Alliance & Leicester plc

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 from a low cost platform. This involves retaining and growing mutually beneficial relationships through the development of [illegible] speedy delivery through a wide range of [illegible] excellent and flexible service; a strong [illegible] anticipating and responding to changing customer [illegible]

CONTENTS

BUSINESS SECTORS

Mortgage Lending & Investments

This business sector is responsible for the Group's mortgage lending and retail savings operations together with related business such as general insurance, life assurance and unit [illegible]

Personal Banking

Responsible for the Group's personal current accounts, [illegible] activities. [illegible] improvements, the purchase of cars, the [illegible]

Commercial Banking

Provides a range of services principally to retailers, public sector authorities and utilities, including cash and cheque handling, bill payments, asset finance, merchant acquisition and commercial lending.

Treasury & Group

This sector comprises the Group's treasury subsidiary, investment income generated by [illegible] capital and corporate [illegible]

HIGHLIGHTS [illegible]

[illegible]

The year in brief

Underlying operating profit up 10%

Group underlying operating profit, excluding costs associated with EMU, Year 2000, and conversion, increased from £425m to £469m

Pre-tax profit up 15%

Pre-tax profit up 15% to £455m (1997: £395m, after charging exceptional costs of conversion of £28m)

Earnings per share of 54.6p, up 10%

Underlying earnings per share (EPS) excluding conversion costs of 54.6p (1997: 49.6p), basic EPS of 54.6p (1997: 44.8p)

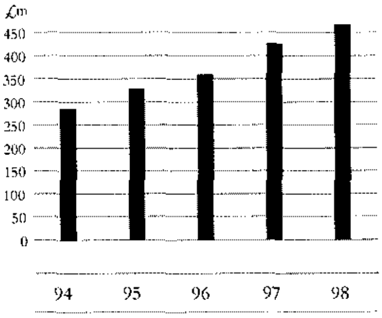
Underlying Group cost:income ratio down to 57.2%

Underlying Group cost:income ratio, excluding costs associated with EMU, Year 2000 and conversion costs, down from 59.4% to 57.2%

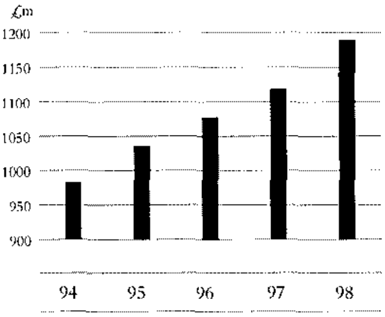
Total dividend of 24.5p per share, up 18%

Proposed final dividend of 16.5p per share giving total dividend of 24.5p per share for 1998 (1997: total dividend of 20.8p per share)

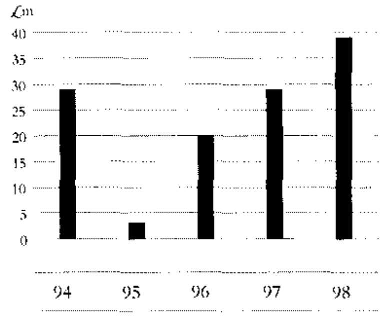
Underlying operating profit



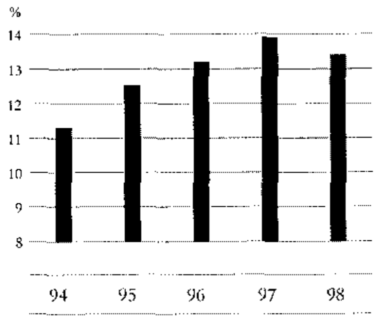
Operating income



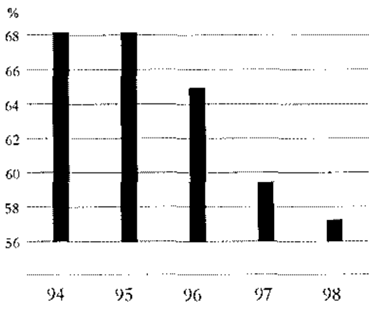
Charge for losses



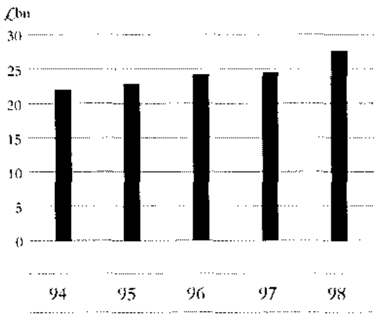
Tier 1 capital ratio



Underlying cost:income ratio



Total assets



Chairman's statement

John R. Windeler
Chairman

This is my first public statement as Chairman of Alliance & Leicester plc, and it gives me the welcome opportunity to pay tribute to my predecessor, Simon Everard. Simon stepped down as Chairman after his 70th birthday at the end of last year, and will not be standing for re-election at this year's Annual General Meeting.

His connection with Alliance & Leicester has been a long and distinguished one, and we are fortunate to have had his unstinting service for so many years. Simon Everard is a well known and successful businessman. A director, and former Chairman of international chemical company Ellis & Everard plc, he joined the Board of the Leicester Temperance Building Society in 1967. He was appointed Chairman of Alliance & Leicester Building Society in 1994. His business experience and wise counsel were of immense importance during the complex process which preceded the conversion, and successful flotation of Alliance & Leicester plc in April 1997. I had the pleasure and privilege of serving as a director of Alliance & Leicester under Simon Everard's chairmanship. During my time as Deputy Chairman, I learned a great deal from his example about the proper management of debate, and the importance of true consensus. It is due in no small measure to his unfussy style of leadership, coupled with a sharp sense of humour, that the Board of Alliance & Leicester has maintained its enviable unanimity of purpose. With the continued support of an enthusiastic and experienced Board of directors, I am confident that we can build on the solid platform so carefully fostered by Simon Everard.

I would also like to extend my thanks to John Baden for his many dedicated years as Deputy Chairman and to Michael Allen for his contribution as director. Both retired during 1998.

In his Chairman's statement for the Report and Accounts last year, Simon Everard said that he was pleased to report on a fifth year of record profits. As the new Chairman, I am delighted to begin my own statement by reporting that your Company has made record profits in 1998, for the sixth successive year.

Your Board recognises, that for our shareholders, the dividend paid on their shares is an important indicator of the emphasis we place on shareholder value. The double-digit growth in those dividends for 1998 demonstrates our determination to deliver maximum shareholder value.

In his own review of our 1998 results, Group Chief Executive Peter White refers to the intensely competitive nature of the retail financial services market in the UK. Our financial results show that

Alliance & Leicester continues to grow and prosper in this testing economic environment.

The Government is determined to maintain a low inflation, and low interest rate economy – conditions which are welcomed by our borrowers, but not perhaps by the many thousands of savers who rely on their investments to supplement other income. The prospect of continued low inflation has, to some extent, depressed the housing market. Sustained low interest rates on the other hand, have made mortgage payments more affordable. In those circumstances, re-mortgaging has increased considerably, causing some lenders to lose market share.

I am encouraged by the fact that Alliance & Leicester has increased its share of net mortgage lending in 1998. We are determined to retain our franchise in this traditional market; although the diversity of our Group means that we are less vulnerable to the vagaries of the housing market than many of our competitors.

All of our business units produced excellent results in 1998. I have no doubt that these results reflect the drive and determination of Peter White and his executive team. Their determination to drive down our operating costs, and deliver consistent value and efficient service to our customers, provides the basis for your Company's continued success.

In my view, another important factor which has helped Alliance & Leicester to grow and prosper, is the consistent implementation of our business strategy. All our business units are considerably assisted by the fact that our strategy has been rigorously developed, and is straightforwardly expressed. Alliance & Leicester intends to continue its profitable growth, by developing its existing businesses, and through merger or acquisition – provided that there is a strong business case, and that any merger or acquisition we do make fits our long-term business objectives, and enhances shareholder value.

Competition is good for customers, and for those companies that have the ability and the resources to meet, and beat that competition. I believe that Alliance & Leicester is one of those companies.

During their recent accreditation visit to Alliance & Leicester Personal Finance, Investors in People commented on the fact that staff at all levels understand the Group's strategy, and are fully aware of the part they play in its delivery. It is gratifying to receive such independent endorsement, and I would like to take this opportunity to thank all of our staff for their continued effort and commitment.

As we start on a new year we know that we face even more intense competition, not only from the established banks, but from a variety of newcomers to the financial services market. Competition is good for customers, and for those companies that have the ability and the resources to meet, and beat that competition. I believe that Alliance & Leicester is one of those companies, and that we will continue to grow and prosper during 1999, and the years ahead.

JOHN R WINDELER
Chairman

Group Chief Executive's review

Peter White
Group Chief Executive

Alliance & Leicester's pre-tax profit in 1998 was £455m, a record for the sixth year in a row and up by 15% on the £395m achieved in 1997.

Excluding the costs of Year 2000 and EMU, and the costs of conversion in 1997, profit was £469m, 10% higher than the equivalent figure in 1997. Underlying earnings per share grew by 10%, from 49.6p to 54.6p, and the full year dividend will be 24.5p, up by 18% on 1997.

BUSINESS ENVIRONMENT IN 1998

There were conflicting signals on the health of the economy throughout 1998, however the UK financial services markets remained reasonably robust.

Average house prices increased moderately during the year, although in some areas of the country they remained static. Gross mortgage lending increased, much of it due to remortgaging business, and the consumer credit markets were strong.

There remains intense competition within the financial services industry, with a number of well-publicised new entrants into the sector.

STRATEGY

Against this background, Alliance & Leicester continued with its successful and focused strategy, aimed at further enhancing long-term shareholder value.

Alliance & Leicester has a number of strengths to enable it to meet its goal of increasing long-term shareholder value:

- The growth potential from each of our chosen business sectors.
- The diversity of our income streams.
- The scope to improve cost efficiency.
- The Group's financial strength.

BUSINESS GROWTH

Our strategy is to continue to grow each business, as long as the pricing in each market allows for a satisfactory return on capital, and asset quality remains acceptable. During 1998 our business volumes grew in key markets including mortgages, unsecured personal lending, credit cards, corporate cash handling and asset finance.

We have the potential to cross-sell more Alliance & Leicester products to our existing personal customer base of over 5.5m customers.

We now have a broad range of competitive products, improved sales management and sales incentives and improved use of customer data. A new sales system has been launched in all branches during 1998, which I discuss in more detail below. We now track the average number of Alliance & Leicester product types held by our personal customers, and this figure increased by 3% during 1998, despite an overall increase in the number of customers.

DIVERSITY OF INCOME STREAMS

Our three main business units increased their profits in 1998. Indeed, some 41% of Group profits is now being generated from outside the 'traditional' Mortgage Lending

& Investments area. We have well-established businesses, with proven strengths, in each of our chosen areas of diversification. We have a market-leading cash handling business in Girobank, a growing asset financing operation in Sovereign Finance, and a significant and growing Personal Banking business.

COST EFFICIENCY

Successful UK financial service companies will be those that can deliver products and services from a low cost base. This belief is central to Alliance & Leicester's strategy.

The tight control of costs, and continued improvement in our efficiency, remain significant objectives for 1999 and beyond. The Group's cost:income ratio has improved from 68.1% in 1995 to 58.5% in 1998 and the ratio for Mortgage Lending & Investments from 54.9% in 1995 to 43.4% in 1998. Indeed, as explained in the Financial Review, our performance relative to some of our competitors would have been even better on a 'like-for-like' accounting basis.

While good progress has been achieved, we are confident that there is more to come. Various projects, such as the rationalisation of mortgage application processing, and the streamlining of our branch mortgage sales system, will further improve the service we give to our customers, and deliver cost efficiencies. In addition, significant steps have been taken to achieve overhead cost savings, for example through the introduction of a new integrated general ledger system.

FINANCIAL STRENGTH

The Group will continue to use its financial strength to increase long-term shareholder value. A relatively straightforward and strong balance sheet (with the vast majority of assets being secured residential mortgages) is complemented by an absence of any exposure to those overseas markets which have experienced financial turbulence, or to Hedge Funds. In addition we do not adopt certain accounting policies which could increase our profit figures. For example we write off the cost of mortgage incentives as they occur.

All new projects and product pricing are required to generate a return higher than the appropriate cost of capital.

We will continue to use our capital to grow shareholder value, through organic growth and, when suitable opportunities arise, through value-adding acquisitions.

The Group's Tier 1 capital ratio was 13.5% when we converted to plc status in April 1997. Organic growth has meant that, despite new capital being generated from the business since then, the Tier 1 ratio at the end of 1998 had reduced to 13.4%. We have set a target Tier 1 ratio of 8% in 2001.

A number of factors have changed over the past few months. The world financial outlook appears to have stabilised. The outlook for the UK economy is arguably better than it looked a few months ago. The Euro has been successfully launched. UK interest rates are significantly lower and look likely to stay low – which will increase the opportunity cost of carrying excess capital. We are also 6 months into the 3 year period we have given ourselves to reach our target Tier 1 ratio.

All of these factors have featured in our continuing assessment of our capital position. In the light of these factors, our current intention is to begin to buy-back our shares in 1999. The amount and timing of these purchases will depend on market conditions, and the matter will be approached flexibly in the light of circumstances.

In any case, we will not start to buy back shares until after the abolition of Advance Corporation Tax in April, and we will only buy back at prices which would increase earnings per share.

ALLIANCE & LEICESTER STAFF AND MANAGEMENT

We have made considerable efforts to ensure that as many as possible of our staff have a meaningful stake in the Group's continuing success, through a variety of share ownership schemes.

Almost all employees received at least 250 free shares on flotation. By the end of 1998, more than 6,800 had retained those shares in the trust account set up for the purpose. Staff can also make regular monthly savings in the ShareSave scheme, which grants options to buy Alliance & Leicester shares at a discounted rate, and executive directors and the 125 most senior managers have received executive share options.

The necessary, continuing process of change within the Group has required a lot of effort from dedicated staff, and has also entailed some tough decisions by management. I am confident that the quest for improved performance will continue to develop profitable long-term relationships with our customers, and increase shareholder value.

Looking now at each of our business units in turn:

MORTGAGE LENDING & INVESTMENTS

Mortgage Lending & Investments (MLI) consists of residential mortgages and retail savings, together with our life assurance, general insurance and unit trust businesses. MLI's underlying profits in 1998 were £267m, up 8% on the £248m achieved in 1997.

Whilst Alliance & Leicester is more diversified than most of the so-called 'mortgage banks', we view it as important to maintain our strong mortgage market franchise. We have an internal target to achieve a market share of new lending at least as great as our share of outstanding mortgages, so long as pricing and asset quality are acceptable. We will not slavishly follow this target if, for any reason, it were no longer to deliver appropriate shareholder value.

Our gross mortgage lending in 1998 was £3.8bn, up by 46% on the £2.6bn lent in 1997. Our net mortgage lending was £1.2bn, a market share of 4.6% – higher than our 4% share of the UK mortgage stock. We have achieved this through improved marketing, innovative products, a restructured sales force and more effective sales targeting.

We introduced a popular 'capped rate' mortgage product in January 1998. We also launched a flexible mortgage during 1998, allowing flexible payments and payment holidays.

The number of units processing mortgage applications declined from 28 to 15 during 1998. We have significantly improved the time taken to grant further advances to existing mortgage customers.

The retail savings market has been intensely competitive during 1998. New entrants to the market have attracted quite significant savings inflows by offering very competitive – and often uneconomic – interest rates. What remains to be seen is how long these new suppliers will be prepared to subsidise their nascent banking businesses by offering 'loss-leader' interest rates.

There have been a few indications that market participants will revert to more rational pricing in future. For example, interest rate tiers have now been introduced for a number of the high profile supermarket accounts, rather than a single rate applying to all amounts.

We have used our diversification to fund mortgage growth through a variety of sources, without relying on currently expensive new retail savings. These sources included increased wholesale funding, and increased corporate customer balances.

During 1998 64% of our gross mortgage lending was fixed or capped rate products which are structured, and mainly funded, using the wholesale markets.

Alliance & Leicester attaches great importance to efficient monitoring and control of arrears in mortgage lending and across the Group's whole portfolio. The use of technology ensures that arrears are identified, monitored and managed accordingly. The current levels of mortgage arrears indicate no significant asset quality problems.

The Group's insurance and unit trust businesses continued to grow during 1998. Our general insurance business provides household insurance, mortgage payment cover and travel insurance. Our life assurance subsidiary provides life cover, critical illness insurance and investment bonds. The Group has no significant exposure to pensions mis-selling.

Funds under management within Alliance & Leicester Unit Trust Managers more than doubled in 1998 and now stand at around £270m.

PERSONAL BANKING

The Personal Banking business unit includes the Group's personal unsecured lending operation, as well as the credit card and current account businesses. Personal Banking's underlying profits in 1998 were £94m, up by 21% on the £78m achieved in 1997.

Alliance & Leicester Personal Finance (ALPF), our unsecured personal lending business, saw its tenth successive year of record sales volumes and profits. The business is a low cost telephone and postal-based operation, with applications processed on-line using proven credit scorecards. ALPF's strategy is to offer very competitive prices and excellent service levels, with some 90% of applications handled within 24 hours.

Lending decisions are based on objective criteria and central underwriting. No discretion is given, for example, to local branch managers, nor to other third-parties who may have a vested interest in completing a sale of their own product rather than in ensuring loan quality. It has been our consistent policy to use credit scoring and other techniques to ensure proper business quality, and if necessary to accept lower rates of volume growth rather than sacrifice credit quality.

ALPF's new lending in 1998 was £1.2bn, an increase of 30% on 1997. This growth was achieved without lowering our rigorous standards when accepting business. The rate of growth in the second half of 1998 was lower than that in the first half, reflecting a reduction in the quality of loan applications, which is to be expected at this stage of the economic cycle.

ALPF's arrears and loss experience remains substantially better than the industry average. This is, I believe, the clearest evidence of our ability to run a successful and profitable unsecured loans business, as we have demonstrated for the last ten years.

Group Chief Executive's review continued

Alliance & Leicester launched its innovative 'money back' credit card in March 1997. This had gained around 500,000 customers by the end of 1998. In total, Alliance & Leicester has over 900,000 credit card customers, with 10 major retailers now offering increased 'money back' to Alliance & Leicester credit card holders.

The Group's award-winning personal current accounts continue to offer an excellent service to customers. During 1998 we introduced interactive voice response service for all of our current account customers, which was well received by customers and enables the most common enquiries to be dealt with more quickly and efficiently.

THE DISTRIBUTION OF PERSONAL FINANCIAL SERVICES

The past few years have seen significant changes in the distribution of personal financial products. Successful providers will be those offering a mix of channels that can respond effectively to customers' rapidly changing requirements.

We have increased the size of our ATM network to 597, including machines sited with major retailers. The number of branches in the network reduced by 3 to 316 and our rolling programme aimed at upgrading key branches to a more modern format is providing a more effective environment for selling. Our distribution capability is further enhanced through the national network of over 19,000 post offices available to Alliance & Leicester Giro customers.

During 1998 a new sales system, the Alliance & Leicester Integrated Sales System (ALISS), was introduced into all our branches. This will make an important contribution to Alliance & Leicester's drive for improved cross-selling. ALISS enables branch staff to see the complete range of Alliance & Leicester products that customers hold. The system analyses our customer base to suggest sales opportunities to branch staff. It also includes a sales management system, so that sales leads can be monitored and progress checked.

The Group's relationship with mortgage intermediaries continues to improve with surveys showing intermediaries' satisfaction with Alliance & Leicester continuing to rise.

Customers can now buy a very wide range of products from Alliance & Leicester by telephone, including current accounts, credit cards, general insurance, savings and personal loans. In addition, early in 1999 we launched a Mortgage Direct service, enabling mortgage applications to be made by post and telephone.

The use of the Internet for personal financial services is likely to grow rapidly over the coming years. Alliance & Leicester's internet site has been expanded to include a number of innovative features. We are also piloting a PC-based Home Banking service for 2,000 customers. This pilot has gone well and plans are for the expansion of the service to a full internet banking operation during 1999.

COMMERCIAL BANKING

The Commercial Banking business unit contains Girobank and its asset finance subsidiary, Sovereign Finance. Operating profit from this unit rose to £70m, up by 21% from £58m in 1997.

Girobank remains a market-leader for cash handling services, and business volumes were higher than in 1997 for each of cash handling (£77.3bn), cash sales (£9.0bn), bill payments (209m transactions) and merchant acquiring.

In August 1998, the Group and Post Office Counters Limited (POCL) signed revised contracts covering the relationship between the two companies. The new contracts follow the framework set out in the Heads of Agreement which were signed in August 1997. There are separate agreements for three main areas of business, recognising the different pace of change within each of these markets.

Girobank's cash handling business is covered by a contract for eight years, followed by a rolling two year notice period. The agreement on bill payments business is for five years, again followed by a rolling two year notice period. The agreement covering Alliance & Leicester Giro personal banking products is for three years, followed by a rolling two year notice period.

These agreements provide a sound basis for continued growth for Girobank and POCL.

During 1998 Sovereign Finance grew significantly. The majority of Sovereign's big ticket leases are fully bank guaranteed, reflecting our cautious approach to expansion in this area. Sovereign's management have a wealth of experience in asset finance and adopt a risk averse approach to new business. As a result, despite growth in volumes there are no signs of increasing levels of arrears.

TREASURY & GROUP

Treasury & Group contains the profit-stream from Alliance & Leicester Group Treasury plc (ALGT), as well as income generated by the Group's capital which is not allocated to any of the other three business units. Treasury & Group also contains those central Group costs that cannot be allocated to the other business units.

1998 witnessed considerable volatility in the world's equity and money markets, and a decisive shift in sentiment towards the future trend in sterling interest rates. ALGT made encouraging progress, recording a pre-tax profit of £18m (1997: £14m). We expect to see an expansion of our treasury activities over the next few years, building on a culture which will continue to be primarily risk averse. In January 1999 we recruited David Bennett from the Lloyds TSB Group to become our new Group Treasurer and he will lead the development of this area.

OUTLOOK FOR 1999

With the introduction of the Euro, the likelihood of lower interest rates and a possible economic slowdown, competition for financial services will remain intense in 1999.

Competitive pressure on margins, particularly in the mortgage market, will continue, and the diversity of Alliance & Leicester's income streams helps here. There is little prospect in the United Kingdom of the severe personal sector asset quality problems of the early 1990s.

Whatever the background for 1999 and beyond, certain basic factors will apply. Organisations that survive and thrive will be those that are focused, providing products from a low cost base through a ruthless attention to costs, and taking opportunities to grow income. Above all, they will be those organisations that give priority to long-term shareholder value when shaping their business decisions. Through a strict adherence to these criteria, I am confident that Alliance & Leicester will enjoy a successful future.

PETER WHITE
Group Chief Executive

Financial review

OVERVIEW OF RESULTS

Group pre-tax profit increased by 15% to £455m (1997: £395m). Excluding the exceptional costs of conversion in 1997, the Group underlying operating profit increased by 8% to £455m (1997: £423m) and 10% if additionally the costs of EMU and Year 2000 were excluded. The underlying Group cost:income ratio fell to 58.5% (1997: 59.6%), and if the incremental costs of Year 2000 and EMU were excluded, it would have fallen to 57.2% (1997: 59.4%).

Underlying earnings per share increased by 10% to 54.6p, compared with an underlying earnings per share figure, excluding exceptional costs, of 49.6p for 1997. A final dividend of 16.5p per share is proposed, payable in May 1999, which, together with the interim dividend of 8p per share already paid, gives a total dividend of 24.5p per share for 1998, compared to a total dividend for 1997 of 20.8p. Underlying earnings represent a dividend cover of 2.23 (1997: 2.38).

BUSINESS SECTOR PROFITABILITY

The contribution to profit by each business sector, compared to 1997 was as follows:

	Six months ended 30.06.98 £m	Six months ended 31.12.98 £m	**Year ended 31.12.98 £m**	Year ended 31.12.97 £m
Mortgage Lending & Investments	136	131	**267**	248
Personal Banking	49	45	**94**	78
Commercial Banking	31	39	**70**	58
Treasury & Group	20	18	**38**	41
Year 2000 and EMU costs	(6)	(8)	**(14)**	(2)
Underlying operating profit	230	225	**455**	423
Exceptional costs	–	–	**–**	(28)
Profit before tax	230	225	**455**	395

Group underlying operating profit for 1998 has increased by 8% to £455m. Excluding incremental costs of £14m associated with Year 2000 and EMU, the increase would be 10%.

In the Mortgage Lending & Investments sector, profitability grew in total by £19m over 1997 primarily due to an improvement in non-interest income arising from mortgage-related fee income. Second half profits were £5m lower than first half reflecting an increase in redundancy costs of £3m and a reduction of £3m in commercial loan loss recoveries.

Personal Banking profits increased by £16m over 1997 reflecting strong business growth. The value of unsecured loans advanced in 1998 was £1,189m, up 30% on 1997 lending, but the rate of growth was slowed in the second half to a rate up 19% on 1997. This lower rate of growth resulted in reduced commission income in the second half compared to the first half and also the level of loss provisions were increased in the second half.

In the Commercial Banking sector, profitability grew by £12m over 1997, reflecting an improvement in net interest income and a reduction in administrative expenses. Second half profits were £8m higher than first half profits reflecting an increase in both net interest and other income and a reduction in administrative expenses.

In Treasury & Group profitability fell by £3m in 1998 mainly due to increased redundancy costs which were £5m higher than in 1997.

Overall, 41% of underlying operating profit came from activities outside the Mortgage Lending & Investments business sector (1997: 41%).

COMPONENTS OF PROFIT

Comparing the 1998 and 1997 profit and loss account shows:

	Six months ended 30.06.98 £m	Six months ended 31.12.98 £m	**Year ended 31.12.98 £m**	Year ended 31.12.97 £m
Net interest income	363	377	**740**	693
Non-interest income	223	226	**449**	425
Total income	586	603	**1,189**	1,118
Administrative expenses	(342)	(353)	**(695)**	(666)
Exceptional costs	–	–	**–**	(28)
Total administrative expenses	(342)	(353)	**(695)**	(694)
Bad debt provisions	(14)	(25)	**(39)**	(29)
Profit before tax	230	225	**455**	395
Taxation	(71)	(66)	**(137)**	(134)
Profit after tax	159	159	**318**	261
Underlying earnings per share	27.3p	27.3p	**54.6p**	49.6p

Total income for 1998 of £1,189m was £71m or 6% higher than 1997, and reflected an increase in both net interest income of £47m and non-interest income of £24m. The growth in income more than offsets the increase in administrative expenses and bad debt provisions to give an overall increase in pre-tax profit of £60m to £455m.

The following tables provide a breakdown of the profit and loss account by business sector. Costs associated with Year 2000 and EMU have been included within the Treasury & Group sector in order to avoid distorting the results of the main business units.

Year ended 31 December 1998

	Mortgage Lending & Investments £m	Personal Banking £m	Commercial Banking £m	Treasury & Group £m	Total Group £m
Net interest income	375	227	74	64	**740**
Non-interest income	104	91	254	–	**449**
Total income	479	318	328	64	**1,189**
Administrative expenses	(208)	(190)	(257)	(40)	**(695)**
Bad debt provisions	(4)	(34)	(1)	–	**(39)**
Underlying profit	267	94	70	24	**455**
Exceptional costs					**–**
Profit before tax					**455**

Year ended 31 December 1997

	Mortgage Lending & Investments £m	Personal Banking £m	Commercial Banking £m	Treasury & Group £m	Total Group £m
Net interest income	380	192	62	59	693
Non-interest income	84	81	260	–	425
Total income	464	273	322	59	1,118
Administrative expenses	(211)	(172)	(263)	(20)	(666)
Bad debt provisions	(5)	(23)	(1)	–	(29)
Underlying profit	248	78	58	39	423
Exceptional costs					(28)
Profit before tax					395

Capital has been allocated to business units, at the start of the year, with 8% equity and 3% subordinated debt based on an estimate of year end risk weighted assets.

The comparative business sector results for December 1997 have been restated to reflect this policy of capital allocation.

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 7.29% for the first half of 1998 and 7.18% for the second half of 1998 to give a full year average of 7.23% for 1998, compared to 6.56% for 1997. Against a background of higher rates, the following table provides a detailed analysis of the interest margin achieved on interest-earning assets.

	Six months ended 30.06.98 £m	Six months ended 31.12.98 £m	**Year ended 31.12.98 £m**	Year ended 31.12.97 £m
Net interest income	363	377	**740**	693
Average balances:				
Interest-earning assets (IEA)	24,624	25,796	**25,216**	23,097
Financed by:				
Interest-bearing liabilities	20,864	21,820	**21,346**	19,659
Interest-free liabilities	3,760	3,976	**3,870**	3,438
Average rates:	%	%	**%**	%
Gross yield on average IEA	8.20	8.20	**8.20**	7.41
Cost of interest-bearing liabilities	6.17	6.27	**6.22**	5.18
Interest spread	2.03	1.93	**1.98**	2.23
Contribution of interest-free liabilities	0.94	0.97	**0.95**	0.77
Net interest margin on average IEA	2.97	2.90	**2.93**	3.00

Group net interest was £47m above 1997. Average interest-earning assets are 9% higher than 1997, whilst the Group net interest margin (as a % of average interest-earning assets) is 0.07% lower at 2.93%. An increased contribution from interest-free liabilities and increased earnings on interest-earning assets compared to base rate has been offset by an increased cost of interest-bearing liabilities compared to base rate.

Financial review continued

The improvement in net interest income was from growth in Personal Banking (from higher unsecured lending balances and increased earnings on interest-free current accounts); Commercial Banking (higher earnings on interest-free corporate current account balances) and Treasury & Group (higher net interest income in Alliance & Leicester Group Treasury).

The following tables analyse the net interest margin by business sector:

Year ended 31 December 1998

	Mortgage Lending & Investments	Personal Banking	Commercial Banking	Treasury & Group	**Total Group (i)**
Net interest £m	375	227	74	64	**740**
Mean interest-earning assets £m	20,595	3,480	2,194	10,832	**25,216**
Net interest margin as % mean IEA	1.82	6.52	3.36	0.59	**2.93**

Year ended 31 December 1997

	Mortgage Lending & Investments	Personal Banking	Commercial Banking	Treasury & Group	Total Group (i)
Net interest £m	380	192	62	59	693
Mean interest-earning assets £m	19,398	2,847	1,659	8,636	23,097
Net interest margin as % mean IEA	1.96	6.75	3.71	0.69	3.00

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

Mortgage Lending & Investments net interest income was £5m lower than 1997. Whilst mean interest-earning assets have increased by 6.2% the net interest margin has fallen from 1.96% to 1.82%. The reduction in interest spread has been partly offset by higher earnings on interest-free balances.

The improvement in net interest income in Personal Banking results from the growth in unsecured lending and credit card balances and the positive impact of higher interest rates on assets funded by interest-free current accounts. The growth in interest-earning assets more than offsets the reduction in net interest margin.

Commercial Banking net interest income was £12m higher than 1997 which included the positive impact of growth in interest-free corporate current account balances which have benefited from higher rates in 1998, and growth in leasing and asset finance.

The Treasury & Group sector includes Alliance & Leicester Group Treasury plc, (ALGT), and the income from the Group's capital not allocated to the other business sectors. The Treasury & Group net income was £5m higher than 1997, mainly due to higher net interest income in ALGT.

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:

	Six months ended 30.06.98 %	Six months ended 31.12.98 %	**Year ended 31.12.98 %**	Year ended 31.12.97 %
Average bank base rates	7.29	7.18	**7.23**	6.56
Headline mortgage rate	8.70	8.88	**8.79**	7.87
Gross yield on interest-earning assets	7.63	7.62	**7.63**	6.94
Cost of interest-bearing liabilities	6.16	6.26	**6.22**	5.32
Interest spread	1.47	1.36	**1.41**	1.62
Contribution of interest-free liabilities	0.39	0.42	**0.41**	0.34
Net interest margin	1.86	1.78	**1.82**	1.96

The table illustrates that the interest spread at 1.41% was 0.21% lower than 1997. The negative impact of increased cost of funds is offset by an improvement in the yield on interest-earning assets. Increased contribution from the growth in interest-free balances, combined with the positive impact of higher interest rates, has reduced the fall in the net interest margin from 1.96% to 1.82%. The net interest spread reduced from 1.47% for the first half of 1998 to 1.36% for the second half reflecting the increased cost of funds.

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

	Year ended 31.12.98 £m	Year ended 31.12.97 £m
Cashbacks	18	25
Other incentives	12	7
Variable rate discounts:		
New lending '98	13	–
Prior years: '97	34	25
'96	21	31
'94/5	7	18
	75	74
Subtotal	105	106
Fixed and capped rates:		
New lending '98	49	–
Prior years: '97	25	15
'96	10	26
'94/5	7	28
	91	69
Total charge to P&L	196	175

At the end of 1998 there were £97m (1997: £106m) 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 16 months (1997: 17 months). The average discount (per annum) on new variable rate discounted lending advanced in 1998 was 2.61% compared to 2.51% on new lending in 1997 with an average discount period of around 29 months (1997: 30 months). Fixed rate lending in 1998 represented 64% (1997: 22%) of gross advances and the average fixed and capped rate period for lending in 1998 was 39 months.

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 31.12.98 £m	Year ended 31.12.97 £m
Cashbacks:		
New lending '98	2	–
Prior years: '97	4	2
'96	3	3
'94/5	3	8
	12	13
Other cash incentives:		
New lending '98	1	–
Prior years: '97	1	1
'96	1	1
'94/5	1	1
	4	3
Variable rate discounts:		
New lending '98	8	–
Prior years: '97	16	8
'96	12	13
'94/5	10	34
	46	55
Adjustment for redemptions net of penalties	11	6
Charge to P&L on alternative policy	73	77
Charge to P&L on existing policy	105	106

Comparison of the charge under the alternative policy of £73m with the charge under our existing accounting policy of £105m indicates that reported pre-tax profit would have increased by £32m in 1998, compared to an equivalent increase of £29m in 1997.

The following table breaks down a simplified balance sheet for 1998 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.

1998	Mortgage Lending & Investments £m	Personal Banking £m	Commercial Banking £m	Treasury & Group £m	Total Group £m
Interest-earning assets:					
Cash and treasury assets including loans and advances to banks	83	–	–	4,499	**4,582**
Residential mortgages	17,763	–	27	–	**17,790**
Commercial secured loans	151	–	100	–	**251**
Unsecured lending and leasing	–	1,855	738	–	**2,593**
Balances with Group Treasury (i)	2,598	1,625	1,329	–	–
Balances with business units (ii)	–	–	–	6,333	–
Total	20,595	3,480	2,194	10,832	**25,216**
Interest-bearing liabilities:					
Customer accounts	15,062	682	535	1,830	**18,109**
Money market deposits and debt securities in issue	–	–	–	2,769	**2,769**
Subordinated debt	301	59	43	65	**468**
Balances from Group Treasury (ii)	3,883	1,713	737	–	–
Balances from business units (i)	–	–	–	5,552	–
Total	19,246	2,454	1,315	10,216	**21,346**
Net interest-free funds	1,349	1,026	879	616	**3,870**
Total	20,595	3,480	2,194	10,832	**25,216**

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 £449m and is analysed by business sector below:

	Year ended 31.12.98 £m	Year ended 31.12.97 £m
Mortgage Lending & Investments	**104**	84
Personal Banking	**91**	81
Commercial Banking	**254**	260
Treasury & Group	**–**	–
Total	**449**	425

The increase in Mortgage Lending & Investments non-interest income was due to higher fixed rate mortgage fees and administration fee income as a result of growth in mortgage lending and remortgage activity. In Personal Banking, the growth in volume of personal loans and credit cards has generated increased commission and fee income.

In Commercial Banking, business volumes for bill payments and cash and cheque handling increased slightly over 1997, however the increased proportion of electronic bill payments together with competitive pressures on pricing have led to a reduction in fee income. The volume of Benefits Agency cheques processed in 1998 has fallen resulting in lower fee income which was offset partly by the growth in merchant acquiring fee income.

ADMINISTRATIVE EXPENSES

Cost reduction and improvement in cost efficiency remain key objectives for the Group. An analysis of administrative expenses (including depreciation but excluding the exceptional costs of conversion in 1997) is as follows:

	Year ended 31.12.98 £m	Year ended 31.12.97 £m
Staff costs and related expenditure	204	215
Premises and equipment	64	69
Post Office related	165	174
Advertising and promotions	68	52
Depreciation	34	35
Redundancy and relocation	12	16
Year 2000 and EMU	14	2
Other	134	103
Total	695	666

Administrative expenses were in total £695m compared to £666m in 1997. Reductions in staff costs have arisen primarily in the Commercial Banking sector following the transfer of processing operations to Unisys Payment Services Ltd (UPSL) in November 1997. Advertising and promotion costs have increased, primarily in the Personal Banking sector, in order to support the growth in unsecured lending and credit cards. Further costs have been incurred in connection with Year 2000 and EMU projects. The increase in 'other' expenditure relates primarily to UPSL outsourcing costs and merchant acquiring costs. Excluding the costs of Year 2000 and EMU, and the planned increase in marketing costs, costs in 1997 and 1998 were broadly level.

Following the signing of new contracts with Post Office Counters Limited (POCL) in August 1998, the accounting treatment for various POCL-related cost and income items will change with effect from January 1999 in order to reflect the revised contractual terms. This is necessary due to the fundamentally different charging structure within the new Cash Contract, which sees a move away from individual service charges to an all-encompassing performance related payment. Based on the 1998 results, there would be no overall profit effect but there would be an impact on various headings within the profit and loss account. Net interest income would increase by £8m; 'other income' would fall by £48m; there would be a £1m reduction in 'other' costs and a £39m reduction in Post Office Counter Charges. The change in treatment would have resulted in an overall net payment to POCL of £126m which, in future, will be shown as a single entry under Post Office related costs.

In common with all other financial institutions and many other industries, the Group is taking action to deal with the potential business problems arising from the advent of the Year 2000. All areas of the Group use information technology and may also be affected by failures in business partners' systems or banking industry networks. A programme team is managing delivery of the solutions led by a senior divisional director and work is now well advanced. The overall approach is consistent with that suggested by the British Bankers' Association, both in terms of process and on overall timescale which will ensure that critical systems are compliant by early 1999. The Group is adopting the definition of compliance issued by the British Standards Institute (DISC PD 2000).

The Group's Year 2000 programme is split into five phases. The first three phases – impact assessment; planning, initiation and cost approval, and internal application and infrastructure development for all business critical systems – are complete. The final two phases – business process testing and external interface testing – will be completed in early 1999.

Total costs for the whole Year 2000 project are currently estimated at £35-40m, not all of which will be incremental. The incremental revenue costs for 1998 are £12m (1997: £2m) and around a further £4m is anticipated in 1999. Apart from testing, future costs include provision for both the development of fallback arrangements for critical systems and the costs of special operational arrangements which will be in place over the Millennium weekend.

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 costs of preparing for the introduction of the Euro in 1998 were £2m.

Financial review continued

The underlying Group cost:income ratio, excluding costs of conversion, has reduced to 58.5% (1997: 59.6%). Analysing the cost:income ratio by sector shows:

	Year ended 31.12.98 %	Year ended 31.12.97 %
Mortgage Lending & Investments	43.4	45.4
Personal Banking	59.9	63.0
Commercial Banking	78.3	81.7
Treasury & Group	62.7	34.7
Group Total	58.5	59.6

Excluding Year 2000 and EMU costs, the Group cost: income ratio would be 57.2% (1997: 59.4%). In addition, the cost:income ratio for Mortgage Lending & Investments would be further reduced to 40.6% (1997: 42.7%) if mortgage incentives were amortised in line with certain other mortgage lenders.

The Group places great emphasis on cost productivity and on a consistent basis with 1998 it is planned that total administrative expenses will fall in 1999 by more than the reduction in Year 2000 costs.

STAFF NUMBERS

The number of staff employed by the Group on a full time equivalent basis has risen by 3% from 7,304 at the end of 1997 to 7,544 at the end of 1998. This increase was due to volume related growth in mortgage processing, unsecured lending and credit card operations.

The number of agency and contractor staff engaged by the Group at the end of 1998 fell to 279 compared with 470 at the end of 1997. The figures include agency staff engaged in the Year 2000 project.

In total, own staff and agency staff increased by 49 from 7,774 at the end of 1997 to 7,823 at the end of 1998. Total staff numbers include around 65 staff engaged full time on the Year 2000 project.

CHARGES FOR BAD AND DOUBTFUL DEBTS

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

	Year ended 31.12.98 £m	Year ended 31.12.97 £m
Residential mortgages	13	14
Commercial secured loans	(9)	(9)
Unsecured loans & leasing	35	24
Total	39	29
Interest suspended in the period	3	2

The total charge for losses increased in 1998 due to growth in the volume of unsecured lending. During the year considerable work was undertaken in order to refine our residential loss provisioning methodology using statistical modelling techniques. As a result, the majority of our general residential loss provisions have now been reallocated to more specific areas.

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

	As at 31.12.98 £m	As at 31.12.98 %	As at 31.12.97 £m	As at 31.12.97 %
Residential mortgages	55	0.30	47	0.28
Commercial secured loans	23	8.61	26	11.46
Unsecured loans & leasing	91	2.91	74	3.71
Total	169	0.78	147	0.76
General	42		57	
Specific	127		90	
Total	169		147	

In addition to the £55m of residential provisions held on balance sheet, the Group has an offshore captive insurance subsidiary with available funds totalling £46m (1997: £32m). These funds are disclosed in the Group balance sheet under the heading 'accruals and deferred income'. Together this pool provides £101m of cover for losses in the residential mortgage book. Further cover is provided on a percentage of the mortgage book through reinsurance of risk with external insurers.

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 1998 Value of arrears £000	31 December 1998 Arrears as a % of residential mortgage balances	31 December 1997 Value of arrears £000	31 December 1997 Arrears as a % of residential mortgage balances
2.5 – 5%	9,299	0.051	9,107	0.053
5 – 7.5%	7,218	0.040	6,813	0.040
7.5 – 10%	5,470	0.030	5,089	0.030
10% +	16,362	0.090	20,617	0.121
Repossession stock	3,263	0.018	2,454	0.014
Total	41,612	0.228	44,080	0.258

The reduction in the value of residential arrears arises due to the removal from arrears reporting of certain borrowers in receipt of DSS interest benefit which have now been identified as performing. Adjusting for this factor, the arrears level as a percentage of mortgage balances would have been broadly the same as at the end of December 1997.

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

	As at 31.12.98 %	As at 31.12.97 %
Value of loans > 30 days in arrears as % of total loans	5.0	4.6
Average for Finance and Leasing Association Members %	7.4	6.2

The arrears as a percentage of balances has increased in 1998 but is still significantly lower than the industry average.

These signs of deterioration in the industry, which emerged in the second half, caused us to slow the rate of new lending as we adopted a more defensive stance.

Sovereign Finance plc, our asset finance subsidiary, has two main categories of lending – the 'big ticket' portfolio of individual transactions over £20m of £494m and a small/medium ticket portfolio of £545m. All big ticket transactions are pre-approved by a Special Review Team, which includes executive and non-executive directors.

Big ticket advances are backed by bank guarantees, or the equivalent, to 96% of the value advanced. The arrears trend in the small/medium ticket portfolio, as a percentage of gross outstandings, has continued to fall and is lower than the industry average.

TAXATION

A corporation tax rate of 31% (1997: 31.5%) has been used in preparing these results. The tax charge for 1998 of £137.3m (1997: £133.9m) represents 30.2% of profit before tax (1997: 33.9%, with an underlying rate of 31.7% after adjusting for the 1997 exceptional costs of conversion).

BALANCE SHEET

The structure of the consolidated balance sheet as at 31 December 1998 is shown below in summary format:

	As at 31.12.98 £m	As at 31.12.97 £m
Assets		
Cash, treasury assets and loans and advances to banks	4,857	4,436
Loans and advances to customers:		
Residential mortgages	18,185	17,022
Commercial secured loans	239	201
Unsecured loans and finance leases	3,051	1,911
	21,475	19,134
Fixed and other assets	1,247	834
	27,579	24,404
Liabilities		
Customer accounts	19,892	18,948
Deposits by banks	721	89
Debt securities in issue	3,407	1,821
Other liabilities	1,432	1,293
Subordinated loan capital	273	575
Called up share capital	292	291
Share premium	20	–
Profit and loss account	1,542	1,387
	27,579	24,404

Financial review continued

Gross residential mortgage lending was £3.8bn (1997: £2.6bn) out of total UK mortgage lending of £89.5bn, which represents a market share of 4.2% (1997: 3.4%). Fixed and capped rate mortgage lending represented 64% of gross advances for 1998 (1997: 22%). Net lending of £1.2bn (1997: £0.4bn) represents a market share of 4.6% (1997: 1.5%). Of the total residential mortgages, 64% is covered by redemption penalties at the end of 1998.

	Year ended 31.12.98 £bn	Year ended 31.12.97 £bn
Gross advances	3.8	2.6
Redemptions and capital repayments	(2.6)	(2.2)
Net lending	1.2	0.4

The following table analyses residential lending by type of borrower and illustrates the growth in the proportion of remortgage business undertaken.

	Year ended 31.12.98 %	Year ended 31.12.97 %
First time buyer	24	24
Next time buyer	37	50
Remortgage	39	26
	100	100

The following table analyses unsecured loans and leasing balance.

	As at 31.12.98 £m	As at 31.12.97 £m
Unsecured consumer loans	1,544	1,172
Credit card balances	504	299
Leasing and hire purchase	823	307
Other	180	133
	3,051	1,911

Unsecured consumer loan balances increased by 32% in 1998 partly reflecting the growth in the consumer credit market. Tight control over lending quality through the deployment of credit scoring was maintained throughout 1998.

In addition to the leasing and hire purchase balance shown above, Sovereign Finance plc had £154m of assets leased to customers under operating leases, which are included under the heading of fixed assets.

Customer balances have increased by £944m to £19.9bn (1997: £18.9bn) reflecting an increase of £2,146m in corporate customer balances offset by a fall of £1,202m in personal customer balances.

	As at 31.12.98 £bn	As at 31.12.97 £bn
Personal customer balances	15.9	17.1
Corporate customer balances	4.0	1.8
Total customer balances	19.9	18.9

CAPITAL STRUCTURE

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

	As at 31.12.98 £m	As at 31.12.97 £m
Capital: Tier 1	1,845	1,673
Tier 2	317	598
Deductions	(77)	(45)
Total capital	2,085	2,226
Total risk weighted assets	13,791	12,079
Risk asset ratios:		
Total capital	15.1%	18.4%
Tier 1	13.4%	13.9%

Alliance & Leicester is well capitalised following the abolition of the Priority Liquidation Distribution Reserve (PLDR) in the Building Societies Act 1997. The Group's excess Tier 1 capital above a target ratio of 8% is around £740m at the end of 1998 and it remains the Group's objective to achieve the target ratio in 2001.

Whilst the Tier 1 ratio fell by 0.5% during 1998 due to growth in lending, it is now our intention to accelerate this process and commence a share repurchase programme after the abolition of Advance Corporation Tax in April 1999.

During 1998, we redeemed our issues of Undated Subordinated Variable Rate Notes, of which £200m was outstanding, and £50m Subordinated Floating Rate Notes due 2004. This represented 1.8% of the reduction in the total risk asset ratio.

Neither of these issues featured in the long-term capital strategy of the Group. The undated issue was approaching an expensive step-up in interest cost, and the 2004 issue had entered a period where it was progressively qualifying less as capital. In addition, a further £53m of subordinated debt matured during the year.

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. 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. Recognising the importance of sustaining a steady income from the investment of the Group's non interest-bearing liabilities, the interest rate position beyond the one-year band tends to be always positive, reflecting a net holding of 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 authorised limits and parameters in regard to 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 Group Credit Policy Committee. Authorised limits on a counterparty are governed largely by the size of its capital base and, where published, credit ratings assigned by the major rating agencies. The Group has no treasury exposure on counterparties resident in South Korea, Thailand, the Philippines, Indonesia, Malaysia, South America, Eastern Europe or Russia.

Derivative instruments are used by the Group to hedge open positions in the management of the balance sheet 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 the 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, structured savings products and leasing transactions.

The Group carries no material foreign exchange risk. Borrowings in foreign currencies are hedged into a sterling interest rate liability, using the spot and forward foreign exchange markets, or invested in treasury assets denominated in the relevant currency. The growth in the last few years of the Group's assets in fixed rate mortgages, consumer finance loans and, more recently, 'big ticket' leasing deals has led to our committing increased resources, both in terms of staff and systems, to the management of interest rate risk.

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.

Debt securities forming part of the Group's treasury assets, which include certificates of deposit, UK government stocks, and Treasury and eligible 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 1998	**1,891**	**2,156**	**4,047**
Interest rate repricing profile	(47%)	(53%)	
31 December 1997	1,994	1,923	3,917
Interest rate repricing profile	(51%)	(49%)	

Non interest-bearing liabilities comprise mainly interest-free personal and corporate current accounts and shareholders' funds, and totalled £4.0bn at 31 December 1998. This comprises a core fund of £3.1bn and £0.9bn which represents fluctuations above core balance levels on current accounts and capital not allocated to business units. Fixed rate investments of the core fund, with an outstanding maturity of over one year, totalled 70% of the fund.

PROFIT RATIOS

The Group's underlying profit ratios, excluding exceptional costs, compared to 1997 were as follows:

	Year ended 31.12.98 %	Year ended 31.12.97 %
Post tax return on capital	**18.0**	17.9
Post tax return on mean assets	**1.2**	1.2
Post tax return on mean risk weighted assets	**2.5**	2.5

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

1998	Mortgage Lending & Investments £m	Personal Banking £m	Commercial Banking £m	Treasury & Group £m	Total Group £m
Underlying post tax profit	187	64	50	17	**318**
Average Tier 1 allocated	892	157	118	599	**1,766**
Post tax return on capital %	20.9	40.7	42.0	2.9	**18.0**
1997 Post tax return on capital %	20.8	48.0	65.9	4.6	**17.9**

In spite of the growth in profit in Commercial Banking, the return on capital has fallen. This is due to the allocation of capital to enable significant growth in the leasing business at a lower rate of return than the higher returns achieved on the core Girobank business.

Board of Directors

John Windeler Aged 55
Non-Executive Chairman
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 Limited. He became Chairman on 1 January 1999.

Sir Michael Thompson Aged 67
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 and before that the University of East Anglia, he has broad management and strategic planning experience. He has served on many public authorities, trusts and committees in education, health and science.

Peter White Aged 57
Group Chief Executive
Peter White is a chartered accountant. After 11 years in a number of senior positions in the financial services industry, he was appointed Group Chief Executive of Alliance & Leicester in 1991. He led the conversion of Alliance & Leicester, then a mutual building society, and its successful flotation and launch as a public company in April 1997. He is Chairman of Girobank plc, and a member of the Council of the British Bankers' Association. For two years until 1998 he was Chairman of the Council of Mortgage Lenders, and is a member of its Executive Committee. He is also a non-executive director of Reckitt & Colman plc.

Richard Banks Aged 47
Managing Director, Girobank plc
Richard Banks became Managing Director of Girobank plc in March 1996 having held a number of senior positions in Girobank since he joined the Company in 1987. He is responsible for the Group's commercial banking operations and was appointed to the Board of Alliance & Leicester on 1 February 1998.

Peter Barton Aged 61
Non-Executive Director
Peter Barton is a solicitor who has many years experience in the finance sector. He joined Robert Fleming & Co in 1995 as Director and Chief Operating Officer of the Investment Banking Division and presently has overall responsibility for investment banking business in Central and Eastern Europe. His other directorships include Foreign & Colonial US Smaller Companies plc, Lambert Fenchurch Group plc and Howard de Walden Estates Limited. He was appointed to the Board of Alliance & Leicester on 13 May 1998.

Frances Cairncross Aged 54
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 Aged 67
Non-Executive Director
Nicholas Corah was formerly Deputy Chairman of East Midlands Electricity plc and Chairman of Corah plc. He 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 the Alliance & Leicester Pension Scheme.

Simon Everard Aged 70
Non-Executive Director
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. He was Chairman of the Company until 31 December 1998.

Trevor Hilliard Aged 53
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 became Managing Director, Retail Financial Services, in December 1997 having held a number of senior positions since joining the Group. He is responsible for all sales to personal customers, including mortgages, unsecured loans, retail savings and current accounts. He also has responsibility for strategic marketing, credit and risk and the various insurance subsidiaries.

Richard Pym Aged 49
Group Finance Director
Richard Pym joined Alliance & Leicester in 1992 and became Group Finance Director in 1993. A physics graduate and Fellow of the Institute of Chartered Accountants, his previous career was with Thomson McLintock & Co, British Gas plc, BAT Industries plc and The Burton Group plc. He is a non-executive director of Selfridges plc.

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 1998.

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

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

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

RESULTS AND DIVIDENDS

The profit on ordinary activities before tax for the year ended 31 December 1998 was £455.2m (1997: £394.6m). An interim net dividend of 8.0 pence per share (1997: 6.4 pence per share) was paid on 19 October 1998.

The directors propose a final net dividend for the year of 16.5 pence per share (1997: 14.4 pence per share) to be paid on 17 May 1999.

DIRECTORS

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

J R Windeler *Chairman* (Chairman from 1.1.99)
Sir Michael Thompson *Deputy Chairman*
E J Baden *Deputy Chairman* (to 18.8.98)
P R White *Group Chief Executive*
M J Allen (to 27.4.98)
R L Banks (from 1.2.98)
M P S Barton (from 13.5.98)
F A Cairncross
G N Corah
S Everard (Chairman to 31.12.98)
T M Hilliard
R A Pym

The names and brief biographies of the current directors are shown on page 21. Mr J R Windeler and Sir Michael Thompson will retire by rotation and being eligible, will offer themselves for re-election at the forthcoming Annual General Meeting.

In addition, Mr P Barton who was appointed a director on 13 May 1998 will also retire from the Board, and being eligible, will offer himself for election.

Mr Everard will retire at the Annual General Meeting having reached the age of 70 and will not be seeking re-election.

Directors' Service Contracts

Details of directors' service contracts are included in the Report on Directors' Remuneration on page 26.

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 on Directors' Remuneration on pages 27 and 28.

Substantial Shareholders

Shareholders with an interest in the issued ordinary share capital of the Company disclosed in accordance with Sections 198-208 of the Companies Act 1985 are shown in note 30.

CORPORATE GOVERNANCE

The Group's Statement of Corporate Governance is set out on pages 29 to 31.

CHARITABLE AND POLITICAL DONATIONS

During 1998, the Group made donations for charitable purposes amounting to £480,750 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. In November 1998 Peter White, our Group Chief Executive, led a 'Seeing is Believing' initiative in the Leicestershire area focusing on education and inner city regeneration. Alliance & Leicester will continue to provide support to the projects visited.

STAFF

It is the Group's policy to have effective communication and consultation with its staff. Regular staff involvement is achieved through two-way dialogue between staff and their managers, and consultative and negotiating committees, including discussion with in-house staff associations and trade unions. Regular meetings, group wide team briefings, circulars and newsletters help to ensure that staff are aware of the organisation's performance and objectives. In addition, the Group Chief Executive addresses the Group's top 1,000 managers each year at his briefing sessions, signposting future direction and responding to questions from around the Group.

The Group encourages the involvement of employees in the performance of the Company through the employee ShareSave Scheme. 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 1998 were 29 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 concern for the environment is an integral part of business strategy. The Group is fully aware of all its environmental responsibilities and seeks to minimise the impact of its operations on the environment.

In 1998 the Group initiated formal reporting of environmental issues. We launched our 'Environmental Policy: Statement of Intent' within which we set out our objectives for achieving environmental best practice.

We also participated in Business in the Environment's Index of Corporate Environmental Engagement survey and the results from this Index will be published early in 1999.

During 1999 it is our aim to begin setting meaningful performance targets appropriate to our business sector and produce our first Environmental Review Document. We will be looking to consolidate those environmentally friendly initiatives already in place within the organisation and to develop new ones.

AUTHORITY TO PURCHASE SHARES

The authority for the Company to purchase, in the market, up to 58.43m of its shares, representing some 10 per cent of the issued share capital, expires at the Annual General Meeting. This authority was not used during the year and shareholders will be asked to give a similar authority at the Annual General Meeting.

SPECIAL BUSINESS AT THE ANNUAL GENERAL MEETING

The Annual General Meeting will be held on 4 May 1999. 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
25 February 1999

Report on Directors' Remuneration

REMUNERATION COMMITTEE'S COMPOSITION AND SCOPE

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

Sir Michael Thompson (Chairman)
Mr J R Windeler
Mr G N Corah
Mr S Everard

The Committee is responsible for determining, pursuant to a policy framework on executive remuneration approved by the Board, 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.

REMUNERATION POLICY

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

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

Details of individual directors' remuneration, share options and long-term incentive schemes are set out on pages 26 and 28 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. Executive directors participate in the staff Profit Related Pay Scheme.

Annual Bonus

At the discretion of the Committee, executive directors are eligible to receive an annual performance bonus up to a maximum of 70% (100% in the case of the Group Chief Executive) of their annual basic salaries at the time the bonus is awarded. The amount of the bonus 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.

Executive directors receive a proportion (maximum one quarter) of their annual bonus in the form of deferred shares which the Company will match (see later under Long-Term Incentive Schemes). The rights to deferred shares cannot normally be exercised for three years and lapse if not exercised within seven years.

Long-Term Incentive Schemes

In order to align the interests of executive directors and certain senior managers with those of shareholders, there are share schemes for executive directors and certain senior managers:

1. Executive directors and certain senior managers are granted options under the Alliance & Leicester Approved and Unapproved Company Share Option Schemes. The aggregate value of options to subscribe for new shares (at market value on the day before grant) granted to each individual cannot exceed four times annual remuneration in any ten year period. Options cannot normally be exercised for three years from the date of issue. The performance condition that has been applied to these schemes is that options can only be exercised if the percentage growth in earnings per share over a three year period exceeds the

Retail Price Index (RPI) inflation by at least 9% over the same period.

2. In addition, the Company will match an award of deferred shares (see under Annual Bonus above) on the basis of up to two matched shares for each deferred share comprised within an award. The rights to matching shares cannot normally be exercised for three years and lapse if not exercised within seven years. Save for the first award of rights to matching shares where no performance conditions were applied, subsequent awards are subject to satisfying objective performance criteria designed to link the receipt of the matched shares to sustained improvement in the underlying performance of the Company.

Employee Share Schemes

Directors may also participate in the Company's existing Employee Share Scheme and Savings Related Share Option Scheme on the same basis as all other employees.

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) Pensions 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 Mr White 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 Pym and Mr Hilliard are entitled to a pension of 2/3rds of their final pensionable salary inclusive of retained benefits on retirement from service at age 60.

Mr Pym is not required to contribute.

There is an unfunded unapproved pension arrangement to increase the Pension Scheme benefit to the level promised, where, because of Inland Revenue limitations (including those resulting from the earnings cap) these cannot be paid in total from the Scheme.

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

All pensions 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.

Other Benefits

Executive directors are eligible for a range of 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.

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 and within the limits specified in the Articles of Association of the Company.

Three non-executive directors, Mr S Everard, Sir Michael Thompson and Mr G N Corah, are entitled as former directors of the Company's predecessor Alliance & Leicester

Report on Directors' Remuneration continued

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) 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. Whilst several non-executive directors continue to have the benefit of membership of the Group's private medical insurance scheme, the Remuneration Committee has decided that this benefit will not be available for newer directors.

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 which does not have 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 (or, if a lesser sum, salary and pension benefits for the period from the date of termination to the executive director's 60th birthday). The executive directors may terminate their contracts of employment at any time by giving six months prior notice. The Board believes notice periods of up to 2 years continue to be necessary in order to retain and recruit executive directors of an appropriate calibre.

DIRECTORS' REMUNERATION

Year ended 31 December 1998

Executive Director	Salaries £000	Bonus £000	Deferred Bonus (i) £000	Other Benefits £000	Total 1998 £000	Total 1997 £000
P R White	438	344	51	45	878	681
R A Pym	260	130	26	12	428	370
T M Hilliard	235	120	24	7	386	278
R L Banks (from 1.2.98)	160	83	17	10	270	–
K Southwood (to 28.2.97)	–	–	–	–	–	388
Subtotal	1,093	677	118	74	1,962	1,717

Non-Executive Director	Fees £000	Bonus £000	Deferred Bonus (i) £000	Other Benefits £000	Total 1998 £000	Total 1997 £000
J R Windeler	47	–	–	1	48	38
Sir M Thompson	56	–	–	1	57	66
M J Allen (to 27.4.98)	9	–	–	2	11	31
E J Baden (to 18.8.98)	47	–	–	1	48	74
M P S Barton (from 13.5.98)	17	–	–	–	17	–
F A Cairncross	28	–	–	–	28	29
G N Corah	34	–	–	4	38	44
S Everard	157	–	–	1	158	153
N Crowley (to 20.4.97)	–	–	–	–	–	18
Subtotal	395	–	–	10	405	453
Total	1,488	677	118	84	2,367	2,170

Note:

i) Maximum aggregate market value at date of grant of shares recommended by the Remuneration Committee to the Trustees of the Alliance & Leicester Share Ownership Trust to be awarded in March 1999, in accordance with the deferred bonus arrangements described on page 24 of this report. The director will receive these shares after 3 years if he is still employed by the Company (or has left, for example, on retirement).

PENSION ENTITLEMENTS

Executive Director	P R White	R A Pym	T M Hilliard	R L Banks
Age attained at 31.12.98	56	49	53	47
Normal retirement age	60	60	60	60
	£	£	£	£
Amount of accrued pension per annum at 31.12.98	297,514	43,124	53,264	32,506
(at 31.12.97)	(213,708)	(30,571)	(35,354)	(21,918)
Change in amount of accrued pension p.a. net of revaluation during year to 31.12.98	76,967	11,575	16,767	9,887
(to 31.12.97)	(21,385)	(9,474)	(5,971)	(4,083)
Directors contributions payable during year to 31.12.98	22,083	–	11,854	8,542

Details of terms and conditions associated with the above pensions are shown on page 25.

Non-Executive Director	S Everard	Sir Michael Thompson	G N Corah
Age attained at 31.12.98	70	67	66
Normal retirement age	70	70	70
	£	£	£
Amount of accrued pension p.a. at 31.12.98	62,212	31,355	15,678
Amount of pension accruing during 1998	–	–	–
Directors' contributions	–	–	–

On the death of 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 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 date they retire (both now being aged over 65).

Mr Everard reached age 70 during the year but remained as a non-executive director on 31 December 1998. On his death, a widow's pension of one half of his full pension entitlement is payable.

DIRECTORS' INTERESTS IN ORDINARY SHARES

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

Directors	Fully Paid Shares of 50p each As at 1.1.98 (or date of appointment if later)	As at 31.12.98‡
J R Windeler	500	1,000
Sir Michael Thompson	3,455	3,455
P R White	7,174	9,941
R L Banks	500	500
M P S Barton	500	500
F A Cairncross	7,464	8,964
G N Corah	4,217	4,217
S Everard	2,500	2,500
T M Hilliard	1,350	1,350
R A Pym	500	500

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

Report on Directors' Remuneration continued

RIGHTS TO ACQUIRE SHARES

In addition, the following directors have options to subscribe for shares of 50p each granted under the terms of the Alliance & Leicester Share Option Schemes:

Directors	Number of options: As at 1.1.98 (or date of appointment if later)	Granted during the year	As at 31.12.98	Exercise price £	Exercise period
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
	Nil	55,524	55,524	9.00½*	6/3/01 - 6/3/05
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
	Nil	31,093	31,093	9.00½*	6/3/01 - 6/3/05
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
	Nil	33,870	33,870	9.00½*	6/3/01 - 6/3/05
R L Banks	5,628		5,628	5.33#	23/4/00 - 23/4/07
	16,417		16,417	5.33*	23/4/00 - 23/4/04
	3,239		3,239	4.26‡	1/8/02 - 1/2/03
	Nil	38,589	38,589	9.00½*	6/3/01 - 6/3/05
	Nil	513	513	6.72‡	1/11/03 - 1/5/04

‡ 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.

No options were exercised during the year.

There were no changes in directors' share interests between 31 December 1998 and 9 February 1999.

On 31 December 1998 the market price of ordinary shares in Alliance & Leicester plc was £8.84 and the range during 1998 was £7.74 to £9.64.

BONUS AWARDS

The following table shows the directors' interests in options awarded under the deferred bonus scheme. The value of the award is included within the table of directors emoluments in the relevant bonus year.

Executive Director	Bonus year		Value of award £	Market value at date of grant £	No. of options	Exercise price £	Exercise period
P R White	1997	Deferred shares	40,000	9.00½	4,441	Nil	6/3/01-6/3/05
	1997	Matched shares	40,000	9.00½	4,442	Nil	6/3/01-6/3/05
R A Pym	1997	Deferred shares	22,800	9.00½	2,531	Nil	6/3/01-6/3/05
	1997	Matched shares	22,800	9.00½	2,532	Nil	6/3/01-6/3/05
T M Hilliard	1997	Deferred shares	18,812	9.00½	2,089	Nil	6/3/01-6/3/05
	1997	Matched shares	18,812	9.00½	2,089	Nil	6/3/01-6/3/05

On behalf of the Board

Sir Michael Thompson

Chairman Remuneration Committee

25 February 1999

Statement of Corporate Governance

Principles of Corporate Governance

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

Board Structure

The Company's Board comprises six non-executive directors (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. The Chairman is Mr John Windeler, the Group Chief Executive is Mr Peter White and the senior independent non-executive director is the Deputy Chairman, Sir Michael Thompson.

The Board meets regularly and approves and closely monitors the Alliance & Leicester Group's business strategy. There is a formal schedule of matters specifically reserved to the Board for decision and procedures which allow directors to take independent professional advice in the course of their duties. Day-to-day conduct of the Group's business is entrusted to the Group Chief Executive and his senior management colleagues.

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

The non-executive directors are not employees of the Company and the Board considers that all the non-executive directors are independent of management and free from business or other relationships which could materially interfere with the exercise of their independent judgement. It should be noted in this context that the pension entitlements of three non-executive directors are fully accrued in accordance with the details disclosed in the Report on Directors' Remuneration. The non-executive directors do, however, play a full part as members of the Board "team" and share responsibility for Board decisions. They bring a diversity of business perspective 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. Newly apppointed directors submit themselves for election by shareholders at the first opportunity after their appointment and at three yearly intervals thereafter. They receive induction training upon appointment.

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

Nomination Committee

Under the chairmanship of Mr Windeler this Committee has the task of recommending new appointments to the Board and reviewing re-appointments when they become due. It has formal Terms of Reference and its current membership comprises the Chairman, the Deputy Chairman, Miss F A Cairncross and Mr S Everard.

Remuneration Committee

Under the chairmanship of Sir Michael Thompson this Committee determines the remuneration and contractual arrangements of individual executive directors having regard to a general policy framework for executive remuneration established by the Board. The Board's Report on Directors' Remuneration appears on pages 24 to 28.

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

Sir Michael Thompson (Chairman)
Mr J R Windeler
Mr G N Corah
Mr S Everard

Audit Committee

Under the chairmanship of Mr Windeler the duties of the Committee fall into two main areas: internal control and financial reporting.

Internal Control: the Committee reviews the effectiveness of the Group's systems of internal control, and 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, the interim report and internal audit reports. The Committee focuses on reviewing any changes in accounting policy, major areas of judgement and estimates, and compliance with accounting principles and regulatory requirements.

Meetings of the Committee are normally attended by the Group Finance Director, the Director of Group Risk Management, the Head of Internal Audit and the Head of Group Compliance.

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

Membership of the Committee comprises the Chairman, the Deputy Chairman and Mr Corah.

The Board has also established two other committees. The Group Credit Policy Committee reviews all aspects of lending credit risk and the Group Assets and Liabilities Committee monitors and controls the level of structural balance sheet risk across the Group.

Pension Funds

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

Relations with Shareholders

The Company values dialogue with its institutional shareholders through meetings and results briefings. The Company also appreciates that the Annual General Meeting and the documents sent to shareholders before the meeting provide an opportunity to communicate with private investors and encourage them to value their association with the Company. The Annual Accounts and Summary Financial Statement present an opportunity for the Board to account to shareholders for its stewardship of the Group's business.

Compliance Statement

The majority of the Combined Code provisions replicated the provisions of the Cadbury Committee's Code of Best Practice with which, in the opinion of the directors, the Company has continued to comply since 1 January 1998. A limited number of the changes introduced by the Combined Code are, however, new and of a continuing nature. An example affecting the Company is the requirement to give at least 20 working days notice of the Annual General Meeting. Whilst the Company did not give such notice for its Annual General Meeting held in May 1998 (before the Combined Code was appended to the Listing Rules) it intends to do so in future years.

Again, whilst no performance conditions applied to the initial operation of the share matching arrangements in

1998, they will be applied to subsequent awards (see Report on Directors' Remuneration).

Also, the Board recognised in mid 1998 that the Combined Code requirement for the appointment of a senior independent non-executive director would be fulfilled by one of its two non-executive Deputy Chairmen. However, the formal appointment of a single person as the senior independent non-executive director was not made until December 1998 prior to the accession of one of the two Deputy Chairmen to the chairmanship.

Finally, all directors in post at the time of flotation of the Company in April 1997 will have stood for re-election by May 2000 which will ensure an orderly transition to a system of retirements at three yearly intervals thereafter.

While the Board is ultimately responsible for the Group's system of internal controls and for monitoring its effectiveness, formal guidance as to the review of non-financial internal control has yet to be published by the Institute of Chartered Accountants in England and Wales. Consequently, the directors consider that they are unable to report that they have undertaken during the year a formal review of the effectiveness of the Group's system of non-financial internal controls envisaged by the Combined Code. However, the directors have reviewed the effectiveness of the Group's system of internal financial control for the year to 31 December 1998 in accordance with guidance on Internal Control and Financial Reporting issued by the Rutterman Working Group in December 1994 and as part of their responsibility to establish and maintain systems of internal financial control.

Subject to the exceptions listed above and in the Report on Directors' Remuneration, in the directors' opinion the Company complied with the provisions of Section 1 of the Combined Code throughout the year ended 31 December 1998.

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 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 and Compliance functions to identify and manage all major risks to which the Group is exposed; and an Internal Audit function to report to the directors on the effectiveness of key internal controls in relation to these major risks. In addition, line management carry out, twice a year, a formal self-assessment of these major risks and the effectiveness of key internal controls in their areas of responsibility.

The systems of internal control are 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 they cannot provide absolute assurance.

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

Going Concern

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

Statement of Directors' Responsibilities

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

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

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

Report of the Auditors 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 Report on Directors' Remuneration on pages 24 to 28.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors are responsible for preparing the Annual Report, including as described on page 32 the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange, and by our profession's ethical guidance.

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

We review whether the statement on page 30 reflects the Company's compliance with those provisions of the Combined Code specified for our review by the Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the Company's corporate governance procedures or its internal controls

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with 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 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 1998 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
25 February 1999

Consolidated Profit & Loss Account

For the year ended 31 December 1998	Notes	Continuing Operations 1998 £m	1997 £m
Interest receivable:			
Interest receivable and similar income arising from debt securities		196.4	185.8
Other interest receivable and similar income		1,871.9	1,525.4
Interest payable		(1,328.6)	(1,017.8)
NET INTEREST INCOME		739.7	693.4
Fees and commissions receivable		443.9	400.4
Fees and commissions payable		(67.1)	(47.5)
Other operating income		72.5	71.4
TOTAL NON-INTEREST INCOME		449.3	424.3
OPERATING INCOME		1,189.0	1,117.7
Administrative expenses:			
Underlying	2	(660.9)	(630.8)
Exceptional costs of conversion	2	–	(28.0)
Depreciation and amortisation		(34.2)	(35.0)
		(695.1)	(693.8)
Provisions for bad and doubtful debts	14	(38.7)	(29.3)
OPERATING PROFIT ON ORDINARY ACTIVITIES BEFORE TAX		455.2	394.6
Tax on profit on ordinary activities	7	(137.3)	(133.9)
PROFIT ATTRIBUTABLE TO THE SHAREHOLDERS OF ALLIANCE & LEICESTER PLC	8	317.9	260.7
Dividends	9	(142.6)	(121.1)
RETAINED PROFIT FOR THE YEAR	31	175.3	139.6
Earnings per ordinary share	10	54.6p	44.8p
Underlying earnings per ordinary share	10	54.6p	49.6p
Fully diluted earnings per ordinary share	10	54.3p	44.7p

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

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

Consolidated Balance Sheet

As at 31 December 1998	Notes	1998 £m	1997 £m
Assets			
Cash and balances at central banks		66.5	84.7
Treasury bills and other eligible bills	11	454.9	202.8
Loans and advances to banks	12	2,061.1	1,841.6
Items in the course of collection from other banks		128.8	118.0
Loans and advances to customers	13	21,475.1	19,133.6
Debt securities	15	2,274.8	2,307.1
Tangible fixed assets	17	440.5	355.7
Other assets	18	171.9	60.0
Prepayments and accrued income	19	269.2	173.0
Long-term assurance business attributable to shareholders	20	56.2	32.6
		27,399.0	24,309.1
Long-term assurance assets attributable to policyholders	20	179.6	94.6
TOTAL ASSETS		27,578.6	24,403.7
Liabilities			
Deposits by banks	21	721.0	89.1
Items in the course of transmission to other banks		141.6	200.6
Customer accounts	22	19,892.2	18,948.4
Debt securities in issue	23	3,406.8	1,820.6
Other liabilities	24	345.3	349.9
Accruals and deferred income	25	711.6	629.2
Provisions for liabilities and charges	26	54.0	18.4
Subordinated liabilities:			
undated loan capital	29	–	198.9
dated loan capital	29	273.2	376.0
		25,545.7	22,631.1
Shareholders' funds (equity)			
Called up share capital	30	292.1	291.0
Share premium account	31	19.7	–
Profit and loss account	31	1,541.5	1,387.0
		1,853.3	1,678.0
		27,399.0	24,309.1
Long-term assurance liabilities to policyholders	20	179.6	94.6
TOTAL LIABILITIES		27,578.6	24,403.7
Memorandum items			
Contingent liabilities	34	30.5	–
Commitments	34	306.0	199.0

Approved by the Board of directors on 25 February 1999 and signed on its behalf by:

J R Windeler *Chairman*

P R White *Group Chief Executive*

R A Pym *Group Finance Director*

Company Balance Sheet

As at 31 December 1998	Notes	1998 £m	1997 £m
Assets			
Cash and balances at central banks		54.4	59.7
Treasury bills and other eligible bills	11	–	–
Loans and advances to banks	12	3,248.4	3,927.5
Loans and advances to customers	13	18,806.8	17,499.6
Debt securities	15	193.3	372.9
Investment in subsidiary undertakings	16	442.9	425.4
Tangible fixed assets	17	237.4	228.1
Other assets	18	201.8	188.7
Prepayments and accrued income	19	146.1	135.1
TOTAL ASSETS		23,331.1	22,837.0
Liabilities			
Deposits by banks	21	4,826.1	2,303.7
Customer accounts	22	14,551.5	16,056.0
Debt securities in issue	23	1,279.2	1,495.6
Other liabilities	24	293.1	331.1
Accruals and deferred income	25	565.0	551.1
Provisions for liabilities and charges	26	14.6	13.4
Subordinated liabilities:			
undated loan capital	29	–	198.9
dated loan capital	29	273.2	376.0
		21,802.7	21,325.8
Shareholders' funds (equity)			
Called up share capital	30	292.1	291.0
Share premium account	31	19.7	–
Profit and loss account	31	1,216.6	1,220.2
		1,528.4	1,511.2
TOTAL LIABILITIES		23,331.1	22,837.0

Approved by the Board of directors on 25 February 1999 and signed on its behalf by:
J R Windeler *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 1998	1998 £m	1997 £m
Total recognised gains & losses, being the profit attributable to the shareholders of Alliance & Leicester plc	317.9	260.7

Reconciliation of Movements in Shareholders' Funds

For the year ended 31 December 1998	1998 £m	1997 £m
Group profit attributable to the shareholders of Alliance & Leicester plc	317.9	260.7
Dividends	(142.6)	(121.1)
Retained profit for the financial year	175.3	139.6
New share capital:		
Conversion share issue:		
Shares issued	–	291.0
Transfer from general reserve on conversion	–	(291.0)
QUEST share issue (Note 30):		
Shares issued	1.1	–
Share premium	19.7	–
Reduction in general reserve	(20.8)	–
	–	–
Statutory cash bonus	–	(17.9)
Net increase in shareholders' funds	175.3	121.7
Opening shareholders' funds	1,678.0	1,556.3
Closing shareholders' funds	1,853.3	1,678.0

Consolidated Cash Flow Statement

For the year ended 31 December 1998	Notes	1998 £m	1997 £m
NET CASH INFLOW/(OUTFLOW) FROM OPERATING ACTIVITIES	37	941.8	(734.3)
Returns on investments and servicing of finance:			
Interest paid on loan capital		(44.8)	(47.2)
Taxation		(123.5)	(106.9)
Capital expenditure and financial investment:			
Purchase of investment securities		(7,922.5)	(6,298.7)
Sale and maturity of investment securities		7,705.5	7,063.4
Injection of capital into life fund		(17.5)	–
Purchase of tangible fixed assets		(157.7)	(89.4)
Sale of tangible fixed assets		13.6	10.0
Net cash (outflow)/inflow from capital expenditure and financial investment		(378.6)	685.3
Acquisitions and disposals	37	(2.3)	–
Equity dividends paid		(126.7)	(35.8)
Statutory cash bonus paid		–	(17.9)
NET CASH INFLOW/(OUTFLOW) BEFORE FINANCING		265.9	(256.8)
Financing:			
Repayment of loan capital	37	(303.0)	–
DECREASE IN CASH	37	(37.1)	(256.8)

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 was 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, are presented so as to show the results of the combined entity as though the combination had occurred prior to 1 January 1997.

FRS 6 and the Companies Act set out certain conditions to be met in order that merger accounting can be adopted. Not all of these conditions were 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 was not practicable to quantify the effect of the departure.

GOODWILL
Goodwill arising on the acquisition of subsidiary companies, which is represented by the excess of fair value of the purchase consideration over the fair value of assets acquired, is capitalised and shown as an asset in the balance sheet and subsequently amortised over the economic life of the asset as a charge to the profit and loss account. This is a change from the previous policy of writing off goodwill to reserves on acquisition. As permitted by FRS 10 prior year figures have not been restated to reflect this change in accounting policy. Goodwill previously written off to reserves amounts to £42.2m. There is no effect on profit for the year of this change.

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 less estimated residual value is written off on a straight line basis over their estimated useful lives as follows:

Freehold buildings	40 to 75 years
Leasehold buildings	over the remainder of the lease up to 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.

PENSIONS
The Group operates both defined benefit and defined contribution arrangements. Under the defined benefit section

1 PRINCIPAL ACCOUNTING POLICIES *continued*

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

SECURITIES
Securities intended for use on a continuing basis in the bank's activities are classified as investment securities and are stated in the balance sheet at cost. 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 and written off when there is no longer any realistic prospect of recovery. The outstanding provisions are deducted from loans and advances, along with the interest on non-performing loans held in suspense. The charge in the profit and loss account represents the net increase 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 effective rate of corporation tax, are included within other operating income in the Group profit and loss account.

2 ADMINISTRATIVE EXPENSES

	1998 £m	1997 £m
Staff costs:		
Wages and salaries	163.3	173.1
Social security costs	15.1	15.0
Other pension costs	10.9	14.6
	189.3	202.7
Other administrative expenses	471.6	428.1
Total	660.9	630.8

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

Exceptional administrative expenses of conversion of £28m in 1997, comprise costs directly associated with the former Society's conversion to plc status and are excluded from the above costs.

3 PROFIT ON ORDINARY ACTIVITIES BEFORE TAX

	1998 £m	1997 £m
Is stated after:		
(i) Income		
Income from listed investments	83.5	76.0
(ii) Charges		
Hire of computers and equipment	1.0	7.5
Auditors' remuneration:		
Group		
as auditors	0.4	0.4
other fees paid to the auditors and their associates	1.0	1.9
Company		
as auditors	0.2	0.2
other fees paid to the auditors and their associates	0.7	1.5

4 STAFF NUMBERS

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

	Full time		Part time	
	1998	1997	1998	1997
Total	6,376	7,038	2,736	2,697

Notes to the Accounts continued

5 DIRECTORS' EMOLUMENTS

	1998 £m	1997 £m
Services as a director	0.4	0.4
Other services	2.0	1.4
	2.4	1.8
Pensions to past directors		
Compensation for loss of office	–	0.3
Total	2.4	2.1

Directors' emoluments include those emoluments received by directors from the Company and its associated bodies. Compensation for loss of office in 1997 includes £8,343 pension enhancement. The highest paid director is the Group Chief Executive.
A detailed analysis of directors' emoluments is given on page 26 in the Report on Directors' Remuneration.

6 DIRECTORS' LOANS AND TRANSACTIONS

The aggregate amount outstanding at 31 December 1998 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 £1,280,549 representing loans to 10 persons.

7 TAX ON PROFIT ON ORDINARY ACTIVITIES

	1998 £m	1997 £m
UK corporation tax at 31% (31.5%)	100.9	86.4
Relief for overseas taxation	(5.1)	(0.5)
	95.8	85.9
Deferred tax	33.9	45.8
Overseas taxation	7.6	2.2
	137.3	133.9

The tax charge for 1998 is 30.2% of profit before tax. The tax charge for 1997 was 33.9% of profit before tax. This was higher than the standard rate of 31.5% principally because of the tax treatment of the exceptional expenses of conversion. The 1997 underlying rate after adjusting for these items was 31.7%.

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

£151.4m (1997: £221.8m) 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.

9 DIVIDENDS

	1998 pence per share	1997 pence per share	1998 £m	1997 £m
Interim	8.0	6.4	46.6	37.2
Final	16.5	14.4	96.0	83.9
Total	24.5	20.8	142.6	121.1

10 EARNINGS PER SHARE

Earnings per ordinary share are calculated by dividing the Group profit attributable to shareholders of £317.9m (1997: £260.7m) by the weighted average number of ordinary shares in issue and ranking for dividend of 582.1m (1997: 582.0m) during the year.

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

	1998 £m	1997 £m
Profit for the financial year as reported	317.9	260.7
Adjusted for:		
Exceptional administrative expenses of conversion	–	28.0
Underlying profit for the financial year	317.9	288.7

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

	1998 Number m	1997 Number m
Weighted average number of ordinary shares in issue	582.1	582.0
Weighted average dilutive options outstanding	3.4	1.6
	585.5	583.6

11 TREASURY BILLS AND OTHER ELIGIBLE BILLS

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Investment securities				
Treasury bills and similar securities	–	13.1	–	–
Other eligible bills	454.9	189.7	–	–
Total	454.9	202.8	–	–
Market value of investment securities	454.9	202.7	–	–
Unamortised discounts on investment securities	2.4	1.9	–	–

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

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
At 1 January 1998	202.8	85.2	–	–
Additions	2,652.1	1,582.6	–	576.3
Disposals	(2,402.7)	(1,463.8)	–	(576.3)
Amortisation of discounts and premiums	2.7	(1.2)	–	–
At 31 December 1998	454.9	202.8	–	–

12 LOANS AND ADVANCES TO BANKS

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Amounts due from subsidiary undertakings	–	–	3,212.2	3,836.2
Other loans and advances	2,061.1	1,841.6	36.2	91.3
Total	2,061.1	1,841.6	3,248.4	3,927.5
Repayable on demand	25.3	44.2	141.2	282.7
Remaining maturity:				
3 months or less	1,696.7	1,410.2	2,728.0	3,190.2
1 year or less but over 3 months	339.1	386.1	179.2	122.0
5 years or less but over 1 year	–	–	150.0	132.6
Over 5 years	–	1.1	50.0	200.0
Total	2,061.1	1,841.6	3,248.4	3,927.5

Amounts due from subsidiary undertakings include £50m subordinated debt (1997: £50m).

13 LOANS AND ADVANCES TO CUSTOMERS

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Advances secured on residential properties	18,185.3	17,021.4	18,099.0	16,970.7
Other secured advances	238.8	200.8	106.2	132.2
Unsecured loans	2,227.4	1,604.0	566.0	355.7
Net investment in finance leases and hire purchase contracts	823.6	307.4	–	–
Amounts due from subsidiary undertakings	–	–	35.6	41.0
Total	21,475.1	19,133.6	18,806.8	17,499.6
Repayable on demand	135.5	102.5	105.2	107.2
Remaining maturity:				
3 months or less	783.6	472.1	519.6	312.7
1 year or less but over 3 months	681.2	436.7	45.8	55.5
5 years or less but over 1 year	1,731.1	1,399.0	441.7	371.7
Over 5 years	18,312.5	16,870.3	17,813.8	16,741.4
Less: provisions	(168.8)	(147.0)	(119.3)	(88.9)
Total	21,475.1	19,133.6	18,806.8	17,499.6

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

The cost of equipment acquired during the year for the purpose of finance lease and hire purchase agreements was £739.8m (1997: £277.8m).

The aggregate amounts receivable, including capital repayments, under finance and hire purchase agreements were £315.1m (1997: £230.9m).

Notes to the Accounts continued

14 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 1998				
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
Charge for the year:				
Increase/(decrease) in provision	16.7	(2.0)	36.0	50.7
Recoveries of amounts previously written off	(3.4)	(7.1)	(1.5)	(12.0)
	13.3	(9.1)	34.5	38.7
Amounts written off in year	(5.7)	5.6	(16.8)	(16.9)
At 31 December 1998				
General	7.1	5.8	29.3	42.2
Specific	47.8	16.7	62.1	126.6
Total	54.9	22.5	91.4	168.8
COMPANY				
At 1 January 1998				
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
Charge for the year:				
Increase/(decrease) in provision	42.4	(2.3)	7.6	47.7
Recoveries of amounts previously written off	(3.4)	(7.2)	–	(10.6)
	39.0	(9.5)	7.6	37.1
Amounts written off in year	(5.7)	5.7	(6.7)	(6.7)
At 31 December 1998				
General	8.9	5.2	10.3	24.4
Specific	71.7	16.2	7.0	94.9
Total	80.6	21.4	17.3	119.3

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 1998 £m	Company 1998 £m
Non-performing loans before provisions	45.8	44.9
Non-performing loans after provisions	29.1	28.7

15 DEBT SECURITIES

	Group 1998		Group 1997		Company 1998		Company 1997	
	Book value £m	Market value £m	Book value £m	Market value £m	Book value £m	Market value £m	Book value £m	Market value £m
INVESTMENT SECURITIES								
Issued by public bodies:								
Government securities	255.7	265.9	460.4	465.3	193.3	203.2	372.9	377.6
Other public sector securities	76.2	77.4	27.5	28.8	–	–	–	–
	331.9	343.3	487.9	494.1	193.3	203.2	372.9	377.6
Issued by other issuers:								
Bank and building society certificates of deposit	875.0	876.9	1,047.6	1,046.0	–	–	–	–
Other debt securities	1,067.9	1,071.4	771.6	771.6	–	–	–	–
	1,942.9	1,948.3	1,819.2	1,817.6	–	–	–	–
Total	2,274.8	2,291.6	2,307.1	2,311.7	193.3	203.2	372.9	377.6
Analysed by listing status:								
INVESTMENT SECURITIES								
Listed in the UK	1,048.2	1,062.1	910.2	914.6	193.3	203.2	372.9	377.6
Listed or registered elsewhere	153.6	154.7	149.3	151.1	–	–	–	–
Unlisted	1,073.0	1,074.8	1,247.6	1,246.0	–	–	–	–
	2,274.8	2,291.6	2,307.1	2,311.7	193.3	203.2	372.9	377.6

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
BOOK VALUE				
Analysed by maturity:				
Due within one year	1,023.1	1,260.7	83.2	116.6
Due one year and over	1,251.7	1,046.4	110.1	256.3
Total	2,274.8	2,307.1	193.3	372.9
Unamortised discounts on investment securities	5.4	12.1	3.3	10.4

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 1998	2,270.4	36.7	2,307.1
Acquisitions	5,295.3	(25.0)	5,270.3
Disposals	(5,298.2)	(4.6)	(5,302.8)
Amortisation of discounts, premiums and indexation	–	0.2	0.2
At 31 December 1998	2,267.5	7.3	2,274.8
COMPANY			
At 1 January 1998	362.5	10.4	372.9
Acquisitions	20.0	1.4	21.4
Disposals	(192.5)	(4.2)	(196.7)
Amortisation of premiums	–	(4.3)	(4.3)
At 31 December 1998	190.0	3.3	193.3

16 INVESTMENT IN SUBSIDIARY UNDERTAKINGS

	Company	
	Loans £m	Shares £m
At 1 January 1998	41.0	425.4
Additions	67.8	17.5
Repayments	(73.2)	–
At 31 December 1998	35.6	442.9

The principal subsidiary undertakings of Alliance & Leicester plc at 31 December 1998 are listed below. These subsidiary undertakings are incorporated and all operate in the United Kingdom except Alliance & Leicester International Limited, which is incorporated, and operates, in the Isle of Man and Alliance & Leicester Mortgage Insurance (Guernsey) Limited which is incorporated in, and operates in Guernsey.

DIRECTLY HELD SUBSIDIARIES	NATURE OF BUSINESS
Girobank plc	Banking
Alliance & Leicester Personal Finance Limited	Unsecured lending
Alliance & Leicester Mortgage Insurance (Guernsey) Limited	Insurance
Alliance & Leicester Life Assurance Company Limited	Ordinary long-term insurance cover
Alliance & Leicester 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
Alliance & Leicester International Limited	Offshore deposit taking

All subsidiary undertakings are limited by shares and are unlisted.

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

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

17 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	Total £m
GROUP					
COST					
At 1 January 1998	283.9	15.4	47.8	352.1	699.2
Additions	8.9	0.1	4.1	145.5	158.6
Disposals	(4.8)	(0.8)	(1.2)	(25.1)	(31.9)
At 31 December 1998	288.0	14.7	50.7	472.5	825.9
DEPRECIATION AND AMORTISATION					
At 1 January 1998	94.7	4.6	32.6	211.6	343.5
Charge in year	10.0	0.5	3.7	51.0	65.2
Disposals	(1.8)	(0.5)	(1.0)	(20.0)	(23.3)
At 31 December 1998	102.9	4.6	35.3	242.6	385.4
NET BOOK VALUE					
At 31 December 1998	185.1	10.1	15.4	229.9	440.5
At 31 December 1997	189.2	10.8	15.2	140.5	355.7

Freehold land and buildings includes land of £28.8m which is not depreciated. The net book value of land and buildings occupied by the Group for its own activities was £189.5m (1997: £195.5m).

The cost of assets leased to customers under operating leases and included in equipment, fixtures and vehicles above was £196.8m (1997: £94.5m). The related cumulative depreciation of £43.1m (1997: £22.2m) includes £26.3m (1997: £14.1m) 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 £32.1m (1997: £20.7m).

Included in the total net book value of equipment, fixtures and vehicles is £9.4m (1997: £9.7m) in respect of assets held under finance leases. Depreciation for the year on these assets was £5.2m (1997: £4.9m).

Notes to the Accounts continued

17 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	Total £m
COMPANY					
COST					
At 1 January 1998	237.7	10.5	40.9	147.0	436.1
Additions	7.7	0.1	4.1	29.1	41.0
Disposals	(4.8)	(0.8)	(1.2)	(1.7)	(8.5)
At 31 December 1998	240.6	9.8	43.8	174.4	468.6
DEPRECIATION AND AMORTISATION					
At 1 January 1998	70.2	4.1	27.6	106.1	208.0
Charge in year	8.2	0.4	3.3	15.6	27.5
Disposals	(1.8)	(0.5)	(1.0)	(1.0)	(4.3)
At 31 December 1998	76.6	4.0	29.9	120.7	231.2
NET BOOK VALUE					
At 31 December 1998	164.0	5.8	13.9	53.7	237.4
At 31 December 1997	167.5	6.4	13.3	40.9	228.1

Freehold land and buildings includes land of £27.8m which is not depreciated. The net book value of land and buildings occupied by the Company for its own activities was £161.8m (1997: £164.5m).

Included in the total net book value for equipment, fixtures and vehicles is £3.3m (1997: £Nil) in respect of assets held under finance leases. Depreciation for the year on these assets was £1.6m (1997: £Nil).

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Future capital expenditure:				
Contracted for but not provided in the accounts	0.8	10.4	0.5	10.3

18 OTHER ASSETS

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Due within one year	171.8	60.0	191.6	181.6
Due after more than one year	0.1	–	10.2	7.1
Total	171.9	60.0	201.8	188.7
AMOUNTS INCLUDE				
Due from subsidiary undertakings	–	–	189.1	171.0

19 PREPAYMENTS AND ACCRUED INCOME

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Accrued interest	184.8	99.2	90.0	88.4
Prepayments and other accruals	84.4	73.8	56.1	46.7
Total	269.2	173.0	146.1	135.1

20 LONG-TERM ASSURANCE BUSINESS

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

	1998 £m	1997 £m
GROUP		
Net tangible assets of life company:		
Surplus retained within the long-term assurance funds	41.3	23.8
Net worth of life company:		
Value of policies in force	14.9	8.8
Long-term assurance business attributable to shareholders	56.2	32.6
The long-term assurance assets attributable to policyholders are:		
Investments	221.3	116.3
Value of policies in force	14.9	8.8
Net current (liabilities)/assets	(0.4)	2.1
	235.8	127.2
Less: Long-term assurance business attributable to shareholders	(56.2)	(32.6)
Long-term assurance business attributable to policyholders	179.6	94.6

The increase in value of the Group's long-term assurance business included in the profit and loss account amounted to £9.0m before tax (1997: £6.8m) and £6.1m after tax (1997: £4.4m).

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	7.5% pa gross of tax
Growth of non-linked funds	4.5% pa gross of tax
Policyholder taxation – life	20%
Shareholder taxation – life	30%
Expense inflation	4.5% pa

Notes to the Accounts continued

21 DEPOSITS BY BANKS

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Amounts due to subsidiary undertakings	–	–	4,824.1	2,275.6
Other deposits	721.0	89.1	2.0	28.1
Total	721.0	89.1	4,826.1	2,303.7
Repayable on demand	13.7	46.0	74.5	43.6
Remaining maturity:				
3 months or less	665.5	27.6	4,558.3	1,887.2
1 year or less but over 3 months	41.8	4.5	49.6	116.6
5 years or less but over 1 year	–	11.0	117.0	195.5
Over 5 years	–	–	26.7	60.8
Total	721.0	89.1	4,826.1	2,303.7

22 CUSTOMER ACCOUNTS

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Repayable on demand	15,573.5	17,075.5	14,010.7	15,915.0
With agreed maturity dates or periods of notice – remaining maturity:				
3 months or less but not repayable on demand	3,282.9	1,621.4	40.3	55.3
1 year or less but over 3 months	1,000.5	205.0	473.0	57.4
5 years or less but over 1 year	35.3	46.5	27.5	28.3
Over 5 years	–	–	–	–
Total	19,892.2	18,948.4	14,551.5	16,056.0

23 DEBT SECURITIES IN ISSUE

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Bonds and medium-term notes – remaining maturity:				
1 year or less	470.6	349.8	470.6	349.8
2 years or less but over 1 year	399.4	470.3	399.4	470.3
5 years or less but over 2 years	748.6	399.1	–	399.1
Over 5 years	224.8	150.0	150.0	150.0
	1,843.4	1,369.2	1,020.0	1,369.2
Other debt securities in issue – remaining maturity:				
3 months or less	1,085.3	243.4	224.0	59.9
1 year or less but over 3 months	408.1	208.0	35.2	66.5
2 years or less but over 1 year	70.0	–	–	–
	1,563.4	451.4	259.2	126.4
Total	3,406.8	1,820.6	1,279.2	1,495.6

24 OTHER LIABILITIES

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Falling due within one year:				
Trade creditors	15.6	13.5	4.8	2.4
Corporation taxation	97.1	98.8	50.6	57.2
Other taxation	69.3	68.9	66.6	66.1
Dividends payable	101.2	85.3	101.2	85.3
Finance leases	7.8	2.1	1.7	–
Other liabilities	42.2	57.2	68.2	120.1
Total	333.2	325.8	293.1	331.1
Falling due after more than one year:				
Finance leases	12.1	24.1	–	–
Total	345.3	349.9	293.1	331.1
Amounts include				
Due to subsidiary undertakings	–	–	47.7	79.2

The maturity of net obligations under finance leases is as follows:				
1 year or less	7.8	2.1	1.7	–
5 years or less but over 1 year	12.0	23.5	–	–
Over 5 years	0.1	0.6	–	–
Total	19.9	26.2	1.7	–

Notes to the Accounts continued

25 ACCRUALS AND DEFERRED INCOME

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Interest accrued on subordinated liabilities	6.7	10.7	6.7	10.7
Other accrued interest	496.0	442.9	411.4	459.7
Captive mortgage indemnity fund	47.4	31.6	–	–
Other	161.5	144.0	146.9	80.7
Total	711.6	629.2	565.0	551.1

26 PROVISIONS FOR LIABILITIES AND CHARGES

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Deferred taxation (note 27)	39.4	5.0	–	–
Other provisions for liabilities and charges (note 28)	14.6	13.4	14.6	13.4
Total	54.0	18.4	14.6	13.4

27 DEFERRED TAXATION

The amounts provided for deferred taxation are set out below:

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Difference between accumulated depreciation and capital allowances	40.7	10.2	2.2	1.3
Other timing differences	(1.3)	(5.2)	(12.4)	(8.4)
Total	39.4	5.0	(10.2)	(7.1)
Full potential deferred liability/(asset):				
Difference between accumulated depreciation and capital allowances	34.9	2.1	7.3	4.2
Other timing differences	(17.2)	(20.7)	(19.4)	(14.2)
Total	17.7	(18.6)	(12.1)	(10.0)

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 1998	5.0	(7.1)
Amount charged during year	33.9	(3.1)
Deferred tax asset acquired on leasing transaction	0.5	–
At 31 December 1998	39.4	(10.2)

28 OTHER PROVISIONS FOR LIABILITIES AND CHARGES

	Post retirement medical benefits £m
GROUP AND COMPANY	
At 1 January 1998	13.4
Transfer from profit and loss account	1.8
Provisions utilised	(0.6)
At 31 December 1998	14.6

29 SUBORDINATED LIABILITIES

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Undated loan capital	–	200.0	–	200.0
Dated loan capital	275.0	378.0	275.0	378.0
Total subordinated liabilities	275.0	578.0	275.0	578.0
Less: Unamortised issue costs	(1.8)	(3.1)	(1.8)	(3.1)
Total	273.2	574.9	273.2	574.9

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.

Maturing by 1998	–	53.0	–	53.0
Maturing by 2004	–	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
Total	275.0	578.0	275.0	578.0

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

	Terms	Group and Company £m
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

30 CALLED UP SHARE CAPITAL

	1998 Number m	1998 Amount £m	1997 Number m	1997 Amount £m
Authorised share capital:				
Ordinary shares of 50p each	**776.0**	**388.0**	776.0	388.0
Issued and fully paid	**584.3**	**292.1**	582.0	291.0

The Group has established a Qualifying Employee Share Ownership Trust (QUEST) to acquire shares in the Company for the benefit of employees and directors of the Company and its subsidiaries.

On 12 March 1998 the QUEST subscribed at a market price of 922p per share, for 2,256,081 of the Company's ordinary 50p shares. The cost of financing has been transferred by the Company directly to profit and loss account reserves. A share premium account has been established for the excess of the subscription price over nominal value which amounts to £19.7m. Under the terms of the Trust Deed, dividends are required to be waived on the shares held by the QUEST.

In addition, a further 5,980 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 and 7,295 ordinary shares of 50p each were issued, for 533p per share to employees of the Company exercising options under the terms of the Approved and Unapproved Company Share Option Schemes.

The following options are outstanding:

	1998 Number	1997 Number
1997 Approved Company Share Options exercisable 2000 to 2007 at 533p	**624,697**	630,325
1997 Unapproved Company Share Options exercisable 2000 to 2004 at 533p	**547,769**	549,436
1998 Approved Company Share Options exercisable 2001 to 2008 at 900.5p	**100,108**	–
1998 Unapproved Company Share Options exercisable 2001 to 2005 at 900.5p	**403,648**	–
1997 Alliance & Leicester ShareSave Scheme options exercisable at the end of a 3 or 5 year savings contract commencing July 1997 at 426p	**5,214,866**	6,067,055
1998 Alliance & Leicester ShareSave Scheme options exercisable at the end of a 3 or 5 year savings contract commencing November 1998 at 672p	**1,346,529**	–

SUBSTANTIAL SHARE INTERESTS

In accordance with sections 198 to 208 of the Companies Act 1985, the following shareholders disclosed a major interest in the share capital of the Company as at 9 February 1999.

	%
Alliance & Leicester ShareSafe Limited	14.20
Prudential Corporation plc	3.05

31 RESERVES

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Profit and loss account				
At 1 January	1,387.0	1,556.3	1,220.2	1,428.4
Retained profit for the year	175.3	139.6	8.8	100.7
Statutory cash bonus	–	(17.9)	–	(17.9)
Reduction in reserves resulting from shares issued to QUEST	(20.8)	–	(12.4)	–
New share capital substituted	–	(291.0)	–	(291.0)
At 31 December	1,541.5	1,387.0	1,216.6	1,220.2
Share premium account				
At 1 January	–	–	–	–
Premium on ordinary shares issued in relation to QUEST	19.7	–	19.7	–
At 31 December	19.7	–	19.7	–

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 (1997: £42.2m); Company £nil (1997: £nil).

32 ASSETS AND LIABILITIES IN FOREIGN CURRENCIES

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Assets denominated in sterling	27,344.3	24,283.2	23,071.9	22,753.6
Assets denominated in other currencies	234.3	120.5	259.2	83.4
Total assets	27,578.6	24,403.7	23,331.1	22,837.0
Liabilities denominated in sterling	27,028.2	24,306.5	23,071.9	22,753.6
Liabilities denominated in other currencies	550.4	97.2	259.2	83.4
Total liabilities	27,578.6	24,403.7	23,331.1	22,837.0

The above assets and liabilities denominated in currencies other than sterling do not indicate the Group's exposure to foreign exchange risk. The Group has hedged all material foreign currency exposures by off balance sheet hedging instruments (see note 36).

33 PENSIONS

	1998 £m	1997 £m
Regular cost	13.5	14.0
Variations from regular cost(i)	(2.4)	1.8
Notional interest on prepayment	(1.4)	(1.4)
Total	9.7	14.4

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

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

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

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

The pension costs are assessed in accordance with the advice of independent qualified actuaries using the projected unit method. The latest actuarial valuation was made as at 31 March 1998. The significant assumptions in these valuations were that salaries increase on average by 4.75% p.a., long-term return on investments is 7% p.a. in the period before members reach retirement and 6% p.a. in the post-retirement period, and that pensions increase in line with inflation at 2.75% p.a.

At 31 March 1998 the market value of the assets of the Scheme was £631.9m and this was sufficient to cover 115% of the liabilities for benefits due to members in respect of service prior to that date. Contributions to the Scheme amounted to £12.6m.

The excess of £2.9m of the contributions over the pension charge has increased the prepayment of £19.5m at the start of the year. An asset of £22.4m representing total net accumulated prepaid contributions is included in the Group balance sheet as at 31 December 1998.

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.
The charge in the year for post retirement medical benefits in the Group accounts is £1.2m (1997: £nil).

34 MEMORANDUM ITEMS

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Contingent liabilities				
Guarantees	30.5	–	–	–
Commitments				
Irrevocable undrawn loan facilities	306.0	199.0	–	–

35 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 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
At 31 December, annual commitments under operating leases are as follows:				
Land and buildings				
Leases which expire:				
Within 1 year	0.2	0.1	0.2	0.1
1-5 years	2.2	1.3	2.2	1.1
Over 5 years	8.4	10.2	8.3	7.9
Total	10.8	11.6	10.7	9.1
Other operating leases				
Leases which expire:				
Within 1 year	–	–	–	–
1-5 years	–	–	2.0	1.7
Total	–	–	2.0	1.7

Notes to the Accounts continued

36 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.

	1998 Contract amount £m	1998 Replacement cost £m	1997 Contract amount £m	1997 Replacement cost £m
GROUP				
Exchange rate contracts:				
Forward foreign exchange:				
In not more than one year	478.3	4.1	211.4	2.9
In more than one year but not more than five years	–	–	12.2	–
	478.3	4.1	223.6	2.9
With OECD financial institutions	367.8	3.6	111.3	1.5
With non-financial institutions	110.5	0.5	112.3	1.4
Total exchange rate contracts	478.3	4.1	223.6	2.9
Interest rate contracts with OECD financial institutions:				
Interest rate swaps:				
In not more than one year	2,804.4	24.5	1,495.7	16.5
In more than one year but not more than five years	4,830.4	26.5	2,108.6	22.0
In more than five years	770.5	66.6	888.4	33.9
	8,405.3	117.6	4,492.7	72.4
Caps, Collars and Floors, FRAs and Futures:				
In not more than one year	200.0	1.1	115.0	–
In more than one year but not more than five years	2,070.5	41.2	350.0	2.5
In more than five years	30.0	0.8	–	–
	2,300.5	43.1	465.0	2.5
Total interest rate contracts	10,705.8	160.7	4,957.7	74.9
Total	11,184.1	164.8	5,181.3	77.8

36 DERIVATIVE FINANCIAL INSTRUMENTS *continued*

	1998 Contract amount £m	1998 Replacement cost £m	1997 Contract amount £m	1997 Replacement cost £m
COMPANY				
Exchange rate contracts with OECD financial institutions:				
Forward foreign exchange	–	–	–	–
Interest rate contracts with OECD financial institutions:				
Interest rate swaps:				
In not more than one year	2,677.0	38.7	2,573.3	10.6
In more than one year but not more than five years	5,880.3	51.9	3,665.8	23.7
In more than five years	470.0	54.4	695.0	30.1
	9,027.3	145.0	6,934.1	64.4
Caps, Collars and Floors, FRAs and Futures:				
In not more than one year	–	–	–	–
In more than one year but not more than five years	1,260.5	37.1	–	–
In more than five years	30.0	0.8	–	–
	1,290.5	37.9	–	–
Total	10,317.8	182.9	6,934.1	64.4

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

37 RECONCILIATION OF OPERATING PROFIT TO NET OPERATING CASH FLOWS

For the year ended 31 December 1998	1998 £m	1997 £m
Operating profits	455.2	394.6
Increase in accrued income and prepayments	(93.9)	(65.4)
Increase in accruals and deferred income	81.5	125.8
Provision for bad and doubtful debts	38.7	29.3
Loans and advances written off net of recoveries	(16.9)	(17.4)
Depreciation and amortisation	65.2	49.1
Interest on subordinated loan added back	44.8	47.2
Provisions for liabilities and charges	1.2	–
Increase in shareholders interest in long-term assurance fund	(9.0)	(6.8)
Other non-cash movements	(5.0)	(1.6)
Net cash flow from trading activities	561.8	554.8
Net (increase)/decrease in collections/transmissions	(69.8)	32.0
Net increase in loans and advances to banks and customers	(2,523.3)	(1,318.5)
Net increase in deposits by banks and customer accounts	1,575.7	601.1
Net increase/(decrease) in debt securities in issue	1,586.2	(520.7)
Net (increase)/decrease in other assets	(111.5)	7.0
Net decrease in other liabilities	(75.7)	(97.0)
Other non-cash movements	(1.6)	7.0
Net cash inflow/(outflow) from operating activities	941.8	(734.3)

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

	At 1/1/98 £m	Cashflow £m	At 31/12/98 £m
Cash and balances at central banks	84.7	(18.2)	66.5
Loans and advances to other banks repayable on demand	44.2	(18.9)	25.3
	128.9	(37.1)	91.8

The Group is required to maintain balances with the Bank of England which at 31 December 1998 amounted to £27.3m (1997: £60.1m).

ANALYSIS OF CHANGES IN FINANCING DURING THE YEAR

	Share capital £m	Subordinated liabilities £m
Balance at 1 January 1998	291.0	574.9
Cash outflow from financing	–	(303.0)
Other movements	1.1	1.3
Balance at 31 December 1998	292.1	273.2

ACQUISITIONS OF GROUP UNDERTAKINGS

	1998 £m	1997 £m
Fair value of net assets acquired:		
Loans and advances to customers	78.4	–
Other liabilities	(75.6)	–
Provisions for liabilities and charges	(0.5)	–
Satisfied by cash	2.3	–

38 SEGMENTAL ANALYSIS

The Group has four business sectors: Mortgage Lending & Investments, Personal Banking, Commercial Banking and Treasury & Group. The information contained within the following table, in a format guided by SSAP 25 and the BBA SORP on segmental reporting, represents an analysis of the Group profit before tax and Group total assets. Further information is provided in the notes below. A more detailed and relevant breakdown is given within the Financial Review on pages 10 to 20.

1998	Mortgage Lending & Investing £m	Personal Banking £m	Commercial Banking £m	Treasury & Group £m	Total Group £m
Total income	478.5	317.9	328.5	64.1	1,189.0
Profit on ordinary activities before tax and exceptional costs	267.2	94.2	69.9	23.9	455.2
Exceptional costs					–
Profit on ordinary activities before tax					455.2

	Mortgage Lending & Investing £m	Personal Banking £m	Commercial Banking £m	Treasury & Group £m	Inter-group eliminations £m	Total Group £m
Gross assets	22,660.8	3,935.8	2,859.8	11,936.3	(13,814.1)	27,578.6
Inter-group eliminations	(3,492.7)	(1,819.9)	(1,057.8)	(7,443.7)	13,814.1	–
Total assets	19,168.1	2,115.9	1,802.0	4,492.6	–	27,578.6

1997	Mortgage Lending & Investing £m	Personal Banking £m	Commercial Banking £m	Treasury & Group £m	Total Group £m
Total income	464.4	273.3	321.0	59.0	1,117.7
Profit on ordinary activities before tax and exceptional costs	248.5	78.1	57.5	38.5	422.6
Exceptional costs					(28.0)
Profit on ordinary activities before tax					394.6

	Mortgage Lending & Investing £m	Personal Banking £m	Commercial Banking £m	Treasury & Group £m	Inter-group eliminations £m	Total Group £m
Gross assets	21,623.2	3,245.7	2,237.6	8,516.8	(11,219.6)	24,403.7
Inter-group eliminations	(3,484.9)	(1,712.7)	(1,380.9)	(4,641.1)	11,219.6	–
Total assets	18,138.3	1,533.0	856.7	3,875.7	–	24,403.7

Notes

a) Capital is allocated to business sectors on the basis of 8% equity and 3% subordinated debt. Excess capital is held within Treasury & Group.

b) Costs have been assigned to each sector based on resources consumed. Corporate overheads not directly attributable to business units, including Year 2000 and EMU costs, are included within Treasury & Group. Exceptional costs, being the costs of conversion in 1997, are the consequence of corporate decisions made by the Group, and have not therefore been allocated across business sectors.

c) The Group operates entirely within the banking and insurance business, and operations are not managed on the basis of an allocation of net assets. The level of banking assets can fluctuate throughout the year, therefore the information derived from the year end figures does not provide a picture representative of the year as a whole. A more meaningful analysis of average interest-earning assets and average interest-bearing liabilities by business sector is contained within the Financial Review on page 14.

Shareholder Information

SHAREHOLDER ANALYSIS AS AT 31 DECEMBER 1998

	No. of holders*	Percentage of total holders	No. of shares	Percentage of ordinary share capital
Shareholding range:				
1 – 250	941,326	93.05	230,995,911	39.54
251 – 500	59,868	5.92	29,114,454	4.98
501 – 10,000	9,759	0.96	11,945,868	2.04
10,001 – 50,000	332	0.03	8,042,148	1.38
50,001 – 100,000	122	0.01	9,002,552	1.54
100,001 and over	323	0.03	295,169,411	50.52
	1,011,730	100.00	584,270,344	100.00
Classification of shareholders:				
Personal holders (**)			275.2 million	47.1%
Institutional holders			309.1 million	52.9%

(*) 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	4 May 1999
Final dividend for the year to 31 December 1998 payable	17 May 1999
Interim results to be announced	6 August 1999

Dividend History

Interim dividend 1997	6.4p
Final dividend 1997	14.4p
Interim dividend 1998	8.0p
Final dividend 1998	16.5p

Registrar's Address:
Lloyds TSB Registrars
54 Pershore Road South
Kings Norton
Birmingham B22 1AD
Tel: 0870 607 0414

Alliance & Leicester
Share Dealing Service:
Barclays Stockbrokers Limited
Tay House
300 Bath Street
Glasgow G2 4JR
Tel: 0990 168 355

A brief history of Alliance & Leicester

1853

1863

1985

1974

1989

1997

1996

Designed and produced by Lloyd Northover

Alliance
Leicester

Registered Office:
49 Park Lane
London W1Y 4EQ

Company No: 3263713

http://www.alliance-leicester.co.uk

Document1

Alliance & Leicester plc

1998

Summary Financial Statement

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Alliance Leicester

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Alliance & Leicester recognises that the delivery of shareholder value depends upon our ability to create real value for our customers from a low cost platform.

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.

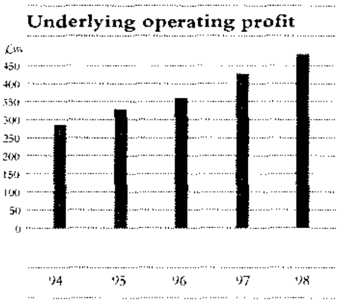
The year in brief

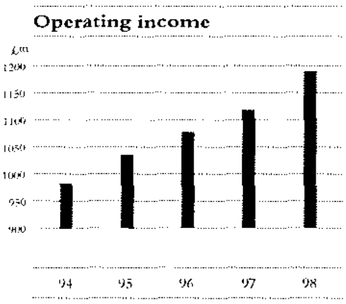
- **Underlying operating profit up 10%**
  Group underlying operating profit, excluding costs associated with EMU, Year 2000, and conversion, increased from £425m to £469m

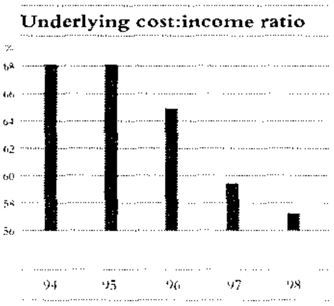
- **Pre-tax profit up 15%**
  Pre-tax profit up 15% to £455m (1997: £395m, after charging exceptional costs of conversion of £28m)

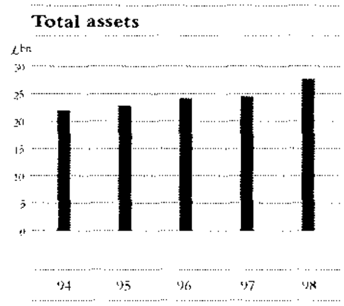
- **Underlying Group cost:income ratio down to 57.2%**
  Underlying Group cost:income ratio, excluding costs associated with EMU, Year 2000 and conversion costs down from 59.4% to 57.2%

- **Total dividend of 24.5p per share, up 18%**
  Proposed final dividend of 16.5p per share giving total dividend of 24.5p per share for 1998 (1997: total dividend of 20.8p per share)









Business Review and Future Plans

We are pleased to report that Alliance & Leicester's pre-tax profit in 1998 was £455m, a record for the sixth year in a row and up by 15% on the £395m achieved in 1997.

Excluding the costs of Year 2000 and EMU, and the costs of conversion in 1997, profit was £469m, 10% higher than the equivalent figure in 1997. Underlying earnings per share grew by 10%, from 49.6p to 54.6p, and the full year dividend will be 24.5p, up 18% on 1997.

In order to achieve our three year Tier 1 capital target of 8%, it is our intention to return excess capital by buying back shares. The amount and timing of these purchases will, of course, depend on market conditions, and the matter will be approached flexibly in the light of circumstances. In any case we will not start any buy-back until after the abolition of Advance Corporation Tax in April, and shares will be bought at prices which would increase our earnings per share.

We recognise that for our shareholders, the dividend paid on their shares is an important indicator of the emphasis we place on shareholder value. The double-digit growth in those dividends for 1998 demonstrates our determination to deliver maximum shareholder value.

Our three main business units increased their profits in 1998.

MORTGAGE LENDING & INVESTMENTS

In the Mortgage Lending & Investments business, underlying profits in 1998 were £267m, up 8% on the £248m achieved in 1997.

Our gross mortgage lending in 1998 was £3.8bn, up ~~49%~~ 46% on the £2.6bn lent in 1997. We have achieved this through improved marketing, innovative products, a restructured sales force and more effective sales targeting.

We introduced a popular 'capped rate' mortgage product in January 1998. We also launched a flexible mortgage during 1998, allowing flexible payments and payment holidays.

The retail savings market has been intensely competitive during 1998. New entrants to the market have attracted quite significant savings inflows by offering very competitive – and often uneconomic – interest rates. What remains to be seen is how long these new suppliers will be prepared to subsidise their nascent banking businesses by offering 'loss-leader' interest rates.

We have used our diversification to fund mortgage growth through a variety of sources, without relying on expensive new retail savings. These sources included increased wholesale funding, and increased corporate customer balances.

PERSONAL BANKING

Personal Banking's underlying profits in 1998 were £94m, up by 21% on the £78m achieved in 1997.

Alliance & Leicester Personal Finance, our unsecured personal lending business saw its tenth successive year of record sales volumes and profits. The business is a low cost telephone and postal-based operation, with applications processed on-line using proven credit scorecards.

We launched our innovative 'money back' credit card in March 1997. This had gained around 500,000 customers by the end of 1998. In total, we now have over 900,000 credit card customers, with 10 major retailers now offering increased 'money back' to Alliance & Leicester credit card holders.

The Group's award-winning personal current accounts continue to offer an excellent service to customers. During 1998 we introduced interactive voice response service for all of our current account customers, which was well received by customers and enables the most common enquiries to be dealt with more quickly and efficiently.

COMMERCIAL BANKING

Operating profit from Commercial Banking rose to £70m, up by 21% from £58m in 1997.

Girobank remains a market-leader for cash handling services, and business volumes were higher than in 1997 for each of cash handling, cash sales, bill payments and merchant acquiring.

During 1998, Girobank's asset finance subsidiary, Sovereign Finance, grew significantly. The majority of Sovereign's big ticket leases are fully bank guaranteed, reflecting our cautious approach to expansion in this area.

OUTLOOK

With the introduction of the Euro, the likelihood of lower interest rates and a possible economic slowdown, competition for financial services will remain intense in 1999.

Whatever the background for 1999 and beyond, certain basic factors will apply. Organisations that survive and thrive will be those that are focused, providing products from a low cost base, and taking opportunities to grow income. Above all, they will be those organisations that give priority to long-term shareholder value when shaping their business decisions. Through a strict adherence to these criteria, we are confident that Alliance & Leicester will enjoy a successful future.

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Summary Financial Statement

THIS SUMMARY FINANCIAL Statement is a summary of information in the Annual Report and Accounts. (It does not contain sufficient information to allow a full understanding of the results and state of affairs of the Group). For details of how to apply for a full copy of the Annual Report and Accounts see Page 6.

SUMMARY DIRECTORS' REPORT

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 subsidiary, Girobank plc, provides a wide range of banking and financial services to business and public sector customers.

The Group's business during the year and future plans are reviewed on pages 1 to 2 of this document.

Results and Dividends

The profit on ordinary activities before tax for the year ended 31 December 1998 was £455.2 million (1997: £394.6m).

An interim dividend of 8.0 pence (1997: 6.4 pence) per share was paid on 19 October 1998.

The directors propose a final dividend for the year of 16.5 pence (1997: 14.4 pence) per share to be paid on 17 May 1999.

Directors

The names of directors of the Company are shown on Page 6. Mr R Banks, Managing Director of Girobank plc, was appointed an executive director on 1 February 1998. Mr M J Allen retired as a director on 27 April 1998. Mr P Barton was appointed a non-executive director on 13 May 1998. Mr E J Baden retired as a director and Deputy Chairman on 18 August 1998.

Report of the Auditors

The auditors' report on the full accounts for the year ended 31 December 1998 was unqualified. (It did not include a statement under sections 237 (2) (accounting records or returns inadequate or accounts not agreeing with records and returns) or 237 (3) (failure to obtain necessary information and explanations) of the Companies Act 1985).

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Group Summary Statement

Summary Consolidated Profit & Loss Account For the year ended 31 December 1998	**1998** **£m**	1997 £m
Net interest income	**739.7**	693.4
Non-interest income	**449.3**	424.3
Administrative expenses:		
Underlying	**(695.1)**	(665.8)
Exceptional	**–**	(28.0)
	(695.1)	(693.8)
Provisions for bad and doubtful debts	**(38.7)**	(29.3)
Profit on ordinary activities before tax	**455.2**	394.6
Tax on profit on ordinary activities	**(137.3)**	(133.9)
Profit attributable to the shareholders of Alliance & Leicester plc	**317.9**	260.7
Dividends	**(142.6)**	(121.1)
Retained profit for the year	**175.3**	139.6
Earnings per ordinary share	**54.6p**	44.8p
Underlying earnings per ordinary share	**54.6p**	49.6p
Fully diluted earnings per ordinary share	**54.3p**	44.7p

Note: Underlying operating profit is defined as pre-tax profit before non-recurring exceptional items.

Directors' emoluments

The aggregate emoluments of the directors for the year ended 31 December 1998 were £2.4m (1997: £2.1m).

Summary Consolidated Balance Sheet As at 31 December 1998	**1998** **£m**	1997 £m
ASSETS		
Cash, treasury bills and other eligible bills	**521.4**	287.5
Loans and advances to banks	**2,061.1**	1,841.6
Items in the course of collection from other banks	**128.8**	118.0
Loans and advances to customers	**21,475.1**	19,133.6
Debt securities	**2,274.8**	2,307.1
Tangible fixed assets	**440.5**	355.7
Other assets	**441.1**	233.0
Long-term assurance assets attributable to shareholders	**56.2**	32.6
Long-term assurance assets attributable to policyholders	**179.6**	94.6
Total assets	**27,578.6**	24,403.7
LIABILITIES		
Deposits by banks	**721.0**	89.1
Items in the course of transmission to other banks	**141.6**	200.6
Customer accounts	**19,892.2**	18,948.4
Debt securities in issue	**3,406.8**	1,820.6
Other liabilities	**1,110.9**	997.5
Subordinated liabilities	**273.2**	574.9
Shareholders' funds (equity)	**1,853.3**	1,678.0
Long-term assurance liabilities to policyholders	**179.6**	94.6
Total liabilities	**27,578.6**	24,403.7
Memorandum items: Commitments and contingent liabilities	**336.5**	199.0

Approved by the Board of directors on 25 February 1999 and signed on its behalf by:
J Windeler **Chairman** P R White **Group Chief Executive** R A Pym **Group Finance Director**

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Board of Directors

John Windeler
Chairman
Sir Michael Thompson
Deputy Chairman
Peter White
Group Chief Executive
Richard Banks
Managing Director, Girobank
Peter Barton
Frances Cairncross
Nicholas Corah
Simon Everard
Trevor Hilliard
Managing Director, Retail Financial Services
Richard Pym
Group Finance Director

Report of the Auditors

Auditors' Statement to the members of Alliance & Leicester plc.

We have examined the Summary Financial Statement on page 4.

Respective responsibilities of directors and auditors

The summary financial statement is the responsibility of the directors. Our responsibility is to report to you our opinion on its preparation and consistency with the full annual accounts and the directors' report.

Basis of opinion

We conducted our examination in accordance with the Auditing Guideline 'The auditors' statement on the summary financial statement' adopted by the Auditing Practices Board.

Our report on the Group's full annual accounts describes the basis of our audit opinion on those accounts.

Opinion

In our opinion the summary financial statement is consistent with the full annual accounts and directors' report of Alliance & Leicester plc for the year ended 31 December 1998 and complies with the requirements of Section 251 of the Companies Act 1985 and the regulations made thereunder.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants and Registered Auditor
London, 25 February 1999

Important notice to shareholders

A free copy of the Annual Report and Accounts is available on request by writing to: Group Secretariat, Alliance & Leicester plc, Customer Services Centre, Narborough, Leicester, LE9 5XX. If, in addition, you would like to receive the full Annual Report and Accounts of Alliance & Leicester plc in future years please write to: Group Secretariat, Alliance & Leicester plc, at the address above giving your full name, address and your shareholder account number (which can be obtained from your dividend tax voucher).

Registrar's Address:

Lloyds TSB Registrars, 54 Pershore Road South, Kings Norton, Birmingham B22 1AD. Tel: 0870 607 0414.

Alliance & Leicester Share Dealing Service:

Barclays Stockbrokers Limited, Tay House, 300 Bath Street, Glasgow G2 4JR. Tel: 0990 168 355.

Alliance & Leicester plc. Registered Office: 49 Park Lane London W1Y 4EQ. Company No: 3263713.
The Alliance & Leicester Marketing Group, consisting of the Alliance & Leicester plc and Alliance & Leicester Life Assurance Company Limited, which are regulated by the Personal Investment Authority, and Alliance & Leicester Unit Trust Managers Limited, which is regulated by IMRO, only sells its own life assurance, pension, unit trust and PEP products.