ALLIANCE & LEICESTER plc

Registered in England and Wales
No. 3263713

ANNUAL REPORT AND ACCOUNTS

FOR THE YEAR ENDED
31 DECEMBER 2011

ALLIANCE & LEICESTER plc
COMPANY NUMBER: 3263713

REPORT OF THE DIRECTORS

The Directors submit their report together with the financial statements for the year ended 31 December 2011

Principal activity and business review

The principal activity of the Company was the provision of an extensive range of personal financial services In addition, the Company provided a wide range of banking and financial services to business and public sector customers The Company is authorised and regulated by the UK Financial Services Authority

Following the transfer of almost all the Company's business to Santander UK plc in 2010 under a business transfer scheme pursuant to Part VII of the Financial Services and Markets Act 2000 ('FSMA'), the only business remaining in the Company was a small portfolio of corporate loans which was transferred to Santander UK plc in 2011

The Santander UK plc Group (the "Group") manages its operations on a divisional basis For this reason, the Company's Directors believe that further key performance indicators for the Company are not necessary or appropriate for an understanding of the development, performance or position of the business The performance of the divisions of Santander UK plc, which include the Company, are discussed in the Group's Annual Report which does not form part of this Report

The purpose of this Report is to provide information to the members of the Company and as such it is only addressed to those members The Report may contain certain forward-looking statements with respect to the operations, performance and financial condition of the Company By their nature, these statements involve inherent risks and uncertainties since future events, circumstances and other factors can cause results and developments to differ materially from the plans, objectives, expectations and intentions expressed in such forward-looking statements Members should consider this when relying on any forward-looking statements The forward-looking statements reflect knowledge and information available at the date of preparation of this Report and the Company undertakes no obligation to update any forward-looking statement during the year Nothing in this Report should be construed as a profit forecast

The Directors do not expect any significant change in the level of business in the foreseeable future

Principal risks and uncertainties

The Company's principal risks and uncertainties together with the processes that are in place to monitor and mitigate those risks where possible can be found in note 11

Results and dividends

The profit for the year on ordinary activities after taxation amounted to £1,000,000 (2010 £73,000,000)

The results of the Company are discussed in the Principal Activities and Business Review above The Directors do not recommend the payment of a final ordinary dividend (2010 nil) No interim ordinary dividends were paid in 2011 (2010 nil) As part of the transfer of the Company's business into Santander UK plc in May 2010 under a scheme allowed by Part VII of FSMA 2000, a transfer out of distributable reserves of £1,300m was made to the parent

Directors

The Directors who served throughout the year and to the date of this report were as follows

Ana Botín	
José María Nus	Appointed on 17 March 2011
Alison Brittain	Resigned on 22 March 2011
Stephen Pateman	Appointed on 1 June 2011
Lord Burns	Resigned on 13 March 2012
Juan Rodríguez Inciarte	Resigned on 13 March 2012
Jane Barker	Resigned on 31 December 2011
Roy Brown	Resigned on 13 March 2012
José María Carballo	Resigned on 13 March 2012
José María Fuster	Resigned on 13 March 2012
Rosemary Thorne	Resigned on 13 March 2012
Keith Woodley	Resigned on 31 December 2011

REPORT OF THE DIRECTORS (continued)

Statement of Directors' responsibilities

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

Company law requires the Directors to prepare financial statements for each financial year Under that law, the Directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union Under company law, directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period In preparing these financial statements, International Accounting Standard 1 requires that directors

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

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

Statement of Going Concern

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out above The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements In addition, notes 12 and 11 to the financial statements include the Company's objectives, policies and processes for managing its capital, its financial risk management objectives and its exposures to liquidity risk, credit risk and market risk

After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future However, in 2010 and 2011, the majority of the Company's existing activities were transferred to a parent company, Santander UK plc As required by IAS 1 'Presentation of Financial Statements', management has prepared the financial statements on the basis that the Company is no longer a going concern Preparation of the financial statements on an "other than going concern" basis has had no impact on the amounts reported

Financial instruments

The Company's risks are managed on a Group level by the ultimate UK parent company, Santander UK plc

The financial risk management objectives of and policies of the Group, the policy for hedging each major type of forecasted transaction for which hedge accounting is used, and the exposure of the Group to price risk, credit risk, liquidity risk and cash-flow risk are outlined in the Group financial statements

Further disclosures regarding financial risk management objectives and policies and the Company's exposure to principal risks can be found in note 11

Third party indemnities

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

REPORT OF THE DIRECTORS (continued)

Payment policy

Given the nature of the Company's business, the Company does not have any suppliers and therefore does not operate a payment policy The Company has no creditors and is unable to quantify the practice on payment of creditors

Auditor

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

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

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006

In accordance with Sections 485 and 487 of the Companies Act 2006, Deloitte LLP are deemed to have been re-appointed as auditor of the Company

By Order of the Board

For and on behalf of the Board
Karen M Fortunato, Secretary

18 April 2012

Registered Office
2 Triton Square
Regent's Place
London
NW1 3AN

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ALLIANCE & LEICESTER plc

We have audited the financial statements of Alliance & Leicester plc (the "Company") for the year ended 31 December 2011 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement, and the related notes 1 to 13 The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union

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

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

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the Directors, and the overall presentation of the financial statements In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

Opinion on financial statements
In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2011 and of its profit for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

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

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

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

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

Matthew Perkins

Matthew Perkins (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
18 April 2012

ALLIANCE & LEICESTER plc
COMPANY NUMBER: 3263713

FINANCIAL STATEMENTS
For the year ended 31 December 2011

Income Statement
For the year ended 31 December 2011

Discontinued operations	2011 £m	2010 £m
Interest and similar income	3	1,205
Interest expense and similar charges	(2)	(917)
Net interest income	1	288
Fee and commission income	-	102
Fee and commission expense	-	(18)
Net fee and commission income	-	84
Net trading and other expense	-	(67)
Total operating income	1	305
Administration expenses	-	(162)
Depreciation and amortisation	-	(12)
Total operating expenses excluding provisions and charges	-	(174)
Impairment losses on loans and advances	-	(41)
Total operating provisions and charges	-	(41)
Profit before tax	1	90
Taxation charge	-	(17)
Profit for the year	1	73
Attributable to		
Equity holders of the parent	1	56
Perpetual Preferred securities holders	-	17

All profits during the year were generated from discontinued operations (2010 All discontinued)

Statement of Comprehensive Income
For the year ended 31 December 2011

	2011 £m	2010 £m
Profit for the year	1	73
Other comprehensive income		
Losses on cash flow hedges taken directly to equity	-	(40)
Tax on items taken directly to equity	-	8
Net loss recognised directly in equity	-	(32)
Gains on available-for-sale securities transferred to profit or loss on sale	-	46
Tax on items transferred to profit	-	(13)
Net transfers to profit	-	33
Total other comprehensive income for the year before tax	-	6
Tax relating to components of other comprehensive income	-	(5)
Total comprehensive income for the year	1	74
Attributable to		
Equity holders of the parent	1	57
Perpetual Preferred securities holders	-	17

The accompanying notes form an integral part of the financial statements

ALLIANCE & LEICESTER plc
COMPANY NUMBER 3263713

FINANCIAL STATEMENTS
For the year ended 31 December 2011

Balance Sheet
At 31 December 2011

	Notes	2011 £m	2010 £m
Assets held for distribution to owners			
Derivative financial instruments		-	7
Loans and advances to banks		**168**	164
Loans and advances to customers		-	170
Total assets held for distribution to owners		**168**	341
Liabilities held for distribution to owners			
Deposits by banks		**1**	167
Derivative financial instruments		-	7
Current tax liabilities		-	1
Total liabilities held for distribution to owners		**1**	175
Equity			
Share capital	4	**1,228**	1,228
Share premium	4	**124**	124
Other reserves		**90**	90
Retained earnings		**(1,275)**	(1,276)
Total ordinary shareholders' equity		**167**	166
Total liabilities and equity		**168**	341

The accompanying notes form an integral part of the financial statements

The Financial Statements on pages 5 to 21 were approved and authorised for issue by the Board on 18 April 2012 and signed on its behalf by

Stephen Pateman
Director

Ana Botín
Director

Company Registered Number 3263713

ALLIANCE & LEICESTER plc
COMPANY NUMBER· 3263713

FINANCIAL STATEMENTS
For the year ended 31 December 2011

Statement of Changes in Equity
For the year ended 31 December 2011

				Other reserves				
	Share Capital £m	Share Premium £m	Other equity £m	Capital redemption reserve £m	Available for sale reserve £m	Cash flow hedging reserve £m	Retained earnings £m	Total £m
1 January 2010	928	124	591	90	(168)	138	(32)	1,671
Profit for the year	-	-	-	-	-	-	73	73
Other comprehensive income for the year	-	-	-	-	46	(40)	-	6
Tax on other comprehensive income	-	-	-	-	(13)	8	-	(5)
Issue of share capital	300	-	-	-	-	-	-	300
Dividends	-	-	-	-	-	-	(17)	(17)
Transfer to Santander UK plc	-	-	(297)	-	135	(106)	(1,300)	(1,568)
Redemption of preference shares	-	-	(294)	-	-	-	-	(294)
31 December 2010	1,228	124	-	90	-	-	(1,276)	166
1 January 2011	**1,228**	**124**	-	**90**	-	-	**(1,276)**	**166**
Profit for the year	-	-	-	-	-	-	**1**	**1**
31 December 2011	**1,228**	**124**	-	**90**	-	-	**(1,275)**	**167**

Cash Flow Statement
For the year ended 31 December 2011

Discontinued operations	2011 £m	2010 £m
Net cash flow used in operating activities	-	(14,328)
Net cash flow used in financing activities	-	(534)
Net decrease in cash and cash equivalents	-	(14,862)
Cash and cash equivalents at beginning of the year	-	14,862
Cash and cash equivalents at the end of the year	-	-

The accompanying notes form an integral part of the financial statements

1 Accounting Policies

International Financial Reporting Standards

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

Recent accounting developments

In 2011, the Company adopted the following significant new or revised standards or amendments to standards

a) IAS 24 "Related Party Disclosures"- In November 2009, the IASB issued amendments to IAS 24 which clarified the definition of a related party, introduced a partial exemption from some disclosure requirements for government-related entities and included an explicit requirement to disclose commitments involving related parties IAS 24 (2009) was adopted with effect from 1 January 2011 Retrospective application is required The adoption of IAS 24 (2009) did not affect the Group's disclosures

b) There are a number of other changes to IFRS that were effective from 1 January 2011 Those changes did not have a significant impact on the Company's financial statements

Future accounting developments

The Company has not yet adopted the following significant new or revised standards and interpretations, and amendments thereto, which have been issued but which are not yet effective for the Company

a) IAS 1 'Presentation of Financial Statements' – In June 2011, the IASB issued amendments to IAS 1 that retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements However, the amendments to IAS 1 require additional disclosures to be made in the other comprehensive income section such that items of other comprehensive income are grouped into two categories (i) items that will not be reclassified subsequently to profit or loss, and (ii) items that will be reclassified subsequently to profit or loss when specific conditions are met Income tax on items of other comprehensive income is required to be allocated on the same basis The amendments to IAS 1 are effective for annual periods beginning on or after 1 July 2012

   The Company anticipates that IAS 1 (2011) will be adopted in the Company's financial statements for the annual period beginning on 1 January 2013 and that the application of the new Standard will modify the presentation of items of other comprehensive income accordingly Retrospective application is required The Company does not anticipate that these amendments to IAS 1 will have a significant impact on the Company's disclosures

b) IFRS 7 'Financial Instruments Disclosures' – In October 2010, the IASB issued amendments to IFRS 7 that increase the disclosure requirements for transactions involving transfers of financial assets The amendments are intended to provide greater transparency around risk exposures when a financial asset is transferred but the transferor retains some level of continuing exposure in the asset The amendments also require disclosures where transfers of financial assets are not evenly distributed throughout the period The amendments to IFRS 7 are effective for annual periods beginning on or after 1 July 2011, with earlier application permitted Disclosures are not required for comparative periods before the date of initial application of the amendments

   The Company anticipates that IFRS 7 (2010) will be adopted in the Company's financial statements for the annual period beginning on 1 January 2012 The Company does not anticipate that these amendments to IFRS 7 will have a significant impact on the Group's disclosures regarding transfers of financial assets However, if the Company enters into other types of transfers of financial assets in the future, disclosures regarding those transfers may be affected

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2011

1 Accounting Policies (continued)

Future accounting developments (continued)

c) IFRS 9 'Financial Instruments' – In November 2009, the IASB issued IFRS 9 and in October 2010, issued an amendment to IFRS 9 which introduce new requirements for the classification and measurement of financial assets and financial liabilities and for derecognition In November 2011, the Board reached a tentative agreement to change the mandatory effective date of IFRS 9 to annual periods beginning on or after 1 January 2015 rather than being required to apply them for annual periods beginning on or after 1 January 2013 as is currently the case Early application would continue to be permitted

> IFRS 9 requires all recognised financial assets that are within the scope of IAS 39 'Financial Instruments Recognition and Measurement' to be subsequently measured at amortised cost or fair value Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods All other debt investments and equity investments are measured at their fair values at the end of subsequent accounting periods

> The most significant effect of IFRS 9 regarding the classification and measurement of financial liabilities relates to the accounting for changes in fair value of a financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability Specifically, under IFRS 9, for financial liabilities that are designated as at fair value through profit or loss, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit or loss was presented in profit or loss

The Company anticipates that IFRS 9 will be adopted in the Company's financial statements for the annual period beginning on 1 January 2015 The Company does not anticipate that the adoption of IFRS 9 will have a significant impact on the Company

d) There are a number of other standards which have been issued or amended that are expected to be effective in future periods However, it is not practicable to provide a reasonable estimate of their effects on the Company's financial statements until a detailed review has been completed

Going concern

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out above The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements In addition, notes 12 and 11 to the financial statements include the Company's objectives, policies and processes for managing its capital, its financial risk management objectives and its exposures to liquidity risk, credit risk and market risk

After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future Following the transfer of almost all the Company's business to Santander UK plc in 2010 under a business transfer scheme pursuant to Part VII of FSMA, the majority of the Company's existing activities were transferred to its parent company, Santander UK plc in 2010 and 2011 As required by IAS 1 'Presentation of Financial Statements', management has prepared the financial statements on the basis that the Company is no longer a going concern In accordance with Santander UK's accounting policy of accounting for internal reorganisations, the assets and liabilities of the Company's business were transferred to Santander UK at their book values in the Company Preparation of the financial statements on an "other than going concern" basis has therefore had no impact on the amounts reported

Basis of preparation

These financial statements have been prepared on an "other than going concern" basis as disclosed above This had no material impact on the amounts and classifications as reported

Following the transfer of almost all the Company's business to Santander UK plc in 2010 under a business transfer scheme pursuant to Part VII of FSMA, the only business remaining in the Company was a small portfolio of corporate loans which was transferred to Santander UK plc in 2011 The principal purpose of the transfers was to increase the efficiency of the Santander UK plc group No gain or loss was recognised on the transfers As a result of the transfers, the entire business of the Company has been classified as a discontinued operation The assets and liabilities of the Company have been classified as a disposal group held for distribution to owners, and measured at the lower of their carrying value and fair value less costs to distribute, except as follows

1. Accounting Policies (continued)

Foreign currency translation

Items included in the Financial Statements of the Company are measured using the currency that best reflects the economic substance of the underlying events and circumstances ('the functional currency') The Financial Statements are presented in pounds sterling, which is the functional currency of the Company

Foreign currency transactions are translated into the functional currency of the Company at the exchange rates prevailing at the dates of the transactions Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement

Revenue recognition

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

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

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

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

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

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

Financial assets

The Company classifies its financial assets as loans and receivables Management determines the classification of its investments at initial recognition

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

1 Accounting Policies (continued)

Valuation of financial instruments

Financial instruments that are classified at fair value through profit or loss (including those held for trading purposes) or available-for-sale, and all derivatives, are stated at fair value The fair value of such financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing, knowledgeable parties, other than in a forced or liquidation sale

Initial measurement

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

Subsequent measurement

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

Level 1 Unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access at the measurement date The Company has no Level 1 positions

Level 2 Quoted prices in markets that are not active, quoted prices for similar assets or liabilities, recent market transactions, inputs other than quoted market prices for the asset or liability that are observable either directly or indirectly for substantially the full term, and inputs to valuation techniques that are derived principally from or corroborated by observable market data through correlation or other statistical means for substantially the full term of the asset or liability Level 2 positions consisted of derivatives

Level 3 Inputs to the pricing or valuation techniques that are significant to the overall fair value measurement of the asset or liability are unobservable The Company has no Level 3 positions

The Company assess active markets for equity instruments based on the average daily trading volume both in absolute terms and relative to the market capitalisation for the instrument The Company assesses active markets for debt instruments based on both the average daily trading volume and the number of days with trading activity The Company assesses active markets for exchange traded derivatives based on the average daily trading volume both in absolute terms and relative to the market capitalisation for the instrument

Market activity and liquidity is discussed in the relevant monthly Risk Forum as well as being part of the daily update given by each business at the start of the trading day This information, together with the observation of active trading and the magnitude of the bid-offer spreads allow consideration of the liquidity of a financial instrument

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

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

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

1. Accounting Policies (continued)

Financial instruments valued using a valuation technique
In the absence of a quoted market price in an active market, management uses internal models to make its best estimate of the price that the market would set for that financial instrument In order to make these estimations, various techniques are employed, including extrapolation from observable market data and observation of similar financial instruments with similar characteristics Wherever possible, valuation parameters for each product are based on prices directly observable in active markets or that can be derived from directly observable market prices

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

Derivative financial instruments
Transactions are undertaken in derivative financial instruments ('derivatives'), which include interest rate, cross currency, other index-related swaps, forwards, caps, floors and swaptions, as well as credit default and total return swaps Derivatives are contracts or agreements whose value is derived from one or more underlying indices or asset values inherent in the contract or agreement, which require no or little initial net investment and are settled at a future date Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and option pricing models as appropriate All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative, except where netting is permitted

Impairment of financial assets

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

Income taxes, including deferred taxes

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

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

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the Company is able to control reversal of the temporary difference and it is probable that it will not reverse in the foreseeable future The Company reviews the carrying amount of deferred tax assets at each balance sheet date and reduces it to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks, and loans and advances to banks

1 Accounting Policies (continued)

Financial liabilities

Financial liabilities are initially recognised when the Company becomes contractually bound to the transfer of economic benefits in the future

(a) Financial liabilities at fair value through profit or loss

Financial liabilities are classified as fair value through profit or loss if they are either held for trading or otherwise designated at fair value through profit or loss on initial recognition A financial liability is classified as held for trading if it is a derivative or it is incurred principally for the purpose of repurchasing or being unwound in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking Derivative financial instruments are classified as fair value through profit or loss, unless in a hedge relationship

(b) Other financial liabilities

All other financial liabilities are initially recognised at fair value net of transaction costs incurred They are subsequently stated at amortised cost and the redemption value recognised in the income statement over the period of the liability using the effective interest method Deposits by banks are classified as amortised cost

Borrowings

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

Share capital

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

Dividends

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

2 Audit services

The fees for audit services payable to the Company's auditor for the audit of the Company's accounts for the current year and prior year has been paid on the Company's behalf by the ultimate UK parent company, Santander UK plc, in accordance with company policy, for which no recharge has been made The statutory audit fee for the current year is £0 1m (2010 £0 1m)

3 Contingent liabilities and commitments

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

	2011 **£m**	2010 £m
Formal standby facilities, credit lines and other commitments with original term to maturity of		
– 1 year or less	-	-
– More than 1 year	-	27
	-	27

4. Share capital

	Ordinary shares of 50 pence each £m
Issued and fully paid share capital	
At 1 January 2011	**1,228**
Shares issued	-
At 31 December 2011	**1,228**
At 1 January 2010	928
Shares issued	300
At 31 December 2010	1,228

On 28 April 2010, the Company issued 600,004,000 ordinary shares of £0 50 each to Santander UK plc at par

	Ordinary shares of 50 pence each £m
Share premium account	
At 1 January 2011	**124**
Shares issued	-
At 31 December 2011	**124**
At 1 January 2010	124
Shares issued	-
At 31 December 2010	124

5 Dividends

No dividend was paid or proposed in 2011 In 2010, dividends of £17m were declared on the £300m Step-up Callable Perpetual Preferred securities prior to the transfer of the securities to Santander UK plc with effect from 28 May 2010 under a business transfer scheme under Part VII of the Financial Services and Markets Act 2000 as described in Note [7]

6 Directors' emoluments and interests

The remuneration of the Directors of the Company is set out in the 'Directors' Remuneration' table in the Santander UK plc 2011 Annual Report and Accounts Any loans, quasi loans and credit transactions entered into or agreed by the Company with persons who are or were Directors, Other Key Management Personnel and each of their connected persons during the year are set out in the Santander UK plc Annual Report and Accounts 2011 and 2010 No directors were remunerated for their services to the Company Directors' emoluments are borne by the ultimate UK parent company Santander UK plc No emoluments were paid by the Company to the directors during the year (2010 £nil)

7. Transfer of the business of the Company to Santander UK plc

On 28 May 2010, the Company transferred almost all its business and certain associated liabilities to Santander UK plc pursuant to a court-approved business transfer scheme under Part VII of the Financial Services and Markets Act 2000 ('FSMA') (the 'Part VII Scheme') Following the transfer, the only business remaining in the Company was a small portfolio of corporate loans which was transferred to Santander UK plc in 2011 In accordance with Santander UK's accounting policy of accounting for internal reorganisations, the assets and liabilities of the Company's business were transferred to Santander UK plc at their book values in the Company

The principal purpose of the transfer was to increase the efficiency of the Santander UK plc group The transfer provided benefits for the Company's customers transferred to Santander UK plc under the Part VII Scheme and for Santander UK plc This included access to Santander UK's full product range as well as use of over 1,400 branches (including agencies), four times as many branches as were available for customers of the Company prior to the Part VII Scheme By rationalising systems and improving the sales and risk management processes through having a single view of customers' dealings, Santander UK plc also benefited from the significant synergies that were announced to the market at the time of the acquisition of the Company by Banco Santander, S A in 2008

A summary of the net assets transferred to Santander UK plc in 2010 was as follows

Net assets transferred	2010 £m
Assets	
Cash and balances at central banks	474
Derivative financial instruments	639
Financial assets designated at fair value	43
Loans and advances to banks	37,260
Loans and advances to customers	50,301
Available-for-sale securities	8
Loans and receivables securities	7,715
Macro hedge of interest rate risk	204
Investment in subsidiaries	886
Intangible assets	46
Property, plant and equipment	127
Other assets, tax assets and lease assets	1,005
Total assets	98,708

	2010 £m
Liabilities	
Deposits by banks	47,640
Deposits by customers	41,796
Derivative financial instruments	440
Trading liabilities	3
Financial liabilities designated at fair value	34
Debt securities in issue	5,351
Other borrowed funds	4
Subordinated liabilities	1,052
Other liabilities	629
Current tax liabilities	2
Deferred tax liabilities	47
Retirement benefit obligations	142
Total liabilities	97,140
Net assets	1,568

The Company's preference shares did not transfer under the Part VII scheme Therefore, holders of those preference shares were given the opportunity to exchange them for new preference shares in Santander UK plc on substantially the same terms

8 Related party disclosures

Transactions with Directors, Other Key Management Personnel and each of their connected persons
Any transactions undertaken by Directors, Other Key Management Personnel and their connected persons with the Company in the course of normal banking for 2011 and 2010 are set out in the Santander UK plc Annual Report and Accounts

Remuneration of Key Management Personnel
The remuneration of the Directors, and Other Key Management Personnel of the Company, in aggregate for each of the categories specified in IAS 24 Related Party Disclosures for 2011 and 2010 is set out in the Santander UK plc Annual Report and Accounts Further information about the aggregate remuneration of the Directors in 2011 and 2010 is provided in the 'Directors' Remuneration' table in the Santander UK plc Annual Report and Accounts

Parent undertaking and controlling party
The Company's immediate parent company is Santander UK plc, a company registered in England and Wales The Company's ultimate parent undertaking and controlling party is Banco Santander, S A , a company registered in Spain Banco Santander, S A is the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the Company is a member Santander UK plc is the parent undertaking of the smallest group of undertakings for which group accounts are drawn up and of which the Company is a member
Copies of all sets of group accounts, which include the results of the Company, are available from Secretariat, 2 Triton Square, Regent's Place, London NW1 3AN

Transactions with related parties
Transactions with related parties during the year and balances outstanding at the year end

	Interest, fees and other income received		Interest, fees and other expenses paid		Amounts owed by related parties		Amounts owed to related parties	
	2011	2010	**2011**	2010	**2011**	2010	**2011**	2010
	£m	£m	**£m**	£m	**£m**	£m	**£m**	£m
Ultimate parent company	-	(1)	-	4	-	-	-	-
Parent company	**(1)**	-	**1**	4	**168**	164	-	(172)
Fellow subsidiaries	-	(468)	-	696	-	-	**(1)**	-
	(1)	(469)	**1**	704	**168**	164	**(1)**	(172)

Following the transfer of almost all the Company's business to Santander UK plc in 2010 under a business transfer scheme pursuant to Part VII of FSMA as described in Note [7], the only business remaining in the Company was a small portfolio of corporate loans which was transferred to Santander UK plc in 2011 In accordance with Santander UK's accounting policy of accounting for internal reorganisations, the assets and liabilities of the Company were transferred to Santander UK at their book values in the Company The balances above include debt securities in issue held by related parties Transactions with fellow subsidiaries mainly relate to funding received from Santander UK plc

9 Events after the balance sheet date

On 5 January 2012, the Company's banking licence and associated FSA permissions were surrendered

10 Financial instruments

a) Measurement basis of financial assets and liabilities

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost Note [1] describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised

At 31 December 2011, all the Company's financial assets and financial liabilities were measured on an ongoing basis at amortised cost The following table analyses the Company's financial instruments at 31 December 2010 into those measured at fair value and those measured at amortised cost in the balance sheet

31 December 2010	Held at fair value	Held at amortised cost			Total
	Derivatives held for hedging	Financial assets at amortised cost	Financial liabilities at amortised cost	Non-financial assets / liabilities	
	£m	£m	£m	£m	£m
Assets					
Derivative financial instruments	7	-	-	-	7
Loans and advances to banks	-	164	-	-	164
Loans and advances to customers	-	170	-	-	170
	7	334	-	-	341
Liabilities					
Deposits by banks	-	-	167	-	167
Derivative financial instruments	7	-	-	-	7
Current tax liabilities	-	-	-	1	1
	7	-	167	1	175

b) Fair values of financial instruments carried at amortised cost

The following tables provide an analysis of the fair value of financial instruments not measured at fair value in the balance sheet

2011	**Carrying value £m**	**Fair value £m**	**Surplus/ (deficit) £m**
Assets			
Loans and advances to banks	**168**	**168**	-
Liabilities			
Deposits by banks	**1**	**1**	-

2010	Carrying Value £m	Fair value £m	Surplus/ (deficit) £m
Assets			
Loans and advances to banks	164	164	-
Loans and advances to customers	170	175	5
Liabilities			
Deposits by banks	167	162	(5)

The surplus/(deficit) in the table above represents the surplus/(deficit) of fair value compared to the carrying amount of those financial instruments for which fair values have been estimated

Valuation methodology

The fair value of financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale If a quoted market price is available for an instrument, the fair value is calculated based on the market price Where quoted market prices are not available, fair value is determined using pricing models which use a mathematical methodology based on accepted financial theories, depending on the product type and its components Further information on fair value measurement can be found in Note [1] and the Valuation techniques section below

10 Financial instruments (continued)

b) Fair values of financial instruments carried at amortised cost (continued)

Fair value management
The fair value exposures, as tabled above, are managed by using a combination of hedging derivatives and offsetting on balance sheet positions The approach to specific categories of financial instruments is described below

Assets

Loans and advances to banks
The carrying amount is deemed a reasonable approximation of the fair value, because they are short term in nature

Loans and advances to customers
Loans and advances to personal customers are made both at variable and at fixed rates As there is no active secondary market in the UK for such loans and advances, there is no reliable market value available for such a significant portfolio
a) Variable rate
The Directors believe that the carrying value of the variable rate loans may be assumed to be their fair value
b) Fixed rate
Certain of the loans secured on residential properties are at a fixed rate for a limited period, typically two to five years from their commencement At the end of this period these loans revert to the relevant variable rate The excess of fair value over carrying value of each of these loans has been estimated by reference to the market rates available at the balance sheet date for similar loans of maturity equal to the remaining fixed period

Liabilities.

Deposits by banks
The carrying amount is deemed a reasonable approximation of the fair value, because it is short-term in nature

c) Fair value valuation bases of financial instruments carried at fair value

At 31 December 2011 there were no financial assets and liabilities accounted for at fair value The following table summarises the fair values at 31 December 2010 of the financial asset and liability classes accounted for at fair value, by the valuation methodology used by the Company to determine their fair value The table also discloses the percentages that the recorded fair values of financial assets and liabilities represent of the total assets and liabilities, respectively, that are recorded at fair value in the balance sheet

At 31 December 2010

		Quoted prices in active markets		Internal models based on: Market observable data		Internal models based on: Significant unobservable data		Total		Valuation technique
Balance sheet category		£m	%	£m	%	£m	%	£m	%	
Assets										
Derivative assets	Exchange rate contracts	-	-	1	14	-	-	1	14	A
	Interest rate contracts	-	-	6	86	-	-	6	86	A & B
Total assets at fair value		-	-	7	100	-	-	7	100	
Liabilities										
Derivative liabilities	Exchange rate contracts	-	-	1	14	-	-	1	14	A
	Interest rate contracts	-	-	6	86	-	-	6	86	A & B
Total liabilities at fair value		-	-	7	100	-	-	7	100	

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2011

10 Financial instruments (continued)

d) Valuation techniques

The main valuation techniques employed in the Company's internal models to measure the fair value of the financial instruments disclosed above at 31 December 2010 are set out below The principal inputs into these models are derived from observable market data

A In the valuation of financial instruments requiring static hedging (for example interest rate and currency derivatives) and in the valuation of deposits, the 'present value' method is used Expected future cash flows are discounted using the interest rate curves of the applicable currencies The interest rate curves are generally observable market data and reference yield curves derived from quoted interest rates in appropriate time bandings, which match the timings of the cash flows and maturities of the instruments

B In the valuation of financial instruments exposed to interest rate risk that require either static or dynamic hedging (such as interest rate futures, caps and floors, and options), the present value method (futures), Black's model (caps/floors) and the Hull/White and Markov functional models (Bermudan options) are used These types of models are widely accepted in the financial services industry The significant inputs used in these models are observable market data

In determining fair value, the Company also considers the credit risk of its counterparties, as well as its own creditworthiness, on all over-the-counter (OTC) derivatives in the trading book The Company attempts to mitigate credit risk to third parties by entering into netting and collateral arrangements Net counterparty exposure (counterparty positions netted by offsetting transactions and both cash and securities collateral) is then valued for counterparty creditworthiness and this resultant value is incorporated into the fair value of the respective instruments

The credit risk adjustment is measured as a lifetime expected loss for each counterparty based on the probability of default, the loss given default and the expected exposure of the OTC derivative position with the counterparty

The probability of default is calculated at the counterparty level through the use of internal rating models The loss given default ("LGD") is calculated at the facility level and takes into account the counterparty characteristics as well as the instrument traded Credit ratings and LGD are updated by the credit team as new relevant information becomes available and at periodic reviews performed at least annually

The expected exposure is calculated on a portfolio level and is based on the underlying risks of the portfolio The main drivers of the expected exposure are the size of the risk position with the counterparty along with the prevailing market environment

The Company also considers its own creditworthiness when determining the fair value of an instrument, including OTC derivative instruments if the Company believes market participants would take that into account when transacting the respective instrument The approach to measuring the impact of the Company's credit risk on an instrument is done in the same manner as for third party credit risk The impact of the Company's credit risk is considered when calculating the fair value of an instrument, even when credit risk is not readily observable such as in OTC derivatives contracts The Company has not realised any profit or loss on revaluing fair values of derivatives to reflect its own creditworthiness If the Company had reflected such adjustments it would not have had a material impact on the valuations

The fair values of the financial instruments arising from the Company's internal models take into account, among other things, contract terms and observable market data, which include such factors as bid-offer spread, interest rates, credit risk, exchange rates, the quoted market price of raw materials and equity securities, volatility and prepayments

The estimates thus obtained could vary if other valuation methods or assumptions were used The Company believes its valuation methods are appropriate and consistent with other market participants Nevertheless, the use of different valuation methods or assumptions to determine the fair value of certain financial instruments could result in different estimates of fair value at the reporting date and the amount of gain or loss recorded for a particular instrument Most of the valuation models are not significantly subjective, because they can be tested and, if necessary, recalibrated by the internal calculation of and subsequent comparison to market prices of actively traded securities, where available

e) Internal models based on observable market data

During 2010 and 2011, there were no transfers between Level 1 and Level 2 financial instruments

f) Internal models based on information other than market data

There are no financial instruments whose fair values are estimated using internal models based on information other than market data

11. Risk management

The Company's risks are managed at a Santander UK level Risk management is carried out by the central risk management function of the Santander UK plc group Disclosures relating to the Santander UK group's risk management can be found in the Santander UK plc 2011 Annual Report and Accounts, which does not form part of these financial statements

Credit Risk

Credit risk is the risk of financial loss arising from the default of a customer or counterparty to which the Company has directly provided credit, or for which the Company has assumed a financial obligation, after realising collateral held Credit risk includes residual credit risk, which arises when credit risk measurement and mitigation techniques prove less effective than expected
In addition, concentration risk which is part of credit risk, includes large (connected) individual exposures, and significant exposures to groups of counterparts whose likelihood of default is driven by common underlying factors, e g sector, economy, geographical location or instrument type

Maximum exposure to credit risk

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

	2011 £m	2010 £m
Derivative financial instruments	-	7
Loans and advances to customers	-	170
Loans and advances to banks	168	164
Total exposure	**168**	341

Market risk

Market risk is the risk of a reduction in economic value or reported income resulting from a change in the variables of financial instruments including interest rate, equity, credit spread, property and foreign currency risks
Market risks are transferred from the originating business to Asset and Liability Management ('ALM') within Santander UK Group Infrastructure, where they can be managed in conjunction with exposures arising from the funding, liquidity or capital management activities of ALM Funds received with respect to deposits taken are lent on to Santander UK Group Infrastructure on matching terms as regards interest rate repricing and maturity Similarly, loans are funded though matching borrowings from Santander UK Group Infrastructure

Liquidity risk

Liquidity risk is the risk that the Company, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure them only at excessive cost Liquidity risks arise throughout the Company's businesses Its primary business activity is commercial banking and, as such, it engages in maturity transformation, whereby callable and short-term commercial deposits are invested in longer-term customer loans

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

The Company sources its wholesale funding from Santander UK plc

Maturities of financial liabilities

The table below analyses the maturities of the undiscounted cash flows relating to financial liabilities of the Company based on the remaining period to the contractual maturity date at the balance sheet date This table is not intended to show the liquidity of the Company

At 31 December 2011	Demand £m	Up to 3 Months £m	3-12 months £m	1-5 Years £m	Over 5 Years £m	Total £m
Deposits by banks	1	-	-	-	-	1
Total financial liabilities	**1**	**-**	**-**	**-**	**-**	**1**

At 31 December 2010	Demand £m	Up to 3 Months £m	3-12 months £m	1-5 Years £m	Over 5 Years £m	Total £m
Deposits by banks	1	17	43	106	-	167
Total financial liabilities	1	17	43	106	-	167

12 Capital Management and Resources

Capital management and capital allocation

The Santander UK plc Board is responsible for capital management strategy and policy and ensuring that capital resources are appropriately monitored and controlled within regulatory and internal limits within the Santander UK group of companies ('Santander UK') Authority for capital management flows to the Chief Executive Officer and from her to specific individuals who are members of Santander UK's Asset and Liability Management Committee ('ALCO')

ALCO adopts a centralised capital management approach that is driven by Santander UK's corporate purpose and strategy This approach takes into account the regulatory and commercial environment in which Santander UK operates, Santander UK's risk appetite, the management strategy for each of Santander UK's material risks (including whether or not capital provides an appropriate risk mitigant) and the impact of appropriate adverse scenarios and stresses on Santander UK's capital requirements This approach is reviewed annually as part of Santander's UK's Internal Capital Adequacy Assessment Process ('ICAAP')

Santander UK manages its capital requirements, debt funding and liquidity on the basis of policies and plans reviewed regularly at ALCO Capital requirements are also reviewed as part of the ICAAP process while debt funding and liquidity are also reviewed as part of the Internal Liquidity Adequacy Assessment ('ILAA') Process To support its capital and senior debt issuance programmes, Santander UK is rated on a stand-alone basis

On an ongoing basis, and in accordance with the latest ICAAP review, Santander UK forecasts its regulatory and internal capital requirements based on the approved capital volumes allocated to business units as part of the corporate planning process and the need to have access to a capital buffer Capital allocation decisions are made as part of planning based on the relative returns on capital using both economic and regulatory capital measures Capital allocations are reviewed in response to changes in risk appetite and risk management strategy, changes to the commercial environment, changes in key economic indicators or when additional capital requests are received

This combination of regulatory and economic capital ratios and limits, internal buffers and restrictions, together with the relevant costs of differing capital instruments and a consideration of the various other capital management techniques are used to shape the most cost-effective structure to fulfil Santander UK's capital needs

Capital adequacy

The Company manages its capital on a Basel II basis Throughout 2011, the Company held capital over and above its regulatory requirements, and managed internal capital allocations and targets in accordance with its capital and risk management policies On 5 January 2012, the Company's banking licence and associated FSA permissions were surrendered

Capital

	2011 £m	2010 £m
Core Tier 1 capital	**168**	166
Deductions from Core Tier 1 capital	**-**	(3)
Total Core Tier 1 capital after deductions	**168**	163
Other Tier 1 capital	**-**	-
Total Tier 1 capital after deductions	**168**	163
Tier 2 capital	**-**	-
Deductions from Tier 2 capital	**-**	-
Total Tier 2 capital after deductions	**-**	-
Total capital resources	**168**	163

The Company's Tier 1 capital consists of shareholders' equity and audited profits for the years ended 31 December 2011 and 2010 after adjustment to comply with UK Financial Services Authority rules Tier 1 deductions related to intangible assets recognised during the year and expected losses in excess of loan loss allowances for portfolios on the IRB approach for measuring credit risk

13 Parent undertaking and controlling party

The Company's immediate parent company is Santander UK plc, a company registered in England and Wales

The Company's ultimate parent undertaking and controlling party is Banco Santander, S A , a company registered in Spain Banco Santander, S A is the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the Company is a member Santander UK plc is the parent undertaking of the smallest group of undertakings for which the group accounts are drawn up and of which the Company is a member

Copies of all sets of group accounts, which include the results of the Company, are available from Secretariat, Santander UK plc, 2 Triton Square, Regent's Place, London, NW1 3AN