk of losses in difficult, volatile or unusual markets. It also makes us more transparent as the scenarios are easy to understand in headline terms.

Stress testing scenarios
The scenarios we use for stress testing are part of our process for setting our trading market risk appetite. They are central to the monthly Board Risk Appetite reporting. The scenarios are also part of the daily processes for setting and monitoring risk management limits. The scenarios we create are partly inspired by past events, like the global financial crisis. They also include plausible ways that unusual market conditions could occur in future. This includes changes in interest rates, equity prices, exchange rates and credit spreads.

Some scenarios are more severe than others. We consider them all, along with VaR, so that we have a more complete and accurate idea of our overall risk profile. When we set the sizes of the 'shocks' (sudden market changes) in each scenario, we look at how long each different type of risk would last. This is because we can sell some positions more easily than others. If it would take a long time to reduce a particular position in the stressed circumstances, we need to apply a correspondingly large shock to that position (as prices will move further over a longer time period). That helps us to see how different amounts of liquidity in the markets would affect us in a stress event, such as an equity crash. It is important to make sure that the stress result we report is as realistic as possible.

How we use stress testing
We use limits to manage how much risk we take. They are expressed as how much we could lose in a stress event. We need to make sure the effects of potential poor market conditions do not exceed the Risk Appetite set by the Board. Each of our desks uses stress testing as part of their daily risk management metrics. We regularly inform senior managers – including the Executive Risk Control Committee and the Board Risk Committee – about the results of our stress calculations, based on our current positions.

Capital requirement measures
Whenever we make changes to our models, we assess their effect on our capital requirements. Sometimes that means we need to tell the PRA and get their approval before we can make the change.

Method	Description
The Internal Models Approach (IMA)	The PRA has given us permission to use the IMA, in line with CRR, and every three months the PRA reviews what we are doing. The IMA means we can use Regulatory and Stressed VaR and RNIV to calculate the trading market risk capital requirement for the risk factors and businesses that we have PRA approval for.
The standardised approach	For risk factors and businesses not included in the IMA, we use the standardised approach set out by the CRR and PRA Supervisory Statements. At 31 December 2017, this amounted to 11% (2016: 10%) of our total market risk capital requirement.
Stressed versus Regulatory VaR	Stressed VaR is the biggest part of our trading market risk capital requirements. In 2017 and 2016, it was an average of six times bigger than the Regulatory VaR part. The factors that had the biggest effect on Stressed VaR in 2017 and 2016 were interest rate delta and interest rate basis. (For more on each of those factors, see the footnotes to the table in the 'Trading market risk review' section.) The difference is caused by the way the market was behaving during the time the Stressed VaR data covers. We regularly check the stress period we use, to make sure we are using the worst period of stress since 2007 that is relevant to our portfolio. In 2017 the selected stressed VaR historical window has had three different 250 day periods applied, aligning to the portfolio at the time.
Risks Not in VaR (RNIV) risk capital	These risk factors can arise when there is not enough (or no) market data from the past, or when the quality of the data is not good enough. They tend to be for products that are not priced regularly, or whose risk structure is more complex. In 2017, RNIV risk factors made up, on average, less than 3% (2016: 4%) of our IMA capital requirements for trading market risk. The biggest individual risk factors are dividend risk, caused by changes in market expectations about dividends, and Repo, which is the risk of a difference in the markets forward price and our own models' internal forward price. The VaR approach does not capture these risks very well because of the illiquid nature of the risk factors. We normally find new RNIVs by analysing profit and loss, and new products. Then we include them in our calculation of our capital requirement, whether or not they are material at the time, and inform the regulator in the appropriate manner. We can use two approaches to calculate how much RNIV capital we should hold, depending on what kind of market data is available. The first approach means doing a calculation like those for Regulatory VaR and Stressed VaR. For this approach we also use a multiplication factor, following the CRR and PRA rules. The second approach is stress-based, using sensitivities and plausible stressed market moves. At the moment, we only have stress-based RNIVs. And each individual RNIV value is independent, so it does not benefit from diversification in the capital requirements calculation.

Risk mitigation (unaudited)
We manage and control trading market risk within clear parameters. We measure and monitor our risk exposures against these limits. There are specific levels that trigger relevant teams to take action or alert people in other functions. This means we can limit the impact of any negative market movements, while also improving our earnings. We keep the business units that originate trading market risk separate from the functions responsible for managing, controlling and overseeing risk.

Risk monitoring and reporting (unaudited)
We document and maintain a complete set of written policies, procedures and processes to help identify, assess, manage and report trading market risk.

TRADING MARKET RISK REVIEW

2017 compared to 2016 (unaudited)
The VaR figures show how much the fair values of all our tradeable instruments could have changed. Since trading instruments are recorded at fair value, these are also the amounts by which they could have increased or reduced our net income. There was only one floor-wide limit breach in 2017, which occurred in January 2017. This limit breach was driven by the time weighted VaR metric (which is extremely sensitive to the most recent VaR results), and was being driven by a theoretical loss at the end of 2016. This loss was caused by 2016 year-end demand for US Dollars during a time of increased illiquidity, and compounded by a three day effect in the risk sensitivity calculation.

The three loss back-testing exceptions in 2017 were driven by individual events, and no changes or recalibrations to the VaR model were deemed necessary. The exception which occurred in April 2017 was marginal and was mainly driven by underlying interest rate changes. The changes were due to market reaction to the political and economic uncertainty at that time. The two exceptions that occurred in December 2017 were in cross currency and FX swap basis and were driven by US Dollar liquidity issues at year-end which began in mid-December 2017. This was due to year-end volatility and the impact of upcoming tax reforms in the US. There was also one gain exception in December 2017, driven by basis spread (delta) and FX basis due to volatility leading up to year-end.

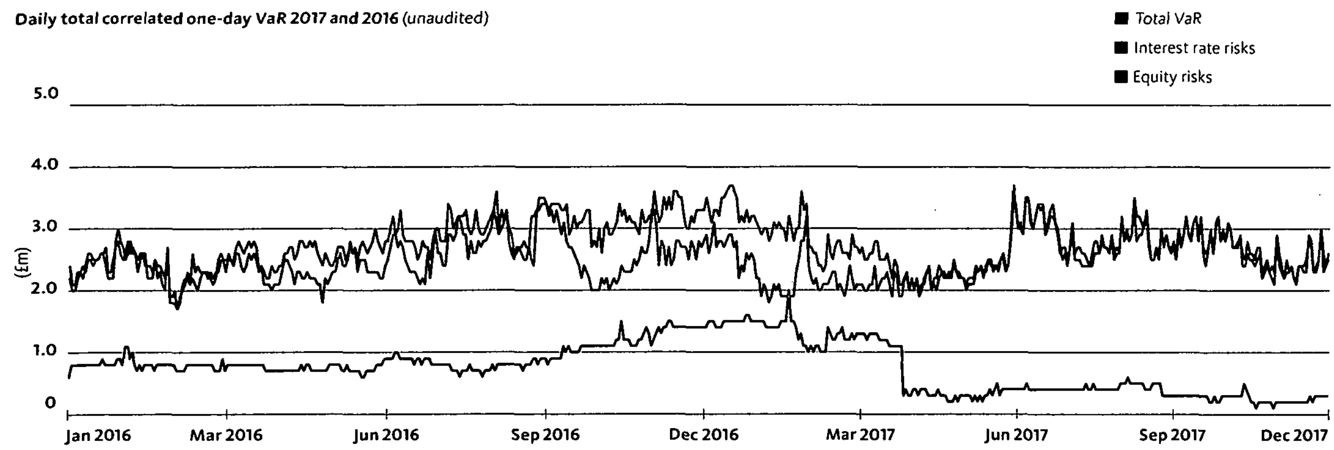
VaR

This table and graph shows our Internal VaR for exposure to each of the main classes of risk for 2017 and 2016.

	Year-end exposure		Average exposure		Highest exposure		Lowest exposure	
Trading instruments	**2017 £m**	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m
Interest rate risks	**2.6**	2.9	**2.5**	2.5	**3.5**	3.6	**1.8**	1.7
Equity risks	**0.3**	1.4	**0.6**	0.9	**2.0**	1.5	**0.2**	0.6
Credit (spread) risks	**–**	–	**–**	–	**–**	–	**–**	–
Foreign exchange risks	**0.3**	1.5	**0.4**	1.4	**1.6**	2.2	**–**	0.1
Diversification offsets[(1)]	**(0.7)**	(2.3)	**(0.8)**	(2.0)	**–**	–	**–**	–
Total correlated one-day VaR	**2.5**	3.5	**2.7**	2.8	**3.7**	3.6	**2.0**	1.7

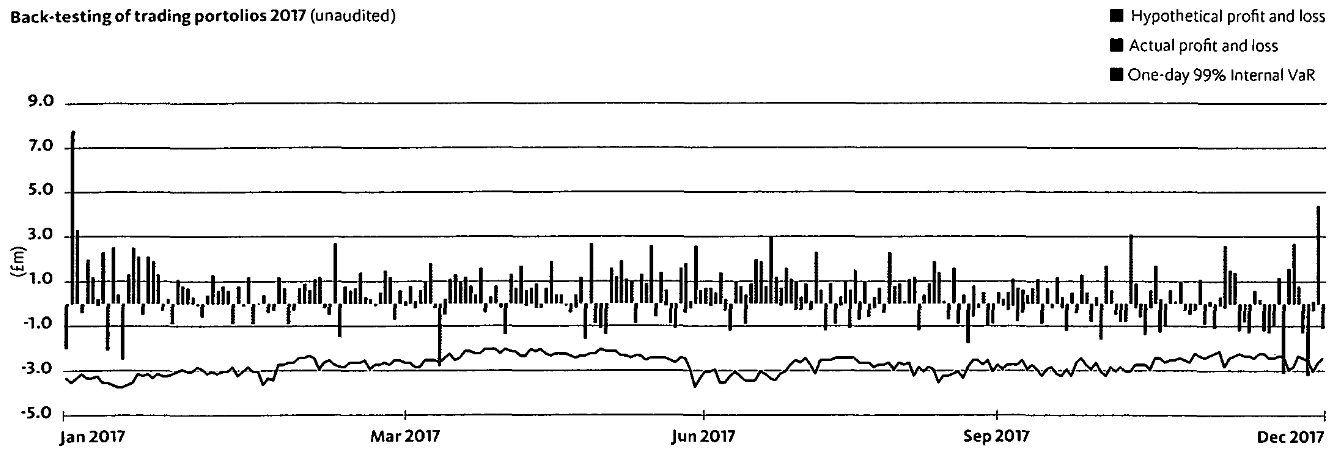
(1) The highest and lowest exposures for each risk type did not necessarily happen on the same day as the highest and lowest total correlated one-day VaR. It is impossible to calculate a corresponding correlation offset effect, so we have not included it in the table.

Daily total correlated one-day VaR 2017 and 2016 (unaudited)



Back-testing (unaudited)
The graph below shows our one-day 99% Internal VaR compared to the Actual and Hypothetical profit and loss.

Back-testing of trading portolios 2017 (unaudited)



BANKING MARKET RISK

OUR KEY BANKING MARKET RISKS (unaudited)

Banking market risk mainly comes from providing banking products and services to our customers, as well as our structural balance sheet exposures. It arises in all our business segments. In Retail Banking and Commercial Banking, it is a by-product of us writing customer business and we transfer most of these risks to Corporate Centre to manage. The only types of material banking market risk that we keep in Retail Banking and Commercial Banking are short-term mismatches due to forecasting variances in prepayment and launch risk. This is where customers repay their loans at a different point than their expected maturity date or do not take the expected volume of new products. In Global Corporate Banking, it arises from short-term markets and lending to corporates, which we also transfer to Corporate Centre to manage. Corporate Centre also manages our structural balance sheet exposures, such as foreign exchange and income statement volatility risk.

Our key banking market risks are:

Key risks	Description
Interest rate risk	**Yield curve risk:** comes from timing mismatches in repricing fixed and variable rate assets, liabilities and off-balance sheet instruments. It also comes from investing non rate sensitive liabilities in interest-earning assets. We mainly measure yield curve risk with NIM and EVE sensitivities. We also use other risk measures, like stress testing and VaR. Our NIM and EVE sensitivities cover all the material yield curve risk in our banking book balance sheet. **Basis risk:** comes from pricing assets using a different rate index to the liabilities that fund them. We are exposed to basis risks associated with Base Rate, reserve rate linked assets we deposit with central banks, the Sterling Overnight Index Average (SONIA) rate, and LIBOR rates of different terms.
Inflation and spread risks	This arises when the value of (or income from) our assets or liabilities is affected by changes in inflation and credit spreads. We hold securities for liquidity and investment purposes that are exposed to these risks. We account for them as available-for-sale (AFS) securities or as held-to-maturity (HTM) investments. For more on our accounting policies, see Note 1 to the Consolidated Financial Statements.
Foreign exchange risk	Our non-trading businesses operate mainly in sterling markets, so we do not create significant foreign exchange exposures. The only exception to this is money we raise in foreign currencies. For more on this, see the 'Wholesale funding' section.
Income statement volatility risk	We measure most of the assets and liabilities in our banking book balance sheet at amortised cost. We sometimes manage their risk profile by using derivatives. As all derivatives are accounted for at fair value, the mismatch in their accounting treatment can lead to volatility in our income statement. This happens even if the derivative is an economic hedge of the asset or liability.

BANKING MARKET RISK MANAGEMENT

Risk appetite

Our framework for dealing with market risk is part of our overall Risk Framework. The banking market risk framework sets out our high-level arrangements and standards to manage, control and oversee banking market risk. Our Risk Appetite sets the controls, risk limits and key risk metrics for banking market risk. We articulate risk appetite by the income and value sensitivity limits we set in our Risk Appetite, at both Santander UK and Banco Santander group levels.

Risk measurement (unaudited)

For banking market risk, we mainly measure our exposures with NIM and EVE sensitivity analysis. We support this with the risk measures we explained in the 'Trading market risk management' section. We also monitor our interest rate repricing gap.

NIM and EVE sensitivities

NIM and EVE sensitivity measures are commonly used in the financial services industry. The calculations for NIM and EVE sensitivities involve many assumptions, including expected customer behaviour (such as early repayment of loans) and how interest rates may move. These assumptions are a key part of our overall control framework, so we update and review them regularly. Our NIM and EVE sensitivities include the interest rate risk from all our banking book positions. Our banking book positions generate almost all our reported net interest income.

NIM sensitivity

- NIM sensitivity is an income-based measure we use to forecast the changes to interest income and interest expense in different scenarios. It gives us a combined impact on net interest income over a given period – usually 12 or 36 months.
- We calculate NIM sensitivity by simulating the NIM using two yield curves. The difference between the two NIM totals is the NIM sensitivity.
- Our main model assumptions are that:
  - The balance sheet is dynamic. This means that it includes the run-off of current assets and liabilities as well as retained and new business
  - We use a behavioural balance sheet rather than contractual one. This means that we adjust balances for behavioural or assumed profile. We do this with most retail products whose behavioural maturity is different to the contractual maturity. This is usually because customers are exercising the option to withdraw or prepay early, or there is no contractual maturity.

EVE sensitivity

- We calculate EVE as the change in the net present value of all the interest rate sensitive items in the banking book balance sheet for a defined set of instantaneous parallel and non-parallel shifts in the yield curve.
- We use a static balance sheet. This means that all balance sheet items run-off according to their contractual, behavioural or assumed run-off behaviour (whichever is appropriate), and there is no retained or new business.

The limitations of sensitivities
We use sensitivities to measure the impact of standard, instantaneous, parallel shifts in relevant yield curves. The advantage of using standard parallel shifts is they generally give us a constant measure of the size of our market risk exposure, with a simple and consistent stress. This compares to specific scenarios like 'flat rates'. The magnitude of flat rates depends on the shape of the current curve and the shift required to reach the flat rate scenario. There is one exception to the relative simplicity of parallel shifts. In order to limit negative interest rates, the yield curve may be 'floored'. Using material parallel shocks does not always seem realistic, or it might not necessarily test the scenarios that have the most impact on us. So we run non-parallel stress tests too – to calculate the impact of some plausible non-parallel scenarios, and over various time periods for income stresses (usually one or three years).

Other ways of measuring risk
As well as using sensitivities and stress tests, we can measure banking market risk using net notional positions. This can give us a simple expression of our exposure, although it generally needs to be combined with other risk measures to cover all aspects of a risk profile, such as projected changes over time.

Other metrics we can use include VaR and Earnings at Risk (EaR). VaR can be useful because it captures changes in economic values. However, VaR will not reflect the actual impact of most of our banking book assets and liabilities on our Income Statement. This is because we account for them at amortised cost rather than fair value. EaR is similar to VaR but captures changes in income rather than value. This approach is mainly used to generate a one-year EaR measure to assess the capital requirement for Basis Risk.

Stress testing
We use stress testing of market risk factors to complement the risk measurement we get from standard sensitivities.

Stress testing scenarios
Simple stress tests (like parallel shifts in relevant curves) give us clear measures of risk control and a consistent starting point for setting limits. More complex, multi-factor and multi-time period stress tests can give us information about specific potential events. They can also test various outcomes that we might not capture through parallel stresses or VaR-type measures because of data or model limitations. We can also use stress tests to estimate losses in extreme market events beyond the confidence level used in VaR models. We can adapt our stress tests to reflect current concerns or market conditions quicker than we can with other risk measures, like VaR. We can include both individual business area stresses and Santander UK-wide scenarios.

Our stress tests fall into three categories:

- **Specific, deterministic stress tests** that are not referenced to market history or expectations (such as parallel stresses of a given size)
- **Historic, deterministic stress tests** with changes in market risk factors based either on specific past events (like the situation in the fourth quarter of 2008) or on our statistical analysis of changes in the past
- **Hypothetical, deterministic stress tests** with changes in market risk factors based on our judgement of possible future rates in a given scenario.

We can produce stress tests using either income or value measures. They cover one or more categories of exposures accounted for on an accruals basis or at fair value. We use expert judgement to define appropriate hypothetical stress tests and any adjusting assumptions based on the balance sheet, management actions and customer behaviour.

How we use stress testing
We discuss stress testing results at senior management committees. They affect Corporate Centre's decisions by highlighting possible risks in the banking book and the effectiveness of remedial actions we could take. We compare stress test results with stress limits and triggers set by our internal committees, or against metrics set by the PRA. If the results are over our limits or triggers, we take remedial actions and follow an escalation process.

Risk mitigation (unaudited)
We mitigate Income Statement volatility mainly through hedge accounting. We monitor any hedge accounting ineffectiveness that might lead to Income Statement volatility with a VaR measure and trigger, reported monthly. For our accounting policies for derivatives and hedge accounting, see Note 1 to the Consolidated Financial Statements. We typically hedge the interest rate risk of the securities we hold for liquidity and investment purposes with interest rate swaps, retaining spread and inflation exposures. These retained exposures are the key drivers of the VaR and stress tests we use to assess the risk of the portfolio.

We hedge our foreign currency funding positions back to sterling, so our foreign exchange positions tend to be residual exposures that remain after hedging. These positions could be, for example, to 'spot' foreign exchange rates or to cross currency basis. We monitor foreign exchange risk against absolute net exposures and VaR-based limits and triggers. For more, see 'Our funding strategy and structure' and 'Term issuance' in the 'Liquidity risk' section.

Risk monitoring and reporting (unaudited)
We monitor the banking market risks of the portfolios we hold for liquidity and investment purposes using sensitivities, VaR and stress tests. We report them against limits and triggers to senior management daily and to ALCO and Executive Risk Control Committee monthly. The VaR we report captures all key sources of volatility (including interest rate, inflation and credit spread risks) to fully reflect the potential volatility.

BANKING MARKET RISK REVIEW

2017 compared to 2016 (unaudited)

The movement in NIM sensitivities in 2017 was largely driven by higher levels of the yield curve over the second half of 2017 and the subsequent base rate rise in November 2017. During 2017, we took actions to prepare for the possibility of negative rates in the UK, including a review of our models to ensure they better reflected the risks inherent in the current low rate environment. These changes in our underlying models also contributed to the movements in the year.

The increase in EVE sensitivities in 2017 was mainly due to the same changes in our underlying models. These movements were partially offset by the impact of the Base Rate rise and the increased volume of fixed rate assets left unhedged over the year.

The increase in the basis risk EaR in 2017 was largely due to changes in the underlying net basis position as a result of the continued reduction in SVR mortgages and growth in bank account liability volumes.

The main risk factors of the portfolios of securities held for liquidity and investment purposes remain the inflation and spread risk exposures. The risk of the portfolios decreased in 2017 due to a reduction in the portfolio size as maturities and sales outweighed purchases, in addition to the portfolio rebalancing away from asset classes with relatively higher risk.

Interest rate risk
Yield curve risk
The table below shows how our base case income and valuation would be affected by a 50 basis point parallel shift (both up and down) applied instantaneously to the yield curve at 31 December 2017 and 2016. Sensitivity to parallel shifts represents the amount of risk in a way that we think is both simple and scalable. 50 basis points is the stress we typically focus on for banking market risk controls, although we also monitor sensitivities to other parallel and non-parallel shifts as well as scenarios.

	2017		2016	
	+50bps £m	-50bps £m	+50bps £m	-50bps £m
NIM sensitivity	212	(125)	240	(82)
EVE sensitivity (unaudited)	95	(213)	54	(30)

Basis risk (unaudited)
We report basis risk using the EaR approach.

	2017 £m	2016 £m
Basis risk EaR	24	13

Interest rate repricing gap (unaudited)
The table below shows the interest rate repricing gap of our balance sheet by repricing buckets.

2017	3 months £m	1 year £m	3 years £m	5 years £m	>5 years £m	Not sensitive £m	Total £m
Assets	142,195	34,661	59,253	18,746	15,453	16,782	287,090
Liabilities	178,179	18,003	25,487	17,746	25,559	24,801	289,775
Off-balance sheet	(10,383)	(3,025)	4,364	5,636	6,093	-	2,685
Net gap	(46,367)	13,633	38,130	6,636	(4,013)	(8,019)	-
2016							
Assets	139,262	31,817	54,289	16,883	16,358	17,337	275,946
Liabilities	166,131	20,418	23,231	18,451	25,517	26,000	279,748
Off-balance sheet	(15,463)	7,596	(611)	7,361	4,919	-	3,802
Net gap	(42,332)	18,995	30,447	5,793	(4,240)	(8,663)	-

Inflation and spread risks (unaudited)
The table below shows the risk metrics covering the portfolios of securities held for liquidity and investment purposes.

	2017 £m	2016 £m
VaR	3	5
Worst three month stressed loss	193	280

Liquidity risk

Overview (unaudited)

Liquidity risk is the risk that, while still being solvent, we do not have the liquid financial resources to meet our obligations when they fall due, or we can only obtain them at high cost.

In this section, we describe our sources and uses of liquidity and how we manage liquidity risk. We also analyse our key liquidity metrics, including our Liquidity Coverage Ratio (LCR) and our eligible liquidity pool.

We then explain our funding strategy and structure and we analyse our wholesale funding. Finally, we analyse how we have encumbered some of our assets to support our funding activities.

Key metrics (unaudited)

LCR decreased to 120% (2016: 139%)

Wholesale funding with maturity <1 year down to £14.9bn (2016: £21.4bn)

LCR eligible liquidity pool decreased to £48.5bn (2016: £50.7bn)

OUR KEY LIQUIDITY RISKS (unaudited)

Through our Liquidity Risk Appetite framework, we manage our funding or structural contingent and market liquidity risks wherever they arise. This can be in any of the following areas:

Key risks	*Description*
Retail and corporate deposit outflows	– Outflows if we are seen as more of a credit risk than our peers.
Wholesale secured and unsecured liquidity outflows	– Wholesale unsecured deposits failing to roll over at maturity date. – An inability to replace our wholesale secured funding on maturity.
Off-balance sheet activities	– Collateral outflows if our credit rating was downgraded. This could also lead to higher costs or less capacity to raise funding. – Outflows of collateral we owe but that have not yet been called. – Outflows of collateral due to market movements. – Drawdowns on committed facilities based on facility type, and counterparty type and creditworthiness.
Other risks	– Funding concentrations – outflows against concentrations of wholesale secured funding providers. – Intra-day cash flows – shortfall on the liquidity we need to support intra-day needs. – Intra-group commitments and support – cash in our subsidiaries becoming unavailable to the wider Santander UK group and contingent calls for funding from our subsidiaries and affiliates. – Franchise retention – outflows we need to support our future business and reputation.

Our main sources of liquidity

Customer deposits finance most of our customer lending. Although these funds are mostly callable, they give us a stable and predictable core of funding. This is due to the nature of retail accounts and the breadth of our retail customer relationships.

We have a strong wholesale funding investor base, diversified across product types and geographies. Through the wholesale markets, we have active relationships in many sectors including banks, other financial institutions, corporates and investment funds. We access the wholesale funding markets for subordinated debt, longer-dated senior unsecured debt through Santander UK Group Holdings plc, covered bonds, structured notes, shorter-dated senior unsecured debt and short-term funding. We also access these markets through Abbey National Treasury Services plc for short-term funding, and through securitisations of certain assets. For more on our programmes, see Notes 16, 24 and 25 in the Consolidated Financial Statements.

We generate funding on the strength of our own balance sheet, our own profitability and our own network of investors. We do not rely on a guarantee from Banco Santander SA or any other member of the Banco Santander group. We do not raise funds to finance other members of the Banco Santander group or guarantee their debts, other than some of our own subsidiaries. As we are a PRA-regulated group, we have to meet PRA liquidity needs on a standalone basis. This means we have to prove to the PRA that we can withstand liquidity and capital stress tests. While we manage our funding and liquidity on a standalone basis, we coordinate our issuance plans with Banco Santander where it is appropriate to do. We also comply with rules set by the PRA, other regulators, and Banco Santander standards. While we manage, consolidate and monitor liquidity risk centrally, we also manage and monitor it in the business area it comes from.

Our main uses of liquidity

Our main uses of liquidity are to fund our lending in Retail Banking and Commercial Banking, to pay interest and dividends, and to repay debt. Our ability to pay dividends depends on various factors. These include our regulatory capital needs, the level of our distributable reserves, and our financial performance. We also use liquidity to pay for business combinations.

LIQUIDITY RISK MANAGEMENT

Introduction (unaudited)
We manage liquidity risk on a consolidated basis. We created our governance, oversight and control frameworks, and our LRA, on the same basis. Under this model, and the PRA's liquidity rules, Santander UK plc and its subsidiaries Abbey National Treasury Services plc and Cater Allen Limited form the Domestic Liquidity Sub-group (DoLSub), which allows the entities to collectively meet regulatory requirements. Each member of the DoLSub will support the others by transferring surplus liquidity in times of stress.

Risk appetite
Our LRA statement is based on the principles of liquidity management we use to manage our balance sheet. It also supports our need to meet or exceed the rules of our regulators. In line with our liquidity management principles, we:

- Ensure that all maturing liabilities can be financed as they fall due, including across currencies and on an intraday basis
- Maintain a level of customer loans versus customer deposits that prevents an over-reliance on wholesale markets
- Maintain sufficient capacity to monetise liquid assets and other counterbalancing capacity within an appropriate timeframe
- Avoid an over-reliance on funding from a single product, customer or counterparty
- Fund long-term assets with long-term liabilities
- Maintain sufficient unencumbered customer assets to support current and future funding and collateral requirements, including under stress
- Ensure that liquidity costs and benefits are allocated to business activities from which they arose.

The Board, under advice from the Board Risk Committee, approves our LRA. Our LRA, in the context of our overall Risk Appetite, is reviewed and approved by the Board each year, or more often if needed.

Risk measurement (unaudited)
We use a number of metrics to manage liquidity risk. These include metrics that show the difference between cash and collateral inflows and outflows in different periods. They also include structural metrics, such as our LDR ratio and our level of encumbered assets.

Stress testing
We also have a liquidity stress test framework in place which is central to our LRA measurement and monitoring. It includes three severe but plausible stress test scenarios. To fit with our risk appetite, the liquidity outflows that come from these stress tests must be fully covered with high-quality liquid assets, other liquid assets and management actions sanctioned at the right level of governance. Additionally, a quarterly funding plan disruption stress scenario now forms part of our LRA monitoring.

Our Risk division runs our stress tests. They are:

Test	Description
Our LRA stress	Three stress tests that cover idiosyncratic, market wide and combined scenarios and look at all our risks during these events. We reviewed and revised our LRA stresses in 2017 and updated the previous single stress scenario to these three whilst also calculating the outflows resulting from each and introducing regular funding plan disruption stress tests.
Global economic stress	A stress test that looks at a slowdown in emerging markets which triggers a rapid deterioration in market sentiment globally and reduced confidence in the banking industry. Consumer purchasing power diminishes, resulting in retail and commercial outflows and drawdowns on liquidity facilities.
Acute retail stress	Stress tests that look at a significant event that damages confidence of retail and commercial depositors, causing a material loss of deposits.
Slow retail stress	Stress tests that look at the impact of a gradual prolonged period of loss of retail and commercial deposits and reduced wholesale financing.
Wholesale stress	A stress test that assesses the impact of a significant loss of wholesale market confidence in Santander UK under which wholesale funding is no longer available to us in any currency.
Protracted stress	A 12-month stress with a three-month period of severe liquidity constraint followed by a slow recovery in confidence in a recessionary economic environment.
Severe combined stress	A stress test that looks at a deep and prolonged UK recession which impairs confidence in the UK banking sector, and results in a reduction in wholesale funding availability. Simultaneously Santander UK suffers an idiosyncratic shock leading to retail and commercial outflows.

We also conduct sensitivity analysis and reverse stress testing for instant liquidity shocks by each key liquidity risk. We do this to understand the impacts they would have on our LRA and our regulatory liquidity metrics.

We monitor our LCR to ensure we continue to meet the requirements. Although the Basel Committee published its final Net Stable Funding Ratio (NSFR) standards in October 2014, the NSFR has not yet been implemented within Europe (unlike the LCR). As such there is no formal NSFR requirement applicable to UK or other EU banks until such time as the European Commission adopts appropriate regulatory and technical standards. Nonetheless, we monitor our NSFR on an ongoing basis and stand ready to comply with the standards once agreed.

Risk mitigation (unaudited)
The Board aims to make our balance sheet resilient at all times and for it to be perceived as such by stakeholders. This preserves our short and long-term viability. The Board recognises that as we are involved in maturity transformation, we cannot hold enough liquidity to cover all possible stress scenarios. The Board requires us to hold enough liquidity to make sure we will survive three plausible but severe stress scenarios. We do this by keeping a prudent balance sheet structure and maintaining our approved liquid resources. The three stress scenarios cover a severe idiosyncratic, market wide and combined stress scenario and we hold sufficient liquidity to survive the worst outcome.

Ongoing business management
Within our framework of prudent funding and liquidity management, we manage our activities to minimise our liquidity risk. We have clear responsibilities for short-term funding, medium-term funding, encumbrance, collateral and liquid asset management. This ensures we manage liquidity risks as part of our daily operations, strategy and planning. We distinguish between short-term and strategic activities as follows:

Short-term tactical liquidity management	Description
Liquid resources	We maintain liquid assets, contingent liquidity and defined management actions to source funds. We do this to cover unexpected demands on cash. This is in both a plausible and significant stress scenario and other more distant and severe but less probable scenarios. Our main stress events are large and unexpected deposit withdrawals by retail customers and the loss of unsecured wholesale funding.
Funding profile	We use metrics to help control outflows in different maturities and concentrations.
Intra-day collateral management	We make sure we have enough collateral to support our involvement in payment and settlement systems.

Strategic funding management	Description
Structural balance sheet shape	We manage our maturity transformation, where we invest shorter-term funding in longer-term assets. We also manage our use of wholesale funding for non-marketable assets, and our use of non-marketable assets to generate liquidity.
Wholesale funding strategy	We avoid relying too much on any individual or groups of customer, currency, market or product that might become highly correlated in a time of stress. We also avoid excessive concentrations in the maturity of our wholesale funding.
Wholesale funding capacity	We maintain and promote our client relationships. We also monitor our line availability and maintain our funding capacity by using lines and markets.

We regularly test the liquidity of our eligible liquidity pool, in line with PRA and Basel rules. We do this by realising some of the assets through repurchase or outright sale to the market. We make sure that over any 12-month period we realise a significant part of our eligible liquidity pool. As well as our eligible liquidity pool, we hold a portfolio of unencumbered liquid assets at all times. Our LRA and PRA requirements determine the size and composition of this portfolio. These assets give us a source of contingent liquidity, as we can realise some of them in a time of stress to create liquidity through repurchase or outright sale to the market.

Structure and organisation
Santander UK has a centralised function for the management of funding, liquidity, capital – the CFO Division. The division also manages interest rate risk in our banking book. Under this approach, the CFO Division is responsible for centralising and managing these risks on behalf of Santander UK. A robust Funds Transfer Pricing (FTP) framework is critical to ensure that these risks are appropriately transferred into the CFO Division and that the costs and benefits are then passed back to the business (and ultimately our customers) and to incentivise the right behaviours in the businesses.

The role of the CFO Division is to:
- Manage the provision of funding in order to meet the requirements of business strategy and plans
- Propose the LRA to the Risk Division and Santander UK Board for approval
- Manage the required liquid asset buffer
- Maintain the Santander UK funding plan, ensuring it is compliant with the LRA and regulatory liquidity and capital requirements
- Manage day-to-day operational liquidity and intra-day liquidity risk
- Manage the Santander UK Recovery Plan and from January 2018 the Resolution Plan and operational continuity processes
- Maintain policy and methodology for liquidity and interest rate FTP
- Manage and submit liquidity regulatory reporting.

Recovery and resolution framework
In the event of a liquidity or capital stress, Santander UK has developed a series of actions that would be taken that form part of the Recovery and Resolution Plan. This enables us to respond to a wide variety of stresses, from mild to severe, in a coordinated and efficient manner. The Recovery and Resolution Plan addresses how a capital or liquidity stress would be managed. It would be invoked in response to triggers across a range of metrics falling outside threshold levels, or a qualitative assessment of potential serious risks to our financial position and balance sheet strength. All of these metrics are part of our existing risk management processes. The Recovery and Resolution Plan has two phases with the first invoked as early and proactively as possible in order to mitigate a stress with suitable actions. Phase 2 would be invoked if a stress is severe enough to warrant more significant action.

The Recovery Plan is approved by the Board under advice from the Board Audit Committee and is subject to ongoing review and enhancement.

Risk monitoring and reporting (unaudited)
We monitor liquidity risk daily, weekly and monthly. We do this through different committees and levels of management, including ALCO and the Board Risk Committee.

LIQUIDITY RISK REVIEW (unaudited)

2017 compared to 2016
- Throughout 2017 we maintained robust risk management controls to monitor and manage the levels of our eligible liquidity pool and encumbrance. The LCR decreased to 120% at 31 December 2017 (2016: 139%), reflecting the increased requirements due to EU adoption of Regulatory Technical Standards for assessing additional collateral outflows and efficient liquidity planning. The average LCR was 129%.
- Our LCR eligible liquidity pool significantly exceeded our wholesale funding of less than one year, with a coverage ratio of 326% at 31 December 2017 (2016: 237%), the coverage ratio increased primarily due to lower term funding maturities in 2018, the ratio continues to be volatile due to the management of normal short-term business commitments.
- The reduction in the LRA was due to the increased severity of the stress scenarios and the extended 90 day term of the stress compared to the 60 day term of the 2016 scenario. There is also a new requirement to hold sufficient liquidity to cover the functioning of the notes circulation scheme.

Liquidity Coverage Ratio

This table shows our LCR and LRA at 31 December 2017 and 2016. It reflects the stress testing methodology in place at that time.

	LCR		LRA[1]	
	2017 £bn	2016 £bn	2017 £bn	2016 £bn
Eligible liquidity pool (liquidity value)	**47.4**	50.1	**45.7**	45.2
Net stress outflows	**(39.7)**	(36.0)	**(34.7)**	(27.3)
Surplus	**7.7**	14.1	**11.0**	17.9
Eligible liquidity pool as a percentage of anticipated net cash flows	**120%**	139%	**132%**	166%

(1) The 2016 LRA was a two month stress horizon, the 2017 LRA is a three month requirement based on the running of three stress scenarios.

LCR eligible liquidity pool

This table shows the carrying value and liquidity value of our eligible liquidity pool assets at 31 December 2017 and 2016. It also shows the weighted average carrying value in the year.

	Carrying value		Liquidity value[1]		Weighted average carrying value in the year	
	2017 £bn	2016 £bn	2017 £bn	2016 £bn	2017 £bn	2016 £bn
Cash and balances at central banks	**30.9**	16.0	**30.9**	16.0	**23.6**	19.0
Government bonds	**12.5**	29.5	**12.3**	29.5	**19.6**	18.4
Supranational bonds and multilateral development banks	**1.0**	1.5	**1.0**	1.5	**1.1**	1.4
Covered bonds	**2.7**	2.9	**2.3**	2.6	**2.7**	2.6
Asset-backed securities	**0.6**	0.7	**0.5**	0.5	**0.8**	0.8
Equities	**0.8**	0.1	**0.4**	-	**1.1**	0.5
	48.5	50.7	**47.4**	50.1	**48.9**	42.7

(1) Liquidity value is the carrying value with the applicable LCR haircut applied.

Currency analysis

This table shows the carrying value of our eligible liquidity pool by major currencies at 31 December 2017 and 2016, the composition of the pool is consistent with the currency profile of our net liquidity outflows.

	US Dollar £bn	Euro £bn	Sterling £bn	Other £bn	Total £bn
2017	**9.2**	**1.8**	**36.7**	**0.8**	**48.5**
2016	10.1	2.4	37.6	0.6	50.7

Composition of the eligible liquidity pool

This table shows the allocation of the carrying value of the assets in our eligible liquidity pool for LRA and LCR purposes at 31 December 2017 and 2016.

	2017					2016				
	LCR eligible liquidity pool					LCR eligible liquidity pool				
	Level 1 £bn	Level 2A £bn	Level 2B £bn	Total £bn	Of which LRA eligible £bn	Level 1 £bn	Level 2A £bn	Level 2B £bn	Total £bn	Of which LRA eligible £bn
Cash and balances at central banks	**30.9**	-	-	**30.9**	**30.3**	16.0	-	-	16.0	15.0
Government bonds:										
– AAA to AA-	**11.0**	-	-	**11.0**	**11.0**	28.9	0.2	-	29.1	29.1
– A+ to A	-	**1.5**	-	**1.5**	**1.5**	-	0.4	-	0.4	0.4
Supranational bonds and multilateral development banks:										
– AAA to AA-	**1.0**	-	-	**1.0**	**1.0**	1.5	-	-	1.5	1.5
Covered bonds:										
– AAA to AA-	**1.5**	**1.2**	-	**2.7**	**2.7**	1.7	1.2	-	2.9	2.9
Asset-backed securities:										
– AAA to AA-	-	-	**0.6**	**0.6**	**0.6**	-	-	0.7	0.7	0.3
Equities	-	-	**0.8**	**0.8**	**0.8**	-	-	0.1	0.1	0.1
	44.4	**2.7**	**1.4**	**48.5**	**47.9**	48.1	1.8	0.8	50.7	49.3

FUNDING RISK MANAGEMENT

Funding strategy (unaudited)
Our funding strategy continues to be based on maintaining a conservatively structured balance sheet and diverse sources of funding.

Most of our funding comes from customer deposits. The rest is sourced from a mix of secured and unsecured funding in the wholesale markets. Overall this means that we do not rely too heavily on wholesale funds. This is reflected in our customer LDR ratio which we monitor against budget on a monthly basis. At the same time, it makes sure our sources of funding are not too concentrated on any one product. We have checks and controls to limit our asset encumbrance from our secured funding operations. As part of maintaining a diverse funding base, we raise funding in a number of currencies, including euro, and convert it into sterling through currency swaps to fund our commercial assets which are largely sterling denominated.

Our base of stable retail and corporate deposits is a key funding source for us. We leverage our large and diverse customer base to offer products that give us a long-term sustainable source of funding. We do this by focusing on building long-term relationships. Around 90% of our total core retail customer liabilities are covered by the Financial Services Compensation Scheme (the FSCS).

Behavioural maturities
The contractual maturity of balance sheet assets and liabilities highlights the maturity transformation that underpins the role of banks to lend long term, but to fund themselves mainly with shorter-term liabilities, like customer deposits.

We achieve this by diversifying our funding operations across a wide customer base, both in numbers and by type of depositor. In practice, the behavioural profiles of many liabilities show more stability and longer maturity than the contractual maturity. This is especially true of many types of retail and corporate deposits that, while they may be repayable on demand or at short notice, have shown good stability even in times of stress.

We model behaviour profiles using our experience of customer behaviour. We use this data to determine the funds transfer pricing interest rates at which we reward and charge our business units for sources and uses of funds. We apply this rate until a customer changes onto a different product or service offered by us or by one of our competitors.

We continue to improve the quality of our retail, commercial and wholesale deposits. Across all customer segments, we aim to deepen our customer relationships. We do this to lengthen the contractual and behavioural profile of our liability base. In Retail Banking, we support this aim with attractive products such as the 1I2I3 World offering.

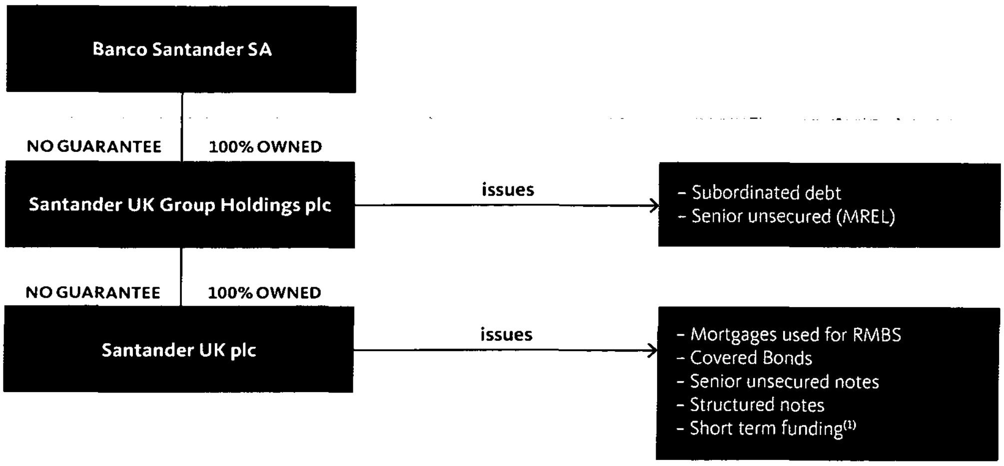
Deposit funding
Our Retail Banking and Commercial Banking activities are mainly funded by customer deposits. The rest is funded through wholesale markets.

Wholesale funding
Wholesale funding and issuance model (unaudited)
Banco Santander is a multiple point of entry resolution group. This means that should it fail, it would be split up into parts. Healthy parts might be sold or be kept as a residual group without their distressed sister companies. The resolution or recapitalisation of the distressed parts might be effected via 'bail in' of bonds that had been issued to the market by a regional intermediate holding company.

Santander UK is a single point of entry resolution group. This means that resolution would work downwards from the group's holding company (i.e. Santander UK Group Holdings plc). Losses in subsidiaries would first be transferred up to Santander UK Group Holdings plc. If the holding company is bankrupt as a result, the group needs resolving. The 'bail in' tool is applied to the holding company, with the equity being written off and bonds converted into equity as necessary to recapitalise the group. Those bondholders would become the new owners, and the group would stay together.

Santander UK Group Holdings plc is the immediate holding company of Santander UK plc, which in turn is the immediate parent company of Abbey National Treasury Services plc. This structure is a Bank of England recommended configuration which aims to resolve banks without disrupting the activities of their operating companies, thereby maintaining continuity of services for customers.

Our current structure is:



(1) Short-term funding is in the process of being transferred from Abbey National Treasury Services plc to Santander UK plc.

Composition of wholesale funding (unaudited)

We are active in the wholesale markets and we have direct access to both money market and long-term investors through our funding programmes. This makes our wholesale funding well diversified by product, maturity, geography and currency. This includes currencies available across a range of channels from money markets, repo markets, senior unsecured, secured, medium-term and subordinated debt. Details of our main programmes are available in the Funding Information section of our website www.santander.co.uk/uk/about-santander-uk/investor-relations/funding-information.

As part of our ring-fencing plan, Santander UK plc is now our main operating company issuer of senior unsecured debt and covered bonds. Santander UK Group Holdings plc is the issuer of subordinated debt and Minimum Requirement for Own Funds and Eligible Liabilities (MREL)/Total Loss Absorbing Capacity (TLAC) eligible senior unsecured debt. For more on our ring-fencing plan see Note 39.

We also have access to the UK Government schemes set out below. For each scheme, eligible collateral includes all collateral that is eligible in the Bank of England's Discount Window Facility. We ensure that sufficient collateral is placed and available at the Discount Window.

Scheme	Description
Discount Window Facility (DWF)	The DWF is a bilateral on-demand service for firms experiencing either a firm-specific or market-wide shock. It allows firms to borrow highly liquid assets in return for less liquid collateral. This lending can be large in size and for a variable term.
Term Funding Scheme (TFS)	The TFS aims to reinforce the transmission of Base Rate cuts to the interest rates actually faced by households and businesses by providing term funding to banks at rates close to Base Rate. The TFS allows participants to borrow central bank reserves in exchange for eligible collateral. It links the price and quantity of funding to net lending to UK households, the non-financial sector and non-bank credit providers over a specified period.
Funding for Lending Scheme (FLS)	The FLS is designed to boost lending to UK households and non-financial companies. It does this by giving funding to banks and building societies for an extended period – it links both the price and quantity of funding to the net UK non-financial sector lending over a specified period. The FLS lets participants borrow UK Treasury bills in exchange for eligible collateral in a drawdown window. The FLS was closed on 31 January 2018.
Contingent Term Repo Facility (CTRF)	The CTRF will be activated by the Bank of England in response to actual or prospective market-wide stress. It gives short-term liquidity to the market through monthly auctions using eligible collateral as security.
Indexed Long-Term Repo (ILTR)	The ILTR is aimed at banks, building societies and broker-dealers with a predictable need for liquid assets. The Bank of England offers funds via an ILTR operation once each calendar month, normally with a six-month maturity. Participants can borrow using eligible collateral as security.

FUNDING RISK REVIEW

2017 compared to 2016 (unaudited)

- Together with our immediate parent, Santander UK Group Holdings plc, our overall funding strategy remains to develop and sustain a diversified funding base. We also need to fulfil regulatory requirements as well as support our credit ratings. 2017 presented a positive market environment for issuance despite the continuing backdrop of global geo-political tensions and other political issues causing intermittent volatility. Despite concerns around political events such as the French and UK elections and the ongoing negotiation of the UK's exit from the EU, the market remained open and offered excellent funding opportunities across all asset classes and currencies, allowing issuers to fund themselves in the wholesale markets at the lowest levels since the financial crisis. Equities also proved resilient and ended the year at record highs. In April 2017, we took advantage of the strong risk appetite for higher risk products and issued £500m Perpetual Capital Securities to our immediate parent, Santander UK Group Holdings plc.
- In 2017, medium term funding balances were lower with TFS drawdown replacing some of our matured funding. Our total term funding was £11.8bn (2016: £12.9bn), of which £0.5bn (2016: £nil) was capital issuance, £7.3bn (2016: £8.4bn) was medium-term issuance and £4.0bn (2016: £4.5bn) was TFS.
- The £7.3bn medium-term funding included £2.1bn of downstreamed funding from issuances by our immediate parent (this is currently in the form of loans that rank pari passu with our existing senior unsecured liabilities), £1.2bn of senior unsecured notes from the Company, £2.3bn of covered bonds and £1.7bn of securitisations.
- Maturities in 2017 were £13.1bn (2016: £13.5bn). At 31 December 2017, 75% (2016: 67%) of wholesale funding had a maturity of greater than one year, with an overall residual duration of 43 months (2016: 41 months). The total drawdown outstanding from the TFS was £8.5bn (2016: £4.5bn) and the total drawdowns of UK Treasury Bills under the FLS remained at £3.2bn (2016 £3.2bn).
- Our level of encumbrance from external and internal issuance of securitisations and covered bonds decreased in 2017, as planned. This reflected greater maturities than new issues in the period. We expect our overall level of encumbrance to remain broadly static in 2018.

Reconciliation of wholesale funding to the balance sheet

This table reconciles our wholesale funding to our balance sheet at 31 December 2017 and 2016.

		Balance sheet line item						
2017	**Funding analysis £bn**	**Deposits by banks £bn**	**Deposits by customers[1] £bn**	**Trading liabilities £bn**	**Financial liabilities designated at fair value £bn**	**Debt securities in issue £bn**	**Subordinated liabilities £bn**	**Other equity instruments[2] £bn**
Deposits	**0.3**	**0.2**	–	–	**0.1**	–	–	–
Certificates of deposit and commercial paper	**8.0**	–	–	–	**0.4**	**7.6**	–	–
Senior unsecured – public benchmark	**17.8**	–	**6.0**	–	–	**11.8**	–	–
– privately placed	**3.1**	–	–	–	**1.1**	**2.0**	–	–
Covered bonds	**14.2**	–	–	–	–	**14.2**	–	–
Securitisation and structured issuance	**5.5**	**1.0[3]**	**0.5**	–	–	**4.0**	–	–
Term Funding Scheme	**8.5**	**8.5**	–	–	–	–	–	–
Subordinated liabilities and equity	**5.5**	–	–	–	–	–	**3.2**	**2.3**
Total wholesale funding	**62.9**	**9.7**	**6.5**	–	**1.6**	**39.6**	**3.2**	**2.3**
Repos	**25.6**	**0.1**	–	**25.5**	–	–	–	–
Foreign exchange and hedge accounting	**3.9**	–	**0.3**	–	–	**3.0**	**0.6**	–
Other	**10.3**	**4.0[3]**	–	**5.6[4]**	**0.7**	–	–	–
Balance sheet total	**102.7**	**13.8**	**6.8**	**31.1**	**2.3**	**42.6**	**3.8**	**2.3**

2016								
Deposits by banks	0.7	0.3	–	0.4	–	–	–	–
Certificates of deposit and commercial paper	8.4	–	–	–	0.5	7.9	–	–
Senior unsecured – public benchmark	16.7	–	4.1	–	–	12.6	–	–
– privately placed	4.9	–	–	–	1.4	3.5	–	–
Covered bonds	15.2	–	–	–	–	15.2	–	–
Securitisation and structured issuance	9.6	2.1[3]	0.5	–	–	7.0	–	–
Term Funding Scheme	4.5	4.5	–	–	–	–	–	–
Subordinated liabilities and equity	5.2	–	–	–	–	–	3.4	1.8
Total wholesale funding	65.2	6.9	4.6	0.4	1.9	46.2	3.4	1.8
Repos	8.8	–	–	8.8	–	–	–	–
Foreign exchange and hedge accounting	5.4	–	0.4	–	–	4.1	0.9	–
Other	9.8	2.9[3]	–	6.4[4]	0.5	–	–	–
Balance sheet total	89.2	9.8	5.0	15.6	2.4	50.3	4.3	1.8

(1) This is included in our balance sheet total of £183,648m (2016: £177,172m).
(2) This is £14m (2016: £14m) fixed/floating rate non-cumulative callable preference shares, £235m (2016: £235m) Step-up Callable Perpetual Reserve Capital Instruments and £2,046m (2016: £1,550m) Perpetual Capital Securities. See Note 31 to the Consolidated Financial Statements.
(3) Securitisation and structured issuance comprise of repurchase agreements. Other comprises of items in the course of transmission and other deposits, excluding the Term Funding Scheme. See Note 21 to the Consolidated Financial Statements.
(4) Short positions in securities and unsettled trades, cash collateral and short-term deposits. See Note 23 to the Consolidated Financial Statements.

Maturity profile of wholesale funding

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

2017	<=1 month £bn	>1 and <=3 months £bn	>3 and <= 6 months £bn	>6 and <=9 months £bn	>9 and <=12 months £bn	Sub-total <=1 year £bn	>1 and <=2 years £bn	>2 and <=5 years £bn	>5 years £bn	Total £bn
Downstreamed from Santander UK Group Holdings plc to Santander UK plc[1]										
Senior unsecured – public benchmark	–	–	–	–	–	–	–	3.8	2.1	5.9
– privately placed	–	–	–	–	–	–	–	–	0.1	0.1
Subordinated liabilities and equity (incl. AT1)	–	–	–	–	–	–	0.8	0.8	1.4	3.0
	–	–	–	–	–	–	0.8	4.6	3.6	9.0
Other Santander UK plc										
Deposits by banks	–	0.1	–	–	–	0.1	–	–	–	0.1
Certificates of deposit and commercial paper	0.2	0.6	0.6	0.1	0.1	1.6	–	–	–	1.6
Senior unsecured – public benchmark	0.8	–	–	1.3	–	2.1	2.9	5.4	1.5	11.9
– privately placed	–	0.7	–	–	–	0.7	1.3	0.6	0.4	3.0
Covered bonds	0.9	–	1.0	–	–	1.9	1.3	7.7	3.3	14.2
Securitisation and structured issuance[2]	–	–	0.4	–	0.9	1.3	0.6	1.2	0.1	3.2
Term Funding Scheme	–	–	–	–	–	–	–	8.5	–	8.5
Subordinated liabilities	0.1	–	–	–	0.1	0.2	–	–	2.3	2.5
	2.0	1.4	2.0	1.4	1.1	7.9	6.1	23.4	7.6	45.0
Other group entities										
Deposits by banks	0.1	0.1	–	–	–	0.2	–	–	–	0.2
Certificates of deposit and commercial paper	2.7	2.4	1.3	–	–	6.4	–	–	–	6.4
Securitisation and structured issuance[3]	–	–	–	–	0.4	0.4	1.0	0.9	–	2.3
	2.8	2.5	1.3	–	0.4	7.0	1.0	0.9	–	8.9
Total	4.8	3.9	3.3	1.4	1.5	14.9	7.9	28.9	11.2	62.9
Of which:										
– Secured	0.9	–	1.4	–	1.3	3.6	2.9	18.3	3.4	28.2
– Unsecured	3.9	3.9	1.9	1.4	0.2	11.3	5.0	10.6	7.8	34.7
	4.8	3.9	3.3	1.4	1.5	14.9	7.9	28.9	11.2	62.9

2016	<=1 month £bn	>1 and <=3 months £bn	>3 and <= 6 months £bn	>6 and <=9 months £bn	>9 and <=12 months £bn	Sub-total <=1 year £bn	>1 and <=2 years £bn	>2 and <=5 years £bn	>5 years £bn	Total £bn
Downstreamed from Santander UK Group Holdings plc to Santander UK plc[1]										
Senior unsecured – public benchmark	–	–	–	–	–	–	–	2.7	1.3	4.0
– privately placed	–	–	–	–	–	–	–	–	0.1	0.1
Subordinated liabilities and equity (incl. AT1)	–	–	–	–	–	–	–	0.8	1.7	2.5
	–	–	–	–	–	–	–	3.5	3.1	6.6
Other Santander UK plc										
Deposits by banks	0.1	–	–	–	–	0.1	–	–	–	0.1
Senior unsecured – public benchmark	–	0.9	–	0.9	–	1.8	2.1	6.7	2.1	12.7
– privately placed	0.9	–	–	0.4	0.2	1.5	0.6	1.4	0.2	3.7
Covered bonds	1.0	–	0.8	–	1.4	3.2	1.8	6.1	4.1	15.2
Securitisation and structured issuance[2]	0.8	0.3	1.1	1.4	0.9	4.5	1.3	0.7	0.6	7.1
Term funding scheme	–	–	–	–	–	–	–	4.5	–	4.5
Subordinated liabilities	0.1	–	–	–	–	0.1	0.2	0.2	2.2	2.7
	2.9	1.2	1.9	2.7	2.5	11.2	6.0	19.6	9.2	46.0
Other group entities										
Deposits by banks	0.4	–	–	0.2	–	0.6	–	–	–	0.6
Certificates of deposit and commercial paper	2.9	3.1	1.3	0.7	0.4	8.4	–	–	–	8.4
Senior unsecured – privately placed	–	–	–	–	–	–	0.1	0.5	0.5	1.1
Securitisation and structured issuance[3]	0.3	0.3	0.2	0.2	0.2	1.2	0.9	0.4	–	2.5
	3.6	3.4	1.5	1.1	0.6	10.2	1.0	0.9	0.5	12.6
Total	6.5	4.6	3.4	3.8	3.1	21.4	7.0	24.0	12.8	65.2
Of which:										
– Secured	2.1	0.6	2.1	1.6	2.5	8.9	4.0	11.7	4.7	29.3
– Unsecured	4.4	4.0	1.3	2.2	0.6	12.5	3.0	12.3	8.1	35.9
	6.5	4.6	3.4	3.8	3.1	21.4	7.0	24.0	12.8	65.2

(1) Currently all our senior debt issued out of Santander UK Group Holdings plc is downstreamed into Santander UK plc on an equivalent rankings basis (e.g. senior unsecured is downstreamed as senior unsecured, subordinated capital instruments are downstreamed as subordinated capital instruments, etc.). However, under the end-state MREL/TLAC regime, senior unsecured debt issued out of Santander UK Group Holdings plc will be downstreamed in a form that is subordinated to senior unsecured debt, but senior to subordinated capital instruments issued out of Santander UK plc.
(2) This includes funding from mortgage-backed securitisation vehicles where Santander UK plc is the asset originator.
(3) This includes funding from asset-backed securitisation vehicles where entities other than Santander UK plc are the asset originator.

Currency composition of wholesale funds

This table shows our wholesale funding by major currency at 31 December 2017 and 2016.

	2017				2016			
	Sterling %	US Dollar %	Euro %	Other %	Sterling %	US Dollar %	Euro %	Other %
Downstreamed from Santander UK Group Holdings plc to Santander UK plc								
Senior unsecured – public benchmark	**9**	**67**	**22**	**2**	12	63	21	4
– privately placed	**–**	**–**	**–**	**100**	–	–	–	100
Subordinated liabilities and equity (incl. AT1)	**68**	**32**	**–**	**–**	61	39	–	–
	28	**54**	**14**	**4**	31	53	13	3
Other Santander UK plc								
Deposits by banks	**27**	**73**	**–**	**–**	33	67	–	–
Certificates of deposit and commercial paper	**89**	**10**	**–**	**1**				
Senior unsecured – public benchmark	**9**	**49**	**42**	**–**	12	49	39	–
– privately placed	**7**	**19**	**70**	**4**	3	1	93	3
Covered bonds	**47**	**–**	**52**	**1**	41	–	58	1
Securitisation and structured issuance	**80**	**20**	**–**	**–**	59	29	12	–
Term Funding Scheme	**100**	**–**	**–**	**–**	100	–	–	–
Subordinated liabilities	**52**	**48**	**–**	**–**	55	45	–	–
	49	**19**	**32**	**–**	39	21	39	1
Other group entities								
Deposits by banks	**–**	**100**	**–**	**–**	7	93	–	–
Certificates of deposit and commercial paper	**34**	**65**	**1**	**–**	31	68	1	–
Senior unsecured – privately placed	**–**	**–**	**–**	**–**	22	59	19	–
Securitisation and structured issuance	**91**	**–**	**9**	**–**	87	5	8	–
	47	**50**	**3**	**–**	41	55	4	–
Total	**45**	**28**	**25**	**2**	39	30	30	1

Term issuance

In 2017, our external term issuance (sterling equivalent) was:

	Sterling £bn	US Dollar £bn	Euro £bn	Other £bn	Total 2017 £bn	Total 2016 £bn
Downstreamed from Santander UK Group Holdings plc to Santander UK plc						
Senior unsecured – public benchmark	**–**	**1.6**	**0.4**	**–**	**2.0**	3.1
– privately placed	**–**	**–**	**–**	**0.1**	**0.1**	0.1
Subordinated debt and equity (incl. AT1)	**0.5**	**–**	**–**	**–**	**0.5**	–
	0.5	**1.6**	**0.4**	**0.1**	**2.6**	3.2
Other Santander UK plc						
Securitisations	**0.5**	**–**	**–**	**–**	**0.5**	0.6
Covered bonds	**2.3**	**–**	**–**	**–**	**2.3**	0.6
Senior unsecured – public benchmark	**–**	**1.1**	**–**	**–**	**1.1**	–
– privately placed	**0.1**	**–**	**–**	**–**	**0.1**	–
Term Funding Scheme	**4.0**	**–**	**–**	**–**	**4.0**	4.5
	6.9	**1.1**	**–**	**–**	**8.0**	5.7
Other group entities						
Securitisations	**0.9**	**0.3**	**–**	**–**	**1.2**	0.8
Covered bonds	**–**	**–**	**–**	**–**	**–**	0.8
Senior unsecured – public benchmark	**–**	**–**	**–**	**–**	**–**	1.4
– privately placed	**–**	**–**	**–**	**–**	**–**	1.0
	0.9	**0.3**	**–**	**–**	**1.2**	4.0
Total gross issuances	**8.3**	**3.0**	**0.4**	**0.1**	**11.8**	12.9

Encumbrance (unaudited)
We have encumbered an asset if we have pledged it as collateral against an existing liability. This means it is no longer available to secure funding, meet our collateral needs or be sold to reduce future funding needs.

Being able to pledge assets as collateral is an integral part of a financial institution's operations. It includes asset securitisation or related structured funding, pledging collateral to support using payment or settlement systems and entering into derivatives, securities repurchase agreements and securities borrowing arrangements.

We do various things that lead to asset encumbrance. These include where we:

- Enter into securitisation, covered bonds, and repurchase agreements (including central bank programmes) to access medium and long-term funding
- Enter into short-term funding transactions. These include repurchase agreements, reverse repurchase agreements and stock borrowing transactions as part of our operational liquidity management
- Participate in payment and settlement systems
- Post collateral as part of derivatives activity.

We monitor our mix of secured and unsecured funding sources in our funding plan. We aim to use our available collateral efficiently to raise secured funding and to meet our other collateralised obligations.

Our biggest source of encumbrance is where we use our mortgage portfolio to raise funds through securitisation, covered bonds or other structured borrowing. We control our levels of encumbrance from these by setting a minimum level of unencumbered assets that must be available after we factor in our future funding plans, whether we can use our assets for our future collateral needs, the impact of a possible stress and our current level of encumbrance.

On-balance sheet encumbered and unencumbered assets

	Assets encumbered as a result of transactions with counterparties other than central banks				Other assets (assets encumbered at the central bank and unencumbered assets)					
					Assets positioned at the central bank (i.e. pre-positioned plus encumbered)	Assets not positioned at the central bank				
2017	As a result of covered bonds £m	As a result of securitisations £m	Other £m	Total £m	£m	Readily available for encumbrance £m	Other assets capable of being encumbered £m	Cannot be encumbered £m	Total £m	Total assets £m
Cash and balances at central banks(1)(2)	–	–	1,010	1,010	395	31,366	–	–	31,761	32,771
Trading assets	–	–	17,092	17,092	–	903	12,560	–	13,463	30,555
Derivative financial instruments	–	–	–	–	–	–	–	19,942	19,942	19,942
Financial assets designated at fair value	–	–	–	–	–	1,405	691	–	2,096	2,096
Loans and advances to banks	–	–	105	105	–	935	4,887	–	5,822	5,927
Loans and advances to customers	18,891	16,530	31	35,452	57,644	64,412	20,459	21,523	164,038	199,490
Financial investments	–	–	6,755	6,755	–	10,856	–	–	10,856	17,611
Interests in other entities	–	–	–	–	–	–	–	73	73	73
Intangible assets	–	–	–	–	–	–	–	1,742	1,742	1,742
Property, plant and equipment	–	–	–	–	–	–	1,598	–	1,598	1,598
Retirement benefit assets	–	–	–	–	–	–	–	449	449	449
Other assets	–	–	–	–	–	–	–	2,511	2,511	2,511
Total assets	**18,891**	**16,530**	**24,993**	**60,414**	**58,039**	**109,877**	**40,195**	**46,240**	**254,351**	**314,765**
2016										
Cash and balances at central banks(1)(2)	–	–	600	600	370	16,137	–	–	16,507	17,107
Trading assets	–	–	13,582	13,582	–	2,807	13,646	–	16,453	30,035
Derivative financial instruments	–	–	–	–	–	–	–	25,471	25,471	25,471
Financial assets designated at fair value	–	–	–	–	–	1,463	677	–	2,140	2,140
Loans and advances to banks	–	–	115	115	–	1,030	3,203	–	4,233	4,348
Loans and advances to customers	20,234	19,996	25	40,255	23,801	96,741	18,137	20,804	159,483	199,738
Financial investments	–	–	2,684	2,684	–	14,782	–	–	14,782	17,466
Interests in other entities	–	–	–	–	–	–	–	61	61	61
Intangible assets(3)	–	–	–	–	–	–	–	1,685	1,685	1,685
Property, plant and equipment	–	–	–	–	–	–	1,491	–	1,491	1,491
Retirement benefit assets	–	–	–	–	–	–	–	398	398	398
Other assets	–	–	–	–	–	–	–	2,571	2,571	2,571
Total assets	20,234	19,996	17,006	57,236	24,171	132,960	37,154	50,990	245,275	302,511

(1) Encumbered cash and balances at central banks include minimum cash balances we have to hold at central banks for regulatory purposes.
(2) Readily realisable cash and balances at central banks are amounts held at central banks as part of our liquidity management activities.
(3) Restated to reflect the change in accounting policy relating to business combinations between entities under common control, as described in Note 1 to the Consolidated Financial Statements.

Assets encumbered as a result of transactions with counterparties other than central banks mainly relate to funding we had secured against our loans and advances to customers. It also includes cash collateral in trading assets that we posted to meet margin needs on derivatives.

Other assets classified as readily available for encumbrance include cash and securities we hold in our eligible liquidity pool. They also include other unencumbered assets that give us a source of contingent liquidity. We do not rely on these extra unencumbered assets in our LRA, but we might use some of them in a time of stress. We can create liquidity by using them as collateral for secured funding or through outright sale.

Other assets that are not classified as readily available for encumbrance are mainly derivatives and loans and advances to customers and banks.

Loans and advances to customers are only classified as readily available for encumbrance if they are already in a form we can use to raise funding without any other actions on our part. This includes excess collateral that is already in a secured funding structure. It also includes collateral that is pre-positioned at central banks and is available for use in secured financing.

All other loans and advances are classified as not readily available for encumbrance, but some would still be suitable for use in secured funding structures.

Encumbrance of customer loans and advances
We have issued prime retail mortgage-backed and other asset-backed securitised products to a diverse investor base through our mortgage-backed and other asset-backed funding programmes.

We have raised funding with:

- Mortgage-backed notes, both issued to third parties and retained – the latter being central bank eligible collateral for funding purposes in other Bank of England facilities
- Other asset-backed notes.

We also have a covered bond programme. Under this, we issue securities to investors secured by a pool of residential mortgages.

For more on how we have issued notes from our secured programmes externally and also retained them, and what we have used them for, see Notes 16 and 33 to the Consolidated Financial Statements.

CREDIT RATINGS (unaudited)

2017 compared to 2016
In August 2017, Moody's affirmed the long-term ratings for Santander UK plc and Santander UK Group Holdings plc, with the outlook for both changed from negative to stable. Additionally, in October 2017, Fitch improved the outlook of Santander UK plc to Rating Watch Positive (RWP), reflecting their expectation that senior unsecured debt will be down-streamed from Santander UK Group Holdings plc in the next 12 months. Furthermore, in November 2017, S&P improved the outlook of Santander UK plc from negative to stable, as a result of the UK banking sectors' increased earnings resilience and progress towards end-state regulatory requirements.

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

	Standard & Poor's	Fitch	Moody's
2017			
Senior unsecured	**A**	**A**	**Aa3**
Outlook	**Stable**	**RWP**	**Stable**
Short-term	**A-1**	**F-1**	**P-1**
Standalone	**bbb+**	**a**	**a3**

Contractual credit rating downgrade exposure (cumulative cash flow)
This table shows the cumulative cash outflows of Santander UK plc due to a credit rating downgrade.

	2017		2016	
	One-notch downgrade £bn	**Two-notch downgrade £bn**	One-notch downgrade £bn	Two-notch downgrade £bn
Securitisation derivatives	**2.3**	**2.3**	3.3	3.4
Contingent liabilities and derivatives margining	**1.6**	**1.8**	1.3	1.6
Total contractual funding or margin requirements	**3.9**	**4.1**	4.6	5.0

Capital risk

Overview (unaudited)

Capital risk is the risk that we do not have an adequate amount or quality of capital to meet our internal business needs, regulatory requirements and market expectations, including dividend and AT1 distributions.

In this section, we set out how we are regulated by the PRA (as a UK banking group) and the European Central Bank (ECB) as a member of the Banco Santander group. We also give details of the Bank of England's 2017 stress testing exercise and an update on emerging rules.

We explain how we manage capital on a standalone basis as a subsidiary in the Banco Santander group.

We then analyse our capital resources and key capital ratios.

Key metrics (unaudited)

CET1 capital ratio of 12.2% (2016: 11.6%)

Total capital resources increased to £17.1bn (2016: £16.2 bn)

THE SCOPE OF OUR CAPITAL ADEQUACY

Regulatory supervision
Santander UK plc is incorporated in the UK. For capital purposes, we are subject to prudential supervision by the:

- **PRA:** as a UK banking group
- **ECB:** as a member of the Banco Santander group. The ECB supervises Banco Santander as part of the Single Supervisory Mechanism (SSM).

Although we are part of the Banco Santander group, we do not have a guarantee from our ultimate parent Banco Santander SA and we operate as an autonomous subsidiary. As we are regulated by the PRA, we have to meet the PRA capital requirements on a standalone basis. We also have to show the PRA that we can withstand capital stress tests without the support of our parent. Reinforcing our corporate governance framework, the PRA exercises oversight through its rules and regulations on the Board and senior management appointments.

Santander UK Group Holdings plc is the holding company of Santander UK plc and is the head of the Santander UK group for regulatory capital and leverage purposes. The basis of consolidation for our capital disclosures is the same one we use for our Consolidated Financial Statements.

CAPITAL RISK MANAGEMENT

The Board is responsible for capital management strategy and policy and ensuring that our capital resources are monitored and controlled within regulatory and internal limits. We manage our funding and maintain capital adequacy on a standalone basis. We operate within the capital risk framework and appetite approved by our Board. This takes into account the commercial environment we operate in, our strategy for each of our material risks and the potential impact of any adverse scenarios or stresses on our capital position.

Management of capital requirements
Our capital risk appetite aims to maintain capital levels appropriate to the level of stress applied, and the expected regulatory response.

- In an adverse economic stress, which we might expect to occur once in 20 years, the firm should maintain an economic capital surplus, and should exceed all regulatory capital minimum criteria at all times
- In a very severe economic stress, which we might expect to occur once in 100 years, and which has been designed to test any specific weaknesses of a firm's business model, the firm should maintain an economic capital surplus, and should meet all regulatory minimums at all times. This is subject to the use of regulatory buffers designed for such a stress.

Management of capital resources
We use a mix of regulatory and economic capital ratios and limits, internal buffers and restrictions to manage our capital resources. We also take account of the costs of differing capital instruments and capital management techniques. We also use these to shape the best structure for our capital needs.

We decide how to allocate our capital resources as part of our strategic planning process. We base this in part on the relative returns on capital using both economic and regulatory capital measures.

We plan for severe stresses and we set out what action we would take if an extremely severe stress threatened our viability and solvency. This could include not paying dividends, selling assets, reducing our business and issuing more capital.

Risk measurement
We apply Banco Santander SA's approach to capital measurement and risk management for CRD IV. As a result, Santander UK plc is classified as a significant subsidiary of Banco Santander SA. For more on the CRD IV risk measurement of our exposures, see Banco Santander SA's Pillar 3 report.

Key metrics (unaudited)
The main metrics we use to measure capital risk are:

Key risk metrics	Description
CET1 capital ratio	CET1 capital as a percentage of RWAs.
Total capital ratio	CRD IV end-point Tier 1 capital divided by RWAs.

Stress testing (unaudited)
Each year we create a capital plan, as part of our ICAAP. We also develop a series of macroeconomic scenarios to stress test our capital needs, and confirm that we have enough regulatory capital to meet our projected and stressed capital needs and to meet our obligations as they fall due. We augment our regulatory minimum capital with internally assigned buffers. We hold buffers to ensure we have enough time to take action against unexpected movements.

Risk mitigation
We have designed our capital risk framework, policies and procedures to ensure that we operate within our risk appetite.

We manage capital transferability between our subsidiaries in line with our business strategy, our risk and capital management policies, and UK laws and regulations. There are no legal restrictions on us moving capital resources promptly, or repaying liabilities, between the Company and its subsidiaries.

Santander UK plc, Abbey National Treasury Services plc, and Cater Allen Limited, which are the three PRA-regulated entities in the Santander UK group, are party to a capital support deed dated 23 December 2015 (the Capital Support Deed) with certain other non-regulated subsidiaries of Santander UK plc and Santander UK Group Holdings plc. The parties to the Capital Support Deed form a core UK group as defined in the PRA Rulebook. Exposures of each of the three regulated entities to other members of the core UK group are exempt from large exposure limits that would otherwise apply. The purpose of the Capital Support Deed is to support the prompt transfer of available capital resources from, or repayment of liabilities by, the non-regulated parties to any of the regulated parties in the event that one of the regulated parties has breached or is at risk of breaching its capital resources requirements or risk concentrations requirements. The core UK group permission expires on 31 December 2018.

Risk monitoring and reporting
We monitor and report regularly against our capital plan. We do this to identify any change in business performance that might affect our capital. Every month, we also review the economic assumptions we use to create and stress test our capital plan. We do this to identify any potential reduction in our capital.

CAPITAL RISK REVIEW

2017 compared to 2016 (unaudited)

Our CET1 capital ratio improved 60bps to 12.2% at 31 December 2017 (2016: 11.6%), reflecting higher CET1 capital from steady profits and lower RWAs. Our total capital ratio increased to 19.7% at 31 December 2017 (2016: 18.5%), with higher CET1 and AT1 capital.

Bank of England stress testing

The latest PRA stress test results were released on 28 November 2017. We significantly exceeded the PRA's stress test CET1 capital ratio threshold requirement of 7.6%, with a stressed CET1 capital ratio of 9.6%, before management actions and 9.7% after allowed management actions. We also exceeded the leverage threshold requirement of 3.25%, with a stressed leverage ratio of 3.3%. Once again, we had the lowest stressed CET1 drawdown of all the participating UK banks, demonstrating the resilience of our balance sheet and predictable medium-low risk profile.

The Bank of England's CET1 hurdle rate comprises the CRR Pillar 1 minimum of 4.5% and the Pillar 2A CET1 minimum of 3.1%. The minimum came into effect on 1 January 2018 and represents an increase of 0.3 percentage points over the previous Pillar 2A CET1 minimum of 2.8%, which was applicable until 31 December 2017.

Our plans for 2018 include a number of refinements to our regulatory capital models in response to supervisory recommendations and consultations. The FPC announced an increase in the countercyclical buffer from 0% to 1%. IFRS 9 was implemented from 1 January 2018, changing the way in which we raise loan loss provisions, and has the potential to make regulatory stress testing results far more pro-cyclical than the current approach. We are engaging with the PRA regarding disclosures and the need to recalibrate capital requirements as a result of this change in approach. The estimated impact of IFRS 9 on the CET1 capital ratio is 8bps before the application of any regulatory transitional arrangements which the Santander UK group will adopt and which is expected to reduce the amount impacting the CET1 capital ratio in 2018. As a result, the adoption of IFRS 9 is not expected to have a material impact on the Santander UK group's capital position.

Key capital ratios (unaudited)

	2017 %	2016 %
CET1 capital ratio	**12.2**	11.6
AT1	**2.4**	1.8
Grandfathered Tier 1	**0.8**	0.8
Tier 2	**4.3**	4.3
Total capital ratio	**19.7**	18.5

The total subordination available to Santander UK plc bondholders was 19.7% (2016: 18.5%) of RWAs.

Regulatory capital resources

This table shows our regulatory capital.

	2017 £m	2016 £m
CET1 capital	**10,620**	10,201
AT1 capital	**2,762**	2,271
Tier 1 capital	**13,382**	12,472
Tier 2 capital	**3,741**	3,772
Total regulatory capital	**17,123**	16,244

AT1 capital

These are preference shares and innovative/hybrid Tier 1 securities. None of the instruments we issued before 1 January 2014 fully meet the CRD IV AT1 capital rules, which apply from that date. These instruments will be phased out by CRD IV rules which restrict their recognition as capital. The £750m Perpetual Capital Securities (net of issuance costs), the £800m Perpetual Capital Securities and the £500m Perpetual Capital Securities we issued since then fully meet the CRD IV AT1 capital rules.

Tier 2 capital

These are fully CRD IV eligible Tier 2 instruments and grandfathered Tier 2 instruments whose recognition as capital is being phased out under CRD IV.

Pension risk (unaudited)

Overview

Pension risk is the risk caused by our contractual or other liabilities with respect to a pension scheme (whether established for our employees or those of a related company or otherwise). It also refers to the risk that we will need to make payments or other contributions with respect to a pension scheme due to a moral obligation or for some other reason.

In this section, we explain how pension risk is managed and mitigated.

Key metrics

Funding Deficit at Risk reduced to £1,540m (2016: £1,690m)

Both interest rate and inflation hedge ratios on the Funding basis remained stable at 57% (2016: 56%) and 64% (2016: 62%) respectively.

OUR KEY PENSION RISKS

Definition
Pension risk is one of our key financial risks and arises mainly because Santander UK plc is the sponsor of the Santander (UK) Group Pension Scheme (the Scheme), a defined benefit scheme. Our risk is that over the long-term the Scheme's assets, together with future returns and future contributions, might not be enough to meet liabilities as they fall due. Where the value of the Scheme's assets is lower than the Scheme's liabilities, we could have to (or might choose to) make extra contributions. We might also need to hold more capital to reflect this risk.

Sources of risk
The key pension risk factors the Scheme is exposed to are:

Key risks	Description
Interest rate risk	The risk that movements in (long-term) interest rates cause changes in the value of the Scheme's liabilities that are not matched by changes in the value of the Scheme's assets.
Inflation risk	The Scheme's liabilities are impacted by inflation as annual pension increases are linked to RPI and CPI. The risk is that movements in inflation causes changes in the value of the Scheme's liabilities that are not matched by changes in the value of the Scheme's assets.
Longevity risk	Due to the long-term nature of the obligation, the value of the Scheme's liabilities are also impacted by changes to the life expectancy of Scheme members over time. The Scheme's liabilities are mainly in respect of current and past employees and are expected to stretch beyond 2080.
Investment risk	The risk that the return on Scheme's assets (relative to Scheme's liabilities) is less than anticipated.

Both our accounting and regulatory capital positions can be sensitive to changes in key economic data and the assumptions we have used in our valuations. These include our accounting assumptions on discount, inflation rates and life expectancy.

For more on the size of our defined benefit pension schemes and the nature of these risks, see Note 28 to the Consolidated Financial Statements. This includes a sensitivity analysis of our key actuarial assumptions.

We also have defined contribution schemes for some employees. Benefits at retirement primarily depend on the contributions made (by both the employees and us) and how well the investments (chosen by employees) perform. These schemes carry far less market risk exposure for us, however, we remain exposed to operational and reputational risks. To manage these risks, we monitor the performance of defined contribution investment funds and we engage with our employees to ensure they are given enough information about their investment choices.

PENSION RISK MANAGEMENT

Scheme governance
The Scheme operates under a trust deed. The corporate trustee, Santander (UK) Group Pension Trustees Limited (the Trustee), is a wholly owned subsidiary of the Santander UK group. It delegates investment decisions to the board of Santander (CF Trustee) Limited (CF Trustee). The CF Trustee meets each month and is the main forum for the CF Trustee to analyse and agree investment management strategies with input from the company as and when required.

As well as reviewing our pension risk appetite and approving actuarial valuations, the Santander UK Pensions Committee discusses and forms views on the Scheme's investment strategy. The Pension Risk forum, a Risk division management forum, monitors our pension risk within our approved risk framework, risk appetite and policies. Although we work with the Trustee to ensure the Scheme is adequately funded, our responsibilities are clearly segregated from those of the Trustee.

Risk appetite
Our appetite for pension risk is reviewed by the Pensions Committee at least once a year. It is then sent to the Board for approval. We ensure that our risk appetite is a key consideration in all decisions and risk management activities related to the Scheme.

We measure pension risk on both a technical provisions (funding) basis and an accounting basis (measured under IAS 19 'Employee Benefits'). We manage and hedge pension risk on the funding basis. However, we also consider the impact on the accounting basis. Both the funding and the accounting bases are inputs into our capital calculations.

Risk measurement
Our key risk metrics include:

Key risk metrics	Description
Funding Deficit at Risk	We use a VaR and stress testing framework to model the Scheme's assets and liabilities to show the potential deterioration in the current funding position. This ensures we adequately capture the risks, diversification benefits and liability matching characteristics of the obligations and investments of the Scheme. We use a time period of 1 year and a 95% confidence interval in our VaR model.
Required Return	This estimates the return required from the Scheme's assets each year to reach a pre-defined funding target by a fixed date in the future.
Pensions CET1 Volatility	This measures the potential for capital volatility due to the pension risk related capital deduction.

Our stress testing looks at how the Scheme's assets and liabilities respond to a range of deterministic financial and demographic shocks. We incorporate the results, and their impact on our balance sheet, income statement and capital, into our overall enterprise wide stress test results. We perform internal forward-looking stress testing each month and historic stress testing each quarter. We also perform stress tests for regulators, including for ICAAPs and PRA stress tests.

Risk mitigation
The key tools we use to mitigate pension risk are:

Key tools	Description
Investment strategies	The Trustee has developed the following investment principles: – To maintain a portfolio of assets of appropriate quality, suitability and liquidity which will generate income and capital growth to meet, along with new contributions from members and the employers, the cost of current and future benefits which the Scheme provides, as set out in the trust deed and rules; – To limit the risk that the assets fail to meet the liabilities, over the long term, as required by legislation; – To invest in a way that is suitable to the nature and duration of the expected future benefit payments; – To minimise the long-term costs of the Scheme to us by maximising the return on the assets whilst having regard to the objectives shown above. The assets of the funded plans are held independently of the Santander UK group's assets in separate trustee administered funds. The investment strategy is kept under review. The Trustee invests the Scheme's assets in a diversified portfolio of UK and overseas equities, corporate and government bonds, property, infrastructure development opportunities and other assets.
Hedging strategies	The Trustee has a hedging strategy to reduce inflation and interest rate risks. Hedging decisions are made, following discussions between the Trustee and us, and executed by the CF Trustee. This includes investing in suitable fixed income and inflation-linked assets, and entering into inflation and interest rate swaps. The Trustee may also adopt other hedging to mitigate specific risks such as equity hedging strategies which are used to reduce market risks from investing in public market equities. The case study on the next page describes the equity hedging implemented during 2017.
Other mitigants	We continue to mitigate pension risk in other ways. For example: – From 1 March 2015, a cap on pensionable pay increases of 1% each year was applied to staff in the Scheme; – In 2010 the cap on future pension increases for benefits accrued after 5 April 2010 was lowered; – In 2008, the Santander (UK) Common Investment Fund was created to pool investments and the CF Trustee was set up to make investment and hedging decisions on behalf of the Trustee. This improved the investment decision making process; – In 2002, the Scheme was closed to new staff.

Risk monitoring and reporting
We monitor pension risk each month and report on our metrics at Executive Risk Control Committee, Pensions Committee and also, where thresholds are exceeded (or likely to be), to the Board Risk Committee and the Board in accordance with our pension risk appetite. Senior management will then decide what, if any, remedial action should be recommended, which we then discuss with the Trustee and where relevant the CF Trustee.

PENSION RISK REVIEW

2017 compared to 2016

Our pension risk profile has grown over the last few years, mainly driven by the fall of long-term gilt yields. During 2017 however risk levels reduced due to mitigating strategies employed during the year. Following completion of the 2016 triennial valuation in March 2017, the CF Trustee began an extensive investment and hedging strategy review. As a result, the CF Trustee has implemented a number of actions, which have already reduced the risk profile of the Scheme. We are also improving risk management and control, along with associated governance. In addition, during the year we changed the actuarial experts we use to help us assess pension obligations.

Risk monitoring and measurement

We continue to focus on achieving the right balance between risk and reward. In 2017, overall asset returns were positive mainly from equities. Our long-term objective is to reduce the risk of the Scheme and eliminate the deficit on the funding basis. The Funding Deficit at Risk decreased to £1,540m (2016: £1,690m). In 2017, the Scheme put in place more equity hedging as part of a review of the CF Trustee's investment strategy. This reduced the Funding Deficit at Risk by £300m. During 2017, interest rate and inflation hedging remained stable. The interest rate hedging ratio was 57% at 31 December 2017 (2016: 56%) on the funding basis, and the inflation hedging ratio was 64% (2016: 62%).

In August 2017, the Pensions Committee considered the impact of potential inflation shocks on the accounting position, both current and forecasted to the end of the recovery plan. The four scenarios varied the levels of RPI inflation, long-term inflation expectations, and expected RPI inflation volatility. The analysis showed small improvements in the current and forecasted accounting positions in three of the four scenarios. In the fourth scenario, high inflation with low volatility, there was a small potential worsening of the current accounting position, which was considered manageable. Under this scenario, the forecast still resulted in a significant accounting surplus by the end of the recovery plan. On an accounting basis, the Scheme is almost fully hedged against movements in inflation.

Triennial funding valuation

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

Accounting position

During 2017, the accounting surplus of the Scheme and other funded arrangements increased, with sections in surplus of £449m at 31 December 2017 (2016: £398m) and sections in deficit of £245m (2016: £223m). The overall position was £204m surplus (2016: £175m). There were also unfunded scheme liabilities of £41m at 31 December 2017 (2016: £39m). The improvement in the overall position was mainly driven by positive investment performance, which more than offset the increase in Scheme's liabilities due to the lower discount rate assumption driven by lower long term interest rates and credit spreads. For more on our pension schemes, including the current asset allocation and our accounting assumptions, see Note 28 to the Consolidated Financial Statements.

The CF Trustee began a strategic review of the Common Investment Fund's (CIF's) asset allocation in 2017 to assess its ability to deliver the investment returns needed to meet the agreed 2016 Actuarial Valuation recovery plan.

This plan is designed to close the funding gap between the Scheme's assets and its pension liabilities through a mix of Company contributions and investment returns over the next 10 years.

Listed equity markets have delivered strong investment returns since March 2009 and reached record levels in 2017. Global equity prices now look increasingly expensive across a range of valuation measures. As a result, and whilst the asset allocation review is being completed, the CF Trustee decided to buy a tactical investment to protect part of its listed equity portfolio from falls in equity markets.

This tactical investment was put in place by buying a basket of derivatives whose performance is driven by underlying equity markets.

The combined portfolio of the listed equities and the derivatives basket effectively changes the payout profile that the CIF will earn from its total listed equities whilst the derivatives basket is held over the next 12 months.

The derivatives basket sells positive listed equity returns above the return required by the CIF should they occur and uses the revenue from that sale to buy protection to safeguard the value of the listed equities should equity markets fall below the levels when the derivatives basket was bought.

The cost to the CIF is minimal because the derivatives basket is structured so that the revenue from selling positive equity returns broadly meets the cost of buying the downside protection.

The derivatives basket can be unwound at any time in its planned holding period and it will be kept under review by the CF Trustee so that it can react if market conditions change.

Conduct and regulatory risk (unaudited)

Overview

In 2017, we merged the conduct and regulatory risk types into one framework. We did this to better reflect their similarities and to streamline our risk types.

Conduct risk is the risk that our decisions and behaviours lead to a detriment or poor outcome for our customers. It also refers to the risk that we fail to hold and maintain high standards of market integrity.

Regulatory risk is the risk of financial or reputational loss, imposition or conditions on regulatory permission, as a result of failing to comply with applicable codes, regulator's rules, guidance and regulatory expectations.

We are committed to ensuring conduct strategy is embedded in our business and that the fair treatment of our customers is at the heart of what we do.

In this section, we explain how we manage conduct and regulatory risk. We also describe our main conduct provisions, with a focus on PPI, and give some insight into our support for vulnerable customers.

Key metrics

- Our PPI provision at 31 December 2017 amounted to £356m (2016: £457m)
- Other conduct provisions at 31 December 2017 amounted to £47m (2016: £36m)

OUR KEY CONDUCT AND REGULATORY RISKS

We believe that delivering a Simple, Personal and Fair bank starts with meeting the needs and expectations of our customers. To achieve this we are committed to making sure that our strategy, proposition and initiative approval process, and systems, operations and controls are well designed and delivered.

We see our key exposure to conduct and regulatory risk through the risk of errors in our product design, sales practices, post-sale servicing, operational processes and complaint handling. All of these may result in the risk that we do not meet our customers' needs, align to the expectations of our regulators or deliver the expected outcomes.

Our Conduct and Regulatory Framework is built on the following underlying types of risk:

Key risks	Description
Regulatory	The risk that we fail to adhere with relevant laws, regulations and codes which could have serious financial, reputational and customer impacts. This includes the risk that we may be adversely impacted by changes and related uncertainty about UK and international regulations. We categorise regulatory risk into financial and non-financial risk. This is aligned to our main regulators who are the: – PRA, which is responsible for the prudential regulation and supervision. Its main aim is to promote the safety and soundness of the firms it supervises; and – FCA, which focuses on the regulation of conduct by financial services firms. Its aims include securing an appropriate degree of protection for customers. As well as being subject to UK regulation, as part of the Banco Santander group, we are impacted indirectly through regulation by the Banco de España (the Bank of Spain) and, at a corporate level, by the ECB through the Single Supervisory Mechanism. We also fall within the scope of US regulation, including the Dodd-Frank Wall Street Reform and Consumer Protection Act. This places restrictions on our activities both in the UK and the US. We also have to adhere to the rules and guidance of other regulators and voluntary codes in the UK.
Product	The risk that we offer products and services that do not result in the right outcomes for our customers.
Sales	The risk that we sell products and services to our customers without giving them enough information to make an informed decision or we do not provide correct advice.
After-sale and servicing	The risk that failures of our operations, processes, servicing activity, IT or controls result in poor outcomes for our customers. This includes the risks that: – We do not give appropriate after-sale communications to customers, making it difficult for them to contact us, or we fail to take account of a customer's vulnerability – We do not have robust systems and controls to detect and prevent fraud.
Culture	The risk that we do not maintain a culture that encourages the right behaviour and puts the customer at the heart of what we do.
Competition	The risk of financial harm, criminal liability, customer harm or reputational damage that we may incur because we fail to comply with relevant competition law or being involved in any competition law investigation or proceedings.

CONDUCT AND REGULATORY RISK MANAGEMENT

Risk appetite

We aim to comply with and exceed all regulatory requirements and we have no appetite to make decisions or operate in a way that leads to unfair outcomes for our customers or negatively impacts the market.

Our Board approves our risk appetite and we cascade it to our business units through our risk framework and policies. Our Board agrees our conduct and regulatory risk appetites and limits each year, or more often if events mean that we need to. We also have lower level risk tolerance thresholds that are agreed at least annually by the Board Risk Committee. Our material conduct and regulatory risk exposures are subject to, and reported against, our conduct and regulatory risk appetite statements, as well as lower level triggers and thresholds for management action.

Risk measurement

Due to the close links between our conduct, regulatory and operational risk frameworks, our tools to identify, assess, manage and report these risks also apply where such exposures and risks have a conduct and/or regulatory risk impact.

We consider conduct and regulatory risk as part of the governance around all our business decisions. We have specific forums and committees to make decisions on conduct and regulatory risk matters. They do this after due consideration by the business, our Business Support Units and Risk Control Units, as well as the Board Responsible Banking Committee.

Risk mitigation

Our conduct and regulatory risk framework and policies set out the principles, standards, roles and responsibilities and governance for conduct and regulatory risk, such as:

Policies	Description
Product approval	Our product approval process aims to minimise our exposure to conduct, legal, regulatory or reputational risks in the design, marketing, sales and service of new products and services. We assess all our products and services within a formal framework to make sure they are within our risk appetite and agreed metrics, processes and controls are in place.
Suitable advice	We give guidance to advisers and staff on the key principles, minimum requirements and ethical behaviours they must follow when they give advice or conduct a non-advised sale. This ensures our customers are sufficiently informed when they make a buying decision. The main products we cover are mortgages, investments, savings and protection.
Training and competence	In line with the expectations of our regulators, we train our staff and require them to maintain an appropriate level of competence (in line with their role and responsibilities) to ensure customers achieve fair outcomes. We invest in all our people to ensure that we achieve our mandatory risk objectives and that everyone acknowledges their personal responsibility for risk management through our I AM Risk approach.
Treating vulnerable customers fairly	Some customers may be impacted financially or personally as a result of their circumstances. Our guidelines give our business areas a clear and consistent understanding of what vulnerability can mean and the types of customers that may need more support. Our guidelines also help prevent those customers from entering financial difficulty or any other financial loss. We work with key charities and other specialists to develop our understanding of vulnerability. We also consider vulnerability in our product approval process, and have mandatory training on it for all our people.

We support our conduct and regulatory risk framework and policies with tools that allow us to identify and assess any new and emerging conduct risks. These include:

Key tools	Description
Strategy and business planning	Our Strategy and Corporate Development team help align our overall corporate strategy, financial plans, risk appetite and operational capabilities through our annual process to set our strategy. We derive our business unit plans from our overall corporate strategy and they contain a view of conduct and regulatory risk along with our other key risk types.
Sales quality assurance	We subject our sales to internal quality assurance and, as appropriate, external monitoring to ensure the quality of our sales and practices.
Operational risk and control assessments	Our business and business support units assess our operational risks and controls to give us a consolidated risk view across all our business areas. We complete the assessments through a central tool to evaluate and manage our residual risk exposures.
Scenario testing and horizon scanning	We consider conduct and regulatory risk in our scenario testing. This reviews possible root causes and assumptions to determine the likelihood and size of the impact, and actions to enhance our controls where required.
Conduct risk reporting	We use dashboards to give us an end-to-end view of our conduct risks (from product, sales and post-sales and servicing) across our business. This allows us to apply a lens to manage conduct risk and understand if it is in line with our risk appetite.
Compliance monitoring	We carry out an annual assurance programme for conduct and regulatory risk. This includes mystery shopping, branch oversight and thematic reviews.

Risk monitoring and reporting

Our risk and control forums support management to manage risks and controls in their business units. Reporting includes commentary on trends and root causes so that we can take effective action. The data reported to senior management contains essential information that gives them a clear understanding of current and potential emerging conduct and regulatory risks and issues.

We support this with conduct risk dashboards, which take into account a range of metrics across common areas such as mystery shopping, quality assurance and complaints. Our Legal and Regulatory function reports directly to the Board to give a view on legal, conduct, regulatory, reputational and financial crime risks, and to escalate issues or any breach of our risk appetite.

CONDUCT AND REGULATORY RISK REVIEW

2017 compared to 2016

To make sure we fully consider customer impacts across our business, we maintained a strong focus on robust oversight and control over our proposition, and maintaining Compliance teams across all our key business lines. We also embedded conduct risk frameworks across all business divisions, and worked closely with Operational Risk, leveraging the risk toolkit to identify, assess, manage and report conduct and regulatory risk.

In 2017, we continued to build on the progress we made in 2016. As part of this, we:

- Assessed the views and new policy areas in the FCA's Business Plan and Mission Statement. We then built them into our business planning, controls and oversight activities
- Strengthened our work with Banco Santander to ensure that we have a consistent approach
- Improved our framework and guidance for how we support vulnerable customers, including ageing customers
- Enhanced our management information to help us identify forward-looking risks earlier. We also analysed internal and external developments to capture the lessons learnt
- Carried out face to face training in addition to mandatory modules to help colleagues on topical areas of conduct risk
- Developed a new conduct and compliance centre of excellence in our Legal and Regulatory division
- Refined and improved our product approval process.

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

PPI provisions

The remaining provision for PPI redress and related costs amounted to £356m, including an additional net provision of £40m in Q417 bringing the total charge for the year to £109m. The Q417 provision relates to an increase in estimated future claims driven by the start of the FCA advertising campaign for PPI, offset by an expected decline pertaining to a specific PPI portfolio review. We continue to monitor our provision levels in respect of recent claims experience.

Other conduct provisions

Other conduct provisions amounted to £47m (2016: £36m), and included a provision of £35m, relating to the sale of interest rate derivatives. This charge followed an ongoing review regarding regulatory classification of certain customers potentially eligible for redress.

For more on our conduct remediation provision, including sensitivities, see Note 27 to the Consolidated Financial Statements. We explain more about these sensitivities in 'Critical accounting policies and areas of significant management judgement' in Note 1 to the Consolidated Financial Statements.

In recent years we have increased our focus on consumer vulnerability. We use guidance from the FCA, Money & Mental Health Policy Institute, Citizens Advice and other consumer bodies to collaborate at an industry level. We have built on work we started in 2015 increasing our awareness and ability to respond to the needs of vulnerable customers.

Recognising vulnerability through our contact with customers is key in being able to identify how we can give our customers the best support. To equip our customer facing colleagues and give them the confidence they need to deal with a range of sensitive issues, we have given them training in this area. To do this, we used real customer scenarios to highlight different vulnerable situations. We have also developed an online Vulnerable Customer Support Tool for our colleagues to give them more information and guidance. We are also piloting a Specialist Support Team for our colleagues when they need more support. This team set up a dedicated helpline for both customers and colleagues to support people affected by the Grenfell Tower Fire in June 2017.

We recognised that our customers who were impacted would need easy access to a dedicated source of information and guidance given their very unique and tragic circumstances. In 2018, we plan to expand our Specialist Support Team to support all our customer facing colleagues. We have also tested a Friends and Family alert service, where a customer can ask us to notify a named and trusted friend or family member when certain transactions occur on their account. This has given peace of mind and a sense of added security for customers who may feel vulnerable or want to keep control of their banking with a little support.

Protecting vulnerable customers is a bank wide responsibility and we now have an overarching policy which sets out our principles of good conduct in this area.

Through this approach, we now consider vulnerability in every new initiative. We have seen the impact of this in areas such as the roll out of our voice guided, contactless-enabled ATMs and the development of our mobile banking app. We also work closely with the Digital Accessibility Centre, and adapting our technology to the needs of customers with physical disabilities is a key part of our design and testing stages. As an example, the use of fingerprints and Face ID (IOS only), to access our mobile banking app removes the need to remember passwords. The use of voice activation to navigate online services also improves access for people with visual impairments.

We are committed to providing services, products and support to all of our customers who are vulnerable. We look to build on these initiatives and develop even more ways to help them in 2018.

Other key risks (unaudited)

Overview

In this section, we describe how we manage our other key risks and discuss developments in the year.

Our other key risks are:

- **Operational risk:** the risk of direct, or indirect, loss due to inadequate or failed internal processes, people and systems, or external events.
- **Financial crime risk:** the risk that we are used to further financial crime, including money laundering, sanctions evasion, terrorist financing, bribery and corruption.
- **Legal risk:** the risk of loss due to legal deficiencies in contracts; failure to take appropriate measures to protect assets; failure to manage legal disputes appropriately; failure to assess or implement the requirements of a change of law; or failure to comply with law or regulation or to discharge duties or responsibilities created by law or regulation.
- **Model risk:** the risk of loss from decisions mainly based on results of models due to errors in their design, application or use.
- **Strategic risk:** the risk of loss or damage due to strategic decisions that impact the long-term interests of our key stakeholders, or from an inability to adapt to external developments.
- **Reputational risk:** the risk of damage to the way our reputation and brand are perceived by the public, clients, government, colleagues, investors, or any other interested party.

OPERATIONAL RISK

OUR KEY OPERATIONAL RISKS

Operational risk is inherent in our business. As a result, we aim to manage it down to as low a level as possible, rather than eliminate it entirely. Operational risk events can have a financial impact and can also affect our business objectives, customer service and regulatory obligations. These events can include product misselling, fraud, process failures, system downtime and damage to assets.

Our top three key operational risks are:

Key risks	Description
Cyber risk	The use of technology and the internet have changed the way we live and work. They have allowed us to develop and improve the way we deal with our customers. It is critically important that we give our customers a secure environment in which to deal with us. Failure to protect the data assets of the bank and its customers against theft, damage or destruction from cyber-attacks could result in both damage to our reputation and direct financial losses. This applies not only to our own systems but also to those of our third party providers and counterparties in the market.
Outsourced and third party supplier management	We rely extensively on third parties, both within the Banco Santander group and outside of it, for a range of services and goods. These include outsourced services, such as IT infrastructure, software development and banking operations. Third party risk is a key operational risk for us due to the number, complexity and criticality of the services being provided. Many third parties are also shared across the sector and this could increase risk due to complexity and capacity issues at the suppliers. The failure of a supplier may cause operational disruption, breach of data security or regulations, negative customer impact, financial loss or reputational damage.
Process and change management	A key part of our business strategy is to develop and deliver new banking channels and products. These include mobile banking and third party payment products. The scale and pace of our plans increases our operational risk. We are also implementing a large number of regulatory and legal changes, impacting all areas of our business. There is more on this in the 'Regulatory risk' section. Our business units are reporting operational issues due to the volume and complexity of these changes. These changes could have financial, customer, reputational and regulatory impacts if we do not manage them properly.

OPERATIONAL RISK MANAGEMENT

Risk appetite
We set our operational risk appetite at a Santander UK level and we express it through measures approved by the Board. These include risk statements and metrics set against the seven CRD IV loss event types. We cascade our appetite across our business areas by setting out lower level triggers and thresholds and processes by which risks and events must be managed and escalated, and by which they may be formally accepted.

Risk measurement and mitigation
The key components of the operational risk toolset we use to measure and mitigate risk are:

Operational risk toolset	Description
Operational risk and control assessments	Our business units identify and assess their operational risks to ensure they manage and control them within our operational risk appetite. They also ensure that we prioritise any actions needed. Every area has to identify their risks, assess their controls for adequacy and formulate a plan to address any deficiencies.
Risk scenario analysis	We perform this across all of our business units. It involves a top down assessment of our most significant operational risks. Each business unit has a set of scenarios that it reviews and updates each year. The analysis gives us insight into rare but high impact events. It also allows us to better understand the potential impacts and to address any issues.
Key indicators	Key indicators and their tolerance levels give us an objective view of the degree of risk or the strength of a control at any point in time. They also show a trend over a period of time and give us early warning of potential risk exposures. The most common key indicators we use are key risk indicators, which highlight the degree of risk, and key control indicators which show how strong and effective the controls are.
Operational risk losses	Our operational risk loss appetite sets the level of total operational risk loss (expected and unexpected) in any given year (on a 12 months rolling basis) that we consider to be acceptable.
Operational risk event management	Operational risk events occur when our controls do not operate as we planned and this leads to customer impact, financial loss, regulatory impacts and/or damage to our reputation. We have processes to capture and analyse loss events. We use data from these processes to identify and correct any control weaknesses. We also use root cause analysis to identify emerging themes, to prevent or reduce the impacts of recurrence and to support risk and control assessments, scenario analysis and risk reporting.
Risk based insurance	Where appropriate, we use insurance to complement other risk mitigation measures.

We also mitigate our key operational risks in the following ways:

Key risks	Risk mitigation
Cyber risk	We operate a layered defence approach to cyber risk, which aims to prevent, detect, respond to and recover from cyber-attack. We continually review how effective our controls are against globally recognised security standards. This includes the use of maturity assessments and both internal and external threat analysis. Our comprehensive approach to validating our controls includes tests designed to replicate real-world cyber-attacks. We reflect the test findings in our ongoing improvement plans. We use robust technology to protect our customers and we continually invest in the fight to counter scams. As part of this, we run an ongoing customer education campaign, and we offer tips and advice on our online security centre – www.santander.co.uk/securitycentre. We are successful in preventing the vast majority of fraud and protecting our customers' money. Protecting our customers, systems and information is a top priority and in 2017, we undertook a large programme of staff training, customer education and technology improvements. This also included enhanced technical measures to ensure our technology continues to be resilient to online cyber-disruption. Our Cyber Resilience programme continued to evolve and adapt to cyber threats. We also launched a successful 'Phish and Chips' campaign designed to raise awareness and give customers the knowledge they need to prevent themselves becoming a victim of fraud. We continue to work with other banks through our membership of the Cyber Defence Alliance, in which we share intelligence on cyber threats and effective mitigation strategies. For more, see the "Protecting our customers" case study.
Outsourced and third party supplier management	We have a third party supplier risk framework to ensure that those with whom we intend to conduct business meet our risk and control standards throughout the life of our relationship with them. We also monitor and manage our ongoing supplier relationships to ensure our standards and contracted service performance continue to be met.
Process and change management	Our operational risk exposure is increased where we engage in new activities, develop new products, enter new markets or implement new business processes or systems. As a result, we conduct operational risk assessments for material change programmes and new product developments before they receive approval to proceed.

Risk monitoring and reporting
Reporting is a key part of how we manage risk. It ensures we identify, escalate and manage issues on a timely basis. We can identify exposures through our operational risk and control assessments, risk scenario analysis, key indicators and incidents. We report exposures for each business unit through regular risk and control reports. These include details on risk exposures and how we plan to mitigate them. We prioritise and highlight events that have a material impact on our finances, reputation, or customers by reporting them to key executives and committees.

We have a crisis management framework in place covering all levels. This includes the Board, senior management and our business and support functions. Our framework identifies possible trigger events and sets out the processes to manage a crisis or major incident, and we test it at least annually. If an event occurs, we have business continuity plans in place to recover the services as quickly as possible. These are aligned with our key customer journeys and delivery of critical IT services.

We use the standardised approach for Pillar 1 operational risk capital needs. We use an internal model aligned to the CRD IV advanced measurement approach to assess our Pillar 2 capital needs. We also use it to model our operational risk losses we might incur in a stress.

OPERATIONAL RISK REVIEW

Operational risk event losses

The table below shows our operational losses in 2017 and 2016 for reportable events with an impact over £10,000, excluding conduct risk events (which we discuss separately in the 'Conduct and regulatory risk' section), by CRD IV loss event types. We manage some of these risks in our Risk Framework in other risk types, including regulatory and financial crime risk even though we report them here.

	2017		2016	
	Value %	Volume %	Value %	Volume %
Internal fraud	**5**	**1**	4	2
External fraud	**37**	**49**	23	40
Employment practices and workplace safety	**–**	**1**	–	1
Clients, products, and business practices	**24**	**22**	18	34
Business disruption and system failures	**1**	**–**	–	1
Execution, delivery, and process management	**33**	**27**	55	22
	100	**100**	100	100

2017 compared to 2016

In line with industry experience, in 2017 we saw a high volume of low value 'external fraud' events. These mainly relate to card, telephone banking and online payment fraud. We continue to look at ways to enhance our fraud prevention strategy in response to the evolving external landscape. Our losses from 'Execution, delivery and process management' events relate to historic systems functionality and process issues.

In 2017, we enhanced our approach to operational risk. This included the roll-out of more modules of our operational risk system. This was part of a final year of investment to implement our transformation programme. By the end of 2017, the programme was substantially complete. The Open Banking initiative and the new Payment Services Directive (PSDII) together bring significant opportunity for us to develop new products and services to enhance the ways customers use their data and pay for services, but they also introduce a new layer of risk to both customers and Santander. In 2017 we carried out detailed operational risk assessments in relation to these initiatives, in order to identify, assess, manage and report the key risks involved. Our focus on managing these risks continues, with further assessments planned for 2018.

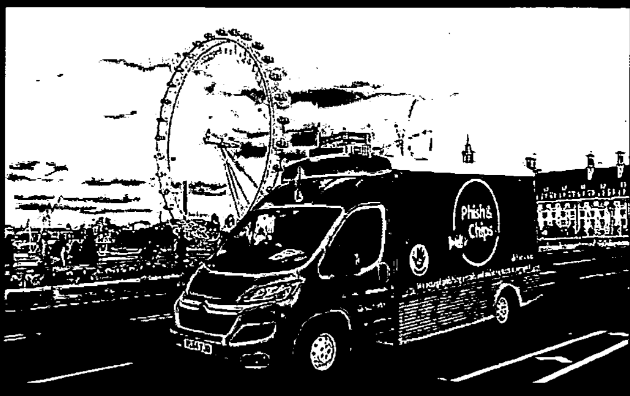
In 2017, in line with other large UK banks and other organisations, we continued to be subject to cyber-attack. Our focus has been on improving our detection capabilities against malicious activity and building a UK intelligence led Cyber Defence Centre, to protect both our customers and our shareholders. We continually improve our systems, processes, controls and staff training to reduce our cyber risk and to help protect our customers, systems and data. As a result we had no significant disruption in 2017 due to cyber-attack. Our Cyber Resilience Programme operates with a layered defence approach, and continually evolves and adapts to cyber threats. We perform cyber security testing and evaluate security event scenarios where the results and insights drive updates to our system security and control remediation plans. We also continue to invest in our security services. Together with our Cyber Defence Centre and our data centres, this gives us a solid foundation to achieve our digital transformation. Our approach will also ensure that we support future growth in an environment of improved cyber resilience and reduced legacy IT issues.

Fraud, scam and online security stories continued to feature strongly in headlines and political debate in 2017. As criminals have become more sophisticated in their approach, banks and other organisations have been in an ongoing race to keep one step ahead of them.

In 2017, we undertook a large programme of staff training, customer education and technology improvements to protect our customers. This included enhanced technical measures to make sure our online banking services are resilient to online cyber-disruption. Our new cyber security training ensures all our staff understand the threats to financial services and that we all have the expertise, through a practical assessment, to spot criminals' emails and attempts to compromise our IT systems.

For our customers, we designed a campaign to raise awareness and give them the knowledge they need to avoid becoming a victim of fraud. We knew we needed to create something that would engage people and grab their attention. We created a specially branded Phish & Chips van that toured the UK. It offered free fish and chips to people who could show a suspected phishing email or smishing text message. For people without a suitable email or text, a short quiz let them show that they could identify fraudulent emails and texts. In return for this, they also won fish and chips. The van attracted plenty of interest, enabling us to talk about how to avoid scams to 3,500 people. Our message was also picked up and broadcast across 93 media outlets while social media reached over 1.5 million people.

Our research revealed that 74% of the UK public have been targeted with phishing emails, smishing texts and vishing calls. Each person targeted received an average of 16 fraudulent emails, texts or calls last year. This adds up to 600 million attempted scams in the last 12 months. Our Phish & Chips initiative is part of our continued commitment to fighting fraud. We also work closely with industry and government. As part of this, we used the UK Finance 'Take Five' branding and literature in our Phish & Chips campaign. Looking forward, we aim to lead the way in keeping our customers safe from fraudsters.



FINANCIAL CRIME RISK

OUR KEY FINANCIAL CRIME RISKS

We are committed to the strongest possible response to financial crime risk. We recognise that if we fail in this area it could impact our finances, reputation and operations, as well as our customers and wider society. Geopolitical factors and new criminal methods can quickly change the risks we face. We have robust systems and controls, formal policies and a governance framework, training and intelligence and risk assessment capabilities, as well as our partnership with UK authorities, to support us to detect and prevent financial crime.

Our key financial crime risks are:

Key risks	Description
Money laundering	We are used by criminals to transform the proceeds of crime into seemingly legitimate money or other assets.
Terrorist financing	We are used by terrorists to deposit, distribute or collect funds that are used to fund their activity.
Sanctions	We do not identify payments, customers or entities that are subject to economic or international sanctions.
Bribery and corruption	We fail to put in place effective controls to prevent or detect bribery and corruption.

FINANCIAL CRIME RISK MANAGEMENT

Risk appetite

We are committed in our efforts to counter financial crime and to comply with applicable UK law and sanctions regulations. We have controls in place to manage this risk as we have a minimal tolerance for residual financial crime risk. We have a zero tolerance for non-compliance with sanctions programmes and the restrictions imposed through such instruments. We cascade our risk appetite and policies throughout the business.

Risk measurement

We use a number of different tools to measure our exposure to financial crime risk:

- We conduct risk assessments of customers, sectors, jurisdictions and business units to assess our risk profile and to ensure we comply with all applicable sanctions regimes
- We use monthly key risk indicators to measure and report financial crime risk to senior management
- Our Financial Intelligence Unit conducts assessments of particular types of threat, including drawing on information provided by law enforcement and public authorities.

Risk mitigation

Our financial crime function is focused on predicting, detecting, preventing and, where possible, disrupting financial crime. We require all our business units to manage their activities in line with the principles and guidance in our financial crime risk framework. These requirements are set out in our anti-money laundering (AML), counter terrorist financing, sanctions, and anti-bribery and corruption policies and standards.

In line with UK and international laws and standards, we adopt a risk-based approach to financial crime risk mitigation. Key elements of this approach include:

- **Risk assessments** – we assess customer, product, business, sector and geographic risk to target efforts to mitigate financial crime most effectively
- **Customer due diligence** – we seek to understand customers' activities and banking requirements and, in order to minimise the risk that we are used for money laundering or terrorist financing, we conduct regular reviews of our higher-risk customer relationships to ensure any new financial crime considerations are identified and addressed
- **Partnerships with public authorities** – we are an active participant in the Joint Money Laundering Intelligence Task Force (JMLIT), which supports public-private collaboration to tackle financial crime. The JMLIT was set up in May 2016 and developed with partners in government, UK Finance (formerly the British Bankers' Association), law enforcement and over 20 major UK and international banks under the leadership of the Financial Sector Forum.

Risk monitoring and reporting

We monitor key financial crime developments and enhance our controls to comply with new or amended laws, regulations or industry guidance. We produce and report financial crime risk data by business unit which covers all aspects of the business life cycle. Each month we report an analysis of the financial crime key risk indicators to the Executive Risk Control Committee together with a directional indication of the risk profile and any significant deterioration of the metrics.

FINANCIAL CRIME RISK REVIEW

2017 compared to 2016

In 2017, we continued to enhance our Financial Crime Framework through our Transformation Programme including review by a newly formed Board Responsible Banking Committee. It aims to deliver a target model for how we manage financial crime across our business. Our target model refines and builds on what we have already delivered. We aim to address the evolving demands of financial crime regulations, as well as the expectations of our regulators and industry practice to achieve a sustainable model. As part of this, we:

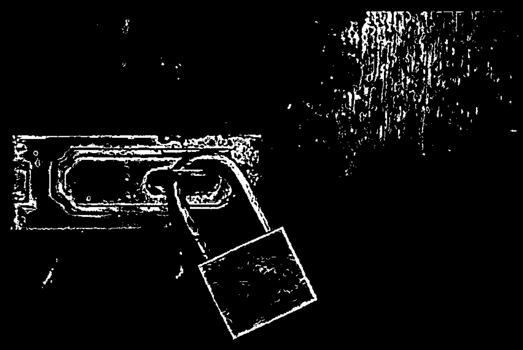
- Re-affirmed the key financial crime risk management capabilities we need, including ownership and accountabilities across our first and second lines of defence, business areas and operations
- Reviewed the key process steps and features for each business area and customer type, in addition to the main technology and data components that will underpin the operational aspects of the target state
- Enhanced the governance that will be needed to oversee the effective management of our financial crime risks
- Enhanced our financial crime training strategy, with a strong focus on anti-financial crime culture. We also improved our management data and anti-bribery and corruption.

Whilst we have well established AML systems and controls, there is further investment and work required to complete the Transformation Programme, delivering strengthening measures to ensure ongoing adherence to regulatory standards during a period of intense regulatory change. The delivery of the programme is a key priority and the Board has approved revisions to the Transformation Programme to ensure it is effective and sustainable. Progress will be tracked through key phases of the Transformation Programme with full visibility to the Board, and regular engagement with the FCA. The Financial Crime Steering Committee, chaired by the CLRO and the CEO, with membership from senior management from businesses and technology, has been established to govern Santander UK's transformation and ensure the adequacy of financial crime systems and controls.

We are an active participant of the JMLIT, which aims to combat high end organised crime and money laundering. One of the top priorities of the UK government and the JMLIT is taking action against human trafficking. This form of modern slavery is estimated to generate global criminal profits of £110bn a year. Inevitably, some of this makes its way into the UK financial system. It is thought to affect tens of thousands of people in every large town and city in the UK.

Our Financial Intelligence Unit (FIU) was invited to be a member of the JMLIT Expert Working Group on human trafficking. The group aims to finds ways that the financial sector can work with the government and law enforcement to identify cases of human trafficking in response to changing trends in criminal behaviour. As a member of the group, our FIU volunteered to analyse intelligence from law enforcement to develop an effective profile of victims and perpetrators of labour exploitation. This is the most common form of human trafficking reported in the UK. The FIU used our analysis to produce a National Crime Agency (NCA) alert, which was published on behalf of the JMLIT and sent to all UK financial institutions. The alert provided a number of key behavioural and transactional indicators of human trafficking. This has since been used as a resource for training and proactive detection of cases.

Our involvement in JMLIT, and initiatives like it, help prevent and reduce our risk of facilitating organised crime. The bigger picture however, is that by identifying suspects and victims of human trafficking, law enforcement can intervene quicker. This helps to catch those who continue to prey on vulnerable people.



Strategic report
Financial review
Governance
Risk review
Financial statements
Shareholder information

LEGAL RISK

We have always recognised the importance of effective legal risk management. In 2017, we enhanced our Risk Framework to create a separate legal risk type to reflect the current environment, including the volume and breadth of regulatory change and how significant it is to our business.

Legal risk arises from the following main sources:

- **Legal deficiencies in contracts:** the risk that we use inadequate or incorrect documents to enter into or enforce a contract or protect our interests or assets
- **Failure to take appropriate steps to protect assets:** the risk that we follow an ineffective or incorrect process to protect our interests or assets or those of our customers
- **Failure to manage legal disputes appropriately:** the risk of mismanagement of legal claims arising from our business
- **Failure to assess or implement the requirements of a change of law**
- **Failure to comply with law or regulation or to discharge duties or responsibilities created by law or regulation.**

Legal risk management

- **Risk appetite** – we apply robust controls to manage legal risks and have a minimal tolerance for legal risk.
- **Risk measurement** – we measure legal risk under the categories above and assess both how likely the risk is to occur and its potential impact on our business if it does.
- **Risk mitigation** – legal risk arises throughout our business units and business support units in their day-to-day activities. Our Legal team give specialist advice and support to those business areas to mitigate legal risk.
- **Risk monitoring and reporting** – all our business units consider legal risk as part of their operational risk and control assessments. We monitor and report key legal risks and issues on a timely basis. We escalate them to the Executive Risk Control Committee, Board Risk Committee and Board Responsible Banking Committee as needed.

2017 compared to 2016

In 2017 we further enhanced our approach to legal risk. We:

- Developed a standalone legal risk type to reflect the current environment, including the volume and breadth of regulatory change and its significance to our business
- Clarified the line 1 and 2 responsibilities for legal risk and aligned the risk oversight approach with other risk types owned by the CLRO
- Embedded legal risk reporting into a revised governance structure in accordance with other risk types owned by the CLRO.

MODEL RISK

Our key model risks arise from potential flaws in our modelling techniques, or the incorrect use of a model. They include risks arising from model data, systems, development, performance and governance.

Model risk management

- **Risk appetite** – we express our appetite for model risk through the risk assessments of our most material risk models. This is agreed by the Board at least annually.
- **Risk measurement** – we consider both the percentage of models that have been independently assessed, as well as the outcome of those reviews, in our measurement of model risk.
- **Risk mitigation** – we mitigate model risk through controls over the use of models throughout their lifecycle. We maintain a central model inventory that includes data on owners, uses and key dates. We assess how important each model is to our business. Recommendations arising from independent reviews are tracked through to resolution. We also maintain a clear approval path for new model developments, updates and performance tracking.
- **Risk monitoring and reporting** – we report model risks and issues using model risk management and control forums. We escalate issues to the Executive Risk Control Committee when necessary, or if our risk appetite is breached.

2017 compared to 2016

We continued to evolve our approach to model risk management as we identify new model types and modelling techniques. We assess the importance of the model within our business and use this to ensure we follow an effective governance process for each model. This includes having the most material models independently validated. We have clear roles and responsibilities that focus on the model owner, developer and reviewer, and we have clarified the role of the model user. We enhanced our controls and reporting to highlight the top risks. We continue to evolve our model risk appetite, using lower level performance indicators.

STRATEGIC RISK

Strategic risk can adversely affect our long-term success as it could lead to our business model becoming out of date, ineffective, or inconsistent with our strategic goals. This could arise if we:

- Have a partial picture of our operating environment. This can include the economy, new rules and regulations, shifting customer expectations, competitor activity and changes in technology
- Misjudge our own capabilities, or ability to implement our strategy
- Pursue initiatives like acquisitions that might not fit with our business model or miss opportunities that we could benefit from.

Strategic risk management

- **Risk appetite** – we have a low to moderate appetite for strategic risk. This limits the risks we are prepared to take to achieve our strategic objectives and is aligned to our balanced, customer-centric business model.
- **Risk measurement** – our Board and senior management regularly review potential risk associated with our operations and our plans to ensure we stay within our risk appetite.
- **Risk mitigation** – we manage strategic risk by having a clear and consistent strategy, taking account of both external factors and our own capabilities as we deliver our aim: to be the best retail and commercial bank earning the lasting loyalty of our people, customers, shareholders and communities. We have an effective planning process which ensures we refine, strengthen, and adapt our strategy to reflect changes in the environment. It also means that we can identify key risks and opportunities to help people and businesses prosper.
- **Risk monitoring and reporting** – we closely track our business environment – such as changes in the economy, customer expectations, technology, regulations, government policies and competition. We also look at long-term trends and how they might affect us, as well as risks arising from our operation or our plans. As part of this, we report a range of indicators to track our performance. These include our KPIs as set out in the 'Strategic Report'.

2017 compared to 2016

Our business environment is always changing, and this affects how we do business.

- In 2017, the UK economy performed better than initial expectations following the UK's decision to leave the EU, however significant uncertainty still remains and there are a range of potential outcomes when the UK exits the EU, some of which could have an adverse economic impact. However, we are well-placed to manage such uncertainties while continuing to deliver our strategy. We are the UK's leading full-service scale challenger with a continued focus on customers and innovative solutions. We have a resilient balance sheet and a proven track record of achieving consistent profitability through uncertain times.
- The post financial crisis regulatory agenda has led to significant change, some of which has the potential to impact our profitability, for example through changing business models. Notable initiatives include Open Banking which could potentially open the market to new entrants, and ring-fencing. We are actively exploring the risks and opportunities that Open Banking creates. During 2017, we made good progress with our ring-fencing plans and intend to implement the necessary changes well in advance of the regulatory deadline. For more on our ring-fencing plans, see Note 39.
- Throughout 2017 customer expectations continued to shift, with the adoption of new technologies and increasing use of digital channels. At the same time, the pace and scale of changes in technology remained intense. We responded to these changes by adopting new technology into our business model to offer real benefit for our customers, for example through our NeoCRM tool, a customer relationship software that enables customer conversations to be seamlessly conducted across different channels.
- Competitive pressure remained high, mainly from established players but also from new technology-led entrants looking to disrupt the market. We expect this to continue in 2018, however we believe our customer-focused business model and strategy, together with our adaptable and innovative approach, will enable us to thrive in this environment. We are already embracing the opportunities this creates by partnering with Fintech companies, including through our Santander InnoVentures fund. This fund invests in companies with proven expertise leveraging technology which could benefit our customers.
- Overall, we continue to embrace change and are making good progress towards our strategic goals. For more on this, see the 'Strategic Report' section.

REPUTATIONAL RISK

Our key reputational risks arise from failures in corporate governance or management, failing to treat our customers fairly, the actual or perceived way we do business, and the sectors and countries we deal with. They also result from how our clients and those who act for us conduct themselves, and how business is conducted in our industry. External factors may also present a reputational risk to us. These can include the macro environment and the performance of the sector.

Sustained damage to our reputation could have a material impact on our ability to operate fully. In turn, this could affect our financial performance and prospects.

Reputational risk is not static; today's decisions may be judged by different standards tomorrow. We build this into our risk culture, evaluation and sanction procedures.

Reputational risk management

- **Risk appetite** – we have a low appetite for reputational risk, which is agreed by the Board at least annually. We express it in terms of the risk measures we describe below.
- **Risk measurement** – we assess our exposure to reputational risk daily. We base this on analysis of social, print, and broadcast media as well as political and market commentators. Our analysis looks at our activities and those of our UK peers and is designed to help us identify large reputational events, or a prolonged deterioration in our reputation. We measure the perception of Santander UK by key stakeholder groups at least annually, using third party research. This includes employees, media, politicians and customer groups.
- **Risk mitigation** – all our business units consider reputational risk as part of their operational risk and control assessments. We also consider it as part of our new product assessments. Our Corporate Communications and Legal Teams, supported by our Compliance, Marketing and Risk teams, help our business units to mitigate reputational risk, and agree action plans as required. They do this as part of their overall responsibility to monitor, build and protect our reputation and brand.
- **Risk monitoring and reporting** – we monitor and report key reputational risks and issues on a timely basis. We escalate them to the Executive Risk Control Committee, and Board Risk Committee as needed. Our Corporate Communications, Legal and Marketing Team also reports regularly to our Executive Committee on Corporate Social Responsibility, Sustainability and Public Affairs policies. They do this from an environment, community and sector point of view.

2017 compared to 2016

In 2017, we further strengthened our governance and culture across the business. We set up a Reputational Risk Committee to discuss the risks we face. These include customer issues, lending decisions and supplier management. It meets regularly and on an ad-hoc basis as needed. We also continued to:

- Work towards our corporate goals for 2018. We acted to improve the way we work, simplify complex processes and develop technology to improve our customers' experience
- Embed Simple, Personal and Fair across the business through the governance of The Santander Way committee. This included our Executive Committee conversations initiative, and other events and visits that gave our staff the chance to ask questions about topics that are on their mind
- Embed the behaviours that support our purpose, aim and values. We did this most notably by including them in our staff appraisals. From the mid-year 2016, behaviours carried equal weighting with achievements in all staff performance management
- Enhance our reputational risk appetite and agreed escalation processes.

We worked closely with the business on communication plans for key events such as implementing ring-fencing on our operations and preparing for the UK's exit from the EU. We also promoted the community and wider society support that Santander UK provides through its Corporate Social Responsibility work, and the Santander Cycles Schemes in London and Milton Keynes.

Financial statements

Contents

Independent auditors' report to the members of Santander UK plc

Report on the audit of the financial statements

Opinion

In our opinion, Santander UK plc's group financial statements and parent company financial statements (the "financial statements"):

- give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2017 and of the group's profit and the group's and the parent company's cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union and, as regards the parent company's financial statements, as applied in accordance with the provisions of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report, which comprise:

- the consolidated and company balance sheets as at 31 December 2017;
- the consolidated income statement and statement of comprehensive income for the year then ended;
- the consolidated and company statements of cash flows for the year then ended;
- the consolidated and company statements of changes in equity for the year then ended; and
- the notes to the financial statements, which include a description of the significant accounting policies.

Certain required disclosures have been presented in the Risk review in the Annual Report on pages 57 to 135 rather than in the notes to the financial statements. Except for items marked as unaudited, the Risk review forms an integral part of the financial statements. The information on pages 230 to 232 concerning subsidiaries and joint ventures is also included in the financial statements.

Our opinion is consistent with our reporting to the Board Audit Committee.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 1 to the financial statements, the group, in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion, the group financial statements have been properly prepared in accordance with IFRSs as issued by the IASB.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

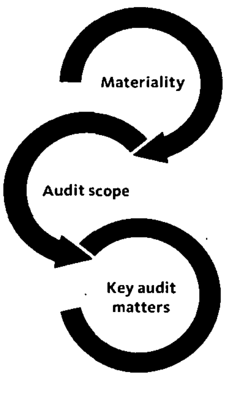
Independence

We remained independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

Other than those disclosed in note 7 to the financial statements, we have provided no non-audit services to the group or the parent company in the period from 1 January 2017 to 31 December 2017.

Our audit approach
Overview



- Overall group materiality: £90.8m (2016: £95.0m), based on 5% of profit before tax.
- Overall parent company materiality: £65.8m (2016: £83.0m), based on 5% of profit before tax.

- We planned and scoped our audit to obtain sufficient coverage over the group's four reporting segments. We performed a statutory audit of the company, and its principal subsidiary Abbey National Treasury Services plc. We also performed audit procedures over a number of other reporting units that had individual account balances that were significant to the group.

- The areas of focus which were of most significance in the audit of the financial statements were:
  - Impairment of loans and advances to customers.
  - IFRS 9 transition disclosure.
  - Provision for Payment Protection Insurance.
  - Valuation of defined benefit pension obligations.
  - IT access management.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the group and parent company and the industry in which they operate, and considered the risk of acts by the group and the parent company which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at group, parent company and significant reporting units to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

We focused on laws and regulations that could give rise to a material misstatement in the group and parent company financial statements, including but not limited to, the Companies Act 2006, the Prudential Regulation Authority's and Financial Conduct Authority's regulations and the Listing Rules. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the regulators, review of correspondence with legal advisors, enquiries of management and review of internal audit reports in so far as they related to the financial statements. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We found Payment Protection Insurance to be a key audit matter, and this is discussed further below. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

The key audit matters below relate to both the group and the parent company.

Key audit matter	How our audit addressed the key audit matter
Impairment of loans and advances to customers **Refer to pages 38 to 39 (Board Audit Committee Chair's report), pages 160 to 163 (Accounting Policies), page 165 (Critical Accounting Estimates), and page 176 (note 15: Loans and Advances to customers).** Impairment allowances represent management's best estimate of credit losses incurred within a portfolio at the balance sheet date. The identification and the determination of allowances is inherently judgemental. The key allowance risks are within the residential mortgage portfolio within Retail Banking and the corporate loan portfolios within the Commercial Banking, Global Corporate Banking and Corporate Centre segments. Loss allowances are calculated on a collective basis for large homogeneous portfolios such as residential mortgages using statistical models. The calculations are driven by a number of observable and management determined inputs. Modelling assumptions and parameters, such as the propensities for default and subsequent possession once impaired, are based on historical data and current customer credit data. Our focus was on the following key areas: – Appropriateness of the models used to estimate impairment provisions and the critical assumptions used in those models, such as those used to estimate impairment events which have been incurred but not reported. – Appropriateness and completeness of overlays or post model adjustments ("PMAs") recognised by management to reflect model weaknesses or emerging risks. In corporate loan portfolios, individual impairment assessments are performed where there are observed impairment indicators. There is significant judgement required for each loan to determine the level of any provision. Our focus was on the timely identification of impaired loans and the principal assumptions applied by management in estimating the impairment allowance such as the value of collateral and forecast cash flows. We paid particular attention to management's assessment of the recoverability of loans to Carillion plc within the Global Corporate Banking (GCB) segment.	We understood and evaluated the design of the key controls over the impairment processes and tested their operating effectiveness. These controls included: – the governance over the impairment provisioning processes which includes model review and approval and the review of key model drivers; – timely identification by management of impairment events and relevant loans showing indicators of impairment; and – review and approval of the key judgements and impairment model outputs, including the completeness and appropriateness of PMAs. We noted no significant exceptions in the design, implementation or operating effectiveness of these controls. Accordingly, we relied on them for the purposes of our audit. In addition, we performed the substantive procedures described below. *Residential mortgages* We assessed whether key model methodologies remained appropriate, making use of our credit risk modelling experts and our industry knowledge. This included an evaluation of management's basis for determining whether a loan is impaired based on accounting rules, our understanding of the portfolios and market practice. We tested the coding used in the models and the calculation of key model inputs. We performed sensitivity analysis in order to identify higher risk assumptions and inputs which included impairment and possession propensities, historical loss rates and future house price inflation. In these areas we performed additional targeted procedures. We concluded that the assumptions and inputs used were reasonable. We considered whether relevant risks were captured in the modelled provisions, and where PMAs were determined to be appropriate, whether these were complete and correctly addressed the model weakness identified. We were satisfied with the coverage and appropriateness of the recognised PMAs. *Corporate loans* We tested a sample of performing loans (including loans on management's watch list) to evaluate whether impairment events had been identified by management in a timely manner. We did not identify any further impairment events. For a sample of individually impaired loans, including Carillion plc, we evaluated the specific circumstances of the borrower, including the latest developments, the basis for measuring the impairment provision, and whether key judgements were appropriate. We reperformed management's impairment calculations, testing key inputs such as expected future cash flows and discount rates. We tested the valuation of collateral held and challenged management on subjective estimates and assumptions. We also compared gains and losses realised when a loan is sold or exited to the existing provision. Based on the procedures performed and the evidence obtained, we found management's methodology, assumptions and judgements to be reasonable.

Area of focus

IFRS 9 transition disclosure
Refer to page 39 (Board Audit Committee Chair's report) and page 151 to 153 (Accounting Policies).

IFRS 9 Financial Instruments is effective from 1 January 2018, replacing the existing financial instruments standard IAS 39. As required by IAS 8 Accounting Policies, Accounting Estimates and Errors, the impact of the new standard is disclosed in the 2017 financial statements. The disclosures are significantly less comprehensive than those which will be made in the 2018 financial statements.

IFRS 9 requires the recognition of expected credit losses ('ECL') rather than incurred credit losses and is therefore a fundamentally different approach. Management is required to determine the expected loss that may occur over either a 12 month period or the remaining life of an asset, depending on the categorisation of the individual asset. This categorisation is determined by an assessment of whether there has been a significant increase in credit risk ('SICR') of the borrower since loan origination. It is also necessary to consider the impact of different future macroeconomic conditions in the determination of ECLs.

The calculation of ECLs in accordance with IFRS 9 is complex and involves a number of judgemental assumptions. As a result, we consider the IFRS 9 transition disclosure to be a key audit matter.

Management has made a number of interpretations and assumptions when designing and implementing models that are compliant with the new standard. The models use risk parameters, such as loss given default ('LGD') and probability of default ('PD') to calculate an ECL based on past experience. Management apply judgement in situations where this past experience is not considered to be reflective of future outcomes due to limited or incomplete data. This includes the use of proxy LGDs relating to corporate loans due to the limited level of historical loss data on the group's portfolios.

The following judgements are also key to the determination of the ECL:

- Setting of appropriate thresholds for what represents a SICR;
- The determination of forward looking macroeconomic scenarios and the probability weights applied to each; and
- Assessment of model and data limitations and use of post model adjustments ('PMAs') to address such risks.

How our audit addressed the area of focus

We understood and tested key transition controls in relation to:

- the validation of models and the approval process for use by management; and
- review and approval of key assumptions and the output of IFRS 9 models.

Our work on these controls allowed us to rely on them for the purposes of our audit of the transitional disclosures. We also performed the following substantive procedures.

We understood and critically assessed the ECL models developed by the group using a risk based approach. This included a review of accounting policy choices made by management to ensure these were compliant with the requirements of IFRS 9. We used our credit modelling experts to assess the model methodologies for the key risk parameters against the requirements of the standard and industry practice.

We tested the models by reperforming model calculations which produce the risk parameter outputs. We critically reviewed management's assumptions in response to data limitations, focusing on the LGD used for corporate loans. We concluded that management's judgements in deriving LGDs were reasonable.

We evaluated key assumptions such as the thresholds used to determine SICR and forward looking macroeconomic scenarios including the related weightings. We used PwC credit risk modellers and economists to challenge management's assumptions, including the consideration of alternative scenarios and publicly available market consensus data.

We considered whether relevant risks were captured in the modelled provisions and the results of model validation testing in challenging management on the completeness and appropriateness of PMAs. We then evaluated whether the PMAs correctly addressed the model and data weaknesses identified and tested the calculation of the adjustments.

Based on the evidence obtained, we found the methodologies and assumptions used in preparing the IFRS 9 transition disclosure to be reasonable.

Area of focus

Provision for Payment Protection Insurance
Refer to page 38 (Board Audit Committee Chair's report), page 164 (Accounting Policies), page 165 (Critical Accounting Estimates), pages 189 (note 27: Provisions) and page 197 (note 29: Contingent Liabilities and Commitments)

A provision of £356m is held in respect of Payment Protection Insurance ('PPI') policies historically sold, reflecting expected payments associated with customer redress and operational costs.

In March 2017, the Financial Conduct Authority issued Policy Statement 17/3 which introduced a time bar of 29 August 2019 to submit claims and also included guidance on how banks should respond to the issue of undisclosed commissions arising out of the Plevin v Paragon Personal Finance Ltd Supreme Court ruling. An FCA led advertising campaign commenced in August and will continue at various intervals until the time bar.

In calculating the provision, management is required to make significant judgements in estimating the number of customers that will complain in the future and associated uphold rates, and the cost of redress arising out of the Plevin case. During the year, management also obtained external legal advice in connection with the group's liability for paying redress claims in relation to a specific portfolio. In consequence there was a net increase to the provision relating to a higher estimate of future claims offset by a release relating to the specific portfolio.

How our audit addressed the area of focus

We understood and evaluated the design and tested the operating effectiveness of the controls over the process to determine the PPI provision, including consideration of new or emerging risks. We determined we could rely on these controls for the purposes of our audit. Given the judgements involved, we also examined the provision in detail and sought additional evidence.

We evaluated the appropriateness of the methodology used by management to forecast the number of PPI complaints, including Plevin, expected to be received in the future in light of recent experience, the FCA's Policy Statement and future advertising campaigns and market practice. Where management made adjustments to the model, we assessed the supporting evidence to justify the change.

We tested the provisioning model and underlying assumptions, including those related to inflows and uphold rates. For those assumptions based on historic information, we considered whether this continued to be appropriate for future experience.

We compared the output of alternative scenarios to those used by management and considered the sensitivity to possible variations in the key assumptions. This could result in different amounts to those calculated by management, but in our view these differences were within a reasonable range of probable outcomes in the context of the degree of uncertainty.

We reviewed management's judgement and supporting legal advice in respect of the treatment of the specific portfolio of claims. We evaluated the accounting implications against the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets and concluded the accounting treatment was appropriate.

We evaluated whether the disclosures made in the financial statements were sufficiently clear in describing the uncertainties and the risks associated with PPI provisions. We found the disclosures to be appropriate.

Area of focus	How our audit addressed the area of focus
Valuation of defined benefit pension obligations **Refer to page 39 (Board Audit Committee Chair's report), page 155 (Accounting Policies), page 165 (Critical Accounting Estimates), and page 192 (note 28: Retirement Benefit Plans).** The accounting valuation of the obligations of the Santander (UK) Group Pension Scheme (the 'Scheme') is dependent on a number of assumptions about future experience. Small changes in the discount rate, inflation rate and mortality assumptions can have a material impact on the valuation of the pension obligations. The discount and inflation rates are illiquid data inputs and difficult to estimate due to the long duration of the pension obligations. Management revised their method for determining the inflation assumption and adopted new mortality assumptions during the year. A new actuarial expert was also appointed in 2017.	We evaluated the design and tested the operating effectiveness of the controls for determining the actuarial assumptions used in calculating the valuation of future obligations. We determined we could rely on these controls for the purposes of our audit. We used our actuarial specialists to evaluate management's assumptions and methodologies. We utilised PwC developed benchmarks and external market data, as well as our industry experience. We evaluated the model adopted to derive the discount rate assumption, including the extrapolation technique used to estimate future cash flows expected to be paid through to the end of the Scheme's duration. In respect of the revised methodology to derive the inflation assumption, we evaluated management's approach and compared this to market practice. We also evaluated the approach adopted with respect to the new mortality assumptions. We considered the objectivity and competence of management's new actuarial expert, and evaluated the impact on the valuation of the pension obligations given differences in the model used by the new expert. Based on the evidence obtained, we found the assumptions and methodologies used in the valuation of the Scheme's defined benefit obligations to be reasonable. We read and assessed the disclosures made in the financial statements, including the disclosures of the assumptions, and found them to be appropriate.
IT access management **Refer to page 40 (Board Audit Committee Chair's report)** Controls over access rights to technology platforms ensure that changes to applications and data are authorised and made in an appropriate manner. Specifically, controls to restrict, log and monitor individuals' access to applications and supporting infrastructure components are important. These controls ensure that only appropriate individuals have access and that this access is monitored to mitigate the risk of fraud or error and to ensure the integrity of automated business controls. In the prior year, it was identified that controls over developers' access rights to applications used in financial reporting processes required improvement to ensure that access was sufficiently restricted and monitored. The segment most affected was Global Corporate Banking and the systems impacted included trade processing, settlement systems, reconciliation tools and confirmation systems. Management implemented new access controls in the latter half of 2017. Since effective controls did not operate for the entire audit period, we continued to consider this issue as a key audit matter.	We identified the systems, relevant to our audit, affected by the access control issue. We obtained the complete list of individuals with access to these production systems and inspected account privileges to confirm the extent of access and the scope of the issue. We then identified which financial statement line items were impacted and performed an assessment of the risk of misstatement. We tested the procedural change controls over systems and automated business controls relevant for financial reporting and determined we could rely on these controls. We tested compensating IT controls, including controls over granting access and the periodic review of access rights. We also tested the new IT controls implemented by management to remediate the access issue which we found to be effective. We tested business compensating controls, including key reconciliations and where relevant increased the extent of our testing. We performed additional substantive procedures on the year end balance sheet and income statement accounts impacted by the IT access issue. Our additional testing of compensating controls and substantive testing of the balance sheet and income statement was concluded satisfactorily.

How we tailored the audit scope

· We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the group and the parent company, the accounting processes and controls, and the industry in which they operate.

The group comprises four segments for which it reports its operating results and financial position. These are Retail Banking, Commercial Banking, Global Corporate Banking and Corporate Centre. The segments maintain their own accounting records and report to the group through an integrated consolidation system. Each segment is made up of a number of individual reporting units ('components'). We identified the components which, in our view, required a full scope audit either due to their size or their risk characteristics in the context of the group's consolidated financial statements. The company and Abbey National Treasury Services plc comprise all of the individually financially significant components. We performed a statutory audit of Abbey National Treasury Services plc.

We used component auditors within PwC who are familiar with the relevant businesses to audit specific reporting units within the company and Abbey National Treasury Services plc. We then identified further components that we determined to be individually significant in respect of one or more account balances and performed specific audit procedures over those account balances. Specific audit procedures were performed at the group's head office including the testing of pension assets and liabilities, PPI provisions, the consolidation process, goodwill and taxation.

Processes and controls supporting the group's operations are also performed at Banco Santander S.A. in Spain, including the hosting and monitoring of certain IT systems. As part of the planning and execution of the audit, we worked closely with the component auditor to ensure that the procedures performed on our behalf were sufficient for our purposes and we reviewed the results of their work.

The procedures which we performed over the reporting units accounted for 85.6% of total operating income and 96.3% of total assets of the group.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent company financial statements
Overall materiality	£90.8m (2016: £95.0m).	£65.8m (2016: £83.3m).
How we determined it	5% of profit before tax.	5% of profit before tax.
Rationale for benchmark applied	We chose 5% of profit before tax, a generally accepted auditing practice and a key performance indicator for the group's stakeholders.	We chose 5% of profit before tax, a generally accepted auditing practice and a key performance indicator for the group's stakeholders.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £5.5m and £60.0m. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We agreed with the Board Audit Committee that we would report to them misstatements identified during our audit above £4.0m (group and parent company audits) (2016: £4.0m) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the group's and the parent company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's and parent company's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006, (CA06) and ISAs (UK) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic Report and Directors' Report
In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the group and parent company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report. (CA06)

The directors' assessment of the prospects of the group and of the principal risks that would threaten the solvency or liquidity of the group
As a result of the directors' voluntary reporting on how they have applied the UK Corporate Governance Code (the "Code"), we are required to report to you if we have anything material to add or draw attention to regarding:

- The directors' confirmation on page 53 of the Annual Report that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The directors' explanation on page 54 of the Annual Report as to how they have assessed the prospects of the group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report in respect of this responsibility.

Other Code Provisions
As a result of the directors' voluntary reporting on how they have applied the Code, we are required to report to you if, in our opinion:

- The statement given by the directors, on page 56, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the group's and parent company's position and performance, business model and strategy is materially inconsistent with our knowledge of the group and parent company obtained in the course of performing our audit.
- The section of the Annual Report on page 37 describing the work of the Board Audit Committee does not appropriately address matters communicated by us to the Board Audit Committee.

We have nothing to report in respect of this responsibility.

Responsibilities for the financial statements and the audit
Responsibilities of the directors for the financial statements
As explained more fully in the Directors' Responsibilities Statement set out on page 56, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report
This report, including the opinions, has been prepared for and only for the parent company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting
Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.

Appointment
Following a recommendation by the Board, we were first appointed by the members on 31 March 2016 to audit the financial statements for the year ended 31 December 2016, and we were re-appointed on 31 March 2017. The period of total uninterrupted engagement is 2 years.

Other voluntary reporting

Going concern
The directors have requested that we review the statement on page 54 in relation to going concern as if the parent company were a premium listed company. We have nothing to report having performed our review.

The directors' assessment of the prospects of the group and of the principal risks that would threaten the solvency or liquidity of the group
The directors have requested that we perform a review of the directors' statements on pages 53 and 54 that they have carried out a robust assessment of the principal risks facing the group and in relation to the longer-term viability of the group, as if the parent company were a premium listed company. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the Code; and considering whether the statements are consistent with the knowledge and understanding of the group and parent company and their environment obtained in the course of the audit. We have nothing to report having performed this review.

Other Code Provisions
The directors have prepared a corporate governance statement and requested that we review it as though the parent company were a premium listed company. We have nothing to report in respect of the requirement for the auditors of premium listed companies to report when the directors' statement relating to the parent company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' remuneration
The parent company voluntarily prepares a Directors' Remuneration Report in accordance with the provisions of the Companies Act 2006. The directors requested that we audit the part of the Directors' Remuneration Report specified by the Companies Act 2006 to be audited as if the parent company were a quoted company. In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

JHolloway

Jonathan Holloway (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
27 February 2018

Consolidated Income Statement

For the years ended 31 December

	Notes	2017 £m	2016 £m	2015 £m
Interest and similar income	3	**5,905**	6,467	6,695
Interest expense and similar charges	3	**(2,102)**	(2,885)	(3,120)
Net interest income		**3,803**	3,582	3,575
Fee and commission income	4	**1,222**	1,188	1,115
Fee and commission expense	4	**(415)**	(418)	(400)
Net fee and commission income		**807**	770	715
Net trading and other income	5	**302**	443	283
Total operating income		**4,912**	4,795	4,573
Operating expenses before impairment losses, provisions and charges	6	**(2,499)**	(2,414)	(2,400)
Impairment losses on loans and advances	8	**(203)**	(67)	(66)
Provisions for other liabilities and charges	8	**(393)**	(397)	(762)
Total operating impairment losses, provisions and charges		**(596)**	(464)	(828)
Profit before tax		**1,817**	1,917	1,345
Tax on profit	9	**(561)**	(598)	(381)
Profit after tax		**1,256**	1,319	964
Attributable to:				
Equity holders of the parent		**1,235**	1,292	939
Non-controlling interests	32	**21**	27	25
Profit after tax		**1,256**	1,319	964

Consolidated Statement of Comprehensive Income

For the years ended 31 December

	2017 £m	2016 £m	2015 £m
Profit after tax	**1,256**	1,319	964
Other comprehensive income:			
Other comprehensive income that may be reclassified to profit or loss subsequently:			
Available-for-sale securities:			
- Change in fair value	**80**	127	14
- Income statement transfers	**(54)**	(115)	42
- Taxation	**(6)**	(16)	(2)
	20	(4)	54
Cash flow hedges:			
- Effective portion of changes in fair value	**(238)**	4,365	(307)
- Income statement transfers	**(94)**	(4,076)	305
- Taxation	**89**	(72)	(6)
	(243)	217	(8)
Currency translation on foreign operations	**–**	(3)	(5)
Net other comprehensive income that may be reclassified to profit or loss subsequently	**(223)**	210	41
Other comprehensive income that will not be reclassified to profit or loss subsequently:			
- Pension remeasurement	**(103)**	(528)	319
- Taxation	**26**	133	(89)
	(77)	(395)	230
Own credit adjustment:			
- Transfers	**(29)**	–	–
- Taxation	**7**	–	–
	(22)	–	–
Net other comprehensive income that will not be reclassified to profit or loss subsequently	**(99)**	(395)	230
Total other comprehensive income net of tax	**(322)**	(185)	271
Total comprehensive income	**934**	1,134	1,235
Attributable to:			
Equity holders of the parent	**913**	1,107	1,209
Non-controlling interests	**21**	27	26
Total comprehensive income	**934**	1,134	1,235

The accompanying Notes to the Financial Statements form an integral part of these Consolidated Financial Statements.

Consolidated Balance Sheet

At 31 December

	Notes	2017 £m	2016[1] £m
Assets			
Cash and balances at central banks		**32,771**	17,107
Trading assets	11	**30,555**	30,035
Derivative financial instruments	12	**19,942**	25,471
Financial assets designated at fair value	13	**2,096**	2,140
Loans and advances to banks	14	**5,927**	4,348
Loans and advances to customers	15	**199,490**	199,738
Financial investments	18	**17,611**	17,466
Interests in other entities	19	**73**	61
Intangible assets	20	**1,742**	1,685
Property, plant and equipment		**1,598**	1,491
Retirement benefit assets	28	**449**	398
Other assets		**2,511**	2,571
Total assets		**314,765**	302,511
Liabilities			
Deposits by banks	21	**13,784**	9,769
Deposits by customers	22	**183,648**	177,172
Trading liabilities	23	**31,109**	15,560
Derivative financial instruments	12	**17,613**	23,103
Financial liabilities designated at fair value	24	**2,315**	2,440
Debt securities in issue	25	**42,633**	50,346
Subordinated liabilities	26	**3,793**	4,303
Other liabilities		**2,730**	3,221
Provisions	27	**558**	700
Current tax liabilities	9	**3**	54
Deferred tax liabilities	9	**88**	128
Retirement benefit obligations	28	**286**	262
Total liabilities		**298,560**	287,058
Equity			
Share capital	30	**3,119**	3,119
Share premium	30	**5,620**	5,620
Other equity instruments	31	**2,281**	1,785
Retained earnings		**4,732**	4,255
Other reserves		**301**	524
Total shareholders' equity		**16,053**	15,303
Non-controlling interests	32	**152**	150
Total equity		**16,205**	15,453
Total liabilities and equity		**314,765**	302,511

(1) Restated to reflect the change in accounting policy relating to business combinations between entities under common control, as described in Note 1.

The accompanying Notes to the Financial Statements form an integral part of these Consolidated Financial Statements.

The Financial Statements were approved and authorised for issue by the Board on 27 February 2018 and signed on its behalf by:

Nathan Bostock
Chief Executive Officer

Antonio Roman
Chief Financial Officer

Company Registered Number: 2294747

Consolidated Cash Flow Statement

For the years ended 31 December

	Notes	2017 £m	2016 £m	2015 £m
Cash flows from operating activities				
Profit after tax		**1,256**	1,319	964
Adjustments for:				
Non-cash items included in profit:				
– Depreciation and amortisation		**354**	322	295
– Amortisation of premiums on debt securities		**22**	29	67
– Provisions for other liabilities and charges		**393**	397	762
– Impairment losses		**257**	132	156
– Corporation tax charge		**561**	598	381
– Other non-cash items		**(230)**	(628)	151
– Pension charge for defined benefit pension schemes		**32**	26	29
		1,389	876	1,841
Net change in operating assets and liabilities:				
– Cash and balances at central banks		**(25)**	(30)	(22)
– Trading assets		**(941)**	(2,049)	(4,237)
– Derivative assets		**5,529**	(4,560)	2,110
– Financial assets designated at fair value		**25**	257	480
– Loans and advances to banks and customers		**(1,832)**	(2,265)	(7,789)
– Other assets		**(246)**	(121)	(532)
– Deposits by banks and customers		**10,900**	14,434	9,399
– Derivative liabilities		**(5,490)**	1,595	(1,224)
– Trading liabilities		**15,017**	2,837	(2,606)
– Financial liabilities designated at fair value		**717**	336	27
– Debt securities in issue		**132**	409	(1,166)
– Other liabilities		**(1,397)**	1,589	(138)
		22,389	12,432	(5,698)
Corporation taxes paid		**(484)**	(507)	(419)
Effects of exchange rate differences		**(574)**	3,885	(585)
Net cash flows from operating activities		**23,976**	18,005	(3,897)
Cash flows from investing activities				
Investments in other entities	19	**–**	–	(109)
Proceeds from disposal of subsidiaries[1]		**–**	149	–
Purchase of property, plant and equipment and intangible assets		**(542)**	(374)	(356)
Proceeds from sale of property, plant and equipment and intangible assets		**52**	65	40
Purchase of financial investments		**(726)**	(9,539)	(2,021)
Proceeds from sale and redemption of financial investments		**2,032**	2,359	1,928
Net cash flows from investing activities		**816**	(7,340)	(518)
Cash flows from financing activities				
Issue of AT1 Capital Securities	31	**500**	–	750
Issuance costs of AT1 Capital Securities		**(4)**	–	–
Issue of debt securities and subordinated notes		**6,645**	5,547	13,267
Issuance costs of debt securities and subordinated notes		**(15)**	(17)	(33)
Repayment of debt securities and subordinated notes		**(13,763)**	(11,352)	(16,098)
Repurchase of preference shares and other equity instruments	31	**–**	(7)	(99)
Dividends paid on ordinary shares	10	**(829)**	(419)	(575)
Dividends paid on preference shares and other equity instruments		**(152)**	(128)	(126)
Dividends paid on non-controlling interests		**(19)**	(12)	–
Net cash flows from financing activities		**(7,637)**	(6,388)	(2,914)
Change in cash and cash equivalents		**17,155**	4,277	(7,329)
Cash and cash equivalents at beginning of the year		**25,705**	20,351	27,363
Effects of exchange rate changes on cash and cash equivalents		**(634)**	1,077	317
Cash and cash equivalents at the end of the year		**42,226**	25,705	20,351
Cash and cash equivalents consist of:				
Cash and balances at central banks		**32,771**	17,107	16,842
Less: regulatory minimum cash balances		**(395)**	(370)	(340)
		32,376	16,737	16,502
Net trading and other cash equivalents		**5,953**	6,537	2,068
Net non-trading other cash equivalents		**3,897**	2,431	1,781
Cash and cash equivalents at the end of the year		**42,226**	25,705	20,351

(1) In 2016, the Santander UK group sold a number of subsidiaries for a cash consideration of £149m. The net assets disposed of consisted of other assets and other liabilities of £138m

The accompanying Notes to the Financial Statements form an integral part of these Consolidated Financial Statements.

Consolidated Statement of Changes in Equity

For the years ended 31 December

	Share capital £m	Share premium £m	Other equity instruments £m	Other reserves: Available-for-sale £m	Other reserves: Cash flow hedging £m	Other reserves: Currency translation £m	Retained earnings[1][3] £m	Total £m	Non-controlling interests £m	Total £m
At 1 January 2017	**3,119**	**5,620**	**1,785**	**48**	**471**	**5**	**4,255[3]**	**15,303**	**150**	**15,453**
Profit after tax	–	–	–	–	–	–	**1,235**	**1,235**	**21**	**1,256**
Other comprehensive income, net of tax:										
– Available-for-sale securities	–	–	–	**20**	–	–	–	**20**	–	**20**
– Cash flow hedges	–	–	–	–	**(243)**	–	–	**(243)**	–	**(243)**
– Pension remeasurement	–	–	–	–	–	–	**(77)**	**(77)**	–	**(77)**
– Own credit adjustment	–	–	–	–	–	–	**(22)**	**(22)**	–	**(22)**
Total comprehensive income	–	–	–	**20**	**(243)**	–	**1,136**	**913**	**21**	**934**
Issue of AT1 Capital Securities	–	–	**496**	–	–	–	–	**496**	–	**496**
Dividends on ordinary shares	–	–	–	–	–	–	**(553)**	**(553)**	–	**(553)**
Dividends on preference shares and other equity instruments	–	–	–	–	–	–	**(152)**	**(152)**	–	**(152)**
Dividends on non-controlling interests	–	–	–	–	–	–	–	–	**(19)**	**(19)**
Tax on other equity instruments	–	–	–	–	–	–	**46**	**46**	–	**46**
At 31 December 2017	**3,119**	**5,620**	**2,281**	**68**	**228**	**5**	**4,732**	**16,053**	**152**	**16,205**
At 1 January 2016	3,119	5,620	1,792	52	254	8	4,048	14,893	135	15,028
Profit after tax	–	–	–	–	–	–	1,292	1,292	27	1,319
Other comprehensive income, net of tax:										
– Available-for-sale securities	–	–	–	(4)	–	–	–	(4)	–	(4)
– Cash flow hedges	–	–	–	–	217	–	–	217	–	217
– Pension remeasurement	–	–	–	–	–	–	(395)	(395)	–	(395)
– Currency translation on foreign operations	–	–	–	–	–	(3)	–	(3)	–	(3)
Total comprehensive income	–	–	–	(4)	217	(3)	897	1,107	27	1,134
Repurchase of other equity instruments	–	–	(7)	–	–	–	–	(7)	–	(7)
Dividends on ordinary shares	–	–	–	–	–	–	(593)	(593)	–	(593)
Dividends on preference shares and other equity instruments	–	–	–	–	–	–	(128)	(128)	–	(128)
Dividends on non-controlling interests	–	–	–	–	–	–	–	–	(12)	(12)
Tax on other equity instruments	–	–	–	–	–	–	31	31	–	31
At 31 December 2016	3,119	5,620	1,785	48	471	5	4,255	15,303	150	15,453
At 1 January 2015	3,119	5,620	1,125	(2)	262	13	3,425	13,562	–	13,562
Profit after tax	–	–	–	–	–	–	939	939	25	964
Other comprehensive income, net of tax:										
– Available-for-sale securities	–	–	–	54	–	–	–	54	–	54
– Cash flow hedges	–	–	–	–	(8)	–	–	(8)	–	(8)
– Pension remeasurement	–	–	–	–	–	–	229	229	1	230
– Currency translation on foreign operations	–	–	–	–	–	(5)	–	(5)	–	(5)
Total comprehensive income	–	–	–	54	(8)	(5)	1,168	1,209	26	1,235
Acquisition of subsidiary	–	–	–	–	–	–	–	–	109	109
Issue of AT1 Capital Securities	–	–	750	–	–	–	–	750	–	750
Repurchase of preference shares and other equity instruments	–	–	(83)	–	–	–	(16)	(99)	–	(99)
Dividends on ordinary shares	–	–	–	–	–	–	(427)	(427)	–	(427)
Dividends on preference shares and other equity instruments	–	–	–	–	–	–	(126)	(126)	–	(126)
Tax on other equity instruments	–	–	–	–	–	–	24	24	–	24
At 31 December 2015	3,119	5,620	1,792	52	254	8	4,048	14,893	135	15,028

(1) Includes capital redemption reserve of £nil (2016: £nil, 2015: £21m) arising from the purchase of £300m fixed/floating rate non-cumulative callable preference shares in 2017, 2016 and 2015.
(2) The impact of the early adoption of IFRS 9 requirements for the presentation of gains and losses on such financial liabilities relating to own credit in other comprehensive income as described in Note 1, was £18m (net of tax).
(3) Restated to reflect the change in accounting policy relating to business combinations between entities under common control, as described in Note 1.

The accompanying Notes to the Financial Statements form an integral part of these Consolidated Financial Statements.

Company Balance Sheet

At 31 December

	Notes	2017 £m	2016(1) £m
Assets			
Cash and balances at central banks		**27,643**	13,591
Derivative financial instruments	12	**4,038**	7,391
Financial assets designated at fair value	13	**793**	85
Loans and advances to banks	14	**15,164**	25,699
Loans and advances to customers	15	**206,157**	200,574
Financial investments	18	**20,118**	17,513
Interests in other entities	19	**4,490**	4,486
Intangible assets	20	**1,677**	1,633
Property, plant and equipment		**1,181**	1,204
Current tax assets	9	**187**	137
Retirement benefit assets	28	**436**	384
Other assets		**1,637**	1,500
Total assets		**283,521**	274,197
Liabilities			
Deposits by banks	21	**28,021**	19,741
Deposits by customers	22	**198,921**	194,674
Derivative financial instruments	12	**2,244**	3,440
Financial liabilities designated at fair value	24	**1,297**	321
Debt securities in issue	25	**32,048**	34,496
Subordinated liabilities	26	**3,870**	4,411
Other liabilities		**2,087**	2,516
Provisions	27	**514**	674
Deferred tax liabilities	9	**73**	70
Retirement benefit obligations	28	**286**	262
Total liabilities		**269,361**	260,605
Equity			
Share capital	30	**3,119**	3,119
Share premium	30	**5,620**	5,620
Other equity instruments	31	**2,281**	1,785
Retained earnings		**3,139**	2,993
Other reserves		**1**	75
Total shareholders' equity		**14,160**	13,592
Total liabilities and equity		**283,521**	274,197

(1) Restated to reflect the change in accounting policy relating to business combinations between entities under common control, as described in Note 1.

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

The profit after tax of the Company attributable to shareholders was £889m (2016: £1,171m). As permitted by Section 408 of the UK Companies Act 2006, the Company's individual Income Statement has not been presented.

The Financial Statements were approved and authorised for issue by the Board on 27 February 2018 and signed on its behalf by:

Nathan Bostock
Chief Executive Officer

Antonio Roman
Chief Financial Officer

Company Registered Number: 2294747

Company Cash Flow Statement

For the years ended 31 December

	Notes	2017 £m	2016 £m	2015 £m
Cash flows from operating activities				
Profit after tax		**889**	1,171	115
Adjustments for:				
Non-cash items included in profit:				
– Depreciation and amortisation		**301**	279	243
– Amortisation of premiums on debt securities		**20**	21	20
– Provisions for other liabilities and charges		**354**	377	719
– Impairment losses		**181**	93	152
– Corporation tax charge		**416**	496	227
– Other non-cash items		**(465)**	250	215
– Pension charge for defined benefit pension schemes		**31**	24	27
		838	1,540	1,603
Net change in operating assets and liabilities:				
– Cash and balances at central banks		**(23)**	(30)	(19)
– Derivative assets		**3,353**	(4,089)	109
– Financial assets designated at fair value		**(705)**	(25)	23
– Loans and advances to banks and customers		**(17,169)**	(13,898)	(15,510)
– Other assets		**(216)**	(292)	(313)
– Deposits by banks and customers		**12,922**	(2,917)	21,405
– Derivative liabilities		**(1,196)**	412	874
– Financial liabilities designated at fair value		**45**	(31)	-
– Debt securities in issue		**1,631**	324	-
– Other liabilities		**(985)**	(391)	(196)
		(2,343)	(20,937)	6,373
Corporation taxes paid		**(362)**	(393)	(132)
Effects of exchange rate differences		**(95)**	1,540	(104)
Net cash flows from operating activities		**(1,073)**	(17,079)	7,855
Cash flows from investing activities				
Purchase of property, plant and equipment and intangible assets	20	**(339)**	(337)	(313)
Proceeds from sale of property, plant and equipment and intangible assets		**17**	41	28
Purchase of financial investments		**(725)**	(9,539)	(2,021)
Proceeds from sale and redemption of financial investments		**1,550**	1,659	617
Net cash flows from investing activities		**503**	(8,176)	(1,689)
Cash flows from financing activities				
Issue of AT1 Capital Securities	31	**500**	-	750
Issuance cost of AT1 Capital Securities	31	**(4)**	-	-
Issue of debt securities and subordinated notes		**4,311**	36,028	1,059
Issuance costs of debt securities and subordinated notes		**(8)**	(6)	(6)
Repayment of debt securities and subordinated notes		**(7,441)**	(3,822)	(1,251)
Repurchase of preference shares and other equity instruments	31	**–**	(7)	(99)
Dividends paid on ordinary shares	10	**(829)**	(419)	(575)
Dividends paid on preference shares and other equity instruments		**(152)**	(128)	(126)
Net cash flows from financing activities		**(3,623)**	31,646	(248)
Change in cash and cash equivalents		**(4,193)**	6,391	5,918
Cash and cash equivalents at beginning of the year		**34,344**	27,953	22,035
Effects of exchange rate changes on cash and cash equivalents		**(38)**	-	-
Cash and cash equivalents at the end of the year		**30,113**	34,344	27,953
Cash and cash equivalents comprise of:				
Cash and balances at central banks		**27,643**	13,591	14,562
Less: regulatory minimum cash balances		**(353)**	(330)	(300)
		27,290	13,261	14,262
Net non-trading other cash equivalents		**2,823**	21,083	13,691
Cash and cash equivalents at the end of the year		**30,113**	34,344	27,953

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

Company Statement of Changes in Equity

For the years ended 31 December

	Share capital £m	Share premium £m	Other equity instruments £m	Other reserves: Available-for-sale £m	Other reserves: Cash flow hedging £m	Retained earnings[1] £m	Total £m
At 1 January 2017	**3,119**	**5,620**	**1,785**	**52**	**23**	**2,993**	**13,592**
Profit after tax	**–**	**–**	**–**	**–**	**–**	**889**	**889**
Other comprehensive income, net of tax:							
– Available-for-sale securities	**–**	**–**	**–**	**16**	**–**	**–**	**16**
– Cash flow hedges	**–**	**–**	**–**	**–**	**(90)**	**–**	**(90)**
– Pension remeasurement	**–**	**–**	**–**	**–**	**–**	**(76)**	**(76)**
– Own credit adjustment	**–**	**–**	**–**	**–**	**–**	**(8)**	**(8)**
Total comprehensive income	**–**	**–**	**–**	**16**	**(90)**	**805**	**731**
Issue of AT1 Capital Securities	**–**	**–**	**496**	**–**	**–**	**–**	**496**
Dividends on ordinary shares	**–**	**–**	**–**	**–**	**–**	**(553)**	**(553)**
Dividends on preference shares and other equity instruments	**–**	**–**	**–**	**–**	**–**	**(152)**	**(152)**
Tax on other equity instruments	**–**	**–**	**–**	**–**	**–**	**46**	**46**
At 31 December 2017	**3,119**	**5,620**	**2,281**	**68**	**(67)**	**3,139**	**14,160**
At 1 January 2016	3,119	5,620	1,792	72	(6)	2,898	13,495
Profit after tax	–	–	–	–	–	1,171	1,171
Other comprehensive income, net of tax:							
– Available-for-sale securities	–	–	–	(20)	–	–	(20)
– Cash flow hedges	–	–	–	–	29	–	29
– Pension remeasurement	–	–	–	–	–	(386)	(386)
Total comprehensive income	–	–	–	(20)	29	785	794
Repurchase of other equity instruments	–	–	(7)	–	–	–	(7)
Dividends on ordinary shares	–	–	–	–	–	(593)	(593)
Dividends on preference shares and other equity instruments	–	–	–	–	–	(128)	(128)
Tax on other equity instruments	–	–	–	–	–	31	31
At 31 December 2016	3,119	5,620	1,785	52	23	2,993	13,592
At 1 January 2015	3,119	5,620	1,125	23	–	3,101	12,988
Profit after tax	–	–	–	–	–	115	115
Other comprehensive income, net of tax:							
– Available-for-sale securities	–	–	–	49	–	–	49
– Cash flow hedges	–	–	–	–	(6)	–	(6)
– Pension remeasurement	–	–	–	–	–	227	227
Total comprehensive income	–	–	–	49	(6)	342	385
Issue of AT1 Capital Securities	–	–	750	–	–	–	750
Repurchase of preference shares and other equity instruments	–	–	(83)	–	–	(16)	(99)
Dividends on ordinary shares	–	–	–	–	–	(427)	(427)
Dividends on preference shares and other equity instruments	–	–	–	–	–	(126)	(126)
Tax on other equity instruments	–	–	–	–	–	24	24
At 31 December 2015	3,119	5,620	1,792	72	(6)	2,898	13,495

(1) Restated to reflect the change in accounting policy relating to business combinations between entities under common control, as described in Note 1.

The accompanying Notes to the Financial Statements form an integral part of these Financial Statements.

1. ACCOUNTING POLICIES

These financial statements are prepared for Santander UK plc (the Company) and the Santander UK plc group (the Santander UK group) under the UK Companies Act 2006. The principal activity of the Santander UK group is the provision of an extensive range of personal financial services, and a wide range of banking and financial services to personal, business and public sector customers.

Santander UK plc is a public limited company, incorporated in England and Wales having a registered office at 2 Triton Square, Regent's Place, London, NW1 3AN, phone number 0870-607-6000. It is an operating company undertaking banking and financial services transactions..

Basis of preparation

These financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year. The financial statements have been prepared on the going concern basis using the historical cost convention, as modified by the revaluation of available-for-sale financial assets, financial assets and financial liabilities held at fair value through profit or loss and all derivative contracts, assets held for sale, retirement benefit obligations and cash-settled share-based payments, where applicable. An assessment of the appropriateness of the adoption of the going concern basis of accounting is disclosed in the Directors' statement of going concern set out in the Directors' Report.

Compliance with International Financial Reporting Standards

The Santander UK group Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB), including interpretations issued by the IFRS Interpretations Committee (IFRS IC) of the IASB (together IFRS). The Santander UK group has also complied with its legal obligation to comply with International Financial Reporting Standards as adopted by the European Union as there are no applicable differences between the two frameworks for the periods presented.

The Company financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union and as applied in accordance with the provision of the UK Companies Act 2006.

Disclosures required by IFRS 7 'Financial Instruments: Disclosure' relating to the nature and extent of risks arising from financial instruments, and IAS 1 'Presentation of Financial Statements' relating to objectives, policies and processes for managing capital, can be found in the Risk review which form an integral part of these financial statements.

The Santander UK group designates certain financial liabilities at fair value through profit or loss where they contain embedded derivatives or where associated derivatives used to economically hedge the risk are held at fair value. Following the endorsement of IFRS 9 'Financial Instruments' by the EU in December 2016, the Santander UK group has elected to early apply from 1 January 2017 the requirements for the presentation of gains and losses on such financial liabilities relating to own credit in other comprehensive income without applying the other requirements in IFRS 9. The cumulative own credit adjustment component of the cumulative fair value adjustment on financial liabilities designated at fair value through profit or loss was £18m (net of tax) and is included in opening retained earnings. For the Company the cumulative own credit adjustment component of the cumulative fair value adjustment on financial liabilities designated at fair value through profit or loss was £20m (net of tax) and is included in opening retained earnings. Comparatives have not been restated.

Change in accounting policy

During the year, management changed the accounting policy for business combinations between entities under common control. Previously, the Santander UK group applied acquisition accounting under IFRS 3 where the acquisition was for cash consideration. Where the acquisition was for non-cash consideration, the acquisition was accounted for in a manner consistent with group reconstruction relief under the UK GAAP (merger accounting). Management has elected to account for all business combinations between entities under common control at their book values in the acquired entity by including the acquired entity's results from the date of the business combinations and not restating comparatives. Management believes changing to this basis of accounting is more relevant to accounting for business combinations between entities under common control. Applying acquisition accounting to such transactions where all of the businesses are ultimately controlled by the same party both before and after the business combinations is seen as being less relevant as there are no parties external to Banco Santander SA. For the Santander UK group, the effect of changing the accounting policy is to reduce goodwill by £631m and reduce retained earnings by the same amount, this amount representing the difference between the purchase price and the aggregate book value of the assets and liabilities of Santander Cards Limited, Santander Cards (UK) Limited (and its subsidiaries), Santander Cards Ireland Limited and Santander Consumer (UK) plc, which were acquired from Banco Santander SA in 2010. For the Company, the effect is to reduce goodwill by £456m and reduce retained earnings by the same amount, this amount representing the difference between the purchase price and the aggregate book value of the assets and liabilities of Santander Cards Limited, Santander Cards (UK) Limited (and its subsidiaries) and Santander Cards Ireland Limited. Each of the comparative periods presented has been restated to reflect the change in accounting policy. The application of the change in accounting policy did not result in any material change to the accounting for the acquisition of Alliance & Leicester plc from Banco Santander SA in 2009.

Future accounting developments

As at 31 December 2017, the Santander UK group has not yet adopted the following significant new or revised standards and interpretations, and amendments thereto, which have been issued but which are not yet effective for the Santander UK group:

a) IFRS 9 'Financial Instruments' (IFRS 9) – In July 2014, the International Accounting Standards Board (IASB) approved IFRS 9 to replace IAS 39 'Financial Instruments: Recognition and Measurement'.

IFRS 9 sets out the requirements for recognition and measurement of financial instruments. The main new developments of the standard are discussed below.

Classification and measurement of financial assets and financial liabilities: Under IFRS 9, financial assets are classified on the basis of the business model within which they are held and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss. For many financial assets, the classification and measurement outcomes are similar to IAS 39. However, under IFRS 9, embedded derivatives are not separated from host financial assets and equity securities are measured at fair value either through profit or loss or, in certain circumstances, an irrevocable election may be made to present fair value movements in other comprehensive income. The requirements for the classification and measurement of financial liabilities were carried forward unchanged from IAS 39, however, the requirements relating to the fair value option for financial liabilities were changed to address own credit risk and, in particular, the presentation of gains and losses within other comprehensive income. For the Santander UK group:

- The vast majority of financial assets which are classified as loans and receivables or held-to-maturity investments under IAS 39 (including certain debt securities) will continue to be measured at amortised cost under IFRS 9;

- Most debt securities classified as available-for-sale financial assets will be measured at fair value through other comprehensive income, with some being measured at fair value through profit or loss;
- Treasury and other eligible bills classified as available-for-sale financial assets will be measured at amortised cost or fair value through other comprehensive income depending upon the business model in which they are held; and
- Certain loans currently designated at fair value through profit or loss under IAS 39 may be reclassified to amortised cost where they are held within a business model whose objective is to hold the assets to collect contractual cash flows and those cash flows represent solely payments of principal and interest on the principal outstanding.

Impairment: IFRS 9 introduces fundamental changes to the impairment of financial assets measured at amortised cost or at fair value through other comprehensive income, lease receivables and certain commitments to extend credit and financial guarantee contracts. It is no longer necessary for losses to be incurred before credit losses are recognised. Instead, under IFRS 9, an entity always accounts for expected credit losses (ECLs), and any changes in those ECLs. The ECL approach must reflect both current and forecast changes in macroeconomic data over a horizon that extends from 12 months to the remaining life of the asset if a borrower's credit risk is deemed to have deteriorated significantly at the reporting date compared to the origination date. The estimate of ECLs, should reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes and considering reasonable and supportable information at the reporting date. Similar to the current incurred credit loss provisioning approach, management will exercise judgement as to whether additional adjustments are required in order to adequately reflect possible events or current conditions that could affect credit risk.

For financial assets, an ECL is the current value of the difference between the contractual cash flows owed to the entity and the cash flows which the entity expects to receive. For undrawn loan commitments, an ECL is the current value of the difference between the contractual cash flows owed to the entity and the cash flows which the entity expects to receive if the loan is drawn.

An assessment of each facilities' credit risk profile will determine whether they are to be allocated to one of three stages:

- Stage 1: when it is deemed there has been no significant increase in credit risk since initial recognition, a loss allowance equal to a 12-month ECL – i.e. the proportion of lifetime expected losses resulting from possible default events within the next 12-months – will be applied;
- Stage 2: when it is deemed there has been a significant increase in credit risk since initial recognition, but no credit impairment has materialised, a loss allowance equal to the lifetime ECL – i.e. lifetime expected loss resulting from all possible defaults throughout the residual life of a facility – will be applied; and
- Stage 3: when the facility is considered credit impaired, a loss allowance equal to the lifetime ECL will be applied. Similar to incurred losses under IAS 39, objective evidence of credit impairment is required.

The assessment of whether a significant increase in credit risk has occurred since initial recognition involves the application of both quantitative measures and qualitative factors, requires management judgement and is a key aspect of the IFRS 9 methodology.

Hedge accounting: The general hedge accounting requirements align more closely with risk management practices and establish a more principle-based approach thereby allowing hedge accounting to be applied to a wider variety of hedging instruments and risks. Macro hedge accounting is being dealt with as a separate project. Until such time as that project is complete, and to remove any potential conflict between any existing macro hedge accounting undertaken under IAS 39 and the new general hedge accounting requirements of IFRS 9, entities can choose to continue to apply the existing hedge accounting requirements in IAS 39. Santander UK group has decided to continue IAS 39 hedge accounting and consequently, there are no changes being implemented to hedge accounting policies and practices.

Transition and impact: IFRS 9 has been endorsed for use in the European Union. The mandatory effective date of IFRS 9 is 1 January 2018. The classification, measurement and impairment requirements will be applied retrospectively by adjusting the opening balance sheet at the date of initial application. There is no requirement to restate comparative information.

For the Santander UK group, the application of IFRS 9 decreases shareholders' equity at 1 January 2018 by £192m (net of tax), comprised of a £49m decrease arising from the application of the new classification and measurement requirements for financial assets (as explained above), and a c£211m decrease arising from the application of the new ECL impairment methodology, these amounts being partially offset by the recognition of a deferred tax asset of £68m. For the Company, the application of IFRS 9 decreases shareholders' equity at 1 January 2018 by £158m (net of tax) comprised of a £25m decrease arising from the application of the new classification and measurement requirements for financial assets (as explained above) and a c£191m decrease arising from the application of the new ECL impairment methodology, these amounts being partially offset by the resulting deferred tax asset of £58m.

These impacts take into account the narrow-scope amendments made to IFRS 9 by the IASB in October 2017 entitled 'Prepayment Features with Negative Compensation (Amendments to IFRS 9)'. These amendments which are not effective until annual periods beginning on or after 1 January 2019 can be adopted early. The amendments permit some prepayable financial assets with negative compensation to be measured at amortised cost that, but for the amendment, would have been measured at fair value through profit or loss. Negative compensation arises where the contractual terms permit the borrower to prepay the instrument before its contractual maturity, but the prepayment amount could be less than unpaid amounts of principal and interest. To qualify for amortised cost measurement, the negative compensation must be "reasonable compensation" for early termination of the contract. The amendments are awaiting EU endorsement.

As referred to in the 'Compliance with International Financial Reporting Standards' section above, the Santander UK group elected to early apply from 1 January 2017 the requirements for the presentation of gains and losses on certain financial liabilities relating to own credit in other comprehensive income. This presentational change had no impact on shareholders' equity.

Recommendations of the Enhanced Disclosure Task Force (EDTF) with respect to Expected Credit Losses

The following additional information is provided in accordance with the recommendations of the EDTF in their 30 November 2015 report entitled 'Impact of Expected Credit Loss Approaches on Bank Risk Disclosures' regarding applying the key principles within an expected credit loss (ECL) approach and the risk management organisation, processes and key functions.

a) How Santander UK interprets and expects to apply the key principles within an ECL approach

In forecasting ECLs under IFRS 9, Santander UK has leveraged retail and corporate credit risk models used for underwriting, portfolio management and regulatory capital. These credit risk measurement tools principally capture idiosyncratic (customer and facility) risk drivers and when transformed into probability of default (PD), exposure at default (EAD) and loss given default (LGD) estimates, form the basis for quantifying ECL.

Outputs from these models have been incorporated into a new modelling framework developed for IFRS 9, which combines other factors that explicitly capture systemic effects (relating to changes in credit conditions) and the maturity of the exposure. Systemic effects are accounted for by using the outputs of existing macroeconomic stress testing models as factors in the ECL calculation, while the addition of time related factors (such as time since last rating) enable the forecasting of risk, for each individual loan, to be extended over the lifetime of the exposure and reflect economic forecasts.

The ability to forecast beyond 12 months is further supplemented by the introduction of a new survival rate (SR) model which predicts the likelihood that an exposure will still be open and not defaulted at any point during its remaining life (after making allowance for early redemptions).

The calculation of ECL is based on either possible defaults within a period of 12 months following the reporting date (12-month ECL) or defaults arising throughout the residual life of the exposure (Lifetime ECL). The forecast horizon will be determined according to a stage allocation assessment, whereby an underlying facility is assigned to one of three stages as set out above. The assessment of whether there has been significant increase in credit risk since initial recognition, for the purpose of moving exposures between stages, will incorporate a number of quantitative, qualitative and days past due 'backstop' tests. The determination incorporates a measure of the change in default risk between initial recognition and the reporting date.

For each term loan the output of the PD, EAD, LGD and SR models are multiplied together to derive a measure of ECL for each month to the end of the contractual period. The resulting ECL forecast is then discounted using the effective interest rate to reflect the time value of money. Summing each monthly ECL to the end of the contractual term gives the lifetime ECL, while the 12-month ECL is calculated by summing the first 12-monthly ECL values only. For revolving credit facilities the lifetime period is determined to be the point at which either the SR model predicts all exposures have closed or the ECL value is zero through the effects of discounting.

ECLs will be based on macroeconomic inputs reflecting a set of scenarios that will incorporate, as a minimum; a base scenario, an upside scenario and a downside scenario based on various macroeconomic variables, e.g. GDP, house prices, unemployment rates, etc. Each scenario will be assigned a probability weighting that reflects the likelihood of occurrence. The resulting ECL for each scenario will be combined to give an unbiased, probability-weighted ECL value.

b) Santander UK's governance processes over ECL

A separate IFRS 9 Steering Group, was set up to manage the implementation of IFRS 9. With respect to ECL, a number of cross-functional working groups were mobilised to opine and make proposals on model design and integration, technical accounting and implementation. Approvals and ratification were sought at a series of Management Committees and Forums, whilst key risks, assumptions, issues, and dependencies, aligned to material portfolios/key design considerations, have been tracked at the Steering Group.

ECL impairment models are sensitive to changes in credit conditions, and reflect various management judgements that give rise to measurement uncertainty. The governance framework for generating and reviewing the scenarios and weights leverages Santander UK's existing processes to assess risk appetite and manage stress testing, which incorporate the views of subject matter experts across numerous business functions and a comparison with external benchmarks prior to running forecasting models. The following fora review provision drivers and ensure that management judgements remain appropriate:

- The Model Risk Control Forum, which reviews and approves required changes to ECL models;
- The Asset and Liability Committee is responsible for reviewing and approving the economic scenarios and probability weights used to calculate forward-looking scenarios;
- The Credit Provisions Forum reviews management judgements and approves IFRS 9 ECL impairment allowances; and
- The Board Audit Committee reviews and challenges the appropriateness of the estimates and judgements made by management.

b) IFRS 15 'Revenue from Contracts with Customers' (IFRS 15) – In May 2014, the IASB issued IFRS 15. The effective date of IFRS 15 is 1 January 2018. The standard establishes a principles-based approach for revenue recognition and introduces the concept of recognising revenue for performance obligations as they are satisfied. Revenue relating to lease contracts, insurance contracts and financial instruments is outside the scope of IFRS 15. For Santander UK group's fee and commission income, which is within the scope of the standard, income is recognised as services are provided and this continues under the performance obligation approach in IFRS 15. There have been no significant changes in the recognition of in scope income and, consequently, IFRS 15 has no material impact for the Santander UK group.

c) IFRS 16 'Leases' (IFRS 16) – In January 2016, the IASB issued IFRS 16. The standard is effective for annual periods beginning on or after 1 January 2019. Earlier adoption is permitted for entities that apply IFRS 15 at or before the date of initial application of IFRS 16. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure for both lessees and lessors. For lessee accounting, IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments for all leases with a term of more than 12 months, unless the underlying asset is of low value. For lessor accounting, IFRS 16 substantially carries forward the lessor accounting requirements from the existing leasing standard (IAS 17) and a lessor continues to classify its leases as operating leases or finance leases and to account for those two types of leases differently. At the date of publication of these Consolidated Financial Statements the impact of the standard is currently being assessed and it is not yet practicable to quantify the effect of IFRS 16 on these Consolidated Financial Statements. Details of existing operating lease commitments in respect of leases where the Santander UK group is lessee and that are likely to come on the balance sheet under IFRS 16 are set out in Note 29.

Comparative information
As required by US public company reporting requirements, these financial statements include two years of comparative information for the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows and related Notes.

Consolidation
a) Subsidiaries
The Consolidated Financial Statements incorporate the financial statements of Santander UK plc and entities (including structured entities) controlled by the Company and its subsidiaries. Control is achieved where the Company has (i) power over the investee; (ii) is exposed, or has rights, to variable returns from its involvement with the investee; and (iii) has the ability to use its power to affect its returns. The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Company has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Company considers all relevant facts and circumstances in assessing whether or not the Company's voting rights in an investee are sufficient to give it power, including:

- The size of the Company's holding of voting rights relative to the size and dispersion of holdings of the other vote holders
- Potential voting rights held by the Company, other vote holders or other parties
- Rights arising from other contractual arrangements
- Any additional facts and circumstances that indicate that the Company has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, the results of a subsidiary acquired or disposed of during the year are included in the consolidated income statement and the consolidated statement of comprehensive income from the date the Company gains control until the date when the Company ceases to control the subsidiary. Inter-company transactions, balances and unrealised gains on transactions between Santander UK group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered.

The acquisition method of accounting is used to account for the acquisition of subsidiaries which meet the definition of a business. The cost of an acquisition is measured at the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition. Acquisition related costs are expensed as incurred. The excess of the cost of acquisition, as well as the fair value of any interest previously held, over the fair value of the Santander UK group's share of the identifiable net assets of the acquired subsidiary, associate or business at the date of acquisition is recorded as goodwill. When the Santander UK group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), less liabilities of the subsidiary and any non-controlling interests. Amounts previously recognised in other comprehensive income in relation to the subsidiary are accounted for (i.e. reclassified to profit or loss or transferred directly to retained earnings) in the same manner as would be required if the relevant assets or liabilities are disposed of. The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IAS 39 'Financial Instruments: Recognition and Measurement' or, when applicable, the costs on initial recognition of an investment in an associate or jointly controlled entity.

Business combinations between entities under common control (i.e. fellow subsidiaries of Banco Santander SA (the ultimate parent)) are outside the scope of IFRS 3 – 'Business Combinations', and there is no other guidance for such transactions under IFRS. The Santander UK group elects to account for business combinations between entities under common control at their book values in the acquired entity by including the acquired entity's results from the date of the business combination and not restating comparatives. Reorganisations of entities within the Santander UK group are accounted for at their book values.

Interests in subsidiaries are eliminated during the preparation of the Consolidated Financial Statements. Interests in subsidiaries in the Company unconsolidated financial statements are held at cost subject to impairment.

b) Joint ventures
Joint ventures are joint arrangements whereby the parties that have joint control of the arrangement have rights to the net assets of the joint arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control. Accounting policies have been aligned to the extent there are differences from the Santander UK group's policies.

The Santander UK group's investments in joint ventures are accounted for by the equity method of accounting and are initially recorded at cost and adjusted each year to reflect the Santander UK group's share of the post-acquisition results of the joint venture. When the Santander UK group's share of losses of a joint venture exceed the Santander UK group's interest in that joint venture, the Santander UK group discontinues recognising its share of further losses. Additional losses are recognised only to the extent that the Santander UK group has incurred legal or constructive obligations or made payments on behalf of the joint venture.

Foreign currency translation

Items included in the financial statements of each entity (including foreign branch operations) in the Santander UK group are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity (the functional currency). The Consolidated Financial Statements are presented in sterling, which is the functional currency of the Company.

Income statements and cash flows of foreign entities are translated into the Santander UK group's presentation currency at average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December.

Exchange differences arising from the translation of the net investment in foreign entities are recognised in other comprehensive income. When a foreign entity is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Foreign currency transactions are translated into the functional currency of the entity involved at the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement unless recognised in other comprehensive income in connection with a cash flow hedge. Non-monetary items denominated in a foreign currency measured at historical cost are not retranslated. Exchange rate differences arising on non-monetary items measured at fair value are recognised in the consolidated income statement except for differences arising on available-for-sale equity securities which are recognised in other comprehensive income.

Revenue recognition

a) Interest income and expense

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

In accordance with IFRS, the Santander UK group recognises interest income on assets after they have been written down as a result of an impairment loss. Interest continues to be accrued on all loans and the element of interest that is not anticipated to be recovered is provided for. Interest income on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

b) Fee and commission income and expense

Fees and commissions that are not an integral part of the effective interest rate are recognised when the service is provided, or on the performance of a significant act. For retail and corporate products, fee and commission income consists principally of collection services fees, commission on foreign currencies, commission and other fees received from retailers for processing credit card transactions, fees received from other credit card issuers for providing cash advances for their customers through the Santander UK group's branch and ATM networks, annual fees payable by credit card holders and fees for non-banking financial products. Revenue from these income streams is recognised when the service is provided.

For insurance products, fee and commission income consists principally of commissions earned on the sale of building and contents insurance, life protection insurance and payment cover insurance. Revenue from these income streams is recognised when the service is provided.

Fee and commission income which forms an integral part of the effective interest rate of a financial instrument (e.g. certain loan commitment fees) is recognised as an adjustment to the effective interest rate and recorded in 'Interest income'.

c) Dividend income

Except for equity securities classified as trading assets or financial assets held at fair value through profit or loss, described below, dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for equity securities.

d) Net trading and other income

Net trading and other income comprises all gains and losses from changes in the fair value of financial assets and liabilities held at fair value through profit or loss (including financial assets and liabilities held for trading, trading derivatives and designated as fair value through profit or loss), together with related interest income, expense, dividends and changes in fair value of any derivatives managed in conjunction with these assets and liabilities. Changes in fair value of derivatives in a fair value hedging relationship are also recognised in net trading and other income. Net trading and other income also include income from operating lease assets, and profits/(losses) arising on the sales of property, plant and equipment and subsidiary undertakings.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, including computer software, which are assets that necessarily take a substantial period of time to develop for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognised in profit or loss in the period in which they occur.

Pensions and other post-retirement benefits

The Santander UK group operates various pension schemes. The schemes are generally funded through payments to insurance companies or trustee-administered funds, as determined by periodic actuarial calculations. A defined benefit scheme is a pension scheme that guarantees an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service or compensation. A defined contribution plan is a pension scheme under which the Santander UK group pays fixed contributions as they fall due into a separate entity (a fund). The pension paid to the member at retirement is based on the amount in the separate fund for each member. The Santander UK group has no legal or constructive obligations to pay further contributions into the fund to 'top up' benefits to a certain guaranteed level. Pension costs are charged to the 'Administration expenses', within the line item 'Operating expenses before impairment losses, provisions and charges' with the net interest on the defined benefit asset or liability included within 'Net interest income' in the income statement.

a) Defined benefit schemes
The asset or liability recognised in respect of defined benefit pension schemes is the present value of the defined benefit obligation at the balance sheet date, less the fair value of scheme assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The assets of the schemes are measured at their fair values at the balance sheet date. Full actuarial valuations of the Santander UK group's defined benefit schemes are carried out on a triennial basis. Each scheme's trustee is responsible for the actuarial valuations and in doing so considers or relies in part on a report of a third party expert.

The present value of the defined benefit obligation is estimated by projecting forward the growth in current accrued pension benefits to reflect inflation and salary growth to the date of pension payment, then discounted to present value using the yield applicable to high-quality AA rated corporate bonds of the same currency and which have terms to maturity closest to the terms of the scheme liabilities, adjusted where necessary to match those terms. In determining the value of scheme liabilities, demographic and financial assumptions are made by management about life expectancy, inflation, discount rates, pension increases and earnings growth, based on past experience and future expectations. Financial assumptions are based on market conditions at the balance sheet date and can generally be derived objectively.

Demographic assumptions require a greater degree of estimation and judgement to be applied to externally derived data. Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). An asset is only recognised to the extent that the surplus can be recovered through reduced contributions in the future or through refunds from the scheme. The income statement includes the net interest income/expense on the net defined benefit liability/asset, current service cost and any past service cost and gain or loss on settlement. Remeasurement of defined benefit pension schemes, including return on scheme assets (excludes amounts included in net interest), actuarial gains and losses (arising from changes in demographic assumptions, the impact of scheme experience and changes in financial assumptions) and the effect of the changes to the asset ceiling (if applicable), are recognised in other comprehensive income.

Remeasurement recognised in other comprehensive income will not be reclassified to the income statement. Past-service costs are recognised as an expense in the income statement at the earlier of when the scheme amendment or curtailment occurs and when the related restructuring costs or termination benefits are recognised. Curtailments include the impact of significant reductions in the number of employees covered by a scheme, or amendments to the terms of the scheme so that a significant element of future service will no longer qualify for benefits or will qualify only for reduced benefits. Curtailment gains and losses on businesses that meet the definition of discontinued operations are included in profit or loss for the year from discontinued operations. Gains and losses on settlements are recognised when the settlement occurs.

b) Defined contribution plans
For defined contribution plans, the Santander UK group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. Once the contributions have been paid, the Santander UK group has no further payment obligation. The regular contributions constitute net periodic costs for the year in which they are due and are included in staff costs which are presented in Administration expenses in the income statement.

c) Post-retirement medical benefit plans
Post-retirement medical benefit liabilities are determined using the Projected Unit Credit Method, with actuarial valuations updated at each year-end. The expected benefit costs are accrued over the period of employment using an accounting methodology similar to that for the defined benefit pension scheme.

Share-based payments
The Santander UK group engages in cash-settled and equity-settled share-based payment transactions in respect of services received from certain of its employees. Shares of the Santander UK group's parent, Banco Santander SA are purchased in the open market by the Santander UK group (for the Employee Sharesave scheme) or are purchased by Banco Santander SA or another Banco Santander company (for awards granted under the Long-Term Incentive Plan and the Deferred Shares Bonus Plan) to satisfy share options as they vest.

Options granted under the Employee Sharesave scheme are accounted for as cash-settled share-based payment transactions. Awards granted under the Long-Term Incentive Plan and Deferred Shares Bonus Plan are accounted for as equity-settled share-based payment transactions.

The fair value of the services received is measured by reference to the fair value of the shares or share options initially on the date of the grant for both the cash and equity settled share-based payments and then subsequently at each reporting date for the cash settled share-based payments. The cost of the employee services received in respect of the shares or share options granted is recognised in the income statement within administration expenses, over the period that the services are received, which is the vesting period.

A liability equal to the portion of the goods or services received is recognised at the current fair value determined at each balance sheet date for cash-settled share-based payments. A liability equal to the amount to be reimbursed to Banco Santander SA is recognised at the current fair value determined at the grant date for equity-settled share-based payments.

The fair value of the options granted under the Employee Sharesave scheme is determined using an option pricing model, which takes into account the exercise price of the option, the current share price, the risk free interest rate, the expected volatility of the Banco Santander SA share price over the life of the option and the dividend growth rate. The fair value of the awards granted for the Long-Term Incentive Plan was determined at the grant date using an option pricing model, which takes into account the share price at grant date, the risk free interest rate, the expected volatility of the Banco Santander SA share price over the life of the award and the dividend growth rate. Vesting conditions included in the terms of the grant are not taken into account in estimating fair value, except for those that include terms related to market conditions. Non-market vesting conditions are taken into account by adjusting the number of shares or share options included in the measurement of the cost of employee service so that ultimately, the amount recognised in the income statement reflects the number of vested shares or share options.

Where an award has been modified, as a minimum, the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award or incremental fair value of the modification of the award is recognised in addition to the expense of the original grant, measured at the date of modification, over the modified vesting period.

A cancellation that occurs during the vesting period is treated as an acceleration of vesting, and recognised immediately for the amount that would otherwise have been recognised for services over the vesting period.

Strategic report
Financial review
Governance
Risk review
Financial statements
Shareholder information

Goodwill and other intangible assets
Goodwill represents the excess of the cost of an acquisition, as well as the fair value of any interest previously held, over the fair value of the Santander UK group's share of the identifiable net assets of the acquired subsidiary, associate, or business at the date of acquisition. Goodwill on the acquisition of subsidiaries and businesses is included in intangible assets. Goodwill on acquisitions of associates is included as part of investment in associates. Goodwill is tested for impairment at each balance sheet date, or more frequently when events or changes in circumstances dictate, and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity or business include the carrying amount of goodwill relating to the entity or business sold.

Other intangible assets are recognised if they arise from contracted or other legal rights or if they are capable of being separated or divided from the Santander UK group and sold, transferred, licensed, rented or exchanged. The value of such intangible assets is amortised on a straight-line basis over the useful economic life of the assets in question, which ranges from three to seven years. Other intangible assets are reviewed annually for impairment indicators and tested for impairment where indicators are present.

Software development costs are capitalised when they are direct costs associated with identifiable and unique software products that are expected to provide future economic benefits and the cost of these products can be measured reliably. These costs include payroll, the costs of materials and services and directly attributable overheads. Internally developed software meeting these criteria and externally purchased software are classified in intangible assets on the balance sheet and amortised on a straight-line basis over their useful life of three to seven years, unless the software is an integral part of the related computer hardware, in which case it is treated as property, plant and equipment as described below. Capitalisation of costs ceases when the software is capable of operating as intended. Costs associated with maintaining software programmes are expensed as incurred.

Property, plant and equipment
Property, plant and equipment include owner-occupied properties (including leasehold properties), office fixtures and equipment and computer software. Property, plant and equipment are carried at cost less accumulated depreciation and accumulated impairment losses. A review for indications of impairment is carried out at each reporting date. Gains and losses on disposal are determined by reference to the carrying amount and are reported in net trading and other income. Repairs and renewals are charged to the income statement when the expenditure is incurred. Internally developed software meeting the criteria set out in 'Goodwill and other intangible assets' above and externally purchased software are classified in property, plant and equipment on the balance sheet where the software is an integral part of the related computer hardware (e.g. operating system of a computer).

Classes of property, plant and equipment are depreciated on a straight-line basis over their useful life, as follows:

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

Depreciation is not charged on freehold land and assets under construction.

Financial assets and liabilities
Financial assets and liabilities are initially recognised when the Santander UK group becomes a party to the contractual terms of the instrument. The Santander UK group determines the classification of its financial assets and liabilities at initial recognition. Financial assets are classified as financial assets at fair value through profit or loss, loans and receivables, available-for-sale financial assets and held-to-maturity investments. Financial assets that are classified at fair value through profit or loss, which have not been designated as such or are not accounted for as derivatives, or assets classified as available-for-sale, may subsequently in rare circumstances, be reclassified from the fair value through profit or loss category to the loans and receivables, available-for-sale or held-to-maturity categories. In order to meet the criteria for reclassification, the asset must no longer be held for the purpose of selling or repurchasing in the near-term and must also meet the definition of the category into which it is to be reclassified had it not been required to classify it at fair value through profit or loss at initial recognition. The reclassified value is the fair value of the asset at the date of reclassification. The Santander UK group has not utilised this option and therefore has not reclassified any assets from the fair value through profit or loss category that were classified as such at initial recognition. Financial liabilities are classified as fair value through profit or loss if they are either held for trading or otherwise designated at fair value through profit or loss on initial recognition.

Financial assets are derecognised when the rights to receive cash flows have expired or the Santander UK group has transferred its contractual right to receive the cash flows from the assets and either: (1) substantially all the risks and rewards of ownership have been transferred; or (2) the Santander UK group has neither retained nor transferred substantially all of the risks and rewards, but has transferred control. Financial liabilities are derecognised when extinguished, cancelled or expired.

A regular way purchase is a purchase of a financial asset under a contract whose terms require delivery of the asset within the timeframe established generally by regulation or convention in the market place concerned. Regular way purchases of financial assets classified as loans and receivables, issues of equity or financial liabilities measured at amortised cost are recognised on settlement date; all other regular way purchases and issues are recognised on trade date.

a) Financial assets and liabilities at fair value through profit or loss
Financial assets and financial liabilities are classified as fair value through profit or loss if they are either held for trading or otherwise designated at fair value through profit or loss on initial recognition.

Financial assets and financial liabilities are classified as held for trading if they are derivatives or if they are acquired or incurred principally for the purpose of selling or repurchasing in the near-term, or form part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking.

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

Financial assets and financial liabilities classified as fair value through profit or loss are initially recognised at fair value and transaction costs are taken directly to the income statement. Gains and losses arising from changes in fair value are included directly in the income statement except for gains and losses on financial liabilities designated at fair value through profit and loss relating to own credit which are presented in other comprehensive income.

Derivative financial instruments, trading assets and liabilities and financial assets and liabilities designated at fair value are classified as fair value through profit or loss.

b) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments, that are not quoted in an active market and which are not classified as available-for-sale or fair value through profit or loss. They arise when the Santander UK group provides money or services directly to a customer with no intention of trading the loan. Loans and receivables are initially recognised at fair value including direct and incremental transaction costs. They are subsequently valued at amortised cost, using the effective interest method. Loans and receivables consist of loans and advances to banks, loans and advances to customers, and loans and receivables securities.

c) Available-for-sale financial assets
Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale and are not categorised into any of the other categories described. They are initially recognised at fair value including direct and incremental transaction costs. They are subsequently held at fair value. Gains and losses arising from changes in fair value of available-for-sale securities are recognised in other comprehensive income until sale or until determined to be impaired when the cumulative gain or loss or impairment losses are transferred to the income statement. Where the financial asset is interest-bearing, interest is determined using the effective interest method.

Income on investments in equity shares, debt instruments and other similar interests is recognised in the income statement as and when dividends are declared and interest is accrued. Impairment losses and foreign exchange translation differences on monetary items are recognised in the income statement.

d) Held-to-maturity investments
Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Santander UK group's management has the positive intention and ability to hold to maturity other than:

- Those that the Santander UK group designates upon initial recognition as at fair value through profit or loss;
- Those that the Santander UK group designates as available-for-sale; and
- Those that meet the definition of loans and receivables.

These are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method, less any provision for impairment.

A sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments to available-for-sale financial assets.

e) Borrowings
Borrowings (which include deposits by banks, deposits by customers, debt securities in issue and subordinated liabilities) are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Borrowings are subsequently stated at amortised cost or fair value through profit or loss dependent on designation at initial recognition. Savings accounts and time deposits are interest-bearing.

Preference shares which carry a contractual obligation to transfer economic benefits are classified as financial liabilities and are presented in subordinated liabilities. The coupon on these preference shares is recognised in the income statement as interest expense on an amortised cost basis using the effective interest method.

f) Other financial liabilities
All other financial liabilities are initially recognised at fair value net of transaction costs incurred. They are subsequently stated at amortised cost, using the effective interest method.

Contracts involving the receipt of cash on which customers receive an index-linked return are accounted for as equity index-linked deposits. The principal products are Capital Guaranteed/Protected Products which give the customers a limited participation in the upside growth of an equity index. In the event the index falls in price, a cash principal element is guaranteed/protected. The equity index-linked deposits contain embedded derivatives. These embedded derivatives, in combination with the principal cash deposit element, are designed to replicate the investment performance profile tailored to the return agreed in the contracts with customers. The cash principal element is accounted for as deposits by customers at amortised cost. The embedded derivatives are separated from the host instrument and are separately accounted for as derivative financial instruments.

g) Sale and repurchase agreements (including stock borrowing and lending)
Securities sold subject to a commitment to repurchase them at a predetermined price (repos) under which substantially all the risks and rewards of ownership are retained by the Santander UK group remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resell (reverse repos) are not recognised on the balance sheet and the consideration paid is recorded as an asset. The difference between the sale and repurchase price is treated as trading income in the income statement, except where the repo is not treated as part of the trading book, in which case the difference is recorded in interest income or expense.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. Securities lent or borrowed are not reflected on the balance sheet. Collateral in the form of cash received or advanced is recorded as a deposit or a loan. Collateral in the form of securities is not recognised.

h) Day One profit adjustments
The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, sometimes the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Santander UK group recognises a trading gain or loss at inception (Day One gain or loss), being the difference between the transaction price and the fair value. When significant unobservable parameters are used, the entire Day One gain or loss is deferred and is recognised in the income statement over the life of the transaction until the transaction matures, is closed out, the valuation inputs become observable or the Santander UK group enters into an offsetting transaction.

Derivative financial instruments

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

Derivatives are held for trading or for risk management purposes. Derivatives are classified as held for trading unless they are designated as being in a hedge relationship. The Santander UK group chooses to designate certain derivatives as in a hedging relationship if they meet specific criteria, as further described within 'hedge accounting' below.

Derivatives are recognised initially (on the date on which a derivative contract is entered into), and are subsequently remeasured, at their fair value. Fair values of exchange-traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow and option pricing models.

Derivatives may be embedded in other financial instruments, such as the conversion option in a convertible bond. Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

Contracts containing embedded derivatives are not subsequently reassessed for separation unless either there has been a change in the terms of the contract which significantly modifies the cash flows (in which case the contract is reassessed at the time of modification) or the contract has been reclassified (in which case the contract is reassessed at the time of reclassification).

All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative, except where netting is permitted. The method of recognising fair value gains and losses depends on whether derivatives are held for trading or are designated as hedging instruments and, if the latter, the nature of the risks being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement, and included within net trading and other income.

Offsetting financial assets and liabilities

Financial assets and liabilities including derivatives are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. The Santander UK group is party to a number of arrangements, including master netting arrangements under industry standard agreements which facilitate netting of transactions in jurisdictions where netting agreements are recognised and have legal force. The netting arrangements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis.

Hedge accounting

The Santander UK group applies hedge accounting to represent, to the maximum possible extent permitted under accounting standards, the economic effects of its risk management strategies. Derivatives are used to hedge exposures to interest rates, exchange rates and certain indices such as retail price indices.

At the time a financial instrument is designated as a hedge (i.e. at the inception of the hedge), the Santander UK group formally documents the relationship between the hedging instrument(s) and hedged item(s), its risk management objective and strategy for undertaking the hedge. The documentation includes the identification of each hedging instrument and respective hedged item, the nature of the risk being hedged (including the benchmark interest rate being hedged in a hedge of interest rate risk) and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value attributable to the hedged risk is to be assessed. Accordingly, the Santander UK group formally assesses, both at the inception of the hedge and on an ongoing basis, whether the hedging derivatives have been and will be highly effective in offsetting changes in the fair value attributable to the hedged risk during the period that the hedge is designated. A hedge is normally regarded as highly effective if, at inception and throughout its life, the Santander UK group can expect, and actual results indicate, that changes in the fair value or cash flow of the hedged items are effectively offset by changes in the fair value or cash flow of the hedging instrument. If at any point it is concluded that it is no longer highly effective in achieving its documented objective, hedge accounting is discontinued.

Where derivatives are held for risk management purposes, and when transactions meet the required criteria for documentation and hedge effectiveness, the derivatives may be designated as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments (fair value hedges); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (cash flow hedges); or (iii) a hedge of a net investment in a foreign operation (net investment hedges). The Santander UK group applies fair value hedge accounting and cash flow hedge accounting but not hedging of a net investment in a foreign operation.

a) Fair value hedge accounting

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. Where the hedged item is measured at amortised cost, the fair value changes due to the hedged risk adjust the carrying amount of the hedged asset or liability. Changes in the fair value of portfolio hedged items are presented separately in the consolidated balance sheet in macro hedge of interest rate risk and recognised in the income statement within net trading and other income. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the income statement. For fair value hedges of interest rate risk, the cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement using the effective interest method over the period to maturity. For portfolio hedged items, the cumulative adjustment is amortised to the income statement using the straight line method over the period to maturity.

b) Cash flow hedge accounting

The effective portion of changes in the fair value of qualifying cash flow hedges is recognised in other comprehensive income in the cash flow hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

The Santander UK group is exposed to cash flow interest rate risk on its floating rate assets and foreign currency risk on its fixed rate debt issuances denominated in foreign currency. Cash flow hedging is used to hedge the variability in cash flows arising from both these risks.

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

Impairment of financial assets
At each balance sheet date the Santander UK group assesses whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered an indicator that the assets are impaired.

Assets carried at amortised cost
For loans and advances, loans and receivables securities and held-to-maturity investments, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in profit or loss. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss is recognised in profit or loss.

More detailed policies for certain portfolios measured at amortised cost are described below.

a) Loans and advances
Impairment loss allowances for loans and advances, less amounts released and recoveries of amounts written off are charged to the line item 'Impairment losses on loans and advances' in the income statement. The impairment loss allowances are deducted from the 'Loans and advances to banks', 'Loans and advances to customers' and 'Loans and receivables securities' line items on the balance sheet.

i) Retail assets
Retail customers are assessed either individually or collectively for impairment. Potential indicators of loss events which may be evidence of impairment for retail borrowers may include:

- Missed payments of capital or interest
- The borrower notifying the Santander UK group of current or likely financial distress
- Request from a borrower to change contractual terms as a result of the borrower's financial difficulty (i.e. forbearance)
- Arrears on other accounts held by the borrower.

Individual assessment
For individually assessed assets, the Santander UK group measures the amount of the loss as the difference between the carrying amount of the asset and the present value of the estimated future cash flows from the asset discounted at the asset's original effective interest rate.

Collective assessment
In making a collective assessment for impairment, financial assets are grouped together according to their credit risk characteristics. These can include grouping by product, loan-to-value, brand, geography, type of customer and previous insolvency events. For each such portfolio or sub-segment of the portfolio, future cash flows are estimated through the use of historical loss experience. The historical loss experience is adjusted to include the effects of changes in current economic, behavioural and other conditions that cannot be successfully depicted solely from historical experience. The loss is discounted at the effective interest rate, except where portfolios meet the criteria for short-term receivables. The unwind of the discount over time is reported through interest and other similar income within the income statement, with an increase to the impairment loss allowances on the balance sheet. Loans for which evidence of potential loss have been specifically identified are group together for the purpose of calculating an allowance for observed losses. Loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an allowance for incurred but not observed (IBNO) losses. Such losses will only be individually identified in the future.

Observed impaired loss allowance
An impairment loss allowance for observed losses is established for all non-performing loans where it is increasingly probable that some of the capital or interest will not be repaid or recovered through enforcement of any applicable security. The allowance for observed losses is determined on a collective (or portfolio) basis for groups of loans with similar credit risk characteristics. The length of time before a loan is regarded as non-performing is typically when the customer fails to make payments when contractually due for three months or longer, although there can be additional qualifying criteria depending upon the product. For additional information on the definition of non-performing loans (NPLs), see 'Credit risk management – risk measurement and control' in the Risk review.

For mortgages and other secured advances, the allowance for observed losses is calculated as the product of the account outstanding balance (exposure) at the reporting date, the estimated proportion that will be repossessed (the loss propensity) and the percentage of exposure which will result in a loss (the loss ratio). The loss propensities for the observed segment (i.e. where the loan is classified as non-performing) represents the percentage that will ultimately be written off, or repossessed for secured advances. Loss propensities are based on recent historical experience, typically covering a period of no more than the most recent twelve months in the year under review. The loss ratio is based on actual cases which have been repossessed and sold using the most recent twelve month average data, segmented by LTV, and is then discounted using the effective interest rate.

For unsecured advances, such as unsecured personal loans, credit cards and overdrafts, the allowance for observed losses is calculated as the product of the number of accounts in the portfolio, the estimated proportion of accounts that will be written off, the estimated proportion of such cases that will result in a loss (the loss factor) and the average loss incurred (the loss per case). The loss per case is based on actual cases using the most recent six month average data of losses that have been incurred, and is then discounted using the effective interest rate.

Based on historical experience, the gross loss ratio or gross loss per case is realised in cash several months after the customer first defaults, during which time interest and fees and charges continue to accrue on the account. The future fees and charges included in the gross loss ratio or gross loss per case are removed and the balance discounted so as to calculate the present value of the loss ratio or loss per case. The discounted loss ratio or loss per case for accounts where a payment has already been missed is higher than for accounts that are up to date because the discounting effect is lower reflecting the fact that the process to recover the funds is further advanced.

IBNO impairment loss allowances
An allowance for IBNO losses is established for loans which are either:

- Performing and no evidence of loss has been specifically identified on an individual basis but because the loans that are not yet past due are known from past experience to have deteriorated since the initial decision to lend was made (for example, where a borrower has not yet missed a payment but is experiencing financial difficulties at the reporting date, e.g. due to a loss of employment, divorce or bereavement), or
- In arrears and not classified as non-performing.

The impairment loss calculation resembles the one explained above for the observed segment except that for the IBNO segment:

- Where the account is currently up to date, the loss propensity represents the percentage of such cases that are expected to miss a payment in the appropriate emergence period and which will ultimately be written off
- Where the account is delinquent, the loss propensity represents the percentage of such cases that will ultimately be written off.

Emergence period
This is the period which the Santander UK group's statistical analysis shows to be the period in which losses that had been incurred but have not been separately identified at the balance sheet date become evident as the loans turn into past due. The emergence period is taken into consideration when determining the loss propensities for performing IBNO segment. Based on the Santander UK group's statistical analysis, the emergence period is six months for unsecured lending and twelve months for secured lending. The longer emergence period for secured lending reflects the fact that a customer is more likely to default on unsecured debt before defaulting on secured lending. The factors considered in determining the length of the emergence period for unsecured lending are recent changes in customers' debit/credit payment profiles and credit scores. The factors considered for secured lending are the frequency and duration of exceptions from adherence to the contractual payment schedule.

ii) Corporate assets
Impairment losses are assessed individually for corporate assets that are individually significant and collectively for corporate assets that are not individually significant.

Individual assessment
At each balance sheet date, the Santander UK group conducts impairment reviews to assess whether there is objective evidence of impairment for individually significant corporate assets. A specific observed impairment is established for all individually significant loans that have experienced a loss event such as where:

- An asset has a payment default which has been outstanding for three months or more
- Non-payment defaults have occurred but where it has become evident that a forbearance exercise will be undertaken due to the inability of the borrower to meet its current contractual repayment schedule
- It is becoming probable that the borrower will enter bankruptcy or other financial reorganisation
- The borrower has a winding up notice issued or insolvency event
- The borrower has had event(s) occur which are likely to adversely impact upon their ability to meet their financial obligations (e.g. where a customer loses a key client or contract)
- The borrower has regularly and persistently missed/delayed payments but where the account has been maintained below three months past due
- The customer loan is due to mature within six months and where the prospects of achieving a refinancing are considered low.

In such situations the asset is transferred to the Commercial Banking Restructuring & Recoveries team. As part of their impairment reviews, an assessment is undertaken of the expected future cash flows (including, where appropriate, cash flows through enforcement of any applicable security held) in relation to the relevant asset, discounted at the loan's original effective interest rate. The result is compared to the current carrying value of the asset. Any shortfall evidenced as a result of such a review will be assessed and recorded as an observed specific impairment loss allowance.

Collective assessment
Observed impairment loss allowances
A collective impairment loss allowance is established for loans which are not individually significant and have suffered a loss event. These non-individually significant loans are grouped together according to their credit risk characteristics and the allowance for observed losses is determined on a collective basis by applying loss rates (i.e. estimated loss given default) derived from analysis of historical loss data of observed losses.

IBNO impairment loss allowances
Loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an IBNO allowance for incurred inherent losses. Such losses will only be individually identified in the future. As soon as information becomes available which identifies incurred losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis for impairment or included in the observed collective assessment above depending on their individual significance.

The allowance for IBNO losses is determined on a portfolio basis using the following factors:

- Historical loss experience in portfolios of similar credit risk characteristics (for example, by product)
- The estimated period between an impairment event occurring and the loss being identified and evidenced by the establishment of an observed loss allowance against the individual loan (known as the emergence period, as discussed below)
- Management's judgement as to whether current economic and credit conditions are such that the actual level of incurred inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

Emergence period
This is the period in which losses that had been incurred but have not been separately identified become evident. The emergence period spans between six to twelve months according to the corporate portfolio being assessed and is estimated having regard to historic experience and loan characteristics across the portfolio. The factors considered in determining the length of the emergence period include the frequency of the management information received or any change in account utilisation behaviour.

iii) Assets subject to forbearance
To support Retail and Corporate customers that encounter actual or apparent financial difficulties, the Santander UK group may grant a concession, whether temporary or permanent, to amend contractual amounts or timings where a customer's financial distress indicates a potential that satisfactory repayment may not be made within the original terms and conditions of the contract. These arrangements are known as forbearance. There are different risk characteristics associated with loans that are subject to forbearance as compared to loans that are not. A range of forbearance arrangements may be entered into by the Santander UK group, reflecting the different risk characteristics of such loans. The Santander UK group's forbearance programmes are described in the credit risk section in the Risk review.

Retail assets
Mortgages
The main types of forbearance offered are capitalisation or a term extension, subject to customer negotiation and vetting. These accounts are reported in arrears until the arrears are capitalised, at which point the accounts will be transferred to the 'performing' category. However, accounts which were classified as 'non-performing' at the point forbearance is agreed continue to be reported as 'non-performing' until the payments received post forbearance equate to the amount of arrears outstanding at the point of forbearance. The impairment provision on these accounts is based on the delinquency cycle in which the account was classified when it entered forbearance, unless the account's status has further deteriorated since then, in which case the impairment provision will be based on the current status.

The impairment loss allowances on these accounts are calculated in the same manner as on any other account, using the Santander UK group's collective assessment methodology. In making a collective assessment for impairment, accounts are grouped according to their credit risk characteristics. For each category of loans, accounts are individually assigned a loss propensity based on a defined behavioural scorecard which reflects any history of forbearance. The loss propensity applied in the collective assessment calculation is higher for forborne accounts than for other performing loans reflecting the higher risk of default attached to these accounts.

Unsecured personal loans (UPLs)
The main type of forbearance offered is reduced repayment arrangements. Where accounts undergoing forbearance are in arrears, these continue to be reported in the delinquency cycle, until all arrears are capitalised or paid up, at which point the accounts will be transferred to the 'performing' category. The impairment provision on these accounts is based on the delinquency cycle in which the account was classified when it entered forbearance, unless the account's status has further deteriorated since then, in which case the impairment provision will be based on the current status. Where the accounts reside in the 'performing' category as a result of forbearance, the impairment allowance requirements are based on default probability that take account of the higher inherent risk in the forborne asset relative to other performing assets.

Other unsecured (credit cards and overdrafts)
The main type of forbearance offered is reduced repayment arrangements. Reduced payment arrangements are treated for impairment purposes in the same way as UPLs above.

Corporate assets
For corporate borrowers, the main types of forbearance offered are term extensions or interest-only concessions and in limited circumstances, other forms of forbearance options (including debt-for-equity swaps), subject to customer negotiation and vetting. If such accounts were classified in the 'non-performing' loan category prior to the forbearance, they continue to be classified as non-performing until evidence of compliance with the new terms is demonstrated (typically over a period of at least three months) before being reclassified as 'substandard'. If the account was categorised as performing at the time the revised arrangements were agreed, the case is reclassified to 'substandard' upon completion of the forbearance agreement.

Once a substandard asset has demonstrated continued compliance with the new terms and the risk profile is deemed to have improved it may be reclassified as a 'performing asset'. Until then, impairment loss allowances for such loans are assessed individually, taking into account the value of collateral held as confirmed by third party professional valuations and the available cash flow to service debt over the period of the forbearance. These impairment loss allowances are assessed and reviewed regularly. In the case of a debt for equity conversion, the converted debt is written off against the existing impairment loss allowance at the point forbearance is granted.

iv) Reversals of impairment
If in a subsequent period, the amount of an impairment loss reduces and the reduction can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the impairment loss allowance accordingly. The write-back is recognised in the income statement.

v) Write-off
For secured loans, a write-off is only made when all collection procedures have been exhausted and the security has been sold or from claiming on any mortgage indemnity guarantee or other insurance. In the corporate portfolio, there may be occasions where a write-off occurs for other reasons, for example, following a consensual restructure or refinancing of the debt or where the debt is sold for strategic reasons into the secondary market at a value lower than the face value of the debt.

There is no threshold based on past due status beyond which all secured loans are written off as there can be significant variations in the time needed to enforce possession and sale of the security, especially due to the different legal frameworks that apply in different regions of the UK. For unsecured loans, a write-off is only made when all internal avenues of collecting the debt have been exhausted and the debt is passed over to external collection agencies. A past due threshold is applied to unsecured debt where accounts that are 180 days past due are written off unless there is a dispute awaiting resolution. Contact is made with customers with the aim to achieve a realistic and sustainable repayment arrangement. Litigation and/or enforcement of security is usually carried out only when the steps described above have been undertaken without success.

All write-offs are on a case-by-case basis, taking account of the exposure at the date of write-off, after accounting for the value from any collateral or insurance held against the loan. The exception to this is in cases where fraud has occurred, where the exposure is written off once full investigations have been completed and the probability of recovery is minimal. The time span between discovery and write-off will be short and may not result in an impairment loss allowance being raised. The write-off policy is regularly reviewed. Write-offs are charged against previously established impairment loss allowances.

vi) Recoveries
Recoveries of impairment losses are not included in the impairment loss allowance, but are taken to income and offset against impairment losses. Recoveries of impairment losses are classified in the income statement as 'Impairment losses on loans and advances'.

b) Loans and receivables securities and held-to-maturity investments
Loans and receivables securities and held-to-maturity investments are assessed individually for impairment. An impairment loss is incurred if there is objective evidence that a loss event has occurred since initial recognition of the assets that has an impact on the estimated future cash flows of the asset. Potential indicators of loss events include significant financial distress of the issuer and default or delinquency in interest and principal payments (breach of contractual terms).

Loans and receivables securities and held-to-maturity investments are monitored for potential impairment through a detailed expected cash flow analysis, where appropriate, taking into account the structure and underlying assets of each individual security. Once specific events give rise to a reasonable expectation that future anticipated cash flows may not be received, the asset originating these doubtful cash flows will be deemed to be impaired with the impairment loss being measured as the difference between the expected future cash flows discounted at the original effective interest rate and the carrying value of the asset.

c) Assets classified as available-for-sale
The Santander UK group assesses at each balance sheet date whether there is objective evidence that an available-for-sale financial asset is impaired. In addition to the criteria for loans and advances and loans and receivables securities set out above, the assessment involves reviewing the financial circumstances (including creditworthiness) and future prospects of the issuer, assessing the future cash flows expected to be realised and, in the case of equity shares, considering whether there has been a significant or prolonged decline in the fair value of the security below its cost. The cumulative loss is measured as the difference between the acquisition cost and the current fair value, less any impairment loss previously reported in the income statement and is removed from other comprehensive income and recognised in the income statement. For impaired debt instruments, further impairment losses are recognised where there has been a further negative impact on expected future cash flows.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase is due to an event occurring after the impairment loss was recognised in the income statement (with objective evidence to support this), the impairment loss is reversed through the income statement. If, in a subsequent period, the fair value of an equity instrument classified as available-for-sale increases, all such increases in the fair value are treated as a revaluation, and are recognised in other comprehensive income. Impairment losses recognised on equity instruments are not reversed through the income statement.

Impairment of non-financial assets
At each balance sheet date, or more frequently when events or changes in circumstances dictate, property plant and equipment (including operating lease assets) and intangible assets (including goodwill) are assessed for indicators of impairment. If indications are present, these assets are subject to an impairment review.

The impairment review comprises a comparison of the carrying amount of the asset or cash generating unit with its recoverable amount: the higher of the asset's or cash-generating unit's fair value less costs to sell and its value in use. The cash-generating unit represents the lowest level at which non-financial assets including goodwill is monitored for internal management purposes and is not larger than an operating segment.

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Value in use is calculated by discounting management's expected future cash flows obtainable as a result of the asset's continued use, including those resulting from its ultimate disposal, at a market based discount rate on a pre-tax basis. The recoverable amounts of goodwill have been based on value in use calculations.

The carrying values of property, plant and equipment, goodwill and other intangible assets are written down by the amount of any impairment and the loss is recognised in the income statement in the period in which it occurs. A previously recognised impairment loss relating to property, plant and equipment may be reversed in part or in full when a change in circumstances leads to a change in the estimates used to determine the property, plant and equipment's recoverable amount. The carrying amount of the property, plant and equipment will only be increased up to the amount that would have been had the original impairment not been recognised. Impairment losses on goodwill are not reversed. For conducting goodwill impairment reviews, cash generating units are the lowest level at which management monitors the return on investment on assets.

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

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

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

Income taxes, including deferred taxes
The tax expense represents the sum of the income tax currently payable and deferred income tax.

Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date. Current taxes associated with the repurchase of equity instruments are reported directly in equity.

A current tax liability for the current or prior period is measured at the amount expected to be paid to the tax authorities. Where the amount of the final tax liability is uncertain or where a position is challenged by a taxation authority, the liability recognised is the most likely outcome. Where a most likely outcome cannot be determined, a weighted average basis is applied.

Deferred income tax is the tax expected to be payable or recoverable on income tax losses available to carry forward and on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Consolidated Financial Statements and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which the assets may be utilised as they reverse. Such deferred tax liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill. Deferred tax assets and liabilities are not recognised from the initial recognition of other assets (other than in a business combination) and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on rates enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items recognised in other comprehensive income or directly in equity, in which case the deferred tax is also recognised in other comprehensive income or directly in equity. Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the Santander UK group is able to control reversal of the temporary difference and it is probable that it will not reverse in the foreseeable future. The Santander UK group reviews the carrying amount of deferred tax assets at each balance sheet date and reduces it to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax relating to actuarial gains and losses on defined benefits is recognised in other comprehensive income. Deferred tax relating to fair value re-measurements of available-for sale investments and cash flow hedging instruments is charged or credited directly to other comprehensive income and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

Cash and cash equivalents
For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, including cash and non-restricted balances with central banks, treasury bills and other eligible bills, loans and advances to banks and short-term investments in securities.

Balances with central banks represent amounts held at the Bank of England and the US Federal Reserve as part of the Santander UK group's liquidity management activities. In addition, it includes certain minimum cash balances held for regulatory purposes required to be maintained with the Bank of England.

Provisions
Provisions are recognised for present obligations arising as consequences of past events where it is more likely than not that a transfer of economic benefits will be necessary to settle the obligation, and it can be reliably estimated.

Conduct provisions are made for the estimated cost of making redress payments with respect to the past sales of products, based on conclusions regarding the number of claims that will be received, including the number of those that will be upheld, the estimated average settlement per case and other related costs. Provision is made for the anticipated cost of restructuring, including redundancy costs, when an obligation exists. An obligation exists when the Santander UK group has a detailed formal plan for restructuring a business, has raised valid expectations in those affected by the restructuring, and has started to implement the plan or announce its main features.

When a leasehold property ceases to be used in the business, provision is made where the unavoidable costs of the future obligations relating to the lease are expected to exceed anticipated rental income. The net costs are discounted using market rates of interest to reflect the long-term nature of the cash flows.

Provision is made for irrevocable loan commitments, other than those classified as held for trading, within impairment loss allowances if it is probable that the facility will be drawn and the resulting loan will be recognised at a value less than the cash advanced.

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

Financial guarantee contracts
Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the terms of a debt instrument. The Santander UK group accounts for guarantees that meet the definition of a financial guarantee contract at fair value on initial recognition. In subsequent periods, these guarantees are measured at the higher of the initial fair value less cumulative amortisation and the amount that would be recognised as a provision in accordance with IAS 37.

Share capital
a) Share issue costs
Incremental external costs directly attributable to the issue of new shares are deducted from equity net of related income taxes.

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

CRITICAL ACCOUNTING POLICIES AND AREAS OF SIGNIFICANT MANAGEMENT JUDGEMENT

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

The following accounting estimates and judgements are considered important to the portrayal of the Santander UK group's financial results and financial condition because: (i) they are highly susceptible to change from period to period as assumptions are made to calculate the estimates, and (ii) any significant difference between the estimated amounts and actual amounts could have a material impact on the Santander UK group's future financial results and financial condition.

In calculating each estimate, a range of outcomes was calculated based principally on management's conclusions regarding the input assumptions relative to historic experience. The actual estimates were based on what management concluded to be the most probable assumptions within the range of reasonably possible assumptions.

a) Impairment loss allowances for loans and advances to customers
The Santander UK group estimates impairment losses for loans and advances to customers, loans and receivables securities, and loans and advances to banks as described in the accounting policy 'Impairment of financial assets'. Management's assumptions about impairment losses are based on past performance, past customer behaviour, the credit quality of recent underwritten business and general economic conditions, which are not necessarily an indication of future losses.

At 31 December 2017, impairment allowances held against loans and advances to customers totalled £940m (2016: £921m, 2015: £1,108m). The net impairment loss (i.e. after recoveries) for loans and advances to customers recognised in 2017 was £203m (2016: £67m, 2015: £66m). In calculating impairment loss allowances, a range of outcomes was calculated, either for each individual loan or by portfolio taking account of the uncertainty relating to economic conditions. For retail lending, the range was based on different management assumptions as to loss propensity and loss ratio relative to historic experience. For corporate lending, the range reflects different realisation assumptions in respect of collateral held.

If management had used different assumptions, a larger or smaller impairment loss allowance would have resulted that could have had a material impact on the Santander UK group's reported profit before tax. Specifically, if management's conclusions were different, but within the range of what management deemed to be reasonably possible, the impairment loss for loans and advances could have decreased by £162m (2016: £193m, 2015: £221m), with a consequential increase in profit before tax, or increased by £229m (2016: £223m, 2015: £167m), with a consequential decrease in profit before tax.

b) Provision for conduct remediation
The provision charge for conduct remediation relating to past activities and products sold recognised in 2017 was £144m (2016: £146m, 2015: £500m) before tax, comprising charges for Payment Protection Insurance (PPI) of £109m (2016: £144m, 2015: £450m) and other products of £35m (2016: £2m, 2015: £50m). The balance sheet provision amounted to £403m (2016: £493m, 2015: £637m), of which £356m (2016: £457m, 2015: £465m) related to PPI. Detailed disclosures on the provision for conduct remediation can be found in Note 27.

The provision mainly represents management's best estimate of Santander UK's future liability in respect of mis-selling of PPI policies. It requires significant judgement by management in determining appropriate assumptions, which include the level of complaints expected to be received, of those, the number that will be upheld and redressed, as well as the redress costs for each of the different populations of customers identified. Based on these factors, management determines its best estimate of the anticipated costs of redress and expected operating costs.

The most critical factor in determining the level of PPI provision is the volume of claims. The uphold rate is informed by historical experience and the average cost of redress can be predicted reasonably accurately given that management is dealing with a high volume and reasonably homogeneous population. In setting the provision, management estimated the total claims that were likely to be received until August 2019.

Had management used different assumptions, a larger or smaller provision charge would have resulted that could have had a material impact on the Santander UK group's reported profit before tax. Detailed disclosures on the assumptions used, including sensitivities, can be found in Note 27.

c) Pensions
The Santander UK group operates a number of defined benefit pension schemes as described in Note 28 and estimates their position as described in the accounting policy 'Pensions and other post retirement benefits'.

The defined benefit pension schemes which were in a net asset position had a surplus of £449m (2016: £398m) and the defined benefit pension schemes which were in a net liability position had a deficit of £286m (2016: £262m).

Accounting for defined benefit pension schemes requires management to make assumptions principally about the discount rate adopted, but also about mortality, price inflation, pension increases, life expectancy and earnings growth. Management's assumptions are based on past experience and current economic trends, which are not necessarily an indication of future experience.

During the year the methodology to derive the inflation rate was changed to better reflect management's view of inflation expectations. At 31 December 2017 this had a negative impact on the accounting surplus of £125m.

Detailed disclosures on the current year service cost and deficit/surplus, including sensitivities and the date of the last formal actuarial valuations of the assets and liabilities of the schemes can also be found in Note 28.

2. SEGMENTS

The principal activity of the Santander UK group is financial services, predominantly in the United Kingdom. The Santander UK group's business is managed and reported on the basis of the following segments:

- **Retail Banking** offers a wide range of products and financial services to individuals and small businesses through a network of branches and ATMs, as well as through telephony, digital and intermediary channels. Retail Banking includes business banking customers, small businesses with an annual turnover of up to £6.5m, and Santander Consumer Finance, predominantly a vehicle finance business.
- **Commercial Banking** offers a wide range of products and financial services provided by relationship teams that are based in a network of regional Corporate Business Centres (CBCs) and through telephony and digital channels. The management of our customers is organised across two relationship teams - the Regional Corporate Bank (RCB) that covers non-property backed trading businesses that are UK domiciled with annual turnover above £6.5m and Specialist Sector Groups (SSG) that cover real estate, social housing, education, healthcare, and hotels.
- **Global Corporate Banking** services corporate clients with a turnover of £500m and above per annum and financial institutions. GCB clients require specially tailored solutions and value-added services due to their size, complexity and sophistication. We provide these clients with products to manage currency fluctuations, protect against interest rate risk, and arrange capital markets finance and specialist trade finance solutions, as well as providing support to the rest of Santander UK's business segments.
- **Corporate Centre** predominantly consists of the non-core corporate and treasury legacy portfolios. Corporate Centre is also responsible for managing capital and funding, balance sheet composition, structure and strategic liquidity risk. The non-core corporate and treasury legacy portfolios are being run-down and/or managed for value.

The segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies.

The basis of presentation in this Annual Report has been changed, and the prior periods restated to reflect a change in the internal transfer of revenues and costs from Corporate Centre to the three customer business segments. This enables a more targeted apportionment of capital and other resources in line with the strategy of each segment.

The segmental information below is presented in a manner consistent with the internal reporting provided to the committee which is responsible for allocating resources and assessing performance of the operating segments and has been identified as the chief operating decision maker. The segmental information is prepared on a statutory basis of accounting.

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

Interest income and interest expense have not been reported separately. The majority of the revenues from the segments are interest income in nature and net interest income is relied on primarily to assess the performance of the segment and to make decisions regarding allocation of segmental resources.

Revenue by products and services
Details of revenue by product or service are disclosed in Notes 3 to 5.

Results by segment

2017	Retail Banking £m	Commercial Banking £m	Global Corporate Banking £m	Corporate Centre £m	Total £m
Net interest income	3,302	395	74	32	3,803
Non-interest income	615	74	364	56	1,109
Total operating income	3,917	469	438	88	4,912
Operating expenses before impairment losses, provisions and charges	(1,871)	(223)	(304)	(101)	(2,499)
Impairment (losses)/releases on loans and advances	(36)	(13)	(174)	20	(203)
Provisions for other liabilities and charges	(342)	(55)	(11)	15	(393)
Total operating impairment losses, provisions and (charges)/releases	(378)	(68)	(185)	35	(596)
Profit/(loss) before tax	1,668	178	(51)	22	1,817
Revenue from external customers	4,505	631	506	(730)	4,912
Inter-segment revenue	(588)	(162)	(68)	818	–
Total operating income	3,917	469	438	88	4,912
Customer loans	168,991	19,391	6,037	5,905	200,324
Total assets(1)	174,524	19,391	51,078	69,772	314,765
Customer deposits	149,315	18,697	4,546	3,363	175,921
Total liabilities	150,847	18,697	45,603	83,413	298,560

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

2016	Retail Banking[2] £m	Commercial Banking £m	Global Corporate Banking £m	Corporate Centre £m	Total £m
Net interest income/(expense)	3,140	383	73	(14)	3,582
Non-interest income	562	76	312	263	1,213
Total operating income	3,702	459	385	249	4,795
Operating expenses before impairment losses, provisions and charges	(1,800)	(215)	(280)	(119)	(2,414)
Impairment (losses)/releases on loans and advances	(20)	(29)	(21)	3	(67)
Provisions for other liabilities and charges	(338)	(26)	(12)	(21)	(397)
Total operating impairment losses, provisions and charges	(358)	(55)	(33)	(18)	(464)
Profit before tax	1,544	189	72	112	1,917
Revenue from external customers	4,369	644	466	(684)	4,795
Inter-segment revenue	(667)	(185)	(81)	933	-
Total operating income	3,702	459	385	249	4,795
Customer loans	168,638	19,381	5,659	6,478	200,156
Total assets[1]	175,100	19,381	39,777	68,253	302,511
Customer deposits	148,063	17,203	4,054	3,031	172,351
Total liabilities	149,793	17,203	36,506	83,556	287,058
2015					
Net interest income	3,097	399	52	27	3,575
Non-interest income	526	91	303	78	998
Total operating income	3,623	490	355	105	4,573
Operating expenses before impairment losses, provisions and (charges)/releases	(1,898)	(217)	(287)	2	(2,400)
Impairment (losses)/releases on loans and advances	(90)	(25)	13	36	(66)
Provisions for other liabilities and (charges)/releases	(728)	(23)	(14)	3	(762)
Total operating impairment losses, provisions and (charges)/releases	(818)	(48)	(1)	39	(828)
Profit before tax	907	225	67	146	1,345
Revenue/(charges) from external customers	4,529	626	437	(1,019)	4,573
Inter-segment revenue	(906)	(136)	(82)	1,124	-
Total operating income	3,623	490	355	105	4,573
Customer loans	167,093	18,680	5,470	7,391	198,634
Total assets[1]	173,479	18,680	36,593	52,023	280,775
Customer deposits	140,358	15,076	3,013	3,808	162,255
Total liabilities	143,157	15,076	32,290	75,224	265,747

(1) Includes customer loans, net of impairment loss allowances.
(2) Restated to reflect the change in accounting policy relating to business combinations between entities under common control, as described in Note 1.

3. NET INTEREST INCOME

			Group
	2017 £m	2016 £m	2015 £m
Interest and similar income:			
Loans and advances to banks	**184**	127	115
Loans and advances to customers	**5,494**	6,198	6,491
Other	**227**	142	89
Total interest and similar income	**5,905**	6,467	6,695
Interest expense and similar charges:			
Deposits by banks	**(46)**	(56)	(63)
Deposits by customers	**(1,330)**	(1,891)	(1,979)
Debt securities in issue	**(590)**	(771)	(926)
Subordinated liabilities	**(134)**	(143)	(138)
Other	**(2)**	(24)	(14)
Total interest expense and similar charges	**(2,102)**	(2,885)	(3,120)
Net interest income	**3,803**	3,582	3,575

Interest and similar income includes £66m (2016: £79m, 2015: £81m) on impaired loans.

4. NET FEE AND COMMISSION INCOME

			Group
	2017 £m	2016 £m	2015 £m
Fee and commission income:			
Retail and corporate products	**1,167**	1,123	1,043
Insurance products	**55**	65	72
Total fee and commission income	**1,222**	1,188	1,115
Fee and commission expense:			
Retail and corporate products	**(406)**	(408)	(392)
Other	**(9)**	(10)	(8)
Total fee and commission expense	**(415)**	(418)	(400)
Net fee and commission income	**807**	770	715

5. NET TRADING AND OTHER INCOME

			Group
	2017 £m	2016 £m	2015 £m
Net trading and funding of other items by the trading book	**205**	75	252
Net income from operating lease assets	**44**	35	46
Net gains on assets designated at fair value through profit or loss	**80**	253	33
Net (losses)/gains on liabilities designated at fair value through profit or loss	**(97)**	28	(65)
Net (losses)/gains on derivatives managed with assets/liabilities held at fair value through profit or loss	**(17)**	(135)	26
Hedge ineffectiveness	**5**	28	(20)
Net profit on sale of available-for-sale assets	**54**	115	–
Other	**28**	44	11
	302	443	283

'Net trading and funding of other items by the trading book' includes fair value losses of £27m (2016: £50m, 2015: £5m) on embedded derivatives bifurcated from certain equity index-linked deposits, as described in the derivatives accounting policy in Note 1. The embedded derivatives are economically hedged internally with the equity derivatives trading desk. These transactions are managed as part of the overall positions of the equity derivatives trading desk, the results of which are also included in this line item, and amounted to gains of £28m (2016: £51m, 2015: £7m). As a result, the net fair value movements recognised on the equity index-linked deposits and the related economic hedges were net gains of £1m (2016: £1m, 2015: £2m).

In 2017, 'Net profit on sale of available-for-sale assets' includes a gain of £48m in respect of the sale of Vocalink shares. In 2016, 'Net profit on sale of available-for-sale assets' included the gain of £119m in respect of the sale of Visa shares.

In September 2017, as part of a capital management exercise, we purchased 91% of the 7.375% 20 Year Step-up perpetual callable subordinated notes. In May 2016, as part of a liability management exercise, certain debt instruments were purchased pursuant to a tender offer. These had no significant impact on the income statement.

Exchange rate differences recognised in the Consolidated Income Statement on items not at fair value through profit or loss were £109m expense (2016: £4,051m expense, 2015: £477m income) and are presented in the line 'Net trading and funding of other items by the trading book.' These are principally offset by related releases from the cash flow hedge reserve of £94m income (2016: £4,076m income, 2015: £305m expense) as set out in the Consolidated Statement of Comprehensive Income, which are also presented in 'Net trading and funding of other items by the trading book'. Exchange rate differences on items measured at fair value through profit or loss are included in the line items relating to changes in fair value.

6. OPERATING EXPENSES BEFORE IMPAIRMENT LOSSES, PROVISIONS AND CHARGES

			Group
	2017 £m	2016 £m	2015 £m
Staff costs:			
Wages and salaries	**743**	728	723
Performance-related payments	**157**	157	163
Social security costs	**93**	94	92
Pensions costs – defined contribution plans	**54**	52	50
– defined benefit plans	**32**	26	29
Other share-based payments	**10**	3	(5)
Other personnel costs	**45**	62	63
	1,134	1,122	1,115
Other administration expenses	**1,011**	970	990
Depreciation, amortisation and impairment	**354**	322	295
	2,499	2,414	2,400

Strategic report
Financial review
Governance
Risk review
Financial statements
Shareholder information

Staff costs

'Performance-related payments' include bonuses paid in the form of cash and share awards granted under the Long-Term Incentive Plan. Included in this are the Santander UK group's equity-settled share-based payments, none of which related to option-based schemes. These are disclosed in the table below as 'Shares award'. 'Other share-based payments' consist of options granted under the Employee Sharesave scheme which comprise the Santander UK group's cash-settled share-based payments. Further details can be found in Note 34. Performance-related payments above include amounts related to deferred performance awards as follows:

	Costs recognised in 2017			Costs expected to be recognised in 2018 or later		
	Arising from awards in current year £m	Arising from awards in prior year £m	Total £m	Arising from awards in current year £m	Arising from awards in prior year £m	Total £m
Cash	5	8	13	10	7	17
Shares	3	13	16	8	10	18
	8	21	29	18	17	35

The following table shows the amount of bonus awarded to employees for the performance year 2017. In the case of deferred cash and share awards, the final amount paid to an employee is influenced by forfeiture provisions and any performance conditions to which these awards are subject. The deferred share award amount is based on the fair value of these awards at the date of grant.

	Expenses charged in the year		Expenses deferred to future periods		Total	
	2017 £m	2016 £m	2017 £m	2016 £m	2017 £m	2016 £m
Cash award – not deferred	116	118	–	–	116	118
– deferred	13	15	17	18	30	33
Shares award – not deferred	12	11	–	–	12	11
– deferred	16	13	18	14	34	27
Total discretionary bonus	157	157	35	32	192	189

The average number of full-time equivalent staff was 19,559 (2016: 19,863, 2015: 20,405). During the year, the Company incurred staff costs of £908m (2016: £908m) and the average number of full-time equivalent staff was 17,759 (2016: 18,150).

Depreciation, amortisation and impairment

In 2017, an impairment charge of £32m was recognised that primarily related to capitalised software costs for a credit risk management system, part of which was no longer in use. In 2016, an impairment charge of £45m was recognised that primarily related to a multi-entity banking platform developed for our non-ring-fenced bank under the original ring-fencing structure.

7. AUDIT AND OTHER SERVICES

	Group		
	2017 £m	2016 £m	2015 £m
Audit fees:			
Fees payable to the Company's auditor(1) and its associates for the audit of the Santander UK group's annual accounts	7.4	4.6	3.6
Fees payable to the Company's auditor(1) and its associates for other services to the Santander UK group:			
– Audit of the Santander UK group's subsidiaries	1.4	1.1	1.8
Total audit fees(2)	8.8	5.7	5.4
Non-audit fees:			
Audit-related assurance services(3)	0.7	0.6	2.7
Taxation compliance services	–	0.1	0.2
Other assurance services	0.1	–	–
Other non-audit services	0.4	1.9	1.7
Total non-audit fees	1.2	2.6	4.6

(1) PricewaterhouseCoopers LLP became the Santander UK group's principal auditor in 2016. Deloitte LLP was the principal auditor during 2015. Excluded from 2016 fees are amounts of £0.2m payable to Deloitte LLP in relation to the 2015 statutory audit.
(2) The 2017 audit fees included £0.6m (2016: £nil) which related to the prior year.
(3) The 2017 audit-related assurance services included £0.1m (2016: £nil) which related to the prior year.

Total audit fees of £8.8m include fees of £1.6m in respect of the audit of the application of IFRS 9. Audit-related assurance services relate to services performed in connection with the statutory and regulatory filings of the Company and its associates. Of this category £0.1 m (2016: £0.1m, 2015: £1.2m) accords with the definition of 'Audit fees' per US Securities and Exchange Commission (SEC) guidance. The remaining £0.6m (2016: £0.5 m, 2015: £1.5m) accords with the definition of 'Audit-related fees' per that guidance and relates to services performed in connection with securitisation, debt issuance and related work and reporting to prudential and conduct regulators which is in accordance with the definition 'Audit-related fees' per SEC guidance. Taxation compliance services accord with the SEC definition of 'Tax fees' and relate to compliance services performed in respect of US Tax returns and other similar tax compliance services. Other assurance services and other non-audit services accord with the SEC definition of 'All other fees'. In 2017 and 2016 these included services performed in respect of the Global Corporate Banking remediation programme. 2015 included services provided by the predecessor auditor in respect of Santander UK's preparation for MiFID II and IFRS 9 Implementation. In 2017 the Company's auditors also earned fees of £45,000 (2016: £893,000) payable by entities outside the Santander UK group for the review of the financial position of corporate and other borrowers.

8. IMPAIRMENT LOSSES AND PROVISIONS

			Group
	2017 £m	2016 £m	2015 £m
Impairment losses on loans and advances:			
Loans and advances to customers (See Note 15)	**257**	132	156
Recoveries of loans and advances, net of collection costs (See Note 15)	**(54)**	(65)	(90)
	203	67	66
Provisions for other liabilities and charges (See Note 27)	**385**	397	762
Provisions for residual value and voluntary termination (See Note 15)	**8**	–	–
	393	397	762
	596	464	828

There were no impairment losses on loans and advances to banks and financial investments.

Impairment losses on loans and advances increased by £136m to £203m (2016: £67m) primarily due to Carillion plc exposures.

9. TAXATION

			Group
	2017 £m	2016 £m	2015 £m
Current tax:			
UK corporation tax on profit for the year	**556**	611	346
Adjustments in respect of prior years	**(27)**	(13)	(16)
Total current tax	**529**	598	330
Deferred tax:			
Charge/(credit) for the year	**23**	(11)	54
Adjustments in respect of prior years	**9**	11	(3)
Total deferred tax	**32**	–	51
Tax on profit	**561**	598	381

The standard rate of UK corporation tax was 27.25% for banking entities and 19.25% for non-banking entities (2016: 28.00% for banking entities and 20.00% for non-banking entities) following the introduction of an 8% surcharge to be applied to banking companies from 1 January 2016. Taxation for other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions. The Finance (No.2) Act 2015 introduced reductions in the corporation tax rate from 20% to 19% in 2017 and 18% by 2020. The Finance Act 2016, which was substantively enacted on 6 September 2016, introduced a further reduction in the standard rate of corporation tax rate to 17% from 2020. The effects of the changes in tax rates are included in the deferred tax balances at both 31 December 2017 and 2016.

The Santander UK group's effective tax rate for 2017, based on profit before tax, was 30.9% (2016: 31.2%, 2015: 28.3%). The tax on profit before tax differs from the theoretical amount that would arise using the basic corporation tax rate of the Company as follows:

			Group
	2017 £m	2016 £m	2015 £m
Profit before tax	**1,817**	1,917	1,345
Tax calculated at a tax rate of 19.25% (2016: 20.00%, 2015: 20.25%)	**350**	384	272
Bank surcharge on profits	**132**	134	–
Non-deductible preference dividends paid	**9**	8	6
Non-deductible UK Bank Levy	**25**	30	20
Non-deductible conduct remediation	**35**	39	90
Other non-equalised items	**30**	8	8
Effect of non-UK profits and losses	**–**	(1)	(1)
Utilisation of capital losses for which credit was not previously recognised	**–**	–	(4)
Effect of change in tax rate on deferred tax provision	**(2)**	(2)	9
Adjustment to prior year provisions	**(18)**	(2)	(19)
Tax charge	**561**	598	381

The decrease in effective tax rate from 2016 to 2017 is largely due to the reduction in the statutory tax rate, reductions in the bank levy and releases in accruals for prior periods offset by the impact of non-deductible conduct remediation in 2017. It is anticipated that the Santander UK group's effective tax rate in future periods will continue to be impacted by the 8% surcharge, the level of any non-deductible conduct remediation, changes to the cost of the Bank Levy and reductions in the statutory rate as noted above.

Current tax assets and liabilities

Movements in current tax assets and liabilities during the year were as follows:

	Group		Company	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Assets	**–**	49	**137**	198
Liabilities	**(54)**	(1)	**–**	–
At 1 January	**(54)**	48	**137**	198
Income statement charge	**(529)**	(598)	**(360)**	(488)
Other comprehensive income credit/(charge)	**44**	(49)	**48**	–
Corporate income tax paid	**484**	507	**362**	393
Other movements	**52**	38	**–**	34
	(3)	(54)	**187**	137
Assets	**–**	–	**187**	137
Liabilities	**(3)**	(54)	**–**	–
At 31 December	**(3)**	(54)	**187**	137

The amount of corporation income tax paid differs from the tax charge for the period as a result of the timing of payments due to the tax authorities together with the effects of movements in deferred tax, adjustments to prior period current tax provisions and current tax recognised directly in other comprehensive income.

Santander UK proactively engages with HM Revenue & Customs to resolve tax matters relating to prior years. The accounting policy for recognising provisions for such matters are described in Note 1 to the Consolidated Financial Statements. It is not expected that there will be any material movement in such provisions within the next twelve months. Santander UK adopted the Code of Practice on Taxation for Banks in 2010.

Deferred tax

The table below shows the deferred tax assets and liabilities including the movement in the deferred tax account during the year:

								Group
	Fair value of financial instruments £m	Pension remeasurement £m	Cash flow hedges £m	Available-for-sale £m	Tax losses carried forward £m	Accelerated tax depreciation £m	Other temporary differences £m	Total £m
At 1 January 2017	**(31)**	**(35)**	**(50)**	**(27)**	**5**	**(5)**	**15**	**(128)**
Income statement (charge)/credit	**(10)**	**(32)**	**–**	**–**	**20**	**1**	**(11)**	**(32)**
Transfers/reclassifications	**–**	**–**	**–**	**7**	**–**	**–**	**(7)**	**–**
Credited/(charged) to other comprehensive income	**–**	**26**	**53**	**(6)**	**–**	**–**	**(1)**	**72**
At 31 December 2017	**(41)**	**(41)**	**3**	**(26)**	**25**	**(4)**	**(4)**	**(88)**
At 1 January 2016	(76)	(115)	(27)	(11)	8	3	(5)	(223)
Income statement (charge)/credit	44	(53)	–	–	(3)	(8)	20	–
Credited/(charged) to other comprehensive income	1	133	(23)	(16)	–	–	–	95
At 31 December 2016	(31)	(35)	(50)	(27)	5	(5)	15	(128)

								Company
	Fair value of financial instruments £m	Pension remeasurement £m	Cash flow hedges £m	Available-for-sale £m	Tax losses carried forward £m	Accelerated tax depreciation £m	Other temporary differences £m	Total £m
At 1 January 2017	**(37)**	**(32)**	**(7)**	**(23)**	**–**	**6**	**23**	**(70)**
Income statement (charge)/credit	**(18)**	**(31)**	**(1)**	**–**	**21**	**(5)**	**(22)**	**(56)**
Credited/(charged) to other comprehensive income	**–**	**25**	**31**	**(3)**	**–**	**–**	**–**	**53**
At 31 December 2017	**(55)**	**(38)**	**23**	**(26)**	**21**	**1**	**1**	**(73)**
At 1 January 2016	(77)	(113)	1	(11)	–	17	7	(176)
Income statement (charge)/credit	40	(53)	–	–	–	(11)	16	(8)
Credited/(charged) to other comprehensive income	–	134	(8)	(12)	–	–	–	114
At 31 December 2016	(37)	(32)	(7)	(23)	–	6	23	(70)

The deferred tax assets/(liabilities) scheduled above have been recognised in both Santander UK plc and the Santander UK group on the basis that sufficient future taxable profits are forecast within the foreseeable future, in excess of the profits arising from the reversal of existing taxable temporary differences, to allow for the utilisation of the assets as they reverse. Based on the conditions at the balance sheet date, management determined that a reasonably possible change in any of the key assumptions underlying the estimated future taxable profits in the Santander UK group's five-year plan (described in Note 20) would not cause a reduction in the deferred tax assets recognised. At 31 December 2017, the Santander UK group and a trading subsidiary Santander Lending Limited recognised a deferred tax asset of £4m (2016: £5m) in respect of prior year trading losses. Future profit forecasts are such that recognition criteria under IAS 12 have been met. These tax losses do not time expire.
At 31 December 2017, the Santander UK group has a recognised deferred tax asset in respect of UK capital losses carried forward of £21m (2016: £nil). There are no unrecognised capital losses carried forward (2016: £nil).

In addition, the Santander UK group has net operating losses carried forward in the US of $76m (2016: $80m). A deferred tax asset on these losses has not been recognised as the Santander UK group does not currently anticipate being able to offset the losses against future profits or gains in order to realise any economic benefit in the foreseeable future and in particular these losses will expire on closure of the Abbey National Treasury Services plc US Branch.

10. DIVIDENDS ON ORDINARY SHARES

Dividends on ordinary shares declared and paid during the year were as follows:

	Group and Company			Group and Company		
	2017 Pence per share	2016 Pence per share	2015 Pence per share	**2017 £m**	2016 £m	2015 £m
In respect of current year – first interim	**1.04**	1.02	1.05	**323**	317	325
– second interim	**0.74**	0.89	0.33	**230**	276	102
	1.78	1.91	1.38	**553**	593	427

11. TRADING ASSETS

	Group	
	2017 £m	2016 £m
Securities purchased under resale agreements	**8,870**	10,712
Debt securities	**5,156**	6,248
Equity securities	**9,662**	5,986
Cash collateral	**6,156**	6,169
Short-term loans	**711**	920
	30,555	30,035

A significant portion of the debt and equity securities are held in our eligible liquidity pool. They comprise mainly of government bonds and quoted stocks. Detailed disclosures can be found in 'Liquidity risk' section of the Risk review.

12. DERIVATIVE FINANCIAL INSTRUMENTS

a) Use of derivatives

The Santander UK group transacts derivatives for four primary purposes:

- To manage the portfolio risks arising from customer business
- To manage and hedge the Santander UK group's own risks
- To create risk management solutions for customers
- To generate profits through sales activities.

Under IAS 39, all derivatives are classified as 'held for trading' (except for derivatives which are designated as effective hedging instruments in accordance with the detailed requirements of IAS 39) even if this is not the purpose of the transaction. The held for trading classification therefore includes two types of derivatives:

- Those used in sales activities and those providing risk solutions for customers
- Those used for own risk management purposes but, for various reasons, either the Santander UK group does not elect to claim hedge accounting for or they do not meet the qualifying criteria for hedge accounting. These consist of:
  - Non-qualifying hedging derivatives (economic hedges), whose terms match other on-balance sheet instruments but do not meet the technical criteria for hedge accounting, or which use natural offsets within other on-balance sheet instruments containing the same risk features as part of an integrated approach to risk management, and hence do not require the application of hedge accounting to achieve a reduction in income statement volatility
  - Derivatives managed in conjunction with financial instruments designated at fair value (the fair value option). The fair value option is described more fully in the Accounting Policy 'Financial assets' and Notes 13 and 24. The Santander UK group's business model is primarily structured to maximise use of the fair value option, rather than electing to apply hedge accounting, in order to reduce the administrative burden on the Santander UK group associated with complying with the detailed hedge accounting requirements of IAS 39
  - Derivatives that do not meet the qualifying criteria for hedge accounting, including ineffective hedging derivatives and any components of hedging derivatives that are excluded from assessing hedge effectiveness
  - Derivative contracts that represent the closing-out of existing positions through the use of matching deals.

The following table summarises the activities undertaken, the related risks associated with such activities and the types of derivatives used in managing such risks. These risks may also be managed using on-balance sheet instruments as part of an integrated approach to risk management.

Activity	Risk	Type of derivative
Management of the return on variable rate assets financed by shareholders' funds and net non-interest-bearing liabilities.	Reduced profitability due to falls in interest rates.	Receive fixed interest rate swaps.
Management of the basis between administered rate assets and liabilities and wholesale market rates.	Reduced profitability due to adverse changes in the basis spread.	Basis swaps.
Management of repricing profile of wholesale funding.	Reduced profitability due to adverse movement in wholesale interest rates when large volumes of wholesale funding are repriced.	Forward rate agreements.
Fixed rate lending and investments.	Sensitivity to increases in interest rates.	Pay fixed interest rate swaps.
Fixed rate retail and wholesale funding.	Sensitivity to falls in interest rates.	Receive fixed interest rate swaps.
Equity-linked retail funding.	Sensitivity to increases in equity market indices.	Receive equity swaps.
Management of other net interest income on retail activities.	Sensitivity of income to changes in interest rates.	Interest rate swaps.
Issuance of products with embedded equity options.	Sensitivity to changes in underlying index and index volatility causing option exercise.	Interest rate swaps combined with equity options.
Lending and investments.	Sensitivity to weakening credit quality.	Purchase credit default swaps and total return swaps.
Borrowing funds in foreign currencies.	Sensitivity to changes in foreign exchange rates.	Cross currency swaps.
Lending and issuance of products with embedded interest rate options.	Sensitivity to changes in underlying rate and rate volatility causing option exercise.	Interest rate swaps plus caps/floors.
Investment in, and issuance of, bonds with put/call features.	Sensitivity to changes in rates causing option exercise.	Interest rate swaps combined with swaptions[1] and other matched options.
Management of the cost of offering sharesave schemes to employees.	Reduced profitability due to increases in the Banco Santander SA share price.	Equity options and equity forwards.

(1) A swaption is an option on a swap that gives the holder the right but not the obligation to buy or sell a swap.

The Santander UK group's derivative activities do not give rise to significant open positions in portfolios of derivatives. Any residual position is managed to ensure that it remains within acceptable risk levels, with matching deals being utilised to achieve this where necessary. When entering into derivative transactions, the Santander UK group employs the same credit risk management procedures to assess and approve potential credit exposures that are used for traditional lending.

b) Trading derivatives

Most of the Santander UK group's derivative transactions relate to sales activities and derivative contracts that represent the closing-out of existing positions through the use of matching deals. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Limited positions may be traded actively or be held over a period of time to benefit from expected changes in exchange rates, interest rates, equity prices or other market parameters. Trading includes market-making, positioning and arbitrage activities. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume; positioning means managing market risk positions in the expectation of benefiting from favourable movements in prices, rates or indices; arbitrage involves identifying and profiting from price differentials between markets and products.

Commercial Banking and Global Corporate Banking deal with customers who wish to enter into derivative contracts. Any market risk arising from such transactions is hedged by Global Corporate Banking. Global Corporate Banking is responsible for implementing Santander UK group derivative hedging with the external market together with its own trading activities. For trading activities, its objectives are to gain value by:

- Marketing derivatives to end users and hedging the resulting exposures efficiently
- The management of trading exposure reflected on the Santander UK group's balance sheet.

c) Hedging derivatives

The Santander UK group uses derivatives (principally interest rate swaps and cross-currency swaps) for hedging purposes in the management of its own asset and liability portfolios, including fixed-rate lending, fixed-rate asset purchases, medium-term note issues, capital issues, and structural positions. This enables the Santander UK group to optimise the overall cost to it of accessing debt capital markets, and to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities. Such risks may also be managed using natural offsets within other on-balance sheet instruments as part of an integrated approach to risk management.

Derivative products which are combinations of more basic derivatives (such as swaps with embedded option features), or which have leverage features, may be used in circumstances where the underlying position being hedged contains the same risk features. In such cases, the derivative used will be structured to match the risks of the underlying asset or liability. Exposure to market risk on such contracts is therefore hedged.

d) Analysis of derivative financial instruments

The contract/notional amounts of derivatives in the tables below indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent actual exposures.

						Group
			2017			2016
		Fair value			Fair value	
	Notional amount £m	Assets £m	Liabilities £m	Notional amount £m	Assets £m	Liabilities £m
Derivatives held for trading:						
Exchange rate contracts	144,160	2,559	4,130	165,521	3,664	6,022
Interest rate contracts	863,151	11,612	11,140	942,798	14,117	14,341
Equity and credit contracts	19,814	888	693	15,325	1,321	860
Total derivatives held for trading	1,027,125	15,059	15,963	1,123,644	19,102	21,223
Derivatives held for hedging						
Designated as fair value hedges:						
Exchange rate contracts	2,641	312	6	3,819	751	-
Interest rate contracts	59,610	1,272	1,470	70,849	1,578	1,790
Equity derivative contracts	16	-	4	74	4	-
	62,267	1,584	1,480	74,742	2,333	1,790
Designated as cash flow hedges:						
Exchange rate contracts	23,117	3,206	55	23,786	3,907	8
Interest rate contracts	12,884	84	115	12,683	120	82
Equity derivative contracts	26	9	-	24	9	-
	36,027	3,299	170	36,493	4,036	90
Total derivatives held for hedging	98,294	4,883	1,650	111,235	6,369	1,880
Total derivative financial instruments	1,125,419	19,942	17,613	1,234,879	25,471	23,103

						Company
			2017			2016
		Fair value			Fair value	
	Notional amount £m	Assets £m	Liabilities £m	Notional amount £m	Assets £m	Liabilities £m
Derivatives held for trading:						
Exchange rate contracts	14,265	774	756	11,306	1,707	1,399
Interest rate contracts	53,358	575	120	44,988	1,710	840
Equity and credit contracts	2,311	91	6	496	42	249
Total derivatives held for trading	69,934	1,440	882	56,790	3,459	2,488
Derivatives held for hedging						
Designated as fair value hedges:						
Exchange rate contracts	3,886	371	153	4,188	899	157
Interest rate contracts	39,972	509	1,100	45,916	549	758
Equity derivative contracts	16	-	4	74	4	-
	43,874	880	1,257	50,178	1,452	915
Designated as cash flow hedges:						
Exchange rate contracts	14,533	1,687	37	15,744	2,431	-
Interest rate contracts	8,275	22	68	8,179	39	37
Equity derivative contracts	26	9	-	24	10	-
	22,834	1,718	105	23,947	2,480	37
Total derivatives held for hedging	66,708	2,598	1,362	74,125	3,932	952
Total derivative financial instruments	136,642	4,038	2,244	130,915	7,391	3,440

Derivative assets and liabilities are reported on a gross basis on the balance sheet unless there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously. Further information about offsetting is presented in Note 38.

The table below analyses the notional and fair values of derivatives by trading and settlement method.

	Notional				Asset		Liability	
		Traded over the counter						
2017	Traded on recognised exchanges £m	Settled by central counterparties £m	Not settled by central counterparties £m	Total £m	Traded on recognised exchanges £m	Traded over the counter £m	Traded on recognised exchanges £m	Traded over the counter £m
Exchange rate contracts	–	–	**169,918**	**169,918**	–	**6,077**	–	**4,191**
Interest rate contracts	**71,618**	**626,600**	**237,427**	**935,645**	–	**12,968**	–	**12,725**
Equity and credit contracts	**30**	–	**19,826**	**19,856**	–	**897**	**1**	**696**
	71,648	**626,600**	**427,171**	**1,125,419**	–	**19,942**	**1**	**17,612**
2016								
Exchange rate contracts	–	–	193,126	193,126	–	8,322	–	6,030
Interest rate contracts	69,501	725,626	231,203	1,026,330	1	15,814	–	16,213
Equity and credit contracts	34	–	15,389	15,423	–	1,334	1	859
	69,535	725,626	439,718	1,234,879	1	25,470	1	23,102

e) Analysis of derivatives designated as hedges

Net gains or losses arising from fair value and cash flow hedges included in net trading and other income

	Group			Company		
	2017 £m	2016 £m	2015 £m	2017 £m	2016 £m	2015 £m
Fair value hedging:						
Gains/(losses) on hedging instruments	**56**	(274)	(26)	**91**	(258)	14
(Losses)/gains on hedged items attributable to hedged risks	**(2)**	335	87	**(62)**	245	(14)
Fair value hedging ineffectiveness	**54**	61	61	**29**	(13)	–
Cash flow hedging ineffectiveness	**(49)**	(33)	(81)	**12**	18	13
	5	28	(20)	**41**	5	13

Santander UK hedges its exposures to various risks, including interest rate risk and foreign currency risk, in connection with certain mortgage assets, covered bond issuances, and subordinated and senior debt securities in issue. The gains or losses arising on these assets and liabilities are presented in the table above on a combined basis.

Hedged cash flows

The following table shows when the hedged cash flows are expected to affect the income statement for designated cash flow hedges.

							Group
2017	Up to 1 year £m	1 to 2 years £m	2 to 3 years £m	3 to 4 years £m	4 to 5 years £m	Over 5 years £m	Total £m
Forecast receivable cash flows	**275**	**280**	**262**	**197**	**160**	**668**	**1,842**
Forecast payable cash flows	**(3,486)**	**(5,288)**	**(3,912)**	**(3,572)**	**(2,224)**	**(7,364)**	**(25,846)**
2016							
Forecast receivable cash flows	240	220	217	202	146	668	1,693
Forecast payable cash flows	(4,059)	(3,392)	(3,681)	(2,998)	(2,274)	(5,611)	(22,015)

							Company
2017	Up to 1 year £m	1 to 2 years £m	2 to 3 years £m	3 to 4 years £m	4 to 5 years £m	Over 5 years £m	Total £m
Forecast receivable cash flows	**148**	**151**	**134**	**104**	**89**	**530**	**1,156**
Forecast payable cash flows	**(2,853)**	**(3,768)**	**(2,613)**	**(886)**	**(1,249)**	**(4,938)**	**(16,307)**
2016							
Forecast receivable cash flows	126	118	119	104	75	492	1,034
Forecast payable cash flows	(2,659)	(2,823)	(2,431)	(1,804)	(118)	(3,447)	(13,282)

There were no transactions for which cash flow hedge accounting had to be ceased during the years ended 31 December 2017 and 2016 as a result of the cash flows no longer being expected to occur. In 2015, there was one cash flow hedge of equity price risk for which hedge accounting ceased as a result of the cash flows no longer being expected to occur.

During the year, gains and losses transferred from the cash flow hedging reserve to net interest income were a net gain of £183m (2016: £167m, 2015: £157m) and to net trading and other income were a net loss of £89m (2016: gain of £3,909m, 2015: loss of £462m). During the year, the Company transferred gains from the cash flow hedging reserve to net interest income of £61m (2016: £42m) and losses to net trading and other income of £197m (2016: £2,212m gains).

13. FINANCIAL ASSETS DESIGNATED AT FAIR VALUE

	Group		Company	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Loans and advances to customers:				
Loans to housing associations	**1,034**	1,215	**703**	–
Other loans	**515**	516	**11**	10
	1,549	1,731	**714**	10
Debt securities	**547**	409	**79**	75
	2,096	2,140	**793**	85

Loans and advances to customers represent loans to housing associations secured on residential property and other loans.

- Loans to housing associations secured on residential property which, at the date of their origination, were managed, and their performance evaluated, on a fair value basis in accordance with a documented investment strategy, and information about them was provided on that basis to management. In 2017, loans to housing associations increased following the transfer of loans from Abbey National Treasury Services plc as part of our ongoing ring-fencing plans. For more information on our ring-fencing plans, see Note 39.
- Other loans representing a portfolio of roll-up mortgages and associated receivables, are managed, and their performance evaluated, on a fair value basis in accordance with a documented investment strategy, and information about them is provided on that basis to management. Since 2009, the Santander UK group's policy has been not to designate similar new loans at fair value through profit or loss.

The net gain during the year attributable to changes in credit risk for loans and advances designated at fair value was £49m (2016: £40m, 2015: £39m). The cumulative net loss attributable to changes in credit risk for loans and advances designated at fair value at 31 December 2017 was £120m (2016: £169m).

14. LOANS AND ADVANCES TO BANKS

	Group		Company	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Securities purchased under resale agreements	**2,464**	1,462	**476**	–
Placements with other banks	**3,463**	2,886	**14,688**	25,699
	5,927	4,348	**15,164**	25,699

15. LOANS AND ADVANCES TO CUSTOMERS

	Group		Company	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Loans secured on residential properties	**155,355**	154,727	**155,350**	154,725
Corporate loans	**31,006**	31,978	**21,781**	15,712
Finance leases	**6,710**	6,730	**–**	–
Secured advances	**–**	10	**–**	–
Other unsecured loans	**6,230**	6,165	**5,522**	5,517
Amounts due from fellow Banco Santander subsidiaries and joint ventures	**1,199**	1,112	**10**	9
Amounts due from Santander UK Group Holdings plc	**8**	5	**8**	5
Amounts due from subsidiaries	**–**	–	**24,399**	25,586
Loans and advances to customers	**200,508**	200,727	**207,070**	201,554
Impairment loss allowances	**(940)**	(921)	**(913)**	(980)
Residual value and voluntary termination provisions[1]	**(78)**	(68)	**–**	–
Net loans and advances to customers	**199,490**	199,738	**206,157**	200,574

(1) In the first half of 2017, we reclassified our provisions for residual value and voluntary termination from the consumer finance impairment loss allowance. In order to facilitate comparison with the current period, prior year comparatives were amended.

In 2017 corporate loans in Santander UK plc increased following the transfer of loans to housing associations from Abbey National Treasury Services plc as part of our ring-fencing plans. For more information on our ring-fencing plans, see Note 39.

Movement in impairment loss allowances:

Group	Loans secured on residential properties £m	Corporate loans £m	Finance leases £m	Other unsecured loans £m	Total £m
At 1 January 2017	**279**	**382**	**45**	**215**	**921**
(Release)/charge to the income statement	**(37)**	**172**	**20**	**102**	**257**
Write-offs and other items[1]	**(17)**	**(64)**	**(19)**	**(138)**	**(238)**
At 31 December 2017	**225**	**490**	**46**	**179**	**940**
Of which:					
– Observed	**105**	**433**	**12**	**59**	**609**
– Incurred but not yet observed	**120**	**57**	**34**	**120**	**331**
	225	**490**	**46**	**179**	**940**
Recoveries, net of collection costs	**3**	**1**	**6**	**44**	**54**
At 1 January 2016	424	395	20	269	1,108
(Release)/charge to the income statement	(116)	59	47	142	132
Write-offs and other items[1]	(29)	(72)	(22)	(196)	(319)
At 31 December 2016	279	382	45	215	921
Of which:					
– Observed	130	287	13	73	503
– Incurred but not yet observed	149	95	32	142	418
	279	382	45	215	921
Recoveries, net of collection costs	4	3	2	56	65
At 1 January 2015	579	558	30	248	1,415
(Release)/charge to the income statement	(123)	(6)	20	265	156
Write-offs and other items[1]	(32)	(157)	(30)	(244)	(463)
At 31 December 2015	424	395	20	269	1,108
Of which:					
– Observed	159	282	12	78	531
– Incurred but not yet observed	265	113	8	191	577
	424	395	20	269	1,108
Recoveries, net of collection costs	2	3	2	83	90

(1) Mortgage write-offs exclude the effect of the unwind over time of the discounting in estimating losses, as described in the accounting policy 'Impairment of financial assets' in Note 1. Mortgage write-offs including this effect were £22m (2016: £33m, 2015: £40m).

Company	Loans secured on residential properties £m	Corporate loans £m	Other unsecured loans £m	Amounts due from subsidiaries £m	Total £m
At 1 January 2017	**277**	**291**	**180**	**232**	**980**
(Release)/charge to the income statement	**(36)**	**120**	**123**	**(26)**	**181**
Write-offs and other items	**(18)**	**(70)**	**(160)**	**–**	**(248)**
At 31 December 2017	**223**	**341**	**143**	**206**	**913**
At 1 January 2016	426	321	195	232	1,174
(Release)/charge to the income statement	(117)	28	148	–	59
Write-offs and other items	(32)	(58)	(163)	–	(253)
At 31 December 2016	277	291	180	232	980
At 1 January 2015	579	388	207	232	1,406
(Release)/charge to the income statement	(122)	33	191	–	102
Write-offs and other items	(31)	(100)	(203)	–	(334)
At 31 December 2015	426	321	195	232	1,174

Finance lease and hire purchase contract receivables may be analysed as follows:

						Group
			2017			2016
	Gross investment £m	Unearned finance income £m	Net investment £m	Gross investment £m	Unearned finance income £m	Net investment £m
Not later than one year	**3,633**	**(177)**	**3,456**	3,047	(183)	2,864
Later than one year and not later than five years	**3,316**	**(226)**	**3,090**	3,906	(236)	3,670
Later than five years	**214**	**(50)**	**164**	264	(68)	196
	7,163	**(453)**	**6,710**	7,217	(487)	6,730

At 31 December 2017 and 2016, the Company had no finance lease and hire purchase contract receivables. The Santander UK group enters into finance leasing arrangements primarily for the financing of motor vehicles and a range of assets to its corporate customers. Included in the carrying value of net investment in finance leases and hire purchase contracts is £886m (2016: £748m) of unguaranteed residual value at the end of the current lease terms, which is expected to be recovered through re-payment, re-financing or sale. Contingent rent income of £5m (2016: £4m, 2015: £4m) was earned during the year, which was classified in 'Interest and similar income'.

Finance lease receivable balances are secured over the asset leased. The Santander UK group is not permitted to sell or repledge the asset in the absence of default by the lessee. The Directors consider that the carrying amount of the finance lease receivables approximates to their fair value.

Included within loans and advances to customers are advances assigned to bankruptcy remote structured entities and Abbey Covered Bonds LLP. These loans provide security to issues of covered bonds and asset or mortgage-backed securities made by the Santander UK group. See Note 16 for further details.

16. SECURITISATIONS AND COVERED BONDS

The Santander UK group uses structured entities to securitise some of the mortgage and other loans to customers that it originates. The Santander UK group also issues covered bonds, which are guaranteed by a pool of the Santander UK group's mortgage loans that it has transferred into Abbey Covered Bonds LLP. The Santander UK group issues mortgage-backed securities, other asset-backed securities and covered bonds mainly in order to obtain diverse, low cost funding, but also to be used as collateral for raising funds via third party bilateral secured funding transactions or for creating collateral which could in the future be used for liquidity purposes. The Santander UK group has successfully used bilateral secured transactions as an additional form of medium-term funding; this has allowed the Santander UK group to further diversify its medium-term funding investor base. The Santander UK group's principal securitisation programmes and covered bond programme, together with the balances of the advances subject to securitisation and the carrying value of the notes in issue at 31 December 2017 and 2016 are listed below. The related notes in issue are set out in Note 25.

Loans and advances to customers include portfolios of residential mortgage loans, and receivables derived from credit agreements with retail customers for the purchases of financed vehicles, which are subject to non-recourse finance arrangements. These loans and receivables have been purchased by, or assigned to, structured entities or Abbey Covered Bonds LLP, and have been funded primarily through the issue of mortgage-backed securities, other asset-backed securities or covered bonds. No gain or loss has been recognised as a result of these sales. The structured entities and Abbey Covered Bonds LLP are consolidated as subsidiaries. The Company and its subsidiaries do not own directly, or indirectly, any of the share capital of any of the structured entities.

a) Securitisations

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

	2017 £m	2016 £m
Master trust structures:		
- Holmes	**4,299**	5,560
- Fosse	**5,732**	7,182
- Langton	**3,893**	5,211
	13,924	17,953
Other securitisation structures:		
- Motor	**1,318**	1,117
- Auto ABS UK Loans	**1,498**	1,260
	2,816	2,377
Total gross assets securitised	**16,740**	20,330

i) Master trust structures

The Santander UK group makes use of a type of securitisation known as a master trust structure. In this structure, a pool of assets is assigned to a trust company by the asset originator. A funding entity acquires a beneficial interest in the pool of assets held by the trust company with funds borrowed from qualifying structured entities, which at the same time issue asset-backed securities to third-party investors or the Santander UK group. The trust company holds the pool of assets on trust for the funding entity and the originator. The originator holds a beneficial interest over the share of the pool of assets not purchased by the funding entity, known as the seller share.

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

Santander UK plc and its subsidiaries receive payments from the securitisation companies in respect of fees for administering the loans, and payment of deferred consideration for the sale of the loans. Santander UK plc and its subsidiaries have no right or obligation to repurchase any securitised loan, except if certain representations and warranties given by Santander UK plc or its subsidiaries at the time of transfer are breached and, in certain cases, if there is a product switch.

Holmes

Outstanding balances of assets securitised and notes in issue (non-recourse finance) at 31 December 2017 and 2016 were:

		2017			2016		
Securitisation company	Closing date of securitisation	Gross assets securitised £m	Notes in issue £m	Issued to Santander UK plc as collateral £m	Gross assets securitised £m	Notes in issue £m	Issued to Santander UK plc as collateral £m
Holmes Master Issuer plc – 2010/1	12 November 2010	**-**	**-**	**-**	318	383	-
Holmes Master Issuer plc – 2011/3	21 September 2011	**534**	**561**	**-**	512	618	-
Holmes Master Issuer plc – 2012/1	24 January 2012	**-**	**-**	**-**	98	118	-
Holmes Master Issuer plc – 2012/2	17 April 2012	**-**	**-**	**-**	585	706	-
Holmes Master Issuer plc – 2012/3	7 June 2012	**-**	**-**	**-**	426	514	-
Holmes Master Issuer plc – 2013/1	30 May 2013	**-**	**-**	**-**	28	-	34
Holmes Master Issuer plc – 2016/1	26 May 2016	**694**	**340**	**389**	1,017	644	584
Holmes Master Issuer plc – 2017/1	16 October 2017	**474**	**499**	**-**	-	-	-
Beneficial interest in mortgages held by Holmes Trustees Ltd		**2,597**	**-**	**-**	2,576	-	-
		4,299	**1,400**	**389**	5,560	2,983	618
Less: Held by the Santander UK group			**-**			-	
Total securitisations (See Note 25)			**1,400**			2,983	

Using a master trust structure, Santander UK plc has assigned portfolios of residential mortgages and their related security to Holmes Trustees Limited, a trust company that holds the portfolios of mortgages on trust for Santander UK plc and Holmes Funding Limited. Proceeds from notes issued to third party investors or the Santander UK group by structured entities under the Holmes master trust structure have been loaned to Holmes Funding Limited, which in turn used the funds to purchase its referred beneficial interests in the portfolio of assets held by Holmes Trustees Limited. The minimum value of assets required to be held by Holmes Trustees Limited is a function of the notes in issue under the Holmes master trust structure and Santander UK plc's required minimum share. The Holmes securitisation companies have placed cash deposits totalling £nil (2016: £231m), which have been accumulated to finance the redemption of a number of securities issued by the Holmes securitisation companies. The share of Holmes Funding Limited in the trust assets is therefore reduced by this amount.

Holmes Funding Limited has a beneficial interest of £1.7bn (2016: £3.0bn) in the residential mortgage loans held by Holmes Trustees Limited, the remaining share of the beneficial interest in residential mortgage loans held by Holmes Trustees Limited belongs to Santander UK plc.

In 2017, £0.5bn (2016: £1.2bn) of mortgage-backed notes were issued from Holmes Master Issuer plc. Mortgage-backed securities totalling £2.0bn (2016: £3.7bn) equivalent were redeemed during the year.

Fosse

Outstanding balances of assets securitised and notes in issue (non-recourse finance) at 31 December 2017 and 2016 were:

				2017			2016
Securitisation company	Closing date of securitisation	Gross assets securitised £m	Notes in issue £m	Issued to Santander UK plc as collateral £m	Gross assets securitised £m	Notes in issue £m	Issued to Santander UK plc as collateral £m
Fosse Master Issuer plc - 2010/1	12 March 2010	–	–	–	446	535	-
Fosse Master Issuer plc - 2011/2	6 December 2011	176	191	34	204	211	34
Fosse Master Issuer plc - 2012/1	22 May 2012	–	–	–	700	738	105
Fosse Master Issuer plc - 2014/1	19 June 2014	–	–	–	366	441	-
Fosse Master Issuer plc - 2015/1	24 March 2015	333	425	–	559	673	-
Beneficial interest in mortgages held by Fosse Master Trust Ltd		5,223	–	–	4,907	–	-
		5,732	616	34	7,182	2,598	139
Less: Held by the Santander UK group			–			–	
Total securitisations (See Note 25)			616			2,598	

The Fosse Master Trust securitisation structure was established in 2006. Notes were issued by Fosse Master Issuer plc to third party investors and the proceeds loaned to Fosse Funding (No.1) Limited, which in turn used the funds to purchase beneficial interests in mortgages held by Fosse Trustee (UK) Limited. Both Fosse Funding (No.1) Limited and Santander UK plc have a beneficial interest in the mortgages held in trust by Fosse Trustee (UK) Limited. The minimum value of assets required to be held by Fosse Trustee Limited is a function of the notes in issue under the Fosse master trust structure and Santander UK plc's required minimum share.

Fosse Master Issuer plc has cash deposits totalling £24m (2016: £260m), which have been accumulated to finance the redemption of a number of securities issued by Fosse Master Issuer plc. Fosse Funding (No.1) Limited's beneficial interest in the assets held by Fosse Trustee (UK) Limited is therefore reduced by this amount.

In 2017 and 2016 there were no mortgage-backed notes issued from Fosse Master Issuer plc. Mortgage-backed notes totalling £1.9bn (2016: £2.9bn) equivalent were redeemed during the year.

Langton

Outstanding balances of assets securitised and notes in issue (non-recourse finance) at 31 December 2017 and 2016 were:

				2017			2016
Securitisation company	Closing date of securitisation	Gross assets securitised £m	Notes in issue £m	Issued to Santander UK plc as collateral £m	Gross assets securitised £m	Notes in issue £m	Issued to Santander UK plc as collateral £m
Langton Securities (2010-1) plc (1)	1 October 2010	986	–	984	987	–	984
Langton Securities (2008-1) plc (2)	23 March 2011	1,373	–	1,371	1,376	–	1,372
Beneficial interest in mortgages held by Langton Master Trust Ltd		1,534	–	–	2,848	–	–
		3,893	–	2,355	5,211	–	2,356

The Langton Master Trust securitisation structure was established in 2008. Notes were issued by the Langton Securities entities to Santander UK plc for the purpose of creating collateral to be used for funding and liquidity. Each entity loaned the proceeds of the Notes issued to Langton Funding (No.1) Limited, which in turn used the funds to purchase a beneficial interest in the mortgages held by Langton Mortgages Trustee (UK) Limited. Both Langton Funding (No.1) Limited and Santander UK plc have a beneficial interest in the mortgages held in trust by Langton Mortgages Trustee (UK) Limited. The minimum value of assets required to be held by Langton Mortgages Trustee Limited (UK) is a function of the notes in issue under the Langton master trust structure and Santander UK plc's required minimum share.

In 2017 and 2016, there were no issuances from any of the Langton issuing companies. Mortgage-backed notes totalling £nil (2016: £3.4bn) equivalent were redeemed during the year.

ii) Other securitisation structures

The Santander UK group issues notes through pass-through stand-alone vehicles for the securitisation of receivables derived from credit agreements with retail customers for the purchase of financed vehicles.

Motor

Outstanding balances of assets securitised and notes in issue (non-recourse finance) at 31 December 2017 and 2016 were:

		2017			2016		
Securitisation company	Closing date of securitisation	Gross assets securitised £m	Notes in issue £m	Issued to Santander Consumer (UK) plc as collateral £m	Gross assets securitised £m	Notes in issue £m	Issued to Santander Consumer (UK) plc as collateral £m
Motor 2014-1 plc	16 April 2014	–	–	–	125	–	136
Motor 2015-1 plc	2 March 2015	164	38	136	436	352	136
Motor 2016-1 plc	15 December 2016	578	300	300	556	298	300
Motor 2017-1 plc	20 September 2017	576	514	78	–	–	–
		1,318	852	514	1,117	650	572
Less: Held by the Santander UK group			–			–	
Total securitisations (See Note 25)			852			650	

In 2017 there were issuances of £0.5bn (2016: £0.6bn) of asset-backed notes from the Motor securitisation structures. Asset-backed notes totalling £0.3bn (2016: £0.5bn) equivalent were redeemed during the year. In 2016 Motor 2016-1M Limited borrowed £0.2bn through an asset-backed senior loan facility under the Motor securitisation arrangement. This was repaid in full in August 2017.

Auto ABS UK Loans

Outstanding balances of assets securitised and notes in issue (non-recourse finance) at 31 December 2017 and 2016 were:

		2017			2016		
Securitisation company	Closing date of securitisation	Gross assets securitised £m	Notes in issue £m	Issued to PSA Finance UK Limited as collateral £m	Gross assets securitised £m	Notes in issue £m	Issued to PSA Finance UK Limited as collateral £m
Auto ABS UK Loans plc	30 April 2017	1,111	925	221	1,260	1,275	113
Auto ABS UK Loans 2017 plc	15 November 2017	387	315	85	–	–	–
		1,498	1,240	306	1,260	1,275	113
Less: Held by the Santander UK group			–			–	
Total securitisations (See Note 25)			1,240			1,275	

In 2017, asset-backed notes totalling £0.5bn (2016: £0.5bn) were issued from Auto ABS UK Loans plc and £0.4bn (2016: £nil) were issued by Auto ABS UK loans 2017 plc. Asset-backed notes totalling £0.7bn (2016: £0.4bn) were redeemed during the year by Auto ABS UK Loans plc.

b) Covered bonds

Santander UK plc (the Issuer) also issues covered bonds, which are a direct, unsecured and unconditional obligation of the Issuer. The covered bonds benefit from a guarantee from Abbey Covered Bonds LLP. The Issuer makes a term advance to Abbey Covered Bonds LLP equal to the sterling proceeds of each issue of covered bonds. Abbey Covered Bonds LLP uses the proceeds of the term advance to purchase portfolios of residential mortgage loans and their security from Santander UK plc. Under the terms of the guarantee, Abbey Covered Bonds LLP has agreed to pay an amount equal to the guaranteed amounts when the same shall become due for payment but which would otherwise be unpaid by the Issuer.

Outstanding balances of loans and advances assigned to the covered bond programme at 31 December 2017 and 2016 were:

	2017		2016	
	Gross assets assigned £m	Notes in issue £m	Gross assets assigned £m	Notes in issue £m
Euro 35bn Global Covered Bond Programme	19,772	16,866	20,263	17,941
Less: Held by the Santander UK group		(1,067)		(1,313)
Total covered bonds (See Note 25)		15,799		16,628

In 2017, there were issuances of £2.3bn (2016: £2.2bn) from the covered bond programme. Covered bonds totalling £3.3bn (2016: £0.8bn) equivalent were redeemed during the year.

17. TRANSFERS OF FINANCIAL ASSETS NOT QUALIFYING FOR DERECOGNITION

The Santander UK group enters into transactions in the normal course of business by which it transfers recognised financial assets directly to third parties or to structured entities. These transfers may give rise to the full or partial derecognition of the financial assets concerned.

- Full derecognition occurs when the Santander UK group transfers its contractual right to receive cash flows from the financial assets, or retains the right but assumes an obligation to pass on the cash flows from the asset, and transfers substantially all the risks and rewards of ownership. The risks include credit, interest rate, currency, prepayment and other price risks
- Partial derecognition occurs when the Santander UK group sells or otherwise transfers financial assets in such a way that some but not substantially all of the risks and rewards of ownership are transferred but control is retained. These financial assets are recognised on the balance sheet to the extent of the Santander UK group's continuing involvement. There are no assets subject to partial derecognition.

Financial assets that do not qualify for derecognition consist of (i) securities held by counterparties as collateral under repurchase agreements, (ii) securities lent under securities lending agreements, and (iii) loans that have been securitised under arrangements by which the Santander UK group retains a continuing involvement in such transferred assets.

As the substance of the sale and repurchase and securities lending transactions is secured borrowings, the asset collateral continues to be recognised in full and the related liability reflecting the Santander UK group's obligation to repurchase the transferred assets for a fixed price at a future date is recognised in deposits from banks or customers, as appropriate. As a result of these transactions, the Santander UK group is unable to use, sell or pledge the transferred assets for the duration of the transaction. The Santander UK group remains exposed to interest rate risk and credit risk on these pledged instruments. The counterparty's recourse is not limited to the transferred assets.

The Santander UK group securitisation transfers do not qualify for derecognition. The Santander UK group remains exposed to credit risks arising from the mortgage loans and has retained control of the transferred assets. Circumstances in which the Santander UK group has continuing involvement in the transferred assets may include retention of servicing rights over the transferred assets, entering into a derivative transaction with the securitisation vehicle, retaining an interest in the securitisation vehicle or providing a cash reserve fund. Where the Santander UK group has continuing involvement it continues to recognise the transferred assets to the extent of its continuing involvement and recognises an associated liability. The net carrying amount of the transferred assets and associated liabilities reflects the rights and obligations that the Santander UK group has retained.

The following table analyses the carrying amount of financial assets that did not qualify for derecognition and their associated financial liabilities:

				Group
Nature of transaction	2017 £m	2017 £m	2016 £m	2016 £m
Sale and repurchase agreements	**10,808**	**(7,734)**	5,600	(3,831)
Securities lending agreements	**302**	**(235)**	244	(117)
Securitisations (See Notes 16 and 25)	**12,847**	**(4,108)**	15,066	(7,434)
	23,957	**(12,077)**	20,910	(11,382)

				Company
Nature of transaction	2017 £m	2017 £m	2016 £m	2016 £m
Sale and repurchase agreements	**6,379**	**(6,341)**	1,023	(1,023)
	6,379	**(6,341)**	1,023	(1,023)

18. FINANCIAL INVESTMENTS

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Loans and receivables securities	**2,180**	257	**4,706**	796
Debt securities:				
- Available-for-sale	**8,772**	10,449	**8,772**	9,974
- Held-to-maturity	**6,578**	6,648	**6,578**	6,648
Available-for-sale equity securities	**81**	112	**62**	95
	17,611	17,466	**20,118**	17,513

A significant portion of the debt securities are held in our eligible liquidity pool and consist mainly of government bonds and covered bonds. Detailed disclosures can be found in the 'Liquidity risk' section of the Risk review.

The Company's loans and receivables securities consist of investments in debt securities issued by Santander UK group entities.

19. INTERESTS IN OTHER ENTITIES

	Group 2017 £m	Group 2016 £m	Company 2017 £m	Company 2016 £m
Subsidiaries	–	–	**4,487**	4,481
Joint ventures	**73**	61	**3**	5
	73	61	**4,490**	4,486

The Santander UK group consists of a parent company, Santander UK plc, incorporated in the UK and a number of subsidiaries and joint ventures held directly and indirectly by the Company. The Company has no individually significant associates. Details of subsidiaries, joint ventures and associates are set out in the Shareholder Information section and form an integral part of these financial statements.

a) Interests in subsidiaries

The Company holds directly or indirectly 100% of the issued ordinary share capital of its principal subsidiaries. All companies operate principally in their country of incorporation or registration. Santander UK plc has branches in the Isle of Man and Jersey. Abbey National Treasury Services plc has a branch office in the US.

The movement in the Company's interests in subsidiaries was as follows:

	Company Cost £m	Company Impairment £m	Company Net book value £m
At 1 January 2017	**4,913**	**(432)**	**4,481**
Additions	–	**(5)**	**(5)**
Reversal	–	**11**	**11**
Dissolution/disposal	**(94)**	**94**	–
At 31 December 2017	**4,819**	**(332)**	**4,487**
At 1 January 2016	5,754	(554)	5,200
Reversal	–	38	38
Dissolution/disposal	(110)	84	(26)
Capital reduction of investment in subsidiaries	(731)	–	(731)
At 31 December 2016	4,913	(432)	4,481

In 2017 and 2016, the movements on interests in subsidiaries principally represented changes in the capital invested in certain subsidiaries as a result of an internal reorganisation within the Santander UK group.

On 1 January 2018, Santander UK plc acquired 100% of the share capital of Santander UK Operations Ltd (formerly Geoban UK Ltd, a subsidiary of Geoban SA) and Santander UK Technology Ltd (formerly Isban UK Ltd, a subsidiary of Ingenieria De Software Bancario SL) for an aggregate cash consideration of £55m. Immediately prior to this, the UK branch of Produban Servicios Informaticos Generales SL was acquired by Santander UK Technology Ltd for a cash consideration of £17m. These acquisitions will enable the Santander UK group to be more customer-centric by having greater business alignment and end-to-end control of IT and operations. In each case, the cash consideration is subject to the finalisation of the book values of the businesses transferred.

Subsidiaries with significant non-controlling interests

The only subsidiary with significant non-controlling interests is PSA Finance UK Limited, which operates in the UK. In 2017 and 2016, the proportion of ownership interests and voting rights held by non-controlling interests was 50%.

	2017 £m	2016 £m
Profit attributable to non-controlling interests	**21**	27
Accumulated non-controlling interests of the subsidiary	**152**	150
Dividends paid to non-controlling interests	**19**	12
Summarised financial information:		
– Total assets	**3,215**	3,450
– Total liabilities	**2,909**	3,417
– Profit for the year	**43**	55
– Total comprehensive income for the year	**43**	55

Interests in consolidated structured entities

Structured entities are formed by Santander UK to accomplish specific and well-defined objectives. Santander UK consolidates these structured entities when the substance of the relationship indicates control, as described in Note 1. In addition to the structured entities disclosed in Note 16 which are used for securitisation and covered bond programmes, the only other structured entities consolidated by the Santander UK group are described below. All the external assets in these entities are included in the financial statements and in relevant Notes of these Consolidated Financial Statements. Other than as set out below, no significant judgements were required with respect to control or significant influence.

i) Guaranteed Investment Products 1 PCC Limited (GIP)

GIP is a Guernsey-incorporated, closed-ended, protected cell company. The objective of each cell is to achieve capital growth for retail investors. In order to achieve the investment objective, GIP, on behalf of the respective cells, has entered into transactions with Santander UK. Santander Guarantee Company, a Santander UK group company, also guarantees the shareholders of cells a fixed return on their investment and/or the investment amount. GIP has no third party assets. Although the share capital is owned by the retail investors, Santander UK continues to have exposure to variable risks and returns through Santander Guarantee Company's guarantee and has therefore consolidated this entity.

ii) Santander UK Foundation Limited
Santander UK Foundation Limited supports disadvantaged people throughout the UK through the charitable priorities of education and financial capability. The entity was set up by Santander UK and all its revenue arises through donations from Santander UK, and its third party assets are minimal, comprising of available-for-sale assets of £16m (2016: £15m). This entity has been consolidated as Santander UK directs its activities.

b) Interests in joint ventures
Santander UK does not have any individually material interests in joint ventures. As set out in the accounting policies in Note 1, interests in joint ventures are accounted for using the equity method. In the year ended 31 December 2017, Santander UK's share in the profit after tax of its joint ventures was £12m (2016: £13m) before elimination of transactions between Santander UK and the joint ventures. At 31 December 2017, the carrying amount of Santander UK's interest was £73m (2016: £61m). At 31 December 2017 and 2016, the joint ventures had no commitments and contingent liabilities.

c) Interests in unconsolidated structured entities
Structured entities sponsored by the Santander UK group
Santander UK has interests in structured entities which it sponsors but does not control. Santander UK considers itself a sponsor of a structured entity when it facilitates the establishment of the structured entity. Other than as set out below, no significant judgements were required with respect to control or significant influence. The structured entities sponsored but not consolidated by Santander UK are as follows.

i) Santander (UK) Common Investment Fund
In 2008, a common investment fund was established to hold the assets of the Santander UK Group Pension Scheme. The Santander (UK) Common Investment Fund is not consolidated by Santander UK, but its assets of £11,626m (2016: £11,125m) are accounted for as part of the defined benefit assets and obligations recognised on Santander UK's balance sheet. See Note 28 for further information about the entity. As this entity holds the assets of the pension scheme it is outside the scope of IFRS 10. Santander UK's maximum exposure to loss is equal to the sum of the carrying amount of the assets held.

ii) Trust preferred entities
The trust preferred entities, Abbey National Capital Trust I and Abbey National Capital LP I are 100% owned finance subsidiaries (as defined in Regulation S-X under the US Securities Act 1933, as amended) of Santander UK plc which were set up by Santander UK solely for the issuance of trust preferred securities to third parties and lend the funds on to other Santander UK companies. On 7 February 2000, Abbey National Capital Trust I issued US$1bn of 8.963% Non-cumulative Trust Preferred Securities, which have been registered under the US Securities Act of 1933, as amended. Abbey National Capital Trust I serves solely as a passive vehicle holding the partnership preferred securities issued by Abbey National Capital LP I and each has passed all the rights relating to such partnership preferred securities to the holders of trust preferred securities issued by Abbey National Capital Trust I. All of the trust preferred securities and the partnership preferred securities have been fully and unconditionally guaranteed on a subordinated basis by Santander UK plc. The terms of the securities do not include any significant restrictions on the ability of Santander UK plc to obtain funds, by dividend or loan, from any subsidiary. The trust preferred entities are not consolidated by Santander UK as Santander UK plc is not exposed to variability of returns from the entities.

iii) Credit Protection entities
Santander UK has established two credit protection vehicles, Grafton CLO 2016-1 Designated Activity Company (Grafton) and Red 1 Finance CLO 2017-1 Designated Activity Company (Red 1), private limited companies incorporated in Ireland. Grafton and Red 1 have issued £100m and £87m Credit Linked Notes respectively to third party investors which reference portfolios of Santander UK group loans. Concurrently these vehicles sell credit protection to Santander UK in respect of the referenced loans and, in return for a fee, are liable to make protection payments to the Santander UK group upon the occurrence of a credit event in relation to any of the referenced loans. The entities are not consolidated by Santander UK because the third party investors have the exposure, or rights to, to the variability of returns from the performance of the entity. No assets are transferred to, or income received from, these vehicles. The maximum exposure to loss is equal to any unamortised fees paid to the credit protection entities in connection with the credit protection outlined above.

Structured entities not sponsored by the Santander UK group
Santander UK also has interests in structured entities which it does not sponsor or control. These largely relate to the legacy treasury asset portfolio and consist of holdings of mortgage and other asset-backed securities issued by entities that were established and/or sponsored by other unrelated financial institutions. These securities comprise the loans and receivables securities included in Note 18. Management has concluded that the Santander UK group has no control or significant influence over these entities and that the carrying value of the interests held in these entities represents the maximum exposure to loss.

20. INTANGIBLE ASSETS

a) Goodwill

	Group			Company		
	Cost £m	Accumulated impairment £m	Net book value £m	Cost £m	Accumulated impairment £m	Net book value £m
At 31 December 2016[1], 1 January 2017[1] and 31 December 2017	**1,285**	**(82)**	**1,203**	**1,194**	**–**	**1,194**

(1) Comparative periods restated to reflect the change in accounting policy relating to business combinations between entities under common control, as described in Note 1.

Impairment of goodwill
During 2017 and 2016, no impairment of goodwill was recognised. Impairment testing in respect of goodwill allocated to each cash-generating unit (CGU) is performed annually or more frequently if there are impairment indicators present. For the purpose of impairment testing, the CGUs are based on customer groups within the relevant business divisions.

The cash flow projections for each CGU are based on the five-year plan prepared for regulatory purposes, based on Santander UK's 3-Year Plan and approved by the Santander UK plc Board. The assumptions included in the expected future cash flows for each CGU take into consideration the UK economic environment and financial outlook within which the CGU operates. Key assumptions include projected GDP growth rates, the level of interest rates and the level and change in unemployment rates in the UK. The discount rate used to discount the cash flows is based on a pre-tax rate that reflects the weighted average cost of capital allocated by Santander UK to investments in the business division in which the CGU operates. The growth rate used reflects management's five-year forecasts, with a terminal growth rate for each year applied thereafter, in line with the estimated long-term average UK GDP growth rate.

Based on the conditions at the balance sheet date, management determined that a reasonably possible change in any of the key assumptions described above would not cause an impairment of goodwill to be recognised.

The following CGUs (all within Retail Banking) include in their carrying values goodwill that comprises the goodwill reported by Santander UK. The CGUs do not carry on their balance sheets any other intangible assets with indefinite useful lives. The calculations have been based on value in use using cash flows based on the five-year plan.

	Goodwill		Discount rate		Growth rate[2]	
CGU	2017 £m	2016[1] £m	2017 %	2016 %	2017 %	2016 %
Personal financial services	**1,169**	1,169	**10.8**	11.4	**1**	2
Private banking	**30**	30	**10.8**	11.4	**1**	1
Other	**4**	4	**10.8**	11.4	**1**	2
	1,203	1,203				

(1) Restated to reflect the change in accounting policy relating to business combinations between entities under common control, as described in Note 1.
(2) Average growth rate based on the five-year plan for the first five years and a growth rate of 1.5% (2016: 2.0%) applied thereafter.

In 2017, the discount rate decreased by 0.6 percentage points to 10.8% (2016: 11.4%). The decrease reflected changes in current market and economic conditions. In 2017, the change in growth rates reflected Santander UK's updated strategic priorities in the context of forecast economic conditions.

b) Other intangibles

	Group			Company		
	Cost £m	Accumulated amortisation/ impairment £m	Net book value £m	Cost £m	Accumulated amortisation/ impairment £m	Net book value £m
At 1 January 2017	**760**	**(278)**	**482**	**773**	**(334)**	**439**
Additions	**205**	**-**	**205**	**184**	**-**	**184**
Disposals	**(3)**	**3**	**-**	**(3)**	**3**	**-**
Charge	**-**	**(116)**	**(116)**	**-**	**(108)**	**(108)**
Impairment	**-**	**(32)**	**(32)**	**-**	**(32)**	**(32)**
At 31 December 2017	**962**	**(423)**	**539**	**954**	**(471)**	**483**
At 1 January 2016	601	(204)	397	630	(263)	367
Additions	213	-	213	197	-	197
Disposals	(54)	47	(7)	(54)	47	(7)
Charge	-	(76)	(76)	-	(73)	(73)
Impairment	-	(45)	(45)	-	(45)	(45)
At 31 December 2016	760	(278)	482	773	(334)	439

Other intangible assets consist of computer software. The assessment of whether an asset is exhibiting indicators of impairment as well as the calculation of impairment, which requires the estimate of future cash flows and fair values less costs to sell, also requires the preparation of cash flow forecasts and fair values for assets that may not be regularly bought and sold.

In 2017, intangible asset impairments primarily related to capitalised software costs for a credit risk management system, part of which was no longer in use. In 2016, intangible asset impairments primarily related to a multi-entity banking platform developed for our non-ring-fenced bank under the original ring-fencing structure.

21. DEPOSITS BY BANKS

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Items in the course of transmission	**303**	308	**300**	302
Securities sold under repurchase agreements	**1,076**	2,384	**843**	1,706
Deposits held as collateral	**1,760**	778	**1,057**	58
Other deposits[1]	**10,645**	6,299	**9,050**	5,406
Amounts due to Santander UK subsidiaries	**-**	-	**16,771**	12,269
	13,784	9,769	**28,021**	19,741

(1) Includes drawdown from the TFS of £8.5bn (2016: £4.5bn).

22. DEPOSITS BY CUSTOMERS

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Current and demand accounts – interest-bearing	**85,749**	85,967	**82,465**	83,134
– non-interest-bearing	**2**	67	**2**	67
Savings accounts[1]	**70,461**	58,305	**69,597**	57,400
Time deposits	**19,951**	27,203	**18,086**	24,623
Securities sold under repurchase agreements	**502**	502	**502**	502
Amounts due to Santander UK subsidiaries	**–**	–	**21,295**	23,827
Amounts due to Santander UK Group Holdings plc[2]	**6,256**	4,464	**6,256**	4,464
Amounts due to fellow Banco Santander subsidiaries	**727**	664	**718**	657
	183,648	177,172	**198,921**	194,674

(1) Includes equity index-linked deposits of £1,301m (2016: £1,618m). The capital amount guaranteed/protected and the amount of return guaranteed in respect of the equity index-linked deposits were £1,301m and £67m (2016: £1,618m and £129m) respectively.
(2) Includes downstreamed funding from our immediate parent company Santander UK Group Holdings plc.

23. TRADING LIABILITIES

	Group	
	2017 £m	2016 £m
Securities sold under repurchase agreements	**25,504**	8,798
Short positions in securities and unsettled trades	**3,694**	2,801
Cash collateral	**1,911**	3,535
Short-term deposits	**–**	426
	31,109	15,560

24. FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
US$10bn Euro Commercial Paper Programmes	**387**	454	**–**	–
US$30bn Euro Medium Term Note Programme	**169**	184	**169**	184
Structured Notes Programmes	**932**	1,137	**957**	–
Warrants programme	**–**	2	**–**	–
Eurobonds	**147**	137	**147**	137
Structured deposits	**680**	526	**24**	–
	2,315	2,440	**1,297**	321

The fair value is based on quoted prices in an active market for the specific instrument concerned, if available. When quoted market prices are unavailable, the fair value is estimated using valuation techniques, the inputs for which are either based upon quoted prices in an inactive market for the instrument, or are estimated by comparison with quoted prices in an active market for similar instruments. In both cases, the fair value includes the effect of applying the credit spread which is appropriate to the Santander UK group's liabilities. The change in fair value attributable to the Santander UK group's own credit spread is computed as follows: for each security at each reporting date, an externally verifiable price is obtained or a price is derived using credit spreads for similar securities for the same issuer or credit default swaps. Each security is then valued using discounted cash flows, incorporating a LIBOR-based discount curve. The difference in the valuations is attributable to the Santander UK group's own credit spread. This methodology is applied consistently across all securities where it is believed that counterparties would consider the Santander UK group's creditworthiness when pricing trades.

As part of our ring-fencing plans, with effect from 1 November 2017, all outstanding structured notes and warrants issued by Abbey National Treasury Services plc under the Structured Notes Programmes and the Warrants Programme were novated to Santander UK plc. All rights, obligations and liabilities of Abbey National Treasury Services plc under these structured notes and warrants have been taken over and assumed by Santander UK plc and all future structured notes will be issued by Santander UK plc. In addition, during 2017 Santander UK plc established separate commercial paper and certificate of deposit programmes, with similar terms to the existing Abbey National Treasury Services plc programmes. For more information on our ring-fencing plans, see Note 39.

Gains and losses arising from changes in the credit spread of securities issued by the Santander UK group reverse over the contractual life of the debt, provided that the debt is not repaid at a premium or a discount. The net loss during the year attributable to changes in the Santander UK group's own credit risk on the above securities was £29m (2016: £6m gain, 2015: £23m gain). The cumulative net loss attributable to changes in the Santander UK group's own credit risk on the above securities at 31 December 2017 was £7m (2016: £22m gain). Of the change in carrying value during the year ended 31 December 2017, cash and non-cash changes amounted to £(263)m and £138m respectively. Non-cash changes consist of £(46)m of unrealised foreign exchange differences, £37m for changes in fair value and £147m of other changes predominantly accrued interest. For the Company, of the change in carrying value during 2017, cash and non-cash changes amounted to £890m and £86m respectively. Non-cash changes consist of £(1)m of unrealised foreign exchange differences, £21m for changes in fair value and £66m of other changes predominantly accrued interest.

At 31 December 2017, the amount that would be required to be contractually paid at maturity of the securities above was £4m lower (2016: £35m) than the carrying value.

25. DEBT SECURITIES IN ISSUE

	Group		Company	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Medium-term notes:				
- US$30bn Euro Medium Term Note Programme	**8,816**	10,818	**8,874**	10,921
- US SEC-registered - Santander UK plc	**6,280**	7,499	**6,333**	7,578
- US$20bn Commercial Paper Programmes	**2,906**	2,678	**146**	-
	18,002	20,995	**15,353**	18,499
Euro 35bn Global Covered Bond Programme (See Note 16)	**15,799**	16,628	**15,297**	15,997
Certificates of deposit	**4,681**	5,217	**1,398**	-
Credit Linked Notes	**43**	-	**-**	-
Securitisation programmes (See Note 16)	**4,108**	7,506	**-**	-
	42,633	50,346	**32,048**	34,496

As part of our ring-fencing plans, during 2017 Santander UK plc established separate commercial paper and certificate of deposit programmes, with similar terms to the existing Abbey National Treasury Services plc programmes. For more information on our ring-fencing plans, see Note 39.

The credit linked note was issued by PSA Finance UK Limited and references a pool of auto loans and leases originated by PSA Finance UK Limited that, in return for a fee, provides credit protection on the first 7.6% of losses in the reference portfolio.

Of the change in carrying value in 2017, cash and non-cash changes amounted to £(6,688)m and £(1,025)m respectively. Non-cash changes comprised £(929)m of unrealised foreign exchange differences and £(96)m of other changes, mainly accrued interest. For the Company, of the change in carrying value in 2017, cash and non-cash changes amounted to £(2,546)m and £98m respectively. Non-cash changes comprised £76m of unrealised foreign exchange differences and £22m of other changes.

26. SUBORDINATED LIABILITIES

	Group		Company	
	2017 £m	2016 £m	**2017 £m**	2016 £m
£325m Sterling Preference Shares	**344**	344	**344**	344
£175m Fixed/Floating Rate Tier One Preferred Income Capital Securities	**2**	2	**2**	2
Undated subordinated liabilities	**584**	768	**622**	817
Dated subordinated liabilities	**2,863**	3,189	**2,902**	3,248
	3,793	4,303	**3,870**	4,411

The above securities will, in the event of the winding up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer, other than creditors whose claims rank equally with, or are junior to, the claims of the holders of the subordinated liabilities. The subordination of specific subordinated liabilities is determined in respect of the issuer and any guarantors of that liability. The claims of holders of preference shares and preferred securities are generally junior to those of the holders of undated subordinated liabilities, which in turn are junior to the claims of holders of the dated subordinated liabilities. The subordination of the preference shares and preferred securities ranks equally with that of the £300m fixed/floating rate non-cumulative callable preference shares and £300m Step-up Callable Perpetual Reserve Capital Instruments classified as other equity instruments, as described in Note 31.

During 2017 and 2016, the Santander UK group had no defaults of principal, interest or other breaches with respect to its subordinated liabilities. No repayment or purchase by the issuer of the subordinated liabilities may be made prior to their stated maturity without the consent of the PRA.

During 2017, Santander UK exercised its option to call the £175m Fixed/Floating Rate Tier One Preferred Income Capital Securities. These were fully redeemed on 9 February 2018.

Of the change in carrying value during the year ended 31 December 2017, cash and non-cash changes amounted to £(52)m and £(458)m respectively. Non-cash changes included £(235)m in respect of unrealised foreign exchange differences and £(223)m of other changes. For the Company, of the change in carrying value during 2017, cash and non-cash changes amounted to £(52)m and £(489)m respectively. Non-cash changes included £(235)m in respect of unrealised foreign exchange differences and £(254)m of other changes.

Undated subordinated liabilities

		Group		Company	
	Call date	**2017 £m**	2016 £m	**2017 £m**	2016 £m
10.0625% Exchangeable subordinated capital securities	Any interest payment date	**205**	205	**205**	205
7.375% 20 Year Step-up perpetual callable subordinated notes	2020	**17**	198	**17**	201
7.125% 30 Year Step-up perpetual callable subordinated notes	2030	**362**	365	**400**	411
		584	768	**622**	817

In common with other debt securities issued by Santander UK group companies, the undated subordinated liabilities are redeemable in whole at the option of Santander UK plc, on any interest payment date, in the event of certain tax changes affecting the treatment of payments of interest on the subordinated liabilities in the UK, at their principal amount together with any accrued interest.

During 2017, Santander UK plc exercised its option to call, and redeemed, 91% of the 7.375% 20 Year Step-up perpetual callable subordinated notes.

Dated subordinated liabilities

		Group		Company	
	Maturity	**2017 £m**	2016 £m	**2017 £m**	2016 £m
11.50% Subordinated guaranteed bond	2017	**–**	58	**–**	58
10.125% Subordinated guaranteed bond	2023	**78**	84	**78**	84
9.625% Subordinated notes	2023	**129**	134	**129**	135
5% Subordinated notes (US$1,500m)	2023	**1,103**	1,208	**1,136**	1,260
4.75% Subordinated notes (US$1,000m)	2025	**745**	816	**745**	816
7.95% Subordinated notes (US$1,000m)	2029	**275**	307	**275**	307
6.50% Subordinated notes	2030	**40**	40	**44**	45
8.963% Subordinated notes (US$1,000m)	2030	**113**	126	**113**	126
5.875% Subordinated notes	2031	**9**	10	**11**	11
5.625% Subordinated notes (US$500m)	2045	**371**	406	**371**	406
		2,863	3,189	**2,902**	3,248

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

Each of the subordinated liabilities issued by Santander UK Group Holdings plc has been downstreamed to Santander UK plc by means of Santander UK plc issuing equivalent subordinated liabilities to Santander UK Group Holdings plc.

During 2017, Santander UK plc exercised its option to call the 10.125% Subordinated guaranteed bond. These were fully redeemed on 4 January 2018.

27. PROVISIONS

	Conduct remediation						Group
	PPI £m	Wealth and Investment £m	Other products £m	Regulatory-related £m	Vacant property £m	Other £m	Total £m
At 1 January 2017	**457**	**22**	**14**	**96**	**47**	**64**	**700**
Additional provisions	**109**	**–**	**35**	**93**	**4**	**144**	**385**
Utilisation	**(210)**	**(29)**	**(5)**	**(132)**	**(12)**	**(149)**	**(537)**
Transfers	**–**	**10**	**–**	**–**	**–**	**–**	**10**
At 31 December 2017	**356**	**3**	**44**	**57**	**39**	**59**	**558**
To be settled:							
– Within 12 months	**167**	**3**	**35**	**57**	**23**	**59**	**344**
– In more than 12 months	**189**	**–**	**9**	**–**	**16**	**–**	**214**
	356	**3**	**44**	**57**	**39**	**59**	**558**
At 1 January 2016	465	146	26	93	68	72	870
Additional provisions	144	–	2	141	(6)	116	397
Utilisation	(152)	(124)	(14)	(138)	(15)	(124)	(567)
At 31 December 2016	457	22	14	96	47	64	700
To be settled:							
– Within 12 months	294	22	4	96	25	59	500
– In more than 12 months	163	–	10	–	22	5	200
	457	22	14	96	47	64	700

	Conduct remediation						Company
	PPI £m	Wealth and Investment £m	Other products £m	Regulatory-related £m	Vacant property £m	Other £m	Total £m
At 1 January 2017	**457**	**22**	**14**	**81**	**47**	**53**	**674**
Additional provisions	**109**	**–**	**35**	**74**	**4**	**132**	**354**
Utilisation	**(210)**	**(29)**	**(5)**	**(132)**	**(12)**	**(136)**	**(524)**
Transfers	**–**	**10**	**–**	**–**	**–**	**–**	**10**
At 31 December 2017	**356**	**3**	**44**	**23**	**39**	**49**	**514**
To be settled:							
– Within 12 months	**167**	**3**	**35**	**23**	**23**	**49**	**300**
– In more than 12 months	**189**	**–**	**9**	**–**	**16**	**–**	**214**
	356	**3**	**44**	**23**	**39**	**49**	**514**
At 1 January 2016	465	146	26	47	67	64	815
Additional provisions	144	–	2	126	(6)	111	377
Utilisation	(152)	(124)	(14)	(92)	(14)	(122)	(518)
At 31 December 2016	457	22	14	81	47	53	674
To be settled:							
– Within 12 months	294	22	4	81	25	53	479
– In more than 12 months	163	–	10	–	22	–	195
	457	22	14	81	47	53	674

a) Conduct remediation

The amounts in respect of conduct remediation comprise the estimated cost of making redress payments, including related costs, with respect to the past sales or administration of products. The provision for conduct remediation represents management's best estimate of the anticipated costs of related customer contact and/or redress, including related costs.

(i) Payment Protection Insurance (PPI)

In August 2010, the FSA (now the FCA) published a policy statement entitled 'The assessment and redress of Payment Protection Insurance complaints' (the Policy Statement). The Policy Statement contained rules which altered the basis on which regulated firms must consider and deal with complaints in relation to the sale of PPI and potentially increased the amount of compensation payable to customers whose complaints are upheld.

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