Alliance & Leicester plc
2010 Annual Report

Contents

3263713

Directors' Report

Introduction

The Directors submit their report together with the financial statements for Alliance & Leicester plc ('Alliance & Leicester' or the 'Company') for the year ended 31 December 2010

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

Corporate Structure

The Company is a wholly owned-subsidiary of Santander UK plc and the ordinary shares of the Company are not traded on the London Stock Exchange The Company is part of Banco Santander, S A (together with its subsidiaries, 'Santander') The Company is incorporated in England and has its registered office at Carlton Park, Narborough, Leicester LE19 0AL

The Alliance & Leicester Building Society (the 'Society') was formed in 1985 with the merger of two long-standing building societies, the Alliance Building Society and the Leicester Building Society In 1997, the Society transferred its entire business to Alliance & Leicester plc as part of the conversion and listing on the London Stock Exchange and Alliance & Leicester plc commenced trading as a bank

On 10 October 2008, Banco Santander, S A completed the acquisition of the entire issued ordinary share capital of the Company, implemented by means of a scheme of arrangement under Section 425 of the Companies Act 1985, making the Company a wholly owned subsidiary of Banco Santander, S A Banco Santander, S A is one of the largest banks in the world by market capitalisation Founded in 1857, Banco Santander, S A has more than 90 million customers and over 14,000 branches

In December 2008, following the acquisition by Banco Santander, S A of the Company, Santander UK plc injected approximately £950m of capital into the Company through a subscription for (i) 234,113,712 new ordinary shares in the Company for cash at £2 99 per ordinary share, (ii) US$220m undated subordinated notes issued by the Company, and (iii) euro 115m undated subordinated notes issued by the Company Previously, in October 2008, Santander UK plc subscribed for US$100m undated floating rate subordinated notes issued by the Company As a result of the subscription for ordinary shares, Santander UK plc held 35 6% of the issued share capital of the Company at 31 December 2008

On 9 January 2009, in order to optimise the capital, liquidity funding and overall financial efficiency of the enlarged Santander group, Banco Santander, S A transferred all of the shares it held in the Company to Santander UK plc in exchange for newly issued Santander UK plc ordinary shares Accordingly, Santander UK plc is now the immediate parent company of the Company

On 25 February 2010 it was announced that the Company intended to transfer its business to Santander UK plc under a business transfer scheme pursuant to Part VII of the Financial Services and Markets Act 2000 ('FSMA') On 28 May 2010, the High Court approved the transfer Following the transfer of the Company's business into Santander UK plc, the only business remaining in the Company is a small portfolio of corporate loans which is in the process of being transferred to Santander UK plc

Principal Activities and Business Review

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

Following the transfer of the Company's business to Santander UK plc under a business transfer scheme pursuant to Part VII of FSMA, the only business remaining in the Company is a small portfolio of corporate loans which is in the process of being transferred to Santander UK plc

Competitive environment, future trends and outlook

As discussed above, substantially all of the business of the Company was transferred to Santander UK plc during 2010 It is the intention that the remainder of the business of the Company will be transferred to Santander UK plc during 2011

Review of the development and performance of the business during the year

The Company is required to set out in this report a fair review of the development and performance of the business of the Company during the year ended 31 December 2010 and the position of the Company at the end of the year

The transfer of the Company's business to Santander UK plc during 2010, as discussed above, provided benefits for the Company's customers transferred to Santander UK plc under the Part VII Scheme and for Santander UK plc This included access to Santander UK's full product range as well as use of over 1,400 branches (including agencies), four times as many branches as were available for customers of the Company prior to the Part VII Scheme By rationalising systems and improving the sales and risk management processes through having a single view of customers' dealings, Santander UK plc also benefitted from the significant synergies that were announced to the market at the time of the acquisition of the Company by Banco Santander, S A in 2008

Summarised statutory income statement

Discontinued operations	2010 £m	2009 £m
Net interest income	**288**	648
Non-interest income	**17**	332
Total operating income	**305**	980
Administration expenses	**(162)**	(551)
Depreciation and amortisation	**(12)**	(45)
Total operating expenses excluding provisions and charges	**(174)**	(596)
Impairment losses on loans and advances	**(41)**	(462)
Provisions for other liabilities and charges	**-**	(11)
Total operating provisions and charges	**(41)**	(473)
Profit/(loss) before tax	**90**	(89)
Taxation (charge)/credit	**(17)**	11
Profit/(loss) for the year	**73**	(78)

2010 compared to 2009

Profit before tax of £90m compares to a loss of £(89)m in 2009 Material movements by line principally reflected the transfer of the business of the Company into Santander UK plc in May 2010, and an improving performance in difficult economic conditions with respect to impairment losses on loans and advances delivered as a result of a high quality mortgage book There was no profit/(loss) arising on the transfer of the business of the Company into Santander UK plc

Key performance indicators

Key performance indicators are set at the Santander UK level, rather than separately for the Company Detailed information on the key performance indicators of Santander UK, of which the Company is a part, is set out in the Business Review – Summary in the Santander UK plc 2010 Annual Report, which is available on the Santander UK corporate website (www aboutsantander co uk)

The position of the Company at the year end

The balance sheet at 31 December 2010 is set out on page 12 of the Financial Statements Net assets decreased by 90% to £166m at 31 December 2010 (2009 £1,671m) The movements in the balance sheet items primarily reflected the transfer of the business of the Company into Santander UK plc in May 2010

Principal risks and uncertainties

The Company's principal risks and uncertainties together with the processes that are in place to monitor and mitigate those risks where possible can be found in the Risk Management section in Note 13 of the Financial Statements

Results and ordinary dividends

The results of the Company are discussed in the Principal Activities and Business Review above The Directors do not recommend the payment of a final ordinary dividend (2009 nil) No interim ordinary dividends were paid in 2010 (2009 nil) As part of the transfer of the Company's business into Santander UK plc under a scheme allowed by Part VII of FSMA 2000, a transfer out of distributable reserves of £1,300m was made to the parent

Events after the balance sheet date

None

Directors' Report continued

Going concern

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out above The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements The Company's objectives, policies and processes for managing its capital are described in Note 14 to the financial statements Details of the Company's financial risk management objectives, its financial instruments, and its exposures to credit risk, market risk and other risks are discussed in Note 13 to the financial statements

The Company is part of the Santander UK group The Company is reliant on Santander UK plc and other companies in the Santander UK group for a significant proportion of its funding The Board of Santander UK plc has confirmed that Santander UK plc and the Santander UK group are going concerns, and that it will provide funding to the Company for the foreseeable future In giving this commitment to provide funding to the Company, the Board of Santander UK plc has considered the uncertainties within the Company when preparing the forecasts and budgets of the combined business of the Santander UK group

On 19 March 2009, Santander UK plc gave a full and unconditional guarantee in respect of the unsubordinated liabilities of the Company incurred prior to 31 July 2012 under a deed poll guarantee entered into by Santander UK plc The Company has given a reciprocal guarantee in respect of the unsubordinated liabilities of Santander UK plc incurred prior to 31 July 2012 This reciprocal guarantee has since been transferred to Santander UK plc (and thereby unwound) under power granted by the court order which approved the Company's business transfer scheme under Part VII of the Financial Services and Market Act 2000 in May 2010 (the 'Part VII Scheme')

After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future Following the transfer of the Company's business to Santander UK plc under the Part VII Scheme in May 2010, the only business remaining in the Company is a small portfolio of corporate loans which are in the process of being transferred to Santander UK plc IAS 1 requires that financial statements for any Company that has ceased to trade, or substantially reduced trading, or where there is an intention for the Company to cease to trade, or substantially reduce trading in the next twelve months, are prepared on an "other than going concern" basis Accordingly the financial statements have been prepared on an "other than going concern" basis as there is the intention to cease trading in the next twelve months In accordance with Santander UK's accounting policy of accounting for internal reorganisations, the assets and liabilities of the Company's business were transferred to Santander UK at their book values in the Company Preparation of the financial statements on an "other than going concern" basis has therefore had no impact on the amounts reported

Directors

The Directors who served throughout the year and to the date of this report, except as noted, were

Executive Directors	
Ana Botín	Appointed on 1 December 2010
José María Nus	Appointed on 17 March 2011
António Horta-Osório	Resigned on 1 December 2010
Antonio Lorenzo	Resigned on 1 December 2010
Juan Colombás	Resigned on 1 December 2010
Alison Brittain	

Non-Executive Directors
Lord Burns
Juan Rodríguez Inciarte
Jane Barker
Roy Brown
José María Carballo
José María Fuster
Rosemary Thorne
Keith Woodley

Remuneration

The remuneration of the Directors of the Company is set out in the 'Directors' Remuneration' table in the Santander UK plc 2010 Annual Report and Accounts

Third Party Indemnities

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

Financial Risk Management Objectives

The Company's risks are managed at a Santander UK level Risk management is carried out by the central risk management function of the Santander UK plc group Disclosures relating to the Santander UK group's risk management can be found in the Santander UK plc 2010 Annual Report and Accounts, which does not form part of these financial statements The Company's exposure to market risk, credit risk and liquidity risk are outlined in Note 13 of the Financial Statements

Donations

During the year, the Company made total community contributions of £150,000 (2009 £146,000)

Political Contributions

No contributions (2009 none) were made for political purposes and no political expenditure was incurred

Suppliers

The Company has a Cost Management & Procurement Policy and process that is enforced across all significant purchases from suppliers to provide a consistent approach Checks are made that our suppliers act in an ethical and responsible way, as part of the supplier selection process and by requiring suppliers to adhere to the Company's Corporate Social Responsibility Protocol, unless it is not relevant to the type of work being undertaken The protocol covers human rights, labour standards, environment and anti-corruption, in line with the principles in the UN Global Compact

Policy and Practice on Payment of Creditors

It is the Company's 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 The Company's practice on payment of creditors has been quantified under the terms of Schedule 7 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 Based on the ratio of the aggregate amounts owed to trade creditors at the end of the year to the aggregate amounts invoiced by suppliers during the year to 31 December 2010, trade creditor days for the Company were 7 days (2009 7 days)

Business Principles

The Company's Statement of Business Principles is the same as that for its parent company, Santander UK plc Santander UK plc is committed to maintaining high ethical standards – adhering to laws and regulations, conducting business in a responsible way and treating all stakeholders with honesty and integrity The Company's practices in this regard are aligned with Banco Santander, S A 's General Code of Conduct

Directors' Report continued

Management's Report on Internal Control over Financial Reporting

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

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

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

Management is responsible for establishing and maintaining adequate internal control over the financial reporting of the Company Management assessed the effectiveness of the Company's internal control over financial reporting as of 31 December 2010 based on the criteria established in the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission Based on this assessment, management believes that, as of 31 December 2010, the Company's internal control over financial reporting is effective

Relevant Audit Information

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

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

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

Auditors

Deloitte LLP have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the Company's forthcoming Annual General Meeting

Statement of Directors' Responsibilities

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

Company law requires the Directors to prepare financial statements for each financial year The Directors are required by the International Accounting Standards ('IAS') Regulation to prepare the financial statements under IFRS, as adopted by the European Union The financial statements are also required by law to be properly prepared in accordance with the UK Companies Act 2006 and Article 4 of the IAS Regulation

The Directors acknowledge their responsibility to ensure the financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss presented and that the management report, which is incorporated into this report, includes a fair review of the development and performance of the business and a description of the principal risks and uncertainties the business faces

Directors' Report continued

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

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

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

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

By Order of the Board

Karen M Fortunato
Company Secretary
17 March 2011
Alliance & Leicester plc, Carlton Park, Narborough, Leicester LE19 0AL

Independent Auditor's Report to the Members of Alliance and Leicester plc

We have audited the financial statements of Alliance & Leicester plc for the year ended 31 December 2010 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related Notes 1 to 14 The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRSs') as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006

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

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

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements

Opinion on financial statements
In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs at 31 December 2010 and of its profit for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Separate opinion in relation to IFRSs as issued by the IASB
As explained in the Accounting Policies section of the financial statements, the Company, in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board ('IASB') In our opinion the financial statements comply with IFRSs as issued by the IASB

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

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

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

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

Matthew Perkins

Matthew Perkins (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK
17 March 2011

Income Statement

For the years ended 31 December 2010 and 2009

Discontinued operations	2010 £m	2009 £m
Interest and similar income	**1,205**	2,362
Interest expense and similar charges	**(917)**	(1,714)
Net interest income	**288**	648
Fee and commission income	**102**	383
Fee and commission expense	**(18)**	(23)
Net fee and commission income	**84**	360
Dividends	**-**	100
Net trading and other expense	**(67)**	(128)
Total operating income	**305**	980
Administration expenses	**(162)**	(551)
Depreciation and amortisation	**(12)**	(45)
Total operating expenses excluding provisions and charges	**(174)**	(596)
Impairment losses on loans and advances	**(41)**	(462)
Provisions for other liabilities and charges	**-**	(11)
Total operating provisions and charges	**(41)**	(473)
Profit/(loss) before tax	**90**	(89)
Taxation (charge)/credit	**(17)**	11
Profit/(loss) for the year	**73**	(78)
Attributable to		
Equity holders of the parent	**56**	(114)
Perpetual Preferred securities holders	**17**	17
Preference shareholders	**-**	19

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

The Notes on pages 14 to 34 are an integral part of these Financial Statements

Statement of Comprehensive Income

For the years ended 31 December 2010 and 2009

	2010 £m	2009 £m
Profit/(loss) for the year	**73**	(78)
Other comprehensive income/(loss)		
Actuarial losses on retirement benefit obligations	-	(192)
Gains on available-for-sale securities	-	180
Losses on cash flow hedges taken directly to equity	**(40)**	(4)
Tax on items taken directly to equity	**8**	-
Net loss recognised directly in equity	**(32)**	(16)
Gains on available-for-sale securities transferred to profit or loss on sale	**46**	-
Tax on items transferred to profit	**(13)**	-
Net transfers to profit	**33**	-
Total other comprehensive income/(loss) for the year before tax	**6**	(16)
Tax relating to components of other comprehensive income	**(5)**	-
Total comprehensive income/(loss) for the year	**74**	(94)
Attributable to		
Equity holders of the parent	**57**	(130)
Perpetual Preferred securities holders	**17**	17
Preference shareholders	**-**	19

The Notes on pages 14 to 34 are an integral part of these Financial Statements

Balance sheet

At 31 December 2010 and 2009

	Notes	2010 £m	2009 £m
Assets held for distribution to owners			
Cash and balances at central banks		-	446
Derivative financial instruments		**7**	582
Financial assets designated at fair value		-	50
Loans and advances to banks		**164**	46,208
Loans and advances to customers		**170**	52,132
Available-for-sale securities		-	8
Loan and receivable securities		-	9,994
Macro hedge of interest rate risk		-	306
Investment in subsidiary undertakings		-	887
Intangible assets		-	38
Property, plant and equipment		-	133
Current tax assets		-	76
Deferred tax assets		-	286
Other assets		-	310
Total assets held for distribution to owners		**341**	111,456
Liabilities held for distribution to owners			
Deposits by banks		**167**	54,085
Deposits by customers		-	47,691
Derivative financial instruments		**7**	318
Financial liabilities designated at fair value		-	83
Debt securities in issue		-	5,879
Subordinated liabilities		-	1,028
Other liabilities		-	540
Provisions		-	11
Current tax liabilities		**1**	-
Retirement benefit obligations		-	150
Total liabilities held for distribution to owners		**175**	109,785
Equity			
Perpetual Preferred securities	4	-	297
Preference shares	5	-	294
		-	591
Share capital	5	**1,228**	928
Share premium	5	**124**	124
Other reserves		**90**	60
Retained earnings		**(1,276)**	(32)
Total ordinary shareholders' equity		**166**	1,671
Total liabilities and equity		**341**	111,456

The Notes on pages 14 to 34 are an integral part of these Financial Statements

The Financial Statements on pages 10 to 34 were approved and authorised for issue by the Board on 17 March 2011 and signed on its behalf by

Ana Botín
Chief Executive Officer

Company Registered Number 3263713

Statement of changes in equity

For the years ended 31 December 2010 and 2009

	Share Capital £m	Share Premium £m	Other equity £m	Other reserves: Capital redemption reserve £m	Other reserves: Available for sale reserve £m	Other reserves: Cash flow hedging reserve £m	Retained earnings £m	Total £m
1 January 2009	328	724	605	90	(293)	141	220	1,815
Profit for the year	-	-	-	-	-	-	(78)	(78)
Other comprehensive income for the year	-	-	-	-	180	(4)	(192)	(16)
Tax on other comprehensive income	-	-	-	-	(55)	1	54	-
Dividends	-	-	-	-	-	-	(36)	(36)
Transfer between reserves	600	(600)	-	-	-	-	-	-
Other movements	-	-	(14)	-	-	-	-	(14)
31 December 2009	928	124	591	90	(168)	138	(32)	1,671
1 January 2010	**928**	**124**	**591**	**90**	**(168)**	**138**	**(32)**	**1,671**
Profit for the year	-	-	-	-	-	-	**73**	**73**
Other comprehensive income for the year	-	-	-	-	**46**	**(40)**	-	**6**
Tax on other comprehensive income	-	-	-	-	**(13)**	**8**	-	**(5)**
Issue of share capital	**300**	-	-	-	-	-	-	**300**
Dividends	-	-	-	-	-	-	**(17)**	**(17)**
Transfer to Santander UK plc	-	-	**(297)**	-	**135**	**(106)**	**(1,300)**	**(1,568)**
Redemption of preference shares	-	-	**(294)**	-	-	-	-	**(294)**
31 December 2010	**1,228**	**124**	-	**90**	-	-	**(1,276)**	**166**

Cash flow statement

For the years ended 31 December 2010 and 2009

Discontinued operations	2010 £m	2009 £m
Net cash flow (used in)/from operating activities	**(14,328)**	12,686
Net cash flow from investing activities	-	1,594
Net cash flow used in financing activities	**(534)**	(1,785)
Net (decrease)/increase in cash and cash equivalents	**(14,862)**	12,495
Cash and cash equivalents at beginning of the year	**14,862**	2,367
Cash and cash equivalents at the end of the year	-	14,862

The Notes on pages 14 to 34 are an integral part of these Financial Statements

Notes to the Financial Statements

1. Accounting Policies

International Financial Reporting Standards

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

Recent accounting developments
In 2010, the Company adopted the following significant new or revised standards or amendments to standards

a) IFRS 3 'Business Combinations' – In January 2008, the IASB issued an amendment to IFRS 3 which clarifies and changes certain elements of accounting for a business combination, including the measurement and accounting for non-controlling interests, contingent consideration, step acquisitions and acquisition-related costs and also widens the scope of the standard There are also associated amendments to IAS 27, IAS 28 and IAS 31

IFRS 3 (2008) has been applied in the current year prospectively to business combinations for which the acquisition date is on or after 1 January 2010 Its adoption has affected the accounting for business combinations in the current year as follows

> IFRS 3 (2008) allows a choice on a transaction-by-transaction basis for the measurement of non-controlling interests at the date of acquisition (previously referred to as 'minority' interests) either at fair value or at the non-controlling interests' share of recognised identifiable net assets of the acquiree

> IFRS 3 (2008) changes the recognition and subsequent accounting requirements for contingent consideration Previously, contingent consideration was recognised at the acquisition date only if payment of the contingent consideration was probable and it could be measured reliably, any subsequent adjustments to the contingent consideration were always made against the cost of the acquisition Under the revised Standard, contingent consideration is measured at fair value at the acquisition date, subsequent adjustments to the consideration are recognised against the cost of the acquisition only to the extent that they arise from new information obtained within the measurement period (a maximum of 12 months from the acquisition date) about the fair value at the date of acquisition All other subsequent adjustments to contingent consideration classified as an asset or a liability are recognised in profit or loss

Any adjustments to contingent considerations for acquisitions made prior to 1 January 2010 which result in an adjustment to goodwill continue to be accounted for under IFRS 3 (2004) and IAS 27 (2005)

> IFRS 3 (2008) requires the application of acquisition accounting only at the point where control is achieved, for a business combination achieved in stages (step acquisition) If an acquirer has a pre-existing equity interest in an acquiree and increases its equity interest sufficiently to achieve control, it must remeasure its previously-held equity interest in the acquiree at acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss Once control is achieved, all other increases and decreases in ownership interests are treated as transactions among equity holders and reported within equity Goodwill does not arise on any increase, and no gain or loss is recognised on any decrease

> IFRS 3 (2008) requires acquisition-related costs to be accounted for separately from the business combination, generally leading to those costs being recognised as an expense in profit or loss as incurred, whereas previously they were accounted for as part of the cost of the acquisition

> IFRS 3 (2008) requires the recognition of a settlement gain or loss when the business combination in effect settles a pre-existing relationship between the Company and the acquiree

The adoption of IFRS 3 (2008) did not affect the Company

b) IAS 27 'Consolidated and Separate Financial Statements' – In January 2008, the IASB issued an amendment to IAS 27, to reflect the amendment in IFRS 3 The changes in the accounting policy have been applied prospectively from 1 January 2010 The application of IAS 27 (2008) has resulted in changes in the Company's accounting policies for changes in ownership interests in subsidiaries

> Specifically, the revised Standard has affected the Company's accounting policies regarding changes in ownership interests in its subsidiaries that do not result in loss of control In prior years, in the absence of specific requirements in IFRSs, increases in interests in existing subsidiaries were treated in the same manner as the acquisition of subsidiaries, with goodwill or a bargain purchase gain being recognised, when appropriate, for decreases in interests in existing subsidiaries that did not involve a loss of control, the difference between the consideration received and the adjustment to the non-controlling interests was recognised in profit or loss Under IAS 27 (2008), all such increases or decreases are dealt with in equity, with no impact on goodwill or profit or loss

> When control of a subsidiary is lost as a result of a transaction, event or other circumstance, the revised Standard requires the Company to derecognise all assets, liabilities and non-controlling interests at their carrying amount and to recognise the fair value of the consideration received Any retained interest in the former subsidiary is recognised at its fair value at the date control is lost The resulting difference is recognised as a gain or loss in profit or loss

The adoption of IAS 27 (2008) did not affect the Company

c) IAS 28 'Investment in Associates' and IAS 31 'Interest in Joint Ventures' – In January 2008, the IASB made consequential amendments to IAS 28 and IAS 31 to extend the changes in IAS 27

The principle adopted in IAS 27 (2008) that a change in accounting basis is recognised as a disposal and re-acquisition of any retained interest at fair value is extended to IAS 28 and IAS 31 as follows

> IAS 28 is amended such that for a change in equity interest in an associate, the investor remeasures at acquisition date fair value any investment retained in the former associate, with any consequential gain or loss compared to its carrying amount under IAS 28 recognised in profit or loss

> IAS 31 is amended such that for a change in joint control interest in an entity, the investor remeasures at fair value any investment retained in the former jointly controlled entity, with any consequential gain or loss compared to its carrying amount under IAS 31 recognised in profit or loss

> Any amount that has previously been recognised in other comprehensive income, and that would be reclassified to profit or loss following a disposal, is similarly reclassified to profit or loss

The adoption of IAS 28 (2008) did not affect the Company

Future accounting developments

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

a) IFRS 9 'Financial Instruments' – In November 2009, the IASB issued IFRS 9 and in October 2010, issued an amendment to IFRS 9 which introduce new requirements for the classification and measurement of financial assets and financial liabilities and for derecognition IFRS 9 is effective for annual periods beginning on or after 1 January 2013, with earlier application permitted

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

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

The Company does not anticipate that the adoption of IFRS 9 in the Company's financial statements for the annual period beginning on or after 1 January 2013 will have a significant impact on amounts reported in respect of the Company's financial assets and financial liabilities

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

The Company does not anticipate that these amendments to IFRS 7 will have a significant effect on the Company's disclosures regarding transfers of financial assets However, if the Company enters into other types of transfers of financial assets in the future, disclosures regarding those transfers may be affected

c) IAS 24 'Related Party Transactions' – In November 2009, the IASB issued amendments to IAS 24, effective for annual periods beginning on or after 1 January 2011, with earlier application permitted The revised standard modifies the definition of a related party and simplifies disclosures for government-related entities

The disclosure exemptions introduced in IAS 24(2009) do not affect the Company because the Company is not a government-related entity However, disclosures regarding related party transactions and balances in these financial statements may be affected when the revised version of the Standard is applied in future accounting periods because some counterparties that did not previously meet the definition of a related party may come within the scope of the Standard

Notes to the Financial Statements continued

Going concern

The Company is part of the Santander UK group The Company is reliant on Santander UK plc and other companies in the Santander UK group for a significant proportion of its funding The Board of Santander UK plc has confirmed that Santander UK plc and the Santander UK group are going concerns, and that it will provide funding to the Company for the foreseeable future In giving this commitment to provide funding to the Company, the Board of Santander UK plc has considered the uncertainties within the Company when preparing the forecasts and budgets of the combined business of the Santander UK group

On 19 March 2009, Santander UK plc gave a full and unconditional guarantee in respect of the unsubordinated liabilities of the Company incurred prior to 31 July 2012 under a deed poll guarantee entered into by Santander UK plc The Company has given a reciprocal guarantee in respect of the unsubordinated liabilities of Santander UK plc incurred prior to 31 July 2012 This reciprocal guarantee has since been transferred to Santander UK plc (and thereby unwound) under power granted by the court order which approved the Company's business transfer scheme under Part VII of the Financial Services and Market Act 2000 in May 2010 (the 'Part VII Scheme')

After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future Following the transfer of the Company's business to Santander UK plc under the Part VII Scheme in May 2010, the only business remaining in the Company is a small portfolio of corporate loans which are in the process of being transferred to Santander UK plc IAS 1 requires that financial statements for any Company that has ceased to trade, or substantially reduced trading, or where there is an intention for the Company to cease to trade, or substantially reduce trading in the next twelve months, are prepared on an "other than going concern" basis Accordingly the financial statements have been prepared on an "other than going concern" basis as there is the intention to cease trading in the next twelve months In accordance with Santander UK's accounting policy of accounting for internal reorganisations, the assets and liabilities of the Company's business were transferred to Santander UK at their book values in the Company Preparation of the financial statements on an "other than going concern" basis has therefore had no impact on the amounts reported

Basis of preparation

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

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

Foreign currency translation

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

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

Notes to the Financial Statements continued

Revenue recognition

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

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

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

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

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

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

Pensions and other post retirement benefits

The Company and its subsidiaries had various pension schemes The schemes were generally funded through payments to trustee-administered funds as determined by periodic actuarial calculations A defined benefit plan is a pension plan that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service or compensation A defined contribution plan is a pension plan under which the Company pays fixed contributions as they fall due into a separate entity (a fund) and will have no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods

The liability recognised in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date, less the fair value of plan assets The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method Full actuarial valuations of the Company's principal defined benefit schemes were carried out every year The Company was responsible for the actuarial valuations and in doing so considered or relied in part on a report of a third party expert The present value of the defined benefit obligation is determined by the estimated future cash outflows using interest rates of high quality corporate bonds, which have terms to maturity closest to the terms of the related liability adjusted where necessary to match those terms The Company's income statement included the current service cost of providing pension benefits, the expected return on schemes' assets net of expected administration costs, and the interest cost on the schemes' liabilities Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions were taken directly to reserves and recognised in the statement of comprehensive income Past-service costs were charged immediately to the income statement, unless the changes were conditional on the employees remaining in service for a specified period of time, known as the vesting period In this case, the past-service costs were amortised on a straight-line basis over the average period until the benefits became vested

Notes to the Financial Statements continued

For defined contribution plans, the Company paid contributions to trustee-administered funds as they fell due Once the contributions had been paid, the Company had no further payment obligations The regular contributions constituted net periodic costs for the year in which they were due and as such were included in staff costs

Post-retirement medical benefit liabilities were determined using the Projected Unit Credit Method, with actuarial valuations updated at each year-end The expected benefit costs were accrued over the period of employment using an accounting methodology similar to that for the defined benefit pension scheme

Financial assets

The Company classifies its financial assets as financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets Management determines the classification of its investments at initial recognition Financial assets that are classified at fair value through profit or loss, which have not been designated as such or are not accounted for as derivatives or assets classified as 'available-for-sale', may subsequently in rare circumstances, be reclassified to the available-for-sale, loans and receivables or held to maturity categories In order to meet the criteria for reclassification, the asset must no longer be held for the purpose of selling or repurchasing in the near term and must also meet the definition of the category into which it is to be reclassified had it not been required to classify it at fair value through profit or loss at initial recognition The reclassified value is the fair value of the asset at the date of reclassification

(a) Financial assets at fair value through profit or loss
Financial assets are classified as fair value through profit or loss if they are either held for trading or otherwise designated at fair value through profit or loss on initial recognition A financial asset is classified as held for trading if it is a derivative or it is acquired principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking

In certain circumstances financial assets other than those that are held for trading are designated as fair value through profit or loss where this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets or recognising the gains or losses on them on a different basis, where the assets are managed and their performance evaluated on a fair value basis, or where a financial asset contains one or more embedded derivatives which are not closely related to the host contract

Trading assets, derivative financial instruments and financial assets designated at fair value are classified at fair value through profit or loss, except where in a hedging relationship They are derecognised when the rights to receive cash flows from the asset have expired or when the Company has transferred substantially all the risks and rewards of ownership

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

Valuation of financial instruments

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

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

Subsequent measurement

Fair value hierarchy

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

Level 1 Unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access at the measurement date Level 1 positions included equity securities and debt securities

Level 2 Quoted prices in markets that are not active, quoted prices for similar assets or liabilities, recent market transactions, inputs other than quoted market prices for the asset or liability that are observable either directly or indirectly for substantially the full term, and inputs to valuation techniques that are derived principally from or corroborated by observable market data through correlation or other statistical means for substantially the full term of the asset or liability Level 2 positions include exchange rate derivatives, interest rate derivatives, equity and credit derivatives, debt securities, deposits by banks, deposits by customers, and debt securities in issue

Level 3 Inputs to the pricing or valuation techniques that are significant to the overall fair value measurement of the asset or liability are unobservable Level 3 positions consisted solely of debt securities containing embedded derivatives

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

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

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

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

Financial instruments valued using observable market prices

If a quoted market price in an active market is available for an instrument, the fair value is calculated based on the market price

Financial instruments valued using a valuation technique

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

Unrecognised gains as a result of the use of valuation models using unobservable inputs ('Day One profits')

The timing of recognition of deferred day one profit and loss is determined individually It is deferred until either the instrument's fair value can be determined using market observable inputs or is realised through settlement The financial instrument is subsequently measured at fair value, adjusted for the deferred day one profit and loss Subsequent changes in fair value are recognised immediately in the Company income statement without immediate reversal of deferred day one profits and losses

Offsetting financial assets and liabilities

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

Notes to the Financial Statements continued

Sale and repurchase agreements

Securities sold subject to a commitment to repurchase them at a predetermined price ('repos') under which substantially all the risks and rewards of ownership are retained by the Company remain on the balance sheet as trading assets and a liability is recorded in trading liabilities in respect of the consideration received Securities purchased under commitments to resell ('reverse repos') are not recognised on the balance sheet and the consideration paid is recorded in trading assets The difference between the sale and repurchase price is treated as trading income in the income statement

Derivative financial instruments

Transactions are undertaken in derivative financial instruments ('derivatives'), which include interest rate, cross currency, other index-related swaps, forwards, caps, floors and swaptions, as well as credit default and total return swaps Derivatives are contracts or agreements whose value is derived from one or more underlying indices or asset values inherent in the contract or agreement, which require no or little initial net investment and are settled at a future date

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and option pricing models as appropriate All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative, except where netting is permitted

Certain derivatives embedded in other financial instruments, such as the conversion option in a convertible bond, are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the hybrid contract is not carried at fair value through profit or loss These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement Contracts containing embedded derivatives are not subsequently reassessed for separation unless there has been a change in the terms of the contract which significantly modifies the cash flows, or where assets have been reclassified where they are reassessed at the time of reclassification

Impairment of financial assets

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

Financial assets carried at amortised cost
Corporate assets

Impairments for these assets are assessed on both an individual and a collective basis For individual assets impairment reviews are conducted monthly for those assets on the Company's 'Watchlist' of new, emerging and serious circumstances relating to the portfolio, with a particular focus on the following scenarios (1) where an asset has a payment default which has been outstanding for 90 days or more, (2) where non-payment defaults have occurred and/or where it has become evident that some sort of workout or rescheduling exercise is to be undertaken, or (3) where, for example with Real Estate Finance, it has become evident that the value of the Company's security is no longer considered adequate

In such situations, the file is transferred to the Workouts team within Credit Risk As part of their assessment, a full review of the expected future cash flows in relation to the relevant asset, appropriately discounted, will be undertaken with the result compared with the current net book value of the asset Any shortfall evidenced as a result of such a review, particularly where the shortfall is likely to be permanent, will lead to a suitable impairment recommendation

Collective impairments are also looked at for portfolios where it is felt that market events, either specific or general, are likely to determine that losses are already inherent in a portfolio notwithstanding that these events may not have manifested themselves in specific defaults or other triggers that would lead to an individual impairment assessment The amount of any such collective impairment will, for each portfolio concerned, represent management's best estimate of likely loss levels and will take into account *inter alia* estimates of future actual default rates and likely recovery levels

Once a financial asset or a group of financial assets has been written down as a result of an impairment loss, the assets are not placed onto a non-accrual status Subsequent interest income continues to be recognised on an effective interest rate basis, though on the asset value after impairment loss allowances have been deducted

For secured loans, a write-off is made when all collection procedures have been exhausted and the security has been sold For unsecured loans, a write-off is made when all avenues for collecting the debt have been exhausted There may be occasions where a write-off occurs for other reasons, for example, following a consensual restructure of the debt or where the debt is sold for strategic reasons into the secondary market at a value lower than the face value of the debt Write-offs are charged against previously established impairment loss allowances

Leases

The Company as lessor – Operating lease assets are recorded at deemed cost and depreciated over the life of the asset after taking into account anticipated residual values Operating lease rental income and depreciation is recognised on a straight-line basis over the life of the asset Amounts due from lessees under finance leases and hire purchase contracts are recorded as receivables at the amount of the Company's net investment in the leases Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Company's net investment outstanding in respect of the leases and hire purchase contracts

The Company as lessee – The Company enters into operating leases for the rental of equipment or real estate Payments made under such leases are charged to the income statement on a straight-line basis over the period of the lease When an operating lease is terminated before the lease period has expired, any payment to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place

If the lease agreement transfers the risk and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and depreciated over the lower of the estimated useful life and the life of the lease The corresponding rental obligations are recorded as borrowings The aggregate benefit of incentives, if any, is recognised as a reduction of rental expense over the lease term on a straight-line basis

Income taxes, including deferred taxes

The tax expense represents the sum of the income tax currently payable and deferred income tax

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

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

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the Company is able to control reversal of the temporary difference and it is probable that it will not reverse in the foreseeable future

The Company reviews the carrying amount of deferred tax assets at each balance sheet date and reduces it to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered

Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks, treasury bills and other eligible bills, loans and advances to banks and short-term investments in securities

Financial liabilities

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

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

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

In certain circumstances financial liabilities other than those that are held for trading are designated at fair value through profit or loss where this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets and liabilities or recognising the gains or losses on them on a different basis, or where a financial liability contains one or more embedded derivatives which are not closely related to the host contract These liabilities are initially recognised at fair value and transaction costs are taken directly to the income statement Gains and losses arising from changes in fair value are included directly in the income statement

Notes to the Financial Statements continued

Derivative financial instruments and Financial liabilities designated at fair value are classified as fair value through profit or loss, unless in a hedge relationship

(b) Other financial liabilities
All other financial liabilities are initially recognised at fair value net of transaction costs incurred They are subsequently stated at amortised cost and the redemption value recognised in the income statement over the period of the liability using the effective interest method

Deposits by banks, Deposits by customers, Debt securities in issue (unless designated at fair value) and Subordinated liabilities are classified as amortised cost

Borrowings

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

Share capital

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

Provisions

Provisions are recognised for present obligations arising as consequences of past events where it is more likely than not that a transfer of economic benefits will be necessary to settle the obligation, and it can be reliably estimated When a leasehold property ceases to be used in the business, provision is made where the unavoidable costs of the future obligations relating to the lease are expected to exceed anticipated rental income The net costs are discounted using market rates of interest to reflect the long-term nature of the cash flows

Provision is made for the anticipated cost of restructuring, including redundancy costs, when an obligation exists An obligation exists when the Company has a detailed formal plan for restructuring a business, and has raised valid expectations in those affected by the restructuring and has started to implement the plan or announce its main features

Contingent liabilities are possible obligations whose existence will be confirmed only by certain future events or present obligations where the transfer of economic benefit is uncertain or cannot be reliably measured Contingent liabilities are not recognised but are disclosed unless they are remote

Financial guarantee contracts

The Company accounts for guarantees that meet the definition of a financial guarantee contract at fair value on initial recognition In subsequent periods, these guarantees are measured at the higher of the initial fair value less cumulative amortisation and the amount that would be recognised as a provision as described in the Accounting Policies above

Dividends

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

Critical accounting policies and areas of significant management judgement

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

The following estimates and judgements are considered important to the portrayal of the Company's financial condition

Impairment loss allowances for loans and advances
The Company estimates impairment loss allowances for loans and advances to banks, loans and advances to customers, and loan and receivables securities with the objective of maintaining balance sheet impairment loss allowances at the level believed by management to be sufficient to absorb actual losses ('observed impairment loss allowances') and inherent losses ('incurred but not yet observed impairment loss allowances') in the Company's loan portfolio from homogeneous portfolios of assets and individually identified loans in connection with loans and advances to banks and loans and advances to customers The calculation of impairment loss allowances on impaired loans and advances is based on the likelihood of the asset being written off (or repossessed in the case of mortgage loans) and the estimated loss on such a write-off These assessments are made using statistical techniques based on historic experience These determinations are supplemented by various formulaic calculations and the application of management judgement

Notes to the Financial Statements continued

The Company considers accounting estimates related to impairment loss allowances for loans and advances 'critical accounting estimates' because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and advances are based on recent performance experience, and (ii) any significant difference between the Company's estimated losses (as reflected in the impairment loss allowances) and actual losses will require the Company to take impairment loss allowances which, if significantly different, could have a material impact on its future income statement and its balance sheet The Company's assumptions about estimated losses are based on past performance, past customer behaviour, the credit quality of recent underwritten business and general economic conditions, which are not necessarily an indication of future losses

Impairment loss allowances for loans and advances, less amounts released and recoveries of amounts written off in previous years are charged to the line item 'Impairment losses on loans and advances' in the income statement The impairment loss allowances are deducted from the 'Loans and advances to banks', 'Loan and receivable securities' and the 'Loans and advances to customers' line items on the balance sheet If the Company believes that additions to the impairment loss allowances are required, then the Company records additional impairment losses, which would be treated as a charge in the line item 'Impairment losses on loans and advances to customers' in the income statement

The Financial Statements for the year ended 31 December 2010 include an impairment loss for loans and advances for an amount equal to £41m In calculating the impairment loss allowances, a range of outcomes was calculated based principally on management's conclusions regarding the current economic outlook relative to historic experience Had management used different assumptions regarding the current economic outlook, a larger or smaller impairment loss allowance for loans and advances would have resulted that could have had a material impact on the Company's reported profit for the year from discontinued operations in 2010

Specifically, if management's conclusions as to the current economic outlook were different, but within the range of what management deemed to be reasonably possible economic outlooks, the impairment losses for loans and advances could have decreased in 2010 from an actual impairment loss of £41m (2009 £462m) by up to £nil (2009 £56m), with a potential corresponding increase (2009 decrease) in the Company's profit (2009 loss) before tax in 2010 of up to nil% (2009 63%), or increased by up to £2m (2009 £9m), with a potential corresponding decrease (2009 increase) in the Company's profit (2009 loss) before tax in 2010 of up to 2% (2009 10%)

The impairment loss of £41m (2009 £462m) in 2010 was based on what management estimated to be the most probable economic outlook within the range of reasonably possible assumptions

2 Audit services

The fees for audit services payable to the Company's auditors, Deloitte LLP, are analysed as follows

	2010 £m	2009 £m
Fees payable to the Company's auditors for the audit of the Company's annual accounts	**0 1**	0 3
Fees payable to the Company's auditors for the audit of the Company's subsidiaries pursuant to legislation [1]	-	0 6
Total audit fees	**0 1**	0 9

[1] The Company had no subsidiaries following their transfer to Santander UK plc as described in Note 9 Fees payable to the Company's auditors for the audit of the Company s subsidiary undertakings were borne by the Company in the year ended 31 December 2009

3. Contingent liabilities and commitments

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

	2010 £m	2009 £m
Guarantees given to parent	-	208,232
Guarantees given to third parties	-	137
Formal standby facilities, credit lines and other commitments with original term to maturity of		
– 1 year or less	-	1,620
– More than 1 year	**27**	137
	27	210,126

Regulatory

The Company engages in discussion, and fully co-operates with the UK Financial Services Authority in their enquiries, including those exercised under statutory powers, regarding its interaction with past and present customers and policyholders both as part of the UK Financial Services Authority's general thematic work and in relation to specific products and services

Other off-balance sheet commitments

The Company has commitments to lend at fixed interest rates which expose it to interest rate risk

Notes to the Financial Statements continued

Operating lease commitments

	2010 £m	2009 £m
Rental commitments under operating leases expiring		
– No later than 1 year	-	13
– Later than 1 year but no later than 5 years	-	38
– Later than 5 years	-	32
	-	83

4. £300m Step-up Callable Perpetual Preferred Securities

On 22 March 2004, the Company issued £300m of Step-up Callable Perpetual Preferred securities The securities were perpetual securities and paid a coupon on 22 March each year, with the first coupon paid on 22 March 2005 At each payment date, the Company could decide whether to declare or defer the coupon indefinitely If a coupon were deferred then the Company would not pay a dividend on any share until it next made a coupon payment The Company could be obliged to make payment in the event of winding up

The coupon was 5 827% per annum until 22 March 2016 Thereafter the coupon stepped up to a rate, reset every five years, of 2 13% per annum above the gross redemption yield on a UK Government Treasury Security The securities are redeemable at the option of the Company on 22 March 2016 or on each payment date thereafter No such redemption is possible without the consent of the UK Financial Services Authority

The securities were transferred to Santander UK plc with effect from 28 May 2010 under a business transfer scheme under Part VII of the Financial Services and Markets Act 2000 as described in Note 9

5. Share capital and preference shares

	Ordinary shares of 50 pence each £m
Share capital	
Issued and fully paid share capital	
At 1 January 2010	**928**
Shares issued	**300**
At 31 December 2010	**1,228**
At 1 January 2009	328
Shares issued	600
At 31 December 2009	928

The Company has one class of ordinary shares which carry no right to fixed income On 10 June 2009 the Company issued 116,583 ordinary shares of £0 50 each to Alliance & Leicester Share Ownership Trust Limited as nominee and on behalf of participants in the Alliance & Leicester Deferred Bonus Scheme These shares were subsequently transferred to Santander UK plc in accordance with the Scheme of Arrangement, in exchange for 38,817 shares in Banco Santander, S A

On 30 June 2009 the Company issued 1,200,000,000 ordinary shares of £0 50 each in capital of the Company to Santander UK plc, utilising £600,000,000 of the Company's share premium account to issue new bonus shares at par

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

	Ordinary shares of 50 pence each £m
Share premium account	
At 1 January 2010	**124**
Shares issued	**-**
At 31 December 2010	**124**
At 1 January 2009	724
Shares issued	(600)
At 31 December 2009	124

Preference shares

On 24 May 2006, the Company issued £300m fixed/floating rate non-cumulative callable preference shares, resulting in net proceeds of £294m The preference shares entitle the holders to a fixed non-cumulative dividend, at the discretion of the Board, of 6 22% per annum payable annually from 24 May 2007 until 24 May 2019 and quarterly thereafter at a rate of 1 13% per annum above three month sterling LIBOR The preference shares are redeemable only at the option of the Company on 24 May 2019 or on each quarterly dividend payment date thereafter No such redemption is possible without the consent of the UK Financial Services Authority

On 28 April 2010, Santander UK plc issued £300m fixed/floating rate non-cumulative callable preference shares on substantially similar terms to, and in exchange for, the £300m fixed/floating rate non-cumulative callable preference shares previously issued by the Company, pursuant to a scheme of arrangement under Part 26 of the UK Companies Act 2006 (the 'Preference Scheme') Consequently, the £300m fixed/floating rate non-cumulative callable preference shares previously issued by the Company were redeemed

6. Dividends

Dividends declared on the £300m Step-up Callable Perpetual Preferred securities and the £300m fixed/floating rate non-cumulative callable preference shares were as follows

	2010 £m	2009 £m
In respect of current year - interim	**17**	36

7. Collateral pledged and received

The Company pledges assets as collateral in the following areas of the business

The Company enters into securitisation transactions whereby portfolios of residential mortgage loans are purchased by or assigned to special purpose securitisation companies, and have been funded through the issue of mortgage-backed securities Holders of the securities are only entitled to obtain payments of principal and interest to the extent that the resources of the securitisation companies are sufficient to support such payments and the holders of the securities have agreed in writing not to seek recourse in any other form At 31 December 2010, £nil (2009 £21,713m) of residential mortgage loans were so assigned

Collateral is also provided in the normal course of derivative business to counterparties At 31 December 2010, £nil (2009 £21m) of such collateral in the form of cash had been pledged

The Company enters into sale and repurchase agreements and similar transactions, which are accounted for as secured borrowings Upon entering into such transactions, the Company provides collateral equal to 100%-131% of the borrowed amount The fair value of assets that were so pledged at 31 December 2010 was £nil (2009 £19,395m)

The Company also enters into purchase and resale agreements and similar transactions whereby the Company receives collateral The Company is permitted to sell or re-pledge the collateral held The carrying amount of assets that were so provided at 31 December 2010 was £nil (2009 £4,643m) of which £nil (2009 £4,643m) was sold or re-pledged

8 Directors' emoluments and interests

The remuneration of the Directors of the Company is set out in the 'Directors' Remuneration' table in the Santander UK plc 2010 Annual Report and Accounts Any loans, quasi loans and credit transactions entered into or agreed by the Company with persons who are or were Directors, Other Key Management Personnel and each of their connected persons during the year are set out in the Santander UK plc Annual Report and Accounts 2010 and 2009

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

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

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

Notes to the Financial Statements continued

A summary of the net assets transferred to Santander UK plc is as follows

Net assets transferred	£m
Assets	
Cash and balances at central banks	474
Derivative financial instruments	639
Financial assets designated at fair value	43
Loans and advances to banks	37,260
Loans and advances to customers	50,301
Available-for-sale securities	8
Loans and receivables securities	7,715
Macro hedge of interest rate risk	204
Investment in subsidiaries	886
Intangible assets	46
Property, plant and equipment	127
Other assets, tax assets and lease assets	1,005
Total assets	98,708
Liabilities	
Deposits by banks	47,640
Deposits by customers	41,796
Derivative financial instruments	440
Trading liabilities	3
Financial liabilities designated at fair value	34
Debt securities in issue	5,351
Other borrowed funds	4
Subordinated liabilities	1,052
Other liabilities	629
Current tax liabilities	2
Deferred tax liabilities	47
Retirement benefit obligations	142
Total liabilities	97,140
Net assets	1,568

The Company's preference shares did not transfer under the Part VII scheme Therefore, holders of those preference shares were given the opportunity to exchange them for new preference shares in Santander UK plc (on substantially the same terms) by way of the Preference Scheme, as described in Note 5

10. Related party disclosures

Transactions with Directors, Other Key Management Personnel and each of their connected persons

Any transactions undertaken by Directors, Other Key Management Personnel and their connected persons with the Company in the course of normal banking for 2010 and 2009 are set out in the Santander UK plc Annual Report and Accounts

Remuneration of Key Management Personnel

The remuneration of the Directors, and Other Key Management Personnel of the Company, in aggregate for each of the categories specified in IAS 24 Related Party Disclosures for 2010 and 2009 is set out in the Santander UK plc Annual Report and Accounts Further information about the aggregate remuneration of the Directors in 2010 and 2009 is provided in the 'Directors' Remuneration' table in the Santander UK plc Annual Report and Accounts

Parent undertaking and controlling party

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

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

Transactions with related parties

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

	Interest, fees and other income received		Interest fees and other expenses paid		Amounts owed by related parties		Amounts owed to related parties	
	2010 £m	2009 £m	**2010 £m**	2009 £m	**2010 £m**	2009 £m	**2010 £m**	2009 £m
Ultimate parent company	**(1)**	–	**4**	10	**-**	–	**-**	(276)
Parent company	-	–	**4**	20	**164**	5	**(172)**	(340)
Subsidiaries	-	(400)	**-**	271	**-**	10,523	**-**	(8,478)
Fellow subsidiaries	**(468)**	(275)	**696**	416	**-**	46,277	**-**	(61,799)
	(469)	(675)	**704**	717	**164**	56,805	**(172)**	(70,893)

Following the transfer of the Company's business into Santander UK plc under the Part VII Scheme in May 2010 as described in Note 9, the only business remaining in the Company is a small portfolio of corporate loans which is in the process of being transferred to Santander UK plc In accordance with Santander UK's accounting policy of accounting for internal reorganisations, the assets and liabilities of the Company were transferred to Santander UK at their book values in the Company

The balances above include debt securities in issue held by related parties Transactions with fellow subsidiaries mainly relate to funding received from Santander UK plc

11. Events after the balance sheet date

None

12. Financial instruments

a) Measurement basis of financial assets and liabilities

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost The Accounting Policies Note describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised The following tables analyse the Company's financial instruments into those measured at fair value and those measured at amortised cost in the balance sheet

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

Notes to the Financial Statements continued

31 December 2009	Held at fair value				Held at amortised cost		Non-financial assets / liabilities	Total
	Trading	Derivatives held for hedging	Designated at fair value through P&L	Available-for-sale	Loans and receivables	Financial liabilities at amortised cost		
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Cash & balances at central banks	-	-	-	-	446	-	-	446
Derivative financial instruments	344	238	-	-	-	-	-	582
Financial assets designated at FV	-	-	50	-	-	-	-	50
Loans and advances to banks	-	-	-	-	46 208	-	-	46,208
Loans and advances to customers	-	-	-	-	52,132	-	-	52,132
Available-for-sale securities	-	-	-	8	-	-	-	8
Loan and receivables securities	-	-	-	-	9,994	-	-	9,994
Marco hedge of interest rate risk	-	-	-	-	306	-	-	306
Investment in sub undertakings	-	-	-	-	-	-	887	887
Intangible assets	-	-	-	-	-	-	38	38
Property, plant and equipment	-	-	-	-	-	-	133	133
Current tax assets	-	-	-	-	-	-	76	76
Deferred tax assets	-	-	-	-	-	-	286	286
Other assets	-	-	-	-	288	-	22	310
	344	238	50	8	109,374	-	1,442	111,456
Liabilities								
Deposits by banks	-	-	-	-	-	54,085	-	54,085
Deposits by customers	-	-	-	-	-	47,691	-	47,691
Derivative financial liabilities	318	-	-	-	-	-	-	318
Financial liabilities at fair value	-	-	83	-	-	-	-	83
Debt securities in issue	-	-	-	-	-	5,879	-	5,879
Subordinated liabilities	-	-	-	-	-	1,028	-	1 028
Other liabilities	-	-	-	-	-	539	1	540
Provisions	-	-	-	-	-	-	11	11
Retirement benefit obligations	-	-	-	-	-	-	150	150
	318	-	83	-	-	109,222	162	109,785

b) Fair values of financial instruments carried at amortised cost

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

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

2009	Carrying Value £m	Fair value £m	Surplus/ (deficit) £m
Assets			
Cash and balances at central banks	446	446	-
Loans and advances to banks	46,208	46,584	376
Loans and advances to customers	52,132	52,718	586
Loans & receivables securities	9,994	9,543	(451)
Liabilities			
Deposits by banks	54,085	54,858	(773)
Deposits by customers	47,691	47,674	17
Subordinated liabilities	1,028	1,226	(198)

The surplus/(deficit) in the table above represents the surplus/(deficit) of fair value compared to the carrying amount of those financial instruments for which fair values have been estimated The carrying value above of any financial assets and liabilities that are designated as hedged items in a portfolio (or macro) fair value hedge relationship excludes gains and losses attributable to the hedged risk, as this is presented as a single separate line item on the balance sheet

Valuation methodology

The fair value of financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale If a quoted market price is available for an instrument, the fair value is calculated based on the market price Where quoted market prices are not available, fair value is determined using pricing models which use a mathematical methodology based on accepted financial theories, depending on the product type and its components Further information on fair value measurement can be found in the Company's Accounting Policies from pages 14 to 23 and the Valuation techniques section below on page 30 to the Financial Statements

Fair value management

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

Assets:

Cash and balances at central banks/Loans and advances to banks

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

Loans and advances to customers

Loans and advances to personal customers are made both at variable and at fixed rates As there is no active secondary market in the UK for such loans and advances, there is no reliable market value available for such a significant portfolio

a) Variable rate

The Directors believe that the carrying value of the variable rate loans may be assumed to be their fair value

b) Fixed rate

Certain of the loans secured on residential properties are at a fixed rate for a limited period, typically two to five years from their commencement At the end of this period these loans revert to the relevant variable rate The excess of fair value over carrying value of each of these loans has been estimated by reference to the market rates available at the balance sheet date for similar loans of maturity equal to the remaining fixed period

Loan and receivable securities

These debt securities are valued with the assistance of valuations prepared by an independent, specialist valuation firm

Liabilities

Deposits by banks

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

Debt securities in issue and subordinated liabilities

Where reliable prices are available, the fair value of debt securities in issue and subordinated liabilities has been calculated using quoted market prices Other market values have been determined using the same valuation technique for financial instruments accounted for at fair value as described in the Valuation techniques section below on page 30 to the Financial Statements

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

The following tables summarise the fair values at 31 December 2010 and 2009 of the financial asset and liability classes accounted for at fair value, by the valuation methodology used by the Company to determine their fair value The tables also disclose the percentages that the recorded fair values of financial assets and liabilities represent of the total assets and liabilities, respectively, that are recorded at fair value in the balance sheet

At 31 December 2010

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

Notes to the Financial Statements continued

At 31 December 2009

Balance sheet category		Quoted prices in active markets £m	%	Internal models based on: Market observable data £m	%	Significant unobservable data £m	%	Total £m	%	Valuation technique
Assets										
Derivative assets	Exchange rate contracts	-	-	179	28	-	-	179	28	A
	Interest rate contracts	-	-	403	63	-	-	403	63	A & C
Financial assets at FVTPL	Debt securities	-	-	-	-	50	8	50	8	A
Available-for-sale financial assets	Equity securities	8	1	-	-	-	-	8	1	B
Total assets at fair value		8	1	582	91	50	8	640	100	
Liabilities										
Derivative liabilities	Exchange rate contracts	-	-	67	17	-	-	67	17	A
	Interest rate contracts	-	-	243	60	-	-	243	60	A & C
	Equity & credit contracts	-	-	8	2	-	-	8	2	B
Financial liabilities at FVTPL	Deposits by banks	-	-	26	7	-	-	26	7	A
	Deposits by customers	-	-	45	11	-	-	45	11	A
	Debt securities in issue	-	-	12	3	-	-	12	3	A
Total liabilities at fair value		-	-	401	100	-	-	401	100	

d) Valuation techniques

The main valuation techniques employed in the Company's internal models to measure the fair value of the financial instruments disclosed above at 31 December 2010 and 2009 are set out below In substantially all cases, the principal inputs into these models are derived from observable market data The Company did not make any material changes to the valuation techniques or internal models it used during the years ended 31 December 2010 and 2009

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

B In the valuation of equity financial instrument requiring dynamic hedging (principally equity securities, options and other structured instruments), proprietary stochastic volatility models are used These types of models are widely accepted in the financial services industry Observable market inputs are used in these models to generate variables such as the bid-offer spread, foreign currency exchange rates, credit risk, volatility, correlation between indices and market liquidity as appropriate

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

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

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

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

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

Broker quotes and external consensus market data are used for validating the fair values of some items in the trading portfolio, or designated at fair value through profit or loss All derivatives pricing models are validated independently by the Quantitative Risk Group ('QRG') A validation report is produced for each model-derived payment that assesses the mathematical assumptions behind the model and the implementation of the model and its integration within the trading system Where there is observable market data the models calibrate to market Where pricing data is unobservable then the input parameters are regularly reviewed by QRG The source of pricing data is considered as part of the process that determines the classification of the level of a financial instrument

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

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

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

e) Internal models based on observable market data

During 2009 and 2010, there were no transfers between Level 1 and Level 2 financial instruments

f) Internal models based on information other than market data

The collateralised synthetic obligations ('CSOs') securities were valued using internal models based on information other than market data These debt securities were initially recognised at transaction price and subsequently measured using valuation prepared by an independent, third party specialist professional valuation firm During 2010, these securities were transferred to Santander UK plc as part of the scheme allowed by Part VII of FSMA 2000

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy
The following table provides a reconciliation of the movement between opening and closing balances of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs

	Fair value through P&L	
	2010	2009
	£m	£m
At 1 January	**50**	-
Transfers in	-	50
Fair value movements	**9**	-
Sales	**(16)**	-
Transferred to Santander UK plc	**(43)**	-
At 31 December	-	50
Total gains or losses recognised in profit/loss relating to those assets and liabilities held at the end of the year	-	-

13. Risk management

The Company's risks are managed at a Santander UK level Risk management is carried out by the central risk management function of the Santander UK plc group Disclosures relating to the Santander UK group's risk management can be found in the Santander UK plc 2010 Annual Report and Accounts, which does not form part of these financial statements

Credit Risk

Credit risk is the risk of financial loss arising from the default of a customer or counterparty to which the Company has directly provided credit, or for which the Company has assumed a financial obligation, after realising collateral held Credit risk includes residual credit risk, which arises when credit risk measurement and mitigation techniques prove less effective than expected

In addition, concentration risk which is part of credit risk, includes large (connected) individual exposures, and significant exposures to groups of counterparts whose likelihood of default is driven by common underlying factors, e g sector, economy, geographical location or instrument type

Notes to the Financial Statements continued

Maximum exposure to credit risk

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

	2010 £m	2009 £m
Derivative financial instruments	7	514
Financial assets designated at fair value	-	50
Available-for-sale securities	-	8
Loan and receivable securities	-	9,641
Loans and advances to customers	170	41,839
Loans and advances to banks	164	297
Total exposure[1]	341	52,349

(1) In addition, the Company is exposed to credit risk in respect of guarantees granted and loan commitments The estimated maximum exposure to credit risk is described in Note 3

Credit risk mitigation
Collateralisation

The corporate portfolio is largely underpinned by a charge over the underlying asset and in some circumstances, bank letter of credit

Analysis of impairment loss allowances on loans and advances to customers

An analysis of the Company's impairment loss allowances on loans and advances to customers is presented below

	2010 £m	2009 £m
Observed impairment loss allowances		
Advances secured on residential properties – UK	-	62
Amounts due from subsidiaries – UK	-	261
Corporate advances – UK	-	92
Unsecured personal advances – UK	-	39
Total observed impairment loss allowances	-	454
Incurred but not yet observed impairment loss allowances		
Advances secured on residential properties - UK	-	55
Corporate advances - UK	-	29
Unsecured personal advances - UK	-	3
Total incurred but not yet observed impairment loss allowances	-	87
Total impairment loss allowances	-	541

Movements in impairment loss allowances on loans and advances

An analysis of movements in the Company's impairment loss allowances on loans and advances is presented below

	2010 £m	2009 £m
Impairment loss allowances at 1 January	541	364
Amounts written off		
Advances secured on residential properties - UK	(3)	(17)
Corporate advances - UK	(17)	(66)
Unsecured personal advances - UK	(1)	(110)
Total amounts written off	(21)	(193)
Observed impairment losses charged/(credited) against/to profit		
Advances secured on residential properties – UK	7	75
Amounts due from subsidiaries – UK	-	222
Corporate advances – UK	5	27
Other secured advances – UK	-	(1)
Unsecured personal advances – UK	5	47
Total observed impairment losses charged against profit	17	370
Incurred but not yet observed impairment losses charged against profit	24	-
Total impairment losses charged against profit	41	370
Transfer to Santander UK plc	(561)	-
Impairment loss allowances at the end of the year	-	541

Notes to the Financial Statements continued

Market risk

Market risk is the risk of a reduction in economic value or reported income resulting from a change in the variables of financial instruments including interest rate, equity, credit spread, property and foreign currency risks

Market risk consists of trading and non-traded market risks Trading market risk includes risks on exposures held with the intention of benefiting from short term price differences in interest rate variations and other market price shifts Non-traded market risk includes, inter alia, interest rate risk in the investment portfolios The Company accepts that market risk arises from its full range of activities

Market risks are transferred from the originating business to Asset and Liability Management ('ALM') within Santander UK Group Infrastructure, where they can be managed in conjunction with exposures arising from the funding, liquidity or capital management activities of ALM Funds received with respect to deposits taken are lent on to Santander UK Group Infrastructure on matching terms as regards interest rate repricing and maturity Similarly, loans are funded though matching borrowings from Santander UK Group Infrastructure

Liquidity risk

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

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

The Company sources its wholesale funding from Santander UK plc

Maturities of financial liabilities

The table below analyses the maturities of the undiscounted cash flows relating to financial liabilities of the Company based on the remaining period to the contractual maturity date at the balance sheet date Deposits by customers are largely made up of Retail Deposits In particular the 'Demand' grouping includes current accounts and other variable rate savings products The 'Up to 3 months' grouping largely constitutes wholesale funding of wholesale assets of a similar maturity There are no significant financial liabilities related to financial guarantees This table is not intended to show the liquidity of the Company

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

						Company
At 31 December 2009	Demand £m	Up to 3 Months £m	3-12 months £m	1-5 Years £m	Over 5 Years £m	Total £m
Deposits by banks	16,163	12,536	4,307	12,736	9,375	55,117
Deposits by customers	28,595	15,926	2,498	699	-	47,718
Financial liabilities designated at fair value	-	16	29	38	-	83
Loan commitments	229	1,070	905	310	267	2,781
Debt securities in issue	-	476	2,178	3,201	156	6,011
Subordinated liabilities	-	29	40	212	1,458	1,739
	44,987	30,053	9,957	17,196	11,256	113,449
Derivative financial instruments	-	-	-	-	-	-
Total financial liabilities	44,987	30,053	9,957	17,196	11,256	113,449

As the above table is based on contractual maturities, no account is taken of call features related to subordinated liabilities The repayment terms of the debt securities may be accelerated in line with the covenants contained within the individual loan agreements The maturity analyses above for derivative financial liabilities include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows

Notes to the Financial Statements continued

14. Capital Management and Resources

Capital management and capital allocation

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

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

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

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

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

Capital adequacy

The Company manages its capital on a Basel II basis Throughout 2010, the Company held capital over and above its regulatory requirements, and managed internal capital allocations and targets in accordance with its capital and risk management policies

Capital

	2010 £m	2009 £m
Core Tier 1 capital	**166**	1,263
Deductions from Core Tier 1 capital	**(3)**	(241)
Total Core Tier 1 capital after deductions	**163**	1,021
Other Tier 1 capital	-	562
Total Tier 1 capital after deductions	**163**	1,583
Tier 2 capital	-	922
Deductions from Tier 2 capital	-	(203)
Total Tier 2 capital after deductions	-	719
Total capital resources	**163**	2,302

The Company's Tier 1 capital consists of shareholders' equity and audited profits for the years ended 31 December 2010 and 2009 after adjustment to comply with UK Financial Services Authority rules Tier 1 deductions related to intangible assets recognised during the year and expected losses in excess of loan loss allowances for portfolios on the IRB approach for measuring credit risk