Alliance & Leicester plc

Annual Report 1997

ALLIANCE LEICESTER

Alliance & Leicester at a glance

Alliance & Leicester recognises that the delivery of shareholder value depends upon our ability to create real value for our customers. This involves retaining and growing mutually beneficial relationships through the development of innovative products; speedy delivery through a wide range of accessible channels; excellent and flexible service; a strong brand; and anticipating and responding to changing customer needs.

CONTENTS

BUSINESS SECTORS

Mortgage Lending & Investments
This business sector is responsible for the Group's mortgage lending and retail savings operations together with related businesses such as general insurance, life assurance and unit trusts.

Personal Banking
Responsible for the Group's personal current accounts, credit and debit card operations and unsecured lending activities. These include loans for home improvements, the purchase of cars, the consolidation of debt and other purposes.

Commercial Banking
Provides a range of services principally to retailers, local authorities and utilities, including cash and cheque handling, bill payments, asset finance including leasing, merchant acquisition (the processing of debit and credit card transactions) and commercial lending.

Treasury & Group
This sector comprises the Group's treasury subsidiary, investment income generated by non-allocated capital and corporate overheads not directly attributable to business units.

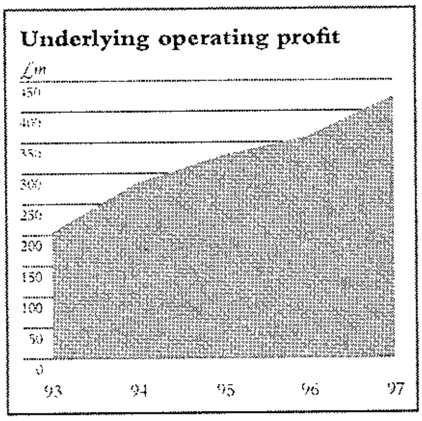
HIGHLIGHTS OF THE YEAR

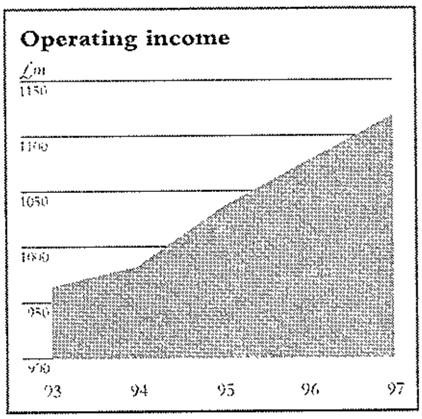
- Gross mortgage lending in 1997 of £2.6 billion (1996 £2.2 billion), a market share of 3.4%.
- Launch of Alliance & Leicester general insurance subsidiary in August 1997.
- Value of new unsecured loans advanced during the year at £914m increased by 36% compared to 1996.
- Introduction of the 'money back' credit card in March 1997, the first of its kind in the UK, with over 240,000 customers at the year end.
- Girobank handles about one pound in every four of cash and cheques which pass through UK retail tills.
- Processed £77 billion of cash and cheques on behalf of retail and wholesale businesses, representing an increase of 5.5% compared to 1996.
- Launch of Alliance & Leicester Group Treasury plc to manage the wholesale funding and liquidity of the Group, and provide a treasury service to the Group and its customers.

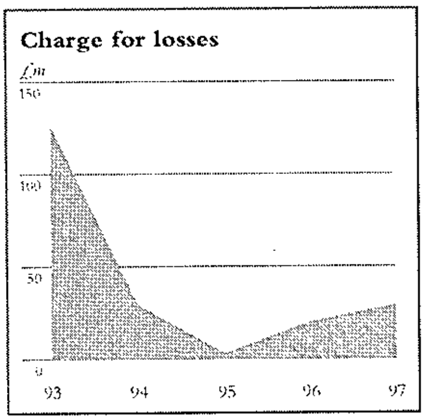
The year in brief

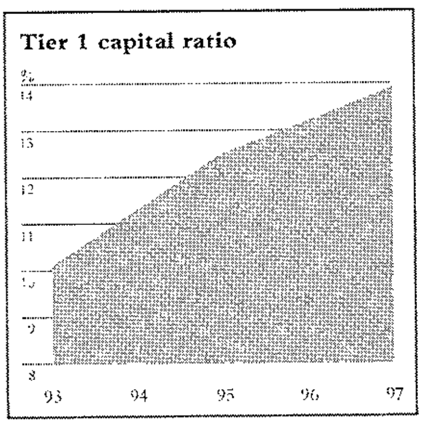
FINANCIAL HIGHLIGHTS

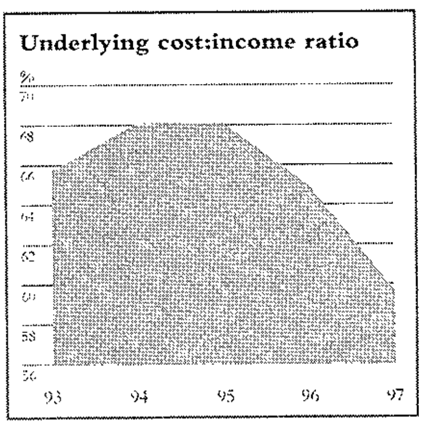
- Group underlying operating profit, before exceptional costs, up 18% to a record £423m (1996: £359m)
- Pre-tax profit up 29% to £395m (1996: £306m), after charging exceptional costs of £28m (1996: £53m)
- Fall in underlying Group cost:income ratio to 59.6% (1996: 64.9%)
- Underlying earnings per share (EPS) of 49.6p per share; basic EPS of 44.8p per share
- Proposed final dividend of 14.4p per share giving a total dividend of 20.8p per share for 1997. (Pro forma total dividend 1996: 16.3p per share).

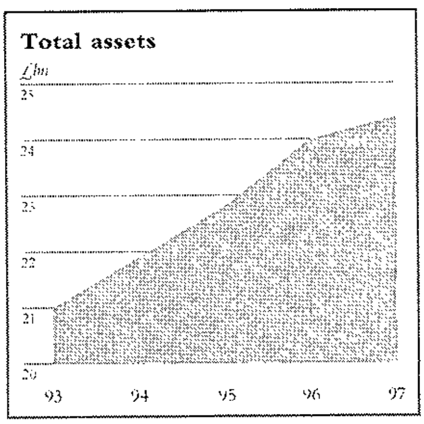












Chairman's statement

Simon Everard
Chairman

FIFTH RECORD YEAR

1997 was a momentous year in the long history of Alliance & Leicester. Following the overwhelming vote in favour of conversion at the Special General Meeting held in the London Arena on 10 December 1996, Alliance & Leicester became a public company on 21 April 1997 and shortly after flotation on the London Stock Exchange, joined the FTSE 100.

The resounding endorsement at the Special General Meeting of your Board's decision to convert was in many ways a tribute to the long and careful consideration that had been devoted to the development of our strategy, and its successful implementation by the senior management team led by Peter White our Group Chief Executive. I would like to thank all the executive directors, managers and staff whose commitment and skill made it possible for Alliance & Leicester to complete the long and tortuous conversion process ahead of schedule, and faster than the other converting societies.

1997 was a momentous year in the long history of Alliance & Leicester.

I think it is fair to claim that we have maintained that momentum as a public company, a claim substantiated by the increase in our underlying operating profits – for the fifth year in succession – from £359 million to £423 million, and the continuing reduction in our cost:income ratio.

Compared with the ending of 144 years of mutuality, and the launch of Alliance & Leicester as a quoted company, it might be felt that everything else was of lesser interest. Nevertheless, I would like to refer to a number of other events which I believe are of importance to the continuing success of your Company.

You will have read a lot about the closure of bank and building society branches. There is no doubt that this is a continuing process as the financial services sector in the UK consolidates, and more people grow used to conducting their personal financial business by post and telephone; and getting their cash and statements of account from the steadily increasing number of ATMs. In the light of these circumstances, Alliance & Leicester has continued to review its branch network – a network which, for the most part, was set up during the days when we were interested chiefly in raising retail funds. Now our interest lies in selling our wide and growing range of financial products and services, with the branches continuing to play an important part. We are continuing to invest in our branch network, and we will be opening some new branches during the year as well as redesigning other branches to make them better equipped to implement their new sales focus. During my regular visits to our branches, I have been impressed and encouraged by the enthusiasm and commitment of our staff, and by the professional manner in which they adapt to their evolving role. They are qualities that augur well for the future.

Following the sale of our offices in Oadby, Leicestershire, and the closure of our offices in Hove, East Sussex, we were able to bring together many of our administration departments under one roof. We believe that this integration at our new Customer Service Centre at Carlton Park, Leicestershire, has been instrumental in developing team spirit and inter-departmental co-operation. I am sure that these changes give us the chance to improve considerably the speed and efficiency of the service we give to our customers – for instance, we have extended the hours of operation of some key areas to meet a growing demand.

Girobank, our commercial banking subsidiary, once again performed well and achieved a very acceptable return on the capital invested in it.

Girobank, our commercial banking subsidiary, once again performed well and achieved a very acceptable return on the capital invested in it. The acquisition in late 1996 of Sovereign Finance from Bank Austria AG, made it possible for Girobank once more to offer asset finance to its existing business customers – a sector in which Girobank had been active prior to its purchase by Alliance & Leicester.

Near the end of the year, Girobank successfully concluded negotiations with Unisys Payment Services Ltd, and signed a contract to outsource document processing. We believe the new arrangement is in the best interests of those Girobank staff who transferred to Unisys Payment Services Ltd, and will provide long-term cost efficiencies for the Group. Thanks to the detailed preparatory work by Girobank management and representatives of the staff, the transfer has gone smoothly.

1997 has been another year of achievement for Alliance & Leicester, and I am indebted to my colleagues on the Board for the help and support they have given during the year. We were sorry to say farewell to Niall Crowley who retired as a director and deputy chairman at the time of our conversion. His wise advice – before and during the conversion process – was greatly valued. On 1 February 1998 we welcomed Richard Banks (Managing Director, Girobank) as an executive director on the Group Board.

Having acknowledged my debt to executive and non-executive colleagues, I want to extend that acknowledgement to every member of our staff. Alliance & Leicester Group is very well served by an extremely competent staff, committed to providing the best possible service to our customers. Under Peter White's dynamic and driving leadership I remain confident about our prospects for 1998 and beyond.

Simon Everard
Chairman

Group Chief Executive's review

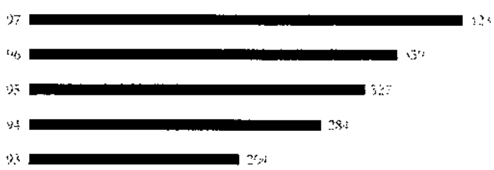
Peter White
Group Chief Executive

I am very pleased to be able to report on a fifth successive year of record profits for Alliance & Leicester. Before exceptional costs, our underlying operating profit was up 18% from £359m to £423m. After charging exceptional costs, our pre-tax profit rose by 29%, from £306m to £395m.

BACKGROUND

The election of a new government – particularly one promising wide ranging regulatory and social reform – has significant implications for companies providing financial services. The granting of operational independence to the Bank of England to set interest rates, the creation of the new Financial Services Authority, the impending pension and welfare reforms, the planned introduction of Individual Savings Accounts and the possibility of Economic and Monetary Union, are all developments that will reshape our competitive environment.

Underlying operating profit up 18% to £423 million



During 1997, the pace of change in financial services accelerated. Our conversion to plc status, along with others, has radically altered the structure of the mortgage market. At the end of 1996 banks accounted for about 39% of outstanding mortgage loans, today they account for 71% of the total. Over the same period, the building societies' share has fallen from 55% to less than 23%.

The traditional barriers to entry into financial services continue to be eroded, and new entrants to the market have the potential to change the industry's cost and pricing structures, increasing the financial pressures on less efficient providers, and making the reduction of operating costs essential for long-term competitiveness.

SHAREHOLDER VALUE

Alliance & Leicester is committed to the creation of value for our shareholders. A business can continue to create shareholder value only if it continues to deliver products and services which its customers want. Most of our individual shareholders are customers, and we are determined to keep the interests of both our shareholders and customers at the centre of everything we do.

ALLIANCE & LEICESTER'S STRENGTHS

Prior to flotation we issued a detailed document, called the Listing Particulars, to all of our future shareholders. This set out five key strengths of Alliance & Leicester. I believe that these strengths are vital to the future success of the Group:

- The number of people who buy our products and services.
- The potential for growth.
- The diversity of income streams.
- The scope for improved cost efficiency.
- Our financial strength.

Our Customers

Alliance & Leicester has around 5.5 million customers. Our strategy is designed to strengthen the relationship we enjoy with our existing customers, and enable us to attract and retain new customers.

Potential for Growth

The Group has well developed plans for substantial growth. This growth will be achieved by designing and producing competitive products, with good levels of service delivered from a low cost base. This philosophy underpins all of the actions we take.

The successful launch and continued profitability of Alliance & Leicester Personal Finance Limited, our unsecured lending subsidiary, proves that we can build businesses which deliver excellent service and profitable growth. Our new businesses in life assurance, unit trusts and general insurance, are based on similar principles, and look set to perform well in the future.

During 1997 some 38% of our operating profits were generated from areas other than the traditional mortgage lending and retail investments business.

We have proved that we can manage acquisitions effectively. The businesses we bought when we purchased Girobank in 1990 continue to thrive, and they form a vital part of the Group. The acquisition of Sovereign Finance, in November 1996, is working well, making it possible for the Group to offer asset financing facilities to corporate customers.

We have also demonstrated our ability to be innovative, and to provide customers with services that really meet their needs. An outstanding example during 1997 was the launch of the 'money back' credit card, the first of its kind in the UK, which had over 240,000 'money back' customers by the end of the year.

Diversity of Income Streams

During 1997 some 38% of our operating profits were generated from areas other than the traditional mortgage lending and retail investments business. We view this diversity of income as a strategic strength. The mortgage market will remain vital to Alliance & Leicester, and we expect steady growth in that market in the medium-term. But the Group also has the proven ability to develop businesses and attract customers for new products. This is a strength which benefits shareholders, and customers as well by making available to them a wider range of good quality products.

Scope for Improved Cost Efficiency

Central to our ability to grow is the need for even greater cost efficiency. Driving down our operating costs enables us to offer more competitive products to our customers. We are continuing to reduce our costs, for example within our Mortgage Lending and Investments division the cost:income ratio – the proportion of income which is spent on costs – has fallen from 50.2% in 1996 to 44.2% in 1997.

Financial Strength

Alliance & Leicester has undoubted financial strength, with a Tier 1 capital ratio of 13.9%. Obviously, capital strength is of vital importance to a financial services company. Our business is confined solely to the United Kingdom, and we have no plans for expansion overseas. However, in a global economy which has recently seen turmoil, and shortages of capital in South East Asia, I believe it is no bad thing to have a strong capital base.

We are aware that we have higher capital ratios than the majority of UK and European banks, and that the efficient use of capital is of critical importance in building shareholder value. I have been very clear about our aims in this respect. We will use our capital to increase shareholder value, for instance, in funding organic growth and, when suitable opportunities arise, by acquisition. We will not make any acquisition which does not meet our strict commercial and strategic criteria.

If in due course we cannot use our capital effectively in this manner, we will return it to our shareholders.

In line with a number of our banking competitors, and in order to give ourselves flexibility for the future, at our Annual General Meeting in 1998, we will be asking shareholders for general authority to purchase our own shares. We will seek to renew this authority on an annual basis thereafter.

CONVERSION & FLOTATION

Alliance & Leicester converted from building society to public limited company status and floated on the London Stock Exchange on 21 April 1997. This complex project was successfully managed so that we completed the conversion process more quickly than the other building societies who converted during the year; and at a cost that was below budget.

Those 27% of our new shareholders who chose to sell their shares immediately, received an average of 533p per share – around £1,300 for the basic allocation of 250 shares.

The banking sector as a whole has been revalued by City analysts during 1997, resulting in substantial increases in the price of bank shares in general. Nonetheless, the 50% increase in our share price, from 533p at flotation to 800p at the end of 1997 is a very encouraging start for Alliance & Leicester plc, and for all our shareholders.

We are aware that we have higher capital ratios than the majority of UK and European banks, and that the efficient use of capital is of critical importance in building shareholder value.

By the end of the year an estimated 44% of our shares were under institutional ownership Our shareholder profile is on page 64.

Looking now at each of our business units in turn:

MORTGAGE LENDING & INVESTMENTS

The traditional retail savings and mortgage markets continue to change. Customers want to be able to gain access to financial services in a variety of ways. Being at the forefront of post and telephone banking, Alliance & Leicester is in an excellent position to respond to these demands.

For many people however, the traditional branch still plays an important part in the provision of personal financial services. The role of the branch network is changing. Handling transactions and giving information can be achieved more efficiently, and more effectively, through the use of appropriate technology.

The branch network must focus more on sales, and on the efficient provision of those services which are best dealt with 'face to face'.

During 1997, we implemented a new scheduling system for the staff in all of our branches. We are also introducing new technology into our branches to help us to improve the service we give to customers, delivering that service at a lower cost, and increasing the potential for effective selling.

We have completed the 'bedding in' of our regional mortgage processing centres. This major project initially led to some customer service problems, but we have learnt a number of lessons and the new structure is now operating well. We have started to roll out new software to speed up mortgage applications, and help us to improve our service, and reduce costs.

We have a network of 319 branches throughout the United Kingdom, and we have no immediate plans for any further significant reductions in the branch network. Indeed we have identified a small number of areas where we would like to open new branches. In our fast-changing market-place, we keep this aspect of our business under constant watch.

Mortgage lending continues to be a very competitive market, with increasingly financially sophisticated customers looking for products and services that meet their demanding requirements. Our gross mortgage lending in 1997 was £2.6 billion, up by 18% on the £2.2 billion achieved in 1996, and representing 3.4% of gross mortgage lending in the UK – compared to 3.1% in 1996.

Our net mortgage lending – that is, new loans made, less capital repayments and repaid loans – was influenced by the Group's conversion to plc status. The announcement of our intended change of status resulted in lower than normal levels of mortgage redemptions in the months leading up to the conversion, but an increase in redemptions in the second half of the year.

1997 was the first full year of operation for Alliance & Leicester's life assurance and unit trust businesses, and we launched our general insurance subsidiary in August.

These businesses will strengthen the Group's relationship with its existing customers, and attract new customers. One advantage of new start-ups is that they can take advantage of current best-practice, to deliver products which are competitive and easy for the customer to understand.

We launched a telesales operation to sell household insurance in June 1997, and we started to underwrite 20% of our household insurance business from August 1997.

PERSONAL BANKING

The Group's Personal Banking division operates in two main areas of business; unsecured lending and transaction accounts (current accounts and credit cards).

Since its start-up in April 1989, our unsecured lending subsidiary – Alliance & Leicester Personal Finance Limited (ALPF) – has continued to thrive throughout the business cycle. ALPF provides a clear demonstration of what can be achieved through the combination of a low cost-base, excellent customer service, competitive prices, a good brand, close control of asset quality and the strong management of arrears.

During 1997 ALPF handled an average of more than 1,000 loan applications every day, with more than 95% of applications

Group Chief Executive's review *continued*

being processed in under 12 hours. ALPF delivered another year of record business volumes and profit, with new lending of £914m (1996: £671m).

ALPF's arrears figures remain good, and better than the averages reported in industry statistics. However, we are alert to, and prepared for, the impact of any downturn in the credit cycle, should it arise.

Our Girobank subsidiary pioneered direct banking in the UK during the 1980s, and Alliance & Leicester's current account products continue to win awards from major independent consumer surveys. During 1997 we introduced new technology to our 24-hour telephone banking service, enabling us to handle a considerable increase in the volume of calls, and to maintain our reputation for quality service, without increasing our costs.

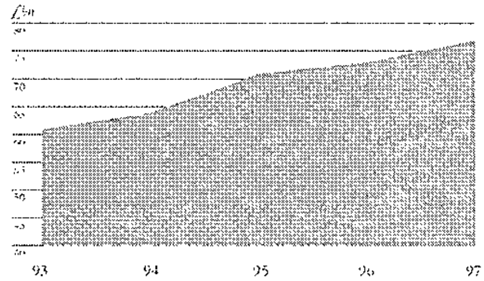
Our long-standing relationship with Post Office Counters Limited (POCL) enables our current account customers to make transactions in around 19,000 post offices, a particularly useful service when many banks are closing branches in rural areas.

The Group has offered credit cards since the acquisition of Girobank in 1990. In 1997 Alliance & Leicester launched the innovative 'money back' credit card, the first in the UK. The response from customers was very good, indeed demand exceeded the targets which we had set for new applications.

Opening credit card accounts is only the first part. The key to success in this market is that customers actually use the cards. Early indications of usage are very encouraging and we have launched other developments to continue this, including partnerships with high street retailers so that customers can obtain 'double money back'.

The credit card market provides an excellent opportunity for operators who can offer innovative products, backed by quality service operated on a low cost base. Alliance & Leicester is well placed to build on the success we enjoyed during 1997, but we will not take on business which will materially lower the quality of our assets.

Cash and cheque handling volumes increased to £77 billion



COMMERCIAL BANKING

Alliance & Leicester's Commercial Banking business, undertaken by Girobank plc, continues to play a vital part within the Group, providing a significant income stream with a return on capital of over 26%. It also forms an important part of the Group's relationship with POCL, and shares infrastructure with our personal banking business.

Girobank remains a market leader in cash and cheque handling in the United Kingdom, handling £1 out of every £4 which passes though the country's retail tills. While, in the long-term, the use of cash in the economy is forecast to decline, it is happening very slowly. Girobank's performance demonstrates this, with total volumes of cash and cheque transactions of £77 billion in 1997, 5.5% up on the £73 billion handled in 1996.

Most of the cash handled by Girobank is sold to POCL, but cash sales to other customers have risen by 40% during 1997 to £6.9 billion.

The use of cheques is declining, as is the use of paper-based bill payments. During 1997, Girobank completed a strategic review of the ways in which it should face that decline. As a result it outsourced the staff and equipment working on cheque and paper processing to Unisys Payment Services Ltd (UPSL) in November 1997. UPSL, a subsidiary of Unisys, specialises in this area of business, and already provides similar services for other banks.

Girobank is working closely with POCL to develop product offerings in the bill payments market. This market is rapidly changing from paper to electronic-based transactions. By developing and marketing new products, based on plastic cards and bar-coding, Girobank has increased volumes in this business from 185 million transactions in 1996 to 208 million in 1997.

Heads of Agreement were signed in August 1997, which incorporated the basic principles of a new contractual arrangement with POCL.

Since then, work has continued on the detailed drafting of the formal 150-page contract and associated schedules. The new terms of the agreement have been implemented and are reflected in our 1997 results.

The agreement is based on contract periods of 5-10 years, dependent on business activity, and will ensure a continuing, mutually beneficial relationship with POCL on terms which provide a sound platform for profitable growth.

1997 was the first full year of operation for Girobank's merchant acquiring service – the processing of electronic credit and debit card payments. Among the major retailers to start using the service in 1997 were Kwiksave, MFI, Scottish & Newcastle and BP.

Sovereign Finance, which Girobank purchased in November 1996, provides experienced management and systems, offering asset finance services to our corporate customers.

MANAGEMENT & STAFF

We have made a number of changes to our management structure during the year, in particular Trevor Hilliard became Managing Director, Retail Financial Services. Trevor is an executive director of the Group, and now has responsibility for the whole of our Mortgage Lending & Investments and Personal Banking businesses. Bringing together the responsibility for all of our personal customers under one reporting line will help us to achieve our objective of increasing the cross-selling of the Group's products.

To deliver record profits, while converting efficiently and quickly to plc status, has been a tremendous achievement. Our management and staff have become accustomed to change, an essential ability if we are to ensure that Alliance & Leicester continues to grow and prosper. It is a tribute to the commitment and professionalism of all our staff that they have so successfully faced and met these challenges.

Peter White
Group Chief Executive

Financial review

Overview of Results

Group underlying operating profit increased by 18% to a record £423m (1996: £359m). The impact of the exceptional costs of conversion, and in addition in 1996 supplementary depreciation, reduced the reported pre-tax profit by £28m to £395m (1996: £306m). Increased income and improved cost control have resulted in a fall in the underlying Group cost:income ratio to 59.6% (1996: 64.9%).

Underlying earnings per share, after adjusting for the exceptional costs, increased by 22% to 49.6p, compared with a notional underlying earnings per share figure of 40.7p for 1996. A final dividend of 14.4p per share is proposed, payable in May 1998, which, together with the interim dividend of 6.4p per share already paid, gives a total dividend of 20.8p per share for 1997 compared to a pro forma dividend for 1996 of 16.3p. Underlying earnings represent a dividend cover of 2.38 (1996: 2.50).

BUSINESS SECTOR PROFITABILITY

The table inside the front cover provides a summary of the activities within each of our business sectors. A fourth sector, 'Treasury and Group' was established in 1997 and the comparative results adjusted appropriately.

The contribution to profit by business sector, compared to 1996 was as follows :

	Year ended 31.12.97 £m	Year ended 31.12.96 £m
Mortgage Lending & Investments	262	229
Personal Banking	80	67
Commercial Banking	66	62
Treasury & Group	15	1
Underlying Operating Profit	423	359
Exceptional Costs	(28)	(53)
Profit before Tax	395	306

There has been profit growth in all business sectors. In the Mortgage Lending & Investments sector, profitability grew by £33m primarily due to costs being £26m lower and also assisted by an improvement in non-interest income mainly arising from the Life Assurance operation and mortgage-related fee income. Gross mortgage lending in 1997 was £2.6bn (1996: £2.2bn) out of total estimated UK mortgage lending of £77bn which represents a market share of 3.4%. In the savings market, the anticipated outflow of funds from branch based accounts following conversion was offset by inflows into postal and offshore accounts.

Personal Banking profits have increased significantly reflecting strong business growth. The value of unsecured loans advanced in 1997 was £914m, up 36% on 1996 lending. This represents a 13.7% market share of the Finance and Leasing Association unsecured market.

Commercial Banking continues to make a significant contribution to Group profit. Competition has remained intense in the cash handling and merchant acquiring markets but the sector has benefited from the full year contribution of Sovereign Finance plc, our leasing subsidiary, acquired in November 1996.

The increase in profit in the fourth sector, 'Treasury & Group' was due to higher interest margins and additional interest earned on the growth in capital not allocated to other business sectors.

In 1997, 38% of underlying operating profit came from activities outside the core mortgage and retail savings market (1996: 36%).

COMPONENTS OF PROFIT

Comparing the 1997 and 1996 profit and loss accounts shows:

	Year ended 31.12.97 £m	Year ended 31.12.96 £m
Net Interest Income	693	644
Non-Interest Income	425	433
Total Income	1,118	1,077
Administrative Expenses	(666)	(699)
Exceptional Costs	(28)	(53)
Total Administrative Expenses	(694)	(752)
Bad Debt Provisions	(29)	(19)
Profit before Tax	395	306

Exceptional costs include the costs of conversion and, for 1996, also included supplementary depreciation on surplus property assets.

This analysis can be broken down further by business sector as follows :

1997	Mortgage Lending & Investments £m	Personal Banking £m	Commercial Banking £m	Treasury & Group £m	Total Group £m
Net Interest Income	394	196	70	33	693
Non-Interest Income	84	81	260	–	425
Total Income	478	277	330	33	1,118
Administrative Expenses	(211)	(174)	(263)	(18)	(666)
Bad Debt Provisions	(5)	(23)	(1)	–	(29)
Underlying Profit	262	80	66	15	423
Exceptional Costs					(28)
Profit before Tax					395

1996	Mortgage Lending & Investments £m	Personal Banking £m	Commercial Banking £m	Treasury & Group £m	Total Group £m
Net Interest Income	401	173	56	14	644
Non-Interest Income	70	71	290	2	433
Total Income	471	244	346	16	1,077
Administrative Expenses	(237)	(162)	(285)	(15)	(699)
Bad Debt Provisions	(5)	(15)	1	–	(19)
Underlying Profit	229	67	62	1	359
Exceptional Costs					(53)
Profit before Tax					306

A review of each significant line of the profit and loss account, together with the analysis by business sector now follows.

NET INTEREST INCOME

Bank base rates averaged 6.56% during 1997, compared to an average annual rate of 5.96% during 1996. Against that background of slightly higher rates, the following table provides a detailed analysis of the interest margin achieved on interest-earning assets.

	Year ended 31.12.97 £m	Year ended 31.12.96 £m
Net Interest Income	693	644
Average Balances:		
Interest-earning Assets (IEA)	23,097	23,040
Financed By:		
Interest-bearing Liabilities	19,659	19,744
Interest-free Liabilities	3,438	3,296
Average Rates:	%	%
Gross Yield on Average IEA	7.41	6.79
Cost of Interest-bearing Liabilities	5.18	4.66
Interest Spread	2.23	2.13
Contribution of Interest-free Liabilities	0.77	0.66
Net Interest Margin on Average IEA	3.00	2.79

Group net interest income was £49m above 1996. Average interest-earning assets were marginally higher than 1996 and the Group net interest margin (as a % of average interest-earning assets) was 0.21% higher at 3.00%. The improvement in net interest income was from growth in Personal Banking (from higher unsecured lending balances and increased earnings on current accounts); Commercial Banking (higher earnings on interest-free corporate current account balances and a full year contribution from Sovereign Finance); and Treasury & Group (higher margins and growth in non-allocated capital); partly offset by a reduction in Mortgage Lending & Investments due to growth in discounted mortgages.

The following table analyses the net interest margin by business sector:

	Mortgage Lending & Investments	Personal Banking	Commercial Banking	Treasury & Group	Total Group (i)
Year ended 31 December 1997					
Net Interest £m	394	196	70	33	693
Mean Interest-earning Assets £m	19,398	2,847	1,742	8,636	23,097
Net Interest Margin as % Mean IEA	2.03	6.87	4.04	0.39	3.00
Year ended 31 December 1996					
Net Interest £m	401	173	56	14	644
Mean Interest-earning Assets £m	19,793	2,378	1,369	10,154	23,040
Net Interest Margin as % Mean IEA	2.02	7.27	4.13	0.13	2.79

Note (i) The Group mean interest-earning assets position is net of consolidation adjustments relating to internally transfer-priced funds

The main reason that the Group net interest margin has improved is that the mix of interest-earning assets has changed with a greater proportion of higher margin personal banking and commercial banking assets. The margin also benefited from the reduction in the Group's liquid assets and wholesale funding in 1997 compared to 1996. This reduction was made possible by changes in regulatory requirements as a result of conversion and has led to a more efficient structuring of the balance sheet.

Mortgage Lending & Investments net interest income was £7m below 1996 at £394m which reflects the higher impact of mortgage discounts and cash incentives in 1997 compared to 1996. This reduction was more than offset by Personal Banking net interest income which was £23m above 1996. Here, the growth in interest-earning assets from higher volumes of unsecured lending more than offset the reduction in the net interest margin.

Commercial Banking net interest income was £14m higher than 1996 which included the positive impact of Sovereign Finance.

The Treasury & Group sector includes Alliance & Leicester Group Treasury plc and the income from the Group's capital not allocated to the other business sectors. Treasury & Group net interest income was £19m higher than 1996 including higher earnings from the growth in the Group's non-allocated capital, which increased from an average of £106m in 1996 to £141m in 1997. The net interest margin showed improvement from 0.13% to 0.39% which in part reflected the improvement in the margin arising from a reduction in liquidity facilitated by conversion.

A significant part of the Group's interest income is earned in the Mortgage Lending & Investments sector. A more detailed analysis of the margin of that sector shows:

	Year ended 31.12.97 %	Year ended 31.12.96 %
Average Bank Base Rates :	6.56	5.96
Gross Yield on Interest-earning Assets	6.91	6.57
Cost of Interest-bearing Liabilities	5.29	4.92
Interest Spread	1.62	1.65
Contribution of Interest-free Liabilities	0.41	0.37
Net Interest Margin	2.03	2.02

The table illustrates that the interest spread at 1.62% was 0.03% lower than 1996. Whilst average base rates were higher in 1997 compared to 1996, the gross yield on interest-earning assets was lower in comparison to bank base rates mainly due to growth in discounted mortgages. The margin impact of the outflow of retail deposits, immediately following conversion, has not yet been fully reflected in the overall cost of retail funds due to pricing strategies following the five base rate increases in 1997.

Discounts and cashbacks provided to customers on residential mortgage loans are charged against net interest receivable as incurred and are analysed as follows:

	Year ended 31.12.97 £m	Year ended 31.12.96 £m
Cashbacks	25	14
Other incentives	7	5
Variable rate discounts:		
New lending '97	25	–
Prior years: '96	31	18
'94/5	18	36
	74	54
Sub-total	106	73
Fixed rates:		
New lending '97	26	–
Prior years: '96	25	18
'94/5	18	57
	69	75
Total charge to P&L	175	148

At the end of 1997 there were £106m (1996: £92m) of variable rate discounts not yet incurred, but committed to customers as a discount on their mortgage interest in future years, which will flow through the profit and loss account in subsequent years, with an average remaining duration of 17 months. The average discount on new variable rate discounted lending advanced in 1997 was 2.51% compared to 2.80% on new lending in 1996 with an average discount period of around 30 months in both years.

An alternative accounting policy, adopted by some other mortgage lenders, is to amortise cashbacks, incentives and variable rate discounts over the penalty redemption period. Had a policy of amortisation been adopted, the estimated charge to the profit and loss account for these incentives would have been as follows:

ALTERNATIVE POLICY	Year ended 31.12.97 £m	Year ended 31.12.96 £m
Cashbacks:		
New lending '97	2	–
Prior years: '96	3	2
'94/5	8	8
	13	10
Other cash incentives:		
New lending '97	1	–
Prior years: '96	1	1
'94/5	1	1
	3	2
Variable rate discounts:		
New lending '97	8	–
Prior years: '96	13	6
'94/5	34	37
	55	43
Adjustment for redemptions net of penalties	6	3
Charge to P&L on alternative policy	77	58
Charge to P&L on existing policy	106	73

Comparison of the alternative policy with our existing accounting policy indicates that reported pre-tax profit would have increased by £29m in 1997 and would also result in the cost:income ratio of the Mortgage Lending & Investments sector being around 2.5% lower. These numbers would be even higher if fixed rate mortgage discounts were amortised but it is unclear what other lenders' policies have been in this area.

The following table breaks down a simplified Balance Sheet for 1997 into its interest-earning or bearing components and sector structure and averages it on a mean monthly basis. These are the balances on which the margins in this review are calculated.

1997	Mortgage Lending & Investments £m	Personal Banking £m	Commercial Banking £m	Treasury & Group £m	Total £m
Interest-Earning Assets:					
Cash and treasury assets including loans and advances to banks	50	–	–	3,875	3,925
Residential Mortgages	17,169	–	22	–	17,191
Commercial Secured Loans	184	–	45	–	229
Unsecured Lending and Leasing	–	1,314	438	–	1,752
Balance with Group Treasury (i)	1,995	1,533	1,237	–	–
Balance with Business Units (ii)	–	–	–	4,761	–
Total	19,398	2,847	1,742	8,636	23,097
Interest-Bearing Liabilities:					
Customer Accounts	14,734	658	526	–	15,918
Money Market Deposits and Debt Securities in Issue	–	–	–	3,163	3,163
Subordinated Debt	–	–	–	578	578
Balance with Group Treasury (ii)	3,160	1,227	374	–	–
Balance with Business Units (i)	–	–	–	4,765	–
Total	17,894	1,885	900	8,506	19,659
Net Interest-Free Funds	1,504	962	842	130	3,438
Total	19,398	2,847	1,742	8,636	23,097

Note: (i) and (ii) represent internal transfer priced funds which net out on consolidation

NON-INTEREST INCOME

Non-interest income, representing mainly fees and commissions, was £8m lower than 1996 at £425m and is analysed by business sector below:

	Year ended 31.12.97 £m	Year ended 31.12.96 £m
Mortgage Lending & Investments	84	70
Personal Banking	81	71
Commercial Banking	260	290
Treasury & Group	–	2
Total	425	433

The increase in Mortgage Lending & Investments non-interest income was due to both higher mortgage volumes and the growing contribution from sales of life assurance products. In Personal Banking, the growth in volumes of personal loans has generated increased commission income, and changes in the overdraft charging structure have generated higher fee income on personal current accounts. This was partly offset by £5m cashback costs on the 'money back' credit card paid to customers in January 1998 but charged in the 1997 accounts, however this increased card usage generated additional income from retailer merchant fees.

In Commercial Banking, underlying increases in electronic bill payments income and the inclusion of Sovereign fee income were offset by lower cash handling and lower Benefits Agency income due to falling levels of unemployment and exceptional cold weather payments in 1996 not being repeated in 1997. The 1996 re-negotiation of Girobank's contract with Post Office Counters Limited (POCL), results in an equal reduction of both non-interest income and administrative expenses in the Commercial Banking sector. The aim of this agreement, effective from 1 April 1996, is to adjust the recharge of costs and income between the parties to more appropriate commercial levels, and has reduced 1997 income and costs by £10m more than in 1996.

The method of accounting for electronic bill payments has now been revised in line with the new Heads of Agreement agreed with POCL in 1997. Previously income collected from customers was included in income, with payments to POCL included in administrative expenses. In 1997, the net income has been included in income reflecting the commission nature of the transaction. This change in accounting treatment has reduced 1997 income and costs by £27m more than if the previous treatment had been pursued.

ADMINISTRATIVE EXPENSES

Cost reduction and improvement in cost efficiency was a key objective for 1997. An analysis of administrative expenses (excluding exceptional costs but including normal depreciation) is as follows:

	Year ended 31.12.97 £m	Year ended 31.12.96 £m
Staff costs and related expenditure	215	225
Premises and equipment	69	67
Post Office related	174	209
Advertising and promotions	52	40
Depreciation	35	36
Redundancy and relocation	16	23
Other	105	99
Total	666	699

Administrative expenses were in total £33m lower than 1996. Savings have arisen in staff costs, redundancy and relocation costs. Post Office costs in 1997 reflected the impact of the contract renegotiations explained above. The increase in advertising and promotions related to new business development and it is likely that this growth in promotional spend will continue into 1998.

The Group has taken significant steps towards resolving the Year 2000 computer related issues and reducing the associated risks. The total project cost, including capital expenditure, is anticipated to be in the region of £30-40m, not all of which will be incremental. The additional revenue costs incurred in 1997 in relation to the project amounted to £2m and it is envisaged that the incremental revenue costs in 1998 will be around £20m. The Group has also commenced planning for potential United Kingdom membership of EMU. It is likely that the costs of any currency conversion will eventually exceed the costs of Year 2000 issues.

The underlying Group cost:income ratio, excluding costs of conversion, has reduced to 59.6% (1996: 64.9%). Analysing the cost:income ratio by sector shows:

	Year ended 31.12.97 %	Year ended 31.12.96 %
Mortgage Lending & Investments	44.2	50.2
Personal Banking	62.8	66.5
Commercial Banking	79.6	82.2
Treasury & Group	54.7	96.2
Group Total	59.6	64.9

STAFF NUMBERS

The number of staff employed by the Group, on a full time equivalent (FTE) basis, has fallen 19% from 8,972 at the end of 1996, to 7,304 at the end of 1997. This significant reduction was due to the implementation of a number of cost reduction initiatives started in 1996, and the transfer of around 700 FTE's to Unisys Payment Services Ltd following an agreement made in August 1997 to outsource Girobank's paper processing operations. In addition, there were also a number of agency and contractor staff engaged by the Group, and at the end of 1997 this number was approximately 470, and the average for the year was around 420.

CHARGES FOR BAD AND DOUBTFUL DEBTS

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

	Year ended 31.12.97 £m	Year ended 31.12.96 £m
Residential Mortgages	14	8
Commercial Secured Loans	(9)	(4)
Unsecured Loans & Leasing	24	15
Total	29	19
Interest Suspended in the Period	2	6

The total charge for losses shows an increase in 1997 due to growth in the volume of unsecured lending partly offset by a recovery in commercial secured loans. Whilst the charge for losses on residential mortgages continues to benefit from the improvement in house prices and in the economy generally, the opportunity has been taken during the year to create a general provision of £20m, and the provision previously described as general under Building Society regulations, has been reclassified as specific, as it represented the provision for accounts where arrears were less than 2.5% of the account balance. It is possible that the most benign phase of the current credit cycle has passed, and although there are no significant indicators of problems ahead, we have wished to be prudent and have created this new general provision to cover latent impairment not yet identified. During 1998 we will be further refining our provisioning methodology and reviewing whether any of this general provision can be allocated to more specific areas.

The closing balances of provisions, together with the ratio of closing provisions to gross loans and advances balances were as follows:

	As at 31.12.97 £m	As at 31.12.97 %	As at 31.12.96 £m	As at 31.12.96 %
Residential Mortgages	47	0.28	42	0.25
Commercial Secured Loans	26	11.46	32	10.44
Unsecured Loans & Leasing	74	3.71	61	4.43
Total	147	0.76	135	0.73

An analysis of the Group's arrears on residential mortgage loans (including residential properties commercially let) was as follows:

Arrears as a % of Mortgage Balance	31 December 1997 Value of Arrears £000	31 December 1997 Arrears as a % of Residential Mortgage Balances	31 December 1996 Value of Arrears £000	31 December 1996 Arrears as a % of Residential Mortgage Balances
2.5 – 5%	9,107	0.053	9,043	0.054
5 – 7.5%	6,813	0.040	7,467	0.045
7.5 – 10%	5,089	0.030	5,889	0.035
10% +	20,617	0.121	22,172	0.133
Repossession Stock	2,454	0.014	3,352	0.020
Total	44,080	0.258	47,923	0.287

The table shows that the value of residential arrears has fallen in comparison with 1996. Alliance & Leicester does not operate a policy of annual mortgage payment reviews on variable rate mortgages, but amends customer payments following each change of mortgage rate. Four rate changes had occurred since the general election in May 1997, and whilst in total arrears are lower at December 1997 than at December 1996, in the low arrears categories there has been some slight deterioration, probably due to customer inaction in not updating standing order payments, which are still used by around 40% of mortgage customers.

The following table shows the arrears level on unsecured lending by Alliance & Leicester Personal Finance Limited compared with the average for members of the Finance and Leasing Association:

	As at 31.12.97 %	As at 31.12.96 %
Value of Loans > 30 Days in Arrears as % of Total Loans	4.6	4.8
Average for Finance and Leasing Association Members %	6.2	7.3

Despite increasing balances the arrears as a percentage of balances have remained steady.

TAXATION

A reduction in the rate of corporation tax from 33% to 31% was announced in the Chancellor's Budget on 2 July 1997. An annual Group corporation tax rate of 31.5% (1996: 33%) has been used for the 12 months to 31 December 1997.

The tax charge for 1997 of £133.9m (1996: £119.5m) was 33.9% of profit before tax (1996: 39.1%). This was higher than the standard rate of 31.5% principally because of the prudent tax treatment of the exceptional expenses of conversion (and in addition in 1996, the provision of supplementary depreciation). The underlying rate after adjusting for these items was 31.7% for 1997, (1996: 33.9%).

The reduction in the rate of corporation tax above, and the further reduction announced in the "Green Budget" on 25 November 1997 to a 30% rate from 1 April 1999, will not have any material impact on the value of the Group's net investment in finance leases.

BALANCE SHEET

The structure of the balance sheet at 31 December 1997 is shown below in summary format:

	As at 31.12.97 £m	As at 31.12.96 £m
Assets		
Cash, treasury assets and loans and advances to banks	4,436	5,058
Loans and advances to customers:		
Residential Mortgages	17,022	16,671
Commercial Secured Loans	201	279
Unsecured Loans and Leasing	1,911	1,311
	19,134	18,261
Fixed and other assets	834	759
	24,404	24,078
Liabilities		
Customer accounts	18,948	18,201
Deposits by banks	89	235
Debt securities in issue	1,821	2,341
Other liabilities	1,293	1,170
Subordinated loan capital	575	575
Called up share capital	291	–
Profit and loss account	1,387	1,556
	24,404	24,078

Against a background of intense competition, our gross residential mortgage lending was £2.6bn (1996: £2.2 bn) representing an estimated market share of 3.4% (1996: 3.1%). An increased level of mortgage redemptions following our conversion to plc status however has reduced net lending to £0.4bn (1996: £0.5bn) which is a market share of 1.5% (1996: 2.3%).

	Year ended 31.12.97 £bn	Year ended 31.12.96 £bn
Gross Advances	2.6	2.2
Redemptions	(2.2)	(1.7)
Net lending	0.4	0.5

The upturn in the housing market in 1997 has been strongest in London and the South East where, historically, we have had a relatively low market presence. Lending in these areas was 33% of our total lending in 1997, whereas in the market as a whole London and the South East represented an estimated 45% of the total UK market. It is a key strategic objective to improve our lending share in this important geographic area.

The following table analyses residential lending by type of borrower:

	Year ended 31.12.97 %	Year ended 31.12.96 %
Borrower Type:		
First time buyer	24	23
Next time buyer	50	50
Remortgage	26	27
	100	100

The following table analyses unsecured loans and leasing balances:

	Year ended 31.12.97 £m	Year ended 31.12.96 £m
Unsecured consumer loans	1,172	833
Credit card balances	299	181
Leasing and hire purchase	307	209
Other	133	88
	1,911	1,311

Unsecured consumer loans increased by 41% in 1997 partly reflecting the growth in the consumer credit market, which was up around 15% on 1996, and also increased marketing activity. Tight control over lending quality through the deployment of credit scoring has been maintained throughout 1997, and early delinquency on 1997 business remains similar to that seen on 1996 business.

Total Group capital expenditure during 1997 was £94m including £50m of assets which have been leased to customers under operating leases by Sovereign Finance.

The impact of withdrawals from branch based customer savings accounts following flotation, as customers speculated on further potential 'windfalls', has been substantially mitigated by growth in postal accounts and interest credited. Postal account balances increased from £700m in 1996 to £3,000m at the end of 1997. As a result, customer balances have increased by £747million since December 1996.

One of the key aims of conversion, and having only one banking regulator for the Group, was to manage the Group's liquidity more efficiently. The success in this respect manifests itself in the lower balances of cash and treasury assets, mirrored by lower debt securities in issue.

CAPITAL STRUCTURE

The Group's risk asset ratio, calculated in accordance with standard banking practice, is given in the table below:

	Year ended 31.12.97 £m	Year ended 31.12.96 £m
Capital: Tier 1	1,673	1,556
Tier 2	598	584
Deductions	(45)	(48)
Total Capital	2,226	2,092
Total Risk Weighted Assets	12,079	11,798
Risk Asset Ratios:		
Total Capital	18.4%	17.7%
Tier 1	13.9%	13.2%

The increase in the Tier 1 capital ratio to 13.9% was after charging £17.9 million to reserves in respect of the statutory cash bonus which was payable to investing members of the Alliance & Leicester Building Society who were not eligible to vote on its conversion to public limited company status and did not receive shares.

Alliance & Leicester is well capitalised following the abolition of the Priority Liquidation Distribution Reserve (PLDR) in the Building Societies Act 1997. In the long term we are planning the Group on the basis of a capital structure of around 8% Tier 1 and, as a result, the capital allocation to our business sectors will be changed to this level in 1998. If we had adopted this structure in this year's accounts, the unallocated Tier 1 capital held at Group level would have been £700m at the year end.

TREASURY ACTIVITIES

The Group's treasury activities are conducted largely through Alliance & Leicester Group Treasury plc ('ALGT'), the obligations of which are guaranteed by Alliance & Leicester plc. ALGT, which is an authorised institution under the Banking Act 1987, commenced operations on 17 March 1997. Its principal responsibilities are to maintain and manage the Group's liquidity, wholesale funding and subordinated debt; provide a treasury service to the Group and its customers; and handle the Group's relationships with other financial institutions in the money and international capital markets. ALGT also plays a pivotal role in managing the Group's interest rate and currency exposures.

We continued to adopt a prudent stance in the management of the Group's balance sheet, avoiding disproportionate, mismatched positions. Limits are set in regard to the maximum interest rate positions which can be carried in various time bands, thus reducing vulnerability to a downturn in the market value of certain fixed-rate assets. Regular meetings of the Group Assets and Liabilities Committee monitor activities in the treasury area, the maturity structure of the Group balance sheet, and limits and parameters authorised by the Board in regard to counterparties, liquid assets, wholesale funding and structural risk management.

ALGT attaches great importance to the management of credit risk in the Group's wholesale money market activities. Treasury policy statements, covering, amongst other things, criteria to be used in considering limits on counterparties and countries, are reviewed annually by the Board. The Group has no treasury exposure on banks resident in South Korea, Thailand, the Philippines, Indonesia, or Malaysia where there has been, in recent months, considerable turbulence in the financial markets. The reporting of large exposures to our banking regulator takes place quarterly.

Derivative instruments are used by the Group to hedge open positions, and not for speculative, trading purposes. The objective of the Group's structural risk management policy is to contain the risk of loss arising from changes in interest rates and currency rates within predetermined limits. For this purpose, a range of derivative hedging instruments are used, principally interest rate swaps, spot and forward currency transactions, futures, forward rate agreements and options. Interest rate risk is controlled on a Group basis, making use of complementary positions which may exist on the balance sheets of the various business units. Interest rate swaps continue to be a major tool in the management of the Group's balance sheet, where positions being hedged might typically be those arising from fixed-rate mortgage income streams or interest costs attached to fixed-rate fundings.

As part of the process of monitoring market risk, a report is submitted to each meeting of the Group Assets and Liabilities Committee, showing the potential change in the aggregate value of the Group's fixed-interest positions which would result from an adverse change in the sterling yield curve. The Group does not carry any material open foreign currency positions.

Debt securities forming part of the Group's treasury assets, which include certificates of deposit, UK government stocks and Treasury bills, are held for use on a continuing basis and without any trading intent.

The following table summarises the repricing profile of the Group's assets, liabilities and off-balance sheet exposures.

	Net assets less than 1 year £m	Net assets more than 1 year £m	Net non-interest bearing liabilities £m
31 December 1997			
Interest rate repricing	1,994	1,923	3,917
profile	(51%)	(49%)	
31 December 1996			
Interest rate repricing	2,157	1,558	3,715
profile	(58%)	(42%)	

PROFIT RATIOS

The Group's underlying profit ratios excluding exceptional costs have improved compared to 1996:

	Year ended 31.12.97 %	Year ended 31.12.96 %
Post Tax Return on Capital	17.9	16.0
Post Tax Return on Mean Assets	1.2	1.0
Post Tax Return on		
Mean Risk Weighted Assets	2.5	2.0

The post tax return on capital by sector is analysed below:

	Mortgage Lending & Investments £m	Personal Banking £m	Commercial Banking £m	Treasury & Group £m	Total Group £m
Underlying post					
tax profit	172	53	51	13	289
Average Tier 1 allocated	1,053	145	191	228	1,617
Post tax return on					
capital %	16.4	36.5	26.7	5.6	17.9
1996 Post tax return					
on capital %	14.6	41.6	25.2	1.0	16.0

The returns on capital of Mortgage Lending & Investments and of Personal Banking have been calculated on the basis of an allocation of equity capital sufficient to meet an 11% Tier 1 risk asset ratio. Commercial Banking's Tier 1 ratio is currently higher at 21.5% and is driven by regulatory requirements on exposure limits. Alliance & Leicester Group Treasury plc commenced operations during 1997 with a capital base comprising £80m Tier 1 capital and £50m undated subordinated loan capital.

FINANCIAL OUTLOOK

The financial results for 1998 will be dependent on two main external factors – the level of interest rates and competition in our main markets.

The future direction for interest rates is less certain at the beginning of 1998 than at the same time in 1997. If interest rates fall in 1998 the housing market will benefit, with resulting improvement in credit performance; however, the income from interest-free liabilities will fall. Conversely, if interest rates rise in 1998, the benefit of interest-free liabilities will increase, but credit losses could deteriorate.

We anticipate with more certainty that competition will continue to be fierce, both on lending rates and on the pricing of retail deposits. That is why we will continue our cost control programmes whilst ensuring we invest in the Alliance & Leicester brand to ensure its increasing value for shareholders.

Board of Directors

Simon Everard
Non-Executive Chairman
Simon Everard is an industrialist with many years experience. This has included Chairmanship of Ellis & Everard plc, which has chemical distribution and trading interests in Europe and the USA. He is a director of Croda International Plc and a Deputy Lieutenant of Leicestershire.

Sir Michael Thompson
Non-Executive Deputy Chairman
Sir Michael Thompson is a distinguished physicist with a scientific background that includes electronics and computers. Formerly Vice Chancellor of the University of Birmingham, he has broad management and strategic planning experience. He has served on a number of public authorities, trusts and committees in education, health and science.

John Baden
Non-Executive Deputy Chairman
John Baden is a chartered accountant and has held senior positions in banking and finance. He is Chairman of the Group Audit Committee and the Group Credit Policy Committee. He is also Deputy Chairman of Girobank plc.

Peter White
Group Chief Executive
Peter White is a chartered accountant and joined the Alliance Building Society in April 1982 as General Manager (Finance Treasury & Management Services) after 11 years in the building society industry. He was appointed Deputy Group Chief Executive and Managing Director in 1989 and Group Chief Executive in 1991. He is Chairman of Girobank plc and a member of the Council of the British Bankers Association. He completed 2 years as Chairman of the Council of Mortgage Lenders in January 1998. He has lectured widely on change management and business transformation. He is also a director of Reckitt & Coleman plc.

Michael Allen
Non-Executive Director
Michael Allen has extensive experience in general and marketing management in the UK, Europe and the USA. He was Group Vice President in Proctor & Gamble's European operations, having held a number of senior management positions in the group, and is a director of Safeway plc and Essex & Suffolk Water plc.

Richard Banks
Managing Director, Girobank
Richard Banks is a chartered banker and joined Girobank in 1987 as General Manager, North East Region becoming Director, Corporate Banking in 1994 and Managing Director in 1996. He was appointed a Director of Alliance & Leicester plc with effect from 1 February 1998.

Frances Cairncross
Non-Executive Director
Frances Cairncross holds MA degrees in history and economics. In 1967 she joined the staff of 'The Times' and since then has held positions with 'The Banker', 'The Observer' and 'The Guardian'. She is currently Public Policy Editor of 'The Economist'. She is a director of the National Institute of Economic and Social Research, a member of the Council of the Institute of Fiscal Studies and an honorary fellow of St Anne's College, Oxford.

Nicholas Corah
Non-Executive Director
Nicholas Corah was formerly Deputy Chairman of East Midlands Electricity plc and Chairman of Corah plc. He was High Sheriff of Leicestershire in 1996/97 and is a Deputy Lieutenant of Rutland. He is a member of the East Midlands Regional Council of the CBI, Chairman of East Midlands Development Company Ltd and Chairman of the Trustees of Alliance & Leicester Pension Scheme.

Trevor Hilliard
Managing Director, Retail Financial Services
Trevor Hilliard joined Alliance & Leicester in 1988 as Managing Director of the unsecured personal lending operation. Formerly with Abbey National plc and Mercantile Credit Company Ltd he was appointed Managing Director, Retail Financial Services in December 1997, responsible for all sales to personal customers.

Richard Pym
Group Finance Director
Richard Pym is a graduate chartered accountant and joined Alliance & Leicester in 1992, becoming Group Finance Director in September 1993. His earlier career included senior appointments at The Burton Group plc and BAT Industries plc. He is also a director of Girobank plc.

John Windeler
Non-Executive Director
John Windeler has had extensive experience in international money and securities markets with two multinational banks. Formerly he was Executive Vice President of Irving Trust Bank in charge of investment banking and strategic planning and then the Group Chief Financial Officer at the National Australia Bank and Chief Executive of that bank's UK insurance division. He is also a director of BMS Associates and Cicada Services Limited.

Directors' report

THE DIRECTORS have pleasure in presenting their report and the consolidated financial statements of Alliance & Leicester plc for the year ended 31 December 1997.

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

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

The Group's business during the year and future plans are reviewed on pages 2 to 20.

RESULTS AND DIVIDENDS

The profit on ordinary activities before tax for the year ended 31 December 1997 was £394.6m (1996: £305.6m). An interim net dividend of 6.4 pence per share was paid on 20 October 1997.

The directors propose a final net dividend for the year of 14.4 pence per share to be paid on 18 May 1998.

SHARE CAPITAL

The Company was formed and shares issued in accordance with the Building Societies Act 1986. Under these statutory provisions, the former Alliance & Leicester Building Society subscribed for 582 million ordinary shares of 50p each in the Company in consideration of a payment of £291 million. The former Society distributed these shares on conversion in April 1997.

MARKET VALUE OF LAND AND BUILDINGS

The net book value of land and buildings at 31 December 1997 of £215.2m includes £35.0m for major alterations and improvements which are depreciated over a period of 10 to 15 years. The net amount of £180.2m, excluding alterations, compares with a market valuation of £190.1m. In arriving at the valuation seven properties which are significant to the Group in terms of their value or use together with a third of the remaining properties were valued. The change in value of this latter sample was applied to those properties which were not valued. The valuation date was 31 December 1997 and the bases of valuation were:

- existing use for properties occupied by the Group
- open market value for properties surplus to the Group's requirements and investment properties
- depreciated replacement cost for properties of a specialist nature

All valuation bases were in accordance with the Appraisal and Valuation Manual of the Royal Institution of Chartered Surveyors.

Six of the significant properties were valued by independent valuers, Richard Ellis, Chartered Surveyors. The remaining properties were valued by a combination of external valuers and the Group's own professionally qualified staff.

DIRECTORS

The following persons were directors of the company or its predecessor, Alliance & Leicester Building Society, during the year:

S Everard *Chairman*
Sir Michael Thompson *Deputy Chairman*
E J Baden *Deputy Chairman*
P R White *Group Chief Executive*
M J Allen
F A Cairncross
G N Corah
N Crowley (to 20.04.97)
T M Hilliard
R A Pym
K C Southwood (to 28.02.97)
J R Windeler

Richard Banks, managing director of Girobank plc, was appointed an executive director on 1 February 1998.

The names and brief biographies of the current directors are shown on page 21. Mr P R White, Mr T M Hilliard and Mr R A Pym will retire by rotation and being eligible, will offer themselves for re-election at the forthcoming Annual General Meeting.

In addition, Mr R L Banks who was appointed a director on 1 February 1998 will also retire from the Board, and being eligible, will offer himself for election.

Directors' Service Contracts

Details of directors' service contracts are included in the Report by the Remuneration Committee on page 27.

Directors' Interests in Contracts

No director had a material interest at any time during the year in any contract of significance, other than a service contract, with the company or any of its subsidiary undertakings.

Directors' Interests in Shares

Directors' interests in the shares of the company and options to acquire shares are set out in the Report by the Remuneration Committee on page 29.

Substantial Shareholders

Shareholders with an interest in the issued ordinary share capital of the Company disclosed in accordance with Section 198-208 of the Companies Act 1985 are shown in note 31.

CORPORATE GOVERNANCE

The Group's Statement of Corporate Governance is set out on pages 30 to 31.

CHARITABLE AND POLITICAL DONATIONS

During 1997, the Group made donations for charitable purposes amounting to £580,517 including its support for Business in the Community. No contributions were made for political purposes.

During the year, Alliance & Leicester continued to develop its relationship with the community. Our corporate community investment programme has given support to a number of organisations nationally and locally. Our support has taken various forms including financial contributions, gifts in kind, management secondments and matching donations given by our staff.

We have maintained and developed our close links with Business in the Community through which we co-operate with other major companies on national initiatives giving practical help to community projects. The Alliance & Leicester has conferred specific responsibility for community affairs at director level, and put in place the management structure to develop our strategy in this important area and achieve defined objectives.

Towards the end of this year, Peter White, our Group Chief Executive, will be leading a 'Seeing is Believing' initiative in the Leicestershire area and issues on which that project is likely to focus include education, disability groups, inner city regeneration including housing initiatives and Welfare to Work.

STAFF

It is the Group's policy to have effective communication and consultation with its staff. Regular staff involvement is achieved through consultative and negotiating committees, including discussion with in-house staff associations and trade unions within both the Company and Girobank. Regular meetings, group wide team briefings, circulars and newsletters help to ensure that staff are aware of the organisation's performance and objectives. The Group encourages the involvement of employees in the performance of the Company through the employee Sharesave Scheme.

Directors' report *continued*

The Group has an equal opportunities policy. The aim of this policy is to ensure that no job applicant or staff member receives less favourable treatment on the ground of race, colour, religion, nationality, ethnic or national origin, sex, marital status or physical disability.

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

CREDITOR PAYMENT POLICY

The Group recognises the importance of maintaining good business relationships with its suppliers. The Group policy is to pay all invoices within the agreed terms.

It is Group policy to:

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

Trade creditor days of the company for the year ended 31 December 1997 were 22 days, based on the ratio of company trade creditors at the end of the year to the amounts invoiced during the year by trade creditors.

ENVIRONMENTAL POLICY

The Group recognises that environmental issues are a fundamental corporate priority of increasing importance. The Group will make every effort to reduce the environmental impact of all it's business activities to a practicable minimum in accordance with good environmental practices. The Group will comply with regulatory and legislative requirements as necessary. The Group recognises the key areas of importance being: energy and water consumption, transport, waste and pollution and the working environment.

Special Business at the Annual General Meeting

The Annual General Meeting will be held on 5 May 1998.

Shareholders will see from the notice of the Annual General Meeting that they are asked to consider and, if thought fit, pass a number of resolutions as special business.

AUDITORS

KPMG Audit Plc have signified their willingness to continue in office and a resolution reappointing them as auditors and authorising the directors to determine their remuneration will be proposed at the Annual General Meeting.

On behalf of the Board

J Hepplewhite

Company Secretary

26 February 1998

Report of the Remuneration Committee

COMMITTEE'S COMPOSITION AND SCOPE

The Remuneration Committee of the Board ("the Committee") comprises five non-executive directors:

Sir Michael Thompson *(Chairman)*

Mr S Everard

Mr E J Baden

Mr M J Allen

Mr G N Corah

The Committee is responsible for determining, under agreed terms of reference, the pay and benefits and contractual arrangements of each executive director.

The Group Chief Executive attends meetings of the Committee except when his own remuneration is being considered.

The Committee considers that since the flotation of the Company the Company has complied with Section A of the Best Practice provisions annexed to the Listing Rules of the London Stock Exchange, which concerns the membership and operation of the Committee. Prior to flotation the Company's predecessor Alliance & Leicester Building Society was governed by a different regulatory regime.

REMUNERATION POLICY

The Committee's objective is to set remuneration so as to attract and retain high calibre executives and to encourage and reward superior business performance. Performance related payments and share awards are provided with the objective of rewarding achievements and aligning the interests of the individual with those of the Group's shareholders. The individual salary, bonus and benefit levels of executive directors are normally reviewed annually by the Committee and due consideration is given to advice from independent advisers.

In framing its policy the Committee has given full consideration to Section B of the Best Practice provisions annexed to the Listing Rules of the London Stock Exchange.

Details of individual director's remuneration and share options are set out on pages 27 and 29 of this report.

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

Basic Salary

Basic salaries for executive directors take into account the role and responsibilities, performance and experience of the individual set against background information from independent advisers on salary levels for similar positions amongst the comparator group of financial plc's within the FTSE 100.

Annual Bonus

At the discretion of the Committee executive directors are eligible to receive an annual performance bonus not exceeding 40% of their annual basic salaries. The amount is determined by the director's performance and is based on the achievement of profit targets and individual performance goals specified and agreed at the beginning of each year together with a discretionary element to be determined by the Committee.

Long Term Incentive Schemes

In order to align the interests of executive directors and certain senior managers with those of shareholders, the Committee recommended and the Board approved, prior to the Company's flotation on 21 April 1997, share schemes for executive directors and senior managers:

1. Executive directors and certain senior managers were granted options under the Alliance & Leicester Approved and Unapproved executive share option schemes. The aggregate value of options to subscribe for new shares granted to each individual cannot exceed four times annual remuneration in any ten year period, or two year's annual remuneration in any one year. Options cannot normally be exercised for three years from the date of issue. Performance conditions are intended to motivate executive directors and senior managers to strive for growth in shareholder value and the present performance condition applied to these schemes is that options can only then be exercised if the percentage growth in earnings per

share over a three year period exceeds the Retail Price Index (RPI) inflation by at least 9% over the same period.
2. In addition, executive directors will receive one quarter of their annual bonus in respect of 1997 in the form of deferred shares which the Company initially intends to match on a one-for-one basis. In the future it is intended that the maximum number of matched shares will be two matched shares for each deferred share comprised within an award. The rights to both the deferred and matching shares cannot normally be exercised for three years and lapse if not exercised within seven years. No performance condition applies to the initial operation of the matching arrangements but it is intended that subsequent awards of rights to matched shares will be subject to satisfying a performance target designed to link the receipt of the matched shares to the sustained improvement in the underlying performance of the Company.

Pensions

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

Its main features, in respect of executive directors, are:

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

The following executive directors have special benefits: Mr P R White is entitled to a pension of 2/3rds of his annual rate of basic salary on retirement from service at age 60. Any AVCs that he pays to enhance his pension benefits (which must ultimately be within Inland Revenue limits) are matched by the Company up to a maximum matching of 5% of his salary.

Mr R A Pym is not required to contribute. There is an unfunded unapproved pension arrangement to increase his Pension Scheme benefit on retirement from service at age 60 to 2/3rds of Final Pensionable Salary (as if the Earnings Cap were not to apply) inclusive of retained benefits from his previous pension arrangements.

In calculating Mr T Hilliard's pension at age 60 (ref (a) above), the 1/60th will be replaced by 1/40th in respect of his pensionable service completed after 1 December 1997. Any AVCs that he pays to enhance his pension benefits (which must ultimately be within Inland Revenue limits) are matched by the Company up to a maximum matching of 5% of his salary.

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

All pensions are subject to contractual increases each April in line with the annual percentage rise in the RPI over the previous calendar year, subject to a maximum of 5%; plus for Mr P R White:

(i) 80% of the annual percentage rise in the RPI falling between 5% and 15%; and
(ii) 50% of the annual percentage rise in the RPI in excess of 15%.

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

Taxable Benefits

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

Sharesave Scheme

Employees, including executive directors, may join an Inland Revenue approved savings related share option scheme. Options have been granted over the Company's ordinary shares, at a 20% discount to the market price at the date of grant, to those who agree to save between £5 and £250 per month.

REMUNERATION FOR NON-EXECUTIVE DIRECTORS

The fees of the Chairman of the Board and the other non-executive directors are determined by the Board as a whole in the light of recommendations by the Group Chief Executive.

Three non-executive directors, Mr S Everard, Sir Michael Thompson and Mr G N Corah, all appointed prior to June 1988, are entitled as former Directors of the Company's predecessor, Alliance & Leicester Building Society, to an unfunded unapproved arrangement providing for a pension on retirement. These obligations have been transferred to the Company. The amounts (which have been fully accrued as at 31 December 1997) are payable from a normal retirement age of 70 and are calculated as two-thirds of the individual's 1996 Director's fees. These amounts are revalued over the period to retirement and increased when the pension comes into payment, in line with the RPI related increase formula set out above for Mr P R White. Non-executive directors have life cover of up to four times basic fees and have the benefit of membership of the Group's private medical insurance scheme.

SERVICE CONTRACTS

The Chairman and other non-executive directors do not have service contracts with the Company, but on appointment are issued with a letter of understanding without contractual force.

The service contracts of the executive directors are terminable by the Company on two years' notice but subject to termination in any event on their 60th birthdays. If the employment of an executive director is terminated by the Company for any reason (other than due cause) without such notice being given then the director will receive payment of 18 months' basic salary (or two years' basic salary if at the time the executive director is 55 or over) and pension benefits. The executive directors may terminate their contracts of employment at any time by giving six months prior notice. The Committee believes that the present notice periods are reasonable and appropriate in order to retain and recruit executive directors of an appropriate calibre and are in line with the market.

DIRECTORS' EMOLUMENTS

Year ended 31 December 1997

	Salaries/ Fees £000	Bonus (i) £000	Other Benefits £000	Compensation for Loss of Office £000	Total 1997 £000	Total 1996 £000
Executive Directors:						
P R White	375	269	37	–	681	549
T M Hilliard	178	94	6	–	278	190
R A Pym	230	128	12	–	370	276
K C Southwood *(to 28.2.97)*	33	–	9	346	388	262
Total	816	491	64	346	1,717	1,277
Non-Executive Directors:						
S Everard	132	20	1	–	153	88
Sir M Thompson	58	–	8	–	66	57
E J Baden	72	–	2	–	74	44
M J Allen	27	–	4	–	31	33
F A Cairncross	29	–	–	–	29	30
G N Corah	40	–	4	–	44	41
N Crowley *(to 20.4.97)*	18	–	–	–	18	58
J R Windeler	37	–	1	–	38	37
	413	20	20	–	453	388
Total	1,229	511	84	346	2,170	1,665

Report of the Remuneration Committee *continued*

a) Mr P R White, Mr T M Hilliard and Mr R A Pym waived their right to receive a free allocation of 250 shares in the capital of the Company at flotation, as an employee.

b) As a consequence of the planned closure of the Hove Administrative Centre in 1997, the Group Board made relocation incentives available to all staff who have had to move. Mr P R White received the final part of his incentive which is included in the bonus figure in the table above.

c) Mr P R White and Mr R A Pym also received a bonus, included in the table above, in connection with the flotation of Alliance & Leicester plc.

Note (i) In accordance with the deferred bonus arrangements, described on page 26 of this report, the Remuneration Committee recommended to the Trustees of the Alliance & Leicester Share Ownership Trust Ltd the award of rights to deferred shares, equal to 25% of the directors' normal annual bonus, together with the award of matching shares on a one-for-one basis. The bonus figure disclosed in the table above, in respect of the executive directors, includes the recommended amounts under these arrangements as follows:

Executive Director	Deferred shares to the value of £	Matching shares to the value of £	Payment for shares
Mr P R White	40,000	40,000	Nil
Mr T M Hilliard	18,812	18,812	Nil
Mr R A Pym	22,800	22,800	Nil

The bonus and matching shares would not normally be exercisable for three years from the date of grant.

PENSION ENTITLEMENTS

Executive Director	P R White	T M Hilliard	R A Pym
Age attained at 31.12.97	55	52	48
Normal Retirement Age	60	60	60
	£	£	£
Amount of accrued pension per annum at 31.12.97	213,708	27,625	30,571
(at 31.12.96)	(185,683)	(20,417)	(20,369)
Change in amount of accrued pension p.a. net of revaluation during year to 31.12.97	21,385	6,478	9,474
(to 31.12.96)	(56,232)	(5,883)	(7,265)
Directors contributions payable during year to 31.12.97	18,750	9,000	0

Details of the terms and conditions associated with the above pensions are shown on page 26. Mr K Southwood left the Group with an entitlement to a deferred pension of £29,777 p.a.

Non-Executive Director	S Everard	Sir Michael Thompson	G N Corah
Age attained at 31.12.97	69	66	65
Normal Retirement Age	70	70	70
	£	£	£
Amount of accrued pension p.a. at 31.12.96	60,767	30,383	15,192
Amount of pension accruing during 1997	15,192	5,064	0
Directors contributions	0	0	0

On the death of Mr Everard, Sir Michael Thompson or Mr Corah before their normal retirement age or after their pension commences a widow's pension of one half of that director's full pension entitlement is payable. If Mr Everard, Sir Michael Thompson or Mr Corah cease to be directors before their normal retirement age, their accrued pension may be drawn without reduction from the former date (each now being aged over 65).

DIRECTORS' INTERESTS IN ORDINARY SHARES

The beneficial interests of directors*, who served on the Board during 1997, in shares in Alliance & Leicester plc were:

	Fully Paid Shares of 50p each	
Directors	At 1 Jan 1997	At 31 Dec 1997‡
S Everard	Nil	2,500
Sir Michael Thompson	Nil	3,455
E J Baden	Nil	750
P R White	Nil	7,174
M J Allen	Nil	500
F A Cairncross	Nil	7,464
G N Corah	Nil	4,217
T M Hilliard	Nil	1,350
R A Pym	Nil	500
J R Windeler	Nil	500

*No director had any beneficial interest in shares in the Company until the Company's flotation on 21 April 1997. ‡Directors' share interests include the interests of their spouses and infant children, as required by Section 328 of the Companies Act 1985.

OPTIONS TO ACQUIRE SHARES

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

	Number of options During the Year		Exercise price £	Exercise period
Directors	Granted+	At 31.12.97		
P R White	5,628	5,628	5.33#	23/4/00 - 23/4/07
	125,704	125,704	5.33*	23/4/00 - 23/4/04
	4,049	4,049	4.26§	1/8/02 - 1/2/03
T M Hilliard	5,628	5,628	5.33#	23/4/00 - 23/4/07
	58,161	58,161	5.33*	23/4/00 - 23/4/04
	4,049	4,049	4.26§	1/8/02 - 1/2/03
R A Pym	5,628	5,628	5.33#	23/4/00 - 23/4/07
	76,923	76,923	5.33*	23/4/00 - 23/4/04
	4,049	4,049	4.26§	1/8/02 - 1/2/03

§ Options granted under the Alliance & Leicester Sharesave Scheme

Options granted under the Alliance & Leicester Approved Company Share Option Scheme

* Options granted under the Alliance & Leicester Unapproved Company Share Option Scheme

+All options to acquire shares were granted after the Company's flotation on 21 April 1997. No options were exercised during the year.

There were no changes in directors' share interests between 31 December 1997 and 26 February 1998.

On 31 December 1997 the market price of ordinary shares in Alliance & Leicester plc was £8.00 and the range during 1997 was £5.33 to £8.31.

ELECTION OF DIRECTORS AT ANNUAL GENERAL MEETING

Mr P R White, Mr R A Pym and Mr T M Hilliard are standing for re-election at the forthcoming Annual General Meeting. Mr R L Banks stands for election at the Annual General Meeting having been appointed to the Board on 1 February 1998. The notice periods under their service contracts are as stated on page 27.

Sir Michael Thompson

Chairman Remuneration Committee

26 February 1998

Statement of Corporate Governance

BOARD STRUCTURE

The Company's Board comprises seven non-executive directors (including the Chairman) and four executive directors who have the collective responsibility for ensuring that the affairs of the Company and its subsidiaries are managed competently and with integrity. It meets regularly and approves and closely monitors the Alliance & Leicester Group's business strategy. Day-to-day conduct of the Group's business is entrusted to the Group Chief Executive and his senior management colleagues.

The non-executive directors exercise independent judgement and are not employees of the Company. They do, however, play their full part as members of the Board 'team' and share responsibility for Board decisions. They bring a diversity of business perspectives and objectivity which complements the 'hands on' expertise of their executive director colleagues.

The composition of the Board is kept under review with the aim of ensuring that the Board collectively possesses the necessary skills and experience for the proper direction of the Group's business activities.

The Board has established several committees which assist the full Board in the exercise of its responsibilities.

The role of the *Group Audit Committee*, under the Chairmanship of Mr. E J Baden, is to ensure that the systems of accounting, business control and management of information are adequate for the needs of the Company and the Group.

The *Remuneration Committee*, under the Chairmanship of Sir Michael Thompson, determines the remuneration and contractual arrangements of executive directors. Its report to shareholders appears on pages 25 to 29.

The *Nomination Committee*, under the chairmanship of Mr S Everard, has the task of recommending new appointments to the Board and reviewing re-appointments when they become due. Membership comprises the Chairman, the two Deputy Chairmen, Mr J R Windeler and Miss F. A. Cairncross.

The *Group Credit Policy Committee*, under the chairmanship of Mr E J Baden, reviews all aspects of lending credit risk.

In addition to these board committees, the Group Assets and Liabilities Committee reviews the Group's balance sheet structural risk.

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

Compliance Statement

In the directors' opinion, the Company has since flotation complied with the provisions of the Cadbury Committee's Code of Best Practice as incorporated in the London Stock Exchange Listing Rules. Its predecessor Alliance & Leicester Building Society was subject to a separate code applicable to building societies.

Systems of Business Control

The directors are required by law to establish systems for the control of the conduct of the business in accordance with Schedule 3 of the Banking Act 1987 (the 'Act'). The directors are required to conduct the business with prudence and integrity, ensuring that there are adequate reserves and other capital resources and assets in liquid form for the protection of the depositors.

The key features of the system of business control established by the directors are: a well defined management structure with clear accountabilities; management information systems, including a budgetary and financial control system; risk management functions to identify and manage major risks; and an internal audit function to report to the directors on the effectiveness of the internal controls.

In addition, line management carry out, twice a year, a formal self assessment of risks to which the Group is exposed and the effectiveness of the countermeasures to manage them. This is followed by a report to the Group Audit Committee, including details of the action plans, to address any issues arising. Action plans are later monitored by Internal Audit, executive management and the Group Audit Committee. The system of internal control is designed to provide reasonable assurance as to the effectiveness of the safeguards protecting the business against the risk of material error, loss or fraud, but it must be recognised that it cannot provide absolute assurance.

The activities of the Group, including the systems of business control, are subject to supervision by the Supervision and Surveillance Division of the Bank of England, to be superseded in 1998 by the Financial Services Authority. The Group is required to submit detailed monthly returns covering all aspects of its current and planned business activities and meets regularly with its supervisors, conducting the relationship in an open and constructive manner.

Going Concern

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

Group Audit Committee

The Group Audit Committee is a committee of the Board comprising the two deputy chairmen, Mr G N Corah and Mr J R Windeler. In addition, meetings are normally attended by the Group Finance Director, the Head of Group Audit and Compliance, and a representative of the external auditors. The main duties of the Committee fall into two main areas: internal control and financial reporting.

Internal Control: the Committee reviews the effectiveness of the Group's systems of internal control, and monitors compliance with regulatory requirements. To do this, the Committee approves the annual internal audit plan which is based on a thorough risk assessment of the full scope of the Group's business activities and monitors progress against the plan.

Financial reporting: the Committee's role is to review, on behalf of the Board, the annual report and accounts and the interim report to ensure that they present a true and fair view of the Group's financial position and profit for the year.

Statement of Directors' Responsibilities

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

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the financial accounts comply with the Companies Act 1985. They are also responsible for establishing and maintaining systems of control, safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Report of the Auditors, KPMG Audit Plc, to the Members of Alliance & Leicester plc

We have audited the financial statements on pages 34 to 63. We have also examined the amounts disclosed relating to emoluments, share options, long-term incentive scheme interests and directors' pension entitlements which form part of the remuneration committee report on pages 25 to 29.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As described on page 32 the Company's directors are responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

BASIS OF OPINION

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

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

OPINION

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 1997 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
~~*Chartered Accountants, Registered Auditor*,~~
8 Salisbury Square, Blackfriars, London
26 February 1998

Review Report by KPMG Audit Plc, to Alliance & Leicester plc on Corporate Governance Matters

In addition to our audit of the financial statements, we have reviewed the directors' statements on pages 30 and 31 on the Company's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and their adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with Listing Rules 12.43(j) and 12.43(v).

BASIS OF OPINION

We carried out our review in accordance with guidance issued by the Auditing Practices Board. This guidance does not require us to perform any additional work necessary to express a separate opinion on the effectiveness of either the Group's system of internal financial control or the Company's corporate governance procedures, or on the ability of the Group to continue in operational existence.

OPINION

With respect to the directors' statements on internal control and going concern on page 31, other than statements going beyond internal financial control which are outside the scope of our report, in our opinion the directors have provided the disclosures required by the Listing Rules and such statements are not inconsistent with the information of which we are aware from our audit work on the financial statements.

Based on enquiry of certain directors and officers of the Company, and examination of relevant documents, in our opinion the directors' statement on page 30 appropriately reflects the Company's compliance with the other paragraphs of the Code specified for our review by the Listing Rules.

KPMG Audit Plc

~~KPMG Audit Plc~~
Chartered Accountants, 8 Salisbury Square, Blackfriars, London
26 February 1998

Consolidated Profit & Loss Account

For the year ended 31 December 1997	Notes	Continuing Operations 1997 £m	1996 £m
Interest receivable:			
Interest receivable and similar income arising from debt securities		185.8	176.5
Other interest receivable and similar income		1,525.4	1,387.4
Interest payable		(1,017.8)	(920.1)
NET INTEREST INCOME		693.4	643.8
Fees and commissions receivable		400.4	406.6
Fees and commissions payable		(47.5)	(37.5)
Other operating income		71.4	64.3
TOTAL NON-INTEREST INCOME		424.3	433.4
OPERATING INCOME		1,117.7	1,077.2
Administrative expenses:			
Underlying	2	(630.8)	(663.3)
Exceptional costs of conversion	2	(28.0)	(26.0)
Depreciation and amortisation:			
Underlying		(35.0)	(35.7)
Supplementary	4	–	(27.1)
		(693.8)	(752.1)
Provisions for bad and doubtful debts	15	(29.3)	(19.5)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAX		394.6	305.6
Tax on profit on ordinary activities	8	(133.9)	(119.5)
PROFIT ATTRIBUTABLE TO THE SHAREHOLDERS OF ALLIANCE & LEICESTER PLC		260.7	186.1
Dividends	10	(121.1)	–
RETAINED PROFIT FOR THE YEAR		139.6	186.1
Earnings per ordinary share	11	44.8p	32.0p
Underlying earnings per ordinary share	11	49.6p	40.7p

There were no material acquisitions in 1997. On 13 November 1996, Girobank plc, a subsidiary of Alliance & Leicester plc, acquired Sovereign Holdings plc (formerly OLB Holdings (UK) plc). The effect of the acquisition was not material to the Group results.

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

Consolidated Balance Sheet

As at 31 December 1997	Notes	1997 £m	1996 £m
Assets			
Cash and balances at central banks		84.7	100.6
Treasury bills and other eligible bills	12	202.8	85.2
Loans and advances to banks	13	1,841.6	1,676.0
Items in the course of collection from other banks		118.0	156.3
Loans and advances to customers	14	19,133.6	18,261.3
Debt securities	16	2,307.1	3,196.1
Tangible fixed assets	18	355.7	321.8
Other assets	19	60.0	80.0
Prepayments and accrued income	20	173.0	107.6
Long-term assurance business attributable to shareholders	21	32.6	28.2
		24,309.1	24,013.1
Long-term assurance assets attributable to policyholders	21	94.6	65.1
TOTAL ASSETS		24,403.7	24,078.2
Liabilities			
Deposits by banks	22	89.1	235.2
Items in the course of transmission to other banks		200.6	206.9
Customer accounts	23	18,948.4	18,201.2
Debt securities in issue	24	1,820.6	2,341.3
Other liabilities	25	349.9	382.7
Accruals and deferred income	26	629.2	501.5
Provisions for liabilities and charges	27	18.4	13.4
Subordinated liabilities :			
undated loan capital	30	198.9	198.9
dated loan capital	30	376.0	375.7
		22,631.1	22,456.8
Shareholders' funds (equity)			
Called up share capital	31	291.0	–
Profit and loss account	32	1,387.0	1,556.3
		1,678.0	1,556.3
		24,309.1	24,013.1
Long-term assurance liabilities to policyholders	21	94.6	65.1
TOTAL LIABILITIES		24,403.7	24,078.2
Memorandum items			
Commitments	35	199.0	34.5

Approved by the Board of Directors on 26 February 1998 and signed on its behalf by:

S Everard *Chairman*

P R White *Group Chief Executive*

R A Pym *Group Finance Director*

Company Balance Sheet

As at 31 December 1997	Notes	1997 £m	1996 £m
Assets			
Cash and balances at central banks		59.7	34.7
Treasury bills and other eligible bills	12	–	–
Loans and advances to banks	13	3,927.5	1,172.8
Items in the course of collection from other banks		–	–
Loans and advances to customers	14	17,499.6	17,851.2
Debt securities	16	372.9	2,675.9
Investment in subsidiary undertakings	17	425.4	134.9
Tangible fixed assets	18	228.1	222.7
Other assets	19	188.7	151.9
Prepayments and accrued income	20	135.1	75.2
TOTAL ASSETS		22,837.0	22,319.3
Liabilities			
Deposits by banks	22	2,303.7	313.8
Customer accounts	23	16,056.0	17,102.6
Debt securities in issue	24	1,495.6	2,284.3
Other liabilities	25	331.1	169.7
Accruals and deferred income	26	551.1	432.5
Provisions for liabilities and charges	27	13.4	13.4
Subordinated liabilities :			
undated loan capital	30	198.9	198.9
dated loan capital	30	376.0	375.7
		21,325.8	20,890.9
Shareholders' funds (equity)			
Called up share capital	31	291.0	–
Profit and loss account	32	1,220.2	1,428.4
		1,511.2	1,428.4
TOTAL LIABILITIES		22,837.0	22,319.3

Approved by the Board of Directors on 26 February 1998 and signed on its behalf by:

S Everard *Chairman*

P R White *Group Chief Executive*

R A Pym *Group Finance Director*

Group Statement of Total Recognised Gains & Losses

For the year ended 31 December 1997	1997 £m	1996 £m
Total recognised gains & losses, being the profit attributable to the shareholders of Alliance & Leicester plc	260.7	186.1

Reconciliation of Movements in Shareholders' Funds

For the year ended 31 December 1997	1997 £m	1996 £m
Group profit attributable to the shareholders of Alliance & Leicester plc	260.7	186.1
Dividends	(121.1)	–
	139.6	186.1
New share capital:		
Shares issued	291.0	–
Transfer from general reserve on conversion	(291.0)	–
	–	–
Goodwill arising on acquisitions	–	(39.9)
Statutory cash bonus	(17.9)	–
Net increase in shareholders' funds	121.7	146.2
Opening shareholders' funds	1,556.3	1,410.1
Closing shareholders' funds	1,678.0	1,556.3

Consolidated Cash Flow Statement

For the year ended 31 December 1997	Note	1997 £m	1996 £m
NET CASH (OUTFLOW)/INFLOW FROM OPERATING ACTIVITIES	38	(853.1)	1,207.9
Returns on investments and servicing of finance:			
Interest paid on loan capital		(47.2)	(35.1)
Taxation		(106.9)	(112.1)
Capital expenditure and financial investment:			
Purchase of investment securities		(4,716.1)	(9,236.1)
Sale and maturity of investment securities		5,599.6	8,381.0
Purchase of tangible fixed assets		(89.4)	(61.4)
Sales of tangible fixed assets		10.0	6.6
		804.1	(909.9)
Acquisitions and disposals		–	(68.1)
Equity dividends paid		(35.8)	–
Statutory cash bonus paid		(17.9)	–
NET CASH (OUTFLOW)/INFLOW BEFORE FINANCING		(256.8)	82.7
Financing:			
Issue of loan capital		–	200.0
(DECREASE)/INCREASE IN CASH	38	(256.8)	282.7

Notes to the Accounts

1 PRINCIPAL ACCOUNTING POLICIES

BASIS OF PRESENTATION
The consolidated accounts are prepared in accordance with the special provisions of Part VII of the Companies Act 1985 applicable to banking companies and banking groups

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

BASIS OF CONSOLIDATION
The Group Accounts consolidate the Accounts of the bank and all its subsidiaries at the end of the year. Where subsidiaries are acquired during the year, their results are included in the Group Accounts from the date of acquisition.

The Alliance & Leicester Group was created by the transfer, on 21 April 1997, of the whole of the undertakings of the Alliance & Leicester Building Society ('the Society') to a newly formed company Alliance & Leicester plc pursuant to Section 97 of the Building Societies Act 1986.

The acquisition of the Society has been accounted for in accordance with the principles of merger accounting as set out in Financial Reporting Standards No 6 'Acquisitions and Mergers' and Schedule 4A to the Companies Act 1985. By adopting this accounting treatment the consolidated accounts of Alliance & Leicester Group for the year ended 31 December 1997, together with the corresponding figures, are presented so as to show the results of the combined entity as though the combination had occurred on 1 January 1996.

FRS6 and the Companies Act set out certain conditions to be met in order that merger accounting can be adopted. Not all of these conditions have been met by the transfer of the Society's business to Alliance & Leicester plc, however, the directors believe that it is appropriate to apply merger accounting. Had acquisition accounting been applied, only post conversion results would have been reported and there would have been adjustments to fair values: the directors do not believe this would have given a true and fair view of the results and state of affairs of the Group. It has not been practicable to quantify the effect of the departure.

GOODWILL
Goodwill arising on the acquisition of subsidiary companies, which is represented by the excess of cost over the fair value of assets acquired, is written off to reserves in the period of acquisition. If a capital reserve arises, where the fair value of assets exceeds the cost, this is credited direct to reserves.

DEFERRED TAXATION
Provision is made using the liability method for taxation which is deferred as a result of timing differences, only to the extent that it is likely that such taxation will become payable or receivable in the foreseeable future.

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

Freehold buildings	40 to 75 years
Leasehold buildings	over the remainder of the lease up to 50 years
Plant, fixtures and major alterations	10 to 15 years
Equipment and motor vehicles	4 to 7 years

No depreciation is provided on freehold land

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

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

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

REPAIRS AND RENEWALS
The cost of repairs and renewals is charged to administrative expenses in the period in which the expenditure is incurred.

OPERATING LEASE AGREEMENTS
Rentals under operating leases are charged to administrative expenses on a straight line basis.

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

Notes to the Accounts continued

1 PRINCIPAL ACCOUNTING POLICIES *continued*

PENSION COSTS
The cost of providing pensions and related benefits is charged to the profit and loss account so as to spread the costs evenly over the employees' working lives. The difference between the charge to the profit and loss account and the contributions paid to the scheme is shown as an asset or a liability in the Balance Sheet.

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

PROVISIONS FOR BAD AND DOUBTFUL DEBTS
Specific provisions are made in respect of loans and advances where recovery is considered doubtful; a general provision is made for losses which, although not specifically identified, are known to be inherent in any portfolio of lending. Where the collection of interest is in significant doubt, it is credited to a suspense account. The outstanding provisions are deducted from loans and advances, along with the interest on non-performing loans held in suspense. The charge in the profit and loss account represents the net increase in the provisions less recoveries for the year.

INCENTIVES TO BORROWERS
The costs of mortgage cashbacks, discounts and other incentives to borrowers are charged as incurred to interest receivable.

INTRA-GROUP CHARGING
Where services are provided between Group members, the charges are made on a commercial basis.

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

OFF-BALANCE SHEET INSTRUMENTS
The Group uses various financial instruments for the purposes of reducing interest and exchange rate risk. The income or expenditure effect of these financial instruments is spread over the duration of the contract and included in 'interest receivable' or 'interest payable' depending upon the balance sheet position hedged.

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

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

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

2 ADMINISTRATIVE EXPENSES

	1997 £m	1996 £m
Staff costs:		
Wages and salaries	173.1	177.1
Social security costs	15.0	14.3
Other pension costs	14.6	18.3
	202.7	209.7
Other administrative expenses	428.1	453.6
Total	630.8	663.3

The charges above exclude those incurred by Alliance & Leicester Life Assurance Company Limited, which are charged to the income from long-term assurance business.

The above costs exclude exceptional administrative expenses of conversion of £28m (1996: £26m) directly associated with the society's conversion to plc status, and supplementary depreciation in 1996 (see Note 4).

3 PROFIT ON ORDINARY ACTIVITIES BEFORE TAX

	1997 £m	1996 £m
Is stated after:		
(i) Income		
Income from listed investments	76.0	65.8
(ii) Charges		
Hire of computers and equipment	7.5	7.3
Auditors' remuneration:		
Group		
as auditors	0.4	0.3
for other services	1.9	4.2
Company		
as auditors	0.2	0.1
for other services	1.5	3.5

4 SUPPLEMENTARY DEPRECIATION

Supplementary depreciation of £27.1m, in 1996, includes provision for the permanent diminution in value of freehold land amounting to £15.8m and additional depreciation of £11.3m on other property assets.

Notes to the Accounts continued

5 STAFF NUMBERS

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

	Full time		Part time	
	1997	1996	1997	1996
Total	7,038	7,984	2,697	2,368

6 DIRECTORS' EMOLUMENTS

	1997 £m	1996 £m
Services as a Director	0.4	0.4
Other services	1.4	1.4
	1.8	1.8
Pensions to past Directors	–	1.7
Compensation for loss of office	0.3	0.4
Total	2.1	3.9

Directors' emoluments include those emoluments received by directors from the Company and its associated bodies. Pensions to past Directors, or widows thereof, comprise lump sum ex-gratia payments of £nil (1996: £1.7m) to former non-executive Directors. Compensation for loss of office includes £8,343 pension enhancement. The highest paid director is the Chief Executive. A detailed analysis of Directors' emoluments is given on page 27 in the Report by the Remuneration Committee.

7 DIRECTORS' LOANS AND TRANSACTIONS

The aggregate amount outstanding at 31 December 1997 in respect of loans in the ordinary course of business from the Company, or a subsidiary company, to directors of the Company and persons connected with the directors of the Company was £302,642 representing loans to 11 persons.

8 TAX ON PROFIT ON ORDINARY ACTIVITIES

	1997 £m	1996 £m
UK Corporation tax at 31.5% (33%)	86.4	121.1
Relief for overseas taxation	(0.5)	(0.6)
	85.9	120.5
Deferred tax	45.8	(1.6)
Overseas taxation	2.2	0.6
	133.9	119.5

The tax charge for 1997 is 33.9% of profit before tax. This is higher than the standard rate of 31.5% principally because of the tax treatment of the exceptional expenses of conversion. The underlying rate after adjusting for these items is 31.6%.

9 GROUP PROFIT DEALT WITH IN THE ACCOUNTS OF ALLIANCE & LEICESTER PLC

£221.8m (1996: £125.4m) of the Group profit attributable to ordinary shareholders has been dealt with in the accounts of Alliance & Leicester plc. As permitted by Section 230 of the Companies Act 1985, the profit and loss account of Alliance & Leicester plc has not been presented separately.

10 DIVIDENDS

	1997 pence per share	1996 Pro forma pence per share	1997 £m	1996 Pro forma £m
Interim (paid)	6.4	5.4	37.2	31.4
Final (proposed)	14.4	10.9	83.9	63.5
Total	20.8	16.3	121.1	94.9

The 1996 pro forma pence per share, and pro forma dividend represent the total dividends the directors would have expected to recommend, by applying the Company's dividend policy to the Group's underlying results for that year as disclosed in Listing Particulars prior to flotation.

11 EARNINGS PER SHARE

Earnings per ordinary share are calculated by dividing the Group profit attributable to shareholders of £260.7m by the weighted average number of ordinary shares in issue of 582 million during the year. The figures for fully diluted earnings per share are not materially different.

The underlying earnings per share is provided to disclose the trend in earnings excluding the distorting effect of non-recurring items. This is based on the same number of shares and the profit for the year after excluding exceptional administrative expenses of conversion and the related taxation and in 1996 the supplementary depreciation as follows:

	1997 £m	Pro forma 1996 £m
Profit for the financial year as reported	260.7	186.1
Adjusted for:		
Exceptional administrative expenses of conversion	28.0	26.0
Supplementary depreciation	–	27.1
Related taxation	–	(2.2)
Underlying profit for the financial year	288.7	237.0

12 TREASURY BILLS AND OTHER ELIGIBLE BILLS

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Investment securities				
Treasury bills and similar securities	13.1	–	–	–
Other eligible bills	189.7	85.2	–	–
Total	202.8	85.2	–	–
Market value of investment securities	202.7	86.0	–	–
Unamortised discounts on investment securities	1.9	0.9	–	–

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

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
At 1 January 1997	85.2	34.7	–	24.7
Additions	1,582.6	563.7	576.3	282.3
Disposals	(1,463.8)	(512.3)	(576.3)	(307.0)
Amortisation of discounts and premiums	(1.2)	(0.9)	–	–
At 31 December 1997	202.8	85.2	–	–

13 LOANS AND ADVANCES TO BANKS

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Amounts due from subsidiary undertakings	–	–	3,836.2	–
Other loans and advances	1,841.6	1,676.0	91.3	1,172.8
Total	1,841.6	1,676.0	3,927.5	1,172.8
Repayable on demand	44.2	285.1	282.7	21.9
Remaining maturity:				
3 months or less	1,410.2	1,307.6	3,190.2	1,075.4
1 year or less but over 3 months	386.1	80.7	122.0	75.5
5 years or less but over 1 year	–	–	132.6	–
Over 5 years	1.1	2.6	200.0	–
Total	1,841.6	1,676.0	3,927.5	1,172.8

Amounts due from subsidiary undertakings include £50m subordinated debt (1996: £nil).

14 LOANS AND ADVANCES TO CUSTOMERS

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Advances secured on residential properties	17,021.4	16,671.6	16,970.7	16,597.1
Other secured advances	200.8	278.9	132.2	182.0
Unsecured loans	1,604.0	1,101.7	355.7	233.7
Net investment in finance leases and hire purchase contracts	307.4	209.1	–	–
Amounts due from subsidiary undertakings	–	–	41.0	838.4
Total	19,133.6	18,261.3	17,499.6	17,851.2
Repayable on demand	102.5	162.5	107.2	899.6
Remaining maturity:				
3 months or less	472.1	293.5	312.7	192.2
1 year or less but over 3 months	436.7	348.4	55.5	53.5
5 years or less but over 1 year	1,399.0	1,041.6	371.7	341.5
Over 5 years	16,870.3	16,550.4	16,741.4	16,453.8
Less: provisions	(147.0)	(135.1)	(88.9)	(89.4)
Total	19,133.6	18,261.3	17,499.6	17,851.2

Net investment in finance leases and hire purchase contracts arise from loans and advances to customers by Soverign Finance plc, a subsidiary undertaking acquired in November 1996.

The cost of equipment acquired during the year for the purpose of finance lease and hire purchase agreements was £277.8m (1996: £23.2m).

The aggregate amounts receivable, including capital repayments, under finance and hire purchase agreements were £230.9m (1996: £27.5m).

Notes to the Accounts continued

15 PROVISIONS FOR BAD AND DOUBTFUL DEBTS

	Advances secured on residential property £m	Advances secured on land £m	Unsecured loans and Leasing £m	Total £m
GROUP				
At 1 January 1997				
General	5.9	9.5	24.0	39.4
Specific	36.0	23.0	36.7	95.7
Total	41.9	32.5	60.7	135.1
Charge for the year:				
Increase/(decrease) in provision	18.1	(2.4)	25.7	41.4
Recoveries of amounts previously written off	(4.0)	(7.0)	(1.1)	(12.1)
	14.1	(9.4)	24.6	29.3
Amounts written off in year	(8.7)	2.9	(11.6)	(17.4)
At 31 December 1997				
General	20.0	8.5	28.1	56.6
Specific	27.3	17.5	45.6	90.4
Total	47.3	26.0	73.7	147.0
COMPANY				
At 1 January 1997				
General	5.9	9.1	7.7	22.7
Specific	36.0	22.4	8.3	66.7
Total	41.9	31.5	16.0	89.4
Charges for the year:				
Increase/(decrease) in provision	18.1	(2.4)	6.4	22.1
Recoveries of amounts previously written off	(4.0)	(6.7)	–	(10.7)
	14.1	(9.1)	6.4	11.4
Amounts written off in year	(8.7)	2.8	(6.0)	(11.9)
At 31 December 1997				
General	20.0	8.3	8.8	37.1
Specific	27.3	16.9	7.6	51.8
Total	47.3	25.2	16.4	88.9

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

	Group 1997 £m	Company 1997 £m
Non-performing loans before provisions	57.7	56.5
Non-performing loans after provisions	32.0	31.2

16 DEBT SECURITIES

	Group 1997 Book value £m	Group 1997 Market value £m	Group 1996 Book value £m	Group 1996 Market value £m	Company 1997 Book value £m	Company 1997 Market value £m	Company 1996 Book value £m	Company 1996 Market value £m
INVESTMENT SECURITIES								
Issued by public bodies:								
Government securities	460.4	465.3	623.8	623.8	372.9	377.6	342.1	340.4
Other public sector securities	27.5	28.8	–	–	–	–	–	–
	487.9	494.1	623.8	623.8	372.9	377.6	342.1	340.4
Issued by other issuers:								
Bank and building society certificates of deposit	1,047.6	1,046.0	2,093.0	2,087.0	–	–	1,874.0	1,863.6
Other debt securities	771.6	771.6	479.3	479.7	–	–	459.8	460.2
	1,819.2	1,817.6	2,572.3	2,566.7	–	–	2,333.8	2,323.8
Total	2,307.1	2,311.7	3,196.1	3,190.5	372.9	377.6	2,675.9	2,664.2
Analysed by listing status:								
INVESTMENT SECURITIES								
Listed in the UK	910.2	914.6	1,018.7	1,019.1	372.9	377.6	737.0	735.7
Listed or registered elsewhere	149.3	151.1	64.9	64.9	–	–	64.9	64.9
Unlisted	1,247.6	1,246.0	2,112.5	2,106.5	–	–	1,874.0	1,863.6
	2,307.1	2,311.7	3,196.1	3,190.5	372.9	377.6	2,675.9	2,664.2

Notes to the Accounts *continued*

16 DEBT SECURITIES *continued*

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
BOOK VALUE				
Analysed by maturity:				
Due within one year	**1,260.7**	2,360.9	**116.6**	2,123.1
Due one year and over	**1,046.4**	835.2	**256.3**	552.8
Total	**2,307.1**	3,196.1	**372.9**	2,675.9
Unamortised discounts on investment securities	**12.1**	8.6	**10.4**	11.9

The movement on debt securities held for investment purposes was as follows:

	Cost £m	Discounts, premiums and indexation £m	Net book value £m
GROUP			
At 1 January 1997	3,163.5	32.6	3,196.1
Acquisitions	4,711.0	5.1	4,716.1
Disposals	(5,604.1)	4.5	(5,599.6)
Amortisation of discounts, premiums and indexation	–	(5.5)	(5.5)
At 31 December 1997	2,270.4	36.7	2,307.1
COMPANY			
At 1 January 1997	2,664.0	11.9	2,675.9
Acquisitions	1,360.2	9.9	1,370.1
Disposals	(3,661.7)	(4.1)	(3,665.8)
Amortisation of premiums	–	(7.3)	(7.3)
At 31 December 1997	362.5	10.4	372.9

17 INVESTMENT IN SUBSIDIARY UNDERTAKINGS

	Company	
	Loans £m	Shares £m
At 1 January 1997	838.4	134.9
Additions	103.3	290.5
Transfer of loans to subsidiary undertaking	(876.6)	–
Repayments	(24.1)	–
At 31 December 1997	41.0	425.4

The Company holds the following interests in subsidiary undertakings. All subsidiary undertakings are incorporated and registered in England and all operate in the United Kingdom except Alliance & Leicester International Limited, which is incorporated in, registered in and operates in the Isle of Man, and Alliance & Leicester Mortgage Insurance (Guernsey) Limited which is incorporated in, registered in and operates in Guernsey.

DIRECTLY HELD SUBSIDIARIES	NATURE OF BUSINESS
Girobank plc	Banking
Alliance & Leicester Personal Finance Limited	Unsecured lending
Alliance & Leicester Estates Limited	Property development & management
Alliance & Leicester International Limited	Offshore deposit taking
Alliance & Leicester Independent Financial Advisers Limited	Independent financial advice
The Alliance & Leicester Corporation Limited	Property management
Alliance & Leicester Mortgage Loans Limited	Mortgage acquisition & secured lending
Alliance & Leicester Syndicated Loans Limited	Syndicated lending
Alliance & Leicester Mortgage Insurance (Guernsey) Limited	Insurance
Alliance & Leicester Life Assurance Company Limited	Ordinary long term insurance cover
Alliance & Leicester Unit Trust Managers Limited	Management of personal equity plans and authorised unit trusts
Alliance & Leicester General Insurance Company Limited	General insurance
Alliance & Leicester Investments Limited	Making and holding of investments
Alliance & Leicester Group Treasury plc	Treasury management

INDIRECTLY HELD SUBSIDIARIES	NATURE OF BUSINESS
Girobank Investments Ltd	Holding index-linked securities
Sovereign Finance plc	Leasing
Sovereign Holdings plc	Leasing and finance

All subsidiary undertakings are limited by shares.

The Company holds 100% of the ordinary share capital of all its directly held subsidiary undertakings.
In the case of indirectly held subsidiary undertakings, the shareholding for Girobank Investments Ltd is held by Girobank plc.

Sovereign Finance plc is a subsidiary of Sovereign Holdings plc which is wholly owned by Girobank plc.

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

Notes to the Accounts continued

18 TANGIBLE FIXED ASSETS

	Freehold land and buildings £m	Leasehold 50 or more years unexpired £m	Leasehold Under 50 years unexpired £m	Equipment fixtures and vehicles £m	Assets in the course of construction £m	Total £m
GROUP						
COST						
At 1 January 1997	239.7	16.1	47.6	285.4	37.5	626.3
Additions	10.2	–	1.1	80.0	–	91.3
Transfer	37.0	–	(0.3)	0.8	(37.5)	–
Disposals	(3.0)	(0.7)	(0.6)	(14.1)	–	(18.4)
At 31 December 1997	283.9	15.4	47.8	352.1	–	699.2
DEPRECIATION AND AMORTISATION						
At 1 January 1997	85.7	4.5	29.4	184.9	–	304.5
Transfer	(0.1)	–	–	0.1	–	–
Charge in year	10.2	0.5	3.7	34.7	–	49.1
Disposals	(1.1)	(0.4)	(0.5)	(8.1)	–	(10.1)
At 31 December 1997	94.7	4.6	32.6	211.6	–	343.5
NET BOOK VALUE						
At 31 December 1997	**189.2**	**10.8**	**15.2**	**140.5**	**–**	**355.7**
At 31 December 1996	154.0	11.6	18.2	100.5	37.5	321.8

Freehold land and buildings includes land of £27.9m which is not depreciated. The net book value of land and buildings occupied by the Group for its own activities was £195.5m (1996: £195.8m).

The cost of assets leased to customers under operating leases and included in equipment, fixtures and vehicles above was £94.5m (1996: £52.5m). The related cumulative depreciation of £22.2m (1996: £12.6m) includes £14.1m (1996: £1.3m) charged during the year which is included within interest receivable in the Group Profit and Loss account.

The aggregate rentals receivable in respect of operating leases were £20.7m (1996: £2.2m).

18 TANGIBLE FIXED ASSETS *continued*

	Freehold land and buildings £m	Leasehold 50 or more years unexpired £m	Leasehold Under 50 years unexpired £m	Equipment fixtures and vehicles £m	Assets in the course of construction £m	Total £m
COMPANY						
COST						
At 1 January 1997	194.9	11.2	40.4	125.5	39.2	411.2
Additions	7.4	–	1.1	23.3	–	31.8
Transfer	38.7	–	–	0.5	(39.2)	–
Disposals	(3.3)	(0.7)	(0.6)	(2.3)	–	(6.9)
At 31 December 1997	237.7	10.5	40.9	147.0	–	436.1
DEPRECIATION AND AMORTISATION						
At 1 January 1997	63.0	4.0	24.8	96.7	–	188.5
Charge in year	8.4	0.5	3.3	10.7	–	22.9
Disposals	(1.2)	(0.4)	(0.5)	(1.3)	–	(3.4)
At 31 December 1997	70.2	4.1	27.6	106.1	–	208.0
NET BOOK VALUE						
At 31 December 1997	167.5	6.4	13.3	40.9	–	228.1
At 31 December 1996	131.9	7.2	15.6	28.8	39.2	222.7

Freehold land and buildings includes land of £23.6m which is not depreciated. The net book value of land and buildings occupied by the Company for its own activities was £164.5m (1996: £164.7m).

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
Future capital expenditure:				
Contracted for but not provided in the accounts	10.4	15.0	10.3	7.3
Authorised but not yet committed	29.5	16.4	23.6	7.9

19 OTHER ASSETS

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
Due within one year	60.0	67.0	181.6	143.0
Due after more than one year	–	13.0	7.1	8.9
Total	60.0	80.0	188.7	151.9
AMOUNTS INCLUDE				
Due from subsidiary undertakings	–	–	171.0	117.9

Notes to the Accounts continued

20 PREPAYMENTS AND ACCRUED INCOME

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
Accrued interest	111.9	97.6	88.4	69.2
Prepayments and other accruals	61.1	10.0	46.7	6.0
Total	173.0	107.6	135.1	75.2

21 LONG-TERM ASSURANCE BUSINESS

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

	1997 £m	1996 £m
GROUP		
Net tangible assets of life companies:		
Surplus retained within the long-term assurance funds	23.8	23.1
Net worth of life companies:		
Value of policies in force	8.8	5.1
Long-term assurance business attributable to shareholders	32.6	28.2
The long-term assurance assets attributable to policyholders are:		
Investments	116.3	92.3
Value of policies in force	8.8	5.1
Net current assets/(liabilities)	2.1	(4.1)
	127.2	93.3
Less: Long-term assurance business attributable to shareholders	32.6	28.2
Long-term assurance business attributable to policyholders	94.6	65.1

The increase in value of the Group's long-term assurance business included in the profit and loss account amounted to £6.8m before tax (1996: £0.0m) and £4.4m after tax (1996: £0.0m).

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

The key assumptions used are

Risk discount rate	11.5% net of tax
Economic assumptions	
Growth of unit-linked funds	7.9% pa gross of tax
Growth of non-linked funds	6.75% pa gross of tax
Policyholder taxation – life	23%
Shareholder taxation – life	31%
Expense inflation	5% pa

22 DEPOSITS BY BANKS

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Amounts due to subsidiary undertakings	–	–	2,275.6	71.9
Other deposits	89.1	235.2	28.1	241.9
Total	89.1	235.2	2,303.7	313.8
Repayable on demand	46.0	95.8	43.6	174.4
Remaining maturity:				
3 months or less	27.6	137.9	1,887.2	137.9
1 year or less but over 3 months	4.5	1.5	116.6	1.5
5 years or less but over 1 year	11.0	–	195.5	–
Over 5 years	–	–	60.8	–
Total	89.1	235.2	2,303.7	313.8

23 CUSTOMER ACCOUNTS

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Repayable on demand	17,075.5	16,589.6	15,915.0	15,940.0
With agreed maturity dates or periods of notice – remaining maturity:				
3 months or less but not repayable on demand	1,621.4	1,141.5	55.3	1,016.3
1 year or less but over 3 months	205.0	445.3	57.4	135.9
5 years or less but over 1 year	46.5	24.8	28.3	10.4
Over 5 years	–	–	–	–
Total	18,948.4	18,201.2	16,056.0	17,102.6
AMOUNTS INCLUDE				
Due to subsidiary undertakings	–	–	–	667.3

24 DEBT SECURITIES IN ISSUE

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Bonds and medium term notes – remaining maturity:				
1 year or less	349.8	298.8	349.8	298.8
2 years or less but over 1 year	470.3	349.2	470.3	349.2
5 years or less but over 2 years	399.1	870.0	399.1	870.0
Over 5 years	150.0	150.0	150.0	150.0
	1,369.2	1,668.0	1,369.2	1,668.0
Other debt securities in issue – remaining maturity:				
3 months or less	243.4	385.2	59.9	328.2
1 year or less but over 3 months	208.0	245.1	66.5	245.1
2 years or less but over 1 year	–	43.0	–	43.0
	451.4	673.3	126.4	616.3
Total	1,820.6	2,341.3	1,495.6	2,284.3

25 OTHER LIABILITIES

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Falling due within one year:				
Trade creditors	13.5	–	2.4	2.6
Taxation	167.7	169.1	123.3	122.6
Dividends payable	85.3	–	85.3	–
Finance leases	2.1	9.3	–	–
Other liabilities	57.2	178.0	120.1	44.5
Total	325.8	356.4	331.1	169.7
Falling due after more than one year:				
Finance leases	24.1	26.3	–	–
Total	349.9	382.7	331.1	169.7
Amounts include				
Due to subsidiary undertakings	–	–	79.2	29.8

The maturity of net obligations under finance leases is as follows:				
1 year or less	2.1	9.3	–	–
5 years or less but over 1 year	23.5	25.8	–	–
Over 5 years	0.6	0.5	–	–
Total	26.2	35.6	–	–

26 ACCRUALS AND DEFERRED INCOME

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Interest accrued on subordinated liabilities	10.7	6.1	10.7	6.1
Other accrued interest	442.9	382.4	459.7	361.1
Captive mortgage indemnity fund	31.6	14.1	–	–
Other	144.0	98.9	80.7	65.3
Total	629.2	501.5	551.1	432.5

27 PROVISIONS FOR LIABILITIES AND CHARGES

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Deferred taxation (note 28)	5.0	–	–	–
Other provisions for liabilities and charges (note 29)	13.4	13.4	13.4	13.4
Total	18.4	13.4	13.4	13.4

28 DEFERRED TAXATION

The amounts provided for deferred taxation are set out below:

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Difference between accumulated depreciation and capital allowances	10.2	1.5	1.3	0.5
Accrued interest	–	(5.8)	–	0.6
Other timing differences	(5.2)	(8.7)	(8.4)	(10.0)
Total	5.0	(13.0)	(7.1)	(8.9)
Full potential liability:				
Difference between accumulated depreciation and capital allowances	2.1	11.4	4.2	3.8
Accrued interest	–	(5.8)	–	0.6
Other timing differences	(20.7)	(37.9)	(14.2)	(10.0)
Total	(18.6)	(32.3)	(10.0)	(5.6)

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

	Group £m	Company £m
Deferred taxation (asset)/liability		
At 1 January 1997	(13.0)	(8.9)
Amount charged during year	45.8	1.8
Deferred tax asset acquired on leasing transaction	(27.8)	–
At 31 December 1997	5.0	(7.1)

29 OTHER PROVISIONS FOR LIABILITIES AND CHARGES

	Post retirement medical benefits £m	Total £m
GROUP AND COMPANY		
At 1 January 1997	13.4	13.4
Transfer from profit and loss account	0.4	0.4
Provisions utilised	(0.4)	(0.4)
At 31 December 1997	13.4	13.4

30 SUBORDINATED LIABILITIES

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
Undated loan capital	200.0	200.0	200.0	200.0
Dated loan capital	378.0	378.0	378.0	378.0
Total subordinated liabilities	578.0	578.0	578.0	578.0
Less: Unamortised issue costs	(3.1)	(3.4)	(3.1)	(3.4)
Total	574.9	574.6	574.9	574.6

Interest on floating rate debt is payable in arrears at rates ranging from 0.355% to 1.00% above sterling LIBOR. The interest rate liabilities of 9.75% on the £75 million Notes due 2008 and of 8.75% on the £200 million Notes due 2006 have each been swapped into floating rate, with rates of up to 1.36% above sterling LIBOR. The subordinated debt was raised in order to widen the capital base of the Company.

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
Maturing by 1998	53.0	53.0	53.0	53.0
Maturing by 2004	50.0	50.0	50.0	50.0
Maturing by 2006	200.0	200.0	200.0	200.0
Maturing by 2008	75.0	75.0	75.0	75.0
Undated subordinated debt	200.0	200.0	200.0	200.0
Total	578.0	578.0	578.0	578.0

The following subordinated loans each exceed 10% of total subordinated liabilities. All three issues are denominated in UK sterling.

	Terms	Group and Company £m
Undated Subordinated Variable Rate Notes	Interest rate (as at 31/12/97) of 1.0% above sterling LIBOR	200.0
Subordinated Notes due 2008	Fixed interest rate of 9.75%	75.0
Subordinated Notes due 2006	Fixed interest rate of 8.75%	200.0

Notes to the Accounts continued

31 CALLED UP SHARE CAPITAL

	As at 31 December 1997	
	Number m	Amount £m
Authorised share capital:		
Ordinary shares of 50p each	776.0	388.0
Issued and fully paid	582.0	291.0

The Company was formed and shares issued in accordance with the Building Societies Act 1986. Under these statutory provisions, the former Alliance & Leicester Building Society subscribed for 582 million ordinary shares of 50p each in the Company in consideration of a payment of £291 million. The former Society distributed these shares on conversion in April 1997. In addition a further 988 ordinary shares of 50p each were issued, for 426p per share, to employees of the Company exercising options over shares under the terms of the Alliance & Leicester ShareSave Scheme.

At 31 December 1997, options to acquire 549,436 Alliance & Leicester shares were outstanding under the Unapproved Executive Share Option Scheme, enabling senior management and directors to subscribe for shares at a price of 533p per share between 2000 and 2004. Under the Approved Executive Share Option Scheme, 630,325 options were outstanding to subscribe for shares at a price of 533p per share between 2000 and 2007. In addition, there were 6,067,055 options outstanding under the Alliance & Leicester ShareSave Schemes for employees to acquire shares at a price of 426p at the end of either a 3 or 5 year savings contract commencing in July 1997.

SUBSTANTIAL SHARE INTERESTS

In accordance with S.198 of the Companies Act 1985, the following shareholders disclosed a major interest in the share capital of the Company.

	%
Alliance & Leicester ShareSafe Limited	16.4

32 PROFIT AND LOSS ACCOUNT

	Group £m	Company £m
At 1 January 1997	1,556.3	1,428.4
Retained profit for the year	139.6	100.7
New share capital substituted	(291.0)	(291.0)
Statutory cash bonus	(17.9)	(17.9)
At 31 December 1997	1,387.0	1,220.2

The cumulative amount of goodwill resulting from acquisitions in earlier financial years, after deducting goodwill relating to disposals made prior to the balance sheet date, which has been written off to Group profit and loss account reserves is £42.2m (1996: £42.2m); Company £nil (1996: £nil).

33 ASSETS AND LIABILITIES IN FOREIGN CURRENCIES

The aggregate amounts of assets and liabilities denominated in foreign currencies were as follows:

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Assets	122.8	32.9	83.4	0.2
Liabilities	122.8	24.0	83.4	2.7

The Group's policy is to hedge all material foreign currency exposures.

34 PENSIONS

The Alliance & Leicester Pension Scheme merged with the Girobank Pension Scheme on 1 April 1997, retaining the name of the former. The trustee boards of both schemes took professional advice from their actuary and external solicitors before enacting the merger. It was confirmed that both schemes were fully funded in relation to their past service liabilities immediately prior to the merger.

The Group now operates an exempt approved pension scheme under which retirement and death benefits are provided for the majority of its employees. The scheme is of the defined benefit type, providing benefits related to a member's final salary during the period leading up to retirement or earlier death. Contributions are payable by the members at the levels required in the scheme's rules. The participating employers pay contributions sufficient to meet the balance of the cost of the benefits as assessed by an independent actuary on the basis of periodic valuations using the projected unit method. The funds of the scheme are administered by trustees independently of the finances of the participating employers.

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

The total pensions charge in the Group Accounts is £14.6m (1996: £16.6m). This consists of a regular cost of £13.2m, being the cost of benefits accrued during the year, net of the contributions payable by the members, an adjustment of £1.8m relating to the charge for the unrecognised liability in respect of past service over the average future service of scheme members (16 years) less £1.4m interest on the prepayment at the start of the year and an exceptional charge of £1.0m relating to the capital cost of augmentations of benefits on redundancies.

Contributions paid by the employers totalled £18.8m (1996: £16.7m). The excess of £4.2m of the contributions over the pension charge has increased the prepayment of £15.3m at the start of the year. An asset of £19.5m representing total net accumulated prepaid contributions is included in the Group Balance Sheet as at 31 December 1997. Pension charges and balance sheet provisions or prepayments have been based on actuarial valuations of the schemes and the unfunded arrangements carried out at 1 April 1996. The market value of the previous schemes' combined assets as at that date was £450m. The actuarial value of those assets represented 105% of the liabilities for benefits due to members and pensioners in respect of service prior to that date. The main assumptions used in the actuarial reviews were that investment returns would exceed salary increases by 2% per annum and that present and future pensions would increase at rates up to 4.75% per annum.

POST RETIREMENT BENEFITS

The Group provides post-retirement medical benefits to certain pensioners and active employees. The liability has been assessed by a qualified actuary as at 31 December 1996, using the projected unit method. The principal actuarial assumptions used in the valuation were a gross interest rate of 9% and medical benefit cost inflation of 10% for 5 years gradually reducing to 7% over a further 5 years and 7% thereafter.

There is no charge in the year for post retirement medical benefits in the Group Accounts (1996: £1.7m).

Notes to the Accounts continued

35 MEMORANDUM ITEMS

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Commitments				
Irrevocable undrawn loan facilities	199.0	34.5	–	–

36 GUARANTEES AND OTHER FINANCIAL COMMITMENTS

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

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

c) Operating lease commitments:

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
At 31 December, annual commitments under operating leases are as follows:				
Land and buildings				
Leases which expire:				
Within 1 year	0.1	0.2	0.1	0.2
1-5 years	1.3	1.6	1.1	1.3
Over 5 years	10.2	10.2	7.9	7.8
Total	11.6	12.0	9.1	9.3
Other operating leases				
Leases which expire:				
Within 1 year	–	7.0	–	7.0
1-5 years	–	2.4	1.7	2.4
Total	–	9.4	1.7	9.4

37 DERIVATIVE FINANCIAL INSTRUMENTS

TYPES OF DERIVATIVES

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

	1997 Contract amount £m	1997 Replacement cost £m	1996 Contract amount £m	1996 Replacement cost £m
GROUP				
Exchange rate contracts:				
Forward foreign exchange:				
In not more than one year	211.4	2.9	73.7	4.2
In more than one year but not more than five years	12.2	–	–	–
	223.6	2.9	73.7	4.2
With OECD financial institutions	111.3	1.5	29.5	1.4
With non-financial institutions	112.3	1.4	44.2	2.8
Total exchange rate contracts	223.6	2.9	73.7	4.2
Interest rate contracts with OECD financial institutions.				
Interest rate swaps:				
In not more than one year	1,495.7	16.5	1,514.7	0.9
In more than one year but not more than five years	2,108.6	22.0	2,115.3	26.8
In more than five years	888.4	33.9	434.5	9.1
	4,492.7	72.4	4,064.5	36.8
Caps, Collars and Floors, FRAs and Futures:				
In not more than one year	115.0	–	265.0	2.3
In more than one year but not more than five years	350.0	2.5	550.0	3.6
	465.0	2.5	815.0	5.9
Total interest rate contracts:	4,957.7	74.9	4,879.5	42.7
Total	5,181.3	77.8	4,953.2	46.9

37 DERIVATIVE FINANCIAL INSTRUMENTS *continued*

	1997 Contract amount £m	1997 Replacement cost £m	1996 Contract amount £m	1996 Replacement cost £m
COMPANY				
Exchange rate contracts with OECD financial institutions:				
Forward foreign exchange	–	–	2.5	–
Interest rate contracts with OECD financial institutions:				
Interest rate swaps:				
In not more than one year	2,573.3	10.6	1,514.7	0.9
In more than one year but not more than five years	3,665.8	23.7	2,268.9	27.6
In more than five years	695.0	30.1	434.6	9.1
	6,934.1	64.4	4,218.2	37.6
Caps, Collars and Floors, FRAs and Futures:				
In not more than one year	–	–	315.0	2.3
In more than one year but not more than five years	–	–	650.0	3.9
	–	–	965.0	6.2
Total	6,934.1	64.4	5,185.7	43.8

The following table shows significant activities which give rise to structural risk, the detailed risk involved and the type of derivative used to hedge the risk.

Activity	Risk	Type of hedge
Fixed rate lending	Sensitivity to increases in interest rates	Interest rate swaps on which the group receives floating rate interest
Fixed rate funding	Sensitivity to falls in interest rates	Interest rate swaps on which the group receives fixed rate interest
Fixed rate asset investments	Sensitivity to increases in interest rates	Interest rate swaps on which the group receives floating rate interest
Funding in foreign currencies	Sensitivity to changes in foreign exchange rates	Spot and forward foreign exchange transactions
Management of investment of reserves and other non-interest bearing liabilities	Sensitivity to falls in interest rates	Interest rate contracts on which the group receives fixed rate interest
Customer foreign exchange business	Sensitivity to changes in foreign exchange rates	Spot and forward foreign exchange transactions

38 RECONCILIATION OF OPERATING PROFIT TO NET OPERATING CASH FLOWS

For the year ended 31 December 1997	1997 £m	1996 £m
Operating profits	394.6	305.6
(Increase)/decrease in accrued income and prepayments	(65.4)	0.7
Increase/(decrease) in accruals and deferred income	125.8	(55.7)
Provision for bad and doubtful debts	29.3	19.5
Loans and advances written off net of recoveries	(17.4)	(39.8)
Depreciation and amortisation	49.1	64.1
Interest on subordinated loan added back	47.2	35.1
Provisions for liabilities and charges	-	1.3
Other non-cash movements	(1.4)	(25.2)
Net cash flow from trading activities	561.8	305.6
Net decrease in collections/transmissions	32.0	146.0
Net (increase)/decrease in loans and advances to banks and customers	(1,318.5)	80.6
Net increase in deposits by banks and customer accounts	601.1	1,027.4
Net decrease in debt securities in issue	(520.7)	(211.3)
Net decrease in other assets	7.0	42.5
Net decrease in other liabilities	(97.0)	(131.5)
Net increase in treasury bills and other eligible bills	(118.8)	(51.4)
Net cash (outflow)/inflow from operating activities	(853.1)	1,207.9

ANALYSIS OF THE BALANCES OF CASH AS SHOWN IN THE BALANCE SHEET

	At 1/1/97 £m	Cashflow £m	At 31/12/97 £m
Cash and balances at central banks	100.6	(15.9)	84.7
Loans and advances to other banks repayable on demand	285.1	(240.9)	44.2
	385.7	(256.8)	128.9

The Group is required to maintain balances with the Bank of England which at 31 December 1997 amounted to £60.1m (1996: £2.6m).

ANALYSIS OF CHANGES IN FINANCING DURING THE YEAR

	Share capital £m	Subordinated liabilities £m
Balance at 1 January 1997	-	574.6
Other movements	291.0	0.3
Balance at 31 December 1997	291.0	574.9

Shareholder Information

SHAREHOLDER ANALYSIS AS AT 31 DECEMBER 1997

	No. of Holders*	Percentage of Total Holders	No. of Shares	Percentage of Ordinary Share Capital
Shareholding Range:				
1 – 250	1,094,037	93.45	271,253,819	46.61
251 – 500	65,339	5.58	31,904,262	5.48
501 – 10,000	10,548	0.90	13,452,220	2.31
10,001 – 50,000	384	0.03	9,654,477	1.66
50,001 – 100,000	158	0.01	11,357,123	1.95
100,001 and over	332	0.03	244,379,087	41.99
	1,170,798	100.00	582,000,988	100.00

Classification of Shareholders:		
Personal Holders (**)	323.7 million	55.6%
Institutional Holders	258.3 million	44.4%

(*) Including those holders whose shares are held in the "Alliance & Leicester Sharesafe" nominee account.
(**) Includes private shareholdings, Sharesafe, shares created on flotation but for which a valid claim has yet to be received, and shares held in Private Client Accounts by institutional investors.

Financial Calendar

Annual General Meeting	5th May 1998
Final Dividend for the year to 31st December 1997 payable	18th May 1998
Interim results to be announced	7th August 1998

Dividend History

Interim dividend 1997	6.4p
Final dividend 1997	14.4p

Registrar's Address:
Lloyds Bank Registrars
The Causeway
Worthing
West Sussex BN99 6DA
Tel: 01903 702050

Alliance & Leicester Share Dealing Service:
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300 Bath Street
Glasgow G2 4JR
Tel: 0990 168 355