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Abbey National plc

Directors' Report & Accounts

ANNUAL REPORT

Year ended
31 December 1996

®

To strengthen Abbey National's market position in UK personal financial services.

To win and hold competitive advantage through superior customer service.

To continue to diversify profit streams away from our traditional mortgage and savings activities.

To remain a low cost operator.

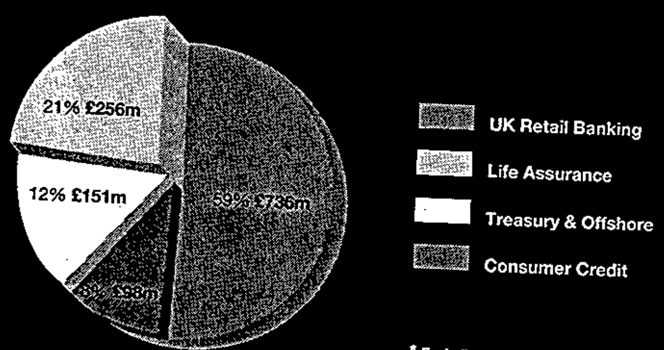
To maintain strong management of risks.

To promote brand strength.

To develop synergies between our mutually supporting businesses.

To achieve above average growth in shareholder value over the long term by meeting the needs of our customers, our staff and all of the other stakeholders in our business.

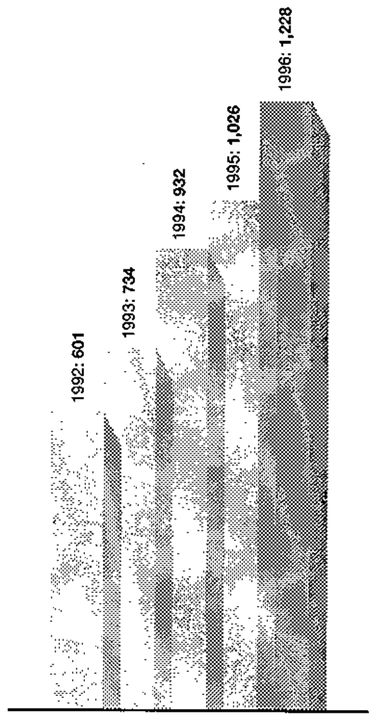
Profit before tax and integration costs by business segment*



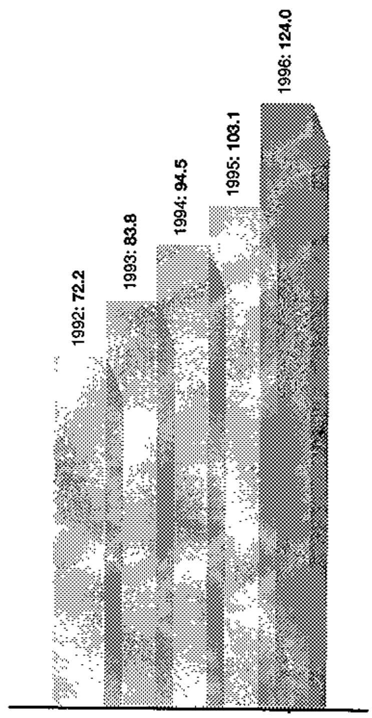
* Excluding Continental Europe and Other Operations

Group Highlights 1996

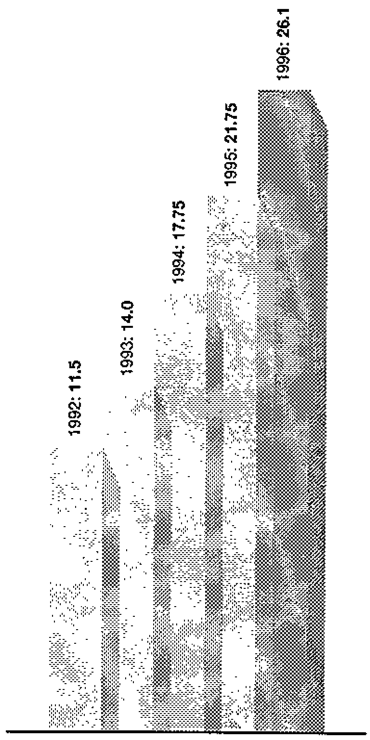
- Profit before tax and integration costs of National and Provincial (N&P) increased from £1,026 million to £1,228 million
- Pre-tax profit increased from £1,026 million to £1,167 million
- Total assets up 20% to £124.0 billion, with a tier 1 capital ratio of 8.5% (1995: 8.4%)
- Earnings per ordinary share before integration costs up 16%
- Proposed final net dividend of 17.4 pence per ordinary share making the full year net dividend 26.1 pence, an increase of 20%



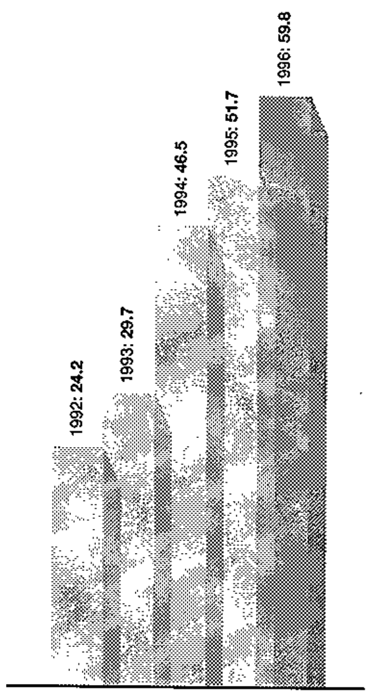
Profit before tax, integration costs and other exceptional items (£m)



Total assets (£bn)



Net dividends (pence per ordinary share)



Earnings per ordinary share* (pence per share)

* excluding integration costs

Chairman's Statement

Lord Tugendhat
Chairman

The merger with the National and Provincial Building Society was the most significant event for the Company since conversion

Abbey National's businesses continued to perform strongly in 1996 - profit before tax and integration costs rose by 20% to £1,228 million, whilst total assets, including those acquired as a result of the merger with the former National and Provincial Building Society, increased to £124.0 billion. The Board is proposing a final net dividend of 17.4 pence per ordinary share. The proposed dividend increases total dividends per ordinary share for the year from 21.75 pence in 1995 to 26.1 pence, a growth of 20%, reflecting a successful year and a belief that we can continue to grow profits. Abbey National's on-going policy is to provide strong dividend growth combined with prudent investment in the business. As the pace of economic recovery in the UK increases we expect it to bring new opportunities and challenges for Abbey National.

National and Provincial

The merger with the former National and Provincial Building Society (N&P) made 1996 a landmark year for Abbey National. It was the most significant event for the Company since conversion to plc status, strengthening our core business and taking our share of the total mortgage market from around 12% to almost 15%. It stands out as an achievement both in terms of the scale of the undertaking and the speed with which it has been accomplished.

Throughout the integration process great efforts were made to avoid disruption to service. The success of the integration would not have been possible without the extraordinary efforts of both Abbey National and former N&P staff throughout 1996, and I would like to extend my thanks and congratulations to everyone involved.

The proposed merger was first announced in July 1995 and we had substantially integrated our respective businesses by 5 August 1996. Abbey National customers now benefit from an enlarged network of 870 branches and more than 1,600 ATMs. The fact that almost all former N&P customers have remained with the enlarged Group reflects the high quality of service Abbey National offers.

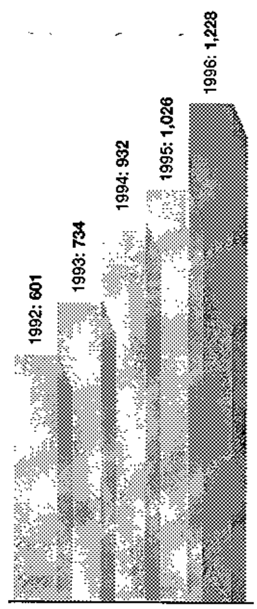
Diversification

One of the reasons Abbey National decided to convert in 1989 was that we believed our diversification plans would be more attainable outside the confines of the Building Societies Act. Diversification into areas related to, but not dependent on, our core mortgage and savings markets was vital for future growth. 40% of our profit is now generated from activities outside our traditional businesses. This has been to our advantage in recent years when we have seen fierce competition for business within a depressed mortgage market. The four major building society conversions currently underway will not be completed until the second half of 1997 - by which time Abbey National will have had a head start of some eight years.

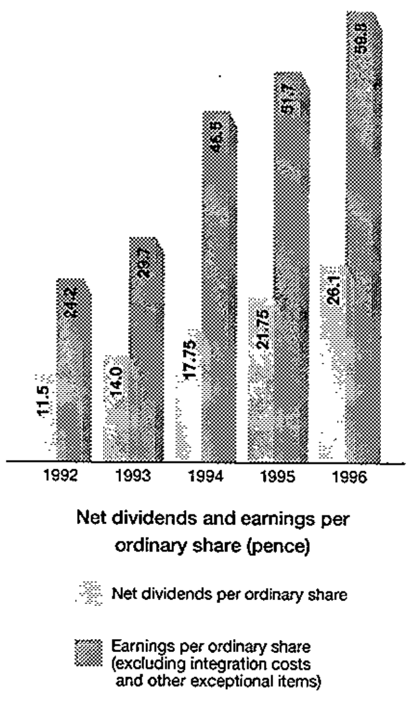
The three areas from which Abbey National now principally generates diversified income are Consumer Credit, Life Assurance, and Treasury & Offshore.

As well as growing our new business areas organically - particularly in the case of our Treasury operations which we developed from scratch to a business with assets of almost £50 billion - Abbey National has a track record of making acquisitions which add shareholder value. Scottish Mutual Assurance was acquired in 1992, since when its premium income has tripled and investment fund performance has been well above average. The skills and experience acquired with Scottish Mutual proved invaluable a year later when we launched Abbey National Life - Abbey National's entry into bancassurance. The Financial Planning Service in Abbey National branches now offers UK Retail Banking customers a range of Abbey National Life pensions and life assurance products. In 1996, Abbey National's life businesses attracted £1.6 billion worth of new business making us one of the UK's top ten life assurers on that basis.

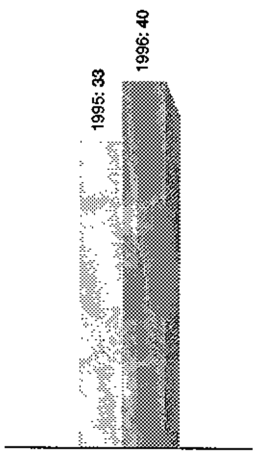
Since June 1995, Abbey National's total consumer credit assets have increased more than fivefold to nearly £2.5 billion. This was due not only to the acquisition of First National Finance Corporation (FNFC) and its subsequent growth through its principal trading subsidiary First National Bank (FNB), but also to the strong growth in sales of our



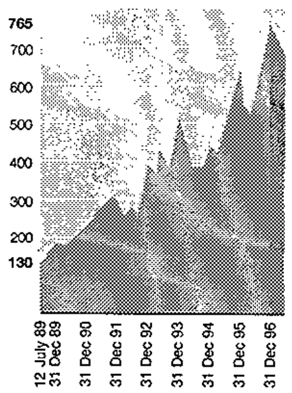
Profit before tax, integration costs and other exceptional items (£m)



Net dividends and earnings per ordinary share (pence)



Profit from non-traditional activities (%)



Share price performance (pence)

Abbey National-branded unsecured loans through branches and over the telephone. Abbey National's consumer credit business generated profits of £98 million in 1996.

In July, FNB acquired the Wagon Finance Group for £116 million. Wagon Finance is one of the UK's largest used-car finance companies, and this acquisition gave Abbey National the ability to offer point of sale finance to buyers of new and used cars through an extensive network of dealer relationships. In August, FNB acquired Elton Holdings Limited, an established provider of car leasing finance, for £12 million.

During 1996, Abbey National made further progress towards its aim of diversifying the business. In June, a joint venture with Norwich Union was announced which will enable Abbey National to provide its own brand of private medical insurance products. This is planned to commence operations in the second half of 1997. In November, a co-operation agreement with Safeway was announced which will offer a household management account to nearly 6 million holders of Safeway's ABC loyalty card. A number of relationships between banks and supermarket chains have emerged recently, as financial services companies have recognised the potential for making their products available to people at the places where they shop. Abbey National and Safeway will now work together to develop new in-store banking technologies and a range of other financial services.

We have continued to widen the range of financial products we offer to our 15 million customers. Our objective in diversifying is to strengthen, rather than dilute, our fundamental purpose of providing high quality financial services to the personal sector.

Mortgage and Savings Markets

As more building society flotations are concluded there should be a return to normality in our traditional mortgage and savings markets. At present, large sections of the market are reluctant to remortgage or transfer savings for fear of losing payments at the time of conversion.

There is evidence of increasing buoyancy in the housing market, particularly in London and the South East. This is welcome, but we have no wish to see a return to the boom conditions of the late 1980s.

In recent years, with intense competition for mortgage business and a low interest rate environment, savers may have felt that they were being given a lower priority. Abbey National has taken steps to increase the focus on providing value for savers: we led the way at the end of 1996 with a rate increase and we have also launched a new range of innovative savings products. These include a unique capital guaranteed stockmarket TESSA which locks in gains from the FT-SE 100 and Standard and Poor's 500 Index.

Shareholders

Following the merger with N&P, the total number of Abbey National shareholders has increased to 2.7 million. In 1989 the Company's market capitalisation was £1.7 billion, and by the end of 1996 this had increased more than sixfold - this growth outstripped that of any other UK bank. In 1996 alone, market capitalisation increased from £8.4 billion to £10.8 billion. Abbey National has consistently created shareholder value - since conversion in 1989 the share price has risen from 130 pence to 765 pence at 31 December 1996. This has been combined with strong dividend growth.

Another telling indicator of shareholder satisfaction is that seven years after conversion, and before the merger with N&P, over 45% of Abbey National's shares were still held by private shareholders - a significantly higher percentage than for comparable flotations such as British Telecom and British Gas.

Staff commitment

1996 has been a challenging year for staff, and it has been a year in which Abbey National's confidence in the ability of its employees has been amply vindicated. I am pleased that they will share in the Company's success through the payment of an 8.0% profit share. In August, each member of Abbey National plc's staff received 50 free Abbey National ordinary shares in recognition of their commitment and hard work during the integration with N&P. The Board also decided in September to grant every member of staff in the Abbey National Group options on 150 shares which can be realised between three and five years hence. This makes Abbey National one of the first UK companies to make such share options available to all staff.

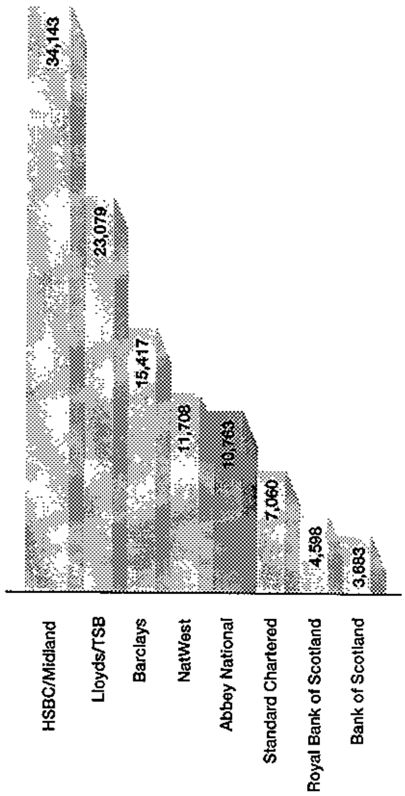
New Board appointments

There were a number of changes to the Abbey National Board in 1996. To my great regret Bob Knighton has decided to fulfil his long-standing intention to retire at 50. His contribution to Abbey National has been immense, culminating with the successful planning and implementation of full integration from day one with N&P. I would like to express the whole Company's gratitude for what he has achieved.

In August 1996, Charles Toner took on the role of Deputy Chief Executive, and Tim Ingram joined the Board as Managing Director, Continental Europe and FNFC. Alastair Lyons, formerly Chief Executive of N&P, became Managing Director with responsibility for life and general insurance. Andrew Pople, formerly Chief Executive of Scottish Mutual Assurance, assumed the role of Managing Director, Retail Division. Lord Shuttleworth, formerly Chairman of N&P, became a Deputy Chairman of Abbey National, and Keith Woodley, formerly a non-executive director of N&P, joined the Abbey National Board as a non-executive director.

Christopher Tugendhat

Lord Tugendhat
Chairman



UK banks: market capitalisation at 31 December 1996 (£m)

Chief Executive's Letter to Shareholders

Peter Birch
Chief Executive

There are huge opportunities for our industry well into the next century. We at Abbey National aim to be a part of this growth

There are significant changes taking place in the UK financial services market. Since Abbey National became a bank in 1989 many changes have taken place, including banks buying building societies; building societies and insurance companies demutualising and banks buying insurance companies. In my statement to you this year, I thought it might be appropriate to put the implications of these changes into perspective.

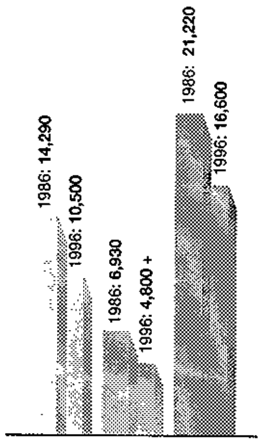
The starting point was in 1986 when the Building Societies Act - the first major new legislation for building societies for 100 years - came into being, extending the powers of building societies. Until 1986, building societies' activities had been restricted to taking deposits and lending money for house purchase. The 1986 Building Societies Act gave building societies wider powers, including the ability to offer personal loans, own a life company, operate overseas and the opportunity to change status and become a bank. Since 1986 these options have been extended. This legislation is prescriptive and quite rightly sought to preserve all the strengths of building societies whilst at the same time giving them wider powers. It also recognised that whilst home ownership would continue to grow, the pace of growth was likely to be slower. At the same time several building societies had, in their own right, become large financial institutions. If they were to survive, these societies recognised that they needed access to increased levels of wholesale funding and wider powers to diversify and retain their customers. In particular, this included the ability to raise capital through conversion and become banks. In a nutshell, to have the freedom to compete.

In 1989 Abbey National became a bank and other building societies began to diversify their activities into personal banking and insurance. Banks and insurance companies in their turn began to compete more aggressively in the savings and mortgage businesses. The reason for this was that lending by banks to small businesses was declining at about 3% per annum, whilst mortgage lending was increasing by 3% per annum and consumer credit by 4% per annum. These changes had the inevitable impact of leading banks and building societies to adapt, to embark upon branch modernisation programmes, and to open their branches for extended hours. Whilst all this was happening technology, too, was playing a role, with automated cash machines appearing on high streets, telephone banking emerging and traditional retailers dipping their toes into the financial services arena. So, what has been the impact of all this change? Customers quite rightly expect more services and expect them to be better and more efficient. Machines have gained acceptance in many customers' minds and are particularly favoured by younger people - all of which has led to a decline in the number of staff employed and a reduction in the number of branches of banks and building societies.

I believe that the trends we have seen in the last ten years will continue, and that by the year 2000 there will be about 12,500 branches of banks and building societies in the UK, and that even fewer people will be employed in the industry. Does this then mean that our industry is in decline? No, far from it. Let me explain.

We are living longer, and retiring earlier. The ratio of working to retired people is likely to fall from 3.4 to 2.6 by early next century. This, in turn, poses funding burdens for the government, who will find it difficult to provide the services and pension provisions that have become an expected part of everyday lives. Such changes will occur gradually, but will mean that there will be a greater onus on all of us to provide for retirement. This will involve making long term savings commitments and ensuring that we properly provide for pensions, health care, nursing care and eventually long term care - and almost everyone underestimates the

Number of UK Building Societies



Branch numbers

Banks*

Building Societies

Totals per year

*Major British banking groups

+Estimate

level of savings necessary to buy this kind of protection. It was against this background that Abbey National changed status in 1989 and then went on to acquire in subsequent years, organisations such as Scottish Mutual, First National Finance Corporation, and National and Provincial Building Society. These new activities are part of our diversification programme, and diversified profit now accounts for 40% of our income. We expect this figure to increase.

As we continue to offer a greater range of services we never forget that our roots are in the building society industry and that the traditional mortgage and savings markets are important to us. These markets, too, are changing. Over the last 100 years the number of building societies has declined from over 2,000 to less than 80. With the changes taking place today, it is inevitable that the number will continue to decline. There could be as few as 50 mostly small building societies by the year 2000.

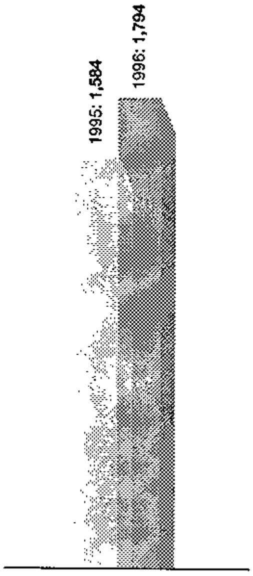
It was not that long ago that building societies enjoyed 90% of the mortgage market. By the end of 1997 their share will be less than 20% on the assumption that planned conversions take place. As more building societies convert, the share of the mortgage market held by building societies will decline further. Having said this, it should of course be recognised that many of the leading institutions which will offer mortgages in the future will be those institutions which were formerly building societies.

The UK mortgage market itself has also seen dramatic change. Home ownership has grown steadily and is now stable at around 67%. At its peak in 1988 the total UK market for net new mortgage lending was more than £40 billion; by 1995 it was just £15 billion. The number of houses bought and sold in 1988 was over 2 million; in 1995 it was 1.1 million. It is hardly surprising that the housing market was in somewhat of a recession for the first part of this decade. But with incomes rising, unemployment falling, negative equity rapidly declining and the ratio of earnings to house values at its lowest level for many years, the situation is changing. The 1996 housing market began to show significant signs of improvement during the second half of the year. Prices everywhere are firmer but with substantial regional variations - in some parts of the country prices are more than 20% higher than a year ago, with more modest increases in other areas. The number of transactions in the housing market during 1996 increased to 1.25 million and the total UK market for net new mortgage lending to about £18 billion - still comparatively small compared to 1988 but enough to bring some confidence back to the market for the first time in eight years and enough to generate a belief that there is likely to be more activity in the future. Our projections are that transactions will increase to 1.5 million and the total mortgage market to about £25 billion by the year 2000. The expectation is for sound, steady and manageable growth taking place against a background of low inflation. This is also good news for savers who are likely to see savings rates increase in order to provide the funds needed for mortgage lending. Abbey National will continue to be innovative - leading the way, whilst remaining competitive with the products it offers its customers in both the mortgage and savings markets.

I hope that this summary has put into perspective some of the changes and challenges we have faced and will continue to be confronted with in the future. Abbey National has changed too, and will continue to adapt in order to serve its 15 million customers and almost 3 million shareholders. There are huge opportunities for this industry well into the next century. We at Abbey National aim to be a part of this growth and to look after the needs and requirements of our customers, our staff and our shareholders.

Peter Birch
Chief Executive

Keighley Town Hall Square Branch, West Yorkshire
(converted from a National and Provincial branch on 5 August 1996)
Dean Atkins, Branch Manager and Alison Roper, Senior Customer Service Assistant



Net interest income (£m)

Operating review

Overview of results

Abbey National's underlying profit before tax increased by 20% to £1,228 million, from £1,026 million, excluding integration costs arising from the transfer of the business of the former National and Provincial Building Society (N&P). Profit before tax was £1,167 million, with the costs of integrating N&P amounting to £61 million. Income growth of 18% to £2,349 million outstripped underlying cost growth of 12% to £977 million, leading to an improvement in the cost:income ratio to 41.6%. Provisions for bad and doubtful debts increased by 76% to £127 million.

Results of operations of the Group by nature of income and expense

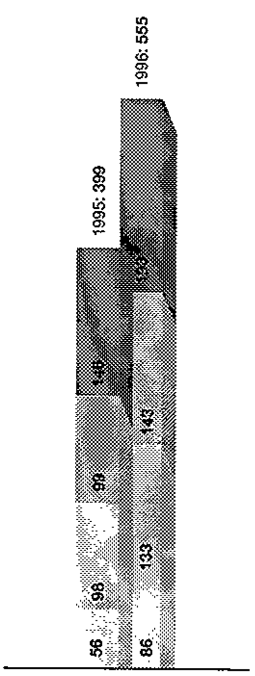
Operating income

Operating income rose by 18%, from £1,983 million to £2,349 million in 1996 with all major areas of the business reporting increases. UK Retail Banking operating income increased by 10%, to £1,595 million, compared with £1,448 million in 1995, as a result of growth in net interest income and increased insurance and personal banking fee income. Treasury & Offshore increased its income by 17% from £277 million to £324 million. Life Assurance income advanced 45% to £158 million, from £109 million in 1995, and Consumer Credit income was up 113% to £209 million, from £98 million in 1995.

Net interest income

	1996	*1995*
Net interest income (£m)	**1,794**	1,584
Group net interest margin (%)	**1.76**	1.71
Average interest earning assets (£bn)	**103.1**	92.3
UK Retail Banking net interest spread (%)	**2.08**	2.15

Net interest income increased by 13% to £1,794 million, primarily resulting from a 12% growth in average interest earning assets. The strong growth in average interest earning assets reflects the expansion of mortgage assets in UK Retail Banking following the transfer of the business of N&P, businesses acquired by First National Bank (FNB) during the year and growth in Treasury & Offshore assets. The increase in the Group net interest margin resulted from the addition of high margin assets following the inclusion of FNB for a full twelve months (only 5 months in 1995), along with the acquisition of Wagon Finance by FNB, and a 66% growth in the Abbey National-branded unsecured loan asset from £549 million to £914 million. This was partially offset by a 7 basis point reduction in the UK Retail Banking net interest spread, caused by continuing competitive pressures in the residential mortgage and liquid saving markets.



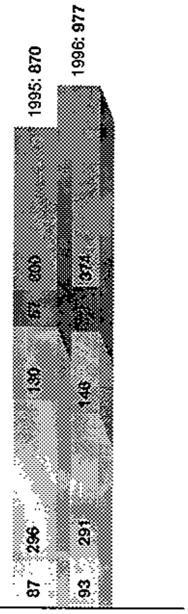
Fees and other income (£m)

- Insurance income receivable
- Other net fees and commissions receivable
- Income from long term assurance business
- Other income

Fees and other income

	1996 *£m*	*1995* *£m*
Insurance income receivable	**193**	146
Other net fees and commissions receivable	**143**	99
Income from long term assurance business	**133**	98
Other income	**86**	56
Total	**555**	399

In total, fees and other income increased by 39% to £555 million. Insurance income increased by 32%, mainly reflecting the benefits of the Group's first full year of operation as a joint venture general insurer, along with the addition of commission from the existing N&P portfolio and a full year's contribution from sales of creditor insurance products through FNB. Other net fees and commissions rose by 44% to £143 million, principally as a result of increased banking income derived from the Abbey National Bank Account and Abbey National Credit Card. Income from long term assurance business increased by 36%, with growth in new business premiums from both Scottish Mutual Assurance and Abbey National Life. Other income increased by 54%, mainly reflecting income growth within Treasury & Offshore, including increased profits from the more actively managed asset portfolios and increased income from Abbey National Financial Products (ANFP). Other income also includes an increase in Mortgage Indemnity Guarantee (MIG) fees taken to income which increased during the year. These are up-front fees charged to customers borrowing at high loan-to-value ratios, and are charged to compensate for the higher risk of loan losses experienced with such loans. Such fees are deferred and taken to income when the related loan losses are identified and provided for. The resulting increase in income relating to MIG fees of £14 million during the year compensates in full for the increase in UK residential mortgage provisions (see 'Provisions').



Operating expenses (£m)

Salaries
Other staff costs
Property and equipment expenses
Other administrative expenses
Depreciation

Operating expenses

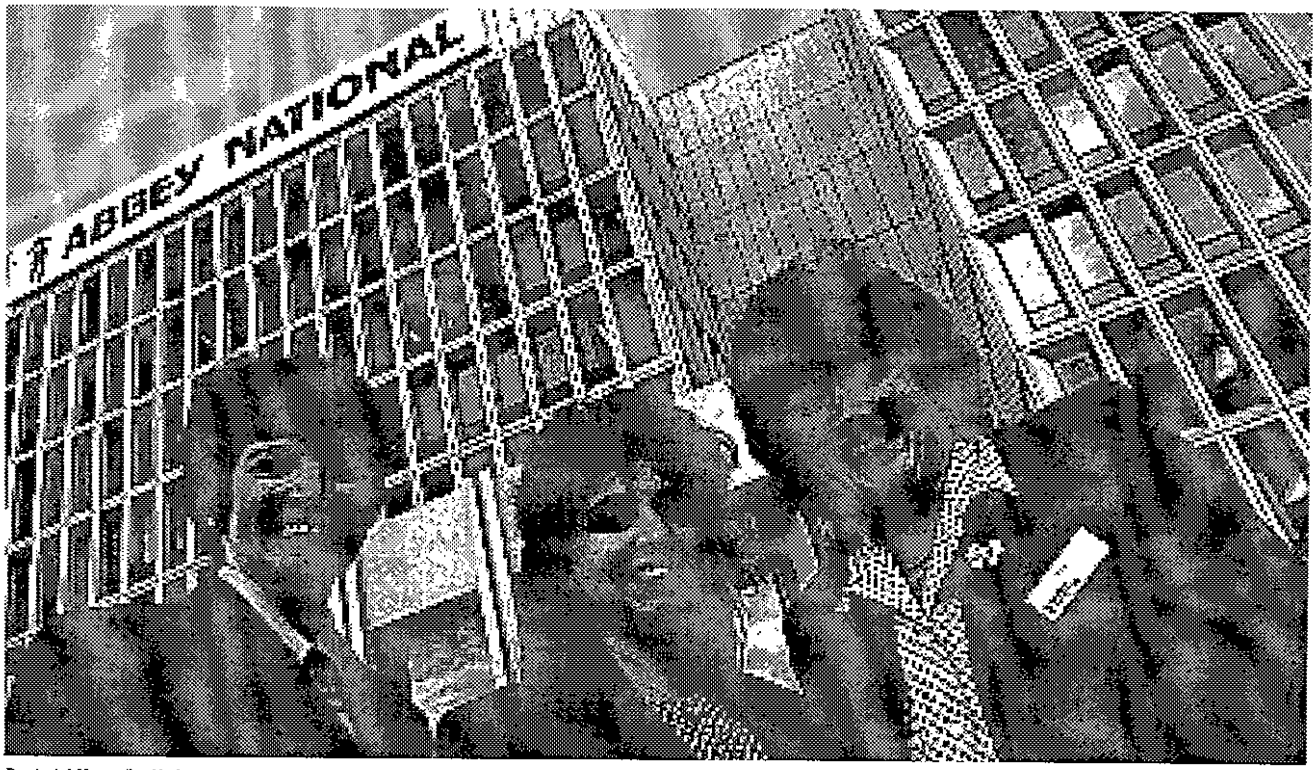
	1996 £m	*1995* £m
Salaries	374	300
Other staff costs	73	57
Property and equipment expenses	146	130
Other administrative expenses	291	296
Depreciation	93	87
Total	977	870
Integration costs	61	-
Headcount (full-time equivalent) at 31 December	22,539	18,203
Average headcount (full-time equivalent)	20,267	17,938

Total operating expenses increased by 12%, to £977 million. Combined salaries and other staff costs increased by 25% to £447 million in 1996. This increase was due to an 11% growth in average salaries and benefits, and a 13% increase in the average number of full-time equivalent staff (FTE) in 1996 to 20,267. Salaries and benefits included an 8.0% profit share payment to employees (1995: 7.5%). The growth in average staff numbers reflects the additional employees transferred with the business of N&P, and the FTE added with FNB's acquisitions of Wagon Finance and Elton Holdings (subsequently renamed First National Vehicle Contracts Limited). The Group employed 22,539 FTE at the end of 1996, including the 3,519 FTE who remain with the Group following transfers of businesses and acquisitions during the year. Underlying staff numbers increased by 817 FTE.

Property and equipment expenses increased by 12% to £146 million, primarily as a consequence of increased rent, rates and maintenance costs relating to the 195 branches added following the transfer of the business of N&P.

The costs associated with the integration of N&P amounted to £61 million, comprising £33 million of staff redundancy payments, £15 million of branch closure costs and £13 million spent on a number of smaller items including branch literature and customer communications. There were no compulsory redundancies in the branch network and the Group honoured its commitment to maintain employment levels post Vesting Day within Abbey National in Bradford.

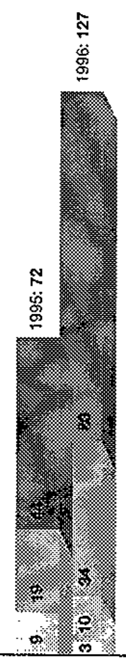
The Group cost:income ratio, excluding integration costs, fell to 41.6% from 43.9% in 1995, reflecting the Group's ongoing emphasis on the control of costs. The cost:income ratio including integration costs was 44.2%.



Provincial House, Bradford.
From left to right: Silvia Holmes, Shahina Khan, Customer Service Assistants, and Sue Ineson, Senior Customer Service Assistant

Provisions

	1996 £m	1995 £m
Bad and doubtful debts		
UK Retail Banking	**80**	44
Consumer Credit	**34**	19
Continental Europe	**10**	9
Other Operations	**3**	–
Total	**127**	72
Contingent liabilities and commitments	**4**	7
Amounts written off fixed asset investments	**13**	8



Provisions (£m)

UK Retail Banking
Consumer Credit
Continental Europe
Other Operations

Provisions for bad and doubtful debts increased by 76% from £72 million to £127 million in 1996. In UK Retail Banking, the £36 million increase in provisioning included a £22 million increase in provisions against personal banking products, reflecting a 270% growth in assets following increased sales of the Abbey National Bank Account and the launch of the Abbey National Credit Card (together with balances on credit cards transferred with N&P). The provision charge for UK residential mortgages increased by £13 million. The benefits of favourable economic conditions, reduced levels of arrears and lower average losses per repossession case were more than offset by higher provisions resulting from the increased size of the residential mortgage asset and the reduced level of external MIG insurance cover, in respect of post-1992 lending. Excluding the impact of this reduced level of external MIG insurance cover which is offset in full by income relating to MIG fees of £14 million charged to the customer (see 'Fees and other income'), residential mortgage provisions were marginally lower. The provision charges for Consumer Credit increased by £15 million to £34 million. This includes £13 million of provisions for Abbey National-branded unsecured loans (1995: £8 million), and £21 million of FNB unsecured loan provisions (1995: £11 million), reflecting the inclusion of the first full year's results of FNB.

Taxation

	1996	1995
Tax on profit on ordinary activities (£m)	**403**	344
Effective tax rate (%)	**34.5**	33.5

The tax charge for 1996 of £403 million (1995: £344 million) was 34.5% of profit before tax (1995: 33.5%), compared with a standard UK corporation tax rate of 33%. The increased rate arose as a result of non-allowable provisions and other non-adjusted items offset partially by the effect of dividend income taxed at different rates, overseas tax losses and ACT written back.

Results of operations of the Group by business segments

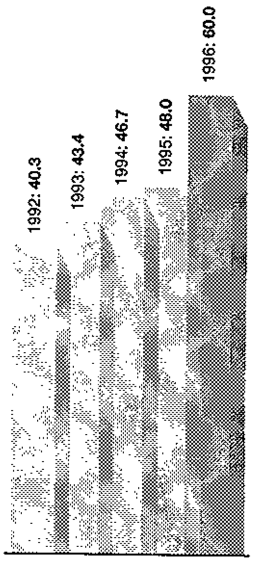
UK Retail Banking

	1996 £m	1995 £m
Net interest income	**1,254**	1,190
Fees and other income	**341**	258
Operating expenses	**(775)**	(714)
Provisions for bad and doubtful debts	**(80)**	(44)
Provisions for contingent liabilities and commitments	**(4)**	(3)
Profit before tax and integration costs	**736**	687
Integration costs	**60**	-
Market share of increase in UK liquid savings (%)	**n/a**	3.5
Market share of UK liquid savings stock (%)	**9.3 (est)**	8.2
Market share of increase in UK mortgages outstanding (%)	**2.4 (est)**	9.3
Market share of UK mortgage stock (%)	**14.7 (est)**	12.3

UK Retail Banking increased its profit before tax by 7% to £736 million, excluding integration costs.

Net interest income increased by 5%, supported by the 25% growth in mortgage assets during the year. As a consequence of the competitive nature of the mortgage market, the spread between UK Retail Banking's average lending rates and average funding rates narrowed from 2.15% to 2.08% in 1996. The UK Retail Banking net interest margin also fell, to 2.37% (1995: 2.52%), partly due to the 7 basis point decline in the UK Retail Banking net interest spread, and partly owing to increased levels of capital injections into other business segments, primarily to finance acquisitions.

Fees and other income increased by 32% to £341 million, principally due to a 25% rise in insurance income, which grew strongly, mainly as a consequence of the Group's first full year of operation as a joint venture insurer, along with the additional commission from the existing N&P portfolio. Income from personal banking continued to grow, driven by an expanded bank account and credit card base. During 1996, 113,000 new bank accounts were opened (1995: 120,000), whilst 141,000 Instant Plus accounts (a card-based account) have been opened since launch in July, and 115,000 Abbey National Visa Credit Card accounts have been opened since its launch in February 1996. Abbey National now has 1.56 million bank accounts, of which over 50% are customers' primary accounts, as well as over 634,000 debit cards (1995: 475,000), and nearly 450,000 credit card accounts in operation. This includes 331,000 former N&P credit card accounts.



Abbey National
UK residential mortgage
asset (£bn)

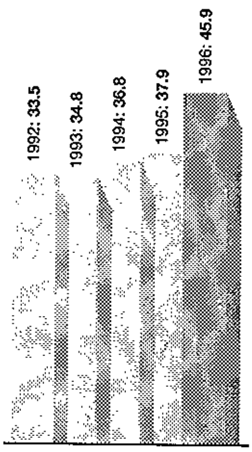
The 9% (£61 million) growth in operating expenses (excluding integration costs) was mainly as a consequence of an additional 3,473 FTE taken on following the transfer of the business of N&P, of whom 2,903 remained with the Group (within UK Retail Banking) at the end of the year.

The provisions charge was £80 million, with £47 million (1995: £34 million) relating to residential mortgages. The provisions charge for residential mortgages was higher as a consequence of the reduced level of external MIG insurance cover in respect of post 1992 lending which increased provisions by £14 million. This was offset in full by the same amount being taken to income relating to MIG fees. Such fees are deferred, and are taken to income when the related loan losses are identified and provided for (see also 'Fees and other income'). Excluding the effects of reduced external MIG insurance cover, residential mortgage provisions were slightly lower, reflecting reduced levels of arrears, and lower average losses per repossession case.

The number of mortgages six months or more in arrears in 1996 decreased from 15,778 to 13,560, (excluding 5,595 cases relating to the former N&P mortgage asset). The average provision for capital losses and interest arrears for a repossessed property under offer has fallen from £13,300 to £10,440 as at 31 December 1996. The stock of repossessed properties fell by 11% from 2,259 in 1995 to 2,017 (including 680 former N&P repossessions) in 1996. Excluding 757 cases relating to the former N&P mortgage asset, repossessions during the year decreased by 3% from 4,464 in 1995 to 4,335 cases in 1996.

Provisions charges against overdrafts and credit cards increased to £34 million (1995:£12 million). This reflects the growth in personal banking unsecured lending assets following the launch of the credit card and increased overdraft balances. At the year end, Abbey National's credit card asset was £205 million (including £116 million of former N&P credit card asset), while the overdraft asset rose 65% during the year to £165 million, reflecting increased usage of overdraft facilities amongst bank account customers.

As at 31 December 1996, Abbey National had a UK mortgage asset of £60.0 billion (1995: £48.0 billion), representing a 14.7% market share. Approximately £11.6 billion of this £12.0 billion increase related to assets transferred from N&P. The remaining £0.4 billion increase represents a 2.4% (1995: 9.3%) market share of the increase in UK mortgages outstanding. This reflects an estimated 11.3% (1995: 11.0%) share of gross mortgage lending (£8.1 billion), and an estimated 14.5% (1995: 11.8%) market share of mortgage capital repayments (that is, customers repaying or redeeming their mortgages) equating to £7.7 billion. This performance was adversely affected by a higher level of redemptions from former N&P customers who may have delayed planned repayments/redemptions until after Vesting Day on 5 August 1996. If the lending figures of N&P achieved for the whole of 1996 had been included, the combined business would have increased its mortgage asset by £1.1 billion, which would have represented a 5.9% share of the increase in UK mortgages outstanding.

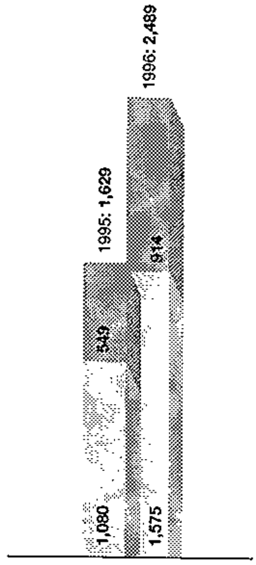


UK retail savings
liability (£bn)

At the end of 1996, UK Retail Banking had UK retail liabilities of £45.9 billion (1995: £37.9 billion), representing an estimated 9.3% share of the total UK liquid savings stock. Notwithstanding the transfer of savings liabilities from N&P, Abbey National experienced a £1.5 billion net outflow of liquid savings during 1996. About £3 billion (representing approximately 60% of the total) of Abbey National's TESSA liability matured in 1996, and approximately one third of this was not re-invested in retail savings products. Abbey National PEPs, unit trusts and investment bonds have attracted £600 million of new business premiums, some of which came from Abbey National savings accounts, reflecting changing customer preferences towards longer term savings products. In addition, many former members of N&P chose to withdraw the cash payment credited to their new Abbey National accounts following Vesting Day. The retail savings performance was adversely affected by the amount of money which continues to be tied up in those building societies that have already announced their intention to convert to plc and speculative money flows going into other building societies.

Consumer Credit

	1996 £m	1995 £m
Profit before tax		
Abbey National	46	36
FNB (Consumer Credit Division)	52	13
Total	98	49
Loan assets		
Abbey National	914	549
FNB (Consumer Credit Division)	1,575	1,080
Total	2,489	1,629



Consumer Credit loan assets (£m)

Abbey National

FNB (Consumer Credit Division)

Pre-tax profit has doubled, principally reflecting the first full year of FNB's inclusion in the results and a 66% increase in Abbey National-branded unsecured personal loan assets. Margins have remained stable for both businesses. In 1996, Abbey National took a 6.7% share of the increase in the non-credit card consumer credit market, compared to a 4.4% share in 1995 (these figures include the overdraft assets of UK Retail Banking).

Abbey National-branded unsecured loan assets continued to grow strongly, increasing by 66% (1995: 44%), as a result of increased customer demand. Provision balances as a proportion of asset have reduced during the year, from 3.5% to 2.7%, reflecting continuing improvements in credit quality.

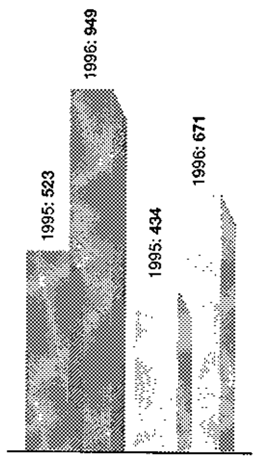
FNB's consumer credit assets grew by 46% in the year, mainly due to the acquisitions of Wagon Finance and Elton Holdings (subsequently renamed First National Vehicle Contracts Limited).

Life Assurance

	1996 £m	1995 £m
Profit before tax		
Abbey National Life *	84	54
Scottish Mutual **	67	51
Total	151	105
New business premiums		
Abbey National Life *	671	434
Scottish Mutual **	949	523
Total	1,620	957

* including Abbey National Unit Trust Managers and N&P Life

** including Pegasus and Scottish Mutual International



Total new business premiums (£m)

Scottish Mutual Assurance

Abbey National Life

Life Assurance increased profit before tax by 44% to £151 million, as a result of growth in business volumes in an improving market. Funds under management increased from £5.5 billion to £7.9 billion during the year.

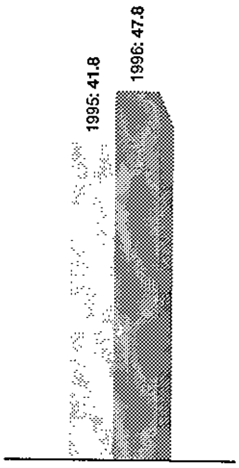
Abbey National Life made a pre-tax profit of £84 million (1995: £54 million). Annualised premium income increased by 55% to £121 million and total new business premium income increased by 55%. Sales of the Abbey National UK Growth PEP grew significantly in 1996, generating £338 million of premium income during the year, representing a 6.0% market share of new business sales. This reflects, in part, the re-investment of maturing Abbey National TESSA balances into long term savings products. The sale of non mortgage-related investment, pensions and protection products to UK Retail Banking customers, in particular Guaranteed Bonds and PEPs, accounted for 55% of policies sold. These policies represent a major component of the Abbey National Life product offering.

Scottish Mutual Headquarters, Glasgow
John Dunn, Personal Pensions
Ruth Peebles and Alison Pollack, Occupational Pensions

Scottish Mutual contributed pre-tax profit of £67 million (1995:£51 million). Annualised premium income increased by 59% to £135 million, and total new business premium income increased by 81%. Sales of regular and single premium pension business and single premium life business through intermediaries were particularly strong. Scottish Mutual's operating expense ratio (the ratio of total management expenses plus commission to annualised new business) for 1996 was 82% (excluding Scottish Mutual International and Pegasus) - substantially down from 102% in 1995.

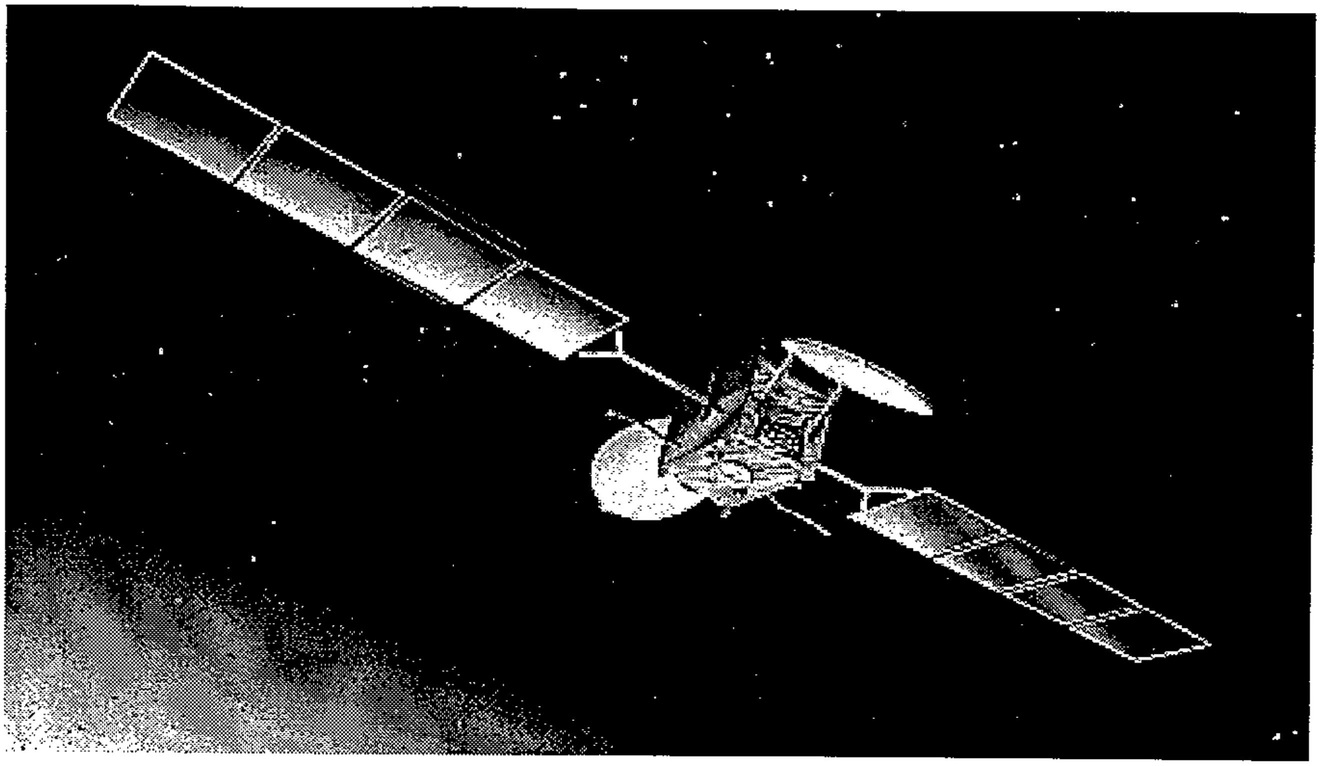
Treasury & Offshore

	1996 *£m*	*1995* *£m*
Net interest income	288	275
Fees and other income	36	2
Operating expenses	(55)	(52)
Amounts written off fixed asset investments	(13)	(8)
Profit before tax and integration costs	256	217
Integration costs	1	–
Total assets (£bn)	47.8	41.8



Treasury operations total assets (£bn)

Treasury & Offshore's profit before tax and integration costs was 18% higher in 1996 at £256 million. This principally reflected a 14% growth in assets during the year, to £47.8 billion, covering a wide range of assets such as asset backed and other high quality investment securities, together with an increased emphasis towards the more active management of selected asset portfolios. The change to the mix of investment and trading assets has also helped provide greater flexibility in capital management.



In 1996 Abbey National provided Inmarsat with leasing finance for two satellites

Treasury & Offshore continued to be a major issuer of debt securities in the international capital markets during the year, raising over US$15 billion in a range of currencies, maturities and geographical areas. It also continued to provide the Group with significant capital, liquidity and funding during a year of expansion. This included making capital available to the Group to finance the N&P transaction.

Treasury & Offshore's net interest income increased by 5% to £288 million in 1996. The key factors behind this performance were additional income from the leasing business and an increase in Abbey National Treasury International Limited's (ANTIL) retail liability. Leases outstanding increased to £3.7 billion from £2.4 billion in 1995, with a number of significant big ticket finance leases undertaken in a range of sectors including energy, property, satellites and shipping. As at 31 December 1996, ANTIL managed 33,000 accounts (1995: 16,300), including 11,400 accounts transferred from N&P, and over £1.3 billion (1995: £1.0 billion) of retail funds.

Fees and other income within Treasury & Offshore grew by £34 million to £36 million in 1996. This principally reflected earnings from the increased volume of assets in the more actively managed portfolios from £1 billion in 1995 to £10.9 billion in 1996, along with a full year contribution from Abbey National Financial Products (ANFP).

Treasury & Offshore's operating expenses increased by £3 million to £55 million in 1996, largely as a consequence of an increase in staff from 310 full time equivalent (FTE) in 1995 to 373 FTE in 1996.

Continental Europe

	1996 £m	1995 £m
Profit before tax	**(19)**	(22)
Provisions charge	**10**	9

Continental Europe's pre-tax loss of £19 million, was 14% lower in 1996 compared to 1995. In Spain, losses increased to £13 million (1995: £9 million) as a consequence of additional provisions required against expected losses on the disposal of repossessed properties, as well as increased operating costs associated with the opening of seven new retail banking branches. The pre-tax loss in France was reduced to £7 million from £8 million, reflecting continuing management actions taken to stabilise loan quality. In Italy, pre-tax profit was £1 million (1995: £5 million loss).

Other operations

	1996 £m	1995 £m
Profit before tax	**6**	(10)

This segment incorporates the results of Abbey National Independent Consulting Group (which includes Abbey National Independent Financial Advisers and the Abbey National Benefit Consulting Division), Abbey National Homes, a number of investment companies and the commercial lending and property assets acquired with FNFC. The loss in 1995 principally related to the disposal of J.Trevor & Webster, the commercial estate agency business.

Development of the business

Strategy for the business

Abbey National's vision is to be the outstanding financial services company in the UK. Abbey National's purpose is to achieve above average growth in shareholder value over the long term. To support this, the Group's strategy is to continue to focus on its principal interdependent businesses - UK Retail Banking (which includes general insurance and money transmission activities), Consumer Credit, Life Assurance and Treasury & Offshore.

The Group intends to continue to broaden its earnings base to reduce dependence on traditional mortgage and savings activities. By the end of 1996, 40.1% of Abbey National's pre-tax profit, excluding integration costs, was derived from non-traditional areas - including Consumer Credit, Life Assurance and Treasury & Offshore.

Complementing the strategic goals outlined above are the Group's objectives to maintain strong management of, and control over, risks; to secure and maintain competitive advantage through superior customer service; to improve efficiency further, and thus maintain a low cost:income ratio; to maintain a prudent capital base; and to preserve and further enhance its strong brand name in the markets in which the Group operates.

Investment for the future

In 1996, Abbey National continued to widen the range of services it provides to customers in areas such as banking, life assurance, general insurance and consumer credit. The transfer of the business of N&P in August further strengthens the Group's traditional mortgage and savings businesses, enabling Abbey National to maintain its position as the UK's second largest mortgage lender, as well as increasing the customer base to around 15 million, providing further cross-selling potential.

UK Retail Banking

During 1996, Abbey National extended its personal banking services. Around 115,000 credit card accounts have been opened since the Abbey National Credit Card was launched in February, complementing the well-established Abbey National Bank Account.

In June, Abbey National announced a joint venture with Norwich Union Healthcare to sell private medical insurance products through both the branch network and Abbey National Direct commencing in the last quarter of 1997.

In July, the Instant Plus account was launched, offering a combined cash withdrawal and debit card facility. This account opens a new section of the banking market to Abbey National, by appealing to those customers who need a transaction account, but do not require all the facilities of a typical bank account.

In November, Abbey National announced a co-operation arrangement with Safeway, offering personal banking services to nearly 6 million holders of Safeway's ABC loyalty card, commencing with the planned launch in March of the ABC Bonus Account, a household management account. This represents a significant expansion of the Group's banking activity within the card market.

In 1997, there will be further innovative development of both savings and mortgage products. These will include further launches of stock market and bond-related savings accounts, a postal account and development of competitive mortgage offerings like the 'Flexi-Break' mortgage and a range of new fixed rates.

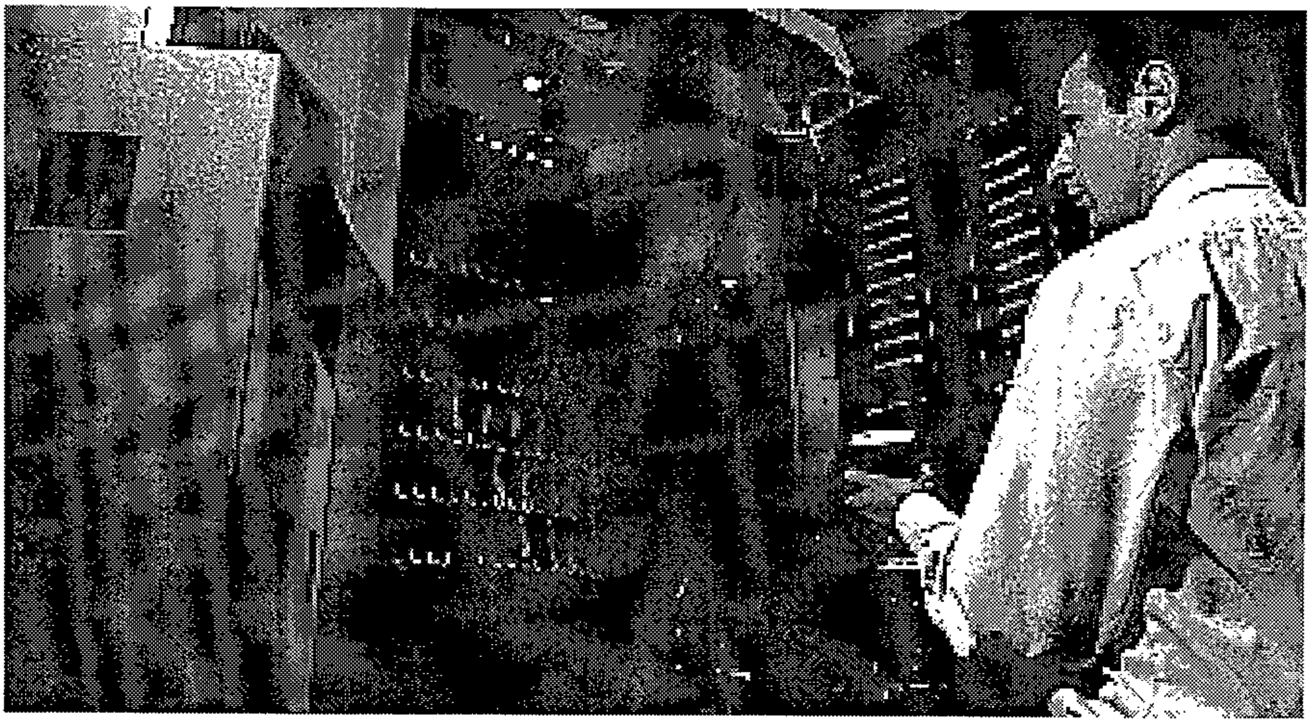
Consumer Credit

Following the acquisition of FNFC in 1995, Abbey National's Consumer Credit activities have continued to expand. During the year, FNB acquired Wagon Finance Group, one of the UK's largest used-car finance companies, and Elton Holdings, a vehicle contract hire business, for a net cost of £116 million and £12 million respectively. Both moves are complementary to FNB's strategy of strengthening its position in the consumer credit market by providing car finance.

Life Assurance

Life Assurance continues to provide new and innovative products to the market. During 1996, Abbey National Life launched an Abbey National Regular Savings PEP, an Abbey National Stock Market Bond and a stand-alone critical illness policy. Scottish Mutual launched various products during the year, including an Income Withdrawal Plan, High Income Bond and Select With-Profit Bond.

In March, Scottish Mutual International was launched, providing the Group with an offshore life office based in Dublin's International Financial Services Centre. This company offers insurance-based savings products to expatriate customers.



Shenley Wood IT centre, Milton Keynes

Treasury & Offshore

Significant progress was made in 1996 as Treasury & Offshore continued to implement its IT strategy, facilitating the ongoing growth and development of the Group's treasury and wholesale banking operation. Three particular milestones were met during the year as Treasury & Offshore replaced its front-office dealing system, implemented and further enhanced its in-house system developed to meet the Capital Adequacy Directive reporting requirements, and commissioned a new back-up dealing room and system support facility in London's Docklands.

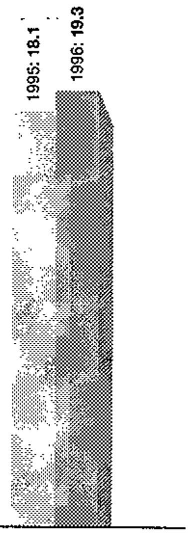
ANFP had a successful first full year, firmly establishing itself as a professional participant in the interbank market.

In November 1996, building on the successful offshore operation in Jersey, Abbey National agreed in principle to form a joint venture with Hambros Bank and Dah Sing Financial Holdings Limited (DSFH) to provide Hong Kong residents with private and offshore banking facilities. This presents an opportunity to participate in the growing Asian private banking market. This was followed in January 1997 by the acquisition of a 5% shareholding in DSFH for HK$381 million (approximately £30 million).

Capital expenditure

Capital expenditure during the year amounted to £147 million (1995:£127 million). This included £35 million of expenditure relating to the replacement of furniture, fittings and computers in former N&P branches and head offices. Of the remaining capital expenditure, £19 million relates to other property expenditure, £49 million relates to the continued investment in upgrading the Group's information technology infrastructure (which is designed to improve processing efficiency and aid decision-making for point-of-sale transactions with customers), and a further £19 million relates to the investment in cars in First National Vehicle Contracts Limited, reflecting new business volumes.

Capital expenditure in recent years has, to a large extent, been incurred for the purpose of extending, modernising and in some cases, resiting UK Retail Banking branches. As part of this programme, administrative processes for mortgages and bank accounts were transferred from the branches to a number of dedicated centres, and work continued in 1996 to rationalise a number of centres, and upgrade the technology employed. As a result of this programme, selling space within the branch network has tripled. With the modernisation of UK Retail Banking's branches now almost complete, the focus will switch towards implementing technology that will provide for greater self-service by customers. This will include the further development of Abbey National's network of internal and remote automated teller machines, thereby establishing Abbeylink as one of the largest networks in the UK.



Post-tax return on average ordinary shareholders' equity (%)

Return to shareholders

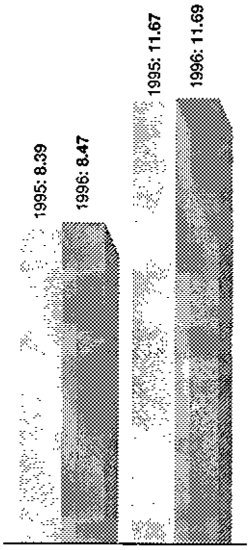
Earnings per share increased by 9% to 56.5p. Excluding the costs associated with the integration of N&P, earnings per share increased by 16% to 59.8p. The proposed dividend increase is 20% to 26.1p, with dividend cover at 2.1 (1995: 2.4).

Abbey National's corporate purpose is to achieve above average growth in shareholder value over the long term. Abbey National uses 'value based cashflow' and 'profit after a charge for capital' (PACC) as a method of evaluating plans and monitoring performance. Value based cashflow is defined as profit attributable to ordinary shareholders less the additional regulatory capital required to support the business. Value based cashflow was £338 million in 1996, up from £261 million in 1995, as a consequence of a combination of improved profit after tax, more efficient capital utilisation in Treasury & Offshore, and slower organic growth in mortgage assets. PACC is defined as profit after tax less a notional charge for Group equity capital. PACC grew 19% in 1996 up from £220 million in 1995, to £261 million, reflecting the increase in the post-tax return on ordinary shareholders' equity from 18.1% to 19.3%.

Financial review

Capital resources

Abbey National's capital resources (shareholders' funds plus subordinated liabilities) increased by £699 million to £6,767 million (1995: £6,068 million). This reflected an increase in shareholders' funds of £452 million, the principal elements of which include £327 million of retained earnings, £474 million of ordinary share capital issued and £220 million of new preference share capital, offset by write-offs of goodwill of £610 million on businesses transferred and acquisitions. In addition there was a net increase in subordinated liabilities of £247 million.

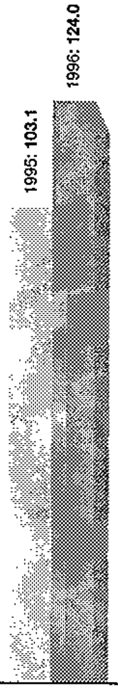


Risk Management

The basic instruments of capital monitoring are the risk asset ratio and the tier 1 capital ratio. As at 31 December 1996 the Group's risk asset ratio was 11.69% (1995: 11.67%) and the tier 1 ratio was 8.47% (1995: 8.39%). The increase in the tier 1 ratio, compared with 1995, was principally due to the increase in shareholders' funds analysed above, partly offset by the requirements to hold capital against the assets of businesses added to the Group during 1996.

With effect from 1 January 1996, the EC Capital Adequacy Directive (CAD) was implemented in the UK. The main feature of the CAD is the classification of assets for regulatory purposes as either 'trading book' assets (those held for resale) or as 'banking book' assets (those held for investment to maturity). The ability to classify certain assets within the 'trading book' has had a moderately favourable effect on the Group's risk asset ratio.

Abbey National's risk asset ratio and tier 1 ratio remain comfortably above the minimum standards for the Group set by the Bank of England. This is intended to maintain the continued confidence of shareholders. Abbey National believes that the Group could operate with a lower level of tier 1, with equity tier 1 still well over 7% at the end of the Group's current planning cycle. Going forward, Abbey National intends to continue to balance the interests of shareholders, depositors, analysts and rating agencies in determining the capital resources required for the business.



Total assets (£bn)

Capital adequacy data

	1996 £m	1995 £m
Tier 1	4,393	3,941
Tier 2 and Tier 3	2,475	2,158
less supervisory deductions	(806)	(613)
Total regulatory capital	6,062	5,486
Total risk weighted assets:		
Banking book	49,084	n/a
Trading book	2,787	n/a
	51,871	46,993
Capital ratios:		
Risk asset ratio	11.69%	11.67%
Tier 1 ratio	8.47%	8.39%

Balance sheet

Total assets increased by 20% to £124.0 billion in 1996, principally reflecting the assets transferred with the business of N&P on 5 August 1996. Of this growth, £8.5 billion was funded through the wholesale debt markets and £7.7 billion from retail sources, whilst a further £2.4 billion related to growth in long-term assurance funds. As at 31 December 1996, wholesale liabilities represented 49% of total liabilities. During 1996, UK mortgage assets grew by £12.0 billion, of which £11.6 billion relates to assets transferred with N&P. The percentage of UK mortgage assets funded from retail savings has fallen from 79% in 1995 to 76% in 1996.

Financial risk management

Abbey National's financial risk management focuses on the major areas of credit risk, market risk, liquidity risk and foreign currency exposure.

Abbey National has a well developed structure for managing financial risk, which consists of a comprehensive set of committees. Of these, the principal committees are the Assets and Liabilities Committee (ALCO), which is charged with the responsibility of monitoring and controlling the level of Group structural balance sheet risk, and the Group Credit Committee (GCC) which monitors and oversees risk levels and credit exposures and approves Group credit policies.

Credit risk

Credit risk is the risk that borrowers will not meet their financial obligations which may result in Abbey National losing the principal amount lent, the interest accrued, or both principal and interest (less any security held). Credit risk occurs mainly in Abbey National's UK residential mortgage portfolio, in Consumer Credit, and in wholesale lending completed within Treasury & Offshore.

In UK Retail Banking a national mortgage lending policy is applied, supported by a number of processes, including credit scoring, which enhance the ability to manage and monitor the credit risk quality of mortgage assets, manage arrears and collections and optimise the values raised from properties in possession. For the Bank Account and Credit Card, behavioural scoring is used for both the granting of additional credit facilities and for card and overdraft renewals. Behavioural scoring is also being used to drive collections activity.

In Consumer Credit all applicants go through an application process which involves the use of credit reference agencies, fraud detection systems, and credit scoring (or behavioural scoring if the applicant has a current account). Where appropriate, applicants are referred to underwriters for subsequent investigation and review before a final decision is made. After an application has been accepted, performance monitoring is carried out to ensure the overall credit assessment meets the original risk criteria. All Consumer Credit products which default are subject to arrears management in order to manage the account out of default, or collections activity in order to minimise the level of write-off.

In Abbey National Treasury Services (ANTS) a clear set of credit mandates and policies has been established, designed to ensure that a substantial majority of credit exposure is rated AA- or better. Analyses of credit exposures and credit risk trends are provided in summary to the ANTS Board each month, and in detail each quarter. Large exposures (as defined by the Bank of England) are reported monthly internally, and quarterly to the Bank of England.

Market risk

Market risk arises in ANTS as a result of investment and funding activities and in UK Retail Banking primarily from fixed rate mortgage and savings products. The principal aim of the Group's market risk exposure management is to limit the adverse impact of interest and other rate movements on profitability. In addition, it seeks to enhance interest earnings within clearly defined parameters. In managing market risk, Abbey National's philosophy is to ensure that the business areas within the Group have sufficient expertise to manage the risks associated with their operations. Within this framework, policies and mandates are established and monitored by ALCO each month.

Liquidity risk

Liquidity risk arises across the Group balance sheet, although liquidity is managed on behalf of the Group by ANTS in accordance with policy guidelines set by the Board and monitored by ALCO. Abbey National views the essential elements of liquidity management as controlling the timing of potential cash outflows, maintaining prudent levels of highly liquid assets and ensuring that access to wholesale and retail funding is available from a wide variety of sources and maturities. These elements are underpinned by a comprehensive management and monitoring process. ANTS management focuses on cash flow planning and day to day cash flow control, and balancing the maturity profiles of ANTS liquid assets and wholesale funding to ensure Group funding and liquidity ratios are adequate. On 1 January 1996, the Bank of England applied a new policy framework on Sterling Stock Liquidity to major retail banks. The policy framework covers the definition of high quality liquid assets and focuses on the daily management of five day net cash flows. Abbey National must comply with this requirement at all times and report to the Bank of England on its liquidity position on a monthly basis.

Foreign currency exposure

Abbey National Group policy is to hedge all non-local currency risks with an additional process for hedging currency income streams operating within ANTS. Currency risk reports which show open positions within ANTS and Group balance sheet positions are reviewed by ALCO.

Derivatives

Derivatives are important risk management tools for financial institutions and their customers. Derivatives are used in two distinct ways by Abbey National: firstly, as hedging instruments to manage balance sheet, foreign exchange rate and interest rate risk, and secondly, in the trading activity undertaken by Abbey National Financial Products and portfolio management within the ANTS trading books. Further description of the Group's use of derivatives, along with financial information, is provided in note 47 on page 74 to the accounts.

The Board of Directors

THE LORD TUGENDHAT
Chairman

Appointed to the Board as joint Deputy Chairman on 1 June 1991 and Chairman on 1 July of that year. He is also non-executive Chairman of Blue Circle Industries PLC and a non-executive director of Eurotunnel plc.

Formerly a Member of Parliament, he was successively a Member (1977-1981) and a Vice President (1981-1985) of the Commission of the European Communities. He was previously Chairman of the Civil Aviation Authority, a Deputy Chairman of National Westminster Bank and Chairman of the Royal Institute of International Affairs (Chatham House). Aged 60.

MAIR BARNES #

Appointed to the Board in 1992. She is Executive Chairman of Vantios Plc, the parent company of Dollond & Aitchison, and a non-executive director of Fosters Trading Company Limited and George Wimpey PLC. From 1987 until February 1994 she was Managing Director of Woolworths plc. Aged 52.

PETER BIRCH CBE FCIB *
Chief Executive

Joined Abbey National as Chief Executive in 1984. He is also a non-executive director of Argos plc and Dalgety PLC. Aged 59.

ALLAN DENHOLM CBE CA +

Appointed to the Board in 1992. He is Deputy Chairman of Scottish Mutual Assurance plc and, since 1993, a director of Abbey National Life plc. Formerly a director of William Grant and Sons Limited, Chairman of East Kilbride Development Corporation and a past President of the Institute of Chartered Accountants of Scotland. Aged 60.

IAN HARLEY FCA *
Finance Director

Appointed to the Board in 1993 as Finance Director. After joining Abbey National in 1977, he became Assistant General Manager in 1988 and has held a number of senior management positions in the Company, including Treasurer and Director, Retail Operations. He is also responsible for information technology. Aged 46.

SIR TERRY HEISER GCB +

Appointed to the Board in 1992. Currently a non-executive director of J Sainsbury plc and Wessex Water plc. He is also a director of the Personal Investment Authority. He was formerly with the Civil Service, holding various senior positions, including Permanent Secretary to the Department of Environment from 1985 to June 1992. Aged 64.

TIM INGRAM FCIB *
Managing Director, Europe and First National Finance Corporation.

Appointed to the Board in August 1996. Chief Executive of First National Finance Corporation plc since its acquisition by Abbey National in 1995, he is also responsible for HMC and Abbey National's French, Italian and Spanish operations. He previously worked for 22 years for ANZ Grindlays Bank where he held a number of senior international banking positions. Aged 49.

GARETH JONES FCA FCT *
Managing Director, Treasury and Wholesale Banking

Appointed to the Board in 1993. He joined Abbey National in 1989 as Assistant General Manager and Treasurer. He was re-appointed Treasurer in September 1993 with responsibility for Abbey National Treasury Services plc after serving as Director, Retail Operations. Aged 48.

MARTIN LLOWARCH FCA +#
Deputy Chairman

A Board member since 1989, he became a non-executive Deputy Chairman in 1994. He is Chairman of Transport Development Group plc and Firth Rixson plc and a non-executive director of Hickson International plc. His past appointments include director and Chief Executive of British Steel plc. Aged 61.

ALASTAIR LYONS FCA MCT ATII *
Managing Director, Insurance Division

Appointed to the Board in August 1996. Previously Chief Executive of National and Provincial Building Society from 1994, having joined them as Finance Director in 1991. Currently responsible for life and general insurance. He is also a non-executive director of the Benefits Agency. Aged 43.

PETER OGDEN

Appointed to the Board in September 1994. He is Chairman of Computacenter Limited, a director of Omnia Limited, which is an investment management company, and a non-executive director of Anglo & Overseas Trust PLC. He was previously a managing director of Morgan Stanley & Co. Aged 49.

ANDREW POPLE *
Managing Director, Retail Division

Appointed to the Board in August 1996. Since joining Abbey National in 1988, has held a number of senior positions including Chief Executive, Scottish Mutual and Head of the Life Division. Current responsibilities include marketing, distribution and retail operations. Aged 39.

THE LORD ROCKLEY +

Joined the Board in 1990. He is a non-executive director of the Kleinwort Benson Group plc, which incorporates a merchant bank used by Abbey National. He is also a non-executive director of Christie's International plc, The Foreign and Colonial Investment Trust PLC and Cobham plc. Aged 62.

THE LORD SHUTTLEWORTH FRICS #
Deputy Chairman

Appointed to the Board as a Deputy Chairman in August 1996. Previously Chairman of National and Provincial Building Society. He is also Lord-Lieutenant for the County of Lancashire and Chairman of the Rural Development Commission. Aged 48.

CHARLES TONER *
Deputy Chief Executive

A Board member since 1992, he was appointed Deputy Chief Executive in August 1996. Since joining Abbey National in 1964, he has held a number of executive appointments including General Manager and Managing Director, Retail Division. Aged 55.

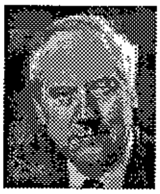
JAMES TUCKEY FRICS #

Appointed to the Board in 1990. He is currently Chief Executive of MEPC plc. Aged 50.

CHARLES VILLIERS FCA *
Managing Director, Corporate Development

A Board Member since 1989. He was formerly the Chief Executive of NatWest Investment Bank Ltd, an executive director of National Westminster Bank plc and the Chairman of County NatWest Ltd. Aged 56.

KEITH WOODLEY FCA +



Appointed to the Board in August 1996. Previously a non-executive director of National and Provincial Building Society from 1991. He is a past president of the Institute of Chartered Accountants in England and Wales and Complaints Commissioner for the London Stock Exchange, the Personal Investment Authority and the Securities and Futures Authority. Aged 57.

John Fry retired on 17 April 1996. Robert Knighton resigned from the Board on 31 December 1996 and will retire from the Company on 31 July 1997. Allan Denholm will retire at the conclusion of the Annual General Meeting on 24 April 1997.

* Executive Director
+ Audit Committee Member
# Personnel and Remuneration Committee Member

If the dates of appointment to the Board are before 12 July 1989, then these dates refer to appointments to the Board of Abbey National Building Society, the predecessor of Abbey National plc. All those directors concerned were appointed to the Board of Abbey National plc on 28 February 1989.

The number of full Board Meetings and committee meetings attended by each Director during the financial period was as follows:

	Number of Meetings Attended
Board Meetings	
The Lord Tugendhat	12
Mair Barnes	12
Peter Birch	12
Allan Denholm	12
Ian Harley	12
Sir Terry Heiser	12
Tim Ingram	4*
Gareth Jones	12
Robert Knighton	11
Martin Llowarch	11
Alastair Lyons	3*
Peter Ogden	12
Andrew Pople	4*
The Lord Rockley	11
The Lord Shuttleworth	4*
Charles Toner	12
James Tuckey	12
Charles Villiers	11
Keith Woodley	4*
Audit Committee	
Allan Denholm	5
Sir Terry Heiser	5
Martin Llowarch	5
The Lord Rockley	5
Keith Woodley	1*
Personnel and Remuneration Committee	
Martin Llowarch	7
Mair Barnes	7
The Lord Shuttleworth	2*
James Tuckey	7

*Reflects attendance since appointment

In 1996 there were 12 full Board meetings, 5 Audit Committee meetings and 7 meetings of the Personnel and Remuneration Committee.

Directors' Report

The directors have pleasure in presenting their report for Abbey National plc for the year ended 31 December 1996.

Principal activities

The principal activity of Abbey National plc and its subsidiaries continues to be the provision of an extensive range of personal financial services. The Operating and financial review for the year, including a review of non-banking activities, is set out on pages 10 to 23 of this document. Note 24 to the accounts on pages 60 and 61 provides a list of the principal subsidiaries and the nature of each company's business as well as details on overseas branches. Details of important events which have occurred since the end of the financial year and prospects for 1997 are included in the Statements of the Chairman and Chief Executive, and in the Operating and financial review, under Development of the business.

Results and dividends

The profit on ordinary activities before tax for the year ended 31 December 1996 was £1,167 million (1995: £1,026 million).

An interim net dividend of 8.70 pence per share was paid on 7 October 1996 (1995: 7.25 pence per share).

The directors propose a final net dividend for the year of 17.4 pence per share (1995: 14.50 pence per share) to be paid on 6 May 1997.

Corporate governance

A report on corporate governance is set out on pages 36 and 37.

Payment policy

Abbey National deals with a large number of suppliers operating in a diverse range of industries and accordingly does not operate a single payment policy in respect of all classes of suppliers. Each individual operating division is responsible for agreeing terms and conditions under which business is to be transacted and for making the supplier aware of these before business is entered into. It is Company policy to ensure payments are made in accordance with the terms and conditions agreed except where the supplier fails to comply with those terms and conditions.

Environmental policy

The Company considers environmental issues, wherever practicable, in all business areas - in investment and lending decisions, in the design and management of its buildings, in choosing suppliers and in the way its resources are used.

Employees

During the year Abbey National continued its commitment to involve employees as financial stakeholders in the business by offering a further invitation to eligible employees to participate in the Company's Sharesave scheme. The Company recognised employees' hard work and effort in successfully integrating Abbey National with the National and Provincial Building Society by offering all eligible staff in the enlarged organisation the opportunity to participate in an All Employee Share Option scheme with eligible employees given the opportunity to buy up to 150 shares in the Company at a predetermined option price in either three, four, or five years time. Employees were also offered an opportunity to participate in a Share Participation scheme of 50 free shares. As a result virtually all employees have a shareholding interest in the Company.

The Company has an active programme of employee communications using a wide variety of media. The aim is to ensure staff are fully informed of news and developments including information on Company performance. Employees are able to relate their views to management through regional question and answer sessions. Consultation with employee representatives takes place at national and local level through the Abbey National Staff Association.

The Company has continued to integrate the principle of equality of opportunity into its human resource policies having been highly commended in the 1996 Employer of the Year Awards organised by the Parents at Work campaign. Local initiatives across the country continue to give practical assistance to young people from minority groups. In addition Abbey National continues to support and contribute to the equality forum, "Opportunity 2000" and the racial equality campaign, "Race for Opportunity."

In this, the year of the Disability Discrimination Act, the Company continues to encourage applications from people with disabilities, and the Company's policy states that it will take all practical steps to assist the recruitment, retention, and development of disabled persons. The Company already operates under the Employment Services' "Positive About Disabled People" symbol.

Share capital

The authorised and issued share capital of the Company are detailed in note 40 to the accounts on page 70.

During the year, 3,018,326 ordinary shares were issued on the exercise of options under the Sharesave scheme, 1,200 shares were issued on the exercise of options under the terms of the Employee Share Option scheme, 162,031 shares were issued under the terms of the Executive Share Option scheme and 840,550 ordinary shares were issued under the terms of the Share Participation scheme. It is proposed to recommend to shareholders at the forthcoming Annual General Meeting that the Sharesave scheme rules be amended to permit the Company to purchase shares in the market for such schemes.

During the year the Company issued 82,644,563 ordinary shares in part consideration for the transfer of the business of National and Provincial Building Society.

On 13 February 1996 the Company issued 100,000,000 10.375% non-cumulative sterling preference shares of £1 each. On 15 November 1996 the Company issued 8,000,000 8.75% non-cumulative series A dollar preference shares of $0.01 each.

At the Annual General Meeting on 17 April 1996 shareholders authorised the Company to make market purchases of its own shares, to a maximum of 132,057,622 ordinary shares of 10 pence each. No purchases have been made during the year and this authority remains valid until the forthcoming Annual General Meeting, when it is intended that a resolution will be put to shareholders to renew the authority.

Market value of land and buildings

The directors believe, on the basis of a regular valuation review process, that the estimated market value of the Company's and its subsidiaries' land and buildings at 31 December 1996 was below the net book value of £380m as disclosed in note 27 to the accounts by approximately £25m. The directors do not consider this to be a permanent diminution in value, and therefore no provision has been made.

Charitable donations

The Company has continued to support a wide range of charitable projects, particularly through Abbey National Charitable Trust Limited (the "Trust").

The total value of support given to charities and the voluntary sector amounted to £1,300,000. This comprised mainly cash donations through the Trust, and other support given in kind, including the value of staff time.

During the year, Abbey National plc donated £464,000 to the Trust's funds. The Trust also received income from its invested Permanent Endowment Funds. Total cash donations of £943,000 to over 700 charities were made through the Trust and by other Abbey National Group companies in 1996.

The Trust has continued to give first priority to charities working to improve equality of opportunity for people with disabilities. It has also given major support to charities helping homeless people and families in crisis. The Trust supports the charity fund raising efforts of Abbey National staff, which included over £100,000 raised for Children in Need. During the year, the Company also became a sponsor of the RADAR People of the Year Awards.

Political contributions

No contributions were made for political purposes.

Directors and directors' interests

John Fry retired as a Deputy Chairman and a director on 17 April 1996. Robert Knighton resigned as a director on 31 December 1996.

Lord Shuttleworth was appointed as a non-executive director and Deputy Chairman and Keith Woodley as a non-executive director on 5 August 1996. On the same date Tim Ingram, Alastair Lyons and Andrew Pople were also appointed to the Board. All five directors, having been appointed since the last Annual General Meeting, will retire and being eligible, offer themselves for re-election at the forthcoming Annual General Meeting.

All other directors listed on pages 24 and 25 have served on the Board for the whole of the period 1 January 1996 to 31 December 1996. Mair Barnes, Gareth Jones, Lord Rockley and James Tuckey will retire by rotation at the Annual General Meeting and, all being eligible, offer themselves for re-election. Allan Denholm, a non-executive director, will retire at the conclusion of the Annual General Meeting.

No director had a material interest in any contract of significance, other than a service contract, with the Company or any of its subsidiaries at any time during the year. Details of all the directors are included on pages 24 and 25 of this document. Disclosures required by Financial Reporting Standard (FRS) 8, 'Related Party Disclosures', are set out in note 50 on page 82 of the accounts.

Directors' interests in the shares of the Company and options to acquire shares are set out in the report on Directors' Remuneration on pages 29 to 35.

Substantial shareholdings

No disclosable interest in the issued ordinary share capital has been notified to the Company in accordance with Sections 198 to 208 of the Companies Act 1985.

Auditors

A resolution to re-appoint Coopers & Lybrand as auditors will be proposed at the forthcoming Annual General Meeting.

Annual General Meeting

Details of the business of the Annual General Meeting can be found in the accompanying booklet entitled "Notice of Annual General Meeting 1997".

Ian K. Treacy.

By Order of the Board
I K Treacy
Company Secretary
26 February 1997

Directors' Remuneration

Under the London Stock Exchange Listing Rules, Abbey National is required to report to shareholders on a number of key considerations affecting the Board's policy on directors' remuneration as well as to provide full information analysing each element of individual directors' remuneration.

Personnel and Remuneration Committee

The Board of Abbey National plc has long had a Remuneration Committee, known as the Personnel and Remuneration Committee, with written terms of reference. These terms of reference were revised during the year and the Committee's brief includes a remit to determine the Company's policy on executive directors' remuneration and the remuneration of each executive director, including pension rights and any compensation payments. Membership of this Committee is indicated against individual directors' details on pages 24 and 25 and is restricted to independent non-executive directors although the Committee consults, as appropriate, with both the Chairman and the Chief Executive. The Committee is assisted in its deliberations by the Human Resources Director and takes advice from time to time from external advisors. The Company has complied throughout 1996 with the best practice provisions set out in Section A of the Annex to the London Stock Exchange Listing Rules.

There have been no significant modifications to the Company's policy on remuneration packages for executive directors since 1994 and the aim of the Board and the Personnel and Remuneration Committee continues to be to maintain a policy to attract, retain and motivate executive directors of appropriate calibre whilst ensuring basic salaries are around the median for our comparator group. This group includes banks, major building societies and insurance companies with which Abbey National competes, and other companies in a variety of fields with a market capitalisation broadly similar to our own. In developing this policy the Personnel and Remuneration Committee gives full consideration to the best practice provisions for remuneration policy and service contracts and compensation as set out in Section B of the Annex to the London Stock Exchange Listing Rules. Details of each director's remuneration package together with details of interests in shares and share options are set out below. There are no elements of remuneration, other than basic salary, which are treated as being pensionable.

Executive directors seeking re-election at the 1997 Annual General Meeting, with the exception of Alastair Lyons, will each have an unexpired contract term of one year. Alastair Lyons' terms and conditions require him to be given two years' notice of termination of his contract, save that after 31 December 1997 his notice period will be reduced to one year. The special contractual relations for Alastair Lyons reflect the terms and conditions that were negotiated following the transfer of the business of the National and Provincial Building Society, where he was Chief Executive. Non-executive directors do not have service contracts, save for the Chairman whose contract is renewable on an annual basis at the first Board Meeting in each year following the Annual General Meeting and provides for payment of fees for a period of twelve months.

All of the executive directors, save for Alastair Lyons, have rolling one year service contracts. If an executive director is made redundant under employment law, he may claim a total payment (which would include payment in lieu of notice period) of up to a maximum of two years salary depending on length of service. Fifteen years of continuous service would be required to secure this maximum payment. This provision is in line with Abbey National's well established practices on redundancy which equally apply to the service contracts of the 80 members of the Abbey National executive management group. During the period 6 August 1997 to 31 December 1997, Alastair Lyons may choose to terminate his employment with Abbey National without notice. If he ceases to be employed by Abbey National before 31 December 1997 (other than in circumstances where he is summarily dismissed with cause), he will be entitled to receive a payment calculated in accordance with the terms applicable to former National and Provincial Building Society employees. In Alastair Lyons' case this would give 6 weeks salary for each complete year of service since 1 March 1991 and 104 weeks pay in lieu of notice. From 1 January 1998 he will be subject to Abbey National practice.

Directors' emoluments

The following table shows an analysis of directors' emoluments excluding pensions, details of which are provided below:

	Salary/ Fee £	*Performance related Annual Bonus £*	*Performance related 3 year Bonus £*	*Other bonus payments £*	*Taxable benefits £*	*1996 Total £*	*1995 Total £*
The Lord Tugendhat (Chairman)	272,727				15,401	288,128	263,762
Executive Directors							
P G Birch (Chief Executive)	381,783	90,000	97,820	25,000	6,300	600,903	447,845
J M Fry (retired 17 April 1996)	56,000		32,667		3,595	92,262	196,810
I Harley	219,533	60,000	57,150		8,698	345,381	255,649
T C W Ingram*	70,067	40,000	20,495		1,389	131,951	
D G Jones	207,297	50,000	54,400	50,000	9,659	371,356	242,285
R F Knighton (resigned 31 December 1996)	214,667	50,000	55,650	75,000	8,436	403,753	262,967
A D Lyons*	104,230	10,000	8,645		2,378	125,253	
A H Pople*	69,655	40,000	28,833		25,054	163,542	
C G Toner	210,030	50,000	55,700		10,321	326,051	260,584
C N Villiers	210,667	50,000	54,650		6,939	322,256	268,315
Non-Executive Directors							
M Barnes	21,000				1,045	22,045	21,278
J A Denholm	26,000					26,000	29,577
Sir Terence Heiser	21,000				78	21,078	20,669
M E Llowarch	34,500				777	35,277	33,811
S Morrison (retired 27 June 1995)							8,792
P J Ogden	18,000					18,000	17,792
The Lord Rockley	21,000					21,000	20,583
The Lord Shuttleworth*	13,091				187	13,278	
J L Tuckey	21,000					21,000	20,583
K S Woodley*	7,864					7,864	
Totals	2,200,111	440,000	466,010	150,000	100,257	3,356,378	2,371,302

* Appointed 5 August 1996

Directors' pensions

Executive directors are eligible to join one of the Company's pension schemes.

The following table shows an analysis of the accrued pension benefits as at 31 December 1996 for executive directors participating in the Company's defined benefits pension schemes.

	Contributions from directors during 1996 £	*Increase in accrued pension during 1996 (1) (5) £*	*Transfer value of the increase in accrued pension during 1996 (2) £*	*Total accrued pension as at 31 December 96 (3) £*	*Total accrued pension as at 31 December 95 (4) £*
Executive Directors					
P G Birch (Chief Executive)	3,800	31,901	473,700	235,899	196,341
J M Fry (retired 17 April 1996)	600	181	2,000	108,448	106,667
I Harley	5,600	10,616	91,000	80,745	67,497
D G Jones	2,100	5,547	53,300	33,184	26,600
R F Knighton (resigned 31 December 1996) (6)	32,200	11,104	584,200	125,821	110,411
A D Lyons*	4,900	4,132	22,800	37,807	33,675
A H Pople*	700	5,160	31,700	23,496	18,336
C G Toner	2,100	11,588	151,800	126,191	110,301
C N Villiers	31,600	11,749	133,200	77,596	63,375
Totals	83,600	91,978	1,543,700	849,187	733,203

* Appointed 5 August 1996

Notes:

[1] The increase in accrued pension during 1996 represents the increase in the annual pension which each director would be entitled to receive from normal retirement age (less the statutory inflationary increase of 3.9%, where relevant), if he had left service voluntarily at 31 December 1996 or at his actual retirement date if earlier. For directors appointed during the year, the increase relates to the period of service from appointment to 31 December 1996.

[2] The transfer value of the increase in accrued pension represents the current capital sum which would be required, using demographic and financial assumptions, to produce an equivalent increase in accrued pension and ancillary benefits, excluding the statutory inflationary increase, and after deducting members' contributions (including AVCs).

[3] The accrued pension as at 31 December 1996 represents the annual pension which each director would be entitled to receive from normal retirement age if he had left service voluntarily at 31 December 1996, or at his actual retirement date if earlier.

[4] Stated as at the date of appointment if later.

[5] The figure for the increase in accrued pension during 1996 which appears in the table does not in all cases equal the difference between the total accrued pension as at 31 December 1996, and the total accrued pension as at 31 December 1995. The difference arises where the increase in accrued pension is stated after deducting the statutory inflationary increase which would have been applied to the deferred pension entitlement had the director left at the start of the year. This deduction has been made where directors have been in service for the whole year, and is made in order to present a figure showing that element of the increase which results from an extra full year of service and from changes in remuneration.

[6] R F Knighton resigned from the Board on 31 December 1996 and has opted to take early retirement from the Company during 1997. This is reflected in the transfer value of the increase in pension during 1996.

[7] The pension provision for T C W Ingram has been made on a defined contributions basis during 1996. The cost of this provision, including ancillary benefits, amounted to £23,100 during the year. He made contributions of nil during the year.

[8] Additional Voluntary Contributions made have been included in the above table where these payments result in an increase in the value of the Director's pension entitlements earned during the year.

The above disclosures for directors' pensions have been made with reference to the consultative document on proposed changes to the Listing Rules issued by the London Stock Exchange in May 1996 following the final report of the Institute and Faculty of Actuaries in April 1996. Further information concerning the Company's pension schemes is set out in note 49 to the accounts.

On his retirement John Fry was permitted to retain his Company car and received a gift. The value of these ex-gratia items, when grossed up for tax purposes, was £52,666. John Fry was a Deputy Chairman and director who had been on the board of Abbey National and its building society predecessor since 1984 and had been an employee for 34 years. As explained on page 33 the Company no longer provides directors with a company car.

A further ex-gratia gift, valued at £4,158 when grossed up for tax purposes, was made to Robert Knighton, who resigned from the Board on 31 December 1996 and will retire from the Company on 31 July 1997 after 27 years with Abbey National.

The remuneration arrangements of the Chairman and non-executive directors are as follows:

The Chairman's emoluments consist wholly of fees and benefits and expenses in respect of services. He is not entitled to participate in any bonus or profit sharing arrangements nor is he entitled to participate in the Executive Share Option scheme. However, he is entitled to participate in the Company's Sharesave scheme which is available to all eligible employees. The Chairman's appointment is non-pensionable and he makes his own private pension arrangements.

Fees are paid to non-executive directors. The basic fee for non-executive directors during 1996 was £18,000 per annum augmented by £3,000 for service on Board committees. On 1 January 1997 the basic fee and the fee for committee service were each increased by £2,000 per annum. The last increase was in June 1995.

Deputy Chairmen and Board Committee Chairmen receive additional fees directly proportionate to those for Board and Committee service.

The remuneration arrangements for executive directors are as follows:

a. Basic salary is considered in relation to similar sized jobs in comparable organisations. The comparators include UK banks, building societies, insurance companies and other UK companies with an equivalent market capitalisation to Abbey National.

b. The basic system of discretionary performance payments was revised during 1994, and now comprises a bonus scheme based on annual performance which pays out for 1996 in March 1997, and a three year scheme. The maximum potential cash payment, to be shared among the executive directors and other members of the top management team for the annual scheme, is 30% of that group's basic salary earned during the year. Such payments are not pensionable.

The actual level of any payment under the annual bonus scheme is determined by the Personnel and Remuneration Committee's view of the Group's performance set against the Chief Executive's objectives included in the annual budget. The Committee pays particular attention to certain quantifiable targets and then modifies that assessment in the light of its view of performance against qualitative objectives, such as customer service and product quality.

The key financial targets for 1996 were: achievement of a specified level of Group pre-tax profits; achievement of a specified cost:income ratio; and a specified measure of shareholder value (known as the value based management profit after capital charge). In setting the quantifiable financial targets the Committee requires an enhanced budget performance over the results achieved in the preceding year. Payments to individual executive directors reflect both corporate and individual performance and in total represented approximately 24% of the basic salaries earned during the year (other than that of John Fry).

c. As well as an annual bonus scheme there is also a three year performance scheme which was first established in 1994 and covered the three calendar years to 1996. The maximum potential cash payment, to be shared among the executive directors and other members of the top management team, is 30% of that group's basic salary. Such payments are not pensionable.

In determining whether or not to make a payment under the three year bonus scheme, and if so its size, the Personnel and Remuneration Committee will be guided by a formula which compares, over the relevant three year period, (i) total shareholder return against the FTSE 100 share index, (ii) performance against relevant quoted and unquoted comparator competitors, and (iii) performance against the Company's Three Year Plan. The maximum bonus is paid for performance in the top quartile and there is no payment for performance in the bottom quartile with pro rata payments in between.

Each of the executive directors set out above participated in the three year bonus scheme pro rata to his service in that period. In respect of the 1994 - 1996 scheme, entitlements represented 25% of participants' basic salaries at 31 December 1996 or at their date of retirement and are detailed above. Entitlements, if any, will not be determined until March 1998 in respect of the 1995 - 1997 scheme and March 1999 in respect of the 1996 - 1998 scheme, both of which are constructed on similar principles. For periods thereafter, the new Long Term Incentive Plan (see below) will replace the present scheme.

d. In addition, the Personnel and Remuneration Committee may in exceptional circumstances make an ex-gratia payment to an individual executive director who has rendered a particular and outstanding contribution. Payments under this heading were made to three directors during 1996 and these are shown under the 'Other Bonus Payments' column above.

e. There is an Executive Share Option scheme, an Employee Sharesave scheme, and an Employee Share Option scheme all of which have been approved by shareholders. Membership of all these schemes was available to executive directors, and their interests are set out below. As from 1 January 1997 executive directors will no longer participate in future grants under the Executive Share Option scheme (see Long Term Incentive Plan below). Grants of Executive share options are made on the determination of the Personnel and Remuneration Committee and reflect both corporate and individual performance. The performance criteria for the Executive Share Option scheme were strengthened during the year and, for options issued from 1997, exercise will require a total shareholder return above the median for quoted comparators in addition to the requirement, introduced for 1996, for the average growth in earnings per ordinary share to exceed the average increase in the Retail Prices Index by 2%. Executive share options are granted on a phased basis rather than in one block. Annual awards are normally equivalent to a maximum sum of one times annual salary, subject always to the Inland Revenue requirements on the total limit that may be awarded under such schemes. Replacement options will only be granted after due consideration by the Personnel and Remuneration Committee and providing performance has shown sustained growth in the preceding years.

Executive Options are granted at an exercise price based on the average of the market price as shown by the Daily Official List of the London Stock Exchange for the three business days immediately preceding the date of grant.

f. Taxable benefits for executive directors include car expenses, medical expenses, relocation expenses and subsidised mortgage loans. During the year the Company bought out the entitlement to a fully expensed car, and the provision of private petrol. The Chief Executive received an annual pensionable salary increase of £16,280 in lieu of such entitlements, whilst for other executive directors (except Alastair Lyons) the pensionable salary increase was £13,600 per annum.

In the case of non-executive directors some travelling expenses are classified as taxable benefits.

During 1996 the Personnel and Remuneration Committee undertook a major review of the current arrangements for remunerating executive directors, with particular attention being paid to the long term bonus and share option schemes. The Committee concluded that a new Long Term Incentive Plan for senior executives should be recommended for adoption at the forthcoming Annual General Meeting. A summary of the proposed Plan is included in the accompanying booklet entitled 'Notice of Annual General Meeting 1997'.

The Long Term Incentive Plan is designed to enhance the link between the remuneration of executives and the Company's medium term performance and will incorporate challenging performance targets. No payment will be made if performance is below median and maximum payment will be made for upper quartile performance, with pro rata payments in between. In the case of the first performance period (1997 - 1999), the performance targets will be based on the share price and dividend performance (total shareholder return) of the Company relative both to specified financial institutions and to the constituents of the FTSE 100 share index.

If shareholders approve the adoption of the Long Term Incentive Plan, the existing three year bonus scheme will cease to operate, and no payments will be made under that scheme after March 1999.

Assuming the Long Term Incentive Plan is adopted, future participation in the Company's Executive Share Option scheme will be primarily confined to less senior executives, a group of approximately 150 managers. Those who participate in the Long Term Incentive Plan will not also participate in future grants under the Executive Share Option scheme. In the first instance the Plan will be open only to 9 members of the Executive Committee, although it is expected that in time the Plan may include the wider senior management population.

Directors' share interests

The beneficial interests of directors and their immediate families in the ordinary shares of 10 pence each in the Company are shown below:

Ordinary shares:

	No. of shares	
	At 1.1.96 (or date of appointment if later)	*At 31.12.96*
M Barnes	1,000	1,000
P G Birch	313,458	313,838
J A Denholm	3,000	3,000
I Harley	20,501	27,643
Sir Terry Heiser	1,500	1,500
T C W Ingram	17,180	18,150
D G Jones	70,910	68,576
R F Knighton (resigned 31/12/96)	14,300	11,350
M E Llowarch	1,750	1,750
A D Lyons	691	691
P J Ogden	4,000	4,000
A H Pople	5,886	4,386
The Lord Rockley	5,000	5,000
The Lord Shuttleworth	816	816
C G Toner	20,143	21,898
J L Tuckey	12,000	12,000
The Lord Tugendhat	10,000	10,000
C N Villiers	26,657	26,323
K S Woodley	660	660

In addition T C W Ingram holds £232,529 Abbey National Floating Rate Unsecured Loan Notes 2000 issued on 23 August 1995 in consideration for shares held in FNFC plc and J A Denholm has a non-beneficial interest in 9,250 ordinary shares of 10 pence each of the Company at 31 December 1996 (1995: nil)

Share options:

	At 1.1.96 (or date of appointment if later)	No. of Options Granted	Exercised	At 31.12.96	Exercise price £	Market price at date of exercise £	Date from which exercisable	Expiry date	Notes
P G Birch	8,456			8,456	1.49		01/07/97	31/12/97	Sharesave
	1,939			1,939	2.32		01/10/98	31/03/99	Sharesave
	1,882			1,882	2.39		01/06/99	30/11/99	Sharesave
	2,418			2,418	4.28		01/10/00	31/03/01	Sharesave
	14,134			14,134	2.99		05/05/95	05/05/02	Executive
	69,478			69,478	2.99		05/05/95	05/05/02	Executive(1)
	25,215			25,215	3.69		29/03/96	29/03/03	Executive
	8,404			8,404	3.69		29/03/96	29/03/03	Executive(2)
	60,897			60,897	4.68		11/04/97	10/04/04	Executive
	71,500			71,500	4.83		10/04/98	09/04/05	Executive
	97,765			97,765	5.37		29/08/98	28/08/02	Executive#
		150		150	5.91		09/09/99	08/09/06	Employee
	362,088	150		362,238					
I Harley	1,616		1,616		2.32	5.995	01/10/96	31/03/97	Sharesave
	1,569			1,569	2.39		01/06/97	30/11/97	Sharesave
	2,418			2,418	4.28		01/10/00	31/03/01	Sharesave
	20,476		5,476	15,000	3.69	5.505	29/03/96	29/03/03	Executive
	6,825			6,825	3.69		29/03/96	29/03/03	Executive (2)
	23,237			23,237	4.68		11/04/97	10/04/04	Executive
	7,745			7,745	4.68		11/04/97	10/04/04	Executive(3)
	40,500			40,500	4.83		10/04/98	09/04/05	Executive
		38,053		38,053	5.65		25/03/99	24/03/06	Executive
		36,379		36,379	5.91		09/09/99	08/09/06	Executive#
		150		150	5.91		09/09/99	08/09/06	Employee
	104,386	74,582	7,092	171,876					
T C W Ingram	3,701			3,701	4.66		01/04/01	30/09/01	Sharesave
	4,180			4,180	4.097		31/08/96	30/08/03	Executive#
	25,663			25,663	5.65		25/03/99	24/03/06	Executive
		150		150	5.91		09/09/99	08/09/06	Employee
	33,544	150		33,694					
D G Jones	1,616		1,616		2.32	7.635	01/10/96	31/03/97	Sharesave
	1,569			1,569	2.39		01/06/97	30/11/97	Sharesave
	2,418			2,418	4.28		01/10/00	31/03/01	Sharesave
	23,322			23,322	2.99		05/05/95	05/05/02	Executive (1)
	25,575			25,575	3.69		29/03/96	29/03/03	Executive
	8,525			8,525	3.69		29/03/96	29/03/03	Executive (2)
	24,038			24,038	4.68		11/04/97	10/04/04	Executive
	8,012			8,012	4.68		11/04/97	10/04/04	Executive(3)
	39,500			39,500	4.83		10/04/98	09/04/05	Executive
		36,106		36,106	5.65		25/03/99	24/03/06	Executive
		22,829		22,829	5.91		09/09/99	08/90/06	Executive#
		150		150	5.91		09/09/99	08/09/06	Employee
	134,575	59,085	1,616	192,044					
R F Knighton (resigned 31/12/96)	8,456			8,456	1.49		01/07/97	31/12/97	Sharesave
	22,404			22,404	3.69		29/03/96	29/03/03	Executive
	7,468			7,468	3.69		29/03/96	29/03/03	Executive(2)
	22,435			22,435	4.68		11/04/97	10/04/04	Executive
	7,478			7,478	4.68		11/04/97	10/04/04	Executive (3)
	39,500			39,500	4.83		10/04/98	09/04/05	Executive
		24,665		24,665	5.65		25/03/99	24/03/06	Executive
		37,665		37,665	5.91		09/09/99	08/09/06	Executive#
		150		150	5.91		09/09/99	08/09/06	Employee
	107,741	62,480		170,221					
A D Lyons		150		150	5.90		09/09/99	08/09/06	Employee
		150		150					
A H Pople	1,939			1,939	2.32		01/10/98	31/03/99	Sharesave
	1,882			1,882	2.39		01/06/99	30/11/99	Sharesave
	2,418			2,418	4.28		01/10/00	31/03/01	Sharesave
	25,000			25,000	4.00		01/09/97	31/08/04	Executive
	30,000			30,000	4.83		10/04/98	09/04/05	Executive
	23,008			23,008	5.65		25/03/99	24/03/06	Executive
		150		150	5.91		09/09/99	08/09/06	Employee
	84,247	150		84,397					

	At 1.1.96 (or date of appointment if later)	*No. of Options* Granted	Exercised	*At 31.12.96*	*Exercise price £*	*Market price at date of exercise £*	*Date from which exercisable*	*Expiry date*	*Notes*
C G Toner	1,616		1,616		2.32	5.995	01/10/96	310/3/97	Sharesave
	1,569			1,569	2.39		01/06/97	30/11/97	Sharesave
		2,221		2,221	4.66		01/04/01	30/09/01	Sharesave
	24,449			24,449	3.69		29/03/96	29/03/03	Executive
	8,149			8,149	3.69		29/03/96	29/03/03	Executive (2)
	24,038			24,038	4.68		11/04/97	10/04/04	Executive
	8,012			8,012	4.68		11/04/97	10/04/04	Executive (3)
	39,500			39,500	4.83		10/04/98	09/04/05	Executive
		30,884		30,884	5.65		25/03/99	24/03/06	Executive
		35,364		35,364	5.91		09/09/99	08/09/06	Executive#
		150		150	5.91		09/09/99	08/09/06	Employee
	107,333	68,619	1,616	174,336					
The Lord Tugendhat	7,845			7,845	2.39		01/06/97	30/11/97	Sharesave
	7,845			7,845					
C N Villiers	1,616		1,616		2.32	6.15	01/10/96	31/03/97	Sharesave
	1,569			1,569	2.39		01/06/97	30/11/97	Sharesave
	2,418			2,418	4.28		01/10/00	31/03/01	Sharesave
	37,111			37,111	2.99		05/05/95	05/05/02	Executive (1)
	31,145			31,145	3.69		29/03/96	29/03/03	Executive
	10,381			10,381	3.69		29/03/96	29/03/03	Executive (2)
	9,612			9,612	4.68		11/04/97	10/04/04	Executive
	3,204			3,204	4.68		11/04/97	10/04/04	Executive (3)
	32,086			32,086	4.83		10/04/98	09/04/05	Executive
		10,055		10,055	5.65		25/03/99	24/03/06	Executive
		36,988		36,988	5.91		09/09/99	08/09/06	Executive#
		150		150	5.91		09/09/99	08/09/06	Employee
	129,142	47,193	1,616	174,719					

Replacement options

Notes:
The executive share options detailed above become exercisable if the average growth of earnings per ordinary share exceeds the average increase in the Retail Prices Index in any three years prior to exercise. For those executive options granted in 1996, the average growth of earnings per ordinary share must exceed the average increase in the Retail Prices Index by 2%.

Parallel discounted options were granted over the shares noted 1, 2 and 3 exercisable as follows:

1. at £2.54 from 5.5.1997 to 5.5.2002. 2. at £3.14 from 29.3.1998 to 29.3.2003. 3. at £3.98 from 11.4.1999 to 10.4.2004.

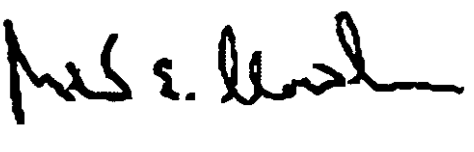
Parallel discounted options become exercisable if the average growth in earnings per ordinary share exceeds the average increase in the Retail Prices Index by at least 10% in any five year period prior to the date of exercise. The option holder may exercise either the standard or discounted option, but not both, thereby reducing both options, subject to the achievement of the appropriate performance criteria. The Board determined in 1994 that it would no longer make grants of discounted options.

The options refer to those granted under the Company's Executive Share Option, Employee Share Option and Sharesave schemes, as set out in note 40 to the accounts.

Options shown under the headings 'Granted' or 'Exercised' refer to options granted or exercised during the year or since appointment if later.

Market price at the date of exercise is the Middle Market Quotation, as derived from the London Stock Exchange Daily Official List. The market price of the shares on 31 December 1996 was 765p (635.5p) and the range during 1996 was 529p to 765p.

There have been no changes to the beneficial and other interests of the directors in the ordinary shares of the Company as shown above up to 26 January 1997, other than the automatic reinvestment on 2 January 1997 of dividends arising from the Abbey National Personal Equity Plan as follows: P G Birch 81 shares, T C W Ingram 6 shares, A H Pople 5 shares, and C G Toner 18 shares.



Martin Llowarch
Deputy Chairman and Chairman of the Personnel and Remuneration Committee.
26 February 1997

Corporate Governance

Corporate Governance is concerned with how companies are directed and controlled and in particular with the role of the Board of Directors and the need to ensure a framework of effective accountability.

The Board comprises a part-time Chairman, eight executive directors and nine non-executive directors. The full Board met on twelve occasions during 1996, including a separate session specifically devoted to the long term strategic direction of the Group. The Board's focus is on strategy formulation, policy and control and a Framework of High Level Authorities is in place which maps out the structure of delegation below Board level as well as specifying those authorities which remain within the Board's preserve. Risk management in banking is critical and the Board has in place policies covering the risks associated with liquidity, foreign exchange, interest rates and credit. A key role is played by the Assets and Liabilities Committee (ALCO), which monitors and controls the level of Group structural balance sheet risk, and by the Group Credit Committee, which reviews and oversees high level credit policies and exposures. ALCO meets monthly and is chaired by the Chief Executive, whilst its membership comprises a number of executive directors and managers. Group Credit Committee meets fortnightly and comprises two executive directors plus several members of the executive management group. The Board, at its regular monthly meetings, reviews the minutes of ALCO which incorporate extracts from the minutes of the Group Credit Committee. During the year further work was undertaken to strengthen risk management within Abbey National, including a review of the role of the Group Risk Department, the endorsement by the Board of a Group High Level Risk Map and an assessment of the role, reporting arrangements and composition of each of the supporting risk committees. As Abbey National diversifies, a growing responsibility falls on the boards of directors of its subsidiary companies, particularly those in the life assurance, treasury and consumer credit sectors. Each of these boards (Scottish Mutual Assurance plc, Abbey National Life plc, Abbey National Treasury Services plc, and First National Finance Corporation plc) includes at least one independent non-executive director.

All directors have access to the advice and services of the Company Secretary and the Board has established a procedure whereby directors, wishing to do so in the furtherance of their duties, may take independent professional advice at the Company's expense.

Two standing board committees are maintained both of which operate within written terms of reference with their minutes circulated for review and consideration by the full complement of directors, supplemented by oral reports from the committee chairmen.

The Audit Committee met five times in 1996. Its prime tasks are to review the scope of external and internal audit, to receive regular reports from the Company's auditors, Coopers & Lybrand and the Chief Internal Auditor, and to review the half yearly and annual accounts before they are presented to the Board, focusing in particular on accounting policies and compliance, and areas of management judgement and estimates. The Committee more generally acts as a forum for discussion of internal control issues. It is currently chaired by Allan Denholm, a past President of the Institute of Chartered Accountants of Scotland.

The Personnel and Remuneration Committee is chaired by myself and met seven times in 1996. Its principal function is to monitor the human resources policies of the Group to ensure they support the business objectives determined by the Board and the interests of shareholders. The Committee is also specifically charged with determining the Company's policy on Executive Director and Executive Management remuneration. Its report to shareholders on how directors are remunerated, together with details of individual directors' remuneration packages, is to be found on pages 29 to 35.

The Board does not operate a nominations committee, but appointments of non-executive directors are made on a formalised basis with the Chairman agreeing selection criteria with his colleagues. Use is made of independent recruitment consultants. The final decision rests with the full Board, after a period of extensive consultation. Appointments are for an initial term of three years which is extendable upon mutual agreement.

The assets of the Company's main pension schemes are held separately from those of the Group and are under the control of the Trustees of each scheme. The four Abbey National pension schemes have a common Corporate Trustee which has six directors, including Lord Tugendhat and two executive directors of the Company. The National and Provincial Pension scheme has a different Corporate Trustee, the Board of which comprises Lord Shuttleworth, two other Company appointed directors and three member-elected directors.

Asset management of these schemes is delegated to a number of independent fund managers and property managers and the Trustees receive independent professional advice on the performance of the external managers. Legal advice to the Trustees is provided by external firms of solicitors. The auditing of the Abbey National pension schemes is separated from that of Abbey National, being undertaken by Deloitte & Touche, however, Coopers & Lybrand, the Company's auditors, are still retained as auditors to the National and Provincial scheme.

The Stock Exchange requires directors to report on compliance with the recommendations set out in the Code of Best Practice published in December 1992 by the Committee on the Financial Aspects of Corporate Governance (the "Code"). The directors have carefully considered these and confirm that Abbey National plc, in the light of the Company's particular circumstances, has met throughout the year and continues to meet the Code's recommendations.

As required by the Code, specific statements are provided below on the application of the concept of "going concern" in the accounts, and on internal control.

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.

Internal control

The Board of directors has overall responsibility for systems of internal financial control throughout the Abbey National Group, though in the context of the size and complexity of operations it has to be understood that such systems can provide only reasonable and not absolute assurance against material misstatement or loss.

The key elements of internal financial control are set out hereunder, though these should be seen within the wider framework of high level controls described above:

- A planning framework which incorporates a Board approved rolling Three Year Plan, with detailed annual operating objectives and milestones to business unit levels.
- A comprehensive system of financial reporting to the Board, based on an annual budget with monthly reports against actual results, analysis of variances, scrutiny of key performance indicators, plus regular reforecasting.
- Well defined regulations governing appraisal and approval of capital expenditure. These include an annual budget, detailed project approval procedures, incorporating appropriate levels of authority, and a post investment review process.
- A network of financial risk committees, supplemented by Group Risk Department, which operate under the overall framework of a Board endorsed group wide high level "Risk Map".
- The Assets and Liabilities Committee (ALCO) receives regular reports which track the various components of market risk, and also the generation and absorption of capital, and the level, composition and trends in liquidity, including projected demands on liquidity.
- The use of Control Manuals to document key controls against identified risks, supplemented by procedure manuals at the operating level. Procedures have also been developed whereby management submits Self Certification Statements confirming compliance with key controls, and these statements are reviewed by the Audit Committee.

Monitoring of the effectiveness of internal control is undertaken by the Audit Committee, which receives regular reports from Internal Audit, and where relevant from external auditors, while the Board also receives regular and exception reports on high level prudential control issues, such as compliance with the Financial Services Act.

The Audit Committee has reviewed the effectiveness of the system of internal financial control which operated during the period covered by this Directors' Report and Accounts.

Martin Llowarch
Deputy Chairman
26 February 1997

Report by the Auditors

To Abbey National plc on Corporate Governance Matters

In addition to our audit of the accounts, we have reviewed the directors' statements on page 37 concerning the Company's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and their adoption of the going concern basis in preparing the accounts. The objective of our review is to draw attention to non-compliance with Listing Rules 12.43(j) and 12.43(v).

Basis of opinion

We carried out our review in accordance with guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the Company's system of internal financial control or its corporate governance procedures, nor on the ability of the Company to continue in operational existence.

Opinion

With respect to the directors' statements on internal financial control and going concern on page 37, in our opinion the directors have provided the disclosures required by the Listing Rules referred to above and such statements are not inconsistent with the information of which we are aware from our audit work on the accounts.

Based on enquiry of certain directors and officers of the Company, and examination of relevant documents, in our opinion the directors' statement on page 37 appropriately reflects the Company's compliance with the other aspects of the Code specified for our review by Listing Rule 12.43(j).

Coopers + Lybrand

Coopers & Lybrand
Chartered Accountants
London
26 February 1997

Directors' Responsibilities for Accounts

The directors of Abbey National plc are required by UK company law to prepare accounts which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year, and of the profit for the year. They are also responsible for ensuring that proper and adequate accounting records have been maintained and that reasonable procedures have been followed for safeguarding the assets of the Group and for preventing and detecting fraud and other irregularities.

In respect of the accounts the directors are required to:

• ensure that appropriate accounting policies, which follow generally accepted accounting practice, have been applied consistently;

• ensure that reasonable and prudent judgements and estimates have been used in the preparation of the accounts;

• prepare the accounts on the going concern basis unless it is inappropriate to presume that the Company and Group will continue in business;

• state whether applicable accounting standards have been followed and to disclose and explain any material departures in the accounts.

Auditors' Report

To the Members of Abbey National plc

We have audited the accounts on pages 41 to 83.

Respective responsibilities of directors and auditors

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

Basis of opinion

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

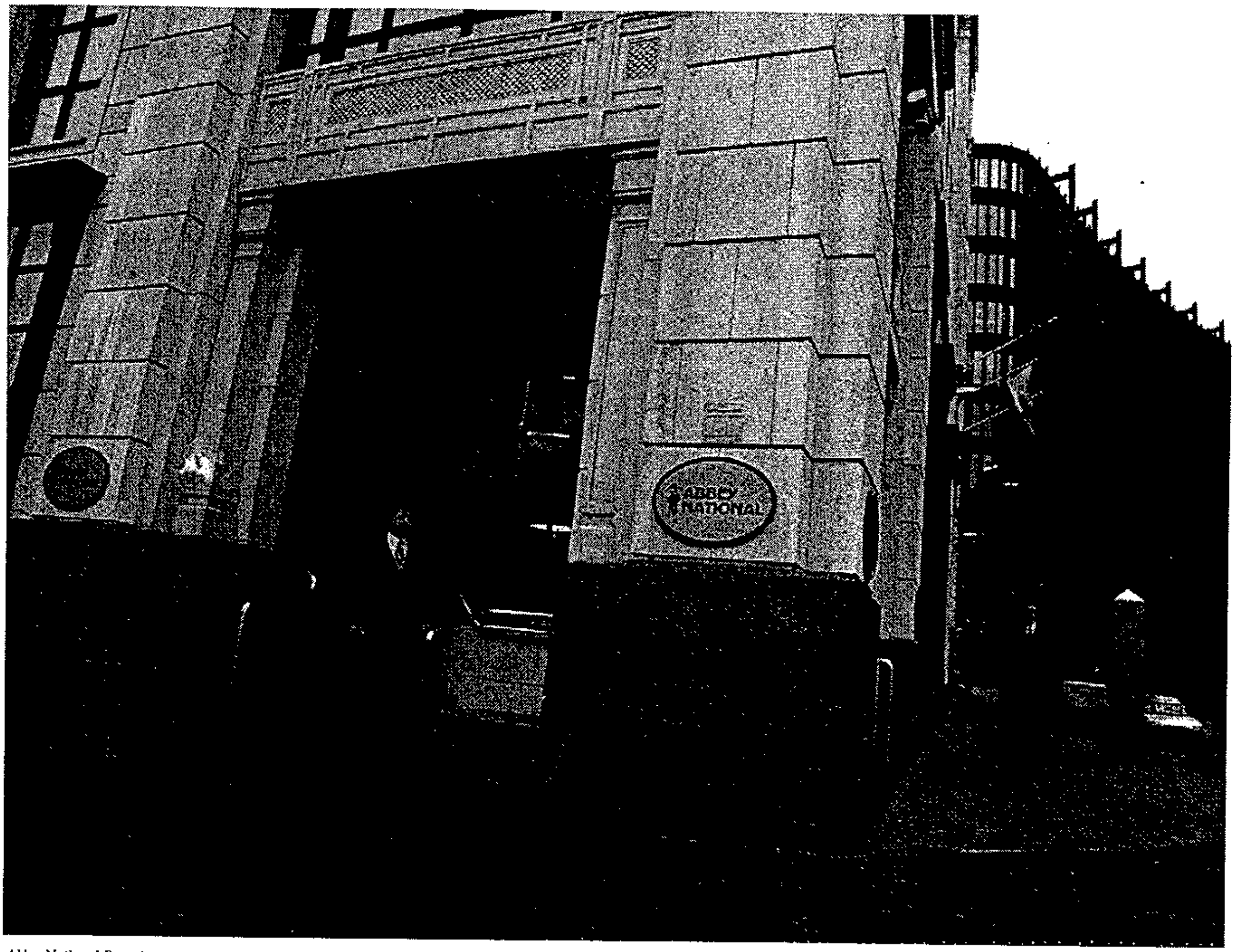
We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or other irregularity or error.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

Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the Company and the Group at 31 December 1996 and of the profit, total recognised gains and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Coopers + Lybrand.

Coopers & Lybrand
Chartered Accountants and Registered Auditors
London
26 February 1997



Abbey National Branch,
Ludgate Circus,
City of London

Consolidated Profit and Loss Account

For the year ended 31 December 1996

Notes		1996 £m	1995 £m
	Interest receivable		
2	Interest receivable and similar income arising from debt securities	**2,016**	2,335
3	Other interest receivable and similar income	**4,544**	4,246
4	Interest payable	**(4,766)**	(4,997)
	Net interest income	**1,794**	1,584
5	Dividend income	**3**	2
	Fees and commissions receivable	**398**	281
	Fees and commissions payable	**(62)**	(36)
	Dealing profits	**29**	6
6	Other operating income	**187**	146
	Total operating income	**2,349**	1,983
	Administrative expenses		
7	Integration costs in continuing businesses	**(61)**	–
8	Other administrative expenses	**(884)**	(783)
27	Depreciation and amortisation	**(93)**	(87)
	Provisions		
11	Provisions for bad and doubtful debts	**(127)**	(72)
38	Provisions for contingent liabilities and commitments	**(4)**	(7)
20	Amounts written off fixed asset investments	**(13)**	(8)
	Profit on ordinary activities before tax	**1,167**	1,026
12	Tax on profit on ordinary activities	**(403)**	(344)
13	**Profit on ordinary activities after tax**	**764**	682
	Minority interests - equity	**3**	1
	Profit attributable to the shareholders of Abbey National plc	**767**	683
41	Transfer to non-distributable reserve	**(67)**	(59)
14	Dividends including amounts attributable to non-equity interests	**(373)**	(290)
	Profit retained for the financial year	**327**	334
	Profit on ordinary activities before tax includes:		
26	for acquired operations (excluding integrated businesses)	**8**	9
	for discontinued operations	**–**	(8)
15	**Earnings per ordinary share**	**56.5p**	51.7p
15	**Earnings per ordinary share, excluding integration costs**	**59.8p**	51.7p

The Group's results as reported are on an historical cost basis. Accordingly, no note of historical cost profits and losses has been presented.

Consolidated Balance Sheet

At 31 December 1996

Notes		1996 £m	1996 £m	1995 £m	1995 £m
	Assets				
	Cash and balances at central banks		228		145
16	Treasury bills and other eligible bills		111		246
17	Loans and advances to banks		2,825		3,579
18	Loans and advances to customers		64,227		51,090
19	Net investment in finance leases		4,310		2,844
20	Debt securities		39,730		35,243
21	Equity shares and other variable yield securities		44		54
22	Long term assurance business		555		425
23	Interests in associated undertakings		8		1
27	Tangible fixed assets		715		585
28	Other assets		1,509		1,649
29	Prepayments and accrued income		1,880		1,753
22	Assets of long term assurance funds		7,869		5,518
	Total assets		124,011		103,132
	Liabilities				
30	Deposits by banks		17,718		19,393
31	Customer accounts		49,678		40,962
32	Debt securities in issue		35,193		26,095
	Dividend proposed		245		191
33	Other liabilities		2,980		1,879
35	Accruals and deferred income		2,591		2,396
36	Provisions for liabilities and charges		970		630
39	Subordinated liabilities including convertible debt		2,374		2,127
22	Liabilities of long term assurance funds		7,869		5,518
			119,618		99,191
	Minority interests - equity		–		–
40	Called up share capital – ordinary shares	141		132	
	– preference shares	200		100	
40	Share premium account	1,441		856	
41	Reserves	230		163	
41	Profit and loss account	2,381		2,690	
42	Shareholders' funds including non-equity interests		4,393		3,941
	Total liabilities		124,011		103,132
	Memorandum items				
	Contingent liabilities				
44	Guarantees and assets pledged as collateral security		2,570		1,129
45	Other contingent liabilities		138		197
			2,708		1,326
46	Commitments		2,910		1,541

Approved by the Board on 26 February 1997 and signed on its behalf by:

Lord Tugendhat
Chairman

Peter G Birch
Chief Executive

Ian Harley
Finance Director

Company Balance Sheet

At 31 December 1996

Notes		1996 £m	1996 £m	1995 £m	1995 £m
	Assets				
	Cash and balances at central banks		227		144
17	Loans and advances to banks		580		522
18	Loans and advances to customers		59,565		46,758
20	Debt securities		1,863		2,815
21	Equity shares and other variable yield securities		21		18
24	Shares in Group undertakings		2,445		2,271
23	Interests in associated undertakings		22		20
27	Tangible fixed assets		626		542
28	Other assets		414		306
29	Prepayments and accrued income		419		246
	Total assets		66,182		53,642
	Liabilities				
30	Deposits by banks		9,936		6,284
31	Customer accounts		47,321		39,781
32	Debt securities in issue		645		36
	Dividend proposed		245		191
33	Other liabilities		760		690
35	Accruals and deferred income		874		818
36	Provisions for liabilities and charges		120		63
39	Subordinated liabilities including convertible debt		2,363		2,079
			62,264		49,942
40	Called up share capital – ordinary shares	141		132	
	– preference shares	200		100	
40	Share premium account	1,441		856	
41	Profit and loss account	2,136		2,612	
42	Shareholders' funds including non-equity interests		3,918		3,700
	Total liabilities		66,182		53,642
	Memorandum items				
	Contingent liabilities				
44	Guarantees and assets pledged as collateral security		62,196		52,841
45	Other contingent liabilities		19		57
			62,215		52,898
46	Commitments		211		124

Approved by the Board on 26 February 1997 and signed on its behalf by:

Lord Tugendhat
Chairman

Peter G Birch
Chief Executive

Ian Harley
Finance Director

Statement of Total Recognised Gains and Losses

For the year ended 31 December 1996

	1996 £m	1995 £m
Profit attributable to the shareholders of Abbey National plc	767	683
Translation differences on foreign currency net investment	(26)	15
Total recognised gains relating to the year	741	698

Consolidated Cash Flow Statement

For the year ended 31 December 1996

Notes		1996 £m	1995 £m
48a	**Net cash inflow from operating activities**	3,239	2,187
	Returns on investments and servicing of finance		
	Dividends paid	(321)	(256)
	Net cash outflow from returns on investments and servicing of finance	(321)	(256)
	Taxation		
	UK corporation tax paid	(153)	(195)
	Overseas tax paid	(11)	(10)
	Total taxation paid	(164)	(205)
	Investing activities		
	Purchases of investment securities	(15,641)	(37,459)
	Sales of investment securities	10,444	32,968
	Redemptions and maturities of investment securities	2,237	2,393
	Purchases of tangible fixed assets	(147)	(127)
	Sales of tangible fixed assets	46	13
	Transfers to life assurance funds	(41)	(10)
48f	Acquisitions of subsidiary and associated undertakings/purchase of business	729	(298)
	Sale of subsidiary undertakings	–	1
	Net cash outflow from investing activities	(2,373)	(2,519)
	Net cash inflow (outflow) before financing	381	(793)
	Financing		
	Issue of ordinary share capital	12	14
	Issue of preference share capital	224	101
	Issue of loan capital	311	715
	Repayments of loan capital	(21)	(128)
48d	**Net cash inflow from financing**	526	702
48c	**Increase (decrease) in cash and cash equivalents**	907	(91)

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 comprise the accounts of the Company and its subsidiary undertakings made up to 31 December, with the exception of a number of leasing, investment, insurance and funding companies, which, because of commercial considerations, have various accounting reference dates. The accounts of these subsidiaries have been consolidated on the basis of interim accounts for the period to 31 December 1996. In addition, Wagon Finance Ltd, which was acquired before 31 December 1996, currently has an accounting reference date other than 31 December. The accounts of this subsidiary have been consolidated on the basis of interim accounts for the period to 31 December 1996.

The assets and liabilities of the long term assurance funds are presented separately from those of other businesses in order to reflect the different nature of the shareholders' interest in them.

Interests in subsidiary and associated undertakings
The Company's interests in subsidiary undertakings and associated undertakings are stated at cost less any provisions for permanent diminution in value. The Group's interests in associated undertakings are stated at the Group's share of the book value of the net tangible assets of the associated undertakings.

Goodwill
Goodwill arising on consolidation as a result of the acquisition of subsidiary and associated undertakings and goodwill arising on the purchase of businesses are taken directly to reserves in the year in which they occur. On disposal of subsidiary and associated undertakings and businesses, the goodwill previously taken to reserves is charged to the profit and loss account balanced by an equal credit to reserves. Where the directors believe that the purchased goodwill in continuing businesses has suffered a permanent diminution in value, a similar charge to the profit and loss account and credit to reserves is made.

Deferred taxation
Deferred taxation is accounted for where it is probable that a liability or asset will arise. Provision is calculated at rates expected to be applicable when the liability or asset crystallises.

Depreciation
Tangible fixed assets are depreciated on a straight line basis over their estimated useful lives. The following annual rates are used:

Premises
Freehold buildings: 1%
Long and short leasehold premises: Over the remainder of the lease, with a maximum of 100 years.
Acquisition premiums are depreciated over the period to the next rent review.

Equipment
Office fixtures, equipment and furniture: 12.5%
Computer equipment: 25% for mainframes and 20% for peripherals
Motor vehicles: 25%

No depreciation is provided on freehold land.

Interest receivable
Interest is suspended where due but not received on loans and advances in arrears where recovery is doubtful. The amounts suspended, less recoveries of amounts suspended in previous years, are excluded from interest receivable on loans and advances.

Fees and commissions receivable
Fees and commissions receivable in respect of services provided are taken to the profit and loss account when the related services are performed. Where fees and commissions are receivable which are in the nature of interest, these are taken to the profit and loss account on a systematic basis over the expected period of the loan, and are included under the heading, Interest receivable. Fees which are receivable in order to cover a proportion of future losses, as explained in more detail under Deferred income, are taken to the profit and loss account as the relevant losses are identified and provided for, and are included under the heading, Other operating income.

Lending-related fees and commissions payable and discounts

Under certain schemes, fees and discounts may be granted to customers as incentives to take out loans. It is usually a condition of such schemes that incentive payments are recoverable by way of early redemption penalty charges in the event of redemption within a specified period ('the penalty period'). Such incentive payments are charged to the profit and loss account over the penalty period where their cost is recoverable from the net interest income earned from the related loans over the penalty period, or from the penalty charge in the event of early redemption. When the related loan is redeemed, sold or becomes impaired any amounts previously unamortised are charged to the profit and loss account. The profit and loss account charge for such fees and discounts is included under the heading, Interest receivable.

Commissions payable to introducers in respect of obtaining certain lending business, where this is the primary form of distribution, are charged to the profit and loss account over the anticipated life of the loans. The profit and loss account charge for such commissions is included under the heading, Fees and commissions payable.

Deferred income

The Company has entered into insurance arrangements with certain insurance subsidiaries, to cover a proportion of future losses on certain UK residential secured loans with high loan to value ratios. In the Group accounts, income from customers in relation to such lending is deferred and is included in the balance sheet under the heading, Accruals and deferred income. The deferred income is released to the profit and loss account as relevant losses are identified and provided for.

Securities

Securities held for investment purposes are stated at cost, adjusted for any amortisation of premium or discount on an appropriate basis over their estimated lives. Provision is made for any permanent diminution in value. Investment securities are intended for use on a continuing basis by the Group.

In accordance with industry practice, securities which are not held for the purpose of investment, certain money market deposits and the associated funding of these assets are stated at market value and profits and losses arising from this revaluation are taken to the profit and loss account. The net return on these assets appears in Dealing profits in the profit and loss account. This net return comprises the revaluation profit and loss referred to above, plus profits and losses on disposal of these assets, plus interest receivable on these assets less interest payable on their associated funding. The cost of securities which are not held for the purpose of investment is not disclosed as it cannot be determined without unreasonable expense. Where securities are transferred from portfolios held for investment purposes to portfolios held for other purposes, the securities are transferred at market value. Gains and losses on these transfers are included in the profit and loss account.

Interests in securities are recognised as assets or, in the case of short positions, liabilities, at the date at which the commitment to purchase or sell is considered to be binding.

Securities sold subject to agreements to repurchase are retained on the balance sheet where the risks and rewards of ownership of the securities remain with the Group. Similarly, securities purchased subject to a commitment to resell are treated as collateralised lending transactions where the Group does not acquire the risks and rewards of ownership. The difference between sale and repurchase prices for such transactions is charged or credited to the profit and loss account over the life of the relevant transactions.

Derivatives

Transactions are undertaken in derivative financial instruments ('derivatives'), which include interest rate swaps, cross currency swaps, futures, options, warrants and similar instruments, for trading and non-trading purposes. Derivatives classified as non-trading are held for the purpose of hedging exposures relating to the Group's assets, liabilities and positions which are held for the purpose of investment.

Gains and losses arising from the hedging of investment transactions are released to the profit and loss account over the life of the asset, liability or position against which the hedge is held. Gains and losses arising from the hedging of assets which are not held for the purpose of investment are taken directly to the profit and loss account. Where a transaction originally entered into as a hedge no longer represents a hedge, its value is restated at fair value and any change in value is taken to the profit and loss account.

Gains and losses on instruments purchased or sold for trading and market making purposes are taken directly to the profit and loss account. Any such transactions outstanding at the balance sheet date are stated at fair value.

Development properties

Completed properties and work in progress are valued at the lower of cost and net realisable value. Cost comprises land purchase, building works thereon and interest.

Equipment leased to customers

Assets leased to customers under agreements which transfer substantially all the risks and rewards associated with ownership, other than legal title, are classified as finance leases. The net investment in finance leases represents total minimum lease payments less gross earnings allocated to future periods. Income from finance leases is credited to the profit and loss account using the actuarial after tax method to give a constant periodic rate of return on the net cash investment.

Provisions for bad and doubtful debts
Specific provisions are made against loans and advances when, as a result of regular appraisals of the assets, it is considered that recovery is doubtful. A general provision is made against loans and advances to cover bad and doubtful debts which have not been separately identified but which are known from experience to be present in any portfolio of loans and advances. The specific and general provisions are deducted from loans and advances. Provisions made during the year, less amounts released and recoveries of amounts written off in previous years, are charged to the profit and loss account.

Securitisations
Certain subsidiary undertakings have issued debt securities, or have entered into funding arrangements with lenders, in order to finance the purchase of certain portfolios of loan assets. These obligations are secured on the loan assets and other assets of the subsidiary undertakings. Where the Group has retained significant benefits and risks relating to the portfolios of loan assets, the loan assets and the related liabilities are presented separately within the relevant headings in the Group balance sheet.

Long term assurance business
The value of the long term assurance business represents the value of the shareholders' interest in the long term assurance funds, which consists of the present value of surplus expected to emerge in the future from business currently in force, together with the Group's interest in the surplus retained within the long term assurance funds.

In determining this value, assumptions relating to future mortality, persistency and levels of expenses are based on experience of the business concerned. Surplus expected to emerge in the future is discounted at a risk-adjusted discount rate after provision has been made for taxation. Changes in the value, which is determined on a post-tax basis, are included in the profit and loss account grossed up at the standard rate of corporation tax. The post-tax increase in the value is treated as non-distributable until it emerges as part of the surplus arising during the year.

The values of the assets and liabilities of the long term assurance funds are based on the amounts included in the accounts of the Life Assurance companies. These are determined in accordance with the terms of the Companies Act 1985 (Insurance Companies Accounts) Regulations 1993, adjusted for the purposes of inclusion in the Group accounts in order to be consistent with the Group's accounting policies and presentation, where a separate asset is established to account for the value of long term assurance business. See note 22.

Foreign currency translation
Income and expenses arising in foreign currencies during the year are translated into sterling at the average rates of exchange ruling over the accounting period unless they are hedged in which case the relevant hedge rate is applied. Dividends are translated at the rate prevailing on the date the dividend is receivable. Assets and liabilities in foreign currencies are translated into sterling at the rates of exchange current at the balance sheet date. Exchange differences arising on foreign currency borrowings used to hedge net assets of overseas Group undertakings are taken directly to reserves to the extent that they offset corresponding exchange differences on the translation of the net assets. Those differences resulting from the restatement of the profits and losses of overseas Group undertakings from average to year-end rates are taken to the reserves. Other translation differences are dealt with through the profit and loss account. In the Company accounts, exchange differences arising on the translation of foreign currency borrowings used to hedge investments in Group undertakings are taken directly to reserves to the extent that they offset the corresponding exchange differences arising on the translation of the investments.

Pensions
Where pensions are provided by means of a funded defined benefits scheme, annual contributions are based on actuarial advice. The expected cost of providing pensions is recognised on a systematic basis over the expected average remaining service lives of members of the scheme.

Cash equivalents
For the purposes of the consolidated cash flow statement, cash equivalents are short term highly liquid investments which are readily convertible into known amounts of cash without notice and which were within three months of maturity when acquired.

Notes to the Accounts

1. Segmental analysis

	UK Retail Banking £m	Consumer Credit £m	Life Assurance £m	Treasury & Offshore £m	Continental Europe £m	Other Operations £m	Group Total £m
1996							
Net interest income	**1,254**	**213**	**4**	**288**	**26**	**9**	**1,794**
Other income and charges	**341**	**(4)**	**154**	**36**	**4**	**24**	**555**
Total operating income	**1,595**	**209**	**158**	**324**	**30**	**33**	**2,349**
Profit (loss) before taxation and integration costs	**736**	**98**	**151**	**256**	**(19)**	**6**	**1,228**
Integration costs in continuing businesses	**(60)**	**–**	**–**	**(1)**	**–**	**–**	**(61)**
Profit (loss) before taxation	**676**	**98**	**151**	**255**	**(19)**	**6**	**1,167**
Includes for acquired operations (excluding integrated businesses)	**–**	**8**	**–**	**–**	**–**	**–**	**8**
Includes for discontinued operations	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Total assets	**63,207**	**2,705**	**8,527**	**47,810**	**1,288**	**474**	**124,011**
Net assets	**1,499**	**245**	**440**	**1,286**	**967**	**(44)**	**4,393**
1995							
Net interest income	1,190	97	2	275	20	–	1,584
Other income and charges	258	1	107	2	2	29	399
Total operating income	1,448	98	109	277	22	29	1,983
Profit (loss) before taxation	687	49	105	217	(22)	(10)	1,026
Includes for acquired operations	–	13	(1)	–	–	(3)	9
Includes for operations discontinued in 1995	–	–	–	–	–	(8)	(8)
Total assets	51,583	1,803	6,001	41,780	1,489	476	103,132
Net assets	1,399	223	282	1,135	961	(59)	3,941

The segmental analysis is prepared on a basis which ensures the comparability of results across the Group's business segments by assuming a consistent allocation of Group capital across those segments.

The results reflect the regulatory capital notionally absorbed by each business, based on the Group's Bank of England regulatory requirements. This is achieved by making a notional adjustment to the profit before taxation of each business entity where relevant, by applying an average market-related interest rate to the difference between the capital held in the entity and the capital which would be required if the Group's Bank of England risk asset ratio was applied to that entity.

There have been no changes in the classification of businesses within segments during the year.

No separate geographical analysis is presented because the only significant non-UK businesses are shown in the Continental Europe business segment.

2. Interest receivable and similar income arising from debt securities

	1996 £m	1995 £m
Income from listed and registered securities	**1,792**	2,111
Income from unlisted securities	**224**	224
	2,016	2,335

Preference dividends of £88m (1995: £30m) are included in income from unlisted securities.

3. Other interest receivable and similar income

	1996 £m	1995 £m
On secured advances	**3,890**	3,832
On unsecured advances	**294**	169
On finance leases	**244**	180
On other assets and investments	**116**	65
	4,544	4,246

Interest receivable on secured advances has been reduced by £187m (£98m) in respect of the charge for lending-related fees and discounts payable, which are charged against interest income over the period of time which the Company has the right to recover the incentives in the event of early redemption. The movements on such incentives are as follows (see also note 29, Prepayments and accrued income):

	Interest rate discounts *£m*	*Cashbacks* *£m*	*Total* *£m*
Group and Company			
At 1 January 1996	76	67	143
Acquisitions of subsidiary undertakings/purchase of business	8	37	45
Expenditure incurred in the year	146	219	365
Transfer to profit and loss account	(129)	(58)	(187)
At 31 December 1996	101	265	366

Interest due but not received on loans and advances in arrears has not been recognised in interest receivable where collectability is in doubt, but has been suspended. The movements on suspended interest are as follows:

	On advances secured on residential properties *£m*	*On other secured advances* *£m*	*On unsecured advances* *£m*	*Total* *£m*
Group				
At 1 January 1996	61	116	6	183
Exchange adjustments	(4)	(12)	–	(16)
Acquisitions of subsidiary undertakings/purchase of business	34	11	1	46
Amounts suspended in the period	19	25	5	49
Irrecoverable amounts written off	(37)	(25)	(3)	(65)
At 31 December 1996	73	115	9	197
Including for the Company:				
At 1 January 1996	35	2	3	40
At 31 December 1996	51	3	5	59
The value of loans and advances at 31 December 1996 on which interest is suspended is as follows:				
Group				
Loans and advances to customers	685	491	110	1,286
Provisions on these amounts	(137)	(201)	(73)	(411)
Company				
Loans and advances to customers	527	23	45	595
Provisions on these amounts	(99)	(16)	(40)	(155)

4. Interest payable

	1996 £m	1995 £m
On retail customer accounts	**1,873**	2,026
On other deposits and loans	**2,893**	2,971
	4,766	4,997
Including:		
Amounts payable on subordinated liabilities	**167**	133
Finance charges in respect of leased assets	**–**	1

5. Dividend income

	1996 £m	1995 £m
Income from equity shares and other variable yield securities	3	2

6. Other operating income

	1996 £m	1995 £m
Income from long term assurance business (see note 22)	133	98
Profits less losses on disposal of investment securities	–	7
Other	54	41
	187	146

7. Administrative expenses: Integration costs in continuing businesses

	1996 £m	1995 £m
Reorganisation and restructuring costs	46	–
Branch closure costs	15	–
	61	–

Integration costs in continuing businesses include all costs relating to the integration of the business of the former National and Provincial Building Society (N&P) into existing businesses of the Abbey National Group.

8. Administrative expenses: Other administrative expenses

	1996 £m	1995 £m
Staff costs:		
Wages and salaries	374	300
Social security costs	32	26
Other pension costs	41	31
	447	357
Other administrative expenses	437	426
	884	783
Other administrative expenses include the following items:		
Hire of equipment	6	6
Rent and rates payable	68	57

The charges above exclude those incurred by Life Assurance, which are charged to the income from long term assurance business.

Staff costs incurred by Life Assurance are:

	1996 £m	1995 £m
Staff costs:		
Wages and salaries	31	30
Social security costs	2	2
Other pension costs	3	3
	36	35

The auditors' remuneration was £2.0m (£1.8m) for audit services and £2.9m (£1.8m) was payable to the Group auditors for other services. Included within the remuneration for audit services is the audit fee for the Company of £0.8m (£0.6m) and for companies within Life Assurance of £0.3m (£0.2m).

9. Directors' emoluments and interests

The aggregate emoluments of directors were:

	1996 £	1995 £
Total emoluments excluding pension contributions	**3,356,378**	2,371,302
Pension contributions	**384,591**	342,476
Ex-gratia payments to former directors	**56,824**	38,500
	3,797,793	2,752,278

The Chairman's emoluments were £288,128 (£263,762). His appointment is non-pensionable and he makes his own private pension arrangements.

The highest paid director is the Chief Executive. His emoluments, excluding pension contributions were £600,903 (£447,845). The pension contribution paid by the Company for the benefit of the Chief Executive was £79,035 (£71,415).

On his retirement, John Fry was permitted to retain his company car and received a gift. The value of these ex-gratia items, when grossed up for tax purposes, was £52,666. John Fry was a Deputy Chairman and director who had been on the Board of Abbey National and its building society predecessor since 1984 and had been an employee for 34 years. As explained on page 33, the Company no longer provides directors with a company car.

A further ex-gratia gift, valued at £4,158 when grossed up for tax purposes, was made to Robert Knighton, who resigned from the Board on 31 December 1996 and will retire from the Company on 31 July 1997 after 27 years with Abbey National.

Ex-gratia payments to former directors in 1995 comprised a gift of £38,500 to Sara Morrison, who retired as a director in June 1995.

The following table shows the number of directors, including the Chairman and the highest paid director, receiving emoluments before pension contributions within the undermentioned ranges.

£	1996	1995
5,001 - 10,000	1	–
10,001 - 15,000	1	–
15,001 - 20,000	1	1
20,001 - 25,000	4	4
25,001 - 30,000	1	1
30,001 - 35,000	–	1
35,001 - 40,000	1	–
45,001 - 50,000	–	1
125,001 - 130,000	1	–
130,001 - 135,000	1	–
140,001 - 145,000	1	–
160,001 - 165,000	1	–
195,001 - 200,000	–	1
240,001 - 245,000	–	1
255,001 - 260,000	–	1
260,001 - 265,000	–	3
265,001 - 270,000	–	1
285,001 - 290,000	1	–
320,001 - 325,000	1	–
325,001 - 330,000	1	–
345,001 - 350,000	1	–
370,001 - 375,000	1	–
405,001 - 410,000	1	–
445,001 - 450,000	–	1
600,001 - 605,000	1	–

Ex-gratia pensions paid to former directors of Abbey National plc in 1996, which have been provided for previously, amounted to £166,038 (£161,225). The Board has determined that it will no longer award any new such ex-gratia pensions and accordingly, no charge (nil) to the profit and loss account has been made in respect of them.

Further details of directors' emoluments and interests are included in the report on Directors' Remuneration on page 29. These details include an analysis of salary and other payments and benefits by director on page 30, an analysis of directors' share interests on page 33, and an analysis of directors' share options on pages 34 and 35.

9. Directors' emoluments and interests (continued)

Details of loans, quasi loans and credit transactions entered into or agreed by the Company or its subsidiaries with persons who are or were directors and connected persons and officers of the Company during the year were as follows:

	Number of persons	*Aggregate amount outstanding £000*
Directors		
Loans	10	751
Quasi loans	5	11
Credit transactions	–	–
Officers		
Loans	48	4,841
Quasi loans	7	11
Credit transactions	–	–

No director had a material interest in any contract of significance, other than a service contract, with the Company or any of its subsidiaries at any time during the year. The directors did not have any interests in shares or debentures of subsidiaries.

Further disclosures relating to these transactions, as required under Financial Reporting Standard (FRS) 8, 'Related party disclosures' are given in note 50.

10. Employees

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

	1996	*1995*
Full time		
Male	**5,784**	5,046
Female	**11,347**	10,234
	17,131	15,280
Part time		
Male	**129**	69
Female	**4,999**	4,391
	5,128	4,460

Included in the above for Life Assurance are 1,445 (1,346) full time and 70 (61) part time staff.

11. Provisions for bad and doubtful debts

	On advances secured on residential properties £m	*On other secured advances £m*	*On unsecured advances £m*	*Total £m*
Group				
At 1 January 1996				
General	43	9	14	66
Specific	148	194	75	417
Exchange adjustments	(4)	(17)	(1)	(22)
Acquisitions of subsidiary undertakings/purchase of business	53	35	13	101
Transfer from profit and loss account	52	15	60	127
Irrecoverable amounts written off	(80)	(23)	(52)	(155)
At 31 December 1996	212	213	109	534
Being for the Group:				
General	67	11	17	95
Specific	145	202	92	439
Including for the Company:				
At 1 January 1996				
General	36	1	8	45
Specific	93	1	30	124
At 31 December 1996				
General	43	1	9	53
Specific	99	16	59	174

12. Tax on profit on ordinary activities

	1996 £m	*1995 £m*
UK Corporation tax:		
Current at 33% (33%)	**249**	286
Prior years	**(148)**	(110)
Double tax relief	**(13)**	(10)
Advance corporation tax written back	**(7)**	–
Deferred tax:		
Current year	**150**	44
Prior years	**148**	117
Tax on franked investment income	**11**	6
Overseas taxation	**13**	11
	403	344

There are unrelieved losses carried forward for which no tax relief has been recognised because their utilisation is currently uncertain. The adjustments in respect of prior years arise mainly because certain subsidiary undertakings have accounting reference dates other than 31 December.

13. Profit on ordinary activities after tax

The profit after tax of the Company attributable to the shareholders is £421m (£510m). As permitted by section 230 of the Companies Act 1985, the Company's profit and loss account has not been presented in these accounts.

14. Dividends

	1996 Pence per share	1995 Pence per share	1996 £m	1995 £m
Ordinary shares				
Interim (paid)	**8.70**	7.25	**115**	97
Final (proposed)	**17.40**	14.50	**245**	191
	26.10	21.75	**360**	288
Preference shares (non-equity)			**13**	2
			373	290

15. Earnings per ordinary share

Earnings per ordinary share have been calculated by dividing the profit attributable to the shareholders of Abbey National plc after preference dividends of £754m (£681m) by the average number of ordinary shares in issue of 1,335m (1,317m).

Earnings per ordinary share have also been calculated on the basis of earnings as described above, adjusted to exclude the post-tax effect of integration costs in continuing businesses.

The adjusted earnings per ordinary share has been calculated in addition to the earnings per ordinary share required by FRS3 because, in the opinion of the directors, its inclusion is necessary to enable the shareholders to assess underlying trading performance.

16. Treasury bills and other eligible bills

	Group 1996		Group 1995	
	Book value £m	Market value £m	Book value £m	Market value £m
Investment securities				
Treasury bills and similar securities	**9**	**9**	34	33
Other securities				
Treasury bills and similar securities	**102**	**102**	212	212
Other eligible bills	**–**	**–**	–	–
	102	**102**	212	212
Total	**111**	**111**	246	245

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

	Group £m
At 1 January 1996	34
Exchange adjustments	(3)
Additions	74
Disposals	(96)
At 31 December 1996	9

17. Loans and advances to banks

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Items in the course of collection	**209**	193	**207**	190
Amounts due from subsidiaries	**–**	–	**361**	328
Other loans and advances	**2,616**	3,386	**12**	4
	2,825	3,579	**580**	522
Repayable:				
On demand	**568**	435	**373**	332
In not more than three months	**1,847**	2,583	**207**	190
In more than three months but not more than one year	**169**	327	**–**	–
In more than one year but not more than five years	**223**	172	**–**	–
In more than five years	**18**	62	**–**	–
	2,825	3,579	**580**	522

The Group enters into reverse sale and repurchase agreements. The total amount of collateralised deposits which are included above is £350m (£345m), including for the Company, nil (nil). The total nominal value of assets acquired as collateral via such agreements amounted to £364m (£326m).

18. Loans and advances to customers

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Advances secured on residential properties	**60,271**	48,746	**57,474**	45,476
Other secured advances	**1,136**	724	**228**	73
Unsecured loans	**2,623**	1,385	**1,204**	631
Collateralised and guaranteed mortgage loans	**197**	235	**–**	–
Amounts due from subsidiaries	**–**	–	**659**	578
	64,227	51,090	59,565	46,758
Repayable:				
On demand or at short notice	**3,268**	2,505	**3,143**	2,352
In not more than three months	**825**	439	**509**	259
In more than three months but not more than one year	**1,112**	839	**768**	533
In more than one year but not more than five years	**4,385**	3,277	**3,355**	2,265
In more than five years	**55,171**	44,513	**52,017**	41,518
Less: provisions	**(534)**	(483)	**(227)**	(169)
	64,227	51,090	59,565	46,758

Included in Group loans and advances to customers are loans to associated undertakings of nil (£12m).

19. Net investment in finance leases

	Group 1996 £m	Group 1995 £m
Amounts receivable	**9,315**	6,152
Less: deferred income	**(5,005)**	(3,308)
	4,310	2,844
Repayable:		
In not more than three months	**29**	27
In more than three months but not more than one year	**57**	55
In more than one year but not not more than five years	**307**	325
In more than five years	**3,917**	2,437
	4,310	2,844
Cost of assets acquired for the purpose of letting under finance leases in the year	**1,541**	675
Gross rentals receivable	**351**	408
Commitments as lessor for the purchase of equipment for use in finance leases	**231**	339
Amounts outstanding subject to a sub-participation	**216**	213

20. Debt securities

	Group 1996		Group 1995		Company 1996		Company 1995	
	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	**7,716**	**8,190**	7,793	8,118	**397**	**404**	1,787	1,847
Other public sector securities	**4,023**	**4,082**	3,884	3,953	**29**	**29**	35	35
	11,739	**12,272**	11,677	12,071	**426**	**433**	1,822	1,882
Issued by other issuers:								
Bank and building society certificates of deposit	**221**	**221**	154	154	**–**	**–**	–	–
Other debt securities	**14,853**	**15,080**	19,408	19,716	**1,183**	**1,183**	993	993
	15,074	**15,301**	19,562	19,870	**1,183**	**1,183**	993	993
Sub-total	**26,813**	**27,573**	31,239	31,941	**1,609**	**1,616**	2,815	2,875
Other securities								
Issued by public bodies:								
Government securities	**1,343**	**1,343**	812	812	**254**	**254**	–	–
Other public sector securities	**32**	**32**	430	430	**–**	**–**	–	–
	1,375	**1,375**	1,242	1,242	**254**	**254**	–	–
Issued by other issuers:								
Bank and building society certificates of deposit	**1,615**	**1,615**	1,776	1,776	**–**	**–**	–	–
Other debt securities	**9,927**	**9,927**	986	986	**–**	**–**	–	–
	11,542	**11,542**	2,762	2,762	**–**	**–**	–	–
Sub-total	**12,917**	**12,917**	4,004	4,004	**254**	**254**	–	–
Total	**39,730**	**40,490**	35,243	35,945	**1,863**	**1,870**	2,815	2,875

The investment securities held by the Company include subordinated investments in subsidiaries of £482m (£482m) and are included within Other debt securities.

	Group 1996		Group 1995		Company 1996		Company 1995	
	Book value £m	Market value £m	Book value £m	Market value £m	Book value £m	Market value £m	Book value £m	Market value £m
Analysed by listing status:								
Investment securities								
Listed in the UK	**7,172**	**7,257**	5,695	5,837	**397**	**404**	1,787	1,847
Listed or registered elsewhere	**15,991**	**16,598**	21,273	21,696	**–**	**–**	–	–
Unlisted	**3,650**	**3,718**	4,271	4,408	**1,212**	**1,212**	1,028	1,028
	26,813	**27,573**	31,239	31,941	**1,609**	**1,616**	2,815	2,875
Other securities								
Listed in the UK	**334**	**334**	16	16	**254**	**254**	–	–
Listed or registered elsewhere	**10,142**	**10,142**	2,033	2,033	**–**	**–**	–	–
Unlisted	**2,441**	**2,441**	1,955	1,955	**–**	**–**	–	–
	12,917	**12,917**	4,004	4,004	**254**	**254**	–	–
Total	**39,730**	**40,490**	35,243	35,945	**1,863**	**1,870**	2,815	2,875

20. Debt securities (continued)

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Book value				
Analysed by maturity:				
Due within one year	**4,273**	3,976	**254**	482
Due one year and over	**35,457**	31,267	**1,609**	2,333
	39,730	35,243	**1,863**	2,815

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

	Cost £m	Provisions £m	Net book value £m
Group			
At 1 January 1996	31,250	(11)	31,239
Exchange adjustments	(2,537)	–	(2,537)
Acquisitions of subsidiary undertakings/purchase of business	693	–	693
Additions	15,634	–	15,634
Disposals	(10,252)	–	(10,252)
Redemptions and maturities	(2,237)	–	(2,237)
Transfers to other securities	(5,632)	–	(5,632)
Transfer from profit and loss account	–	(13)	(13)
Amortisation of premiums	(82)	–	(82)
At 31 December 1996	26,837	(24)	26,813
Company			
At 1 January 1996	2,815	–	2,815
Acquisitions of subsidiary undertakings/purchase of business	638	–	638
Additions	442	–	442
Disposals	(2,239)	–	(2,239)
Amortisation of premiums	(47)	–	(47)
At 31 December 1996	1,609	–	1,609

The total net book value of debt securities held for investment purposes at 31 December 1996 includes unamortised premiums of £30m (£62m) for the Group, and £30m (£146m) for the Company.

The Group enters into sale and repurchase agreements. The total nominal value of assets so transferred and which are included above is £749m (£1,173m) including, for the Company, nil (nil). Collateral associated with these transactions of £737m (£1,161m) for the Group and nil (nil) for the Company is included in Deposits by banks.

Market values are based on market prices of securities where available. Where market prices are not available, the directors' valuation has been used.

Included within investment securities are a number of securities held for hedging purposes. Some of these provide temporary hedging cover where permanent hedges are not immediately available.

There are hedges in place in respect of the majority of securities whereby the rise or fall in their market value will be offset by a substantially equivalent reduction or increase in the value of the hedges.

21. Equity shares and other variable yield securities

	Group 1996		*Group 1995*		*Company 1996*		*Company 1995*	
	Book value £m	*Market value £m*	*Book value £m*	*Market value £m*	*Book value £m*	*Market value £m*	*Book value £m*	*Market value £m*
Listed in the UK	**27**	**50**	25	40	**20**	**40**	17	31
Listed elsewhere	**1**	**1**	1	1	**–**	**–**	–	–
Unlisted	**16**	**16**	28	28	**1**	**1**	1	1
	44	**67**	54	69	**21**	**41**	18	32

Included within unlisted securities of the Group are variable yield securities held by Abbey National Unit Trust Managers Ltd for purposes other than investment, having a book and market value of £8m (£3m). All other equity shares and variable yield securities are held for investment purposes.

The movement on equity shares and other variable yield securities held for investment purposes was as follows:

	Group Cost & Book value £m	*Company Cost & Book value £m*
At 1 January 1996	51	18
Exchange adjustments	(1)	–
Additions	16	3
Disposals	(30)	–
At 31 December 1996	36	21

22. Long term assurance business

The value of the long term assurance business is as follows:

	1996 £m	*1995 £m*
Value of shareholders' interest in the long term assurance funds	**555**	425

The value of the long term assurance business is calculated by discounting the proportion of surplus which is projected to accrue to shareholders in future years from business currently in force, and adding the shareholders' interest in the surplus retained within the long term assurance funds. The basis on which this value is determined is reviewed regularly in the light of the experience of the business and expectations regarding future economic conditions. The principal economic assumptions used have not changed from 1994 and are as follows:

	%
Risk adjusted discount rate (net of tax)	10.0
Return on equities (gross of tax)	9.0
Return on gilts (gross of tax)	7.5
Inflation	4.0

The assumed rates of return on investments above are applied to the value of investments adjusted by reference to the assumed long term rate of investment return.

In view of the different lapse rate and mortality levels which have been experienced in recent years compared to those assumed it was decided to change the assumed levels in 1996. The effect of the change in assumptions was determined by calculating the value of the long term assurance business at the beginning of the year on both the old and new assumptions. This resulted in an increase in the value of long term assurance business of £7m before tax and £5m after tax, which was included in income from long term assurance business for the year ended 31 December 1996.

22. Long term assurance business (continued)

Business in force is defined as all live policies where the first premium has been paid. Recurrent single premium policies are treated as single premium policies, with the exception of Department of Social Security rebate policies, which are treated as regular premium policies. Shareholders are entitled to 10% of the value of bonuses declared in any particular year derived from the Scottish Mutual with profits fund. The level of assumed future bonuses is calculated by projecting the portfolio of with profits business forward and applying reversionary and terminal bonus rates at such a level as to exhaust the level of projected surplus of assets over liabilities. For all other business the entire surplus is attributable to shareholders.

The income from life assurance business which is included as other operating income in the consolidated profit and loss account is calculated as follows:

	1996 *£m*	*1995* *£m*
Value of shareholders' interest in the long term assurance funds at 31 December	**555**	425
Value of shareholders' interest in the long term assurance funds at 1 January	**425**	352
Increase in value of long term assurance business	**130**	73
Transfers into long term assurance funds	**(41)**	(10)
Acquisition of Pegasus Assurance Group Ltd	**-**	(4)
Acquisitions of subsidiary undertakings/purchase of business	**(25)**	-
Net increase in value of long term assurance business	**64**	59
Surplus transferred from long term funds	**24**	7
Income after tax from long term assurance business	**88**	66
Income before tax from long term assurance business	**133**	98

The assets and liabilities of the long term assurance funds are presented separately from those of other businesses in order to reflect the different nature of the shareholders' interest in them. The amounts of these assets, which are valued at market value, and liabilities of the long term assurance funds included in the consolidated balance sheet are based on the Life Assurance balance sheets prepared under the Companies Act 1985 (Insurance Companies Accounts) Regulations 1993.

The assets and liabilities of the long term assurance funds are:

	1996 *£m*	*1995* *£m*
Investments	**4,406**	2,961
Assets held to cover linked liabilities	**2,862**	2,133
Debtors and prepayments	**235**	83
Other assets	**366**	341
Assets of the long term assurance funds	**7,869**	5,518
Technical provisions	**3,485**	2,733
Technical provisions for linked liabilities	**2,894**	2,102
Fund for future appropriations	**659**	577
Other creditors	**831**	106
Liabilities of the long term assurance funds	**7,869**	5,518

23. Interests in associated undertakings

The movement in interests in associated undertakings was as follows:

	Group £m	*Company* £m
At 1 January 1996	1	20
Additions	2	2
Other movements	5	–
At 31 December 1996	8	22

Other movements arose on the disposal by First National Finance Corporation plc (FNFC) of its associated undertakings and the purchase by FNFC of the remaining shareholding in First National Robert Leonard Ltd, which has been reclassified as a subsidiary undertaking. The FNFC associated undertakings had accumulated net losses, which resulted in a negative carrying value in the Group accounts.

On the historical cost basis, the Group's interest in associated undertakings would have been included as follows:

	1996 £m	*1995* £m
Cost	**22**	33
Provisions	**–**	(12)
Net book value	**22**	21

Provisions have reduced to nil due to the transactions described above.

The principal associated undertakings at 31 December 1996 are:

	Nature of business	*Issued share capital*	*Group interest (%)*	*Group's share of results based on accounts for the year ended*
Travellers Exchange Corporation plc	Foreign currency services	166,588 £1 ordinary shares	33	31 December
		2,500,000 £1 preference shares	60	
Commercial Union Underwriting Ltd	Insurance underwriting services	100 £1 ordinary A shares	15	31 December
		30,000,000 £1 ordinary B shares	21	

The United Kingdom is the principal area of operation of both principal associated undertakings and both are registered in England & Wales.

All associated undertakings are unlisted.

Abbey National plc has the right to increase its interests in Commercial Union Underwriting Ltd up to a maximum of 75% after the fifth anniversary of the commencement of the operation, and to 100% in certain circumstances.

24. Shares in Group undertakings

	1996 Cost & Book value £m	*1995 Cost & Book value* £m
Subsidiary undertakings		
Banks	**451**	451
Others	**1,994**	1,820
	2,445	2,271

The movement in shares in Group undertakings was as follows:

	Company £m
At 1 January 1996	**2,271**
Exchange adjustments	**(133)**
Acquisitions of subsidiary undertakings/purchase of business	**134**
Additions	**173**
Disposals	**–**
At 31 December 1996	**2,445**

24. Shares in Group undertakings (continued)

First National Bank plc acquired Wagon Finance Ltd on 2 July 1996 and Elton Holdings Ltd, subsequently renamed First National Vehicle Contracts, on 12 August 1996. The amounts payable in consideration for the issued share capital of the companies were £5m and £7m respectively and were both payable in the form of cash. In addition, a further £110m was paid in settlement of certain indebtedness of Wagon Finance Ltd. The terms of the acquisition of Elton Holdings Ltd by First National Bank plc are such that additional consideration may become payable to the vendors. The amount of any future consideration payable is dependent upon certain conditions being met and the future performance of First National Vehicle Contracts Ltd. The maximum amount payable, which has been provided against in full, is £5m, which may fall due within two to five years. In addition, acquisition costs of £1m were incurred in the purchase of the companies. Both companies are included in the consolidated accounts as acquisitions.

On 30 April 1996, FNFC acquired the remaining share capital of its associated undertaking, First National Robert Leonard Ltd, which has therefore been reclassified as a subsidiary undertaking.

On 5 August 1996, Abbey National plc purchased the business of N&P for a total consideration of £1,363m, including £12m of transfer costs and other provisions. The consideration for the business, excluding costs and provisions, comprised £882m paid in the form of a cash transfer to eligible customer accounts, and £469m paid in the form of ordinary shares in Abbey National plc. The purchase of the business has been accounted for as an acquisition.

Further disclosures relating to these transactions are given in note 25.

On 25 October 1996 the Abbey National Independent Financial Advisers Group of Companies underwent an internal restructure. The principal holding company is now Abbey National Independent Consulting Group Limited.

On 31 December 1996, FNFC underwent an internal restructure. The principal subsidiary is now First National Bank plc.

During the year ended 31 December 1996, Abbey National subscribed for £173m of share capital in subsidiary undertakings. This includes £122m in FNFC to finance the acquisition of Wagon Finance Ltd and Elton Holdings Ltd.

The principal subsidiaries of Abbey National plc at 31 December 1996 are listed below, all of which are directly held except where indicated.

	Nature of business	*Country of incorporation or registration*
Abbey National Independent Consulting Group Ltd	Personal finance	England & Wales
Abbey National Leasing Companies*	Leasing	England & Wales
Abbey National Mortgage Finance plc	Personal finance	England & Wales
Abbey National Treasury Services plc	Treasury operations	England & Wales
First National Bank plc*	Personal finance and commercial lending	England & Wales
Future Insurance Services Limited	General insurance	England & Wales
HMC Group plc	Personal finance	England & Wales
Wagon Finance Ltd*	Personal finance	England & Wales
Abbey National France SA*	Personal finance	France
Abbey National (Gibraltar) Ltd*	Personal finance	Gibraltar
Carfax Insurance Ltd	Insurance	Guernsey
Abbey National Treasury International Ltd*	Personal finance and treasury operations	Jersey
Abbey National Life plc	Insurance	Scotland
Abbey National Unit Trust Managers Ltd*	Unit trust/PEP management	Scotland
N&P Life Assurance Limited	Insurance	Scotland
Scottish Mutual Assurance plc*	Insurance	Scotland
Abbey National Bank SAE	Personal finance	Spain
Abbey National North America Corporation	Funding	United States

* Subsidiary held indirectly through subsidiary companies.

All the above companies are included in the consolidated accounts.The Company holds directly or indirectly 100% of the issued ordinary share capital of its principal subsidiaries except for Future Insurance Services Limited where the Company holds 75% of the issued ordinary share capital. All companies operate principally in their country of incorporation or registration. Abbey National Treasury Services plc also has branch offices in France and Jersey and a representative office in Hong Kong and Abbey National plc has a branch in Italy.

25. Summary of the effect of business purchase and acquisitions

The following table summarises the effect of the purchase of the business of N&P and its subsidiaries:

	Book value before acquisition £m	*Accounting policy adjustments £m*	*Revaluation adjustments £m*	*Total fair value adjustments £m*	*Fair value at acquisiton £m*
Loans and advances to banks	1,359	–	–	–	1,359
Loans and advances to customers	11,840	(2)	(4)	(6)	11,834
Debt securities	693	–	–	–	693
Tangible fixed assets	134	(26)	(4)	(30)	104
Assets of long term assurance funds	246	–	–	–	246
Other assets	242	(3)	29	26	268
Total assets	14,514	(31)	21	(10)	14,504
Customer accounts	10,216	–	10	10	10,226
Debt securities in issue	1,973	–	6	6	1,979
Accruals and deferred income	810	–	–	–	810
Subordinated liabilities	100	–	1	1	101
Liabilities of long term assurance funds	246	–	–	–	246
Other liabilities	267	(6)	42	36	303
Total liabilities excluding shareholders' funds	13,612	(6)	59	53	13,665
Net assets acquired	902	(25)	(38)	(63)	839
Total fair value of the consideration and costs of acquisition					1,363
Total goodwill on purchase of business of N&P					524

Summary of the results of N&P both for the period 1 January 1996 to 4 August 1996 and for the year ended 31 December 1995.

	Period ended 4 August 1996 £m	*Year ended 31 December 1995 £m*
Profit before taxation and exceptional items	**127**	195
Exceptional items	**(29)**	(8)
Profit before taxation	**98**	87
Taxation	**(51)**	(63)
Retained profit	**47**	124

Other than those recognised gains and losses included in the summary headings above, N&P had no recognised gains and losses and so no separate Statement of Total Recognised Gains and Losses has been presented.

25. Summary of the effect of business purchase and acquisitions (continued)

The following table summarises the effect of all acquisitions of subsidiary undertakings, other than the subsidiary undertakings transferred with the business of N&P, in the year ended 31 December 1996:

	Book value before acquisition £m	*Accounting policy adjustments £m*	*Revaluation adjustments £m*	*Total fair value adjustments £m*	*Fair value at acquisition £m*
Loans and advances to banks	8	–	–	–	8
Loans and advances to customers	367	–	–	–	367
Tangible fixed assets	13	–	–	–	13
Other assets	18	–	–	–	18
Total assets	406	–	–	–	406
Deposits by banks	6	–	–	–	6
Debt securities in issue	199	–	–	–	199
Subordinated liabilities	13	–	–	–	13
Other liabilities	141	1	–	1	142
Total liabilities excluding shareholders' funds	359	1	–	1	360
Net assets acquired	47	(1)	–	(1)	46
Total fair value of the consideration and costs of acquisition					128
Goodwill on acquisition of subsidiary undertakings					82

The only significant subsidiary undertaking included in the above table is Wagon Finance Limited and its profit after tax for the year ended 30 June 1996 was £8m.

Summary of goodwill taken to Group reserves

	£m
Total goodwill on purchase of business of N&P	524
Total goodwill on acquisition of subsidiary undertakings	82
Other goodwill movements	4
Total goodwill taken to Group reserves	610

26. Post-acquisition results of business acquired

FRS3, 'Reporting Financial Performance', requires the disclosure of the results of operations acquired during the year which are included in the results of the Group for the current period. The standard provides that where it is not practicable to determine the post-acquisition results of an acquired operation, then this should be stated and the reason for it should be explained.

The business of N&P has been fully integrated into existing businesses of the Abbey National Group. In particular, product systems have been integrated and Abbey National product ranges are offered to the combined customer base. For this reason, it is not practicable to identify the post-acquisition results of the acquired business separately. A summary of the pre-transfer results of N&P is provided in note 25.

27. Tangible fixed assets

	Group			Company		
	Premises £m	Equipment £m	Total £m	Premises £m	Equipment £m	Total £m
Cost						
At 1 January 1996	362	700	1,062	344	647	991
Acquisitions of subsidiary undertakings/purchase of business	69	58	127	69	35	104
Additions	19	128	147	10	98	108
Disposals	(10)	(94)	(104)	(14)	(87)	(101)
At 31 December 1996	440	792	1,232	409	693	1,102
Depreciation						
At 1 January 1996	52	425	477	50	399	449
Acquisitions of subsidiary undertakings/purchase of business	–	10	10	–	–	–
Charge for the year	8	85	93	8	75	83
Disposals	–	(63)	(63)	–	(56)	(56)
At 31 December 1996	60	457	517	58	418	476
Net book value						
At 31 December 1996	380	335	715	351	275	626
At 31 December 1995	310	275	585	294	248	542

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
The net book value of premises comprises:				
Freeholds	**303**	244	**285**	229
Long leaseholds	**20**	10	**10**	9
Short leaseholds	**57**	56	**56**	56
Land and buildings occupied for own activities:				
Net book value at 31 December	**321**	246	**304**	231
The net book value of equipment includes:				
Assets held under finance leases	**7**	3	**3**	3
Depreciation charge for the year on these assets	**4**	5	**4**	5
Capital expenditure which has been contracted, but has not been provided in the accounts	**38**	11	**32**	10

28. Other assets

	Group 1996 £m	*Group 1995 £m*	*Company 1996 £m*	*Company 1995 £m*
Development properties	**26**	26	**–**	–
Foreign exchange and interest rate contracts (see note 47)	**700**	907	**15**	–
Other	**783**	716	**399**	306
	1,509	1,649	**414**	306

Other assets of the Group include £89m (£60m) in respect of unamortised commissions payable to introducers in respect of obtaining certain lending business where this is the primary form of distribution. Such commissions are charged to the profit and loss account over the expected life of the loans, the charge for the period being £40m (£13m).

The figure for development properties includes completed properties of £19m (£21m) and work in progress of £7m (£5m).

The amounts in respect of foreign exchange and interest rate contracts relate to translation differences arising from instruments which are used to hedge currency assets and liabilities, and to the revaluation of certain interest rate contracts where appropriate.

29. Prepayments and accrued income

	Group 1996 £m	*Group 1995 £m*	*Company 1996 £m*	*Company 1995 £m*
Accrued interest due from subsidiaries	**–**	–	**17**	3
Other accrued interest	**1,856**	1,695	**384**	219
Prepayments and other accruals	**24**	58	**18**	24
	1,880	1,753	**419**	246

Other accrued interest in the Company and the Group includes £366m (£143m) in respect of unamortised lending-related fees and discounts paid which are charged against interest income over the period of time which the Company has the right to recover the incentives in the event of early redemption. See note 3 for further details.

30. Deposits by banks

	Group 1996 £m	*Group 1995 £m*	*Company 1996 £m*	*Company 1995 £m*
Items in the course of transmission	**336**	268	**337**	268
Amounts due to subsidiaries	**–**	–	**9,321**	5,522
Other deposits	**17,382**	19,125	**278**	494
	17,718	19,393	**9,936**	6,284
Repayable:				
On demand	**530**	437	**9,274**	5,411
In not more than three months	**13,575**	14,742	**377**	326
In more than three months but not more than one year	**3,221**	3,842	**127**	231
In more than one year but not more than five years	**125**	119	**25**	73
In more than five years	**267**	253	**133**	243
	17,718	19,393	**9,936**	6,284

31. Customer accounts

	Group 1996 £m	*Group 1995 £m*	*Company 1996 £m*	*Company 1995 £m*
Retail funds and deposits	**45,119**	37,564	**43,581**	36,442
Amounts due to subsidiaries	**–**	–	**2,178**	2,740
Other customer accounts	**4,559**	3,398	**1,562**	599
	49,678	40,962	**47,321**	39,781
Repayable:				
On demand	**42,376**	33,856	**44,135**	36,387
In not more than three months	**3,937**	6,173	**679**	3,375
In more than three months but not more than one year	**2,460**	596	**1,858**	19
In more than one year but not more than five years	**420**	320	**238**	–
In more than five years	**485**	17	**411**	–
	49,678	40,962	**47,321**	39,781

Included in Group customer accounts are amounts due to associated undertakings of £1m (nil).

32. Debt securities in issue

	Group 1996 £m	*Group 1995 £m*	*Company 1996 £m*	*Company 1995 £m*
Bonds and medium term notes	**18,542**	14,652	**3**	22
Other debt securities in issue	**16,651**	11,443	**642**	14
	35,193	26,095	**645**	36
Bonds and medium term notes are repayable:				
In not more than three months	**2,008**	1,083	**–**	–
In more than three months but not more than one year	**4,218**	3,184	**–**	–
In more than one year but not more than two years	**3,242**	2,974	**3**	–
In more than two years but not more than five years	**4,342**	3,691	**–**	22
In more than five years	**4,732**	3,720	**–**	–
	18,542	14,652	**3**	22
Other debt securities in issue are repayable:				
In not more than three months	**12,920**	8,433	**468**	6
In more than three months but not more than one year	**3,637**	2,631	**144**	–
In more than one year but not more than two years	**38**	318	**15**	–
In more than two years but not more than five years	**34**	33	**15**	2
In more than five years	**22**	28	**–**	6
	16,651	11,443	**642**	14

Where premiums, discounts and expenses relating to debt securities issued as part of the Group's funding programme are matched by swap fees, the presentation of these premiums, discounts and expenses has been matched with the presentation of swap fees.

33. Other liabilities

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Creditors and accrued expenses	**740**	534	**393**	242
Short positions in government debt securities				
Investment securities	**355**	19	**–**	–
Other securities	**–**	330	**–**	–
Income tax	**169**	197	**169**	197
Corporation tax	**299**	299	**194**	247
Foreign exchange and interest rate contracts (see note 47)	**1,408**	496	**–**	–
Obligations under finance leases (see note 34)	**9**	4	**4**	4
	2,980	1,879	**760**	690

The amounts in respect of foreign exchange and interest rate contracts relate to translation differences arising from instruments which are used to hedge currency assets and liabilities, and to the revaluation of certain interest rate contracts where appropriate.

34. Obligations under finance leases

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Amounts payable:				
In not more than one year	**5**	3	**2**	3
In more than one year but not more than five years	**4**	1	**2**	1
	9	4	**4**	4

35. Accruals and deferred income

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Accrued interest due to subsidiaries	**–**	–	**113**	224
Other accrued interest	**2,362**	2,260	**761**	594
Deferred income	**229**	136	**–**	–
	2,591	2,396	**874**	818

The Company has entered into insurance arrangements with certain insurance subsidiaries, to cover a proportion of future losses on certain UK residential secured loans with high loan to value ratios. In the Group accounts, income from customers in relation to such lending is deferred and is included in the balance sheet under the heading, Accruals and deferred income. The deferred income is released to the profit and loss account as losses are identified and provided for. The balance of such deferred income is £228m (£135m). This includes a balance of £31m added with the purchase of the business of N&P. The amount released during the year was £14m (£4m).

36. Provisions for liabilities and charges

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Deferred taxation (note 37)	**889**	560	**63**	13
Other provisions for liabilities and charges (note 38)	**81**	70	**57**	50
	970	630	**120**	63

37. Deferred taxation

	Group £m	Company £m
At 1 January 1996	560	13
Acquisitions of subsidiary undertakings/purchase of business	34	28
Transfer from profit and loss account	298	22
Other movements	(3)	–
At 31 December 1996	889	63

The amounts provided and total potential liability are:

	Amount provided		Total potential liability	
	Group £m	Company £m	Group £m	Company £m
Tax effect of timing differences due to:				
Excess of capital allowances over depreciation	23	17	23	17
Capital allowances on finance lease receivables	758	–	758	–
Other	108	46	108	46
	889	63	889	63

38. Other provisions for liabilities and charges

	Pension and other similar obligations (1) £m	Provisions for contingent liabilities and commitments £m	Other provisions (2) £m	Total £m
Group				
At 1 January 1996	47	11	12	70
Acquisitions of subsidiary undertakings/purchase of business	1	6	5	12
Transfer from profit and loss account	40	4	11	55
Pension contributions/provisions utilised	(56)	1	(1)	(56)
At 31 December 1996	32	22	27	81
Company				
At 1 January 1996	44	–	6	50
Acquisitions of subsidiary undertakings/purchase of business	1	6	5	12
Transfer from profit and loss account	37	3	6	46
Pension contributions/provisions utilised	(51)	–	–	(51)
At 31 December 1996	31	9	17	57

(1) Included within Other assets is a balance in respect of the pension surplus acquired with the purchase of the business of N&P. This balance, which was £29m as at 5 August 1996, is being amortised over the remaining service lives of employees contributing to the scheme, and £1m was charged to the profit and loss account over the five months to 31 December 1996.

(2) Other provisions include amounts in respect of possible compensation payable as a result of the review of business involving the transfers from occupational to personal pension schemes and the opting-out of and the non-joining of occupational pension schemes. The provisions for the Group excluding Life Assurance are included within Other provisions. Amounts provided in respect of Life Assurance are charged to Income from long term assurance business and carried against the asset Long term assurance business in the balance sheet. In addition, provisions have been made for the administrative costs of carrying out the review, which are included within Provisions for contingent liabilities and commitments as at 31 December 1996.

Amounts provided in respect of pension misselling are as follows:

	Group excluding Life Assurance £m	Life Assurance £m	Group £m	Company £m
At 1 January 1996	6	3	9	5
Acquisitions of subsidiary undertakings/purchase of business	4	7	11	4
Transfer from profit and loss account	6	–	6	3
Provisions utilised	–	–	–	–
At 31 December 1996	16	10	26	12

39. Subordinated liabilities including convertible debt

	Group 1996 £m	*Group 1995 £m*	*Company 1996 £m*	*Company 1995 £m*
Dated subordinated liabilities:				
Subordinated floating rate note 1997	**8**	17	**–**	–
9.00% Subordinated guaranteed bond 2002 (LUX 1,000m)	**19**	22	**–**	–
Subordinated loan stock 2002*	**–**	–	**17**	17
Subordinated guaranteed note 2002 (US $75m)	**44**	48	**–**	–
Subordinated floating rate note 2002 (US $75m)*	**–**	–	**44**	48
8.00% Subordinated guaranteed bond 2002 (DFL 200m)	**68**	80	**–**	–
Subordinated loan 2002 (US $112m)*	**–**	–	**66**	72
10.375% Subordinated guaranteed bond 2002	**100**	101	**–**	–
10.512% Subordinated loan stock 2001*	**–**	–	**100**	100
Subordinated floating rate note 2003 (US $100m)	**58**	64	**–**	–
Subordinated floating rate note 2003 (US $100m)*	**–**	–	**58**	64
Subordinated floating rate note 2004 (US $137m)	**80**	88	**–**	–
Subordinated floating rate note 2004*	**–**	–	**83**	83
Subordinated floating rate note 2004 (CAN $100m)	**43**	47	**–**	–
Subordinated floating rate note 2004 (US $74m)*	**–**	–	**43**	48
8.75% Subordinated guaranteed bond 2004	**151**	151	**–**	–
Subordinated floating rate note 2004*	**–**	–	**150**	150
8.2% Subordinated bond 2004 (US $500m)	**292**	322	**–**	–
Subordinated floating rate note 2004 (US $500m)*	**–**	–	**292**	322
6.69% Subordinated bond 2005 (US $750m)	**436**	484	**436**	484
10.75% Subordinated bond 2006**	**101**	–	**101**	–
Subordinated guaranteed floating rate note 2009 (CHF 130m)	**57**	73	**–**	–
Subordinated floating rate note 2009 (US $102m)*	**–**	–	**60**	66
11.50% Subordinated guaranteed bond 2017	**152**	153	**–**	–
11.59% Subordinated loan stock 2017*	**–**	–	**150**	150
10.125% Subordinated guaranteed bond 2023	**152**	152	**–**	–
10.18% Subordinated loan stock 2023*	**–**	–	**150**	150
Undated subordinated liabilities:				
10.0625% Exchangeable subordinated capital securities	**198**	200	**198**	200
7.35% Subordinated step-up perpetual notes (US $500m)	**289**	–	**289**	–
5.56% Subordinated guaranteed bond (YEN 15 billion)	**76**	94	**76**	94
5.50% Subordinated guaranteed notes (YEN 5 billion)	**25**	31	**25**	31
4.00% Subordinated perpetual notes (YEN 5 billion)	**25**	–	**25**	–
	2,374	2,127	**2,363**	2,079

The subordinated floating rate notes pay a rate of interest related to the LIBOR of the currency of denomination.

*These represent the on-lending to the Company, on a subordinated basis, of issues by subsidiary companies.
** This represents the Subordinated bond transferred with the purchase of the business of N&P.

The 10.0625% Exchangeable subordinated capital securities are exchangeable into fully paid 10.375% non-cumulative non-redeemable sterling preference shares of £1 each, at the option of Abbey National. Exchange may take place on any interest payment date providing that between 30 and 60 days notice has been given to the holders. The holders will receive one new sterling preference share for each £1 principal amount of capital securities held. The rights attaching to these preference shares would be the same as those detailed in note 40.

The 7.35% Subordinated step-up perpetual notes are redeemable at par, at the option of Abbey National, on 15 October 2006 and each fifth anniversary thereafter.

The 4.00% Subordinated perpetual notes are redeemable at par, at the option of Abbey National, on 24 December 2016 and each fifth anniversary thereafter.

In common with other debt securities issued by Group companies, the capital securities are redeemable in whole at the option of Abbey National, on any interest payment date, in the event of certain tax changes affecting the treatment of payments of interest on the capital securities in the United Kingdom, at their principal amount together with any accrued interest.

40. Called up share capital and share premium account

	Ordinary shares of 10 pence each £m	Preference shares of £1 each £m	Preference shares of US$0.01 each £m	Total £m
Authorised share capital				
At 31 December 1995	175	500	6	681
At 31 December 1996	175	1,000	6	1,181
Issued and fully paid share capital				
At 1 January 1996	132	100	–	232
Issued in respect of subsidiary acquisitions/business purchase	8	–	–	8
Issued under employee share option schemes	1	–	–	1
Issue of preference shares	–	100	–	100
At 31 December 1996	141	200	–	341
Share premium account				
At 1 January 1996	855	1	–	856
Shares issued	465	8	116	589
Exchange adjustments	–	–	(4)	(4)
At 31 December 1996	1,320	9	112	1,441

Following approval by shareholders at the Company's 1996 Annual General Meeeting, to increase the Company's authorised preference share capital by £500m, the authorised share capital of Abbey National is £1,181m (£681m) which includes £175m (£175m) ordinary share capital (comprising 1,750 million ordinary shares of 10 pence each) and £1,006m (£506m) preference share capital (comprising 1 billion shares of £1 each and 1 billion shares of US $0.01 each).

Under the Company's Executive, Employee and Sharesave schemes, employees hold options to subscribe for 27,930,883 (24,075,185) ordinary shares at prices ranging from 149.0 to 591.0 pence per share, exercisable up to 2006. During the year 3,181,557 (7,862,810) ordinary shares were issued on the exercise of options for a consideration of £7,642,308 (£14,045,805).

During 1996, 840,550 ordinary shares (nil) were issued to eligible staff under the share participation scheme. The market value of the shares at the date of issue was £4,782,730.

During the period to 31 December 1996, 82,644,563 ordinary shares were issued as part consideration for the purchase of the business of N&P, at an ex-dividend market value of £461,693,851.

The issue of the above shares resulted in the increase in the ordinary share premium account of £465m.

As of 31 December 1996 there were 2,715,303 shareholders. The following table shows an analysis of their holdings:

	Ordinary shares of 10 pence each		Preference shares of £1 each		Preference shares of US$0.01 each	
Size of shareholding	Shareholders	Shares	Shareholders	Shares	Shareholders	Shares
1-100	1,815,710	176,699,828	–	–	2	200
101 - 1,000	867,010	365,195,563	6	3,521	18	8,200
1,001+	31,936	865,277,604	614	199,996,479	7	7,991,600
	2,714,656	1,407,172,995	620	200,000,000	27	8,000,000

40. Called up share capital and share premium account (continued)

Sterling preference shares

On 13 February 1996, Abbey National plc issued 100 million non-cumulative non-redeemable 10.375% Sterling preference shares of £1 each for a consideration of approximately £108m excluding issue costs of £0.1m for the purpose of strengthening the Group's capital base. The terms of these preference shares are identical to the issue made in October 1995, except that the first dividend has been accrued from 13 February 1996, and are described below.

Holders of the sterling preference shares are entitled to receive a bi-annual non-cumulative preferential dividend payable in sterling out of the distributable profits of the Company at a rate per annum which will ensure that the sum of the dividend payable on such date and the Associated Tax Credit (as defined in the terms of the sterling preference shares) represents an annual rate of 10.375% per annum of the nominal amount of such shares.

On a return of capital or on a distribution of assets on a winding up, the sterling preference shares shall rank pari passu with any other shares that are expressed to rank pari passu therewith as regards participation in assets, and otherwise in priority to any other share capital of the Company. On such a return of capital or winding up, each sterling preference share shall, out of the surplus assets of the Company available for distribution amongst the members after payment of the Company's liabilities, carry the right to receive an amount equal to the amount paid up or credited as paid together with any premium paid on issue and the full amount of any dividend otherwise due for payment.

Other than as set out above, no sterling preference share confers any right to participate on a return of capital or a distribution of assets of the Company.

Holders of the sterling preference shares are not entitled to receive notice of or attend, speak and vote at general meetings of the Company unless the business of the meeting includes the consideration of a resolution to wind up the Company or any resolution varying, altering or abrogating any of the rights, privileges, limitations or restrictions attached to the sterling preference shares or if the dividend on the sterling preference shares has not been paid in full for the three consecutive dividend periods immediately prior to the relevant general meeting.

In any such case, the sterling preference shareholders are entitled to receive notice of and attend the general meeting at which such resolution is proposed and will be entitled to speak and vote on such a resolution but not on any other resolution.

US dollar preference shares

On 15 November 1996, Abbey National plc issued 8 million non-cumulative US dollar denominated 8.75% preference shares of $0.01 each for a consideration of $200m excluding issue costs of £3.8m, for the purpose of strengthening the Group's capital base.

Holders of the dollar preference shares are entitled to receive a quarterly non-cumulative preferential dividend payable in US dollars out of the distributable profits of the company payable at a rate per annum which will ensure that the sum of the dividend payable on such date and the Associated Tax Credit represents an annual rate of 8.75% per annum of the nominal amount of such shares.

The dollar preference shares are redeemable, in whole or in part, at the option of Abbey National at any time and from time to time after five years and one day after the date of original issue. Redemption may only occur if the sterling dollar exchange rate is at or above its level at date of allotment, or in the event of a tax or regulatory change. The redemption amount will be $25, unless redeemed in year five to ten in which instance a redemption premium will be payable.

On a return of capital or on a distribution of assets on a winding up, the dollar preference shares shall rank pari passu with any other shares that are expressed to rank pari passu therewith as regards participation in assets, and otherwise in priority to any other share capital of the Company. On such a return of capital or winding up, each dollar preference share shall, out of the surplus assets of the company available for distribution amongst the members after payment of the Company's liabilities, carry the right to receive an amount equal to £22.67, payable in US dollars together with any accrued and unpaid dividends at that time.

Other than as set out above, no dollar preference share confers any right to participate on a return of capital or a distribution of assets of the Company.

Holders of the dollar preference shares are not entitled to receive notice of or attend, speak and vote at general meetings of the Company unless the business of the meeting includes the consideration of a resolution to wind up the Company or any resolution varying, altering or abrogating any of the rights, privileges, limitations or restrictions attached to the dollar preference shares or if the dividend on the dollar preference shares has not been paid in full for the six consecutive quarters immediately prior to the relevant general meeting.

In any such case, the dollar preference shareholders are entitled to receive notice of and attend the general meeting at which such resolution is proposed and will be entitled to speak and vote on such a resolution but not on any other resolution.

41. Reserves and profit and loss account

	Profit and loss account		Non-distributable reserve	
	Group £m	Company £m	Group £m	Company £m
At 1 January 1996	2,690	2,612	163	–
Profit retained for the financial year	327	48	–	–
Goodwill taken to profit and loss account reserve during the year	(610)	(524)	–	–
Exchange adjustments	(26)	–	–	–
Transfer from profit and loss account	–	–	67	–
At 31 December 1996	2,381	2,136	230	–

The cumulative amount of goodwill taken directly to the profit and loss account reserve by the Group to 31 December 1996 and not yet recognised in the profit and loss account is £1,054m (£444m), and by the Company is £524m (nil).

The non-distributable reserve represents the Group's shareholders' interest retained in the long term assurance funds of Life Assurance.

Exchange gains arising from foreign currency borrowings used to hedge investments in overseas Group undertakings of £129m (1995: losses of £76m) have been taken to the reserves of the Group and gains of £133m (1995: losses of £76m) have been taken to the reserves of the Company. These exchange movements are matched by corresponding exchange movements on the investments in the accounts of the Company, and exchange movements on the net assets of overseas Group undertakings in the Group accounts.

42. Reconciliation of movements in shareholders' funds

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Profit attributable to the shareholders of Abbey National plc	**767**	683	**421**	510
Dividends	**(373)**	(290)	**(373)**	(290)
	394	393	**48**	220
Other recognised net gains and losses relating to the year	**(26)**	15	**–**	–
Ordinary share capital subscribed including share premium	**474**	16	**474**	16
Preference share capital subscribed including share premium*	**220**	101	**220**	101
Goodwill recognised in the profit and loss account in the year	**–**	1	**–**	–
Goodwill taken to profit and loss account reserve during the year	**(610)**	(289)	**(524)**	–
Net addition to shareholders' funds	**452**	237	**218**	337
Shareholders' funds at 1 January	**3,941**	3,704	**3,700**	3,363
Shareholders' funds at 31 December	**4,393**	3,941	**3,918**	3,700
Equity shareholders' funds	**4,072**	3,840	**3,597**	3,599
Non-equity shareholders' funds	**321**	101	**321**	101
At 31 December	**4,393**	3,941	**3,918**	3,700

*This amount is net of an exchange gain of £4m (nil) in respect of the US dollar preference shares.

Equity shareholders' funds comprise called up ordinary share capital, ordinary share premium account, profit and loss account and reserves. Non-equity shareholders' funds comprise called up preference share capital and preference share premium account.

43. Assets and liabilities denominated in foreign currency

The aggregate amounts of assets and liabilities denominated in currencies other than sterling were as follows:

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Assets	**38,228**	32,694	**2,833**	2,738
Liabilities	**42,526**	36,698	**2,612**	2,382

The above assets and liabilities denominated in foreign currencies do not indicate the Group's exposure to foreign exchange risk. The Group's foreign currency positions are substantially hedged by off-balance sheet hedging instruments.

44. Memorandum items: Guarantees and assets pledged as collateral security

	Group 1996 £m	*Group 1995 £m*	*Company 1996 £m*	*Company 1995 £m*
Guarantees given by Abbey National plc of subsidiaries' liabilities	**–**	–	**62,188**	52,835
Guarantees given to third parties	**1,759**	343	**8**	6
Mortgaged assets granted to secure future obligations to third parties who have provided security to the leasing subsidiaries	**811**	786	**–**	–
	2,570	1,129	**62,196**	52,841
Credit risk weighted amounts	**435**	318	**8**	6

Credit risk weighted amounts are intended to represent a measure of the credit risk associated with the above principal amounts and are calculated in accordance with the Bank of England's guidelines.

The Company has unconditionally and irrevocably guaranteed all the obligations of Abbey National Treasury Services plc, Abbey National North America Corporation, Abbey National Bank SAE, Abbey National Treasury International Ltd, Abbey National (Gibraltar) Ltd, Abbey National France SA, Abbey National Funding (Jersey) Ltd, Abbey National Treasury (IOM) Ltd and Abbey National Second Capital BV. The Company has guaranteed certain liabilities of Abbey National First Capital BV, Abbey National Homes Ltd, Solarlaser Ltd, Abbey National Beta Investments Ltd and Abbey National Life plc.

45. Memorandum items: Other contingent liabilities

	Group 1996 £m	*Group 1995 £m*	*Company 1996 £m*	*Company 1995 £m*
Other contingent liabilities	**138**	197	**19**	57

Repayment of certain tax credits
Abbey National Treasury Services plc has received a demand from an overseas tax authority for an amount of £118m (at the balance sheet exchange rate) (1995: £140m) relating to the repayment of certain tax credits received and related charges. The subsidiary has been advised that it has strong grounds to challenge the validity of the demand and accordingly no specific provision has been made.

Pension transfers and opt-outs
The Securities and Investments Board (SIB) has issued detailed guidance for the review of business involving the transfers from occupational to personal pension schemes and the opting-out of and the non-joining of occupational pension schemes. The Group has carried out a review of the potential exposures in respect of such business following SIB guidelines, using the information currently available. In view of the uncertainty regarding this issue, provisions in respect of possible compensation to customers have been made where considered appropriate and are included in note 38, Other provisions for liabilities and charges.

Deferred consideration
In connection with the acquisition of a one third share in Travellers Exchange Corporation plc (Travelex) which took place in 1995, the Group has entered into an arrangement whereby additional consideration may become payable to the vendors. The amount of future consideration payable is dependent on the future performance of both Travelex and the foreign exchange and travellers cheque business of Abbey National plc and is payable in cash. No provision has been made for any additional consideration as at 31 December 1996, as it cannot be accurately quantified. The maximum unprovided amount is £8.5m, falling due between years 1997 and 2001 as follows: within one year, £1m; within two to five years, £7.5m.

46. Memorandum items: Commitments

The table below shows the contract or principal amount of commitments other than those relating to derivative financial instruments (see note 47). In addition, credit risk weighted amounts are shown, calculated in accordance with the Bank of England's guidelines which are intended to represent a measure of the credit risk associated with such commitments.

	Group 1996 £m	*Group 1995 £m*	*Company 1996 £m*	*Company 1995 £m*
Forward asset purchases and forward deposits placed	**620**	332	**33**	10
Formal standby facilities, credit lines and other commitments to lend:				
One year and over	**1,526**	1,073	**–**	–
Less than one year	**764**	136	**178**	114
	2,910	1,541	**211**	124
Credit risk weighted amounts	**758**	674	**211**	124

47. Derivatives

The British Bankers' Association Statement of Recommended Practice (BBA SORP) on Derivatives which was published in February 1996 applies in respect of the 1996 accounts. The recommendations have been adopted in full.

Derivative financial instruments ('derivatives') are contracts or agreements whose value is derived from one or more underlying indices or asset values inherent in the contract or agreement. Derivatives are used in two distinct ways by Abbey National. The first is as hedging instruments to manage balance sheet foreign exchange rate and interest rate risk, which is classified as non-trading activity. The second is in the trading activity such as market making activity undertaken by Abbey National Financial Products (ANFP), a separately managed trading unit of the Group, and portfolio management within the ANTS trading books.

Non-trading derivatives

The major instruments used in balance sheet risk management are interest rate and cross currency swaps, which are used to hedge Group balance sheet exposures, fixed rate mortgage and consumer credit lending and savings products in relevant operations throughout the Group. Other exposures to fixed interest rates within Treasury & Offshore include those arising from the risks within the ANTS investment portfolio.

The following table summarises activities undertaken by the Group, the related risks associated with such activities and the types of derivatives which may be used in managing such risks. Such risks may also be managed using on balance sheet instruments as part of an integrated approach to risk management.

47. Derivatives (continued)

Activity	Risk	Type of Hedge
Management of the return on investment of shareholders' funds and net non-interest bearing liabilities.	Reduced profitability due to falls in interest rates.	Receive fixed interest rate swaps. Purchased interest rate floors.
Fixed-rate mortgage lending.	Sensitivity to increase in interest rates.	Pay fixed interest rate swaps. Purchased interest rate caps.
Management of other net interest income on retail activities.	Sensitivity of returns to changes in interest rates.	Interest rate swaps and caps/floors according to the type of risk identified.
Fixed-rate funding (e.g. medium-term note issuance).	Sensitivity to falls in interest rates.	Receive fixed interest rate swaps.
Fixed-rate asset investments.	Sensitivity to increases in interest rates.	Pay fixed interest rate swaps.
Investment in foreign currency assets.	Sensitivity to strengthening of sterling against other currencies.	Cross-currency swaps. Foreign currency funding.
Profits earned in foreign currencies.	Sensitivity to strengthening of sterling against other currencies.	Forward foreign exchange contracts. Purchased options.
Investment in, and issuance of, products with embedded options.	Sensitivity to changes in underlying rate and rate volatility causing option exercise.	Interest rate swaps plus caps/floors, and other matched options.
Investment in, and issuance of, bonds with put/call features.	Sensitivity to changes in rates causing option exercise.	Swaptions*.
Firm commitments (e.g. asset purchases, issues arranged).	Sensitivity to changes in rates between arranging a transaction and completion.	Hedges are arranged at the time of commitments if there is exposure to rate movements.

*A swaption is an option on a swap which gives the holder the right but not the obligation to buy or sell a swap.

Derivative products which are combinations of more basic derivatives (such as swaps with embedded option features), or which have leverage features, may be used in circumstances where the underlying position being hedged contains the same risk features. In such cases the derivative used will be designed to match exactly the risks of the underlying asset or liability. Exposure to market risk on such contracts is therefore fully hedged.

Derivatives used for non-trading activities are accounted for on an accruals basis consistent with the assets, liabilities or positions being hedged.

Trading Derivatives
ANFP is the only area of Abbey National Group actively trading derivative products and is additionally responsible for implementing Group derivative hedging with the external market. ANFP's objective is to gain margin value by marketing derivatives to end-users and hedging the resulting exposures efficiently. Products offered by ANFP include interest rate and cross-currency swaps, caps, floors and swaptions. ANFP has established clear guidelines for staff to ensure that end-users are aware of the potential risk of entering into complex derivative transactions. ANFP also uses these products, together with exchange-traded options and futures, for hedging purposes.

47. Derivatives (continued)

A comprehensive limit structure has been established for ANFP which includes exposures to interest rates, yield curve shape, volatility and spreads. In addition to the normal limits, additional limits covering sensitivity to large changes in the underlying variables have been imposed. Substantially no foreign exchange risk is currently run within ANFP, other than that accruing through profits earned in currencies other than sterling. Direct interest rate exposure is also maintained at low levels, but exact hedges are often not available in the market and this will give rise to a combination of yield curve, volatility and spread risk within the established limits. The overall management and control policy framework at ANFP is consistent with the Group of 30 recommendations regarding derivatives.

ANTS additionally uses derivatives as part of trading activity hedging interest rate exposures created within asset backed and other bond portfolios.

Derivatives used in trading activities are stated at fair value.

Quantitative disclosures

The table below shows the contract or underlying principal amounts, credit risk weighted amounts, and replacement costs of non-trading and trading derivatives analysed by type of contract. Contract or underlying principal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The replacement cost represents the cost of replacing contracts with positive values, calculated at market rates current at the balance sheet date. The credit risk weighted amount, which is calculated according to rules specified by the Bank of England, is based on the replacement cost, but also takes into account measures of the extent of potential future exposure and the nature of the counterparty.

	Group 1996 Contract or underlying principal amount £m	*Group 1996 Credit risk weighted amount £m*	*Group 1996 Net replacement cost £m*	*Group 1995 Contract or underlying principal amount £m*	*Group 1995 Credit risk weighted amount £m*	*Group 1995 Net replacement cost £m*
Non-trading derivatives:						
Exchange rate contracts						
Cross currency swaps	10,850	198	372	9,016	269	675
Forward foreign exchange	6,545	35	12	5,775	23	1
Options (OTC)	–	–	–	–	–	–
	17,395	233	384	14,791	292	676
Interest rate contracts						
Interest rate swaps	56,563	268	1,278	53,300	242	751
Caps, floors and swaptions	7,174	42	2	5,555	55	–
Futures (exchange traded)	2,725	–	1	3,378	–	–
Forward rate agreements	519	–	1	1,943	1	1
	66,981	310	1,282	64,176	298	752

47. Derivatives (continued)

	Group 1996 Contract or underlying principal £m	Group 1996 Credit risk weighted amount £m	Group 1996 Positive fair values £m	Group 1996 Negative fair values £m	Group 1995 Contract or underlying principal £m	Group 1995 Credit risk weighted amount £m	Group 1995 Positive fair values £m	Group 1995 Negative fair values £m
Trading derivatives:								
Exchange rate contracts								
Cross currency swaps	**1,344**	**51**	**115**	**131**	1,234	59	143	144
	1,344	**51**	**115**	**131**	1,234	59	143	144
Interest rate contracts								
Interest rate swaps	**44,254**	**279**	**961**	**1,185**	36,802	278	1,071	979
Forward rate agreements	**7,184**	**1**	**4**	**3**	10,277	7	29	27
Futures (exchange traded)	**8,160**	**–**	**–**	**1**	9,296	–	22	2
Caps floors and swaptions	**4,998**	**15**	**44**	**–**	4,382	11	45	–
	64,596	**295**	**1,009**	**1,189**	60,757	296	1,167	1,008
Equity contracts: futures	**7**	**–**	**–**	**–**	–	–	–	–
Total			**1,124**	**1,320**			1,310	1,152
Effect of netting			**(865)**	**(865)**			–	–
Translation differences on foreign exchange derivatives used for hedging purposes			**350**	**945**			(403)	(656)
Unamortised premiums			**91**	**8**			–	–
Amount included in Other assets/Other liabilities			**700**	**1,408**			907	496

Positive fair values arise where gross positive fair values exceed gross negative fair values on a contract by contract basis. Negative fair values arise where gross negative fair values exceed gross positive fair values on a contract by contract basis. The BBA SORP on Derivatives has interpreted the requirements in Financial Reporting Standard No. 5, 'Reporting the Substance of Transactions' in relation to the netting of asset and liability balances in the context of derivatives. As a result of this interpretation, the totals of positive and negative fair values arising on trading derivatives as at 31 December 1996 have been netted where the Group has a legal right of offset with the relevant counterparty. This netting adjustment is shown on the 'effect of netting' line in the above table. It has not been practicable, however, to restate comparative amounts because they cannot be determined without unreasonable expense.

Included in the above analyses of non-trading and trading derivatives are exchange rate contracts and interest rate contracts with underlying principal amounts of £782m (£580m) and £21,692m (£19,956m) respectively, which were undertaken by Group entities for non-trading purposes with ANFP, which in turn entered into similar contracts with external counterparties. Comparative amounts have been restated following the publication of the BBA SORP on Derivatives in February 1996. Amounts relating to contracts undertaken by Group entities for non-trading purposes with ANFP were previously not shown in the above disclosure instead of being included as non-trading items.

As at the balance sheet date, the Company had interest rate swaps in place with underlying principal amounts totalling £23,755m (£23,164m), credit risk weighted amounts of £23m (£27m) and net replacement cost of £522m (£582m).

Substantially all of the Group's derivatives activity is contracted with financial institutions.

All exchange-traded instruments are subject to cash requirements under the standard margin arrangements applied by the individual exchanges. Such instruments are not subject to significant credit risk. Other derivative contracts are not subject to these cash requirements.

The following table analyses OTC and other non-exchange traded derivatives held for non-trading purposes by remaining maturity:

	1996 Contract or underlying principal £m	1996 Net replacement cost £m	1995 Contract or underlying principal £m	1995 Net replacement cost £m
Derivatives maturing:				
In not more than one year	**31,555**	**398**	29,541	360
In more than 1 year but not more than 5 years	**36,452**	**650**	33,951	644
In more than 5 years	**13,644**	**617**	12,097	424
	81,651	**1,665**	75,589	1,428

47. Derivatives (continued)

Risk management of derivatives

As described on page 22, Abbey National has a formal structure for managing risk, limits, reporting lines, mandates and other control procedures. This structure is reviewed regularly by the Asset and Liability Committee ('ALCO'), which is charged with the responsibility for monitoring and controlling the level of structural balance sheet risk in the Group. The minutes of ALCO are available to the Board.

In order to manage the market risks arising within Abbey National plc and its subsidiaries, authorised personnel within each subsidiary are able to use specified derivative instruments within mandated limits. The Group Credit Committee regularly monitors and reviews credit exposures arising in subsidiary companies, and approves all Group credit policies.

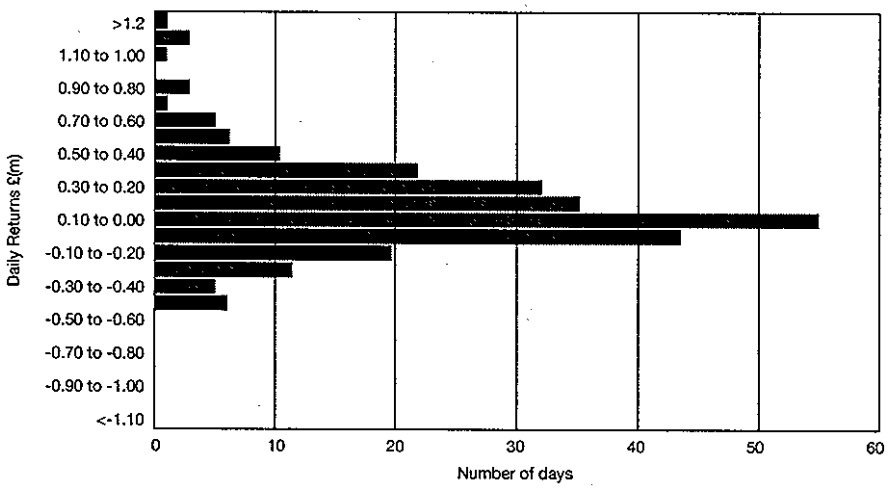
Market risk management within trading portfolios
Trading portfolios are held within ANTS and ANFP. The amount of market risk is controlled through limits on positions which are expressed as the maximum likely loss with a given 95% confidence interval in a one day holding period. These limits are set for each risk factor contained within the portfolio, including inter-alia the absolute levels of interest rates, spreads between interest rate swap rates and government bond yields, the relationship between interest rates for different maturities, the variability of corporate and asset-backed bond spreads and government bond spreads.

The estimated Value at risk ('VAR') thus calculated makes no assumptions about correlation between risk factors except that between the absolute levels of interest rates in different currencies, but takes account of diversification effects. At 31 December 1996 the limit applied to the VAR in the trading portfolios was £19.7m. During the year, the average exposure was £5.5m and maximum exposure was £8.0m. The VAR as at 31 December 1996 was £7.2m.

The effects of instruments whose value does not change linearly with changes in interest rates is fully incorporated into the VAR measures. VAR controls are supplemented by stress testing the portfolios to large instantaneous shocks in market rates and volatilities. The volatilities and correlations applied to the portfolios are revised periodically, and are set using two years of data (where this is available). All the data is equally weighted.

The distribution of daily trading profits on the trading portfolios had a mean of £0.1m, a standard deviation of £0.3m, and the frequency distribution of daily trading profits is shown below:

Frequency distribution of daily trading profit on trading portfolios



Market risk management within non-trading portfolios
Similar VAR controls are applied to interest rate risk occurring in the banking portfolios. As these portfolios are designed to earn interest rate margins, the risk factors included are those which affect the margin of the portfolio, and not necessarily all factors affecting portfolio fair value. Factors which are included are sensitivity to the absolute level of interest rates and distortions in the yield curves. VAR measures are applied using the same one day holding period and based on a 95% confidence interval.

48. Consolidated cash flow statement

a) Reconciliation of profit before tax to net cash inflow from operating activities

	1996 £m	1995 £m
Profit on ordinary activities before tax	**1,167**	1,026
Decrease (increase) in interest receivable and prepaid expenses	**60**	(117)
Decrease in interest payable and accrued expenses	**(687)**	(125)
Provisions for bad and doubtful debts	**127**	72
Provisions for contingent liabilities and commitments	**4**	7
Net advances written off	**(155)**	(128)
Increase in the value of long term assurance business	**(97)**	(88)
Depreciation	**93**	87
Profit on sale of tangible fixed assets and investments	**(3)**	(10)
Loss on disposal of subsidiary undertakings	**–**	7
Effect of other deferrals and accruals of cash flows from operating activities	**72**	68
Net cash inflow from trading activities	**581**	799
Net decrease (increase) in loans and advances	**292**	(2,931)
Net increase in investment in finance leases	**(1,466)**	(566)
Net increase in bills and securities	**(3,716)**	(320)
Net (decrease) increase in deposits and customer accounts	**(3,195)**	4,028
Net increase in debt securities in issue	**6,920**	2,005
Net increase (decrease) in other liabilities less assets	**887**	(338)
Exchange movements	**2,936**	(490)
Net cash inflow from operating activities	**3,239**	2,187

Exchange movements represent exchange movements on cash equivalent balances and on investing and financing activities. The movements are not indicative of the Group's exposure to foreign exchange risk on these items, because foreign currency positions in such balances are substantially hedged by other on-balance sheet and off-balance sheet foreign currency amounts. All other exchange movements, including movements on hedges, are included in the relevant captions in the above reconciliation.

b) Analysis of cash and cash equivalents

Included in the balance sheet are the following amounts of cash and cash equivalents:

	1996 £m	1995 £m
Cash and balances with central banks	**228**	145
Treasury and other eligible bills	**3**	120
Loans and advances to banks	**1,715**	1,472
Debt securities	**1,222**	1,136
	3,168	2,873

The Group is required to maintain balances with the Bank of England which at 31 December 1996 amounted to £221m (£182m). These are shown in loans and advances to banks, and are not included in cash equivalents.

c) Analysis of changes in cash and cash equivalents during the year

	1996 £m	1995 £m
At 1 January	**2,873**	2,904
Net cash inflow (outflow) before adjustment for the effect of foreign exchange rate changes	**907**	(91)
Effect of foreign exchange rate changes	**(612)**	60
At 31 December	**3,168**	2,873

48. Consolidated cash flow statement (continued)

d) Analysis of changes in financing during the year

	1996 Share capital inc. Share premium £m	*1996 Subordinated liabilities £m*	*1995 Share capital inc. Share premium £m*	*1995 Subordinated liabilities £m*
At 1 January	**1,088**	**2,127**	971	1,520
Net cash inflow from financing	**236**	**290**	115	587
Shares issued for a non-cash consideration	**462**	**–**	2	–
Effect of foreign exchange adjustments	**(4)**	**(157)**	–	20
Acquisitions of subsidiary undertakings/purchase of business	**–**	**114**	–	–
At 31 December	**1,782**	**2,374**	1,088	2,127

e) Acquisitions of subsidiary and associated undertakings/purchase of business

	1996 £m	*1995 £m*
Net assets acquired:		
Loans and advances to customers	**12,201**	659
Loans and advances to banks	**1,367**	14
Debt securities	**693**	–
Fixed assets	**117**	–
Other assets	**532**	177
Deposits by banks	**(6)**	(438)
Customer accounts	**(10,229)**	–
Debt securities in issue	**(2,178)**	(227)
Subordinated liabilities	**(114)**	–
Other liabilities	**(1,498)**	(160)
Goodwill	**606**	289
	1,491	314
Satisfied by:		
Unsecured interest bearing loan notes	**–**	11
Cash	**1,012**	301
Deferred consideration	**5**	–
Shares issued	**462**	2
Dividend on shares issued	**7**	–
Provisions for additional consideration	**5**	–
	1,491	314

f) Analysis of the net (inflow) outflow of cash and cash equivalents in respect of acquisitions of subsidiary and associated undertakings/purchase of business

	1996 £m	*1995 £m*
Cash consideration	**1,012**	301
Cash and cash equivalents acquired	**(1,741)**	(3)
Net (inflow) outflow of cash and cash equivalents in respect of the acquisitions of subsidiary and associated undertakings/purchase of business	**(729)**	298

48. Consolidated cash flow statement (continued)

g) Sale of subsidiary undertakings

	1996 £m	1995 £m
Net assets disposed of:		
Fixed assets	–	2
Debtors	–	2
Cash at bank and in hand	–	1
Creditors	–	(1)
	–	4
Provisions made for future liabilities retained	–	4
Goodwill recognised on disposal	–	1
Loss on disposal	–	(7)
Consideration received	–	2
Satisfied by:		
Cash	–	2

h) Analysis of the net inflow of cash and cash equivalents in respect of the sale of subsidiary undertakings

	1996 £m	1995 £m
Cash received as consideration	–	2
Cash and cash equivalents disposed of	–	(1)
Net inflow of cash and cash equivalents in respect of sale of subsidiary undertakings	–	1

49. Retirement benefits

The Abbey National Amalgamated Pension Fund is the principal pension scheme within the Group, covering 60% of the Group's employees, and is a funded defined benefits scheme.

The latest formal actuarial valuation carried out by an independent professionally qualified actuary was made as at 31 March 1996, at which date the market value of the scheme assets was £774m.

The valuation was prepared by using the projected unit funding method. As a result of this valuation, and subsequent assessment as at 31 December 1996, a funding level of 108% is disclosed. The regular employer's contribution rate in respect of benefits accruing after the valuation date is 21.9% of pensionable salaries.

The main long term financial assumptions used in the valuation were:

	% Nominal per annum
Investment return	9.0
Equity dividend growth	4.5
Pension increases	4.25
General salary increases	6.5
General price inflation	4.5

The pension cost of £32m (£28m) reflects the regular contribution rate less an amount in respect of the surplus being recognised over the expected remaining service lives of the members of the fund in accordance with SSAP 24 on accounting for pension costs. Contributions of £44m (£41m) were made to the fund in 1996 and a provision of £32m (£44m) has been included in the balance sheet (see note 38). Formal actuarial valuations of the assets and liabilities of the scheme to determine its financial position are carried out on a triennial basis and, in addition, there is an annual review by the appointed actuary. The results of these reviews are included in the accounts. The next formal valuation will be made not later than 31 March 1999.

The National and Provincial Building Society Pension Fund is a funded defined benefits scheme which covers 13% of the Group's employees, and includes employees who joined the Group with the transfer of the business of N&P. The latest actuarial valuation was made as at 31 March 1994 using the projected unit funding method and disclosed a funding level of 117%. A provision of £1m was transferred in on 5 August 1996. A pension cost of £3m has been charged to the profit and loss account in respect of the five months to 31 December 1996, and contributions to the fund for the period were £5m. Included in other assets as at 5 August 1996 was an amount of £29m in respect of the pension scheme surplus, in accordance with FRS7, 'Fair Values in Acquisition Accounting', based on an actuarial assessment of the scheme at that date. This balance is being amortised over the average remaining service lives of employees in the scheme, and £1m was charged to the profit and loss account over the five months to 31 December 1996.

49. Retirement benefits (continued)

The First National Finance Corporation Pension and Life Assurance Plan covers the employees of First National Finance Corporation plc amounting to 4% of the Group's employees and is also a funded defined benefits scheme. The latest actuarial valuation was made as at 1 May 1996 and disclosed a funding level of 122.5%.

The Scottish Mutual Assurance plc Staff Pension Scheme covers the employees of the Life Assurance Division amounting to 6% of the Group's employees and is also a funded defined benefits scheme. The latest actuarial valuation was made as at 31 December 1994 and disclosed a funding level of 122%. It is estimated that the surplus will be removed by 30 June 2001.

50. Related party disclosures

a) Transactions with directors, executive officers and their close family members

Directors, executive officers and members of their close families have undertaken the following transactions with Abbey National in the course of normal banking business. These transactions were made on the same terms and conditions as applicable to other employees within the Group, or on normal commercial terms.

	No. of directors and executive officers	*Amounts in respect of directors, executive officers (1) and their close family members £000*
Secured loans		
Amounts advanced during the year	1	8
Capital amounts repaid during year	6	217
Balances outstanding as at 31 December 1996	11	814
Unsecured loans and overdrafts		
Net amounts advanced during the year	8	3
Balances outstanding as at 31 December 1996	6	14
Deposit and investment accounts		
Amounts deposited in the year	14	497
Amounts withdrawn in the year	10	245
Balances outstanding as at 31 December 1996	16	990
Bank and instant access accounts		
Net amounts withdrawn during the year	16	56
Balances outstanding as at 31 December 1996	16	231
Life assurance policies and investments		
Premiums paid/amounts invested during the year	4	233
Total sum insured/value of investment	4	426

(1) Executive officers are defined as those officers who report directly to the Group Chief Executive.

Secured and unsecured loans are made by Abbey National to directors, executive officers and their close family members on the same terms and conditions as applicable to other employees within the Group.

Amounts deposited by directors, executive officers and their close family members with Abbey National earn interest at the same rates as those offered to the market.

Directors, executive officers and their close family members have entered into life assurance policies and investments with life assurance subsidiaries of the Group, on normal market terms and conditions, or on the same terms and conditions as applicable to other employees within the Group.

50. Related party disclosures (continued)

b) Transactions with associated undertakings

Abbey National plc acts as agent for Commercial Union Underwriting Limited (CUUL), under which it passes insurance premiums to CUUL and earns an agent's margin. The agency margin amounted to £108m for the year ended 31 December 1996.

Balances outstanding between the Group and associated companies as at 31 December 1996 are detailed in Note 18 and Note 31.

c) Transactions with long term assurance funds

The long term assurance funds are related parties for the purposes of this disclosure because the assets and liabilities of the long term assurance funds are included in the balance sheet.

During the year there were transfers of £41m from the shareholders' funds to the long term assurance funds to support the growth in life assurance business. Additionally, the long term assurance funds transferred a surplus of £36m to shareholders' funds. Further details are provided in note 22.

Included in fees and commissions receivable in the year is an amount of £19m receivable from the long term assurance fund of Abbey National Life in respect of life assurance products sold through the retail branch network.

During the year Abbey National Financial Investment Services incurred costs amounting to £72m on behalf of the long term assurance funds. All such costs were recharged to the long term assurance funds.

As at 31 December 1996, £188m was due to the long term assurance funds and £89m was due from the long term assurance funds by Group entities. Of these respective amounts £184m relates to amounts deposited by the long term assurance funds with Abbey National plc or Abbey National Treasury Services plc, and £47m relates to amounts owed by the long term assurance funds to Abbey National plc. The remaining amounts represent balances between the long term assurance funds and the shareholders' funds of the life assurance businesses within the Group.

Net interest paid to long term assurance funds during the year was £19m.

Included within Assets of long term assurance funds and Liabilities of long term assurance funds are amounts owing between the long term assurance funds of £11m.

d) Transactions with N&P

On 5 August 1996, the business of N&P was transferred to Abbey National, as detailed in note 25.

As at 4 August 1996, the Group had £150m on short term deposit with N&P, and investments totalling £192m in debt securities issued by N&P, while N&P had £722m on short term deposit with the Group.

51. Post balance sheet events

On 31 January 1997, the Group acquired shares in Dah Sing Financial Holdings Limited for HK$381m, representing a 5% holding in the company.

On 21 February 1997, the Group signed an agreement with Hambros Bank and Dah Sing Financial Holdings Limited to form a joint venture international private banking operation, to be based in Hong Kong. A newly formed company, DAH Holdings Limited, will be established, in which the Group will own 24.5% of the equity capital.

Group Financial Summary - Profit and Loss Accounts

	1996 £m	1995 £m	1994 £m	1993 £m	1992 £m
Net interest income	**1,794**	1,584	1,394	1,338	1,265
Other income and charges	**555**	399	365	376	319
Operating expenses	**(977)**	(870)	(755)	(763)	(706)
Provisions for bad and doubtful debts	**(127)**	(72)	(74)	(218)	(274)
Provisions for contingent liabilities and commitments	**(4)**	(7)	–	–	–
Amounts written off fixed asset investments	**(13)**	(8)	2	1	(3)
Profit on ordinary activities before tax, integration costs and other exceptional items	**1,228**	1,026	932	734	601
Integration costs in continuing businesses	**(61)**	–	–	–	–
Other exceptional items:					
Loss on disposal/reorganisation of estate agency business	**–**	–	–	(30)	(138)
Sale of unclaimed shares	**–**	–	–	–	101
Profit on ordinary activities before tax	**1,167**	1,026	932	704	564
Tax on profit on ordinary activities	**(403)**	(344)	(322)	(314)	(247)
Profit on ordinary activities after tax	**764**	682	610	390	317
Minority interests - equity	**3**	1	–	–	–
Profit attributable to the shareholders of Abbey National plc	**767**	683	610	390	317
Transfer to non-distributable reserve	**(67)**	(59)	(65)	(32)	(7)
Dividends - ordinary and preference shares	**(373)**	(290)	(233)	(184)	(151)
Profit retained for the financial year	**327**	334	312	174	159
Profit on ordinary activities before tax and exceptional items includes for:					
operations acquired in the year excluding integrated businesses	**8**	9	22	–	30
operations discontinued in 1995 (with prior year comparative)	**–**	(8)	(9)	–	–
operations discontinued in 1993 (with prior year comparative)	**–**	–	–	(2)	(20)
Earnings per ordinary share	**56.5p**	51.7p	46.5p	29.7p	24.2p
Earnings per ordinary share, excluding integration costs	**59.8p**	51.7p	46.5p	29.7p	24.2p
Dividends per ordinary share (pence)					
Net	**26.10p**	21.75p	17.75p	14.0p	11.5p
Gross equivalent	**32.63p**	27.19p	22.19p	17.5p	14.7p
Dividend cover (times)	**2.1**	2.4	2.6	2.1	2.1

The Group financial summary is based on the audited consolidated financial statements of the Abbey National Group for the five years ended 31 December 1996, and has been derived from the consolidated financial statements for each of the relevant years.

The figure disclosed in respect of Profit on ordinary activities before tax and exceptional items resulting from operations acquired in the year excludes the results of the business transferred from N&P. See note 26 to the accounts.

The calculation of the gross equivalent dividend per ordinary share applies a tax rate of 25% for grossing-up purposes for dividends up to and including the interim dividend for 1992. Thereafter the rate of 20% has been applied.

Group Financial Summary - Balance Sheets

	1996 £m	1995 £m	1994 £m	1993 £m	1992 £m
Assets					
Cash, treasury bills and other eligible bills	**339**	391	598	757	497
Loans and advances to banks	**2,825**	3,579	2,906	3,556	2,276
Loans and advances to customers	**64,227**	51,090	48,484	45,049	42,061
Net investment in finance leases	**4,310**	2,844	2,278	2,253	1,737
Securities and investments	**39,774**	35,297	32,374	25,312	19,998
Long term assurance business	**555**	425	352	287	215
Tangible fixed assets	**715**	585	534	509	518
Other assets	**3,397**	3,403	2,701	2,208	2,105
Assets of long term assurance funds	**7,869**	5,518	4,230	3,871	2,816
Total assets	**124,011**	103,132	94,457	83,802	72,223
Liabilities					
Deposits by banks	**17,718**	19,393	17,826	16,368	13,103
Customer accounts	**49,678**	40,962	38,056	36,143	34,348
Debt securities in issue	**35,193**	26,095	23,852	19,030	14,929
Other liabilities	**6,786**	5,096	5,269	4,136	3,195
Subordinated liabilities including convertible debt	**2,374**	2,127	1,520	868	648
Liabilities of long term assurance funds	**7,869**	5,518	4,230	3,871	2,816
	119,618	99,191	90,753	80,416	69,039
Non-equity shareholders' funds	**321**	101	–	–	–
Equity shareholders' funds	**4,072**	3,840	3,704	3,386	3,184
Total liabilities	**124,011**	103,132	94,457	83,802	72,223

Supplementary Financial Information

The Annual Report on Form 20-F (Form 20-F), which includes information which is, in certain respects, more detailed than is contained in the Directors' Report and Accounts, is filed with the Securities and Exchange Commission in accordance with US legislation. The Form 20-F is available for public inspection, and a copy may be obtained from Abbey National plc, registered office: Abbey House, Baker Street, London NW1 6XL.

The Form 20-F contains certain additional information which is prepared in accordance with generally accepted accounting principles applicable in the United States (US GAAP) which differ in certain respects from those used in the UK (UK GAAP). Extracts from the Form 20-F are presented in the following pages, including an average balance sheet prepared under UK GAAP and a reconciliation of profit after tax and shareholders' funds between US and UK GAAP with a description of the relevant principal differences.

Throughout this section, references to UK and Non-UK refer to the location of the office where the transaction is recorded.

Average Balance Sheet

	1996 Average balance £m	1996 Interest £m	1996 Average rate %	1995 Average balance £m	1995 Interest £m	1995 Average rate %	1994 Average balance £m	1994 Interest £m	1994 Average rate %
Assets									
Treasury bills and other eligible bills									
UK	**77**	**–**	**0.44**	246	5	1.96	149	5	3.12
Non-UK	**11**	**1**	**6.79**	7	–	4.97	9	–	3.69
Loans and advances to banks									
UK	**3,968**	**217**	**5.48**	4,277	278	6.51	3,434	167	4.87
Non-UK	**337**	**25**	**7.30**	324	24	7.25	73	5	6.44
Loans and advances to customers									
UK	**55,712**	**3,968**	**7.12**	48,658	3,888	7.99	45,498	3,533	7.77
Non-UK	**1,347**	**108**	**7.98**	1,344	110	8.17	1,346	94	7.01
Lease receivables									
UK	**3,663**	**243**	**6.62**	2,507	177	7.05	2,278	133	5.85
Non-UK	**42**	**2**	**4.58**	30	1	4.34	29	2	6.56
Debt securities									
UK	**35,720**	**2,337**	**6.54**	33,600	2,320	6.90	27,728	1,590	5.73
Non-UK	**2,219**	**145**	**6.55**	1,351	91	6.77	114	4	3.06
Total average interest earning assets and interest income	**103,096**	**7,046**	**6.83**	92,344	6,894	7.47	80,658	5,533	6.86
Allowance for loan losses	**(682)**	**–**	**–**	(555)	–	–	(563)	–	–
Non-interest earning assets									
Long term assurance fund assets	**6,409**	**–**	**–**	4,625	–	–	3,811	–	–
Other	**5,348**	**–**	**–**	4,796	–	–	4,260	–	–
Total average assets and interest income	**114,171**	**7,046**	**6.17**	101,210	6,894	6.81	88,166	5,533	6.28
Percentage of total – Non-UK	**3.46%**	**–**	**–**	3.21%	–	–	1.84%	–	–
Total average interest earning assets and net interest income	**103,096**	**1,815**	**1.76**	92,344	1,579	1.71	80,658	1,399	1.73
Net interest (income) expense allocated to dealing profits	**–**	**(21)**	**–**	–	5	–	–	(5)	–
Net interest income (Consolidated Profit and Loss Account)	**–**	**1,794**	**–**	–	1,584	–	–	1,394	–

Average Balance Sheet

	1996 Average balance £m	1996 Interest £m	1996 Average rate %	1995 Average balance £m	1995 Interest £m	1995 Average rate %	1994 Average balance £m	1994 Interest £m	1994 Average rate %
Liabilities and shareholders' funds									
Deposits by banks									
UK	**20,114**	**1,197**	**5.95**	19,496	1,303	6.69	15,313	840	5.48
Non-UK	**493**	**28**	**5.69**	720	46	6.40	973	53	5.41
Customer accounts - demand deposits									
UK	**23,798**	**809**	**3.40**	21,725	1,038	4.78	21,511	941	4.38
Non-UK	**175**	**8**	**4.70**	116	6	5.37	103	5	5.20
Customer accounts - time deposits									
UK	**15,112**	**883**	**5.85**	14,382	939	6.53	13,340	844	6.33
Non-UK	**1,114**	**67**	**6.03**	922	63	6.78	721	49	6.74
Customer accounts - wholesale deposits									
UK	**4,080**	**229**	**5.62**	2,486	154	6.21	1,830	107	5.83
Non-UK	**282**	**17**	**5.85**	245	15	5.96	5	–	5.56
Bond and medium term notes									
UK	**16,965**	**1,106**	**6.52**	14,317	911	6.36	13,315	836	6.28
Non-UK	**233**	**15**	**6.31**	377	20	5.36	406	30	7.39
Other debt securities in issue									
UK	**8,968**	**549**	**6.13**	7,760	533	6.86	4,779	261	5.46
Non-UK	**3,287**	**169**	**5.12**	2,795	171	6.13	2,028	91	4.48
Dated and undated loan capital and other subordinated liabilities									
UK	**1,476**	**107**	**7.25**	951	65	6.82	690	51	7.33
Non-UK	**726**	**47**	**6.41**	796	51	6.38	426	26	6.24
Total average interest bearing liabilities and interest expense	**96,823**	**5,231**	**5.40**	87,088	5,315	6.10	75,440	4,134	5.48
Non-interest bearing liabilities									
Long term assurance fund liabilities	**6,409**	**–**	**–**	4,625	–	–	3,811	–	–
Other	**6,656**	**–**	**–**	5,588	–	–	5,231	–	–
Shareholders' funds	**4,283**	**–**	**–**	3,909	–	–	3,684	–	–
Total average liabilities, shareholders' funds and interest expense	**114,171**	**5,231**	**4.58**	101,210	5,315	5.25	88,166	4,134	4.69
Percentage of total - Non-UK	**5.53%**	**–**	**–**	6.53%	–	–	5.45%	–	–
Interest income as a percentage of average interest earning assets			**6.83**			7.47			6.86
Interest expense as a percentage of average interest bearing liabilities			**5.40**			6.10			5.48
Interest spread			**1.43**			1.37			1.38
Net interest margin			**1.76**			1.71			1.73

For the purposes of the average balance sheet, interest income and interest expense have been stated after allocation of interest on instruments entered into for hedging purposes.

Differences between UK GAAP and US GAAP

The significant differences applicable to Abbey National's accounts are summarised below.

Goodwill/core deposit intangible

UK GAAP

Goodwill arising on consolidation as a result of the acquisition of subsidiary and associated undertakings and goodwill arising on the purchase of businesses are taken direct to reserves in the year in which they occur. On disposal of a business, the goodwill previously taken to reserves is recognised in the profit and loss account balanced by an equal credit to reserves. Where the directors believe that the purchased goodwill in continuing businesses has suffered a permanent diminution in value, a similar recognition in the profit and loss account and credit to reserves is made.

US GAAP

Goodwill is capitalised and amortised in the consolidated statement of income over the period in which the benefits are estimated to accrue. In Abbey National's case, a period of 20 years has been used. Goodwill is written off when judged to be irrecoverable.

The element of goodwill relating to retail depositor relationships purchased on acquisition of a savings entity, termed the core deposit intangible, is capitalised separately and amortised in the consolidated statement of income over the estimated average life of the retail customer relationships.

The net assets of businesses acquired have been restated for all material differences between UK and US GAAP that existed on acquisition. This has resulted in an adjustment of £15m to the fair value of net assets transferred with the business of N&P in 1996, and a corresponding adjustment to goodwill, for US GAAP purposes.

Pension costs

UK GAAP

Where pensions are provided by means of a funded defined benefits scheme, annual contributions are based on actuarial advice. The expected cost of providing pensions is recognised on a systematic basis over the expected average remaining service lives of members of the scheme. Variations from regular cost are spread over the average remaining service lives of current employees on a straight line basis.

US GAAP

Under Statement of Financial Accounting Standards (SFAS) No. 87, the same basic actuarial method is used as under UK GAAP, but certain assumptions differ, assets are assessed at fair value and liabilities are assessed at current settlement rates. Certain variations from regular cost are allocated in equal amounts over the average remaining services lives of current employees.

Leasing

UK GAAP

Income from finance leases, including benefits from declining tax rates, is credited to the profit and loss account using the actuarial after tax method to give a constant periodic rate of return on the net cash investment.

US GAAP

Application of SFAS No. 13 gives rise to a level rate of return on the investment in the lease, but without taking into account tax payments and receipts. This results in income being recognised in different periods than under UK GAAP.

Loan origination fees

UK GAAP

Where "introducers" are the primary form of distribution for lending business, related commissions payable are charged to the profit and loss account over the anticipated life of the loans. Other loan origination fees are recognised in income in the period in which they are receivable.

US GAAP

Fee income from originating a loan is spread over the life of the loan in accordance with SFAS No. 91.

Shareholders' interest in long term assurance policies

UK GAAP

The shareholders' interest in the long term assurance funds is valued at the net present value of the surplus expected to emerge in the future from business currently in force, together with the Group's interest in the surplus retained within the long term assurance funds.

US GAAP

The net present value of the profits inherent in the long term assurance policies is not recognised under US GAAP.

For contracts valued in accordance with SFAS No.60, which covers conventional products such as endowment and term assurance policies, premiums are recognised as revenue when due from the policyholders. Costs of claims are recognised when insured events occur. A liability for future policy benefits to be paid to or on behalf of policyholders is established based upon the present value of future benefits less the present value of future net premiums. Acquisition costs are charged to the profit and loss account in proportion to premium revenue recognised.

For contracts valued under SFAS No.97, which covers unit-linked products, premiums and front-end load type charges receivable from customers, and acquisition costs relating to the acquisition of new contracts are capitalised and amortised in proportion to the present value of estimated gross profits. Estimated gross profits are projected on best estimate assumptions with no provisions for adverse deviation. The liability for policy benefits is set equal to the nominal policyholders' account balance. Costs of claims are recognised when insured events occur.

In previous years, the net present value of the surplus expected to emerge in future from business currently in force was excluded from net income and shareholders' funds for US GAAP purposes. Following an exercise to refine the application of US GAAP, these comparative adjustments have been restated.

Stock-Based Compensation

UK GAAP

Equity based instruments, such as share options, issued under compensation plans are accounted for within the called up share capital and share premium accounts on the balance sheet when exercised.

US GAAP

SFAS No. 123, "Accounting for Stock-Based Compensation", encourages companies to account for equity based instruments issued under compensation plans at their fair value, measured at the date at which the instruments are granted. However, the statement also permits the intrinsic value-based method of accounting, under which the compensation cost, being the excess, if any, of the quoted market price of the stock at grant date over the exercise price, must be recognised in the profit and loss account over the vesting period. On the balance sheet this is offset by a corresponding adjustment to share premium. Abbey National has chosen to continue to adopt the intrinsic value based method for the purposes of the reconciliation between UK and US GAAP. Proforma disclosures of the effects of implementing the fair value method under SFAS No. 123 are available in the annual Form 20-F.

Dividend payable

UK GAAP

Dividends declared after the period end are recorded in the period to which they relate.

US GAAP

Dividends are recorded in the period in which they are declared.

Investments in securities

UK GAAP

Securities held for investment purposes are stated at cost adjusted for any amortisation of premium or discount. All securities not held for investment purposes are stated at market value and profits and losses arising from this revaluation are taken to the profit and loss account.

US GAAP

Securities are classified as trading securities, available for sale securities, and held to maturity securities in accordance with SFAS No. 115. Held to maturity securities are accounted for in the same way as securities held for investment purposes under UK GAAP. Trading securities are accounted for in the same way as securities not held for investment purposes under UK GAAP. Available for sale securities are reported at market value, with unrealised gains and losses excluded from earnings, but reported in a separate component of shareholders' equity.

Deferred tax

UK GAAP

Deferred taxation is accounted for only where it is probable that a liability or asset will arise. Provision is calculated at rates expected to be applicable when the liability or asset crystallises.

No deferred tax asset is created in respect of general allowances for lending losses which are not deductible in arriving at UK taxable profits.

US GAAP

Provision for deferred tax under the liability method is required in full for all timing differences, including general allowances for loan losses and tax loss carry forwards.

Deferred tax assets are recognised subject to any adjustment for valuation allowances.

Provisions against lending losses

UK GAAP

Specific provisions, determined using statistical techniques, are made against loans and advances when, as a result of regular appraisals of the assets, it is considered that recovery is doubtful. Statistical techniques are used for large groups of small balance homogenous loans. General provisions are made against loans and advances to cover bad and doubtful debts which have not been separately identified but are known from experience to be present in any portfolio of loans and advances.

US GAAP

The approach described under UK GAAP also applies under US GAAP for almost all of the Group's loan balances. However, for loans within the scope of SFAS No. 114, allowances for lending losses are determined based on the present value of expected future cashflows discounted at the loan's effective rate, or as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Leases and large groups of smaller balance homogenous loans that are collectively evaluated for impairment, such as residential mortgage loans, are outside the scope of SFAS No. 114. Abbey National has reviewed SFAS No. 114 and concludes that it has no material effect on the reconciliation of net income and shareholders' funds between UK and US GAAP.

Future developments

SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities", requires that entities recognise the financial and servicing assets they control and liabilities they have incurred, and derecognise assets when control has been surrendered, and liabilities when extinguished. SFAS No. 125 is required to be adopted for transactions entered into after 31 December 1996. Abbey National is currently reviewing this statement to determine what effect it may have on the reconciliation of net income and shareholders' funds between UK and US GAAP.

Differences between UK and US accounting principles

The following table summarises the significant adjustments to consolidated net income or loss and shareholders' funds which would result from the application of US GAAP instead of UK GAAP.

	1996 *£m*	*1995* *£m*	*1994* *£m*
Consolidated Net Income of Abbey National plc (UK GAAP)	**754**	681	610
Goodwill	**(29)**	(15)	(6)
Core deposit intangible	**(19)**	–	–
Pensions cost	**(6)**	(13)	(14)
Leasing	**(12)**	(16)	(7)
Loan origination fees	**(17)**	2	–
Shareholders' interest in long term assurance business	**(27)**	(1)	(95)
Stock-based compensation costs	**(8)**	–	–
Deferred tax effect of the above US/UK GAAP adjustments	**23**	9	39
Deferred tax	**3**	1	–
Consolidated Net Income of Abbey National plc (US GAAP)	**662**	648	527
per 10 pence ordinary share	**49.6p**	49.2p	40.0p

	1996 *£m*	*1995* *£m*	*1994* *£m*
Shareholders' funds including non-equity interests (UK GAAP)	**4,393**	3,941	3,704
Goodwill	**683**	403	138
Core deposit intangible	**298**	–	–
Net assets of businesses acquired	**(15)**	–	–
Pensions cost	**(38)**	(32)	(19)
Leasing	**(68)**	(56)	(40)
Loan origination fees	**(17)**	–	(2)
Shareholders' interest in long term assurance business	**(105)**	(101)	(61)
Stock-based compensation costs	**(8)**	–	–
Share premium	**8**	–	–
Dividend payable	**245**	191	158
Unrealised surplus on securities available for sale	**783**	706	24
Deferred tax effect of the above US/UK GAAP adjustments	**(195)**	(172)	39
Deferred tax	**29**	22	14
Shareholders' funds including non-equity interests (US GAAP)	**5,993**	4,902	3,955