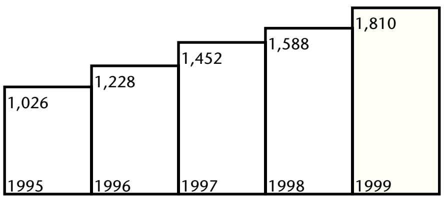
# Directors' Report and Accounts 1999


The Abbey National Group

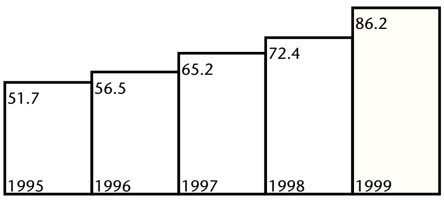
## Results highlights

- Profit before tax increased by 17% to £1,783 million (£1,520 million)
- Profit before tax and exceptional items increased by 14% to £1,810 million (£1,588 million)
- In 1999 diversified business activities accounted for 45% of total Group profit before tax and exceptional items
- Earnings per ordinary share increased by 19% to 86.2 pence
- Proposed final net dividend of 26.85 pence, making the full year net dividend 40.25 pence, an increase of 14%
- Total Group assets up 11% since 31 December 1998 to £180.7 billion

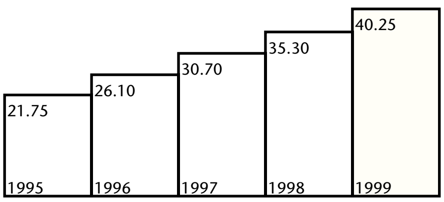
Profit before tax and exceptional items (£m)



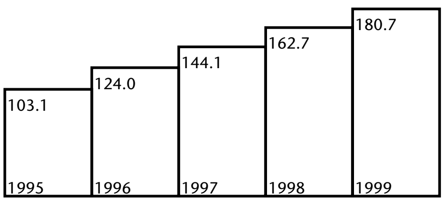

Earnings per ordinary share (pence)




Dividend (pence per ordinary share)




Total assets (£bn)



## Chairman's statement

# Our strategy is focused on delivering shareholder value through carefully managed organic growth.

In 1999, Abbey National demonstrated its continuing ability to develop and evolve its business. We delivered a strong set of results, with a 17% increase in Group profit before tax to £1,783 million. Group assets rose by 11% to a total of £180.7 billion. Our confidence for the future is reflected in a proposed final net dividend payment of 26.85 pence per ordinary share, bringing the total net dividend per share for the year to 40.25 pence, an increase of 14% over 1998.

The year has been marked by speculation about consolidation in the sector. The assumption has been made, in some quarters, that there is an inevitability about this process. Yet it is far from proven that large scale mergers within the financial services sector necessarily deliver positive shareholder value. It is actually a very high risk business for all involved.

Our strategy is focused on delivering shareholder value through carefully managed organic growth. We have also made acquisitions, but only where these enable us to achieve critical mass in important new product and service areas, where they deliver our strategy more quickly, or where they provide skills and capabilities which we believe are important to the future development of the Group. This approach has served our stakeholders well over the last 150 years. Nevertheless, we recognise that the only tradition worth preserving is shifting from what is in the past to what lies ahead.

We are entering a period of rapid and far-reaching change for our industry and indeed for society, however Abbey National has a long track record of managing the radical development of its business. In 2000, we are launching a series of dynamic new initiatives to harness the power of the Internet for the benefit of our customers. We will extend our digital TV banking service, introduced last October, with the aim of reaching into four million UK homes by the end of 2000. Our Retail Bank will give access to a number of its products and services on the web over the next 12 months. In late spring, we will launch a stand-alone, separately-branded, virtual banking proposition targeted at new customers, offering a range of products and facilities extending beyond traditional financial services. We are targeting the registration of more than half a million customers through our e-commerce businesses by the end of 2000. We will keep moving with the times, showing the same dynamism and innovative flair that has enabled us to transform our organisation over the course of the last ten years.

Construction is currently underway on a new purpose-built London head office in Triton Square, due for completion in 2001. This building has been made necessary by the continued expansion of the Group's activities and is designed to provide the most efficient use of space and resources.

Abbey National's operations now extend throughout the length and breadth of the UK. The Group has major offices in London, Bradford, Glasgow, Milton Keynes, Sheffield, Teesside, Liverpool, Bournemouth, Manchester, Fareham, Harrow, Redhill and Enfield – bringing employment opportunities throughout the country. In 1999, we made a further strategic investment in Northern Ireland with the opening by Dr. Mo Mowlam, Secretary of State for Northern Ireland at the time, of a major new office at Mays Meadow in Belfast, which brings new jobs to Northern Ireland. The building is home to a call centre and also a major software development centre focusing on new technologies.

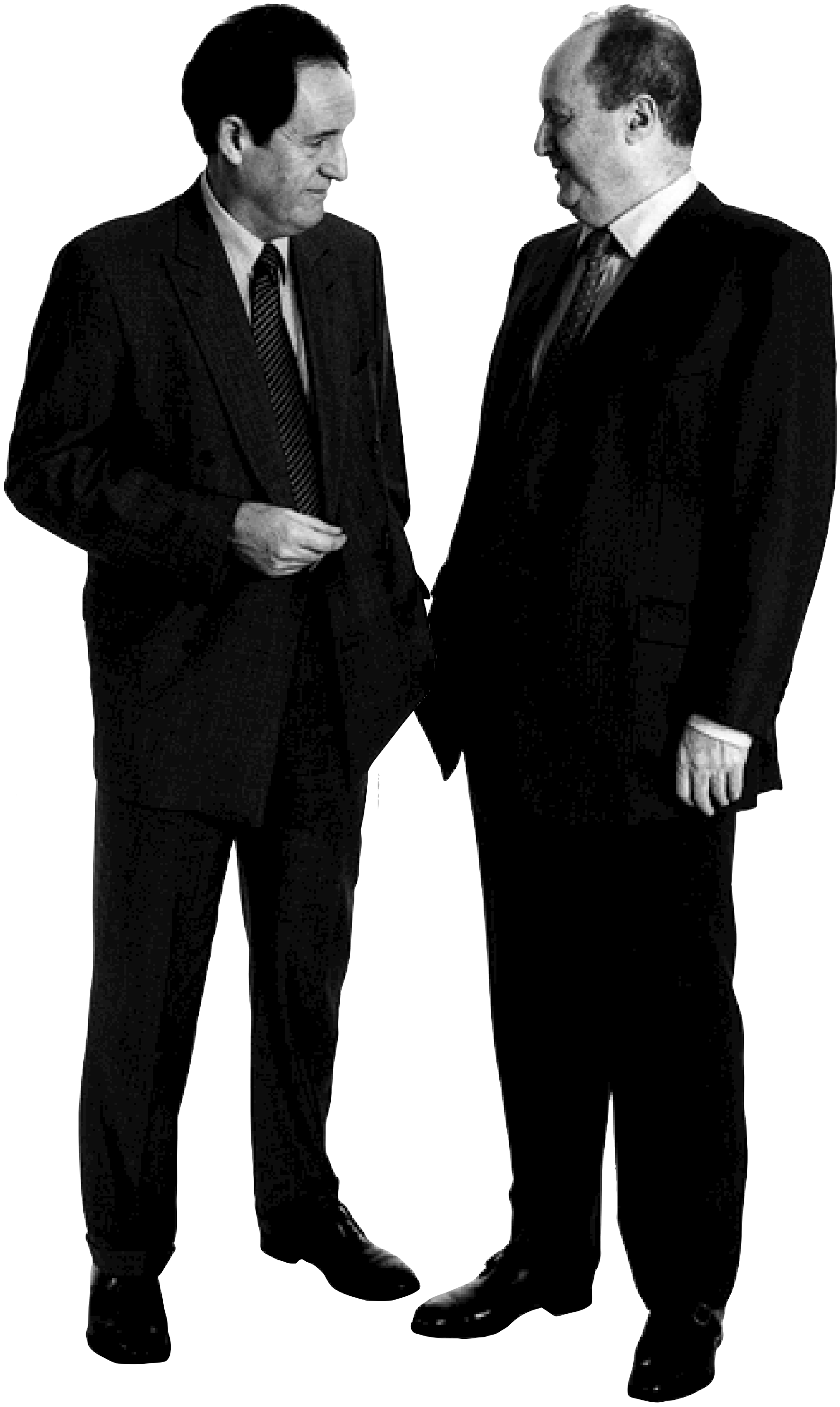
Abbey National also invests in communities at a local level through the Abbey National Charitable Trust's matched donation scheme. This initiative supports the charitable activities of the Group's own staff by matching amounts raised by staff for their own preferred charities. Over 1,000 staff participated in the scheme in 1999 and Abbey National matched an impressive £341,000 – double that of 1998. The Abbey National Charitable Trust as a whole donated a record £1.9 million in 1999, a 75% increase on 1998.

We welcomed John King to the Board as Human Resources Director in May 1999, and in September Richard Hayden joined as a non-executive director. A US citizen, Richard brings to the Board a wealth of international investment banking experience.

Abbey National is nothing without its people and the skills, commitment and dedication they bring to the Company. I would like to conclude by offering my sincere thanks to all who work for Abbey National for their many and valued contributions to these excellent results.

Christopher Tugendhat

**The Lord Tugendhat**
Chairman





**Ian Harley** Chief Executive

**Lord Tugendhat** Chairman

# Chief Executive's review

## In the world of the hybrid organisation – bricks and clicks, high touch and high tech, call it what you will – Abbey National will be a winner.

Seeking opportunities to grow top line revenue has been the major objective of the Group for the last ten years and will continue to be so into the future. We see continuing, significant, growth opportunities for our existing businesses in retail banking, life assurance, wholesale banking, consumer finance, wealth management and long term savings. We will realise opportunities for growth through organic development, acquisitions, joint ventures and partnerships – whatever means are most appropriate to realise our strategy.

We are tuned into a constantly evolving competitive environment and, as our 1999 results show, we are moving ahead with the changing times, aggressively changing how we do business and leveraging our skills into new markets. We are overhauling acquired businesses, and starting new businesses throughout the Group which are capable of generating good risk-adjusted returns, profits and cash flow into the future.

We will continue to improve our operational efficiency across the Group, but we will not hesitate to re-invest cost savings into new propositions, new initiatives and new businesses which enable us to exploit growth opportunities and grow our revenue.

Abbey National has a massive customer base, a powerful brand that people trust, proven products and services, an integrated distribution network with demonstrable fulfilment capabilities and financial strength.

In the world of the hybrid organisation – bricks and clicks, high touch and high tech, call it what you will – Abbey National will be a winner.

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In my statement last year, I set out my three key strategic priorities for the business, which are: to increase revenue, improve cost efficiency and make even more effective use of our capital. During 1999, we made good progress against these objectives: total income grew by 20% to £3,756 million; the Retail Bank achieved its lowest ever cost:income ratio at 41.6%, and our post tax return on equity increased to 22.8%. We have achieved this by continuing to strengthen our retail franchise and through rapid development of businesses operating in complementary and fast growing markets such as life assurance, long term savings, wholesale banking, consumer finance and wealth management.

Over the last ten years, Abbey National has been a market leader in mortgages and savings, where we remain the second biggest provider in the UK. We have also shown our capacity for accelerated investment in new markets identified as having strong long term growth prospects. We have a well diversified multi-brand business, capable of significant growth across the full range of personal retail financial service markets. We have achieved this through a careful balance of organic growth, joint ventures and strategic acquisitions.

- Through First National, Abbey National is now one of the UK's largest finance houses, providing point of sale finance for a full range of consumer goods as well as asset-based finance for businesses.

- In life assurance and long term savings, Abbey National is a top ten UK provider. Scottish Mutual, which markets through independent financial advisers, has been one of the fastest growing life offices in the UK over the last five years. Abbey National Life, which markets its products to Abbey National customers through our retail branch network, is among the UK's most successful bancassurers. These businesses share a single back office systems platform, making them one of the UK life industry's lowest cost providers.

- We have grown our Wealth Management division rapidly during 1999 and we now offer retail products to customers in 190 countries.

- In addition, we are a leading wholesale bank, generating substantial profits from our activities throughout the world in a number of selected fast-growing markets with good risk-adjusted returns.

In 1999, Abbey National laid the foundations for a number of new e-commerce initiatives. Our aim is to register at least one million e-commerce customers over the next 12 months.

We are investing around £200 million in e-commerce propositions scheduled to come on-line during 2000.

– In December 1999, we launched Abbey National on *Open*, the shopping channel available through Sky Digital TV. Within the first month, we had received 15,000 calls for information on personal loans, bank accounts and mortgages, and by the beginning of February we had received more than 25,000 customer contacts. Agreements signed with cable companies NTL and Telewest will extend our digital TV banking service to more channels during 2000, taking Abbey National products and services into 4 million homes by the end of 2000.

– Commencing in late April with our e-banking service, we will be launching a wide range of new on-line products and services to our retail customer base as well as web-enabling many of our current products. These facilities will add new points of contact for our customers.

– We have developed web-enabled systems within our main introducer-based businesses to provide a faster, more efficient and versatile service for introducers selling our products, thereby strengthening these relationships and enabling us to reduce our costs.

– In late spring of 2000, we will launch an entirely new, separately-branded Internet proposition, to be called cahoot, which will further enhance our multi-brand strategy. This new venture makes use of highly efficient straight-through processing and has a variable, out-sourced cost base. Access to the service will be via a range of alternative channels, beginning with the Internet but, over time, introducing new access points such as mobile phones. It will offer products and services to meet a broad range of customers' needs extending beyond traditional banking products. The intention is to form alliances with third parties to enrich the content of the customer offering. This business will develop its own customer base, distinct from that of the Abbey National-branded offering.

## The Retail Bank

Revenue in the Retail Division grew strongly in 1999, increasing by 6%. Net interest income has remained robust, the retail spread has increased, and we have achieved continued growth in commissions, fees and other income.

The underlying strength of the Abbey National brand continues to grow, with increased customer loyalty leading to a rise in product holdings to 1.75 products per customer. Abbey National has been particularly successful at selling life products to the wider customer base with over 1.4 million Retail customers holding at least one Abbey National Life product.

Intrinsic to Abbey National's Retail brand strategy is the development of a truly integrated multi-channel distribution network – our aim is to give customers more opportunities to conduct business with us in ways that suit them. Abbey National's digital TV initiatives, and opening up product and service channels on the Internet, are examples of how we are trying to make our customers' lives easier. By the end of 2000 we expect customers with access to digital TV to be able to meet the vast majority of their banking needs from their sofa – with the exception, of course, of cash and coins!

During 2000, and over the next three years, we will be setting up Costa Coffee cafes in a number of our branches; we will also be introducing interactive access to our services. This is all part of an entirely new concept of the retail branch, providing a new environment in which customers can do business with us. Our network of retail outlets in Safeway stores is another way of making things easier for customers, and we plan to open 20 more of these during the year. We have increased the number of ATMs and now have a total of 2,724 machines, we also have the largest remote ATM network in the UK.

During 1999, Abbey National introduced local market management techniques to the Retail branch network. The programme is driven by a sophisticated market segmentation system using customer database information. This system enables staff in retail branches and call centres to get a clear understanding of the make-up of their local market so that they can anticipate their customers' needs and therefore market products more effectively.

The idea of customer convenience extends beyond the point of contact and through into product design: last year we introduced a range of flexible products such as the Flexible Pension, the Direct Saver account and the Flexible Mortgage. In October 1998, Abbey National was the first company to remove all extended tie-ins from its mortgage products, a move followed in 1999 by other major providers.

We are continuing to focus on transferring simple transactions away from branch counters towards efficient channels such as ATMs, telephones and, very shortly, the Internet. In 1999, only 17.5% of our transactions were completed at branch counters – an industry leading figure. During the year, 9% of our transactions were migrated, freeing up branch staff to advise on new products and help with more complex business. We are also driving down costs by re-engineering business processes for greater efficiency. We expect to see the benefits of this effort during 2000 and 2001.

The combination of strong revenue growth and increased operational efficiency saw the Retail Division's cost: income ratio improve for the second year running to 41.6%.

## Wholesale Banking

Through its activities as a leading wholesale bank, this business delivers sustainable, non-volatile earnings and aims to maximise risk adjusted returns on equity. Wholesale Banking is also the Group's treasury and provides access to wholesale funding as well as excellent capital, liquidity and risk management services.

The Wholesale Bank focuses on five major markets: wholesale lending, asset-backed investments, asset financing, the provision of risk management and financial products, and securities lending.

In 1999, we saw the well-established wholesale lending and asset financing businesses continue to deliver significant and non-volatile income streams as well as seeing a number of new initiatives bear fruit. We also participated in a number of acquisition finance deals in Europe. In asset financing, Wholesale Banking provided project finance to a wide range of sectors including a number of Private Finance Initiative deals, it completed its first full year in the operating lease market, and established a strong record as a discerning investor in private equity funds. The risk management and financial products business, which provides derivative risk management solutions to the Group and third parties, had a very successful year. The securities lending business maintained its position as a market leader in the sterling market and broadened its customer base in Europe.

The Division continued to access high quality funding in 1999 in both the money markets and bond markets. Abbey National raised a total of £13 billion in international capital markets last year and two mortgage securitisations of £1 billion each were launched, which established Abbey National as a leader in the UK securitisation market.

# Chief Executive's review
continued

This business is a premier wholesale bank, capable of using its market presence and scale to focus on markets which offer both high growth potential and attractive risk-adjusted returns. It is well positioned to grow strongly in the new millennium with clear, demonstrable competencies and excellent access to global wholesale markets.

### Life Assurance
In the period between its acquisition by Abbey National in 1992 and in the latest figures available, Scottish Mutual has been one of the fastest growing IFA life offices in the UK. Compound annual sales growth stands at 43% and funds under management have increased to £18.5 billion, up 34% on last year. In 1999, we increased Life Division new business premiums by 41% to £3.55 billion, confirming Abbey National's place as a top ten player in the UK Life Assurance market.

We remain one of the most efficient providers of life assurance and long term savings in the UK through leveraging our shared cost platform in Glasgow and we have an established track record as one of the UK's top investment managers.

During 1999, we introduced a new Flexible Pension product, an important precursor to the Stakeholder Pension. This is a flexible, cost-efficient, affordable product that establishes Abbey National as a leading player in the drive to address the problem of retirement provision in the face of an ageing population.

Scottish Mutual excels at making complex products understandable and tailoring solutions to the needs of individuals and their dependents. It has an instantly recognisable brand and offers customers a broad range of leading-edge products through strong partnership with financial advisers. Scottish Mutual has been swift to seize the opportunity offered by the Internet and has developed a web-based system to improve communications with independent financial advisers (IFAs). During the course of 1999, a range of services for IFAs and customers became available via the Scottish Mutual web site. In addition to information on our products and services, it allows financial advisers to access our marketing library and obtain quotes.

Our Dublin-based Life company, Scottish Mutual International, has increased the range of countries in which it sells to include: Greece, Belgium, Germany, South Africa, Spain, the Netherlands, Switzerland, Luxembourg, Hong Kong and Cyprus.

### Finance House
Good progress was made by Abbey National's Finance House during 1999, with the integration of the three point of sale finance businesses acquired from NatWest at the end of 1998. We now have one of the largest finance houses in the UK which, since 1998, has doubled its balance sheet to £8.7 billion and doubled its revenues to £541 million.

A major change programme is underway, aimed at re-engineering all aspects of the business including corporate structure, organisational design, procedures, systems and locations. Out of over 100 projects, 30 have so far been completed and have contributed significant shareholder value to the division. This process of integration and restructuring will produce major revenue enhancements and cost savings going forward. A concerted drive during 1999 to improve credit quality has already led to significant improvements which should provide benefits in the years ahead. First National has also made a significant investment in a full web-based sales support system to enhance the service offered to introducers, thereby strengthening these relationships while reducing our processing costs.

We believe the investments we have made, and are making, in this business provide a strong base for profitable growth in the future.

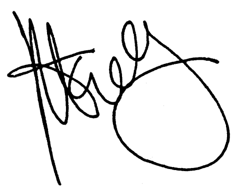
### General Insurance
Sales of buildings and contents policies to both mortgage and non-mortgage customers remained strong in 1999, with new business volumes from our secured creditor product, Paymentcare, increasing by 42%. In addition, Abbey National was one of the UK's fastest growing motor insurers, selling over 59,000 policies. This growth was possible as a result of significantly increasing the processing capacity at our Liverpool direct insurance site, as well as developing the product offering.

We have also reviewed our buildings and contents policies, simplifying the claims process, with most claims now being handled entirely over the phone. A fast-track system which allows customers to deal directly with a network of suppliers of replacement items and repair services has been introduced. In addition, we have enhanced our pricing structure and now offer a multi-product discount which enables customers to benefit from holding both buildings and contents insurances with Abbey National.

### Wealth Management
Wealth Management made significant progress during 1999 and as a new business area offers great potential. The Group's offshore businesses now have over 75,000 customers in 190 countries.

During 2000, our Wealth Management Division will launch a new service for UK customers with more than £50,000 of net assets. The new relationship-based service will offer a combination of advice, discretionary fund management and cash management. As well as face to face advice, customers will be provided with personal information and two way communication through a range of channels including the Internet. This business venture is expected to provide an important new income stream in a market segment which is growing rapidly.

### Summary
We have a fully diversified portfolio of businesses, an integrated, all-encompassing, range of distribution options, an established culture of continuous improvement and a track record of accelerated evolution of the business. With over 15 million customers, strong brand recognition and the financial strength to invest and extract value from new business models, Abbey National is set to be a dominant player in the new millennium.



**Ian Harley**
Chief Executive

**Investment for the future**
The landscape of retail financial services in the UK has evolved rapidly over the 18 months since we stated that we would grow revenue two to three times faster than costs. During that time we have made acquisitions and accelerated our programmes to transform the business. We see tremendous opportunities to create shareholder value by increasing top line revenue growth, however we must continue to invest in order to capture that growth potential. Last year we increased investment by £152 million on e-commerce, new business initiatives, improvements in business infrastructure and process efficiency and we intend to increase the level of investment still further this year. We do not wish to constrain the business to the detriment of rapidly growing our internet capability, diversifying our earnings, acquiring and integrating businesses, all of which are aimed at creating shareholder value. The real drive behind our strategy is to grow revenue while improving our cost efficiency.

The following major steps have been taken to enhance the Group's performance over the next five years:

**1. Growing revenues**
Emphasis continues to be placed on revenue growth across the Group. This includes: increasing the rate of product development through the Abbey National Retail brand; launching a full range of ISAs; launching our flexible pension, flexible mortgage, and Direct Saver account; and investment in a number of customer retention initiatives. In Wholesale Banking, new business streams came on-line, including project finance, acquisition finance and securities lending. Our Finance House, through its recent acquisition, is now the dominant player in the UK. In Scottish Mutual, an international presence is being developed with Scottish Mutual International, based in Dublin, now generating the majority of its business outside the UK.

We have developed a number of new revenue generating businesses for launch in 2000:

A separately-branded, self-contained virtual proposition, known as 'cahoot', will be launched in the first half of 2000 with the following features:

– Targeted at new customers who are ready and eager to embrace e-commerce.

– Multi-channel distribution giving customers access through their PCs, telephones, including WAP enabled mobile phones, and digital televisions.

– High quality, attractively priced services extending beyond financial services through link-ups with innovative providers. Low cost with a focus on customer self-service, using new systems based on straight-through processing technology, leveraging the Group's procurement strength and with much of the cost base outsourced.

A new business (currently known by its codename 'Prosper') will meet the investment and cash management needs of customers with more than £50,000 net assets – a potential market in excess of 4 million people in the UK. The business will offer its clients a combination of face to face advice through a national network and access to information through a range of media, including the Internet. Systems, premises and people are now in place ready for launch later in 2000.

E-banking will become available to Retail banking customers from April 2000 – enabling customers to check and transfer balances, make bill payments, set up standing orders and direct debits and provide access to savings accounts. By the end of the year all other product areas will be online. We will have more than 0.5 million customers online by the year end.

Abbey National intends to become the dominant player in digital TV: in November 1999 the Abbey National brand was launched on Open, the shopping channel available through Sky digital television, and joint ventures with cable operators NTL and Telewest were agreed in December. Abbey National products and services will be on offer in four million homes by the end of 2000.

In addition, a series of e-commerce initiatives across the Group will improve business efficiency. In 2000, full business-to-business web-based systems will be provided to intermediaries by First National and Scottish Mutual, and for Retail mortgage introducers.

**2. Improving operating efficiency**
In total, £106 million was invested in process re-engineering projects across the Group in 1999, improving the business infrastructure and increasing process efficiency. Of this, £34 million was incurred on projects aimed at exploiting Group synergies, and a further £72 million on improving the business infrastructure. These initiatives delivered annualised benefits of £70 million. Within the Retail Bank we have improved process efficiency, reconfigured distribution, integrated debt collections activity, improved call centre forecasting and scheduling, renegotiated contracts with major suppliers, implemented document image processing and workflow techniques, and introduced flexible employment contracts. We also outsourced PC desktop services – the largest deal of its type in the UK.

A series of projects has been initiated to re-engineer other businesses including Finance House: £27 million for integrating the new consumer finance businesses incorporating a branch rationalisation programme; consolidating IT; shared infrastructure and improving service for intermediaries. A further £80 million of expenditure is expected to be incurred up to 2002 to transform the efficiency of this business. £13 million was incurred in Wholesale Banking to bring the derivative systems in-house, revising custody arrangements and introducing new front and back office platforms to support revenue growth.

**3. Improving capital efficiency**
We have focused on improving both funding flexibility and capital efficiency. This included:

– the launch of two £1 billion equivalent mortgage-related floating rate notes in 1999;

– the sale of the 9.9% stake in Irish Permanent;

– the introduction of a US$10 billion asset-backed commercial paper programme;

– in February 2000, the launch of a US$1 billion preferred perpetual security using the Internet – the international capital market's first electronic offering of capital by a bank.

### Overview of results

Profit before tax post exceptionals has increased by 17% to £1,783 million (1998: £1,520 million). These results reflect strong growth in revenue across all of our businesses as well as increased investment in new business propositions which will enhance future earnings, particularly e-commerce.

Total operating income grew 20% to £3,756 million, reflecting 6% revenue growth within UK Retail Banking and 44% in other business segments, with particularly strong performances in Wholesale Banking 20%, Life Division 23%, Finance House 139% and Wealth Management 27%.

Pre-tax profits from activities in newer, faster growing markets outside the UK Retail Bank now contribute 45% of Group profit (1998: 42%), moving further towards our target of 60%.

Significant investment was made in developing new business streams and radically re-engineering the existing business. As a result, the Group cost:income ratio was up slightly to 42.4% (1998: 41.2%). Our strategy remains focused on growing revenue, improving cost efficiency and managing the business' capital in order to respond to the rapidly changing competitive environment.

Earnings per ordinary share increased 19% to 86.2 pence and the post-tax return on average ordinary shareholders' equity increased to 22.8% (1998: 22.0%). A final net dividend of 26.85 pence (full year net dividend 40.25 pence), up 14%, is being proposed, reflecting our confidence in the future.

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

#### Net interest income

| Net interest income | 1999 £m | 1998 £m |
|---|---|---|
| Interest receivable | **9,229** | 9,925 |
| Interest payable | **(6,568)** | (7,684) |
| Net interest income (£m) | **2,661** | 2,241 |
| Group net interest margin (%) | **1.75** | 1.66 |
| UK Retail Banking net interest margin (%) (excluding UPL) | **2.45** | 2.39 |
| Wholesale Banking margin (%) | **0.41** | 0.51 |
| Finance House margin (%) | **7.20** | 6.76 |
| Group average interest earning assets (AIEA) (£bn) | **152.1** | 135.1 |
| UK Retail Banking AIEA (£bn) | **61.8** | 59.5 |
| Wholesale Banking AIEA (£bn) | **94.6** | 80.9 |
| Finance House AIEA (£bn) | **7.8** | 3.6 |
| Group net interest spread (%) | **1.55** | 1.37 |
| UK Retail Banking net interest spread (excluding UPL) (%) | **2.20** | 2.10 |

Net interest income increased by 19% to £2,661 million. Average interest earning assets grew 13% to £152 billion, reflecting the increase in Wholesale Banking's investment asset, Finance House assets, and UK Retail banking and mortgage assets. The Group net interest margin increased by 9 basis points, mainly due to higher margin business in the new consumer finance businesses. Competitive pressures in the residential mortgage market have remained, but despite this the mortgage margin has remained strong due to a reduction in non-performing loans, increased redemption fees from remortgaging and rate changes during the year – contributing to a 10 basis points improvement in the UK Retail Banking net interest spread. Wholesale Banking net interest income was affected by the maturity of certain assets which yielded higher returns than currently available in the market, and an increase in funding costs in the run up to the year end. In addition, funding costs for certain new businesses developed during 1999 are taken against interest earnings while their revenue is reflected predominantly in commissions, fees and other income. In First National, the new consumer finance businesses have increased volumes adding to higher net interest income. Net interest income has also improved due to growth in Wealth Management retail deposits.

The table below shows average balance sheet data.

**Average balance sheet, yields, spreads and margins**

| Group | 1999 Average balance £bn | 1999 Average rate % | 1998 Average balance £bn | 1998 Average rate % |
|---|---|---|---|---|
| Interest earning assets | **151.2** | **6.10** | 135.1 | 7.35 |
| Securitisation gross up | **0.9** | – | | |
| Interest earning assets for margin calculation | **152.1** | | 135.1 | |
| Interest bearing liabilities | **144.4** | **4.55** | 128.5 | 5.98 |
| Securitisation gross up | **0.9** | – | | |
| Interest bearing liabilities for spread calculation | **145.3** | | 128.5 | |
| Shareholders' funds | **5.9** | – | 5.3 | – |
| Other net non-interest bearing liabilities | **25.9** | – | 20.5 | – |

### Definitions

*Net interest margin:* represents net interest income as a percentage of average interest earning assets.

*Net interest spread:* the difference between the average interest rate earned on average interest earning assets and the average interest rate paid on average interest bearing liabilities.

*Securitised assets:* are shown with a deduction for non-recourse finance on the face of the balance sheet. Gross securitised assets before this deduction are used in the calculation of yields, spreads and margins.

#### Commissions, fees and other income

| Commissions, fees and other income | 1999 £m | 1998 £m |
|---|---|---|
| **Total dividend income** | **2** | 4 |
| Insurance income | **210** | 176 |
| Loan & deposit administration, survey & legal fees | **197** | 179 |
| Other Retail Banking income | **182** | 177 |
| Wholesale Banking fees | **55** | 28 |
| Other commissions receivable | **93** | 83 |
| **Fees & commissions receivable** | **737** | 643 |
| Introducer fee charge | **(174)** | (73) |
| Financial markets permanent fees /brokerage fees | **(9)** | (13) |
| Other commissions payable | **(63)** | (50) |
| **Fees & commissions payable** | **(246)** | (136) |
| **Net fees & commissions** | **491** | 507 |
| **Dealing profits** | **98** | 32 |
| Increase in value of long term assurance business | **202** | 162 |
| Deferred income release | **77** | 72 |
| Property & leasing income | **26** | 10 |
| Other financial income | **199** | 90 |
| **Other operating income** | **504** | 334 |
| **Total commissions, fees & other income** | **1,095** | 877 |

In total, commissions, fees and other income increased by 25% to £1,095 million.

Fees and commissions receivable grew by 15% to £737 million, driven by a 19% growth in insurance income to £210 million as a result of increased motor business, and growth in life assurance commissions in Retail and creditor protection sales in First National. Loan and deposit administration, survey and legal fees, increased 10% to £197 million. Increased administration fees in Finance House driven by: new business growth; administration fees from the growth in life business, and in Wealth Management due to the growth in pension schemes under administration. Wholesale Banking fees have been generated through a number of project finance initiatives and provision of acquisition finance, giving a 96% increase to £55 million. Other commissions receivable were up 12% to £93 million, driven by increases in the Finance House and Wealth Management.

Fees and commissions payable grew by 81% to £246 million as a result of a significant increase in the amount of business introduced to the Group for which fees and commissions are paid – most significantly in Finance House.

Dealing profits increased by £66 million to £98 million, largely reflecting the success of the risk management and financial products business.

Other operating income increased by 51% to £504 million, with income from long term assurance business up by 25% to £202 million, which was underpinned by growth from both Scottish Mutual and Abbey National Life. The deferred income release in respect of high loan-to-value ratio loans increased by 7% to £77 million, including £41 million (1998: £39 million) to match provision on such loans (see provisions section) and £36 million (1998: £33 million) in underwriting profit, which represents a return for having borne the additional risk of such loans. Property and leasing income has risen due to the larger number of operating leases that are now undertaken by First National. Other financial income includes: the £60 million of profit relating to the sale of the equity holding in Irish Permanent; increased income in Wholesale Banking's Special Finance business arising from the realisation of gains; as well as increases in Finance House from higher income earned from the joint-venture vehicle, PSA.

## Operating expenses

Total operating expenses increased by 24% from £1,285 million to £1,594 million. This increase included £152 million of additional investment spend on new business initiatives, as well as expenditure on improving business infrastructure and process efficiency. Investment in new businesses comprises Prosper, cahoot and other e-commerce initiatives across the Group. Investment in improving business infrastructure includes mainly integration and re-engineering in Finance House, new IT platforms in Wholesale Banking and Wealth Management and the cost of reconfiguring distribution – such as the opening of new branches in Safeway stores and rolling out local customer marketing systems.

| **Operating expenses (£m)** | Total |
|---|---|
| 1998 total operating expenses | 1,285 |
| Investments in new business initiatives | 46 |
| Investment in improved business infrastructure | 72 |
| Investment in improved processing efficiency | 34 |
| Total additional investment | 152 |
| Acquisition of businesses | 137 |
| Savings generated from processing efficiency | (50) |
| Other (primarily employment cost/marketing) | 70 |
| **Total 1999 operating expenses** | **1,594** |

Investment in improving process efficiency includes the outsourcing of certain IT services, installing teleservice facilities in the Retail Bank and other efficiency projects.

The acquisition of businesses added £137 million to operating expenses, including £10 million of goodwill amortisation. These investments were partly funded by £50 million of process efficiencies which have been realised from this year's and previous years' investment. The remaining increase in underlying costs of £70 million is largely accounted for by increases in salary and pension costs and additional headcount growth, together with marketing spend.

| **Operating expenses by profit and loss line** | 1999 £m | 1998 £m |
|---|---|---|
| **Salaries & other staff costs** | **725** | 599 |
| Bank legal & professional fees | **133** | 82 |
| Advertising & marketing | **65** | 60 |
| **Bank, legal, marketing & professional expenses** | **198** | 142 |
| **Software, computer & other administration expenses** | **401** | 297 |
| Premises & equipment depreciation | **108** | 105 |
| Goodwill and amortisation | **11** | 1 |
| **Depreciation & amortisation** | **119** | 106 |
| Rent payable | **70** | 60 |
| Rates payable | **27** | 25 |
| Other running costs | **54** | 56 |
| **Other property & equipment** | **151** | 141 |
| **Total** | **1,594** | 1,285 |

Salaries and other staff costs increased 21% to £725 million. £110 million or 18% of the increase related to investment in new businesses and acquisitions. Excluding these items, salaries and other staff costs increased by 3%, reflecting net increases in headcount in the Retail Bank, Wholesale Banking and General Insurance, together with annual salary increases and higher pension contributions across the Group, offset by headcount savings due to the process efficiency programme.

Bank, legal, marketing and professional expenses increased by 39% to £198 million. £42 million or 30% of the increase relates to the additional investments and £4 million or 3% to acquisitions. The remaining increase of 6% is accounted for by additional marketing spend, primarily in the Retail Bank.

Software, computer and other administrative expenses increased 35% to £401 million due primarily to the acquisitions and to increased expenditure on telephony, reflecting the migration of transactions away from the counter and software costs relating to e-commerce.

The increases in depreciation and amortisation and in other property and equipment are attributable to the £10 million of goodwill from the acquisition of the three new consumer finance businesses.

### Provisions

The total provisions charge increased 51% to £303 million. Excluding the three new consumer finance businesses, provisions for bad and doubtful debt increased by only £4 million to £205 million.

| Provisions | 1999 £m | 1998 £m |
|---|---|---|
| Secured | **31** | 54 |
| Unsecured (overdrafts and credit card balances) | **73** | 56 |
| Abbey National branded unsecured personal loans | **63** | 57 |
| **UK Retail Banking** | **167** | 167 |
| First National brand | **34** | 26 |
| New consumer finance businesses | **98** | – |
| **Finance House** | **132** | 26 |
| **Continental Europe** | **4** | 4 |
| **Group Central Holdings** | **–** | 4 |
| **Total** | **303** | 201 |
| Contingent liabilities and commitments | **23** | 16 |
| Amount written off fixed asset investments | **26** | 28 |
| Provisions | **303** | 201 |
| Suspended interest (in net interest income) | **27** | 47 |
| Deferred income release against provisions on high LTV loans (in commissions, fees and other income) | **(41)** | (39) |
| **Net cost of bad debt (including £99 million in acquired businesses in 1999)** | **289** | 209 |

Provisions against secured lending have fallen by 43% to £31 million in 1999, reflecting a significant improvement in arrears. The non-performing mortgages (those three months plus in arrears) showed an improving trend from 36,610 cases in December 1998, down 23% to 28,270 cases by the end of the year. The stock of repossessed properties has also seen a 15% reduction in the year to 1,762 cases. Increased house prices contributed to the lower loss per case and ultimately, to the reduced provisions charge.

Provisions against personal banking products (which include overdraft and credit card balances) are similar to the first half of the year and slightly higher than 1998. A slightly more aggressive write-off policy, and improved debt management has resulted in a higher provision charge than in 1998 but has also improved bank account arrears, which fell by 32%. Credit card arrears continue on a downward trend.

Provisions for Abbey National-branded unsecured personal loans have increased to £63 million (1998: £57 million). However, a large element of the increased charge was in the first half of the year, with the second half lower by £11 million against the first half and £7 million lower against the second half of 1998. This improvement resulted from the automation of the debt management process, the benefits of which will continue into the future. Asset growth of 4% has proportionately increased arrears, which as a percentage of loan assets are static.

Provisions in the First National brand have increased with higher bad debts in the motor finance business as a result of a one-off cost in centralising debt collection activity, an 8% increase in asset and a 5% lower residual value of vehicles in First National Motor Finance.

The net cost of bad debt increased by 38% to £289 million. This represents loan provisions plus suspended interest charges, less the deferred income release against provisions. Such income represents fees receivable from customers on high loan-to-value ratio loans (see commissions, fees and other income). Suspended interest fell due to the significant reduction in arrears.

A prudent approach continues to be taken by Wholesale Banking and £26 million has been added to provisions for amounts written off fixed asset investments.

### Taxation

The effective rate of tax was 29.3% (1998: 30.4%). The following table provides a reconciliation of taxes payable at standard UK corporation tax rate and the Group's effective tax rate.

| Taxation | 1999 £m | 1998 £m |
|---|---|---|
| Taxation at UK corporation rate of 30.25% (31%) | **548** | 492 |
| Effect of non-allowable provisions & other non-equalised items | **22** | 9 |
| Effect of non-UK profits & losses | **(9)** | (8) |
| Adjustment to prior year tax provisions | **(12)** | (10) |
| Effect of loss utilisation | **(19)** | – |
| Taxes before the effect of exceptional items | **530** | 483 |
| Effective tax rate before the effect of exceptional items | **29.3%** | 30.4% |

The effective tax rate is obtained by dividing taxes before the effect of exceptional items by income before taxes and exceptional items. The decrease in the effective rate of tax was due mainly to the reduction in the standard rate of UK corporation tax and to the net effects of non-allowable provisions and other non-equalised items, non-UK profits and losses, adjustments to prior year tax provisions and loss utilisation.

### Results of operations of the Group by business segment

#### UK Retail Banking

UK Retail Banking increased its profit before tax by 8% to £996 million, whilst the cost:income ratio improved for the second year running to 41.6%.

Net interest income increased by 7% to £1,621 million. The spread between UK Retail Banking's average lending rates and average funding rates increased from 2.10% to 2.20% at 31 December 1999 (excluding UPLs), due to strong margin management of the mortgage book helped by rate changes throughout the year and to a lesser extent due to mortgage redemption fees and a reduction in secured non-performing loans.

Commissions, fees and other income have increased by 2% to £389 million. This increase includes the release of deferred income (up £5 million on 1998) and increased banking transaction income. However, these increases were offset by reduced income generated from fixed-rate mortgage booking fees this year as the demand for fixed rates reduced, and by additional fees being paid in relation to a higher volume of intermediary business.

Operating expenses rose by 4% to £837 million. This reflects an increase in salary and bonus payments, and an additional 365 FTE headcount in UK Retail Banking recruited mainly into telesales and teleservice as transactions were switched away from the branch network. Business re-engineering projects delivered net cost reductions in areas such as: integrating collections activity, improving call centre scheduling, introducing flexible contracts, reducing the amount of stationery and leaflets in branches, and automating mortgage advances via CHAPS. Software, computer and other administration expenses have risen 16% to £179 million due to increased telephony charges, with a 32% increase in calls handled from customers and increased spend on software costs to create new e-commerce distribution channels through digital television and Internet banking.

The provisions charge has remained flat at £167 million. Arrears levels on secured loans and overdrafts reduced by 23% and 32% respectively and credit cards remain level. However, provisions and arrears on unsecured personal loans have increased slightly due to an increase of 4% in loan assets.

As at 31 December 1999, Abbey National had a UK mortgage asset of £64.7 billion (31 December 1998: £62.3 billion), an estimated 13.1% market share. The £2.4 billion increase during the year represents an estimated 6.3% (1998: 5.9%) market share of the increase in UK mortgages outstanding. This reflects an estimated 10.7% (1998: 12.2%) share of gross mortgage lending amounting to £12.2 billion (£10.9 billion), and an estimated 12.9% (1998: 14.6%) market share of mortgage capital repayments (equating to £9.9 billion). Strong second half performance in net mortgage lending resulted in a market share of 9%, culminating in the last quarter with a market share of 17%.

As at 31 December 1999, Abbey National had retail liabilities of £49.7 billion (31 December 1998: £49.3 billion), an estimated 8.6% share of the total UK personal liquid savings stock. Abbey National had a £1.2 billion net inflow of UK retail liabilities in the second half, giving an annual figure of £0.5 billion (1998: £1.5 billion). This represents an estimated 1.8% (1998: 4.8%) market share of the increase in UK liquid savings. The Direct Saver account has taken £1.8 billion since its launch in September. With the change in the tax rules, TESSAs and PEPs were replaced by ISAs at the start of the tax year with cash ISAs taking a 14% market share up to the year end. The savings market has continued to change this year and the savings flows reflect a change of consumer preferences, with customers searching for better yields from longer term investments rather than short term liquid savings.

The Abbey National-branded unsecured lending business has been reclassified from Finance House to UK Retail Banking in order to better reflect the structure of management responsibility. Prior year comparatives have been restated.

| **UK Retail Banking** | **UK Retail Banking £m** | **Unsecured personal loans £m** | **1999 Total £m** | UK Retail Banking £m | Unsecured personal loans £m | 1998 restated total £m |
|---|---|---|---|---|---|---|
| **Net interest income** | **1,521** | **100** | **1,621** | 1,426 | 96 | 1,522 |
| Fees & commissions receivable | **295** | **–** | **295** | 299 | – | 299 |
| Fees & commissions payable | **(29)** | **–** | **(29)** | (23) | – | (23) |
| Net fees & commissions | **266** | **–** | **266** | 276 | – | 276 |
| Other operating income | **97** | **26** | **123** | 84 | 23 | 107 |
| **Commissions, fees and other income** | **363** | **26** | **389** | 360 | 23 | 383 |
| **Total operating income** | **1,884** | **126** | **2,010** | 1,786 | 119 | 1,905 |
| Salaries & other staff costs | **(386)** | **(17)** | **(403)** | (382) | (16) | (398) |
| Bank, legal, marketing and professional expenses | **(85)** | **(6)** | **(91)** | (77) | (8) | (85) |
| Software, computer & other administration expenses | **(176)** | **(3)** | **(179)** | (145) | (9) | (154) |
| Depreciation & amortisation | **(61)** | **(3)** | **(64)** | (73) | – | (73) |
| Other property & equipment expenses | **(95)** | **(5)** | **(100)** | (91) | (3) | (94) |
| **Operating expenses** | **(803)** | **(34)** | **(837)** | (768) | (36) | (804) |
| **Provisions for bad & doubtful debts** | **(104)** | **(63)** | **(167)** | (110) | (57) | (167) |
| **Provisions for contingent liabilities & commitments** | **(10)** | **–** | **(10)** | (8) | – | (8) |
| **Profit before tax** | **967** | **29** | **996** | 900 | 26 | 926 |
| Cost:income ratio (%) | **42.6** | **27.0** | **41.6** | 43.0 | 30.3 | 42.2 |
| UK Retail Banking spread (%) | **2.20** | **7.10** | **2.30** | 2.10 | 6.70 | 2.20 |
| UK Retail Banking margin (%) | **2.45** | **7.78** | **2.56** | 2.39 | 7.49 | 2.50 |
| Unsecured personal loan assets (£'000s) | | **1,280** | | | 1,225 | |
| Risk weighted assets (RWA)* (£m) | **32,963** | **1,260** | **34,223** | 32,112 | 1,284 | 33,395 |
| Return on equity (RoE)** (%) | **29.3** | **22.9** | **29.1** | 25.9 | 20.3 | 27.2 |

* RWA is an average during the year ** RoE is post-tax return on regulatory equity

## Wholesale Banking

| Wholesale Banking | 1999 £m | 1998 £m |
|---|---|---|
| **Net interest income** | **393** | 411 |
| Dividend income | **–** | 1 |
| Dealing profits | **92** | 27 |
| Fees & commissions receivable | **55** | 32 |
| Fees & commissions payable | **(23)** | (27) |
| Net fees & commissions | **32** | 5 |
| Other operating income | **43** | 22 |
| **Commissions, fees & other income** | **167** | 55 |
| **Total operating income** | **560** | 466 |
| Salaries & other staff costs | **(58)** | (39) |
| Bank, legal, marketing & professional expenses | **(10)** | (9) |
| Software, computer & other administration expenses | **(41)** | (31) |
| Depreciation & amortisation | **(4)** | (3) |
| Other property & equipment expenses | **(2)** | (4) |
| **Operating expenses** | **(115)** | (86) |
| **Amounts written off fixed asset investments** | **(26)** | (19) |
| **Profit before tax** | **419** | 361 |
| **Assets (£bn)** | | |
| Cater Allen International Ltd | **19** | 16 |
| Other Wholesale Banking | **58** | 49 |
| Wholesale Banking | **77** | 65 |
| Treasury | **5** | 5 |
| **Total** | **82** | 70 |
| Cost:income ratio (%) | **20.5** | 18.5 |
| Wholesale Banking Margin (%) | **0.41** | 0.51 |
| Risk weighted assets (RWA) (£m) | **30,036** | 25,345 |
| Return on equity (%) | **14.0** | 13.9 |

Wholesale Banking continued to contribute to the shareholder value of the Group in two ways: firstly, as a Wholesale Bank contributing substantial and steady revenue streams, and secondly as the Group's treasury providing wholesale funding, capital management, liquidity and risk management services to the Group.

In 1999, Wholesale Banking increased its profit by 16% to £419 million and continued to develop the business to ensure the sustainability of this performance.

Total operating income increased by 20% to £560 million. Net interest income, which at £393 million accounted for over two-thirds of total income, was earned by Wholesale Banking's well-established lending activities to predominantly highly rated banks, other financial institutions, corporates and governments, where the balance sheet size increased to £21.1 billion; and investments in asset backed securities (including mortgage backed securities) which remained flat at £18.7 billion. Wholesale Banking performance was impacted by a number of factors during the year which resulted in a 4% decrease in net interest income. These included the maturity of certain assets which yielded higher returns than currently available in the market and an increase in funding costs in the run up to Y2K. In addition, funding costs for certain new businesses developed during 1999 are taken against interest earnings, while their revenue is reflected predominantly in commissions, fees and other income.

Dealing profits increased by £65 million to £92 million. This increase reflects the success of the risk management and financial products business (ANFP) which provides derivative risk management solutions to the Group and third parties. The demand for these products is expected to continue to grow.

Commissions, fees and other income excluding dealing profits increased by 168% from £28 million to £75 million. This reflects the successful diversification of the business into new but related areas where risks and rewards are clearly understood and where Wholesale Banking is capable of exercising its expertise and knowledge. In 1999, Wholesale Banking entered the acquisition finance market, participating in a number of deals acting, for example, as an arranger in the provision of a loan facility to Olivetti SpA in its acquisition of Telecom Italia SpA. Wholesale Banking also increased its participation in a range of asset financing transactions and completed its first year in the operating lease market. Its private equity funds book of £186 million is relatively immature, however, 1999 saw significant uplift in its market value which is not yet reflected in profits. Project finance continued to be a fast growing source of funding in the public sector, and Wholesale Banking financed 35 projects in a range of sectors and countries, of which nine projects were through the UK government's private finance initiative and included the 'Heart of the City' regeneration of Sheffield and new rolling stock for West Coast Mainline Trains. These are all growing markets in which Wholesale Banking will continue to develop its participation.

Wholesale Banking further enhanced the value of the Group through successful management of liquidity throughout 1999, raising funding totalling £13.0 billion in the international capital markets and using its expertise and franchise to further increase the flexibility of the Group's balance sheet through capital issues totalling £1.5 billion. It also managed the launch of two £1 billion equivalent mortgage-backed floating rate notes which gave Abbey National a lead in the UK securitisation market, and managed the launch of preferred perpetual securities in February 2000 – the first bond to be offered by a bank via the Internet.

Wholesale Banking's total assets increased from £70 billion to £82 billion on a restated basis; this followed an accounting presentation change, whereby assets and liabilities under stock borrowing and lending agreements are no longer shown on the balance sheet, with the obligation to return stock borrowed now recorded as a contractual commitment. Risk weighted assets increased from £25.3 billion to £30.0 billion.

Operating expenses increased by £29 million to £115 million. This reflects ongoing investment in systems, investment in new businesses and an associated increase in staff costs with a 19% increase in FTE to 595. Incremental project costs amounted to £13 million, including a major project to re-engineer back-office systems which will be finalised in 2000.

An additional £26 million was added to provisions, reflecting the prudent approach taken in relation to potential credit risks.

## Life Assurance

| Life Assurance | Profit before tax 1999 £m | 1998 £m | New business premiums 1999 £m | 1998 £m | Annualised business premiums[3] 1999 £m | 1998 £m |
|---|---|---|---|---|---|---|
| **Abbey National Life**[1] | **127** | 113 | **1,194** | 851 | **179** | 136 |
| **Scottish Mutual**[2] | **102** | 77 | **2,352** | 1,672 | **283** | 224 |
| **Total** | **229** | 190 | **3,546** | 2,523 | **462** | 360 |

[1] including Abbey National Unit Trust Managers and Abbey National PEP & ISA managers. Included within the new business premiums of ANL are £9 million (£0.9 million annualised) of reassurance premium from related parties.
[2] including Abbey National Financial and Investment services, Pegasus, Scottish Mutual International, Scottish Mutual Portfolio Managers and Aitken Campbell. Included within the new business premiums of SMA are £337 million (£33.7 million annualised) of reassurance premium from related parties.
[3] Annualised business premiums = regular premiums plus 10% of single premium business.

Life Assurance had an excellent year, with profits before tax increasing 21% to £229 million as a result of very strong growth in new business volumes, up 41% to £3,546 million, particularly in the single premium investment markets. Life Assurance has further diversified internationally with Scottish Mutual International entering markets in mainland Europe. Funds under management have increased 34% to £18.5 billion from £13.8 billion as at 31 December 1998.

The new business contribution to embedded value of £98 million is up 51% from 1998 showing that despite increased margin pressures throughout the industry, Life Assurance continues to contribute significant earnings.

Very low total expense ratios in Abbey National Life and Scottish Mutual of 68% and 72% respectively, further demonstrate that the Life Division is well placed to respond to further margin pressure with the advent of Stakeholder Pensions. Recently published statistics demonstrate that Scottish Mutual is the third lowest cost provider in the UK on this basis. The prime enabler of this performance is the Life Division shared cost platform that acts as a service vehicle for all Life Division entities.

Abbey National Life increased pre-tax profit by 12% to £127 million (1998: £113 million) whilst annualised new premium income increased by 32% to £179 million. This trading pattern reflects a complete relaunch of the entire product range with even more customer-focused features and also reflects a change in product mix. New single premium life sales increased 264%, driven by sales of bond products, reflecting customer demand for a predictable investment return which is greater than traditional deposit-based products. A prototype Stakeholder Flexible Pension was launched in August and recent sales performance is very encouraging. This has led to a quarter-on-quarter increase in bancassurance pensions market share from 2.2% to 12.3%. Single PEP and ISA volumes were 78% higher than in 1998, whilst the regular premium version more than doubled with market share of investment ISAs at 8%. The number of Retail customers with a Life product has increased by 4% over the last year and they now represent 10% of the customer base.

| Abbey National Life | 1999 First half (£m) | 1999 Second half (£m) | 1999 Full year (£m) | 1998 First half (£m) | 1998 Second half (£m) | 1998 Full year (£m) |
|---|---|---|---|---|---|---|
| New business premiums | | | | | | |
| Single | | | | | | |
| – Pension | **5** | **13** | **18** | 4 | 7 | 11 |
| – Life | **222** | **251** | **473** | 81 | 49 | 130 |
| – PEPs, Unit Trusts & ISAs | **463** | **173** | **636** | 419 | 234 | 653 |
| Total single premium | **690** | **437** | **1,127** | 504 | 290 | 794 |
| Annual | | | | | | |
| – Pension | **2** | **6** | **8** | 4 | 6 | 10 |
| – Life | **17** | **19** | **36** | 18 | 19 | 37 |
| – PEPs, Unit Trusts & ISAs | **14** | **9** | **23** | 7 | 3 | 10 |
| Total annual premium | **33** | **34** | **67** | 29 | 28 | 57 |
| Total new business premiums | **723** | **471** | **1,194** | 533 | 318 | 851 |
| Annualised equivalent | **102** | **77** | **179** | 79 | 57 | 136 |

| Scottish Mutual new business premiums | 1999 First half (£m) | 1999 Second half (£m) | 1999 Full year (£m) | 1998 First half (£m) | 1998 Second half (£m) | 1998 Full year (£m) |
|---|---|---|---|---|---|---|
| New business premiums | | | | | | |
| Single | | | | | | |
| – Pension | **209** | **194** | **403** | 329 | 353 | 682 |
| – Life | **660** | **1,235** | **1,895** | 393 | 534 | 927 |
| Total single premium | **869** | **1,429** | **2,298** | 722 | 887 | 1,609 |
| Annual | | | | | | |
| – Pension | **23** | **19** | **42** | 28 | 23 | 51 |
| – Life | **4** | **8** | **12** | 5 | 7 | 12 |
| Total annual premium | **27** | **27** | **54** | 33 | 30 | 63 |
| Total new business premiums | **896** | **1,456** | **2,352** | 755 | 917 | 1,672 |
| Annualised equivalent | **114** | **169** | **283** | 105 | 119 | 224 |

Scottish Mutual increased pre-tax profit by 32% to £102 million (1998: £77 million). Annualised new premium income increased by 26% to £283 million. Scottish Mutual new single life business premiums rose 104% to £1,895 million, reflecting strong demand for longer term investments. The With Profits Bond alone took £1.1 billion of new premiums this year, which is understood to make Scottish Mutual the second largest provider of this product in 1999. During the year, Scottish Mutual has revamped and extended its product range with a successful re-entry to the income bond market and a strengthening of its award winning critical illness product range. A detailed strategy has been developed in response to the opportunities presented by the forthcoming Stakeholder Pension market and Scottish Mutual aims to capture significant market share at the high value end of the market. Scottish Mutual has continued to diversify its product range and target markets, with sales through Pegasus and Scottish Mutual International.

## Finance House

| **Finance House** | **FN brand** £m | **New consumer finance business** £m | **Total 1999** £m | Total 1998 restated FN brand only £m |
|---|---|---|---|---|
| **Net interest income** | **256** | **305** | **561** | 241 |
| Fees & commissions receivable | **65** | **42** | **107** | 45 |
| Fees & commissions payable | **(102)** | **(84)** | **(186)** | (81) |
| Net fees & commissions | **(37)** | **(42)** | **(79)** | (36) |
| Other operating income | **32** | **27** | **59** | 21 |
| **Commissions, fees & other income** | **(5)** | **(15)** | **(20)** | (15) |
| **Total operating income** | **251** | **290** | **541** | 226 |
| Salaries & other staff costs | **(49)** | **(66)** | **(115)** | (50) |
| Bank, legal, marketing & professional expenses | **(18)** | **(15)** | **(33)** | (15) |
| Software, computer & other administration expenses | **(31)** | **(60)** | **(91)** | (27) |
| Depreciation & amortisation | **(7)** | **(4)** | **(11)** | (7) |
| Other property & equipment | **(7)** | **(7)** | **(14)** | (7) |
| **Operating expenses** | **(112)** | **(152)** | **(264)** | (106) |
| Provisions for bad & doubtful debts | **(34)** | **(98)** | **(132)** | (26) |
| Provisions for contingent liabilities & commitments | **–** | **(5)** | **(5)** | – |
| Profit before tax | **105** | **35** | **140** | 94 |
| Cost:income ratio (%) | **44.6** | **52.4** | **48.8** | 46.9 |
| Finance House margins (%) | **6.85** | **7.48** | **7.20** | 6.76 |
| RWA (£m) | **3,340** | **5,175** | **8,515** | 2,999 |
| Return on equity (%) | **31.0** | **7.0** | **16.4** | 30.6 |

| **Net loan assets: £m** | **FN brand** | **New consumer finance business** | **Total 1999** | FN brand | New consumer finance business | Total 1998 restated |
|---|---|---|---|---|---|---|
| Consumer Finance: | | | | | | |
| Unsecured | **885** | **–** | **885** | 755 | – | 755 |
| Secured | **1,802** | **–** | **1,802** | 1,728 | – | 1,728 |
| Motor Finance | **575** | **2,663** | **3,238** | 590 | 2,165 | 2,755 |
| Business Finance | **607** | **214** | **821** | 500 | 208 | 708 |
| Retail Finance | **–** | **1,878** | **1,878** | – | 1,741 | 1,741 |
| Total | **3,869** | **4,755** | **8,624** | 3,573 | 4,114 | 7,687 |

The new consumer finance businesses were purchased on the 30 December 1998. The above table includes 50% of the assets of PSA Finance (acquired in May 1999) within Motor Finance which has been accounted for as an associated undertaking in the statutory accounts

Finance House pre-tax profit increased 49% to £140 million.

Total net interest income increased by 133% reflecting asset growth following the acquisition of the three new consumer finance businesses at the end of 1998. Commissions, fees and other income rose by 33% to £(20) million as the benefits of the new consumer finance businesses, increased operating lease income and increased PSA joint-venture income earned were offset by increased introducer fee expense payable to third parties. Operating expenses have increased by 149% due to the new consumer finance business. Provisions for bad and doubtful debts have increased to £132 million, with £98 million of this due to the new consumer finance businesses. The £8 million increase in provisions in the existing First National business is due to a 17% increase in consumer finance unsecured lending balances, higher bad debt costs in the Motor Finance business as a result of the centralisation of debt collection activity, and 5% lower residual value of vehicles.

Finance House is undergoing substantial re-engineering, with the acquisition of the new consumer finance businesses acting as a catalyst for integration and a complete review of all aspects of the enlarged group. This project has cost £27 million in 1999 and includes major systems enhancements as well as rebranding and restructuring the business to create a more efficient divisional structure.

## General Insurance

| General Insurance | 1999 £m | 1998 £m |
|---|---|---|
| **Net interest income** | **(2)** | (5) |
| Fees & commissions receivable | **179** | 178 |
| Fees & commissions payable | **(2)** | (1) |
| Net fees & commissions | **177** | 177 |
| Other operating income | **(32)** | (30) |
| **Commissions, fees & other income** | **145** | 147 |
| **Total operating income** | **143** | 142 |
| Salaries & other staff costs | **(17)** | (15) |
| Bank, legal, marketing & professional expenses | **(6)** | (6) |
| Software, computer & other administration expenses | **(13)** | (20) |
| Depreciation & amortisation | **(2)** | (2) |
| Other property & equipment | **(1)** | (1) |
| **Operating expenses** | **(39)** | (44) |
| **Profit before tax** | **104** | 98 |
| Cost:income ratio (%) | **27.3** | 31.0 |

General insurance profit before tax has increased by 6% to £104 million. Overall, new business volumes have increased by 9%, with Motor new business volumes in particular growing strongly by 141% to 59,000 and creditor volumes increasing 42%. The increase in profit reflects this new business performance, a focus on operating cost containment and an increased retention of the existing customer base. As experienced generally across the insurance market, high claims costs from both subsidence and bad weather events have offset this growth and reduced income to around 1998 levels. Operating expenses have fallen as a result of a £5 million contribution received from a third party for developing a new software system. The 6% increase in headcount in General Insurance reflects growth in the direct business.

## Wealth Management

Wealth Management profit before tax and the costs of project Prosper increased by 38% to £36 million.

Net interest income increased by 32% to £62 million, primarily due to improved performance in the retail deposit business, with a net increase in retail liability of £498 million driven by higher volumes in the offshore banking division.

Commissions, fees and other income increased by 21% to £46 million, mainly due to increased fee income from strategic business growth in pension scheme administration.

Operating expenses increased by £14 million to £72 million, mainly due to initiatives relating to centralisation and system improvements as a result of business restructuring, as well as an increase in staffing to meet increased business volumes. City Deal Services Limited, the Group's execution only stockbroking subsidiary, has largely outsourced its processing activities so that it can be more flexible and able to respond to increased transaction volumes.

The new Wealth Management business (project name Prosper) has been moved into this segment prior to launch later in 2000. At present this business is only represented by £19 million of initial costs.

## Wealth Management

| Wealth Management | Wealth Management existing £m | Prosper £m | 1999 Total £m | 1998 £m |
|---|---|---|---|---|
| **Net interest income** | **62** | – | **62** | 47 |
| Dividend income | **1** | – | **1** | 1 |
| Fees & commissions receivable | **39** | – | **39** | 28 |
| Fees & commissions payable | **(5)** | – | **(5)** | (3) |
| Net fees & commissions | **34** | – | **34** | 25 |
| Other operating income | **11** | – | **11** | 12 |
| **Commissions, fees & other income** | **46** | – | **46** | 38 |
| **Total operating income** | **108** | – | **108** | 85 |
| Salaries & other staff costs | **(41)** | **(4)** | **(45)** | (32) |
| Bank, legal, marketing & professional expenses | **(4)** | **(7)** | **(11)** | (3) |
| Software, computer & other administration expenses | **(20)** | **(8)** | **(28)** | (16) |
| Depreciation & amortisation | **(3)** | – | **(3)** | (3) |
| Other property & equipment | **(4)** | – | **(4)** | (4) |
| **Operating expenses** | **(72)** | **(19)** | **(91)** | (58) |
| **Amounts written off fixed asset investments** | – | – | – | (1) |
| **Profit before tax** | **36** | **(19)** | **17** | 26 |
| Cost:income ratio (%) | **66.7** | | **84.3** | 68.2 |
| RWA (£m) | **1,494** | | **1,494** | 1,203 |
| Return on equity (%) | **23.7** | | **11.0** | 21.6 |

## Continental Europe

| Continental Europe | 1999 £m | 1998 £m |
|---|---|---|
| **Net interest income** | **28** | 17 |
| Fees & commissions receivable | **3** | 3 |
| Fees & commissions payable | **(1)** | (1) |
| Net fees & commissions | **2** | 2 |
| Other operating income | **1** | 16 |
| **Commissions, fees & other income** | **3** | 18 |
| **Total operating income** | **31** | 35 |
| Salaries & other staff costs | **(14)** | (13) |
| Bank, legal, marketing & professional expenses | **(5)** | (6) |
| Software, computing & other administration expenses | **(11)** | (9) |
| Depreciation & amortisation | **(1)** | (1) |
| Other property & equipment expenses | **(3)** | (2) |
| **Operating expenses** | **(34)** | (31) |
| **Provisions for bad & doubtful debts** | **(4)** | (4) |
| **Provisions for contingent liabilities & commitments** | **(1)** | – |
| **Profit before tax** | **(8)** | – |
| Cost:income ratio (%) | **109.7** | 88.6 |
| RWA (£m) | **801** | 713 |
| Return on equity (%) | **-13.1** | -0.7 |
| PBT by country : | | |
| France | **(2)** | (11) |
| Italy | **(6)** | – |
| Spain (only four months in 1998) | **–** | (2) |
| Profit arising from the sale of the Spanish operation | **–** | 13 |

Continental Europe made a loss in 1999, although reduced from 1998 if the profit on the sale of the Spanish business is excluded. In our Italian business, a completely new banking and office computer system has been installed. The French and Italian businesses have been refocused and are concentrating on profitable niche markets.

## cahoot

| cahoot | 1999 £m | 1998 £m |
|---|---|---|
| **Total operating income** | **–** | – |
| Salaries & other staff costs | **(1)** | – |
| Bank, legal, marketing & professional expenses | **(15)** | – |
| **Operating expenses** | **(16)** | – |
| **Provisions for bad & doubtful debts** | **–** | – |
| **Profit before tax** | **(16)** | – |

Cahoot is our separately-branded virtual proposition. A description of the business can be found in the Investment for the Future section.

## Group Central Holdings

| Group Central Holdings | 1999 £m | 1998 £m |
|---|---|---|
| **Net interest income** | **(11)** | 19 |
| Dividend income | **1** | 2 |
| Fees & commissions receivable | **2** | 3 |
| Fees & commissions payable | **–** | – |
| Net fees & commissions | **2** | 3 |
| Other operating income | **126** | 35 |
| **Commissions, fees & other income** | **129** | 40 |
| **Total operating income** | **118** | 59 |
| Salaries & other staff costs | **(65)** | (49) |
| Bank, legal, marketing & professional expenses | **(25)** | (18) |
| Software, computing & other administration expenses | **(35)** | (37) |
| Depreciation & amortisation | **(35)** | (18) |
| Other property & equipment expenses | **(26)** | (28) |
| **Operating expenses** | **(186)** | (150) |
| **Provisions for bad & doubtful debts** | **–** | (4) |
| **Provisions for contingent liabilities & commitments** | **(3)** | (4) |
| **Amounts written off fixed asset investments** | **–** | (8) |
| **Profit before tax** | **(71)** | (107) |
| By business: | | |
| Central Services | **(133)** | (125) |
| Financial Holdings | **62** | 18 |
| **Total** | **(71)** | (107) |

In 1999, interest payable has increased as a result of the issue of new subordinated debt. Commissions, fees and other income is higher as a result of £60 million profit from the sale of the equity holding in Irish Permanent. Operating expenses have increased by £36 million due to a 3% increase in headcount and Group infrastructure costs to support the e-commerce initiatives. In addition, in depreciation and amortisation there is £10 million of goodwill due to the acquisition of the three new consumer finance businesses.

The Financial Holdings segment contains the earnings on the difference between the Group's statutory capital and the target regulatory capital allocated to segments. Financial Holdings also includes the income from the disposal of the equity stake in Irish Permanent as it was used to offset the greater use of regulatory capital in the business following the acquisition from NatWest.

## Return to shareholders

Abbey National's purpose is to continue to achieve above average growth in value for shareholders. Shareholder value is measured by total return to shareholders (TSR), which equates to gross dividends paid plus the movement in the share price over time. Share price for any given year is defined as the average of daily share prices. At 31 December 1999, the Company had a market capitalisation of £14.1 billion and ranked as the 21st largest UK quoted company and 18th largest European bank on this measure.

To ensure that the Company remains focused on shareholder value creation, Abbey National utilises Value Based Management (VBM) as the cornerstone of its planning and budgeting cycle, project evaluation methodology, and monthly management reporting. It also provides a benchmark for incentive schemes in use around the Group. Executive director remuneration via the long term incentive plan is based on the TSR performance of the Company over three years relative both to specified financial institutions and the constituents of the FTSE 100.

VBM is underpinned by a number of measures. Monthly and annual monitoring utilises PAREC (the Profit After Regulatory Equity Charge), profit after tax and after a notional charge for equity. In 1999, PAREC increased from £568 million to £712 million, demonstrating that Abbey National is investing in value creating activities. The evaluation of strategic projects over a timeframe of more than one year uses a measure known as value based cash flow. This is cash available for ordinary shareholders after taking into account capital required to support the business. Value based cash flow in 1999 was £702 million, an increase of 70%, reflecting a combination of increased profits, the £60 million from the disposal of the equity stake in Irish Permanent and a lower growth in risk weighted assets largely within Wholesale Banking.

Since January 1997, the period for the current incentive plan, Abbey National has achieved a 30.2% per annum TSR, placing it 18th in the FTSE 100 and 8th relative to the 10 specified financial institutions listed below.

**Total shareholder returns of Abbey National against its peer group of companies and the FTSE** January 1997 – December 1999

| Rank in peer group | Rank in FTSE | Company | TSR % |
|---|---|---|---|
| 1 | 4 | Bank of Scotland | 47.3 |
| 2 | 8 | Lloyds TSB Group | 38.7 |
| 3 | 9 | Royal Bank of Scotland | 37.6 |
| 4 | 10 | Legal & General | 37.6 |
| 5 | 14 | Barclays | 32.6 |
| 6 | 15 | NatWest Group | 31.7 |
| 7 | 16 | Prudential Corporation | 31.3 |
| **8** | **18** | **Abbey National** | **30.2** |
| 9 | 36 | CGU | 19.8 |
| 10 | 48 | Royal & Sun Alliance | 13.0 |
| | | FTSE – 100 Average | 16.6 |

Over the 5-year period to 31 December 1999, Abbey National was ranked 15th in the FTSE and over the last 10 years the Company was ranked third in terms of delivery of total shareholder value.

The next incentive plan will look at the following financial institutions: Bank of Scotland, Lloyds TSB Group, Royal Bank of Scotland, Legal and General, Barclays, NatWest Group, Prudential Corporation, Alliance & Leicester, Woolwich, Halifax and Northern Rock.

In 1999, earnings per share increased by 19% to 86.2 pence per share. Ordinary dividends of 40.25 pence (a final dividend of 26.85 pence) are payable to shareholders and are covered 2.1 times by earnings (1998: 2.0).

## Strategic decision-making process

Strategic decisions in Abbey National plc are made by the Board through a structured process, supplemented by a continuous evaluation and analysis of strategic opportunities and threats. There are two main strands to the structured process: the Group's formal planning process and a series of strategy conferences held throughout the year.

The Group's formal planning process is an annual event, co-ordinated centrally, in which all business areas write plans covering three calendar years. The plans are written in the context of a strategic framework, agreed by the Board, which sets out the main internal and external factors likely to shape the Group over that three-year period. The plans set out each value centre's long term vision, strategy and implementation plan, together with alternative strategies that have been considered and specific initiatives to grow new income streams for the future. The plans from each of the business areas are challenged by the Chief Executive and executive directors, and then amalgamated into the Group's plan. They drive the deliverables in the performance management process.

There are four strategy conferences held for executive directors during the course of the year and one for the full Board. They set the strategic framework and explore the strategic issues facing the Group, identifying areas for revenue growth, the impact of competitors and market changes.

## Performance management

Performance objectives, measures and targets are identified across the Group at the beginning of the year, using the three-year plan as a framework. They flow from Group level, through each business and central area and into individual performance objectives for each employee. The objectives and performance measures used are the key drivers in achieving above average returns to shareholders. On a monthly basis, performance against the key objectives are discussed by the Executive Committee. Performance measurement encompasses: financial measures such as income growth, return on equity, cost efficiency and margins. The financial measures are themselves driven by the key drivers of value within each business, for example, within Retail Banking, market share in mortgages and savings is measured alongside the retail margin and customer satisfaction measures such as retention and advocacy as well as staff satisfaction.

## Capital management and resources

Abbey National continues to increase shareholder value by active management of its capital resources and will continue to explore capital and balance sheet management opportunities.

The capital resources of the Group are as follows:

| | 1999 £m | 1998 £m |
|---|---|---|
| Tier 1 | **5,871** | 5,205 |
| Tier 2 & Tier 3 | **4,532** | 3,146 |
| Less supervisory deductions | **(1,606)** | (1,107) |
| Total regulatory capital | **8,797** | 7,244 |
| Total risk weighted assets: | | |
| banking book | **71,706** | 67,489 |
| trading book | **4,170** | 3,787 |
| | **75,876** | 71,276 |
| Capital ratios: | | |
| risk asset ratio | **11.6%** | 10.2% |
| tier 1 ratio | **7.7%** | 7.3% |
| equity tier 1 ratio | **7.1%** | 6.7% |

The basic instruments of capital monitoring are the tier 1 capital ratio and risk asset ratio, which compares total regulatory capital to total risk weighted assets. As at 31 December 1999, the tier 1 ratio was 7.7% and the Group's risk asset ratio was 11.6%, both are comfortably above the minimum standards for the Group set by the Financial Services Authority. The increase in the ratios over the last year resulted primarily from retained earnings and, in the case of the risk asset ratio, from the issue of new subordinated capital securities, partly offset by a 6% growth in risk weighted assets.

Abbey National's tier 1 capital (ordinary and preference shareholders' funds after deducting goodwill) increased by £666 million to £5,871 million (31 December 1998: £5,205 million), mainly as a result of £651 million of retained earnings. There was an increase in tier 2 capital (subordinated liabilities and general provisions) of £1,386 million, principally due to the issue of subordinated capital securities during the year. Supervisory deductions mainly represent investments in life assurance and insurance companies within the Group. At the start of 2000 the Group raised US$1billion of perpetual preferred securities, adding to tier 1 capital. This capital has been raised to finance growth in our new business streams, Life Assurance, Finance House and Wholesale Banking.

Significant securitisations of mortgage assets were undertaken in 1999, with £1.9 billion of mortgage assets securitised as at 31 December 1999. A US$10 billion asset-backed commercial paper programme has also been introduced (current outstanding US$8.3 billion as at 31 December 1999).

The Board has assessed the existing dividend policy in the light of the Group's capital requirements for the current planning cycle and, based on current plans, believes that greater returns can continue to be achieved by retaining capital in the business, rather than returning it to shareholders. This is underlined by the fact that post-tax return on average ordinary shareholders' equity increased to 22.8% (1998:22.0%). If future plans do not envisage value-creating organic growth or acquisition opportunities, the Board would then consider returning surplus capital to shareholders, but only if at least £500 million could be returned over a 12 to 18 month period. Confidence in the business is reflected in the 14% increase in the dividend.

## Balance sheet

Total assets increased by 11% to £181 billion in 1999. This growth of £18.0 billion was funded mainly through the wholesale debt markets. As at 31 December 1999, wholesale liabilities represented 53% of total liabilities. The percentage of UK mortgage assets funded from retail savings was 78% (31 December 1998: 80%).

Capital expenditure to 31 December 1999 amounted to £138 million, with UK Retail Banking, spending £112 million of this on the installation of the Safeway in-store branches and other branch refurbishments, new computer software for local marketing capability at the customer interface, remote ATM installations, and expenditure upgrading the telecommunications system. In Finance House, Wholesale Banking and Wealth Management, £11 million, £6 million and £4 million respectively were spent on IT to support business to business e-commerce and building the infrastructure for the new business streams.

## Year 2000 and EMU

### Year 2000

Abbey National's plans to address the Year 2000 issue (the risk of date-related electronic processing errors) were fully implemented by September 1999. The fully co-ordinated Group approach ensured that all the Group's business critical systems were unaffected by the Year 2000 issue, and continue to operate effectively. As a result, the Group's operations were not disrupted over the period and Abbey National was able to provide a full service to its customers. Nevertheless Directors continue to monitor the Year 2000 issue and will do so for the remainder of 2000.

### Economic and Monetary Union (EMU)

The Group's preparations for the introduction of the euro were completed in time for the opening of the financial markets on 4 January 1999. Abbey National was quick to recognise the funding opportunities EMU represented, and raised over 5 billion euro during the year, 3 billion euro of which was raised by 31 March. Other divisions of the Group have introduced new product offerings as a result of EMU, including euro mortgages and savings accounts. The Group continues to prepare for the possibility of the UK entering EMU.

### Analysis of Year 2000 and EMU Spend

The total cost of achieving Year 2000 compliance was £134 million over the period 1997 to 1999. Actual expenditure on Year 2000 of £136 million was slightly higher than estimated as a result of additional work undertaken to review and update business continuity plans to enhance the Group's resilience against future operational risks.

The total cost of achieving EMU compliance in respect of the introduction of the euro, incurred from 1997 to 1999, was £9 million.

An analysis of total spend by expense category and business segment is shown below. These figures include the direct costs of internal resources such as salaries and premises.

**Total project spend**

| | Capital | | Revenue | | Internal | | Total | |
|---|---|---|---|---|---|---|---|---|
| **(£ million)** | Actual | Projected | Actual | Projected | Actual | Projected | Actual | Projected |
| Year 2000 | 21 | 20 | 98 | 96 | 17 | 18 | 136 | 134 |
| EMU | – | 2 | 9 | 7 | – | 1 | 9 | 10 |
| **Total** | 21 | 22 | 107 | 103 | 17 | 19 | 145 | 144 |

**Analysis of Year 2000/EMU spend**

| | Other income | | Operating expense | | Total expenditure revenue | | Capital expenditure | | Total expenditure | |
|---|---|---|---|---|---|---|---|---|---|---|
| **(£ million)** | **1999** | 1998 | **1999** | 1998 | **1999** | 1998 | **1999** | 1998 | **1999** | 1998 |
| UK Retail Banking | **–** | – | **13** | 41 | **13** | 41 | **1** | 2 | **14** | 43 |
| Wholesale Banking | **–** | – | **2** | 2 | **2** | 2 | **1** | 2 | **3** | 4 |
| Life Assurance | **6** | 7 | **–** | – | **6** | 7 | **–** | 1 | **6** | 8 |
| Finance House | **–** | – | **1** | 1 | **1** | 1 | **–** | 1 | **1** | 2 |
| General Insurance | **–** | – | **–** | 4 | **–** | 4 | **–** | – | **–** | 4 |
| Wealth Management | **–** | – | **1** | 1 | **1** | 1 | **–** | – | **1** | 1 |
| Continental Europe | **–** | – | **3** | 4 | **3** | 4 | **–** | – | **3** | 4 |
| Group Central Holdings | **–** | – | **1** | 8 | **1** | 8 | **–** | – | **1** | 8 |
| **Total** | **6** | 7 | **21** | 61 | **27** | 68 | **2** | 6 | **29** | 74 |

Note: All spend in 1999 relates to Year 2000 as EMU preparations were completed in 1998.

Financial instruments are fundamental to the businesses of the Group, and are either held on a continuing basis for the purpose of collection in the form of cash flows over time (non-trading business), or held in order to benefit from short term market price movements or in order to facilitate customers' transactions (trading business). The management of the risks of financial instruments is fundamental to the conduct of banking and financial services business. The Group's financial risk management framework and processes, and the principal financial risks faced by the Group, are described in 'Financial risk management' below.

Abbey National holds or issues financial instruments in the following main categories:

**Customer loans and deposits** are held on a continuing basis in order to earn cash flows from net interest margin and fee income over the life of the instruments or customer relationships. Loans and deposits are held relating to retail and institutional customers, the majority being retail.

**Investments** in portfolios of debt securities and equity shares, excluding strategic investments, are held in order to generate sustainable income streams on a continuing basis, and are classified as non-trading assets. Assets in investment portfolios are predominantly fixed income securities, floating rate notes, asset-backed securities and mortgage-backed securities, and are managed on a floating rate basis using derivative and non-derivative hedging instruments. Income is primarily net interest margin.

**Funding** of the Group balance sheet is provided by customer deposits, money market loans and deposits, debt securities in issue, loan capital and preference shares. Funds are raised from a wide diversity of market sources in a range of maturities.
An additional objective in issuing loan capital and preference shares is to ensure that a prudent level of capital is available to support growth in the Group's businesses (see 'Capital management and resources' above).

**Trading financial instruments** are held in order to benefit from short term market price movements or in order to facilitate customers' transactions. Trading portfolios are held by Wholesale Banking, and mainly comprise highly rated bonds, asset-backed securities and traded asset swaps. Abbey National Financial Products ('ANFP'), a part of Wholesale Banking, provides the Group and external counterparties with products to facilitate their financial business requirements, and also uses derivatives to take advantage of short-term price movements in relative market prices. During 1999, ANFP added an equity derivatives portfolio, which is held for trading purposes and the provision of hedging transactions for both internal and external counterparties.

**Hedging instruments** are used in order to match or eliminate the risk of volatility in earnings from the Group's non-trading and trading assets, liabilities or positions which arises from potential movements in market rates. Such risks may be managed by derivative or non-derivative financial instruments as part of the integrated approach to risk management described below.

For a more detailed description of the Group's use of derivatives, see pages 56 and 57 of the accounts. The accounting policy and financial disclosures for derivatives are given on pages 42 and pages 58 to 59 of the accounts, respectively.

In addition, the Life Assurance division enters into insurance and investment contracts with customers, managing investment funds on their behalf. Such contracts are not classified as financial instruments, but exposures to shareholders resulting from such contracts are included within the market risk measures on non-trading instruments below.

## Financial risk management

Abbey National's financial risk management focuses on the major areas of credit risk, market risk, liquidity risk and residual value risk.

Abbey National has a well developed structure for managing financial risk, which consists of a comprehensive set of committees. Of these, the principal committees are the Asset and Liability Committee (ALCO), which is charged with the responsibility of monitoring and controlling the level of Group balance sheet risk, and the Group Credit Committee (GCC) which monitors and reviews credit risk exposures and approves Group credit policies. There are further risk and credit committees in each major business area which report into the Group committees. Specialist risk managers within each business area have responsibility for the management and control of the financial risks generated within that business. An independent Group Risk function ensures that policies and mandates are established for the Group as a whole, monitors and reports exposures to the Board, and sets standards for financial risk management.

## Credit risk

Credit risk is the risk that counterparties will not meet their financial obligations, which may result in Abbey National losing the principal amount lent, the interest accrued, and any unrealised gains (less any security held). Credit risk occurs mainly in the Group's loan and investment assets, and in derivative contracts.

In UK Retail Banking, a national mortgage lending policy is applied for residential lending, supported by a number of processes (including credit scoring) which enhance the ability to manage and monitor the credit quality of mortgage assets, to manage arrears and collections and to optimise the values raised from properties in possession. For unsecured personal loan, bank account and credit card products credit scoring and behavioural scoring are used to assist in the granting of credit facilities. Behavioural scoring is also being used to focus collections activity.

Finance House activities are generally more risky than those of a residential mortgage lender and involve a diversity of businesses including motor finance, point of sale finance and business finance. As a result credit risk policies pertinent to each business activity and delivery channel are in place with systems to monitor the practices of intermediaries. Credit scoring is widely used and all balances in default are subject to arrears management to manage the account of debt, or collections activity to minimise the level of write off.

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

### Market risk

Market risk is the risk of financial loss arising from adverse price movements associated with the interest rate, foreign exchange and equity markets. The most significant sources of market risk arise in Wholesale Banking as a result of investment, trading, funding and derivatives activities, and in UK Retail Banking, primarily from the provision of fixed rate and structured mortgage and savings products. Within the Life Assurance division, market risk arises on funds managed for the benefit of the customer as well as on specific shareholder funds, with all exposures borne by the shareholder consolidated with other Group market risk exposures. The Group hedges substantially all its foreign exchange risk.

Abbey National recognises that market risk is an inevitable result of being an active participant in financial markets. The Group manages its exposure by limiting the adverse impact of market movements on profitability while seeking to enhance earnings within clearly defined parameters. Abbey National ensures that business areas have sufficient expertise to manage the risks associated with their operations, and to devolve the responsibility for risk taking and risk control within the framework prescribed by the Abbey National Group Market Risk Policy. Business area policies, limits and mandates are established within the context of the Group policy and monitored by business area market risk committees with Group Risk monitoring the consolidated risks daily and ALCO and the Board reviewing the consolidated position at least monthly.

Senior management have recognised the different characteristics of market risk exposures across the Group, and that different risk measures are required to best reflect the risks faced in different types of business activities. In measuring exposure to market risk, business areas use a sensitivity analysis approach, covering both value and earnings as appropriate, as a central tool within their risk management process. The market risk disclosures shown below are calculated using sensitivity analysis. Other approaches such as Value At Risk and stress testing are used as additional risk management tools as appropriate to individual business areas. In order that consistency in measurement is achieved across business areas, ALCO have approved a series of Market Risk Measurement Standards, at the request of the Board, which business areas are required to adhere to.

Senior management receive regular consolidated market risk reports covering the range of risks generated by the Group, which are considered to fall into two broad categories:

**Short term market risk** covers activities where exposed positions are subject to frequent change and where positions could be closed out over a short time horizon. Much of the exposure is generated by the Wholesale Banking activities, and includes both trading and non-trading portfolios. The risk sensitivity is calculated by applying the statistically determined potential adverse movements in market rates that can be expected within a 95% level of confidence as a result of overnight market movements.

**Structural market risk** includes exposures which arise as a result of the structure of portfolios of assets and liabilities. The risk exposure is generated by features inherent in either a product or portfolio structure which are normally present over the life of the portfolio or product. Such exposures can take a number of different forms. Included in structural market risk are the exposures arising on the uncertainty of business volumes from the launch of fixed rate and structured retail products. Such exposures are a requirement of the decision to undertake specific business activities, and where it is possible to manage such exposures this can only be achieved over a longer time horizon. Although long term balance sheet positions are maintained at a minimum level, the Group remains exposed to variances in customer behaviour (often caused by market rate movements) impacting new business take-up and early redemption and causing unfavourable mismatches to arise. The risk sensitivity is calculated by applying the statistically determined potential adverse movements in market risk factors that can be expected within a 95% level of confidence as a result of market movements over a time horizon reflecting the reasonable management horizon of the portfolio (commonly from one week to three months).

The following table shows the sensitivity based consolidated exposures for the major risk classes run by the Group as at 31 December 1999, together with the highest, lowest and average exposures for the year. Exposures within each risk class reflect a range of exposures associated with movements in that financial market, e.g. interest rate risks include the impact of absolute rate movements, basis risks and volatility risks. It should be noted that, due to the range of possible modelling techniques and assumptions and their statistical nature, these measures are not precise indicators of expected future losses but are estimates of the maximum foreseeable change in the value of the portfolio over a specified time horizon and within a given confidence level.

From time to time, losses may exceed the amounts stated where movements in market rates fall outside the statistical confidence interval used in the calculation of the sensitivity analysis. The 95% confidence interval means that the theoretical loss at a risk factor level is likely to be exceeded one business day in twenty. The Group addresses this risk by monitoring stress testing measures across the different business areas as appropriate, and by calculating the sensitivity measures on a prudent basis without making any deduction for correlation between risk classes.

For the year ended 31 December

| **Market risk of financial instruments – trading instruments** | Exposure as at 31 December | | Average exposure | | Highest exposure | | Lowest exposure | |
|---|---|---|---|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| **Short term market risk** | | | | | | | | |
| Interest rate risks | **7.0** | 5.5 | **4.4** | 4.1 | **17.6** | 5.5 | **1.9** | 3.2 |
| Equity risks | **0.4** | 0.1 | **0.3** | – | **0.7** | 0.1 | **–** | – |
| Other risks | **0.1** | 0.1 | **0.3** | 0.1 | **0.6** | 0.2 | **–** | – |

Other risks include spread risk, foreign exchange risk and inflation risk. These risks are not significant, and are therefore not separately disclosed.

For the year ended 31 December

| | Exposure as at 31 December | | Average exposure | | Highest exposure | | Lowest exposure | |
|---|---|---|---|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| **Structural market risk** | | | | | | | | |
| Interest rate risks | **0.8** | – | **0.6** | – | **1.6** | – | **–** | – |
| Equity risks | **9.8** | – | **4.8** | – | **9.8** | – | **1.2** | – |
| Spread risk | **2.2** | 5.7 | **3.1** | 2.6 | **5.5** | 5.7 | **2.2** | 1.6 |

These numbers represent the potential change in market values of such instruments. Trading instruments are recorded at market value, and therefore these numbers represent the potential effect on earnings.

A hypothetical fall of 10% in the relevant market prices or rates as at 31 December 1999 would lead to an effect on reported earnings for the trading instruments in respect of short term risk of £22.8 million, £1.7 million and £0.2 million for interest rate risks, equity risks and other risks, respectively. For structural market risk, the effect on earnings would be £2.5 million, £7.5 million and £3.4 million for interest rate risk, equity risk and spread risk, respectively. A hypothetical fall of 5% in the relevant market prices or rates as at 31 December 1999 would lead to an effect on reported earnings for the trading instruments in respect of short term risk of £11.9 million, £0.5 million and £0.1 million for interest rate risks, equity risks and other risks, respectively. For structural market risk, the effect on earnings would be £1.2 million, £3.8 million and £1.7 million for interest rate risk, equity risk and spread risk respectively.

In addition, a sensitivity analysis of exposures on non-trading financial instruments calculated according to the above methodology is shown below. These numbers represent the potential change in theoretical market values of such instruments, and do not represent the potential effects on the earnings for a given time period. Non-trading instruments are held for collection in the form of cash over time, and are accounted for at amortised cost, with earnings accrued over the relevant life of the instruments. The Group's risk measures, however, focus on potential risks over the life of the non-trading instruments, and are therefore based on valuation measures, using estimated discounted cash flow measures where reliable market values are not available.

For the year ended 31 December

| **Market risk of financial instruments – non-trading instruments** | Exposure as at 31 December | | Average exposure | | Highest exposure | | Lowest exposure | |
|---|---|---|---|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| **Short term market risk** | | | | | | | | |
| Interest rate risks | **1.4** | 1.8 | **1.4** | 2.1 | **2.6** | 3.2 | **0.6** | 1.3 |
| Equity risks | **0.2** | – | **0.1** | – | **0.3** | – | **–** | – |
| **Structural market risk** | | | | | | | | |
| Interest rate risks | **46.4** | 15.5 | **35.4** | 18.3 | **55.8** | 23.2 | **19.0** | 13.4 |
| Equity risks | **0.6** | – | **0.6** | – | **1.1** | – | **–** | – |
| Foreign exchange risks | **0.6** | 2.2 | **1.1** | 2.4 | **2.4** | 3.2 | **0.3** | 1.7 |
| Spread risk | **0.8** | – | **0.2** | – | **1.1** | – | **–** | – |

During 1999, the Group changed the methodology used for consolidated reporting from a single one month time horizon 99% confidence interval measure which captured all structural and short term market risk exposures within a particular risk class, to the range of measures outlined above. This methodology ensures that risks are measured over a time horizon which reflects the capacity of the business to manage the exposure.

It provides a more realistic assessment of the real exposure, notably for trading exposures in liquid markets, where positions could be closed immediately and the risk is now measured to an overnight move in market prices. The new approach therefore better reflects the way in which risk exposures are managed within the business.

## Liquidity risk

Liquidity risk arises across the Group balance sheet. Liquidity is managed on behalf of the Group by ANTS in accordance with policy guidelines set by the Board and monitored by ALCO. This policy is reviewed annually and is in compliance with the FSA's 'Sterling Stock Liquidity' framework. Abbey National views the essential elements of liquidity management as controlling potential cash outflows, maintaining prudent levels of highly liquid assets and ensuring that access to funding is available from a diversity of sources. These elements are underpinned by a comprehensive management and monitoring process. ANTS management focuses on cash flow planning and day-to-day cash flow control, and on balancing the maturity profiles of ANTS' liquid assets and wholesale funding to ensure Group funding and liquidity ratios are adequate. Abbey National's liquidity position is reported to the FSA on a monthly basis.

## Residual value risk

Residual value risk occurs when there is a possibility that the value of a physical asset at the end of certain contracts (e.g. operating leases) may be worth less than that required to achieve the anticipated return from the transaction. Residual value risk arises primarily within Finance House and Wholesale Banking.

Within Finance House, exposure arises within portfolios of contract hire and contract purchase agreements relating to motor vehicles. The balance sheet value of such agreements as at 31 December 1999 amounted to £281 million.

Within Wholesale Banking, exposure arises within structured operating leases, commercial property, and domestic property amounting to £51 million, £36 million and £73 million respectively.

Smaller portfolios also exist elsewhere within the Group amounting to £84 million.

Tools such as residual value insurance products, repurchase agreements and appropriate return conditions are employed by the Group to mitigate the associated risks.

For a discussion of non-financial risk management, see Corporate governance on pages 28 to 30.

# The Board
## Chairman and directors

**Chairman**
**The Lord Tugendhat ***
Lord Tugendhat was appointed as joint Deputy Chairman in June 1991 and as Chairman in July of the same year. He is also Chairman of Blue Circle Industries PLC, a non-executive director of Eurotunnel plc and Rio Tinto PLC, and Chancellor of Bath University. Formerly a Member of Parliament and a vice-president of the European Commission, he has also served as Chairman of the Civil Aviation Authority and the Royal Institute of International Affairs. Aged 63.

**Executive directors**
**Ian Harley FCA FCIB ***
Chief Executive
Ian Harley was appointed Finance Director in 1993 and Chief Executive in March 1998. He began his career with Touche Ross & Co and joined Abbey National as a Financial Analyst from Morgan Crucible Ltd in 1977. He held various appointments before joining the Board including management positions in the Finance Division (Group Financial Controller, Assistant General Manager); the Retail Division (Regional Manager, Finance Director, Operations Director) and the Treasury and Wholesale Banking Division (Treasurer and Chief Executive). Ian Harley is also Chairman of the Association for Payment Clearing Services, a director of Dah Sing Financial Holdings Limited, a non-executive director of Rentokil Initial plc and a member of the Deposit Protection Board and the FSA's Financial Services Practitioners Forum. Aged 49.

**Charles Villiers FCA**
Deputy Chairman
Charles Villiers joined Abbey National and was appointed a director in 1989 and Deputy Chairman in April 1999. His early experience was gained at Arthur Andersen & Co and ICFC. He was formerly Chief Executive of Natwest Investment Bank Ltd, Chairman of County Natwest Ltd and a director of National Westminster Bank plc. He is also a non-executive director of DTZ Holdings PLC. His current responsibilities include the Group's European Operations, the Life Division and the Wealth Management Division. Aged 59.

**Timothy Ingram FCIB**
Managing Director, Consumer Finance
Timothy Ingram was appointed a director in 1996. A career-long banker, he worked for 22 years with ANZ Grindlays Bank, holding various senior international banking appointments. He joined Abbey National in 1995 when it acquired First National Finance Corporation plc and is currently Executive Chairman of First National Bank. He is a non-executive director of Hogg Robinson plc. Aged 52.

**Gareth Jones FCA FCT**
Managing Director, Wholesale Banking
Gareth Jones was appointed a director in 1993. His past experience includes the roles of Finance Director, First Mortgage Securities Limited and Group Treasurer, Redland plc. Gareth Jones joined Abbey National in 1989 as Assistant General Manager and Group Treasurer before becoming Chief Executive of Abbey National Treasury Services plc. He subsequently held the position of Director, Retail Operations before returning to Abbey National Treasury Services plc as Group Treasurer and its Chief Executive. He is a non-executive director of Somerfield plc and is a past Chairman of the Association of Corporate Treasurers. Aged 51.

**John King JP**
Human Resources Director
John King was appointed a director in May 1999. He joined Abbey National in 1972. After holding various training and personnel roles, he assumed overall responsibility for the personnel function in 1988, becoming Human Resources Director in 1992. John King's current responsibilities include Group Property and Survey, the Company's management consultancy area, Strategic Performance Improvement Group and Procurement. Aged 54.

**Malcolm Millington**
IT Director
Malcolm Millington was appointed IT Director in January 1999. He joined Abbey National in 1975 and was appointed Head of IT for Retail in 1993 and Group IT director in 1997. His current responsibilities include Information Technology, Money Transmission Strategy and Electronic Commerce. Aged 48.

**Mark Pain FCA**
Finance Director
Mark Pain was appointed Finance Director in January 1998. He began his career at Touche Ross & Co and joined Abbey National in 1989. He has previously held appointments as Manager, Strategic Planning; Manager, European Operations; Regional Director, Retail; and Group Financial Controller. His current responsibilities include Investor Relations and Corporate Affairs. Aged 38.

**Andrew Pople**
Managing Director, Retail Division
Andrew Pople was appointed a director in 1996. His early career was with the Civil Service followed by the Bank of England. He joined Abbey National in 1988 and has since held

appointments as Regional Director, Retail; Chief Executive, Scottish Mutual Assurance plc and Head of the Life Division. His current responsibilities cover the retail branded business including General Insurance. He is a member of the Board of the Association of British Insurers. Aged 42.

**Ian Treacy FCA**
Director and Secretary
Ian Treacy was appointed as Company Secretary in 1991 and as a director in January 1998. He started his career with Peat, Marwick, Mitchell and Co and subsequently gained experience in stockbroking. He joined Abbey National in 1983 and has held appointments as Manager, European Operations and Deputy Secretary. He is currently responsible for the Group Risk Division. Aged 55.

## Non-executive directors

**Keith Woodley FCA *†**
Deputy Chairman and Senior Independent Non-Executive Director
Keith Woodley was appointed a director in 1996. He became Deputy Chairman and Senior Independent Non-Executive Director in April 1999. He is a former non-executive director of National and Provincial Building Society, a former partner of Deloitte Haskins & Sells and a past President of the Institute of Chartered Accountants in England and Wales. He is currently Complaints Commissioner for the London Stock Exchange, the Personal Investment Authority and the Securities and Futures Authority. He is also a director of the Learning through Landscapes charity. Aged 60.

**Leon Allen †**
Leon Allen, a US citizen, was appointed a director in October 1998. Following an 18 year career with Procter and Gamble and 8 years with RTM Nabisco, he held appointments as President and Chief Executive of Del Monte Foods Europe; Chairman and Chief Executive of Del Monte Foods International Ltd, non-executive Chairman of Devro plc and Chairman and Chief Executive of The Tetley Group Limited. He is non-executive Chairman of Braes Group Ltd and a Trustee of the Royal Association for Disability Rehabilitation (RADAR). Aged 60.

**Mair Barnes *#**
Mair Barnes was appointed a director in 1992. She was previously Managing Director of Woolworths plc, Chairman of Vantios Plc and a non-executive director of George Wimpey PLC. Mair Barnes was Veuve Clicquot Business Woman of the Year 1988 and is currently a non-executive director of Scottish Power plc and an honorary Doctor of Laws, University of Wales. Aged 55.

**Richard Hayden**
Richard Hayden, a US citizen, was appointed a director in September 1999. He previously worked with Goldman Sachs, the US investment bank, for 30 years holding a variety of positions including general partner of Goldman Sachs & Co., Managing Director of Goldman Sachs International, Deputy Chairman of Goldman Sachs International and non-executive Vice Chairman of Goldman Sachs International. Richard Hayden is also a former non-executive director of CK Witco Corporation in the USA. He is currently Executive Chairman of GSC Partners, Europe Ltd. Aged 54.

**Sir Terence Heiser GCB †**
Sir Terence Heiser was appointed a director in 1992. He was previously a Permanent Secretary to the Department of the Environment and is currently a non-executive director of J Sainsbury plc. He is a director of the Personal Investment Authority, a trustee of the Victoria and Albert Museum and of the Prince of Wales Phoenix Trust, and a member of the Executive Committee of the National Trust. He is also a Governor and honorary Fellow of Birkbeck College, London University, a Governor of Sussex University and a Freeman of the City of London. Aged 67.

**Peter Ogden #**
Peter Ogden was appointed a director in 1994. He is a former Managing Director of Morgan Stanley & Co. Peter Ogden is currently Chairman of Computasoft Limited and Omnia Limited and a director of Computacenter PLC. Aged 52.

**The Lord Shuttleworth JP FRICS #**
Lord Shuttleworth was appointed a director in 1996 and held the post of Deputy Chairman from 1996 to April 1999. He was formerly Chairman of the National and Provincial Building Society and the Rural Development Commission. Lord Shuttleworth is also Lord-Lieutenant for the County of Lancashire. Aged 51.

**James Tuckey FRICS †**
James Tuckey was appointed a director in 1990. He is an investment adviser to BP Pensions Services Ltd and is a former Chief Executive of MEPC plc. He is also a Vice-President of the British Property Federation. Aged 53.

* Nomination Committee Member
\# Personnel and Remuneration Committee Member
† Audit Committee Member

**From left to right**
**Chairman and executive directors**
Charles Villiers, Ian Harley, Timothy Ingram, Gareth Jones, The Lord Tugendhat, Ian Treacy, John King JP, Andrew Pople, Malcolm Millington, Mark Pain.

**Non-executive directors**
Mair Barnes, Leon Allen, Sir Terence Heiser, James Tuckey, Peter Ogden, Keith Woodley, The Lord Shuttleworth, Richard Hayden.

# Full contents to financial statements

**The directors have pleasure in presenting their report for Abbey National plc for the year ended 31 December 1999.**

**Principal activities**
The principal activity of Abbey National plc and its subsidiaries continues to be the provision of an extensive range of personal financial services. The Operating and financial review for the year, including a review of non-banking activities, is set out on pages 7 to 23 of this document. Note 24 to the accounts on page 49 provides a list of the principal subsidiaries and the nature of each company's business as well as details of overseas branches. Details of important events which have occurred since the end of the financial year and prospects for 2000 are included in the Chairman's Statement, and in the Operating and financial review under 'Investment for the future'.

**Results and dividends**
The profit on ordinary activities before tax for the year ended 31 December 1999 was £1,783 million (1998: £1,520 million).

An interim net dividend of 13.40 pence per ordinary share was paid on 4 October 1999 (1998: 11.75 pence per ordinary share).

The directors propose a final net dividend for the year of 26.85 pence per ordinary share (1998: 23.55 pence per ordinary share) to be paid on 2 May 2000.

**Corporate governance**
A report on corporate governance is set out on pages 28 to 30.

**Payment policy and practice**
Abbey National deals with a large number of suppliers operating in a diverse range of industries and accordingly does not operate a single payment policy in respect of all classes of suppliers. Each individual operating area is responsible for agreeing terms and conditions under which business is to be transacted and for making the supplier aware of these beforehand. It is, and will continue to be, 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 the Companies Act 1985 (Directors Report) (Statement of Payment Practice) Regulations 1997. Based on the ratio of amounts invoiced by trade creditors during the year to amounts of Company trade creditors at 31 December 1999, trade creditor days for the Company were 24 (1998: 29). The equivalent period calculated for the UK Group is 24 days (1998: 24 days).

**Environmental policy**
The Company considers environmental issues, wherever practical, in all business areas throughout the Group. The Company has an environmental policy which is approved by the Board and was last updated in November 1999.

An Environmental Working Group meets quarterly and oversees environmental performance and the application of policy. Reports on the Company's management of environmental impacts are considered by the Board. There is a dedicated energy team in place to implement projects which reduce energy and water consumption and a campaign to increase the recycling of waste and packaging. Environmental principles are further considered when building, purchasing and refurbishing properties.

**Ethical policy**
The Board recognises that the tone of a company's culture is an important element in its high level control framework and in December 1998 it adopted a Statement of Ethical Principles which was communicated to staff during 1999. Suitable compliance arrangements underpin this Statement which will be subject to regular review. During 1999, the Company published and circulated to all staff members a framework for resolving concerns at work as part of its commitment to ensure fair and ethical treatment.

**Employees**
As in previous years, in 1999 Abbey National invited eligible employees to become financial stakeholders in the Company by participating in the Company's Sharesave Scheme. Additionally, free shares, which in total equated to approximately 2.1% of the basic salaries of all eligible employees, were granted under the Share Participation Scheme to eligible employees as part of the Company's 'Shared Rewards' initiative. Through these schemes, and others that have been introduced over the years, the majority of employees now have a shareholding interest in the Company.

Employee involvement and effective communication remain vital to Abbey National's continued success. The Company publishes a quarterly employee magazine "Abbeyview" combining work-related issues and information with more general topical articles. Access to Abbey National's intranet was extended to all branches and retail outlets during 1999. These innovations, together with more traditional methods of communication, aim to ensure that employees are fully informed of news and developments including information on the Company's performance.

Abbey National understands that communication is a two-way process, and has been actively seeking employee views and opinions in a number of ways, including a Quarterly Opinion Survey, the results of which are widely published.

Abbey National also runs schemes to encourage and reward employees for their ideas and suggestions to improve business performance.

Abbey National has a "Partnership Agreement" with ANSA, the trade union it recognises for employee representation. Consultation with ANSA takes place at both national and local levels.

Abbey National's commitment to equal opportunities for all its employees and customers continued throughout the year. Support of national campaigns such as Opportunity 2000, Race for Opportunity and the EASE (Ease of Access to Services and Employment) Awards continue to play a part in the Company's strategy and this high-level commitment is reflected in the initiatives carried out at local level.

Abbey National fully supports the provisions of the Disability Discrimination Act 1996. The Company has implemented a training programme across the Group to make staff aware of the provisions of the Act and to provide advice on how to deal with both disabled customers and colleagues more effectively. Measures have been put into place to ensure that all of Abbey National's services are equally accessible to disabled customers. For example, communication aids such as textphones and induction loops for hearing-impaired customers have been introduced in branches, and customer information has been made available in different formats including Braille and large print.

The Company remains a committed user of the Department of Employment Service "Positive about Disabled People" symbol, and continues to encourage applications from people with disabilities. All practical measures are taken to assist in the recruitment, retention and career development of disabled people.

**Share capital**
The authorised and issued share capital of the Company are detailed in note 41 to the accounts on page 53.

During the year, 3,325,681 ordinary shares were issued on the exercise of options under the Sharesave Scheme, 848,441 ordinary shares were issued on the exercise of options under the terms of the Employee Share Option Scheme and 380,400 ordinary shares were issued under the terms of the Executive Share Option Scheme. Shares to meet grants under the Executive Share Option Scheme, the Share Participation Scheme, and to satisfy conditional rights under the Long Term Incentive Plan were all purchased in the market.

At the Annual General Meeting on 22 April 1999, shareholders authorised the Company to make market purchases of its own shares, to a maximum of 141,747,666 ordinary shares of 10 pence each, 125,000,000 8 ⅝% preference shares of £1.00 each and 200,000,000 10 ⅜% preference shares of £1.00 each. No purchases have been made during the year under these authorities. These authorities remain valid until the forthcoming Annual General Meeting, when it is intended that resolutions will be put to shareholders to renew them.

**Market value of land and buildings**
On the basis of a regular review process, the estimated aggregate market value of the Group's land and buildings was below the fixed asset net book value of £343 million, as disclosed in note 27 to the accounts, by approximately £5 million. It is considered that, except where specific provisions have been made, the land and buildings have a value in use to the Group which exceeds the estimated market value, and that the net book value is not impaired. Provisions of £13 million have been made for the cost of empty premises.

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

During the year, Abbey National plc donated £1,300,000 (1998: £600,000) to the Trust's funds. The Trust also received income from its invested Permanent Endowment Funds.

Total cash donations of £1,879,061 (1998: £1,075,131) to charities were made through the Trust and by other Abbey National Group companies in 1999.

The total value of support given to charities and the voluntary sector amounted to £2,657,000 (1998: £1,830,000). This comprised mainly cash donations through the Trust, and other support given in kind, including the value of staff time.

The Trust has continued to give priority to charities working to improve equality of opportunity for people with disabilities and charities working to improve educational and employment opportunities for the most disadvantaged groups in society. The Trust also supports the charity fund-raising efforts of Abbey National staff, giving £341,000 to match amounts they raised during the year. The 'Helping Hands' award scheme helps schools to carry out environmental projects.

**Political contributions**
No contributions were made for political purposes.

**Directors and directors' interests**
Details of all the current directors are included on pages 24 and 25.

John King and Richard Hayden were appointed to the Board on 1 May 1999 and 21 September 1999 respectively and having been appointed since the last Annual General Meeting they will retire and, both being eligible, offer themselves for election at the forthcoming Annual General Meeting.

All other directors listed on pages 24 and 25 have served on the Board for the whole of the period 1 January 1999 to 31 December 1999. James Tuckey, Lord Shuttleworth, Keith Woodley, Andrew Pople and Ian Harley will retire by rotation at the Annual General Meeting and, all being eligible, offer themselves for re-election.

No director had a material interest in any contract of significance, other than a service contract, with the Company or any of its subsidiaries at any time during the year. Disclosures required by Financial Reporting Standard (FRS) 8, 'Related Party Disclosures', are set out in note 54 on pages 60 and 61 of the accounts.

## Directors' report continued

Directors' interests in the shares of the Company, awards under the Long Term Incentive Plan and options to acquire shares are set out in the Directors' Remuneration report on pages 30 to 35.

**Substantial shareholdings**
As at 16 February 2000, the Company had not been notified of any disclosable interests in the issued ordinary share capital of the Company in accordance with sections 198 to 208 of the Companies Act 1985.

**Auditors**
A resolution to re-appoint Deloitte & Touche as Auditors will be proposed at the forthcoming Annual General Meeting.

**Annual General Meeting**
Details of the business of the Annual General Meeting can be found in the accompanying booklet 'Notice of Annual General Meeting 2000'.

By Order of the Board

**Ian K Treacy**
Director and Secretary

16 February 2000

## Corporate governance

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

**Combined Code**
This statement, together with the Directors' Remuneration report, set out on pages 30 to 35, explains how Abbey National has applied the principles of good practice in corporate governance set out by the London Stock Exchange in Section 1 of the Combined Code.

**The Board**
At 31 December 1999, the Board comprised a part-time Chairman, nine executive directors, including the Chief Executive, and eight independent non-executive directors, who bring a wide range of skills and experience to the Board. Biographical details of all directors are to be found on pages 24 and 25. The roles of Chairman and Chief Executive are separated and clearly defined. The Chairman is primarily responsible for the working of the Board and the Chief Executive for the running of the business and implementation of Board strategy and policy. The Chief Executive is assisted in managing the business on a day-to-day basis by the Executive Committee, which he chairs and which meets weekly and comprises his direct reports. All the non-executive directors are independent of management and they make a significant contribution to the functioning of the Board, thereby helping to ensure that no one individual or group dominates the Board's decision-making process. The Board met on 12 occasions during 1999, including a separate session specifically devoted to the long-term strategic direction of the Group. The Board's focus is on strategy formulation, policy and control. A framework of high-level authorities is in place which maps out the structure of delegation below Board level as well as specifying those issues which remain within the Board's preserve.

Risk management in banking continues to be critical and the Board devotes appropriate time to considering the risks associated with liquidity, foreign exchange, interest rates and credit as well as compliance and other operational risks. The Assets and Liabilities Committee ('ALCO') plays an important role here by monitoring and controlling the level of Group structural balance sheet risk. ALCO oversees two sub-committees: the Group Credit Committee ('GCC') and the Operational Risk Committee. ALCO meets monthly, chaired by the Chief Executive, and its membership comprises six other executive directors plus one executive manager. GCC comprises two executive directors plus several members of the Executive Management Group and meets fortnightly to review and oversee high-level credit policies and exposures. The Operational Risk Committee includes three executive directors and meets quarterly to review and monitor operational risk exposures within the Group. The Board, at its regular monthly meetings, reviews in detail the minutes of ALCO which incorporate key points from the minutes of GCC and the Operational Risk Committee.

One of the responsibilities of the Chairman is to ensure that Board members receive sufficient and timely information regarding corporate and business issues to enable them to discharge their duties. The adequacy of this information is regularly reviewed.

All directors have access to the advice and services of the Company Secretary and the Board has established a procedure whereby directors, wishing to do so in the furtherance of their duties, may take independent professional advice at the Company's expense. The Company Secretary is also charged with ensuring that all new Board members are equipped to fulfil their duties and responsibilities. As part of the early familiarisation programme, new non-executive directors are encouraged to meet the executive directors individually and engage in a programme of visits to different areas of the Group.

Non-executive directors are appointed for a three year term after which their appointment may be extended upon mutual agreement. It is envisaged that the maximum term for a non-executive director under this regime is unlikely to exceed nine years. In this connection, it has been agreed that James Tuckey, who was initially appointed to the Board in 1990, will be standing down later in 2000. In accordance with the Company's Articles of Association, one-third of the Board are required to retire by rotation each year so that over a three year period all directors will have retired from the Board and faced re-election.

As Abbey National continues to diversify, the Board seeks additional assurance from the Boards of Directors of its subsidiary companies, particularly those in the Life Assurance, Wholesale Banking and Finance House Divisions. Each of these Boards (Scottish Mutual Assurance plc, Abbey National Life plc, Abbey National Treasury Services plc and First National Bank plc) includes at least one independent non-executive director with requisite expertise who is not necessarily a member of the Abbey National plc Board.

**Board committees**
The Board maintains three standing committees, all of which operate within written terms of reference. Their minutes are circulated for review and consideration by the full complement of directors, supplemented by oral reports from the Committee Chairmen.

**Audit Committee**
The Audit Committee is chaired by Keith Woodley and comprises four members. Leon Allen and James Tuckey replaced Lord Rockley and Martin Llowarch on the Committee during the year. The Committee met five times in 1999. Its prime tasks are to review the scope of external and internal audit, to receive regular reports from Deloitte & Touche and the Chief Internal Auditor, and to review the half-yearly and annual accounts before they are presented to the Board, focusing in particular on accounting policies and compliance, and areas of management judgement and estimates. The Committee more generally acts as a forum for discussion of internal control issues and contributes to the Board's review of the effectiveness of the Company's internal control and risk management systems and processes. The Committee also conducts a review of the remit of the internal audit function, its authority, resources and scope of work. Detailed subsidiary level issues are considered by the subsidiary company audit committees set up for key trading subsidiaries. Membership of the Audit Committee is restricted to independent non-executive directors.

**Personnel and Remuneration Committee**
The Personnel and Remuneration Committee is chaired by Mair Barnes since the retirement of Martin Llowarch. Peter Ogden replaced James Tuckey on the Committee during the year. The Committee met six times in 1999. Its principal function is to monitor the human resource policies of the Group to ensure they are consistent with the Company's business objectives and philosophy. It is charged with recommending to the full Board the Company's policy on executive director and executive management remuneration. The Committee determines the individual remuneration package of each executive director. The Board's report to shareholders on how directors are remunerated, together with details of individual directors' remuneration packages, is to be found on pages 30 to 35.

**Nomination Committee**
The Nomination Committee is chaired by Lord Tugendhat and comprises four members. Keith Woodley replaced Lord Shuttleworth on the Nomination Committee during the year. The Committee meets when necessary and at least once in each year. The Committee's primary function is to make recommendations to the Board on all new appointments and also to advise generally on issues relating to Board composition and balance. It met three times during 1999.

The number of full Board meetings and Committee meetings attended by each director during the year was as follows:

| | Board meetings | Audit Committee meetings | Personnel and Remuneration Committee meetings | Nomination Committee meetings |
|---|---|---|---|---|
| The Lord Tugendhat | 12 | | | 3 |
| Ian Harley | 12 | | | 3 |
| Leon Allen | 12 | 3 | | |
| Mair Barnes | 12 | | 6 | 3 |
| Richard Hayden (Appointed 21 September 1999) | 3 | | | |
| Sir Terence Heiser | 12 | 4 | | |
| Timothy Ingram | 12 | | | |
| Gareth Jones | 11 | | | |
| John King (Appointed 1 May 1999) | 8 | | | |
| Malcolm Millington (Appointed 1 January 1999) | 12 | | | |
| Peter Ogden | 12 | | 2 | |
| Mark Pain | 12 | | | |
| Andrew Pople | 12 | | | |
| The Lord Shuttleworth | 11 | | 6 | 2 |
| Ian Treacy | 12 | | | |
| James Tuckey | 11 | 2 | 3 | |
| Charles Villiers | 12 | | | |
| Keith Woodley | 11 | 5 | | 1 |

**Relations with shareholders**
Abbey National values its dialogue with both institutional and private investors. Effective two-way communication with fund managers, institutional investors and analysts is actively pursued and this encompasses issues such as performance, policy and strategy. During 1999, Abbey National directors held discussions with over 120 institutional investors whose combined shareholdings represented over 35% of the total issued ordinary share capital of the Company.

Private investors are encouraged to participate in the Annual General Meeting at which the Chairman presents a review of the results and comments on current business activity. The Chairmen of the Audit, Personnel and Remuneration and Nomination Committees will be available at the Annual General Meeting to answer any shareholder questions.

This year's Annual General Meeting will be held on 27 April 2000. The Notice of the Annual General Meeting, which is in plain English, is circulated more than 20 working days before the Meeting and Abbey National will continue its practice of proposing only unbundled individual resolutions, including a separate resolution relating to the Directors' Report and Accounts.

**Pension funds**
The assets of the Company's main pension schemes are held separately from those of the Group and are under the control of the trustees of each scheme. The four Abbey National pension schemes have a common corporate trustee which has nine directors, comprising six Company appointed directors, including Lord Tugendhat and two other directors of the Company, together with three member-nominated directors. The National and Provincial Pension Scheme has a different corporate trustee, the Board of which comprises Lord Tugendhat, two other Company appointed directors and three member-elected directors. The Scottish Mutual Assurance ('SMA') plc Staff Pension Scheme is administered by six trustees, of which Scottish Mutual appoints four (two of whom are directors and two of whom are members), whilst the active members appoint two of their number as trustees.

Asset management of the schemes (with the exception of the SMA Staff Pension Scheme) is delegated to a number of independent fund managers and, where appropriate, property managers and the trustees receive independent professional advice on the performance of the external managers. Asset management of the SMA Staff Pension Scheme is through a Trustee Investment Account invested in units of SMA's Pooled Managed Fund.

Legal advice to the trustees of the various schemes is provided by external firms of solicitors. The audits of Group Pension Schemes are separated from that of Abbey National. The 1999 audit of the Abbey National pension schemes was undertaken by Deloitte & Touche and will in future be carried out by Grant Thornton. The audit of the National and Provincial Fund is undertaken by Grant Thornton and the audit of the SMA Staff Pension Scheme is undertaken by KPMG Audit Plc.

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

**Internal control**
The Board of Directors has overall responsibility for the system of internal control and for reviewing its effectiveness throughout the Abbey National Group. However, it is important to note that the size and complexity of the Group's operations mean that such a system can only provide reasonable and not absolute assurance against material misstatement or loss. The effectiveness of the internal control system is reviewed by the Audit Committee on behalf of the Board.

The rationale of the system of internal control is to enable the Group to achieve its corporate objectives within an acceptable risk profile, not to eliminate the risk, and the effectiveness of internal control has to be viewed in this context. The Board and executive management structures summarised above describe the processes for determining strategies, policies and the control environment.

The Audit Committee has, on behalf of the Board, reviewed the effectiveness of the system of internal control during the period covered by the Annual Report and Accounts. The basis of the review predated the Turnbull Working Party's guidance ('the guidance') for directors but did cover financial, operational, and compliance control and risk management. Following the publication of the guidance, the Board confirms that procedures have been established to implement it fully for the year ending 31 December 2000. The directors are also of the view that as from 1 January 2000 there is an on-going process for identifying, evaluating and managing the Group's significant risks that is regularly reviewed by the Board and accords with the guidance.

For the purposes of this statement, the Board has adopted the transitional approach as permitted by the London Stock Exchange letter dated 27 September 1999 and therefore sets out below a description of the control procedures. However, it also sets out additional information to assist the understanding of the Company's risk management processes and the system of internal control including financial control. The key elements are as follows:

- Risk management and control embedded within the operations of the Group.
- A framework of high-level authorities (see 'The Board' section above).
- A high-level risk management framework which outlines the risk management philosophy and resultant control environment.
- A planning framework which incorporates a Board approved rolling three year plan, with detailed annual operating objectives and milestones to business unit levels together with the related key risks and sensitivities.
- A Group high-level risk map which identifies the policy mechanisms and independent risk monitoring functions for all risks within broad risk categories; credit, market position, liquidity, insurance, business event, strategic and operational. Ian Treacy, Director and Secretary, heads the Group Risk Division responsible for independent risk monitoring functions which regularly report on financial, compliance and operational risk exposures.
- A comprehensive system of reporting to the Board, based on an annual budget with monthly reports against actual results, analysis of variances, scrutiny of key performance indicators, plus regular reforecasting.
- Well-defined regulations governing appraisal and approval of capital expenditure. These include an annual budget, detailed project approval procedures, incorporating appropriate levels of authority, and a post-investment review process.
- The use of control manuals to document key controls against identified risks, supplemented by procedure manuals at the operating level.

**Internal control** continued
The Board has established a process for reviewing the effectiveness of the system of internal control through reports it receives from these Committees and various independent monitoring functions. The procedures to enable this to operate throughout 2000 have been put in hand. As part of this process, management, including executive directors, submit Self Certification Statements on the effectiveness of risk management and internal controls against material risks. The Board will undertake a formal annual assessment in 2000 and annually thereafter to form its own view on the effectiveness of the system of internal control.

There is a long established internal audit function with requisite expertise. Its role is to provide independent and objective assurance to the Board that the processes by which significant risks are identified, assessed and managed are appropriate and effectively applied, and achieve residual risk exposures consistent with management's risk policy, reporting any material exceptions and following up management responses to ensure effective resolution of issues. The Audit Committee approves the annual plans for internal audit which cover the scope, authority and resources of the function.

**Compliance with the Combined Code**
Abbey National has complied with all the provisions of Section 1 of the Combined Code as laid out in the Listing Rules of the London Stock Exchange throughout 1999.

## Directors' remuneration

The purpose of this report by the Board is to inform shareholders of its policy on directors' remuneration and to provide details of the remuneration of individual directors, as determined by the Personnel and Remuneration Committee. The Board have determined that there are no specific issues which need to be brought to the attention of shareholders. Approval of this report by the Annual General Meeting will not be sought.

**Remuneration strategy**
Abbey National operates in a competitive market. If the Company is to continue to compete successfully it is essential that it attracts, develops and retains high quality staff at all levels. Remuneration policy has an important part to play in achieving this objective. The Company aims to offer all of its staff a remuneration package which is competitive in the relevant employment market and which is set in relation to individual performance. The Company also seeks to align the interests of shareholders and staff by giving staff the opportunity to build up a shareholding in the Company. Through a series of offers under the Sharesave, Share Participation and Employee Share Option Schemes, nearly all staff now have a shareholding interest.

**Personnel and Remuneration Committee**
The Committee exists to provide a mechanism through which the Board can satisfy itself that the Company is adopting human resource policies which are consistent with the Company's business objectives and philosophy. Its written terms of reference require the Committee to recommend policy on executive directors' remuneration to the Board, and in accordance with the provisions of the Combined Code, to determine the remuneration of each executive director, including pension rights and any compensation payments.

The Committee, which is chaired by Mair Barnes, also comprises Peter Ogden and Lord Shuttleworth. Its membership is restricted to independent non-executive directors, although the Committee consults, as appropriate, with both the Chairman and the Chief Executive. The Committee is assisted in its deliberations by the Human Resources Director and takes advice from time to time from external advisers.

**Remuneration policy for executive directors**
The aim of the Board and the Personnel and Remuneration Committee is to maintain a policy which:
- establishes a remuneration structure which will attract, retain and motivate executive directors of appropriate calibre;
- rewards executive directors according to both individual and Company performance;
- establishes an appropriate balance between fixed and variable elements of total remuneration with the performance related element forming a potentially significant proportion of the total remuneration package;
- aligns the interests of executive directors with those of shareholders through the use of performance related rewards and encouraging them to acquire a shareholding in the Company; and
- ensures that directors' remuneration packages are in line with the Group's remuneration policy.

The comparator group used in consideration of remuneration matters comprises retail banks, insurance companies and other companies in a variety of fields with a market capitalisation broadly similar to Abbey National's. The Committee obtains advice and information from external experts when making its comparison.

Details of each director's remuneration package, together with details of interests in shares and share options, are set out below. There are no elements of remuneration, other than basic salary, which are treated as being pensionable.

The remuneration package is made up of the following elements:

**– Basic salary**
Basic salaries are normally reviewed annually and are set to reflect market conditions, personal performance and those paid for similar sized jobs in comparable organisations.

**– Annual performance related bonus**
The discretionary annual performance related bonus scheme is designed to provide a direct link between each individual's remuneration and the performance of the Company in the short term. It is based on individual and Company performance. It will pay out in March 2000 in relation to performance in 1999. The maximum potential cash payment, to be shared among the executive directors, is 30% of that group's basic salary earned during the year. Such payments are not pensionable. For the year 2000, the maximum potential payment associated with this bonus will be increased to 50%.

The aggregate payment under the scheme is determined by the Personnel and Remuneration Committee's view of the Company's performance set against the Chief Executive's objectives including the annual budget. The budget and objectives are set before the start of the financial year and approved by the Board.

The Committee pays particular attention to certain quantifiable targets and may then modify that assessment in the light of its view of performance against qualitative objectives, such as customer service, product quality and the dynamics of the market. The key financial targets for 1999 were: budgeted levels of operating expenses and income; market share targets for key products; and a specified measure of shareholder value (known as the value based management profit after capital charge). In setting the level of bonuses, the Personnel and Remuneration Committee is guided by a formula which envisages an on-target performance equating to half the maximum potential cash payment.

The distribution of the aggregate payment to individual executive directors reflects their individual performance and contribution during the year. The Committee is assisted in the assessment of individual performance of the Chief Executive by the Chairman, and of the other executive directors by the Chief Executive. Aggregate payments under the scheme for 1999 represented 18.5% of the salaries earned during the year (1998: 18%).

**– Long Term Incentive Plan**
A Long Term Incentive Plan for senior executives was adopted at the 1997 Annual General Meeting. It is designed to enhance the link between the remuneration of executives and the Company's medium and long term performance and incorporates challenging performance targets, measured over a three year period. The performance targets are based on the share price and dividend performance (total shareholder return) of the Company relative both to specified financial institutions and to the constituents of the FTSE 100 Share Index.

At the outset of each scheme, the individuals are conditionally granted shares to a maximum value of 70% of their basic salary. The number which are eventually awarded to the individual depends upon the extent to which the performance conditions are met. Half of the awards will be determined by the total shareholder return of the Company relative to the constituents of the FTSE 100 Share Index. The other half of the awards will be determined by the total shareholder return of the Company relative to specified financial institutions. For the 1999–2001 performance period, the specified financial institutions are: Bank of Scotland, Barclays, Lloyds TSB, NatWest, Royal Bank of Scotland, Legal & General, Prudential, Alliance & Leicester, Halifax, Northern Rock and Woolwich. The two parts of the award are determined separately. For each part, the award will be made in full if the Company is ranked in the top quartile of the relevant comparator group; 25% of the award will be made if the Company is ranked at median; and pro rata between these two points. For each part, no award will be made if the Company is ranked below the median of the relevant comparator group. Thus, if the Company is ranked below the median of both comparator groups, no award will be made. Similarly, for the award to be made in full, the Company must be ranked in the top quartile of both comparator groups.

In normal circumstances, to the extent that the performance conditions are satisfied, one half of a participant's shares awarded will be transferred to the individual on the third anniversary of the date the conditional rights were originally granted, while the other half are held in trust for a further two years.

The Plan is currently open only to the nine members of the Executive Committee. Details of the grants to directors under this Plan are set out below. The Long Term Incentive Plan for the performance period 1997-1999 will generate an award of 50% of the shares held in trust for each individual participant. Half of these shares will be awarded in 2000. The other half will remain in trust for a further two years and will only be transferred if the participant is still in the Company's employment at that time.

As from 1 January 1997, executive directors no longer participate in new grants under the Executive Share Option Scheme. Prior grants of executive share options were made on the determination of the Personnel and Remuneration Committee on a phased basis and reflected both corporate and individual performance. Directors' interests in share options are set out below.

From 1 January 1997, participation by way of new grants in the Company's Executive Share Option Scheme has been, and will continue to be, primarily confined to less senior executives, a group of approximately 120 managers.

**– Other payments**
The Personnel and Remuneration Committee may in certain circumstances make ex gratia payments. These circumstances include where an individual executive director has rendered a particular and outstanding contribution. Ex gratia payments may also be made where the employment market for particular directors suggests that the median remuneration for specialist jobs is higher than that paid to the executive directors concerned. Ex gratia payments of £65,000 (1998: nil) were made during 1999.

**– Other payments** continued
Shareholders have approved an employee sharesave scheme, an employee share option scheme and an employee share participation scheme. These schemes are available to all employees including executive directors.

**– Benefits**
Taxable benefits for executive directors include medical expenses and subsidised mortgage loans.

**Service contracts**
Executive directors seeking election or re-election at the 2000 Annual General Meeting will each have an unexpired contract term of one year. Non-executive directors do not have service contracts, save for the Chairman whose contract is renewable on an annual basis at the first Board meeting in each year following the Annual General Meeting and provides for payment of fees for a period of twelve months.

All of the executive directors have rolling one year service contracts. Where the individual is not required to work their contractual notice period, they will be eligible to receive pay in lieu of notice. If an executive director is made redundant within the meaning of the relevant employment legislation, he will be eligible to receive a redundancy severance payment in line with the Company's terms applicable to executive managers. This will be calculated on the basis of 3.25 weeks pay for each year of continuous service up to a maximum of two years' salary. These terms applying to involuntary redundancy have been enhanced so that any payment in lieu of notice will now be made in addition to any redundancy payment, whereas previously this was deemed to be included in the redundancy payment. Over 30 years of continuous service will be required to achieve a maximum payout assuming full payment in lieu of notice and the maximum redundancy payment.

**Chairman and non-executive directors**
The remuneration arrangements of the Chairman and non-executive directors are determined by the Board and are as follows:

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

Fees are paid to non-executive directors. The basic fee for non-executive directors of £25,000 per annum is augmented by £5,000 for service on each of the Audit Committee and Personnel and Remuneration Committee. Mair Barnes receives an additional fee of £2,500 per annum for chairing the Personnel and Remuneration Committee. Lord Shuttleworth receives an additional fee in his capacity as director of Abbey National Group Pension Scheme Trustees Limited and The National and Provincial Building Society Pension Fund Trustees Limited. Keith Woodley's remuneration includes payments for services as a Deputy Chairman of Abbey National plc, a non-executive director of Abbey National Treasury Services plc and as Chairman of both their Audit Committees.

Taxable benefits for non-executive directors include the reimbursement of travel and other incidental expenses for attendance at Board Meetings.

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

| | Salary/ Fee £ | Performance related annual bonus £ | Other payments £ | Taxable benefits £ | 1999 Total £ | 1998 Total £ |
|---|---|---|---|---|---|---|
| **Chairman** | | | | | | |
| The Lord Tugendhat | **325,000** | | | **22,746** | **347,746** | 327,706 |
| **Executive directors** | | | | | | |
| I Harley | **450,000** | **83,250** | | **11,636** | **544,886** | 521,011 |
| T C W Ingram | **270,000** | **49,950** | | **1,146** | **321,096** | 309,587 |
| D G Jones | **300,000** | **55,500** | **65,000** | **7,128** | **427,628** | 370,504 |
| J King (appointed 1 May 1999) | **200,000** | **37,000** | | **1,177** | **238,177** | – |
| M J Millington (appointed 1 January 1999) | **200,000** | **37,000** | | **1,428** | **238,428** | – |
| M A Pain | **225,000** | **41,625** | | **1,291** | **267,916** | 219,562 |
| A H Pople | **280,000** | **51,800** | | **1,254** | **333,054** | 324,284 |
| C G Toner (retired 22 April 1999) | **88,333** | **16,342** | | **889** | **105,564** | 349,062 |
| I K Treacy | **210,000** | **38,850** | | **2,213** | **251,063** | 277,004 |
| C N Villiers | **300,000** | **55,500** | | **1,922** | **357,422** | 362,564 |
| **Non-executive directors** | | | | | | |
| L R Allen | **28,333** | | | **147** | **28,480** | 6,250 |
| M Barnes | **31,667** | | | **2,114** | **33,781** | 30,000 |
| R M Hayden (appointed 21 September 1999) | **6,935** | | | **–** | **6,935** | – |
| Sir Terence Heiser | **30,000** | | | **952** | **30,952** | 28,183 |
| M E Llowarch (retired 22 April 1999) | **27,500** | | | **553** | **28,053** | 49,602 |
| P J Ogden | **28,333** | | | **339** | **28,672** | 22,500 |
| The Lord Rockley (retired 22 April 1999) | **15,000** | | | **–** | **15,000** | 27,812 |
| The Lord Shuttleworth | **43,750** | | | **1,659** | **45,409** | 44,303 |
| J L Tuckey | **30,000** | | | **339** | **30,339** | 27,812 |
| K S Woodley | **80,000** | | | **3,183** | **83,183** | 48,863 |
| **Totals** | **3,169,851** | **466,817** | **65,000** | **62,116** | **3,763,784** | 3,346,609 |

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

The following table shows an analysis of the accrued pension benefits as at 31 December 1999 for executive directors participating in the Company's defined benefits pension schemes. Further information concerning the Company's pension schemes is set out in note 52 to the accounts.

| | Contributions from directors during 1999 (7)£ | Increase in accrued pension during 1999 (1)(5)£ | Transfer value of the increase in accrued pensions during 1999 (2)£ | Total accrued pensions as at 31 December 1999 (3)£ | Total accrued pension as at 31 December 1998 (4)£ |
|---|---|---|---|---|---|
| **Executive directors** | | | | | |
| I Harley | **11,520** | **35,861** | **535,121** | **196,261** | 155,426 |
| T C W Ingram (6) | **–** | **26,398** | **387,746** | **90,000** | 61,630 |
| D G Jones | **82,100** | **26,497** | **333,914** | **93,500** | 64,925 |
| J King (appointed 1 May 1999) | **30,000** | **15,565** | **238,425** | **124,667** | 109,102 |
| M J Millington (appointed 1 January 1999) | **2,000** | **18,952** | **280,365** | **93,015** | 71,766 |
| M A Pain | **2,250** | **7,294** | **65,984** | **43,113** | 34,708 |
| A H Pople | **8,932** | **14,404** | **148,617** | **65,333** | 49,350 |
| C G Toner (retired 22 April 1999) | **883** | **5,202** | **152,427** | **166,616** | 161,414 |
| I K Treacy | **31,500** | **9,850** | **142,359** | **113,050** | 100,000 |
| C N Villiers | **45,000** | **25,958** | **444,628** | **149,000** | 119,227 |
| **Totals** | **214,185** | **185,981** | **2,729,586** | **1,134,555** | 927,548 |

**Notes:**
**1** The increase in accrued pension during 1999 represents the increase in the annual pension which each director would be entitled to receive from normal retirement age (less the statutory inflationary increase of 3.2%, where relevant), if he had left service voluntarily at 31 December 1999 or at his actual retirement date if earlier.

**2** The transfer value of the increase in accrued pension represents the current capital sum which would be required, using demographic and financial assumptions, to produce an equivalent increase in accrued pension and ancillary benefits, excluding the statutory inflationary increase, and after deducting members' contributions (including Additional Voluntary Contributions). Although the transfer value represents a liability to the Company, it is not a sum paid or due to be paid to the individual director and cannot therefore meaningfully be added to the annual remuneration.

**3** The accrued pension as at 31 December 1999 represents the annual pension which each director would be entitled to receive from normal retirement age if he had left service voluntarily at 31 December 1999 or at his actual retirement date if earlier.

**4** Stated as at the date of appointment if later.

**5** In most cases the figure for the increase in accrued pension during 1999 which appears in the table does not equal the difference between the total accrued pension as at 31 December 1999 and the total accrued pension as at 31 December 1998. The difference arises where the increase in accrued pension is stated after deducting the statutory inflationary increase which would have been applied to the deferred pension entitlement had the director left at the start of the year. This deduction has been made where directors have been in service for the whole year, and is made in order to present a figure showing that element of the increase which results from an extra full year of service and from changes in remuneration.

**6** Mr Ingram does not participate in the Company's defined benefits pension scheme. His pension arrangements are on a defined contributions basis. However, the Company has agreed to provide additional benefits as if he were participating in the defined benefits scheme.

**7** Additional Voluntary Contributions made have been included in the above table where these payments result in an increase in the value of the directors' pension entitlements.

**Gains made on exercise of directors' share options**
During the year the exercise of share options by directors resulted in gains as set out below:

| | 1999 Total £ | 1998 Total £ |
|---|---|---|
| I Harley | **70,170** | 572,016 |
| T C W Ingram | **266,124** | – |
| D G Jones | **–** | 283,347 |
| J King (appointed 1 May 1999) | **105,582** | – |
| M A Pain | **–** | 79,227 |
| A H Pople | **215,668** | 395,106 |
| I K Treacy | **174,337** | 465,797 |
| C N Villiers | **67,972** | 634,233 |
| **Total** | **899,853** | 2,429,726 |

**Note:**
Details of the options giving rise to these gains are set out below. The gains are based on the amount by which the market value of shares on the date of exercise exceeded the option price, irrespective of whether the shares were sold or retained.

**Directors' share interests**

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

**Ordinary shares:**

| | No. of shares | |
|---|---|---|
| | **At 1.1.99 or date of appointment if later** | **At 31.12.99** |
| L R Allen | **1,000** | **4,000** |
| M Barnes | **1,000** | **1,000** |
| I Harley | **51,037** | **58,782** |
| R M Hayden (appointed 21 September 1999) | **–** | **4,000** |
| Sir Terence Heiser | **1,000** | **1,000** |
| T C W Ingram | **19,012** | **30,636** |
| D G Jones | **41,169** | **31,189** |
| J King (appointed 1 May 1999) | **36,577** | **39,897** |
| M J Millington (appointed 1 January 1999) | **22,916** | **32,916** |
| P J Ogden | **4,000** | **4,000** |
| M A Pain | **16,064** | **17,964** |
| A H Pople | **37,141** | **50,661** |
| The Lord Shuttleworth | **816** | **816** |
| I K Treacy | **41,372** | **46,079** |
| J L Tuckey | **12,000** | **12,000** |
| The Lord Tugendhat | **17,858** | **18,867** |
| C N Villiers | **29,000** | **26,152** |
| K S Woodley | **2,160** | **2,160** |

In addition, at 31 December 1999, T C W Ingram held £36,529 Abbey National Floating Rate Unsecured Loan Notes 2000 issued on 23 August 1995 in consideration for shares held in FNFC plc (1998: £76,529).

**Share options:**

| | At 1.1.99* | Granted | No. of options exercised | At 31.12.99 | Exercise price £ | Market price at date of exercise £ | Date from which exercisable | Expiry date | Notes |
|---|---|---|---|---|---|---|---|---|---|
| I Harley | 2,418 | | | 2,418 | 4.28 | | 01/10/00 | 31/03/01 | Sharesave |
| | 568 | | | 568 | 6.07 | | 01/04/02 | 30/09/02 | Sharesave |
| | 349 | | | 349 | 9.88 | | 01/04/03 | 30/09/03 | Sharesave |
| | 7,745 | | 7,745 | | 3.98 | 13.04 | 11/04/99 | 10/04/04 | Executive† |
| | 38,053 | | | 38,053 | 5.65 | | 25/03/99 | 24/03/06 | Executive |
| | 36,379 | | | 36,379 | 5.91 | | 09/09/99 | 08/09/06 | Executive# |
| | 150 | | | 150 | 5.91 | | 09/09/99 | 08/09/06 | Employee |
| | 85,662 | | 7,745 | 77,917 | | | | | |
| T C W Ingram | 3,701 | | | 3,701 | 4.66 | | 01/04/01 | 30/09/01 | Sharesave |
| | 4,180 | | 4,180 | | 4.0975 | 14.35 | 31/08/96 | 30/08/03 | Executive# |
| | 25,663 | | 25,663 | | 5.65 | 14.35 | 25/03/99 | 24/03/06 | Executive |
| | 150 | | | 150 | 5.91 | | 09/09/99 | 08/09/06 | Employee |
| | 33,694 | | 29,843 | 3,851 | | | | | |
| D G Jones | 2,418 | | | 2,418 | 4.28 | | 01/10/00 | 31/03/01 | Sharesave |
| | 568 | | | 568 | 6.07 | | 01/04/02 | 30/09/02 | Sharesave |
| | 179 | | | 179 | 10.87 | | 01/04/01 | 30/09/01 | Sharesave |
| | 8,012 | | | 8,012 | 4.68 | | 11/04/97 | 10/04/04 | Executive† |
| | 36,106 | | | 36,106 | 5.65 | | 25/03/99 | 24/03/06 | Executive |
| | 22,829 | | | 22,829 | 5.91 | | 09/09/99 | 08/09/06 | Executive# |
| | 150 | | | 150 | 5.91 | | 09/09/99 | 08/09/06 | Employee |
| | 70,262 | | | 70,262 | | | | | |
| J King | 291 | | | 291 | 6.68 | | 01/04/00 | 03/09/00 | Sharesave |
| (appointed 1 May 1999) | 2,418 | | | 2,418 | 4.28 | | 01/10/00 | 31/03/01 | Sharesave |
| | 349 | | | 349 | 9.88 | | 01/04/03 | 30/09/03 | Sharesave |
| | 4,455 | | | 4,455 | 4.68 | | 11/04/97 | 10/04/04 | Executive† |
| | 13,929 | | 13,929 | | 5.65 | 13.23 | 25/03/99 | 24/03/06 | Executive |
| | 23,181 | | | 23,181 | 5.91 | | 09/09/99 | 08/09/09 | Executive |
| | 150 | | | 150 | 5.91 | | 09/09/99 | 08/09/06 | Employee |
| | 44,773 | | 13,929 | 30,844 | | | | | |

**Directors' share interests** continued
**Share options** continued

| | At 1.1.99* | Granted | No. of options exercised | At 31.12.99 | Exercise price £ | Market price at date of exercise £ | Date from which exercisable | Expiry date | Notes |
|---|---|---|---|---|---|---|---|---|---|
| M J Millington | 4,204 | | | 4,204 | 4.28 | | 01/10/00 | 31/03/01 | Sharesave |
| (appointed 1 January 1999) | 19,000 | | | 19,000 | 4.86 | | 10/04/98 | 09/04/05 | Executive |
| | 20,353 | | | 20,353 | 5.65 | | 25/03/99 | 24/03/06 | Executive |
| | 6,000 | | | 6,000 | 5.64 | | 04/04/99 | 03/04/06 | Executive |
| | 17,451 | | | 17,451 | 7.22 | | 24/03/00 | 23/03/07 | Executive |
| | 10,769 | | | 10,769 | 11.07 | | 13/03/01 | 12/03/08 | Executive |
| | 300 | | | 300 | 5.91 | | 09/09/99 | 08/09/06 | Employee |
| | 150 | | | 150 | 11.95 | | 01/04/03 | 01/04/08 | Employee |
| | 78,227 | | | 78,227 | | | | | |
| M A Pain | 1,285 | | | 1,285 | 6.07 | | 01/04/04 | 30/09/04 | Sharesave |
| | 698 | | | 698 | 9.88 | | 01/04/03 | 30/09/03 | Sharesave |
| | | 371 | | 371 | 9.89 | | 01/04/06 | 01/10/06 | Sharesave |
| | 13,008 | | | 13,008 | 5.65 | | 25/03/99 | 24/03/06 | Executive |
| | 13,850 | | | 13,850 | 7.22 | | 24/03/00 | 23/03/07 | Executive |
| | 150 | | | 150 | 5.91 | | 09/09/99 | 08/09/06 | Employee |
| | 28,991 | 371 | | 29,362 | | | | | |
| A H Pople | 1,882 | | 1,882 | | 2.39 | 13.07 | 01/06/99 | 30/11/99 | Sharesave |
| | 2,418 | | | 2,418 | 4.28 | | 01/10/00 | 31/03/01 | Sharesave |
| | 568 | | | 568 | 6.07 | | 01/04/02 | 30/09/02 | Sharesave |
| | 349 | | | 349 | 9.88 | | 01/04/03 | 30/09/03 | Sharesave |
| | 23,008 | | 23,008 | | 5.65 | 14.15 | 25/03/99 | 24/03/06 | Executive |
| | 150 | | | 150 | 5.91 | | 09/09/99 | 08/09/06 | Employee |
| | 28,375 | | 24,890 | 3,485 | | | | | |
| I K Treacy | 4,707 | | 4,707 | | 2.39 | 13.07 | 01/06/99 | 30/11/99 | Sharesave |
| | 25,042 | | | 25,042 | 5.91 | | 09/09/99 | 08/09/06 | Executive |
| | 18,353 | | 18,353 | | 5.65 | 12.41 | 25/03/99 | 24/03/06 | Executive |
| | 150 | | | 150 | 5.91 | | 09/09/99 | 08/09/06 | Employee |
| | 48,252 | | 23,060 | 25,192 | | | | | |
| The Lord Tugendhat | 1,745 | | | 1,745 | 9.88 | | 01/04/03 | 30/09/03 | Sharesave |
| | 1,745 | | | 1,745 | | | | | |
| C N Villiers | 2,418 | | | 2,418 | 4.28 | | 01/10/00 | 31/03/01 | Sharesave |
| | 568 | | | 568 | 6.07 | | 01/04/02 | 30/09/02 | Sharesave |
| | 349 | | | 349 | 9.88 | | 01/04/03 | 30/09/03 | Sharesave |
| | 9,612 | | | 9,612 | 4.68 | | 11/04/97 | 10/04/04 | Executive |
| | 3,204 | | | 3,204 | 4.68 | | 11/04/97 | 10/04/04 | Executive† |
| | 32,086 | | | 32,086 | 4.83 | | 10/04/98 | 09/04/05 | Executive |
| | 10,055 | | 10,055 | | 5.65 | 12.41 | 25/03/99 | 24/03/06 | Executive |
| | 36,988 | | | 36,988 | 5.91 | | 09/09/99 | 08/09/06 | Executive# |
| | 150 | | | 150 | 5.91 | | 09/09/99 | 08/09/06 | Employee |
| | 95,430 | | 10,055 | 85,375 | | | | | |

* or date of appointment, if later # Replacement options † Parallel discounted options (see below).

**Notes:**
The executive share options detailed above are subject to performance conditions based on the average growth of earnings per ordinary share relative to the average increase in the retail price index in any three years prior to exercise.

Executive share options granted since 1996 become exercisable if the average growth in earnings per ordinary share exceeds the average increase in the retail price index by 2%. Executive share options granted since 1997 become exercisable if the growth in earnings per ordinary share over a three year period exceeds the average increase in inflation by an average of at least 2% per annum, and the Company's total shareholder return at least matches the median performing company in a group of specified financial institutions.

Parallel discounted options are exercisable at £3.98 from 11.4.1999 to 10.4.2004. Parallel discounted options become exercisable if the average growth in earnings per ordinary share exceeds the average increase in the retail price index by at least 10% in any five year period prior to the date of exercise. The option holder may exercise either the standard or discounted option, but not both, thereby reducing both options, subject to the achievement of the appropriate performance criteria. The Board determined in 1994 that it would no longer make grants of discounted options.

The options refer to those granted under the Company's Executive Share Option, Employee Share Option and Sharesave schemes, as set out in note 41 to the accounts on page 53.

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

Market price at the date of exercise is the Middle Market Quotation, as derived from the London Stock Exchange Daily Official List. The market price of the shares on 31 December 1999 was 990p (31 December 1998: 1287p) and the range during 1999 was 939p to 1435p.

There have been no changes to the beneficial and other interests of the directors in the ordinary shares of the Company as shown above up to 16 January 2000.

## Long Term Incentive Plan

Details of the Company's ordinary shares over which the directors have conditional rights under the Long Term Incentive Plan are as follows:

| Conditional rights | Conditional rights held under plan at 1/1/99 | Conditional rights granted during year | Shares awarded during year | Conditional rights lapsed during year | Conditional rights held under plan at 31/12/99 |
|---|---|---|---|---|---|
| I Harley | 42,001 | 24,551 | 9,763 | 9,764 | 47,025 |
| T C W Ingram | 27,754 | 14,731 | 7,135 | 7,135 | 28,125 |
| D G Jones | 33,906 | 16,367 | 9,012 | 9,013 | 32,248 |
| J King | 22,550 | 10,911 | 6,121 | 6,121 | 21,219 |
| M J Millington | 9,589 | 10,911 | – | – | 20,500 |
| M A Pain | 10,488 | 12,275 | – | – | 22,763 |
| A H Pople | 29,855 | 15,276 | 7,886 | 7,886 | 29,359 |
| C G Toner | 33,127 | – | 6,759 | 11,266 | 15,102 |
| I K Treacy | 25,129 | 11,457 | 6,571 | 6,572 | 23,443 |
| C N Villiers | 34,537 | – | 9,388 | 9,388 | 15,761 |

| Shares held in trust | Shares held in trust at 1/1/99 | Shares awarded during year | Shares transferred during year | Shares held in trust at 31/12/99 | These shares are receivable in: 2000 | 2002 |
|---|---|---|---|---|---|---|
| I Harley | – | 9,763 | – | 9,763 | 4,881 | 4,882 |
| T C W Ingram | – | 7,135 | – | 7,135 | 3,567 | 3,568 |
| D G Jones | – | 9,012 | – | 9,012 | 4,506 | 4,506 |
| J King | – | 6,121 | – | 6,121 | 3,060 | 3,061 |
| M J Millington | – | – | – | – | – | – |
| M A Pain | – | – | – | – | – | – |
| A H Pople | – | 7,886 | – | 7,886 | 3,943 | 3,943 |
| C G Toner | – | 6,759 | – | 6,759 | 3,379 | 3,380 |
| I K Treacy | – | 6,571 | – | 6,571 | 3,285 | 3,286 |
| C N Villiers | – | 9,388 | – | 9,388 | 4,694 | 4,694 |

**Notes:**

**1** Shares sufficient to satisfy the conditional rights granted under the Plan during the year were bought in the market and are held by the Abbey National Employee Trust (the Trust), which is administered by an independent professional trustee. The cost of these conditional awards is being charged to the profit and loss account over the three year performance period to which they relate. In 1999, £1,869,123 (1998: £872,198) was charged to the profit and loss account.

**2** Shares are awarded to directors upon the relevant performance criteria being met. Directors receive 50% of the shares awarded to them three years from the date the conditional rights are granted and the remainder five years from the same date. The awards form part of directors' emoluments in the year in which they are received and are disclosed at the value of the shares on the date of receipt by the directors.

**3** The aggregate maximum value of the conditional rights and shares held in trust shown above, based on the maximum number of shares that are receivable by the directors if the Company is ranked in the top quartile of both the relevant comparator groups, and on the market price of the Company's ordinary shares at 31 December 1999, 990p (1998: 1287p), would have been £3,149,982 (1998: £3,173,890). As stated above, all conditional rights are subject to performance criteria. The directors do not receive any of the shares if the Company is ranked below the median of both the relevant comparator groups.

Normally the directors only receive the shares awarded to them if they remain in employment with the Company. Shares held in trust are not subject to any further performance criteria.

**4** By virtue of their being potential beneficiaries of the Trust, each executive director is deemed, for the purpose of the Companies Act 1985, to have an interest in all the shares held by the Trust. At 31 December 1999, the Trust held 389,320 ordinary shares (31 December 1998: 268,936 ordinary shares) for the above-named directors.

## Directors' responsibilities for accounts

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

In respect of the accounts the directors are required to:
– ensure that suitable accounting policies, which follow generally accepted accounting practice, have been applied consistently;
– ensure that reasonable and prudent judgements and estimates have been used in the preparation of the accounts;
– prepare the accounts on the going concern basis unless it is inappropriate to presume that the Company and the Group will continue in business; and
– state whether applicable accounting standards have been followed and to disclose and explain any material departures in the accounts.

## Auditors' report to the members of Abbey National plc

We have audited the accounts on pages 37 to 61 which have been prepared under the accounting policies set out on pages 41 and 42.

**Respective responsibilities of directors and auditors**
The Company's directors are responsible for preparing the Annual Report, including as described above, the accounts. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange, and by our profession's ethical guidance.

We report to you our opinion as to whether the accounts give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the accounts, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions with the Company and other members of the Group is not disclosed.

We review whether the corporate governance statement on page 28 reflects the compliance with the seven provisions of the Combined Code specified for our review by the Stock Exchange, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all the risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

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

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

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

**Opinion**
In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 1999 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

**Deloitte & Touche**
Chartered Accountants and Registered Auditors
London
16 February 2000

## Consolidated profit and loss account for the year ended 31 December 1999

| Notes | | 1999 Before exceptional items £m | 1999 Exceptional items (see note 3) £m | 1999 Total £m | 1998 (restated) Total £m |
|---|---|---|---|---|---|
| | Interest receivable: | | | | |
| | Interest receivable and similar income arising from debt securities | **2,902** | | **2,902** | 3,103 |
| 2 | Other interest receivable and similar income | **6,327** | | **6,327** | 6,822 |
| 4 | Interest payable | **(6,568)** | | **(6,568)** | (7,684) |
| | **Net interest income** | **2,661** | | **2,661** | 2,241 |
| 5 | Dividend income | **2** | | **2** | 4 |
| | Fees and commissions receivable | **737** | | **737** | 643 |
| | Fees and commissions payable | **(246)** | | **(246)** | (136) |
| 6 | Dealing profits | **98** | | **98** | 32 |
| | Other operating income: | | | | |
| 22 | Income from long term assurance business | **202** | **(6)** | **196** | 155 |
| 7 | Other operating income | **302** | | **302** | 172 |
| | **Total operating income** | **3,756** | **(6)** | **3,750** | 3,111 |
| 8 | Administrative expenses | **(1,475)** | **(21)** | **(1,496)** | (1,240) |
| 9 | Depreciation and amortisation | **(119)** | | **(119)** | (106) |
| | Provisions: | | | | |
| 10 | Provisions for bad and doubtful debts | **(303)** | | **(303)** | (201) |
| 39 | Provisions for contingent liabilities and commitments | **(23)** | | **(23)** | (16) |
| | Amounts written off fixed asset investments | **(26)** | | **(26)** | (28) |
| | **Profit on ordinary activities before tax** | **1,810** | **(27)** | **1,783** | 1,520 |
| 11 | Tax on profit on ordinary activities | **(530)** | **8** | **(522)** | (462) |
| 12 | **Profit on ordinary activities after tax** | **1,280** | **(19)** | **1,261** | 1,058 |
| 42 | Transfer to non-distributable reserve | | | **(13)** | (125) |
| 13 | Dividends including amounts attributable to non-equity interests | | | **(610)** | (535) |
| | **Profit retained for the financial year** | | | **638** | 398 |
| 14 | **Earnings per ordinary share – basic** | | | **86.2p** | 72.4p |
| 14 | **Earnings per ordinary share – diluted** | | | **85.5p** | 71.7p |

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

All results arise from continuing operations.

## Consolidated balance sheet as at 31 December 1999

| Notes | | 1999 £m | 1999 £m | 1998 (restated) £m | 1998 (restated) £m |
|---|---|---|---|---|---|
| | **Assets** | | | | |
| | Cash and balances at central banks | | **701** | | 329 |
| 15 | Treasury bills and other eligible bills | | **1,114** | | 2,057 |
| 16 | Loans and advances to banks | | **11,472** | | 7,428 |
| 17 | Loans and advances to customers | | **75,221** | | 72,257 |
| 18 | Loans and advances to customers subject to securitisation | **1,930** | | 217 | |
| | Less: non-returnable finance | **(1,379)** | | (213) | |
| | | | **551** | | 4 |
| 19 | Net investment in finance leases | | **5,441** | | 5,326 |
| 20 | Debt securities | | **59,445** | | 54,203 |
| 21 | Equity shares and other variable yield securities | | **295** | | 123 |
| 22 | Long term assurance business | | **1,042** | | 760 |
| 23 | Interests in associated undertakings | | **59** | | 20 |
| 26 | Intangible fixed assets | | **203** | | 201 |
| 27 | Tangible fixed assets | | **759** | | 731 |
| 28 | Operating lease assets | | **358** | | 223 |
| 29 | Other assets | | **3,930** | | 3,332 |
| 30 | Prepayments and accrued income | | **2,714** | | 2,376 |
| 22 | Assets of long term assurance funds | | **17,439** | | 13,383 |
| | **Total assets** | | **180,744** | | 162,753 |
| | **Liabilities** | | | | |
| 32 | Deposits by banks | | **29,824** | | 35,610 |
| 33 | Customer accounts | | **59,911** | | 52,924 |
| 34 | Debt securities in issue | | **51,407** | | 42,989 |
| | Dividend proposed | | **382** | | 334 |
| 35 | Other liabilities | | **6,930** | | 4,564 |
| 36 | Accruals and deferred income | | **2,857** | | 3,015 |
| 37 | Provisions for liabilities and charges | | **1,275** | | 1,194 |
| 40 | Subordinated liabilities including convertible debt | | **4,641** | | 3,333 |
| 22 | Liabilities of long term assurance funds | | **17,439** | | 13,383 |
| | | | **174,666** | | 157,346 |
| 41 | Called up share capital – ordinary shares | **142** | | 142 | |
| | – preference shares | **325** | | 325 | |
| 41 | Share premium account | **1,536** | | 1,493 | |
| 42 | Reserves | **449** | | 433 | |
| 42 | Profit and loss account | **3,626** | | 3,014 | |
| 43 | Shareholders' funds including non-equity interests | | **6,078** | | 5,407 |
| | **Total liabilities** | | **180,744** | | 162,753 |
| | **Memorandum items** | | | | |
| | Contingent liabilities | | | | |
| 45 | Guarantees and assets pledged as collateral security | | **2,214** | | 1,844 |
| 46 | Other contingent liabilities | | **477** | | 552 |
| | | | **2,691** | | 2,396 |
| | Commitments | | | | |
| 47 | Obligations under stock borrowing and lending agreements | | **17,024** | | 15,026 |
| 47 | Other commitments | | **6,235** | | 2,810 |
| | | | **23,259** | | 17,836 |

For details of the 1998 balance sheet restatement, see 'Accounting policies, Stock borrowing and lending arrangements' on page 42.
The accounts on pages 37 to 61 were approved by the Board on 16 February 2000 and signed on its behalf by:

**Lord Tugendhat** Chairman

**Ian Harley** Chief Executive

**Mark Pain** Finance Director

## Company balance sheet as at 31 December 1999

| Notes | | 1999 £m | 1999 £m | 1998 £m | 1998 £m |
|---|---|---|---|---|---|
| | **Assets** | | | | |
| | Cash and balances at central banks | | **672** | | 324 |
| 16 | Loans and advances to banks | | **4,650** | | 3,361 |
| 17 | Loans and advances to customers | | **62,927** | | 62,165 |
| 18 | Loans and advances to customers subject to securitisation | **1,932** | | 217 | |
| | Less: non-returnable finance | **(1,911)** | | (213) | |
| | | | **21** | | 4 |
| 20 | Debt securities | | **1,302** | | 1,491 |
| 21 | Equity shares and other variable yield securities | | **2** | | 4 |
| 23 | Interests in associated undertakings | | **12** | | 11 |
| 24 | Shares in Group undertakings | | **4,187** | | 2,776 |
| 27 | Tangible fixed assets | | **575** | | 564 |
| 29 | Other assets | | **343** | | 564 |
| 30 | Prepayments and accrued income | | **1,049** | | 694 |
| | **Total assets** | | **75,740** | | 71,958 |
| | **Liabilities** | | | | |
| 32 | Deposits by banks | | **11,020** | | 11,533 |
| 33 | Customer accounts | | **52,919** | | 50,730 |
| 34 | Debt securities in issue | | **21** | | 23 |
| | Dividend proposed | | **382** | | 334 |
| 35 | Other liabilities | | **627** | | 740 |
| 36 | Accruals and deferred income | | **1,024** | | 1,014 |
| 37 | Provisions for liabilities and charges | | **54** | | 72 |
| 40 | Subordinated liabilities including convertible debt | | **4,668** | | 3,343 |
| | | | **70,715** | | 67,789 |
| 41 | Called up share capital – ordinary shares | **142** | | 142 | |
| | – preference shares | **325** | | 325 | |
| 41 | Share premium account | **1,536** | | 1,493 | |
| 42 | Profit and loss account | **3,022** | | 2,209 | |
| 43 | Shareholders' funds including non-equity interests | | **5,025** | | 4,169 |
| | **Total liabilities** | | **75,740** | | 71,958 |
| | **Memorandum items** | | | | |
| | Contingent liabilities | | | | |
| 45 | Guarantees and assets pledged as collateral security | | **128,643** | | 107,615 |
| 46 | Other contingent liabilities | | **8** | | 10 |
| | | | **128,651** | | 107,625 |
| 47 | Commitments | | **497** | | 338 |
| | | | **497** | | 338 |

The accounts on pages 37 to 61 were approved by the Board on 16 February 2000 and signed on its behalf by:

**Lord Tugendhat** Chairman

**Ian Harley** Chief Executive

**Mark Pain** Finance Director

## Statement of total recognised gains and losses for the year ended 31 December 1999

| Notes | | 1999 £m | 1998 £m |
|---|---|---|---|
| | Profit attributable to the shareholders of Abbey National plc | **1,261** | 1,058 |
| 42 | Translation differences on foreign currency net investment | **(1)** | – |
| 42 | Unrealised surplus on revaluation of investment properties | **3** | – |
| | **Total recognised gains relating to the year** | **1,263** | 1,058 |

## Consolidated cash flow statement for the year ended 31 December 1999

| Notes | | 1999 £m | 1998 £m |
|---|---|---|---|
| 51a | **Net cash inflow from operating activities** | **10,527** | 4,688 |
| | Returns on investments and servicing of finance: | | |
| | Interest paid on subordinated liabilities | **(198)** | (195) |
| | Preference dividends paid | **(41)** | (36) |
| | **Net cash outflow from returns on investments and servicing of finance** | **(239)** | (231) |
| | Taxation: | | |
| | UK corporation tax paid | **(316)** | (236) |
| | Overseas tax paid | **(3)** | (52) |
| | **Total taxation paid** | **(319)** | (288) |
| | Capital expenditure and financial investment: | | |
| | Purchases of investment securities | **(20,384)** | (26,335) |
| | Sales of investment securities | **4,166** | 14,314 |
| | Redemptions and maturities of investment securities | **7,383** | 8,102 |
| | Purchases of tangible fixed assets | **(364)** | (219) |
| | Sales of tangible fixed assets | **95** | 70 |
| | Transfers to life assurance funds | **(145)** | (4) |
| 51e,g | **Net cash outflow from capital expenditure and financial investment** | **(9,249)** | (4,072) |
| | **Acquisitions and disposals** | **(30)** | (214) |
| | **Equity dividends paid** | **(520)** | (454) |
| | **Net cash inflow (outflow) before financing** | **170** | (571) |
| | Financing: | | |
| | Issue of ordinary share capital | **18** | 17 |
| | Issue of loan capital | **1,525** | 857 |
| | Repayments of loan capital | **(195)** | – |
| 51c | **Net cash inflow from financing** | **1,348** | 874 |
| 51b | **Increase in cash** | **1,518** | 303 |

For the purposes of the consolidated cash flow statement, cash includes all cash in hand and loans and advances to banks repayable on demand without notice or penalty, including amounts denominated in foreign currencies.

**Basis of presentation**
The consolidated accounts are prepared in accordance with the special provisions of Part VII of the Companies Act 1985 applicable to banking companies and banking groups.

**Accounting convention**
The Group prepares its accounts under the historical cost convention, modified by the revaluation of certain assets, in accordance with applicable UK accounting standards and the Statements of Recommended Accounting Practice issued by the British Bankers' Association and the Irish Bankers' Federation.

**Basis of consolidation**
The Group accounts comprise the accounts of the Company and all its subsidiary undertakings. The accounting reference date of the Company and its subsidiary undertakings is 31 December, with the exception of those leasing, investment, insurance and funding companies, which, because of commercial considerations, have various accounting reference dates. The accounts of these subsidiaries have been consolidated on the basis of interim accounts for the period to 31 December 1999.

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

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

**Goodwill**
Goodwill arising on consolidation as a result of the acquisitions of subsidiary undertakings and the purchase of businesses after 1 January 1998 is capitalised under the heading Intangible fixed assets and amortised on a straight line basis over its expected useful economic life. Such goodwill is subject to review for impairment in accordance with FRS 11, 'Impairment of fixed assets and goodwill' (see below). The useful economic life is calculated using a valuation model which determines the period of time over which returns are expected to exceed the cost of capital, subject to a maximum period of 20 years.

Goodwill arising on consolidation as a result of the acquisitions of subsidiary undertakings, and the purchase of businesses prior to 1 January 1998, has previously been taken to reserves. On disposal of subsidiary undertakings and businesses, such goodwill is charged to the profit and loss account balanced by an equal credit to reserves. Where such goodwill in continuing businesses has suffered an impairment, a similar charge to the profit and loss account and credit to reserves is made.

**Impairment of fixed assets and goodwill**
Tangible fixed assets, other than investment properties, and goodwill are subject to review for impairment in accordance with FRS 11. The carrying values of tangible fixed assets and goodwill are written down by the amount of any impairment, and the loss is recognised in the profit and loss account in the period in which this occurs. Should an external event reverse the effects of a previous impairment, the carrying value of tangible fixed assets and goodwill may be written up to a value no higher than the original depreciated or amortised cost.

**Depreciation**
Tangible fixed assets, other than investment properties (see below), are depreciated on a straight line basis over their estimated useful lives. The following annual rates are used:

| **Premises and Equipment** | |
|---|---|
| Freehold buildings: | 1.0% |
| Long and short leasehold premises: Over the remainder of the lease, with a maximum of 100 years. Acquisition premiums are depreciated over the period to the next rent review. | |
| Office fixtures, equipment and furniture: | 12.5% |
| Computer equipment: | |
| Mainframes | 25.0% |
| Peripherals | 20.0% |
| No depreciation is provided on freehold land. | |

For a description of depreciation on operating lease assets, see 'Equipment leased to customers' below.

**Investment properties**
In accordance with Statement of Standard Accounting Practice (SSAP) 19, 'Accounting for investment properties', investment properties are included in the consolidated balance sheet at their open market value in existing use and are revalued annually. Changes in market value are reflected in the investment revaluation reserve except where the property is permanently impaired when the loss is taken directly to the profit and loss account.

No depreciation is provided in respect of investment properties. This is a departure from the requirements of the Companies Act 1985 which requires all properties to be depreciated. Such properties are not held for consumption but for investment and the directors consider that to depreciate them would not give a true and fair view. Depreciation is only one amongst many factors reflected in the annual valuation of properties and accordingly the amount of depreciation which might otherwise have been charged cannot be separately identified or quantified.

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

**Interest receivable**
Interest is suspended where due but not received on loans and advances in arrears where recovery is doubtful. The amounts suspended are excluded from interest receivable on loans and advances until recovered.

**Fees, commissions and dividends receivable**
Fees and commissions receivable in respect of services provided are taken to the profit and loss account when the related services are performed. Where fees, commissions and dividends are in the nature of interest, these are taken to the profit and loss account on a systematic basis over the expected life of the transaction to which they relate, and are included under the heading, Interest receivable. Fees which are receivable in order to cover a proportion of future losses, as explained in more detail under Deferred income, are taken to the profit and loss account as the relevant losses are identified and provided for, and are included under the heading, Other operating income. Income on investments in equity shares and variable yield securities is recognised as and when dividends are received, and included within Dividend income.

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

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

**Dealing profits**
Dealing profits include movements in prices on a mark to market basis, including accrued interest, on trading derivatives. Dealing profits also include movements in prices, on a mark to market basis excluding accrued interest, on trading debt securities and trading treasury and other eligible bills. In 1998, dealing profits also included interest receivable on trading securities, and interest payable on their associated funding. Following an accounting presentation change, such interest is now included in interest receivable and interest payable. The 1998 comparative balances have been restated with the effect being a £12m reduction in dealing profit, a £457m increase in interest receivable, and a £445m increase in interest payable.

**Deferred income**
The Company has entered into insurance arrangements with certain insurance subsidiaries to cover a proportion of future losses on certain UK loans and advances secured on residential properties with high loan to value ratios, for which a fee may be charged.

In the Group accounts, such fees are deferred and are included in the balance sheet under the heading, Accruals and deferred income. The deferred income balance is held to cover anticipated losses in connection with such lending, and deferred income is released to the profit and loss account to match the expiry of risk or, where the loans become impaired, to match the provisions charge.

**Securities**
Debt securities, equity shares and other variable yield securities (securities) held for investment purposes are stated at cost, adjusted for any amortisation of premium or discount on an appropriate basis over their estimated remaining lives. Provision is made for any impairment. Investment securities are intended for use on a continuing basis by the Group and have been identified as such.

In accordance with industry practice, securities which are not held for the purpose of investment and the associated funding of these assets are stated at market value and profits and losses arising from this revaluation are taken directly to the profit and loss account. The net return on these assets, excluding interest, appears in Dealing profits in the profit and loss account. This net return comprises the revaluation profit and loss referred to above, plus profits and losses on disposal of these assets. The difference between the cost and market value of securities not held for investment is not disclosed as its determination is not practicable.

Where securities are transferred from portfolios held for investment purposes to portfolios held for other purposes, the securities are transferred at market value. Gains and losses on these transfers are taken directly to the profit and loss account, and are included within Other operating income.

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

Securities sold subject to sale and repurchase agreements are retained on the balance sheet where the risks and rewards of ownership of the securities remain with the Group. Similarly, securities purchased subject to purchase and resale agreements are treated as collateralised lending transactions where the Group does not acquire the risks and rewards of ownership.

**Sale and repurchase agreements**
The Group enters into purchase and resale and sale and repurchase agreements as part of its money market business. These amounts are included within Loans and advances to banks, Loans and advances to customers, Deposits by banks and Customer accounts. The difference between sale and repurchase and purchase and resale prices for such transactions is charged or credited to the profit and loss account over the life of the relevant transactions within Interest receivable and Interest payable.

**Stock borrowing and lending arrangements**
The Group enters into stock borrowing and lending agreements as a means of carrying out its money market business. In addition, stock borrowing and lending agreements are entered into for acquiring and selling equities.

In 1998, the right to receive stocks lent under such agreements was recognised on the balance sheet as 'Assets under stock borrowing and lending agreements'. Similarly, obligations to return stocks borrowed under such agreements were recognised on the balance sheet as 'Liabilities under stock borrowing and lending agreements'.

Following an assessment of recent accounting pronouncements and a review of industry practice in 1999, it has been determined that the rights and obligations entered into under stock borrowing and lending agreements do not meet the definition of assets and liabilities. Therefore the Group's accounting policy for transactions entered into under such agreements has been changed to one of de-recognition of the associated right to receive stock and obligation to return stock balances. The 1998 comparative amounts have been restated to reflect this accounting policy change and as a consequence both Total assets and Total liabilities in the consolidated balance sheet have reduced by £15,026 million. Obligations taken on pursuant to entering into such agreements are now reported as Commitments.

Income earned and expense paid on stock borrowing and lending agreements is reported as Fees and commissions receivable and Fees and commissions payable, except when in the nature of interest, in which case they are reported as Interest receivable and Interest payable.

**Debt securities in issue**
Premiums, discounts and expenses relating to bonds and notes issued as part of the Group's funding programme are amortised over the life of the underlying transaction. Bonds and notes issued are therefore stated at net issue proceeds adjusted for amortisation. Where premiums, discounts and expenses are matched by swap fees, the presentation of these premiums, discounts and expenses has been matched with the presentation of the swap fees, in Prepayments and accrued income and Accruals and deferred income.

**Derivatives**
Transactions are undertaken in derivative financial instruments, (derivatives), which include interest rate swaps, cross-currency swaps, futures, equity derivatives, options and similar instruments for both trading and non-trading purposes.

Derivatives classified as trading are held for market making or portfolio management purposes within the Group's trading books. Trading book activity is the buying and selling of financial instruments in order to take advantage of short term changes in market prices or for market making purposes in order to facilitate customer requirements. Trading derivatives are carried at market value in the balance sheet within Other assets and Other liabilities. Valuation adjustments to cover credit and market liquidity risks and future administration costs are made. Positive and negative market values of trading derivatives are offset where the contracts have been entered into under master netting agreements or other arrangements that represent a legally enforceable right of set-off which will survive the liquidation of either party. Gains and losses are taken directly to the profit and loss account and reported within Dealing profits.

Derivatives classified as non-trading are those entered into for the purpose of matching or eliminating risk from potential movements in foreign exchange rates, interest rates, and equity prices inherent in the Group's non-trading assets, liabilities and positions. Non-trading assets, liabilities and positions are those intended for use on a continuing basis in the activities of the Group.

A derivative is designated as non-trading where there is an offset between the effects of potential movements in market rates on the derivative and designated non-trading asset, liability or position being hedged. Non-trading derivatives are reviewed regularly for their effectiveness as hedges. Non-trading derivatives are initially recorded at cost and accounted for on an accruals basis, consistent with the assets, liabilities, or positions being hedged. Income and expense on non-trading derivatives are recognised as they accrue over the life of the instruments as an adjustment to interest receivable or payable.

Where a non-trading derivative no longer represents a hedge because either the underlying non-trading asset, liability or position has been de-recognised, or transferred into a trading portfolio, or the effectiveness of the hedge has been undermined, it is restated at market value and any change in value is taken directly to the profit and loss account and reported within Other operating income. Thereafter the derivative is classified as trading or re-designated as a hedge of a non-trading item and accounted for accordingly.

In other circumstances, where non-trading derivatives are reclassified as trading or where non-trading derivatives are terminated, any resulting gains and losses are amortised over the remaining life of the hedged asset, liability or position.

Unamortised gains and losses are reported within Prepayments and accrued interest and Accruals and deferred income respectively on the balance sheet.

**Derivatives** continued
Derivatives hedging anticipatory transactions are accounted for on a basis consistent with the relevant type of transaction.

Where anticipatory transactions do not actually occur, related derivatives are restated at fair value and changes in value are taken directly to the profit and loss account and reported within Other operating income. Where retained, such derivatives are reclassified as trading or re-designated as a hedge of a non-trading item and accounted for accordingly.

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

Operating lease assets are shown at cost less depreciation, calculated on the actuarial after tax method, and are shown as a separate category of fixed asset since they are held for a different purpose.

Income in respect of Operating lease assets and the depreciation charge for the period are both included within Other operating income.

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

**Securitisations**
Certain Group undertakings have issued debt securities, or have entered into funding arrangements with lenders, in order to finance the purchase of certain portfolios of loan and investment assets. These obligations are secured on the assets of the undertakings. Where the conditions for linked presentation are met, the proceeds of the note issues (to the extent that there is recourse) are shown deducted from the securitised assets on the face of the balance sheet.

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

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

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

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

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

| 1. Segmental analysis | UK Retail Banking £m | Wholesale Banking £m | Life Assurance £m | Finance House £m | General Insurance £m | Wealth Management £m | Continental Europe £m | Central Holdings £m | cahoot £m | Group Total £m |
|---|---|---|---|---|---|---|---|---|---|---|
| 1999 | | | | | | | | | | |
| Net interest income before exceptional items | **1,621** | **393** | **9** | **561** | **(2)** | **62** | **28** | **(11)** | **–** | **2,661** |
| Other income and charges | **389** | **167** | **236** | **(20)** | **145** | **46** | **3** | **129** | **–** | **1,095** |
| **Total operating income** | **2,010** | **560** | **245** | **541** | **143** | **108** | **31** | **118** | **–** | **3,756** |
| Profit (loss) before taxation and exceptional items | **996** | **419** | **229** | **140** | **104** | **17** | **(8)** | **(71)** | **(16)** | **1,810** |
| Year 2000 and EMU costs | **(12)** | **(2)** | **(6)** | **(1)** | **(1)** | **(1)** | **(3)** | **(1)** | **–** | **(27)** |
| Profit (loss) before taxation | **984** | **417** | **223** | **139** | **103** | **16** | **(11)** | **(72)** | **(16)** | **1,783** |
| **Total assets** | **64,838** | **81,741** | **18,893** | **8,697** | **146** | **4,491** | **1,456** | **482** | **–** | **180,744** |
| **Net assets** | **2,445** | **2,087** | **988** | **646** | **42** | **107** | **61** | **(298)** | **–** | **6,078** |
| The average number of staff employed by the Group during the year was as follows: | | | | | | | | | | |
| Employees | **17,084** | **561** | **2,000** | **4,301** | **920** | **1,133** | **362** | **2,840** | **8** | **29,209** |
| 1998 | | | | | | | | | | |
| Net interest income before exceptional items | 1,522 | 411 | (11) | 241 | (5) | 47 | 17 | 19 | – | 2,241 |
| Other income and charges | 383 | 55 | 211 | (15) | 147 | 38 | 18 | 40 | – | 877 |
| Total operating income | 1,905 | 466 | 200 | 226 | 142 | 85 | 35 | 59 | – | 3,118 |
| Profit (loss) before taxation and exceptional items | 926 | 361 | 190 | 94 | 98 | 26 | – | (107) | – | 1,588 |
| Year 2000 and EMU costs | (41) | (2) | (7) | (1) | (4) | (1) | (4) | (8) | – | (68) |
| Profit (loss) before taxation | 885 | 359 | 183 | 93 | 94 | 25 | (4) | (115) | – | 1,520 |
| Includes for: discontinued operations | 1 | – | – | – | – | – | 13 | (9) | – | 5 |
| Total assets | 63,469 | 69,916 | 14,360 | 8,279 | 137 | 4,225 | 1,289 | 1,078 | – | 162,753 |
| Net assets | 2,421 | 1,922 | 643 | 222 | 22 | 98 | 50 | 29 | – | 5,407 |
| The average number of staff employed by the Group during the year was as follows: | | | | | | | | | | |
| Employees | 17,592 | 454 | 1,889 | 2,153 | 904 | 928 | 413 | 3,323 | – | 27,656 |

1998 results have been restated to reflect the transfer of City Deal Services Ltd from Wholesale Banking to Wealth Management, and the transfer of the Abbey National-branded unsecured personal lending business from Finance House to UK Retail Banking.

Consistent with previous years, when arriving at the segmental analysis, certain adjustments have been made. They include an adjustment to reflect the capital notionally absorbed by each segment, based on the Group's Financial Services

Authority regulatory requirements, and an allocation across the segments of the earnings on group reserves.

No separate geographical analysis is presented because the only significant non-UK businesses are shown in the Continental Europe and Wealth Management business segments and represent less than 5% of total assets.

| 2. Other interest receivable and similar income | 1999 £m | 1998 (restated) £m |
|---|---|---|
| On secured advances | **4,550** | 5,171 |
| On unsecured advances | **839** | 582 |
| On finance leases | **337** | 340 |
| On other interest earning assets and investments | **601** | 729 |
| | **6,327** | 6,822 |

Interest receivable on secured advances has been reduced by £235m (£207m) in respect of the charge for lending-related fees and discounts payable, which are charged against interest income over the period of time in which the Group has the right to recover the incentives in the event of early redemption. The movements on such incentives are as follows:

| | Group | | | Company | | |
|---|---|---|---|---|---|---|
| | Interest rate discounts £m | Cashbacks £m | Total £m | Interest rate discounts £m | Cashbacks £m | Total £m |
| At 1 January 1999 | 113 | 435 | 548 | 113 | 433 | 546 |
| Expenditure incurred in the year | 107 | 160 | 267 | 107 | 158 | 265 |
| Transfer to profit and loss account | (110) | (125) | (235) | (110) | (124) | (234) |
| At 31 December 1999 | 110 | 470 | 580 | 110 | 467 | 577 |

Interest due but not received on loans and advances in arrears has not been recognised in interest receivable where collectability is in doubt, but has been suspended. A table showing the movements on suspended interest is included in note 10.

**3. Exceptional items Year 2000 and EMU costs**
The costs incurred during the year in preparing the Group for Year 2000 and Economic and Monetary Union (EMU) have been treated as exceptional items but included within existing captions in the profit and loss account. An analysis of the expenditure incurred, including comparatives, is shown below:

| Year ended 31 December 1999 | Year 2000 £m | EMU £m | Total £m |
|---|---|---|---|
| Expenditure charged to the profit and loss account: | | | |
| Included within: | | | |
| Other administrative expenses | 17 | 4 | 21 |
| Income from long term assurance business | 6 | – | 6 |
| Capital expenditure (included within Tangible fixed assets) | 2 | – | 2 |

| Year ended 31 December 1998 | Year 2000 £m | EMU £m | Total £m |
|---|---|---|---|
| Expenditure charged to the profit and loss account: | | | |
| Included within: | | | |
| Other administrative expenses | 58 | 3 | 61 |
| Income from long term assurance business | 7 | – | 7 |
| Capital expenditure (included within Tangible fixed assets) | 6 | – | 6 |

Further information on Year 2000 and EMU can be found on page 20 of the Operating and financial review.

| 4. Interest payable | 1999 £m | 1998 (restated) £m |
|---|---|---|
| On retail customer accounts | **1,930** | 2,757 |
| On sale and repurchase agreements | **776** | 1,000 |
| On other deposits and loans | **3,621** | 3,727 |
| On subordinated liabilities including convertible debt | **241** | 200 |
| | **6,568** | 7,684 |

| 5. Dividend income | 1999 £m | 1998 £m |
|---|---|---|
| Income from equity shares and other variable yield securities | **2** | 4 |

| 6. Dealing profits | 1999 £m | 1998 (restated) £m |
|---|---|---|
| Debt securities | **20** | 2 |
| Interest rate and equity derivatives | **78** | 30 |
| | **98** | 32 |

| 7. Other operating income | 1999 £m | 1998 £m |
|---|---|---|
| Deferred income release (see note 36) | **77** | 70 |
| Profits less losses on disposal of investment securities | **33** | 17 |
| Profit on disposal of equity shares | **60** | – |
| Income from operating lease assets | **78** | 31 |
| Depreciation on operating lease assets | **(52)** | (20) |
| Income from associated undertakings | **12** | – |
| Other | **94** | 74 |
| | **302** | 172 |

Profit on disposal of equity shares comprises profit made by Abbey National Beta Investments Ltd, a subsidiary of Abbey National plc, on disposal of its holding in Irish Permanent.

| 8. Administrative expenses | 1999 £m | 1998 £m |
|---|---|---|
| Staff costs (1): | | |
| Wages and salaries | **621** | 516 |
| Social security costs | **49** | 42 |
| Other pension costs | **69** | 53 |
| | **739** | 611 |
| Property and equipment expenses: | | |
| Rents payable | **72** | 61 |
| Rates payable | **27** | 25 |
| Hire of equipment | **5** | 6 |
| Other property and equipment expenses | **50** | 50 |
| | **154** | 142 |
| Other administrative expenses (2) | **603** | 487 |
| | **1,496** | 1,240 |

**8. Administrative expenses** continued
**Notes:**
(1) Excludes the following staff costs incurred by the Life Assurance division, which are charged to income from long term assurance business:

| | 1999 £m | 1998 £m |
|---|---|---|
| Staff costs: | | |
| Wages and salaries | **39** | 37 |
| Social security costs | **3** | 3 |
| Other pension costs | **4** | 4 |
| | **46** | 44 |

(2) On 22 April, Deloitte & Touche (D&T) were appointed to carry out statutory audit work for Abbey National plc and substantially all its subsidiaries in 1999, succeeding PricewaterhouseCoopers (PwC), and therefore substantially all 1999 costs relate to D&T. Comparative payments relate to amounts paid to PwC, except for amounts paid prior to 1 July 1998, the date of the merger between Coopers & Lybrand and Price Waterhouse to form PricewaterhouseCoopers, where payments relate to either Coopers & Lybrand or Price Waterhouse.

| All amounts stated net of V.A.T. | 1999 £m | 1998 £m |
|---|---|---|
| Audit services | **3.2** | 3.2 |
| Reporting accountants and other regulatory reporting | **0.9** | 1.0 |
| Sub-total: Audit and similar services | **4.1** | 4.2 |
| Tax services | **0.1** | 0.6 |
| Consultancy and advisory services | **1.9** | 2.2 |
| Sub-total: Other services | **2.0** | 2.8 |
| | **6.1** | 7.0 |

Included within the remuneration for audit services is the audit fee for the Company of £0.8m (£0.9m).

Of the fees payable to the Group's auditors for audit services £3.0m (£3.0m) related to the United Kingdom.

Payments to Deloitte & Touche for Consultancy and advisory services represents less than 5% of the Group's total consultancy expenditure.

| 9. Depreciation and amortisation | 1999 £m | 1998 £m |
|---|---|---|
| Amortisation of intangible fixed assets – purchased goodwill (see note 26) | **11** | 1 |
| Depreciation of tangible fixed assets (see note 27) | **108** | 105 |
| | **119** | 106 |

| 10. Provisions for bad and doubtful debts | On advances secured on residential properties £m | On other secured advances £m | On unsecured advances £m | Total £m |
|---|---|---|---|---|
| **Group** | | | | |
| At 1 January 1999 | | | | |
| General | 109 | 23 | 67 | 199 |
| Specific | 106 | 118 | 138 | 362 |
| Exchange adjustments | (2) | (9) | – | (11) |
| Transfer from profit and loss account | 34 | 47 | 222 | 303 |
| Irrecoverable amounts written off | (40) | (59) | (225) | (324) |
| At 31 December 1999 | 207 | 120 | 202 | 529 |
| Being for the Group: | | | | |
| General | 131 | 23 | 39 | 193 |
| Specific | 76 | 97 | 163 | 336 |
| **Including for the Company:** | | | | |
| At 1 January 1999 | | | | |
| General | 62 | – | 12 | 74 |
| Specific | 57 | 1 | 101 | 159 |
| At 31 December 1999 | | | | |
| General | 68 | – | 14 | 82 |
| Specific | 30 | 1 | 98 | 129 |

**10. Provisions for bad and doubtful debts** continued

Capital provisions as a percentage of loans and advances to customers

| | On advances secured on residential properties % | On other secured advances % | On unsecured advances % | Total % |
|---|---|---|---|---|
| **Group** | | | | |
| At 31 December 1999 | | | | |
| UK | 0.3 | 2.3 | 2.3 | 0.6 |
| Non-UK | 1.2 | 38.4 | 3.4 | 4.6 |
| At 31 December 1998 | | | | |
| UK | 0.3 | 3.4 | 3.2 | 0.6 |
| Non-UK | 1.8 | 44.7 | 2.2 | 7.3 |
| **Company** | | | | |
| At 31 December 1999 | 0.2 | 1.1 | 6.0 | 0.3 |
| At 31 December 1998 | 0.2 | 1.4 | 6.2 | 0.4 |
| Analysis of movements on suspended interest | £m | £m | £m | £m |
| **Group** | | | | |
| At 1 January 1999 | 61 | 78 | 11 | 150 |
| Exchange adjustments | (3) | (8) | – | (11) |
| Amounts suspended in the period | 9 | 3 | 14 | 26 |
| Irrecoverable amounts written off | (25) | (11) | (15) | (51) |
| At 31 December 1999 | 42 | 62 | 10 | 114 |
| Including for the Company: | | | | |
| At 1 January 1999 | 40 | 1 | 8 | 49 |
| At 31 December 1999 | 26 | 1 | 6 | 33 |

The value of loans and advances at 31 December 1999 on which interest is suspended is as follows:

| | | | | |
|---|---|---|---|---|
| **Group** | £m | £m | £m | £m |
| Loans and advances to customers | 466 | 131 | 207 | 804 |
| Provisions on these amounts | (76) | (97) | (110) | (283) |
| **Company** | £m | £m | £m | £m |
| Loans and advances to customers | 341 | 2 | 102 | 445 |
| Provisions on these amounts | (30) | (1) | (67) | (98) |

**Analysis of Group non-performing loans and advances**

The following table presents loans and advances which are classified as 'non-performing' in accordance with US disclosure requirements. Under this definition loans and advances are classified as 'non-performing' if they are either accounted for on a non-accruals basis, or in arrears for more than 90 days, irrespective of whether interest has been suspended or a specific provision made. No interest is suspended or provisions made in respect of such cases where the Group does not expect to incur losses.

| | **1999 £m** | 1998 £m |
|---|---|---|
| Loans and advances on which a proportion of interest has been suspended and/or on which specific provision has been made | **844** | 1,184 |
| Loans and advances 90 days overdue on which no interest has been suspended and on which no specific provision has been made | **1,087** | 1,335 |
| Non-accruing loans and advances | **145** | 170 |
| Total non-performing loans and advances | **2,076** | 2,689 |
| Non-performing loans and advances as a percentage of total loans and advances to customers | **2.75%** | 3.69% |
| Provisions as a percentage of total non-performing loans and advances | **25.47%** | 20.86% |

| **11. Tax on profit on ordinary activities** | **1999 £m** | 1998 £m |
|---|---|---|
| UK Corporation tax: | | |
| Current year at 30.25% (31%) | **460** | 387 |
| Prior years | **(53)** | 113 |
| Double tax relief | **(1)** | (58) |
| Deferred tax: | | |
| Current year | **73** | 90 |
| Prior years | **41** | (123) |
| Overseas taxation | **2** | 53 |
| | **522** | 462 |

**12. Profit on ordinary activities after tax**

The profit after tax of the Company attributable to the shareholders is £1,446m (£544m). As permitted by section 230 of the Companies Act 1985, the Company's profit and loss account has not been presented in these accounts.

| **13. Dividends** | **1999 Pence per share** | 1998 Pence per share | **1999 £m** | 1998 £m |
|---|---|---|---|---|
| Ordinary shares (equity) | | | | |
| Interim (paid) | **13.40** | 11.75 | **190** | 167 |
| Final (proposed) | **26.85** | 23.55 | **382** | 334 |
| | **40.25** | 35.30 | **572** | 501 |
| Preference shares (non-equity) | | | **38** | 34 |
| | | | **610** | 535 |

| **14. Earnings per ordinary share** | 1999 | 1998 |
|---|---|---|
| Profit attributable to the shareholders of | | |
| Abbey National plc (£m) | **1,261** | 1,058 |
| Preference dividends (£m) | **(38)** | (34) |
| Profit attributable to the ordinary shareholders of Abbey National plc (£m) | **1,223** | 1,024 |
| Weighted average number of ordinary shares in issue during the year – basic (million) | **1,418** | 1,414 |
| Basic earnings per ordinary share (pence) | **86.2** | 72.4 |
| Profit attributable to the ordinary shareholders of Abbey National plc (£m) | **1,223** | 1,024 |
| Weighted average number of ordinary shares in issue during the year – basic (million) | **1,418** | 1,414 |
| Dilutive effect of share options outstanding (million) | **12** | 13 |
| Weighted average number of ordinary shares in issue during the year – diluted (million) | **1,430** | 1,427 |
| **Diluted earnings per ordinary share (pence)** | **85.5** | 71.7 |

| | **Group 1999** | | Group 1998 | |
|---|---|---|---|---|
| **15. Treasury bills and other eligible bills** | **Book value £m** | **Market value £m** | Book value £m | Market value £m |
| Treasury bills and similar securities | **12** | **12** | 746 | 746 |
| Other eligible bills | **1,102** | **1,102** | 1,311 | 1,311 |
| **Total** | **1,114** | **1,114** | 2,057 | 2,057 |

Treasury and other eligible bills are mainly held for purposes other than investment. The market value of Treasury and other eligible bills is equal to the carrying value.

| | Group | | Company | |
|---|---|---|---|---|
| **16. Loans and advances to bank** | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| Items in the course of collection | **259** | 216 | **255** | 214 |
| Amounts due from subsidiaries | **–** | – | **4,277** | 2,995 |
| Purchase and resale agreements | **6,397** | 4,983 | **–** | – |
| Other loans and advances | **4,816** | 2,229 | **118** | 152 |
| | **11,472** | 7,428 | **4,650** | 3,361 |
| Repayable: | | | | |
| On demand | **4,942** | 3,711 | **855** | 744 |
| In not more than 3 months | **5,643** | 2,890 | **255** | 214 |
| In more than 3 months but not more than 1 year | **217** | 295 | **338** | 274 |
| In more than 1 year but not more than 5 years | **481** | 461 | **1,040** | 173 |
| In more than 5 years | **189** | 71 | **2,162** | 1,956 |
| | **11,472** | 7,428 | **4,650** | 3,361 |

The loans and advances to banks in the above table have the following interest rate structures:

| | Group | | Company | |
|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| Fixed rate | **6,907** | 5,924 | **2,932** | 1,561 |
| Variable rate | **4,306** | 1,288 | **1,463** | 1,586 |
| Items in the course of collection (non-interest bearing) | **259** | 216 | **255** | 214 |
| | **11,472** | 7,428 | **4,650** | 3,361 |

The Group's policy is to hedge all fixed rate loans and advances to banks to floating rates using derivative instruments, or by matching with other on-balance sheet interest rate exposures. See note 50, Derivatives, 'Non-trading derivatives' for further information.

| 17. Loans and advances to customers | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Advances secured on residential properties | **64,756** | 63,194 | **60,247** | 59,733 |
| Purchase and resale agreements | **77** | 749 | **–** | – |
| Other secured advances | **2,534** | 2,019 | **82** | 68 |
| Unsecured advances | **8,310** | 6,188 | **1,739** | 1,661 |
| Collateralised and guaranteed mortgage loans | **95** | 111 | **–** | – |
| Amounts due from subsidiaries | **–** | – | **880** | 707 |
| | **75,772** | 72,261 | **62,948** | 62,169 |
| Repayable: | | | | |
| On demand or at short notice | **3,644** | 3,575 | **2,943** | 3,356 |
| In not more than 3 months | **3,367** | 2,482 | **568** | 537 |
| In more than 3 months but not more than 1 year | **2,992** | 2,697 | **982** | 905 |
| In more than 1 year but not more than 5 years | **8,599** | 7,006 | **4,403** | 3,985 |
| In more than 5 years | **57,699** | 57,062 | **54,263** | 53,619 |
| Less: provisions (see note 10) | **(529)** | (561) | **(211)** | (233) |
| | **75,772** | 72,261 | **62,948** | 62,169 |

Included in Group loans and advances to customers are loans to associated undertakings of £10m (£7m).

The loans and advances to customers included in the above table have the following interest rate structures:

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Fixed rate | **22,508** | 22,182 | **15,989** | 16,328 |
| Variable rate | **53,793** | 50,640 | **47,170** | 46,074 |
| Provisions | **(529)** | (561) | **(211)** | (233) |
| | **75,772** | 72,261 | **62,948** | 62,169 |

The Group's policy is to hedge all fixed rate loans and advances to customers using derivative instruments, or by matching with other on-balance sheet interest rate exposures. See note 50, Derivatives, 'Non-trading derivatives' for further information.

**18. Loans and advances to customers subject to securitisation**

Loans and advances to customers include portfolios of residential mortgage loans which are subject to non-recourse finance arrangements. These loans have been purchased by special purpose securitisation companies from Abbey National plc, and have been funded primarily through the issue of mortgage-backed floating rate notes (FRNs). No gain or loss has been recognised as a result of these sales.

Abbey National plc and its subsidiaries are under no obligation to support any losses that may be incurred by the securitisation companies or holders of the FRNs except as described below, and do not intend to provide such further support. Mortgage indemnity guarantee (MIG) insurance is provided to the securitisation companies by a subsidiary of Abbey National plc to cover a proportion of potential losses on high loan to value ratio loans, in line with normal market practice. Holders of the FRNs are only entitled to obtain payment 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 FRNs have agreed in writing not to seek recourse in any other form. Abbey National plc receives payments from the securitisation companies in respect of fees for administering the loans, and payment of deferred consideration for the sale of the loans. In addition, Abbey National plc has made interest bearing subordinated loans to the companies and receives interest income thereon. Abbey National plc does not guarantee the liabilities of the subsidiary which provides MIG insurance. Abbey National plc is contingently liable to pay to the subsidiary any unpaid amounts in respect of share capital. At a Group level, a separate presentation of assets and liabilities is adopted to the extent of the amount of insurance cover provided by the subsidiary.

Abbey National plc has entered into a number of interest rate swaps with the securitisation companies. These swaps in effect convert a proportion of the interest flows receivable from customers into variable rate interest rate flows to match with the interest payable on the FRNs.

Abbey National plc has no right or obligation to repurchase the benefit of any securitised loan, except if certain representations and warranties given by Abbey National plc at the time of transfer are breached. Abbey National plc does, however, have the right to repurchase a loan, on application from the securitisation companies, if the loan holder requests a further advance or change in product type.

**18. Loans and advances to customers subject to securitisation** continued

| Securitisation company | Date of securitisation | Gross assets securitised £m | Non-returnable finance £m | Subordinated loans made by the Group £m |
|---|---|---|---|---|
| ILSE No1 plc | 26 February 1998 | 138 | 97 | 6 |
| Holmes Funding No1 plc | 25 February 1999 | 824 | 577 | 12 |
| Holmes Funding No2 plc | 25 October 1999 | 968 | 705 | 3 |

Abbey National plc does not own directly, or indirectly, any of the share capital of any of the above securitisation companies or their parents.

A summarised profit and loss account for the year to 31 December 1999 for ILSE No1 plc, Holmes Funding No1 plc and Holmes Funding No2 plc is set out below:

| | 1999 £m | 1998 £m |
|---|---|---|
| Net interest income | **8** | 3 |
| Other operating income | **1** | – |
| Administrative expenses | **(2)** | (3) |
| Provisions | **(7)** | – |
| Profit for the financial period | **–** | – |

| 19. Net investment in finance leases | Group 1999 £m | Group 1998 £m |
|---|---|---|
| Amounts receivable | **10,930** | 10,666 |
| Less: deferred income | **(5,477)** | (5,326) |
| Less: provisions for impairment (see below) | **(12)** | (14) |
| | **5,441** | 5,326 |
| Repayable: | | |
| In not more than 3 months | **168** | 132 |
| In more than 3 months but not more than 1 year | **383** | 609 |
| In more than 1 year but not more than 5 years | **666** | 578 |
| In more than 5 years | **4,224** | 4,007 |
| | **5,441** | 5,326 |
| Cost of assets acquired for the purpose of letting under finance leases in the year | **427** | 268 |
| Gross rentals receivable | **494** | 472 |
| Commitments as lessor for the purchase of equipment for use in finance leases | **384** | 381 |
| Amounts outstanding subject to a sub-participation | **202** | 210 |

Provisions for impairment relate to small ticket leasing assets.

| 20. Debt securities | Group 1999 Book value £m | Group 1999 Market value £m | Group 1998 Book value £m | Group 1998 Market value £m |
|---|---|---|---|---|
| **Investment securities** | | | | |
| Issued by public bodies: | | | | |
| Government securities | **3,722** | **3,858** | 5,428 | 5,616 |
| Other public sector securities | **2,272** | **2,267** | 3,097 | 3,093 |
| | **5,994** | **6,125** | 8,525 | 8,709 |
| Issued by other issuers: | | | | |
| Bank and building society certificates of deposit | **399** | **400** | 401 | 405 |
| Other debt securities | **37,360** | **37,205** | 29,711 | 29,718 |
| | **37,759** | **37,605** | 30,112 | 30,123 |
| Less: provisions | **(72)** | **–** | (45) | – |
| Sub-total – Non-trading book | **43,681** | **43,730** | 38,592 | 38,832 |
| **Other securities** | | | | |
| Issued by public bodies: | | | | |
| Government securities | **1,618** | **1,618** | 1,863 | 1,863 |
| | **1,618** | **1,618** | 1,863 | 1,863 |
| Issued by other issuers: | | | | |
| Bank and building society certificates of deposit | **10,506** | **10,507** | 9,724 | 9,724 |
| Other debt securities | **3,640** | **3,640** | 4,024 | 4,024 |
| | **14,146** | **14,147** | 13,748 | 13,748 |
| Sub-total – Trading book | **15,764** | **15,765** | 15,611 | 15,611 |
| **Total** | **59,445** | **59,495** | 54,203 | 54,443 |

| **20. Debt securities** continued | **Company 1999** Book value £m | **Company 1999** Market value £m | Company 1998 Book value £m | Company 1998 Market value £m |
|---|---|---|---|---|
| **Investment securities** | | | | |
| Issued by public bodies: | | | | |
| Government securities | **7** | **7** | 372 | 374 |
| Other public sector securities | **29** | **29** | 29 | 29 |
| | **36** | **36** | 401 | 403 |
| Issued by other issuers: | | | | |
| Other debt securities | **1,266** | **1,266** | 1,090 | 1,090 |
| | **1,266** | **1,266** | 1,090 | 1,090 |
| **Total – Non-trading book** | **1,302** | **1,302** | 1,491 | 1,493 |

The Company held no securities for purposes other than investment. The investment securities held by the Company include subordinated investments in subsidiaries of £1,266m (£1,089m) and are included within Other debt securities. Investment securities held by the Group include £20m (nil) of subordinated investments in associates and are included within Other debt securities.

Analysed by listing status:

| | **Group 1999** Book value £m | **Group 1999** Market value £m | Group 1998 Book value £m | Group 1998 Market value £m |
|---|---|---|---|---|
| **Investment securities** | | | | |
| Listed in the UK | **2,528** | **2,562** | 4,538 | 4,640 |
| Listed or registered elsewhere | **38,710** | **38,700** | 31,169 | 31,289 |
| Unlisted | **2,443** | **2,468** | 2,885 | 2,903 |
| Sub-total – Non-trading book | **43,681** | **43,730** | 38,592 | 38,832 |
| **Other securities** | | | | |
| Listed in the UK | **681** | **681** | 70 | 70 |
| Listed or registered elsewhere | **3,134** | **3,134** | 4,799 | 4,799 |
| Unlisted | **11,949** | **11,950** | 10,742 | 10,742 |
| Sub-total – Trading book | **15,764** | **15,765** | 15,611 | 15,611 |
| **Total** | **59,445** | **59,495** | 54,203 | 54,443 |

| | **Company 1999** Book value £m | **Company 1999** Market value £m | Company 1998 Book value £m | Company 1998 Market value £m |
|---|---|---|---|---|
| **Investment securities** | | | | |
| Listed in the UK | **7** | **7** | 372 | 374 |
| Unlisted | **1,295** | **1,295** | 1,119 | 1,119 |
| **Total – Non-trading book** | **1,302** | **1,302** | 1,491 | 1,493 |

| Book value analysed by maturity: | Group **1999 £m** | Group 1998 £m | Company **1999 £m** | Company 1998 £m |
|---|---|---|---|---|
| Due within 1 year | **12,985** | 13,925 | **–** | 395 |
| Due in more than 1 year but not more than 5 years | **18,355** | 17,191 | **29** | – |
| Due in more than 5 years but not more than 10 years | **9,545** | 7,778 | **480** | 221 |
| Due in more than 10 years | **18,632** | 15,354 | **793** | 875 |
| Less: provisions | **(72)** | (45) | **–** | – |
| | **59,445** | 54,203 | **1,302** | 1,491 |

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

| | Group Cost £m | Group Provisions £m | Group Net book value £m |
|---|---|---|---|
| At 1 January 1999 | 38,637 | (45) | 38,592 |
| Exchange adjustments | 11 | | 11 |
| Additions | 19,354 | | 19,354 |
| Disposals | (4,341) | | (4,341) |
| Redemptions and maturities | (7,383) | | (7,383) |
| Transfers to other securities (net) | (2,510) | | (2,510) |
| Transfer from profit and loss account | – | (27) | (27) |
| Amortisation of premiums | (15) | | (15) |
| At 31 December 1999 | 43,753 | (72) | 43,681 |

| **20. Debt securities** continued | Company Cost £m | Company Provisions £m | Company Net book value £m |
|---|---|---|---|
| At 1 January 1999 | 1,491 | – | 1,491 |
| Exchange adjustments | 18 | | 18 |
| Additions | 1,039 | | 1,039 |
| Disposals | (1,241) | | (1,241) |
| Amortisation of premiums | (5) | | (5) |
| At 31 December 1999 | 1,302 | – | 1,302 |

The total net book value of debt securities held for investment purposes at 31 December 1999 includes unamortised discounts of £134m (£262m) for the Group, and unamortised premiums of £1m (£6m) for the Company.

Market values of investment securities are based on quoted market prices of securities where available. Where market prices are not available, valuations are determined using in-house pricing models or, where not appropriate, are stated at amortised cost less any provision for impairment.

Included within investment securities are a number of securities held for hedging purposes. Some of these provide temporary hedging cover where permanent hedges are not immediately available. There are hedges in place in respect of the majority of fixed rate investment securities whereby the rise or fall in their market value, due to interest rate movements, will be offset by a substantially equivalent reduction or increase in the value of the hedges.

Investment debt securities include asset backed and mortgage backed securities sold to various bankruptcy-remote special purpose vehicles.

The special purpose vehicles are owned directly by charitable trusts and are therefore not legal subsidiaries of the Group. However, they have been consolidated into the Group on the basis that substantially all the rewards inherent in those entities are retained in the Group.

The debt security acquisitions by these special purpose vehicles have been funded primarily through the issue of commercial paper to the market.

An aggregated summary profit and loss account for the year ended 31 December 1999 and an aggregated balance sheet as at 31 December 1999 for these entities are shown below.

| Profit and loss account for the period ended 31 December 1999 | £m |
|---|---|
| Interest receivable | 166 |
| Interest payable | (156) |
| Net interest income | 10 |
| Profit for the financial period | 10 |

| Balance sheet as at 31 December 1999 | £m |
|---|---|
| Investment debt securities | 5,160 |
| Prepayments and accrued income | 192 |
| Total assets | 5,352 |
| Debt securities in issue | 5,347 |
| Accruals and deferred income | 5 |
| Total liabilities | 5,352 |

| **21. Equity shares and other variable yield securities** | **Group 1999** Book value £m | **Group 1999** Market value £m | Group 1998 Book value £m | Group 1998 Market value £m |
|---|---|---|---|---|
| Listed in the UK | **66** | **70** | 31 | 87 |
| Listed elsewhere | **36** | **35** | 39 | 24 |
| Unlisted | **193** | **209** | 53 | 56 |
| | **295** | **314** | 123 | 167 |

| | **Company 1999** Book value £m | **Company 1999** Market value £m | Company 1998 Book value £m | Company 1998 Market value £m |
|---|---|---|---|---|
| Listed elsewhere | **–** | **–** | 3 | 3 |
| Unlisted | **2** | **2** | 1 | 1 |
| | **2** | **2** | 4 | 4 |

Included within unlisted securities of the Group are variable yield securities held for purposes other than investment, having book and market values of £47m (£3m). All other equity shares and variable yield securities are held in the non-trading book for investment purposes.

Where available, equity shares and other variable yield securities have been valued using quoted market prices. Where market prices are not available, a valuation based on discounted cash flows, market prices of comparable securities and other appropriate valuation techniques have been used.

### 21. Equity shares and other variable yield securities continued

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

| | Group | | |
|---|---|---|---|
| | Cost £m | Provisions £m | Net book value £m |
| At 1 January 1999 | 121 | (1) | 120 |
| Additions | 162 | | 162 |
| Disposals | (35) | | (35) |
| Charge for the year | – | 1 | 1 |
| At 31 December 1999 | 248 | – | 248 |

| | Company | | |
|---|---|---|---|
| | Cost £m | Provisions £m | Net book value £m |
| At 1 January 1999 | 4 | – | 4 |
| Disposals | (2) | | (2) |
| At 31 December 1999 | 2 | – | 2 |

### 22. Long term assurance business

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

| | 1999 £m | 1998 £m |
|---|---|---|
| Value of shareholders' interest in the long term assurance funds | **1,042** | 760 |

The value of the long term assurance business is calculated by discounting the proportion of surplus which is projected to accrue to shareholders in future years from business currently in force, and adding the shareholders' interest in the surplus retained within the long term assurance funds. The basis on which this value is determined is reviewed regularly in the light of the experience of the business and expectations regarding future economic conditions. The principal long term economic assumptions used are as follows:

| | 1999 % | 1998 % |
|---|---|---|
| Risk adjusted discount rate (net of tax) | **10.0** | 10.0 |
| Return on equities (gross of tax – pension business) | **8.5** | 8.5 |
| Return on equities (gross of tax – life business) | **9.0** | 9.0 |
| Return on gilts (gross of tax) | **6.5** | 6.5 |
| Inflation | **4.0** | 4.0 |

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

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

Income from long term assurance business, which is included as Other operating income in the consolidated profit and loss account, is calculated as follows:

| | 1999 £m | 1998 £m |
|---|---|---|
| Value of shareholders' interest in the long term assurance funds at 31 December | **1,042** | 760 |
| Value of shareholders' interest in the long term assurance funds at 1 January | **760** | 649 |
| Increase in value of long term assurance business | **282** | 111 |
| Transfers into long term assurance funds | **(240)** | (17) |
| Net increase in value of long term assurance business | **42** | 94 |
| Surplus transferred from long term funds | **95** | 13 |
| Income after tax from long term assurance business | **137** | 107 |
| Income before tax from long term assurance business | **196** | 155 |

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

### 22. Long term assurance business continued

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

| | 1999 £m | 1998 £m |
|---|---|---|
| Investments | **9,972** | 7,078 |
| Assets held to cover linked liabilities | **6,092** | 5,141 |
| Debtors and prepayments | **1,084** | 754 |
| Other assets | **291** | 410 |
| Assets of the long term assurance funds | **17,439** | 13,383 |
| Technical provisions | **7,217** | 5,270 |
| Technical provisions for linked liabilities | **6,086** | 5,147 |
| Fund for future appropriations | **1,459** | 961 |
| Other creditors | **2,677** | 2,005 |
| Liabilities of the long term assurance funds | **17,439** | 13,383 |

### 23. Interests in associated undertakings

The movement in interests in associated undertakings was as follows:

| | Group £m | Company £m |
|---|---|---|
| At 1 January 1999 | 20 | 11 |
| Acquisitions | 30 | – |
| Additions | 4 | 4 |
| Disposals | (3) | (3) |
| Retained profits | 8 | – |
| At 31 December 1999 | 59 | 12 |

On 1 January 1999, Abbey National plc disposed of 6% of the investment in CGU Underwriting Ltd (CGUUL) for £3m, received in cash.

The principal associated undertakings at 31 December 1999 are:

| Name and nature of business | Issued share capital | Group interest (%) |
|---|---|---|
| CGU Underwriting Ltd, Insurance underwriting services | 100 £1 ordinary A shares<br>80,000,000 £1 ordinary B shares | 15<br>15 |
| DAH Holdings Ltd, Private banking | 635,910 US$1 ordinary A shares<br>364,090 US$1 ordinary convertible B shares | 9.9<br>50 |
| Willis National Holdings Ltd, Independent financial advice | 1,000 £1 ordinary shares | 49 |
| PSA Finance plc, Personal finance | 40,000,000 £1 ordinary shares | 50 |

The United Kingdom is the principal area of operation of principal associated undertakings except for DAH Holdings Ltd, whose principal areas of operation are Hong Kong and the Channel Islands, and all are registered in England & Wales, except for DAH Holdings Ltd which is registered in Bermuda.

On 7 May 1999, First National Bank plc (FNB) acquired a 50% share of the share capital of PSA Finance plc from Lombard North Central PLC. The consideration was £12m, settled by cash on 10 May 1999. A further £18m of equity shares were subscribed to, for cash, following the completion of the purchase. In addition, FNB was assigned £15m of subordinated loan stock in PSA on 7 May 1999.

All associated undertakings are unlisted and have a year end of 31 December.

Abbey National plc has the right to increase its interests in CGUUL up to a maximum of 75% after the fifth anniversary of the commencement of the operation (July 2000), and to 100% in certain circumstances.

Income from associated undertakings is included within Other operating income.

| 24. Shares in Group undertakings | 1999 Cost & Book value £m | 1998 Cost & Book value £m |
|---|---|---|
| Subsidiary undertakings | | |
| Banks | **1,024** | 304 |
| Others | **3,163** | 2,472 |
| | **4,187** | 2,776 |

The movement in shares in Group undertakings was as follows:

| | Company £m |
|---|---|
| At 1 January 1999 | 2,776 |
| Exchange adjustments | (16) |
| Additions | 1,492 |
| Disposals | (65) |
| At 31 December 1999 | 4,187 |

On 30 December 1999, Abbey National plc sold its investment in First National Tricity Finance Ltd and First National Business Equipment Leasing Ltd to First National Bank plc for £65m cash.

Subscriptions for additional share capital in existing subsidiary undertakings during the year amounted to £1,492m, including £720m in Abbey National Treasury Services plc.

**24. Shares in Group undertakings** continued
Subsidiaries of Abbey National plc entered into the following transactions:

On 11 January 1999, N&P BES Loans Ltd purchased Home Rent Companies 16-23 plc. The amount paid in consideration for the issued share capital was £36m, which replaced existing loans.

The above transaction is included in the consolidated accounts as an acquisition. Further disclosures relating to this transaction can be found in note 25, Summary of the effect of acquisitions and note 51, Consolidated cash flow statement.

The principal subsidiaries of Abbey National plc at 31 December 1999 are shown below, all of which are directly held and unlisted except where indicated.

| | Nature of business | Country of incorporation or registration |
|---|---|---|
| Abbey National General Insurance Services Ltd | General insurance | England & Wales |
| Abbey National Leasing Companies* (25 companies) | Leasing | England & Wales |
| Abbey National Treasury Services plc | Treasury operations | England & Wales |
| Cater Allen International Ltd* | Money market & stockbroking | England & Wales |
| First National Bank plc* | Personal finance and commercial lending | England & Wales |
| First National Tricity Finance Ltd* | Retail point of sale finance | England & Wales |
| Carfax Insurance Ltd | Insurance | Guernsey |
| Abbey National Life plc | Insurance | Scotland |
| Abbey National PEP and ISA Managers Ltd* | PEP & ISA management | Scotland |
| Scottish Mutual Assurance plc* | Insurance | Scotland |
| Abbey National North America Corporation | Funding | United States |

*Subsidiary held indirectly through subsidiary companies.

All the above companies are included in the consolidated accounts. The Company holds directly or indirectly 100% of the issued ordinary share capital of its principal subsidiaries. All companies operate principally in their country of incorporation or registration. Abbey National Treasury Services plc also has branch offices in France and Jersey and a representative office in Hong Kong. Abbey National Treasury International Ltd has representative offices in Hong Kong, Portugal and Spain, and branches in the Isle of Man and Gibraltar. Abbey National plc has branches in Italy and France and a representative office in Dubai.

**25. Summary of the effect of acquisitions**
The acquisition of Home Rent Companies 16-23 plc by N&P BES Loans Ltd resulted in the purchase of £36m tangible fixed assets. There was no difference between the book and fair values at acquisition and no goodwill has been recognised accordingly.

The subsidiary undertakings and business forming the Lombard acquisition were acquired on 30 December 1998, and accordingly fair values of the assets and liabilities were previously estimated on a provisional basis. The purchase consideration and revaluation adjustments have now been finalised for the completion accounts of the entities purchased and consequently a further provision of £10m has been made in respect of loan provisions and goodwill amended accordingly. In addition, a further £3m was added to goodwill in respect of other acquisitions made in 1998.

| **26. Intangible fixed assets** | Purchased goodwill Group £m |
|---|---|
| Cost | |
| At 1 January 1999 | 202 |
| Additions | – |
| Other movements | 13 |
| At 31 December 1999 | 215 |
| Amortisation | |
| At 1 January 1999 | 1 |
| Charge for the year | 11 |
| At 31 December 1999 | 12 |
| Net book value | |
| At 31 December 1999 | 203 |
| At 31 December 1998 | 201 |

Intangible fixed assets comprises positive purchased goodwill arising on acquisitions of subsidiary undertakings and purchases of businesses made since 1 January 1998. Previously, goodwill arising on acquisitions of subsidiary undertakings and purchases of businesses was taken directly to reserves.

The cumulative amount of goodwill taken to the profit and loss account reserve in previous periods by the Group and not subsequently recognised in the profit and loss account is £1,204m (£1,204m), and by the Company £528m (£528m).

Goodwill included above in respect of all material acquisitions is currently being amortised over a period of 20 years.

| | Group | | | |
|---|---|---|---|---|
| **27. Tangible fixed assets** | Investment properties £m | Other premises £m | Equipment £m | Total £m |
| Cost or valuation | | | | |
| At 1 January 1999 | 52 | 436 | 935 | 1,423 |
| Acquisitions of subsidiary undertakings | 36 | – | – | 36 |
| Additions | – | 11 | 127 | 138 |
| Disposals | (23) | (22) | (27) | (72) |
| Revaluation in the year | 3 | – | – | 3 |
| At 31 December 1999 | 68 | 425 | 1,035 | 1,528 |
| Depreciation | | | | |
| At 1 January 1999 | – | 75 | 617 | 692 |
| Charge for the year | – | 9 | 99 | 108 |
| Disposals | – | (2) | (29) | (31) |
| At 31 December 1999 | – | 82 | 687 | 769 |
| Net book value | | | | |
| At 31 December 1999 | 68 | 343 | 348 | 759 |
| At 31 December 1998 | 52 | 361 | 318 | 731 |

As at 31 December 1999, investment properties are included in Tangible fixed assets at their open market value. For properties let out to tenants this is based on their existing value in use and for vacant possessions the market value is calculated accordingly. They are valued on a rolling basis such that the portfolio is valued in full every five years. The valuations are conducted by Colleys, an independent firm of professional valuers.

| | Company | | |
|---|---|---|---|
| | Other premises £m | Equipment £m | Total £m |
| Cost | | | |
| At 1 January 1999 | 372 | 818 | 1,190 |
| Additions | 10 | 104 | 114 |
| Disposals | (14) | (12) | (26) |
| At 31 December 1999 | 368 | 910 | 1,278 |
| Depreciation | | | |
| At 1 January 1999 | 71 | 555 | 626 |
| Charge for the year | 8 | 80 | 88 |
| Disposals | (1) | (10) | (11) |
| At 31 December 1999 | 78 | 625 | 703 |
| Net book value | | | |
| At 31 December 1999 | 290 | 285 | 575 |
| At 31 December 1998 | 301 | 263 | 564 |

| | Group | | Company | |
|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| The net book value of Other premises comprises: | | | | |
| Freeholds | **273** | 292 | **232** | 243 |
| Long leaseholds | **27** | 26 | **15** | 15 |
| Short leaseholds | **43** | 43 | **43** | 43 |
| Land and buildings occupied for own activities: | | | | |
| Net book value at 31 December | **250** | 252 | **211** | 234 |
| The net book value of equipment includes: | | | | |
| Assets held under finance leases | **11** | 2 | **9** | – |
| Depreciation charge for the year on these assets | **2** | 1 | **1** | – |
| Capital expenditure which has been contracted, but not provided for in the accounts | **34** | 10 | **33** | 9 |

## 28. Operating lease assets

| | Group £m |
|---|---|
| Cost | |
| At 1 January 1999 | 268 |
| Additions | 226 |
| Disposals | (63) |
| At 31 December 1999 | 431 |
| Depreciation | |
| At 1 January 1999 | 45 |
| Charge for the year | 52 |
| Disposals | (24) |
| At 31 December 1999 | 73 |
| Net book value | |
| At 31 December 1999 | 358 |
| At 31 December 1998 | 223 |

| | Group 1999 £m | Group 1998 £m |
|---|---|---|
| Capital expenditure which has been contracted, but not provided for in the accounts | **14** | 10 |

## 29. Other assets

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Foreign exchange and interest rate contracts: | | | | |
| Positive market values of trading derivative contracts (see note 50) | **930** | 392 | **–** | – |
| Translation differences on foreign exchange derivatives used for hedging purposes | **565** | 366 | **20** | – |
| Debtors and other settlement balances | **1,905** | 1,752 | **151** | 137 |
| Introducer fees | **305** | 264 | **–** | – |
| Other | **225** | 558 | **172** | 427 |
| | **3,930** | 3,332 | **343** | 564 |

The charge for the period in respect of introducer fees is £174m (£73m).

## 30. Prepayments and accrued income

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Accrued interest due from subsidiaries | **–** | – | **180** | 110 |
| Unamortised lending-related fees (see note 2) | **580** | 548 | **577** | 546 |
| Other accrued interest | **1,897** | 1,788 | **268** | 22 |
| Prepayments and other accruals | **237** | 40 | **24** | 16 |
| | **2,714** | 2,376 | **1,049** | 694 |

## 31. Assets subject to sale and repurchase transactions

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Debt securities | **3,908** | 7,078 | **–** | – |
| | **3,908** | 7,078 | **–** | – |

The above amounts are the assets held under sale and repurchase transactions included within the amounts disclosed in note 20, Debt securities.

## 32. Deposits by banks

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Items in the course of transmission | **262** | 277 | **253** | 269 |
| Amounts due to subsidiaries | **–** | – | **10,565** | 11,053 |
| Sale and repurchase agreements | **18,127** | 21,862 | **–** | – |
| Other deposits | **11,435** | 13,471 | **202** | 211 |
| | **29,824** | 35,610 | **11,020** | 11,533 |
| Repayable: | | | | |
| On demand | **15,156** | 15,273 | **6,237** | 8,649 |
| In not more than 3 months | **11,709** | 14,533 | **253** | 270 |
| In more than 3 months but not more than 1 year | **2,327** | 4,452 | **135** | 274 |
| In more than 1 year but not more than 5 years | **117** | 143 | **42** | 173 |
| In more than 5 years | **515** | 1,209 | **4,353** | 2,167 |
| | **29,824** | 35,610 | **11,020** | 11,533 |

| 33. Customer accounts | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Retail deposits | **49,914** | 49,258 | **45,950** | 45,750 |
| Amounts due to subsidiaries | **–** | – | **5,183** | 3,367 |
| Sale and repurchase agreements | **97** | 214 | **–** | – |
| Other customer accounts | **9,900** | 3,452 | **1,786** | 1,613 |
| | **59,911** | 52,924 | **52,919** | 50,730 |
| Repayable: | | | | |
| On demand | **40,305** | 40,101 | **43,372** | 41,948 |
| In not more than 3 months | **16,523** | 10,245 | **8,417** | 7,823 |
| In more than 3 months but not more than 1 year | **1,179** | 1,064 | **39** | 52 |
| In more than 1 year but not more than 5 years | **258** | 210 | **–** | 4 |
| In more than 5 years | **1,646** | 1,304 | **1,091** | 903 |
| | **59,911** | 52,924 | **52,919** | 50,730 |

Included in Group and Company customer accounts are amounts due to associated undertakings of £4m (£16m) and £4m (nil), respectively.

| 34. Debt securities in issue | Group 1999 Book value £m | Group 1999 Market value £m | Group 1998 Book value £m | Group 1998 Market value £m |
|---|---|---|---|---|
| Bonds and medium term notes | **27,986** | **27,836** | 26,162 | 26,874 |
| Other debt securities in issue | **23,421** | **23,411** | 16,827 | 16,804 |
| | **51,407** | **51,247** | 42,989 | 43,678 |

The market values for medium and long term debt securities in issue have been determined using quoted market prices where reliable prices are available. In other cases, market values have been determined using in-house pricing models, or stated at amortised cost. The market value of short term debt securities in issue do not differ significantly from book value.

| | Company 1999 £m | Company 1998 £m |
|---|---|---|
| Bonds and medium term notes | **–** | – |
| Other debt securities in issue | **21** | 23 |
| | **21** | 23 |

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Bonds and medium term notes are repayable: | | | | |
| In not more than 3 months | **2,517** | 3,475 | **–** | – |
| In more than 3 months but not more than 1 year | **8,382** | 7,529 | **–** | – |
| In more than 1 year but not more than 2 years | **3,472** | 2,901 | **–** | – |
| In more than 2 years but not more than 5 years | **9,912** | 8,577 | **–** | – |
| In more than 5 years | **3,703** | 3,680 | **–** | – |
| | **27,986** | 26,162 | **–** | – |

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Other debt securities in issue are repayable: | | | | |
| In not more than 3 months | **20,103** | 13,243 | **5** | 1 |
| In more than 3 months but not more than 1 year | **1,411** | 3,476 | **16** | 7 |
| In more than 1 year but not more than 2 years | **1,887** | 86 | **–** | 15 |
| In more than 2 years but not more than 5 years | **–** | – | **–** | – |
| In more than 5 years | **20** | 22 | **–** | – |
| | **23,421** | 16,827 | **21** | 23 |

| 35. Other liabilities | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Creditors and accrued expenses | **1,573** | 1,927 | **344** | 380 |
| Short positions in government debt securities | **1,521** | 1,199 | **–** | – |
| Taxation | **481** | 563 | **274** | 360 |
| Foreign exchange and interest rate contracts: | | | | |
| Negative market value of trading derivative contracts (see note 50) | **2,439** | 460 | **–** | – |
| Translation differences on foreign exchange derivatives used for hedging purposes | **907** | 413 | **–** | – |
| Obligations under finance leases – payable in: less than 1 year | **4** | 2 | **4** | – |
| 1 year to 5 years | **5** | – | **5** | – |
| | **6,930** | 4,564 | **627** | 740 |

Short positions in government debt securities are mainly held for purposes other than investment. Such positions are carried at quoted market value.

| 36. Accruals and deferred income | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Accrued interest due to subsidiaries | **–** | – | **103** | 59 |
| Other accrued interest | **2,499** | 2,722 | **921** | 955 |
| Deferred income from residential mortgage lending | **277** | 279 | **–** | – |
| Other deferred income | **81** | 14 | **–** | – |
| | **2,857** | 3,015 | **1,024** | 1,014 |

See accounting policies, page 41, for a description of the accounting treatment of deferred income from residential mortgage lending. The amount taken to the profit and loss account during the year was £77m (£70m).

| 37. Provisions for liabilities and charges | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Deferred taxation (see note 38) | **1,173** | 1,074 | **5** | 2 |
| Other provisions for liabilities and charges (see note 39) | **102** | 120 | **49** | 70 |
| | **1,275** | 1,194 | **54** | 72 |

| 38. Deferred taxation | Group £m | Company £m |
|---|---|---|
| At 1 January 1999 | 1,074 | 2 |
| Transfer from profit and loss account | 114 | 3 |
| Other movements | (15) | – |
| At 31 December 1999 | 1,173 | 5 |

The amounts provided and total potential liability are:

| | Amount provided Group £m | Amount provided Company £m | Total potential liability Group £m | Total potential liability Company £m |
|---|---|---|---|---|
| Tax effect of timing differences due to: | | | | |
| Excess of capital allowances over depreciation | 16 | – | 16 | – |
| Capital allowances on finance lease receivables | 1,084 | – | 1,084 | – |
| Other | 73 | 5 | 73 | 5 |
| | 1,173 | 5 | 1,173 | 5 |

| 39. Other provisions for liabilities and charges | Pension and other similar obligations (1) £m | Provisions for commitments (2) £m | Pension misselling compensation (3) £m | Other provisions (4) £m | Total £m |
|---|---|---|---|---|---|
| **Group** | | | | | |
| At 1 January 1999 (as restated) | (1) | 20 | 23 | 78 | 120 |
| Transfer from profit and loss account | 67 | 20 | 17 | 1 | 105 |
| Pension contributions /provisions utilised | (75) | (12) | (5) | (16) | (108) |
| Unutilised provisions reversed | – | – | – | (15) | (15) |
| At 31 December 1999 | (9) | 28 | 35 | 48 | 102 |
| **Company** | | | | | |
| At 1 January 1999 (as restated) | (2) | 8 | 9 | 55 | 70 |
| Transfer from profit and loss account | 55 | 7 | 3 | – | 65 |
| Pension contributions /provisions utilised | (62) | (6) | – | (3) | (71) |
| Unutilised provisions reversed | – | – | – | (15) | (15) |
| At 31 December 1999 | (9) | 9 | 12 | 37 | 49 |

Following the introduction of FRS12, 'Provisions, Contingent Liabilities and Contingent Assets', the Group have identified four specific classes of provision and have restated the opening balances in accordance with the new classifications.

(1) Pension and other similar obligations
The above balance represents the difference between amounts paid to the respective pension schemes of the Group and any amounts charged to the profit and loss account in accordance with SSAP 24, 'Accounting for pension costs'.

In addition to Pension and other similar obligations included in the above table, a balance in respect of the pension surplus acquired with the purchase of the business of National and Provincial Building Society (N&P) is included within Other assets. This balance, which was £23m (£25m) as at 31 December 1999, is being amortised over the remaining service lives of employees contributing to the scheme, and £2m (£1m) was charged to the profit and loss account in the year ended 31 December 1999.

(2) Provisions for commitments
This comprises amounts in respect of committed expenditure, including: administrative costs of carrying out the review of business involving transfers from occupational to personal pension schemes and the opting-out of and the non-joining of occupational pension schemes (see also below); amounts in respect of vacant premises; and provisions for loyalty bonuses payable in certain unit trusts managed within the Life Assurance division.

(3) Pension misselling compensation
This comprises amounts in respect of compensation payable as a result of the ongoing review of business involving the transfers from occupational to personal pension schemes and the opting-out of and the non-joining of occupational pension schemes. Amounts provided in respect of Life Assurance are charged to Income from long term assurance business and carried against the asset Long term assurance business in the balance sheet. During the year £8m (£3m) was transferred from the profit and loss account in respect of the Life Assurance division and the amount currently provided is £14m (£10m). In addition, provisions have been made for the administrative costs of carrying out the review, which are included within Provisions for commitments (see also above).

(4) Other provisions
Other provisions principally comprise amounts in respect of litigation.

| 40. Subordinated liabilities including convertible debt | Group 1999 £m | Group 1998 £m |
|---|---|---|
| **Dated subordinated liabilities:** | | |
| Registered junior subordinated fixed rate notes 1999 (US $81m) | – | 49 |
| Registered junior subordinated fixed rate notes 1999 (US $26m) | – | 16 |
| 4.513% Registered junior subordinated floating rate extendible notes 1999 (US $65m) | – | 39 |
| Registered junior subordinated fixed rate notes 1999 (US $7m) | – | 4 |
| Subordinated floating rate notes 1999 (US $137m) | – | 83 |
| 4.513% Registered junior subordinated floating rate extendible notes 2000 (US $275m) | **170** | 166 |
| Registered junior subordinated fixed rate notes 2000 (US $53m) | **33** | – |
| 9.00% Subordinated guaranteed bond 2002 (LUX Fr 1bn) | **15** | 17 |
| Subordinated guaranteed floating rate notes 2002 (US $75m) | **46** | 45 |
| 8.00% Subordinated guaranteed bond 2002 (NLG 200m) | **57** | 64 |
| 10.375% Subordinated guaranteed bond 2002 | **100** | 100 |
| Subordinated guaranteed floating rate notes 2003 (US $100m) | **62** | 60 |
| Subordinated collared floating rate notes 2004 (CAN $100m) | **42** | 39 |
| 8.75% Subordinated guaranteed bond 2004 | **151** | 151 |
| 8.2% Subordinated bond 2004 (US $500m) | **309** | 302 |
| 6.69% Subordinated bond 2005 (US $750m) | **462** | 450 |
| 10.75% Subordinated bond 2006 | **101** | 101 |
| Subordinated guaranteed floating rate step-up notes 2009 (Swiss Fr 130m) | **50** | 57 |
| 5.00% Subordinated bond 2009 (DEM 1bn) | **315** | 355 |
| 4.625% Subordinated notes 2011 (e 500m) | **309** | – |
| 11.50% Subordinated guaranteed bond 2017 | **152** | 152 |
| 10.125% Subordinated guaranteed bond 2023 | **152** | 152 |
| 7.983% Subordinated notes 2029 (US $1,000m) | **611** | – |
| 6.50% Subordinated notes 2030 | **148** | – |
| **Undated subordinated liabilities:** | | |
| 10.0625% Exchangeable subordinated capital securities | **199** | 199 |
| 7.35% Perpetual subordinated reset capital securities (US $500m) | **308** | 300 |
| 7.25% Perpetual subordinated capital securities (US $150m) | **90** | – |
| 7.10% Perpetual callable subordinated notes (US $150m) | **91** | – |
| 7.00% Perpetual subordinated capital securities (US $250m) | **150** | – |
| 6.70% Perpetual subordinated reset capital securities (US$ 500m) | **307** | 298 |
| 6.00% Step-down perpetual callable subordinated notes (e 100m) | **61** | – |
| 5.56% Subordinated guaranteed notes (YEN 15bn) | **90** | 80 |
| 5.50% Subordinated guaranteed notes (YEN 5bn) | **30** | 27 |
| Fixed/Floating rate subordinated notes (YEN 5bn) | **30** | 27 |
| | **4,641** | 3,333 |

| | Company 1999 £m | Company 1998 £m |
|---|---|---|
| **Dated subordinated liabilities:** | | |
| Registered junior subordinated fixed rate notes 1999 (US $81m) | – | 49 |
| Registered junior subordinated fixed rate notes 1999 (US $26m) | – | 16 |
| Registered junior subordinated fixed rate notes 1999 (US $7m) | – | 4 |
| Subordinated floating rate notes 1999* | – | 83 |
| Registered junior subordinated fixed rate notes 2000 (US $53m) | **33** | – |
| 4.513% Registered junior subordinated floating rate extendible notes 2000 (US $275m) | **170** | 166 |
| 4.513% Registered junior subordinated floating rate extendible notes 2000 (US $65m) | – | 39 |
| Subordinated loan stock 2002* | **17** | 17 |
| Subordinated floating rate notes 2002 (US $75m)* | **47** | 45 |

| 40. Subordinated liabilities including convertible debt continued | Company 1999 £m | Company 1998 £m |
|---|---|---|
| **Dated subordinated liabilities** continued: | | |
| Subordinated loan 2002 (US $112m)* | **69** | 68 |
| 10.512% Subordinated loan stock 2001* | **100** | 100 |
| Subordinated floating rate notes 2003 (US $100m)* | **62** | 60 |
| Subordinated floating rate notes 2004 (US $74m)* | **46** | 45 |
| Subordinated floating rate notes 2004* | **150** | 150 |
| Subordinated floating rate notes 2004 (US $500m)* | **309** | 302 |
| 6.69% Subordinated bond 2005 (US $750m) | **462** | 450 |
| 10.75% Subordinated bond 2006 | **101** | 101 |
| Subordinated floating rate notes 2009 (US $102m)* | **63** | 62 |
| Subordinated floating rate notes 2009 (DEM 1bn) | **315** | 355 |
| 4.625% Subordinated notes 2011 (e 500m) | **309** | – |
| 11.59% Subordinated loan stock 2017* | **150** | 150 |
| 10.18% Subordinated loan stock 2023* | **150** | 150 |
| 7.983% Subordinated notes 2029 (US $1,000m) | **611** | – |
| 6.50% Subordinated notes 2030 | **148** | – |
| **Undated subordinated liabilities:** | | |
| 10.0625% Exchangeable subordinated capital securities | **199** | 199 |
| 7.35% Perpetual subordinated reset capital securities (US $500m) | **308** | 300 |
| 7.25% Perpetual subordinated capital securities (US $150m) | **90** | – |
| 7.10% Perpetual callable subordinated notes (US $150m) | **91** | – |
| 7.00% Perpetual subordinated capital securities (US $250m) | **150** | – |
| 6.70% Perpetual subordinated reset capital securities (US$ 500m) | **307** | 298 |
| 6.00% Step-down perpetual callable subordinated notes (e 100m) | **61** | – |
| 5.56% Subordinated guaranteed notes (YEN 15bn) | **90** | 80 |
| 5.50% Subordinated guaranteed notes (YEN 5bn) | **30** | 27 |
| Fixed/Floating rate subordinated notes (YEN 5bn) | **30** | 27 |
| | **4,668** | 3,343 |

*These represent the on-lending to the Company, on a subordinated basis, of issues by subsidiary companies.
The subordinated floating rate notes pay a rate of interest related to the LIBOR of the currency of denomination.

The 10.0625% Exchangeable subordinated capital securities are exchangeable into fully paid 10.375% non-cumulative non-redeemable sterling preference shares of £1 each, at the option of Abbey National. Exchange may take place on any interest payment date providing that between 30 and 60 days' notice has been given to the holders. The holders will receive one new sterling preference share for each £1 principal amount of capital securities held. The rights attaching to these preference shares would be the same as those detailed in note 41.

The 7.35% Perpetual subordinated reset capital securities are redeemable at par, at the option of Abbey National, on 15 October 2006 and each fifth anniversary thereafter.

The 7.25% Perpetual subordinated capital securities are redeemable at par, at the option of Abbey National, on or after 15 June 2004.

The 7.10% Perpetual callable subordinated notes are redeemable at par, at the option of Abbey National, on 12 March 2004 and thereafter on each interest payment date.

The 7.00% Perpetual subordinated capital securities are redeemable at par, at the option of Abbey National, on or after 29 April 2004.

The 6.70% Perpetual subordinated reset capital securities are redeemable at par, at the option of Abbey National, on 15 June 2008 and each fifth anniversary thereafter.

The 6.00% Step-down perpetual callable subordinated notes are redeemable at par, at the option of Abbey National, on 19 April 2004 and thereafter on each interest payment date.

The 5.56% Subordinated guaranteed notes are redeemable at par, at the option of Abbey National, on 31 January 2015 and each fifth anniversary thereafter.

The 5.50% Subordinated guaranteed notes are redeemable at par, at the option of Abbey National, on 27 June 2015 and each fifth anniversary thereafter.

The Fixed/Floating rate subordinated notes are redeemable at par, at the option of Abbey National, on 24 December 2016 and each fifth anniversary thereafter.

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

**40. Subordinated liabilities including convertible debt** continued

Subordinated liabilities including convertible debt securities in issue are repayable:

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| In 1 year or less | **203** | 274 | **203** | 274 |
| In more than 1 year but not more than 2 years | **–** | – | **100** | – |
| In more than 2 years but not more than 5 years | **832** | 286 | **763** | 290 |
| In more than 5 years | **2,250** | 1,842 | **2,246** | 1,848 |
| Undated | **1,356** | 931 | **1,356** | 931 |
| | **4,641** | 3,333 | **4,668** | 3,343 |

Subordinated liabilities including convertible debt issued by the Group have a market value, calculated using quoted market prices where available, of £4,783m (£3,932m).

| 41. Called up share capital and share premium account | Ordinary shares of 10 pence each £m | Preference shares of £1 each £m | Preference shares of US$0.01 each £m | Total £m |
|---|---|---|---|---|
| Authorised share capital | | | | |
| At 31 December 1998 | 175 | 1,000 | 6 | 1,181 |
| At 31 December 1999 | 175 | 1,000 | 6 | 1,181 |
| Issued and fully paid share capital | | | | |
| At 1 January 1999 | 142 | 325 | – | 467 |
| At 31 December 1999 | 142 | 325 | – | 467 |
| Share premium account At 1 January 1999 | 1,368 | 9 | 116 | 1,493 |
| Shares issued | 18 | – | – | 18 |
| Capitalisation of reserves in respect of shares issued via QUEST | 25 | – | – | 25 |
| At 31 December 1999 | 1,411 | 9 | 116 | 1,536 |

Under the Company's Executive, All Employee and Sharesave Schemes, employees hold options to subscribe for 26,013,596 (27,909,739) ordinary shares at prices ranging from 299 to 1306 pence per share, exercisable up to August 2009. During the year 4,554,522 (4,751,490) ordinary shares were issued on the exercise of options for a consideration of £43m (£34m).

The terms of the Group's Sharesave Schemes were amended in 1998 so that options maturing during 1998 and thereafter may be subscribed for, at up to full market value, by a qualifying employee share ownership trust (QUEST) formed in 1998.

The QUEST operates in conjunction with the Sharesave Scheme by acquiring shares in the Company and using them to satisfy Sharesave options, by delivering the shares to the employees on payment of the exercise price.

During the year the QUEST has subscribed at market value for ordinary shares at a total cost of £33m (£24m). The Company provided £25m (£17m) to the QUEST for this purpose and £8m (£7m) was received from Sharesave participants. The shares were all transferred by the QUEST to participants in the Group's Sharesave Scheme in satisfaction of their options. The price paid by option holders, including executive directors, was 315 pence per share (five year options) and 239 pence per share (seven year options).

The Company's contribution has been included as a capitalisation of reserves.

As of 31 December 1999 there were 2,076,330 shareholders. The following table shows an analysis of their holdings:

| Size of shareholding | Shareholders | Ordinary shares of 10 pence each Shares |
|---|---|---|
| 1–100 | 1,324,857 | 128,511,709 |
| 101–1,000 | 717,587 | 303,512,291 |
| 1,001+ | 32,765 | 989,929,408 |
| | 2,075,209 | 1,421,953,408 |

| Size of shareholding | Shareholders | Preference shares of £1 each Shares |
|---|---|---|
| 1–100 | – | – |
| 101–1,000 | 19 | 14,363 |
| 1,001+ | 1,061 | 324,985,637 |
| | 1,080 | 325,000,000 |

| Size of shareholding | Shareholders | Preference shares of US$0.01 each Shares |
|---|---|---|
| 1–100 | 7 | 700 |
| 101–1,000 | 27 | 12,845 |
| 1,001+ | 7 | 7,986,455 |
| | 41 | 8,000,000 |

**41. Called up share capital and share premium account** continued

**Sterling preference shares**

Holders of the sterling preference shares are entitled to receive a bi-annual non-cumulative preferential dividend payable in sterling out of the distributable profits of the Company. The rate per annum will ensure that the sum of the dividend payable on such date and the Associated Tax Credit (as defined in the terms of the sterling preference shares) represents an annual rate of 8 $^{5}/_{8}$% per annum of the nominal amount of shares issued in 1998, and an annual rate of 10 $^{3}/_{8}$% for shares issued in 1995 and 1997.

On a return of capital or on a distribution of assets on a winding up, the sterling preference shares shall rank *pari passu* with any other shares that are expressed to rank *pari passu* therewith as regards participation in assets, and otherwise in priority to any other share capital of the Company.

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

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

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

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

**US dollar preference shares**

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

The US dollar preference shares are redeemable, in whole or in part, at the option of Abbey National at any time and from time to time after five years and one day after the date of original issue, 15 November 1996. Redemption may occur only if the sterling dollar exchange rate is at or above its level at date of allotment, US$1.654:£1, or in the event of a tax or regulatory change. The redemption amount will be $25, unless redeemed in years five to ten in which instance a redemption premium will be payable.

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

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

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

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

| **42. Reserves and profit and loss account** | Profit and loss account<br>Group £m | <br>Company £m |
|---|---|---|
| At 1 January 1999 | 3,014 | 2,209 |
| Profit retained for the financial year | 638 | 836 |
| Exchange adjustments | (1) | 2 |
| Capitalised on exercise of share options issued via QUEST | (25) | (25) |
| At 31 December 1999 | 3,626 | 3,022 |

Exchange gains arising from foreign currency borrowings used to hedge investments in overseas Group undertakings of £16m (£11m) have been taken to the reserves of the Group and Company. These exchange movements are matched by corresponding exchange movements on the investments in the accounts of the Company, and exchange movements on the net assets of overseas Group undertakings in the Group accounts.

### 42. Reserves and profit and loss account
continued

| | Non-distributable reserve Group £m | Non-distributable reserve Company £m |
|---|---|---|
| At 1 January 1999 | 433 | – |
| Transfer from profit and loss account | 13 | – |
| At 31 December 1999 | 446 | – |

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

| | Revaluation reserve Group £m | Revaluation reserve Company £m |
|---|---|---|
| At 1 January 1999 | – | – |
| Revaluation movement in the year | 3 | – |
| At 31 December 1999 | 3 | – |

The revaluation reserve represents cumulative revaluation adjustments in respect of the Group's portfolio of investment properties.

### 43. Reconciliation of movements in shareholders' funds

| | Group | | Company | |
|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| Profit attributable to the shareholders of Abbey National plc | **1,261** | 1,058 | **1,446** | 544 |
| Dividends (see note 13) | **(610)** | (535) | **(610)** | (535) |
| | **651** | 523 | **836** | 9 |
| Other recognised net gains and losses relating to the year | **(1)** | – | **2** | (1) |
| Increases in ordinary share capital including share premium | **43** | 34 | **43** | 34 |
| Capitalised reserves on exercise of share options | **(25)** | (17) | **(25)** | (17) |
| Movement on other reserves | **3** | – | **–** | – |
| Goodwill transferred from (taken to) profit and loss account reserve during the year | **–** | (11) | **–** | – |
| Net addition to shareholders' funds | **671** | 529 | **856** | 25 |
| Shareholders' funds at 1 January | **5,407** | 4,878 | **4,169** | 4,144 |
| Shareholders' funds at 31 December | **6,078** | 5,407 | **5,025** | 4,169 |
| Equity shareholders' funds | **5,628** | 4,957 | **4,575** | 3,719 |
| Non-equity shareholders' funds | **450** | 450 | **450** | 450 |
| At 31 December | **6,078** | 5,407 | **5,025** | 4,169 |

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

### 44. Assets and liabilities denominated in foreign currency
The aggregate amounts of assets and liabilities denominated in currencies other than sterling were as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| Assets | **50,747** | 43,364 | **6,401** | 3,902 |
| Liabilities | **57,425** | 46,921 | **5,339** | 3,375 |

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

### 45. Memorandum items
**Guarantees and assets pledged as collateral security**

| | Group | | Company | |
|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| Guarantees given by Abbey National plc of subsidiaries' liabilities | **–** | – | **128,642** | 107,613 |
| Guarantees given to third parties | **1,183** | 813 | **1** | 2 |
| Mortgaged assets granted | **1,031** | 1,031 | **–** | – |
| | **2,214** | 1,844 | **128,643** | 107,615 |

Mortgaged assets granted are to secure future obligations to third parties who have provided security to the leasing subsidiaries.

Guarantees given to third parties include amounts in respect of credit derivative contracts of £432m (£73m). Credit derivatives include contracts such as credit default swaps, spread put options and credit linked notes, whereby credit risk is taken on in respect of reference assets.

### 46. Memorandum items: Other contingent liabilities

| | Group | | Company | |
|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| Other contingent liabilities | **477** | 552 | **8** | 10 |

**46. Memorandum items: Other contingent liabilities** continued
The principal other contingent liabilities are as follows:
**Rediscounted commercial bills**
Cater Allen International Limited has rediscounted commercial bills, including bills sold to the Bank of England under repurchase agreements, amounting to £355m (£419m).

**Repayment of certain tax credits**
Abbey National Treasury Services plc has received a demand from an overseas tax authority for an amount of £100m (at the balance sheet exchange rate) (£113m) relating to the repayment of certain tax credits received and related charges. As at 31 December 1999, additional interest in relation to the demand could amount to £13m (at the balance sheet exchange rate) (£10m). The subsidiary has received legal advice that it has strong grounds to challenge the validity of the demand and accordingly no specific provision has been made.

**47. Memorandum items: Commitments**

**Obligations under stock borrowing and lending agreements**
Obligations under stock borrowing and lending agreements represent contractual commitments to return stock borrowed. These obligations are offset by a contractual rights to receive stock under other contractual agreements.

**Other commitments**
The table below shows the contract or principal amount of commitments other than those relating to derivatives (see note 50).

| | Group | | Company | |
|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| Formal standby facilities, credit lines and other commitments to lend: Less than 1 year | **999** | 1,225 | **497** | 321 |
| 1 Year and over | **2,591** | 1,474 | – | – |
| Forward sale and repurchase agreements | **2,644** | – | – | – |
| Other commitments | **1** | 111 | – | 17 |
| | **6,235** | 2,810 | **497** | 338 |

Other commitments of the Group includes nil (£5m) of expenditure committed to Year 2000 projects.

| **48. Operating leases** | Group | | | |
|---|---|---|---|---|
| | **1999 Property £m** | **1999 Equipment £m** | 1998 Property £m | 1998 Equipment £m |
| Further rental commitments under operating leases expiring: In not more than 1 year | **1** | **2** | 1 | 4 |
| In more than 1 year but not more than 5 years | **17** | **3** | 11 | 5 |
| In more than 5 years | **50** | **–** | 50 | – |
| | **68** | **5** | 62 | 9 |

| | Company | | | |
|---|---|---|---|---|
| | **1999 Property £m** | **1999 Equipment £m** | 1998 Property £m | 1998 Equipment £m |
| Further rental commitments under operating leases expiring: In not more than 1 year | **1** | **2** | 1 | 4 |
| In more than 1 year but not more than 5 years | **15** | **3** | 10 | 4 |
| In more than 5 years | **43** | **–** | 43 | – |
| | **59** | **5** | 54 | 8 |

As at 31 December 1999, the Group held various leases on land and buildings, many for extended periods, and other leases for equipment, which require the following aggregate annual rental payments:

| | **Group 1999 £m** | **Company 1999 £m** |
|---|---|---|
| Year ended 31 December | | |
| 2000 | **70** | **64** |
| 2001 | **68** | **63** |
| 2002 | **65** | **61** |
| 2003 | **60** | **56** |
| 2004 | **56** | **52** |
| Total thereafter | **398** | **371** |

| | **1999 £m** | 1998 £m |
|---|---|---|
| Group rental expense comprises: | | |
| In respect of minimum rentals | **64** | 67 |
| Less: sub-lease rentals | **(6)** | (4) |
| | **58** | 63 |

## 49. Financial Instruments

The Accounting Standards Board issued FRS13, 'Derivatives and other financial instruments: disclosures', which is first effective in Abbey National's accounts for the year ended 31 December 1999. Comparatives are not required in the first year, however they have been provided in the new disclosure format where the information was published in previous years.

The main disclosures appear in the Operating and financial review and accounts as follows:

**In the Operating and financial review:**
The Objectives and policies in holding financial instruments: see 'Financial instruments', Page 21
Financial risk management policies: see 'Financial risk management', Page 21
Trading financial instrument exposure sensitivity analysis: see 'Financial risk management – Market risk of financial instruments – Trading Instruments', Page 22

**In the accounts:**
Dealing profits from financial instruments: see note 6, 'Dealing profits'
Interest rate risk of non-trading financial instruments: see 'Interest rate risk' below
Foreign exchange risk of non-trading financial instruments: see 'Foreign exchange risk' below
The use of derivatives for hedging and trading purposes, with financial disclosures: see note 50, 'Derivatives'
Fair value disclosures: In summary, fair value (i.e. market value) disclosures are required by FRS13 for all financial instruments in the trading book, and the following financial instruments in the non-trading book:

- All derivatives
- All listed and/or publicly traded securities
- All other financial instruments for which there is a liquid and active market

Such disclosures required by the standard are provided in the note to the accounts relevant to the financial instrument type. These may be found in note 15, Treasury bills and other eligible bills; note 20, Debt securities; note 21, Equity shares and other variable yield securities; note 34, Debt securities in issue; note 40, Subordinated liabilities; and note 50, Derivatives. Fair value disclosures are not provided for loans and deposits as there is no liquid and active market for such instruments held by the Group.
The financial assets and liabilities of insurance companies are excluded from the scope of FRS13.

### Interest rate risk

In accordance with FRS 13, interest rate repricing gap information is shown in the tables below, as at 31 December 1999. It provides an estimate of the repricing profile of the Group's assets, liabilities and off-balance sheet exposures for non-trading activities. For the major categories of assets and liabilities, these 'gap' tables show the values of interest earning assets and interest bearing liabilities which reprice within selected time bands. Items are allocated to time bands by reference to the earlier of the next interest rate repricing date and the legal maturity date. This leads to an apparent timing mismatch where the anticipated maturity date is different from the legal maturity date and hedges have been structured accordingly. The positions shown reflect both the repricing behaviour of the administered rates on mortgage and savings products (over which Abbey National has some control) and contracted wholesale on and off-balance sheet positions (which are determined by market rates). The tables do not purport to measure market risk exposure.

### Interest Rate Sensitivity Gap as at 31 December

| | Non-trading | | | | | | Trading | Total |
|---|---|---|---|---|---|---|---|---|
| | Not more than 3 months £m | In more than 3 months but not more than 6 months £m | In more than 6 months but not more than 12 months £m | In more than 1 year but not more than 5 years £m | In more than 5 years £m | Non-interest bearing amounts £m | Total trading Book £m | 1999 £m |
| **Assets** | | | | | | | | |
| Treasury and other eligible bills | 30 | – | – | – | – | – | 1,084 | 1,114 |
| Loans and advances to banks (1) | 3,489 | 310 | – | 205 | 119 | 377 | 6,972 | 11,472 |
| Loans and advances to customers (2) | 52,039 | 1,367 | 1,832 | 14,310 | 5,874 | 273 | 77 | 75,772 |
| Net investment in finance leases | 3,589 | 686 | 654 | 266 | 243 | 3 | – | 5,441 |
| Securities and investments | 32,580 | 2,112 | 666 | 3,508 | 4,644 | 418 | 15,812 | 59,740 |
| Other assets | | | | | | 8,754 | 1,012 | 9,766 |
| Assets of long term assurance funds | | | | | | 17,439 | – | 17,439 |
| **Total assets** | 91,727 | 4,475 | 3,152 | 18,289 | 10,880 | 27,264 | 24,957 | 180,744 |
| **Liabilities** | | | | | | | | |
| Deposits by banks (1) | 4,991 | 1,347 | 886 | 96 | 159 | 1,452 | 20,893 | 29,824 |
| Customer accounts | 51,291 | 1,393 | 1,395 | 5,480 | 186 | 4 | 162 | 59,911 |
| Debt securities in issue | 29,001 | 4,313 | 4,339 | 10,415 | 3,182 | 157 | – | 51,407 |
| Subordinated liabilities | 292 | 173 | 101 | 633 | 3,442 | – | – | 4,641 |
| Other liabilities | 99 | 40 | – | – | – | 7,403 | 3,902 | 11,444 |
| Liabilities of long term assurance funds | | | | | | 17,439 | – | 17,439 |
| Shareholders' funds – non-equity | | | | | | 450 | – | 450 |
| – equity | | | | | | 5,628 | – | 5,628 |
| **Total liabilities** | 85,674 | 7,266 | 6,721 | 16,624 | 6,969 | 32,533 | 24,957 | 180,744 |
| Off-balance sheet items (3) | (11,712) | 2,599 | 4,051 | 4,414 | 204 | 444 | | |
| Interest rate repricing gap | (5,659) | (192) | 482 | 6,079 | 4,115 | (4,825) | | |
| 1999 Cumulative gap | (5,659) | (5,851) | (5,369) | 710 | 4,825 | 0 | | |
| 1998 Cumulative gap | (3,178) | (1,145) | (1,546) | 4,579 | 4,946 | 0 | | |

(1) Non-interest bearing items within loans and advances to banks and deposits by banks, include items in the course of collection and items in the course of transmission, respectively. These are short term receipts and payments within the UK retail banking clearing system. The remaining non-interest bearing item within loans and advances to banks relates to the interest free deposit maintained with the Bank of England.

(2) Non-interest bearing items within loans and advances to customers relate to non-accruing lendings after deduction of associated provisions.

(3) Off-balance sheet items are classified in the table above according to the interest terms contained in the contracts.

Negative gaps are liability sensitive and, all other things being equal, would indicate a benefit if interest rates decline. A positive gap is asset sensitive and, all other things being equal, would indicate a benefit if interest rates increase.

Gap positions shown within the interest rate repricing table are attributable to the balance sheet management of the Group's capital, low rate and non-interest bearing liabilities, aimed at reducing income volatility. Fixed rate assets and liabilities are hedged in line with a broadly risk neutral management objective.

**49. Financial Instruments** continued

A number of Abbey National non-trading assets and liabilities are subject to more complex repricing than can be reflected in the above table or reprice with reference to indices other than interest rates. The market risk exposure is minimised through the use of matching derivatives. The material product groupings include:

a) Loans with embedded interest rate caps and floors. These are subject to a predetermined maximum or minimum interest rate for a period of up to seven years. The risk of volatility in earnings from movements in interest rates is hedged with purchased interest rate caps and floors.

b) Customer accounts where the return of a fixed period is determined by the performance of an equity index. The risk of volatility in earnings from movements in the equity index is hedged using equity swaps.

c) Contracts with interest rate floor and swaption features. These may be written, for example, in order to hedge fixed rate funding at efficient overall funding rates, while setting a predetermined minimum rate of interest to be payable in future periods.

The risks associated with such instruments, and their hedges, are reflected in Financial risk management – Market risk of non-trading financial instruments, in the Operating and financial review.

**Foreign exchange risk**
The Group's main overseas operations are in France and Italy. The Group also has some small operations elsewhere in Europe, North America and Asia. The main operating (or 'functional') currencies of its operations are therefore Sterling and the Euro. As the currency in which the Group prepares its consolidated financial statements is Sterling, it follows that the Group's consolidated balance sheet is affected by movements in the exchange rates between these functional currencies and Sterling. These currency exposures are referred to as structural currency exposures. This is not the same as structural market risk which arises from a variety of exposures inherent in a product or portfolio (see above). Translation gains and losses arising from these exposures are recognised in the Statement of total recognised gains and losses.

The Group mitigates the effect of these exposures by financing a significant proportion of its net investments in its overseas operations with borrowings in the same currencies as the functional currencies involved.

The Group's structural currency exposures as at 31 December 1999 were as follows:

**Structural currency exposures as at 31 December 1999**

| Functional currency of the operation involved | Net investments in overseas operations 1999 £m | Borrowings hedging net investments in overseas operations 1999 £m | Net structural currency exposures 1999 £m | Net structural currency exposures 1998 £m |
|---|---|---|---|---|
| Euro – Subsidiary | 135 | (134) | 1 | 8 |
| – Branches | (21) | – | (21) | (16) |
| Other non-sterling amounts | 8 | (7) | 1 | 1 |
| **Total** | **122** | **(141)** | **(19)** | (7) |

The Group also has some transactional currency exposures. Such exposures arise from the activities of the Group where the operating unit undertakes activities in currencies other than the unit's functional currency. Where such activities show currency mismatches between assets and liabilities, the Group uses a variety of derivative products (e.g. cross currency swaps, forward foreign exchange contracts) to eliminate some or all of the currency risk depending on the amount and nature of the transaction. Controls are in place to limit the size of the Group's open transactional foreign exchange positions.

The table below shows those transactional (or non-structural) exposures which give rise to the net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the Group that are not denominated in the functional currency of the operating unit involved, other than certain non-sterling borrowings treated as hedges of net investments in overseas operations (as shown in the above table). The exposures shown below are stated net of derivatives used to hedge currency risk. As at 31 December 1999 these exposures are as follows:

**Transactional currency exposures as at 31 December 1999**
**Non-Trading book**

| | Net foreign currency monetary assets/(liabilities) | | | | |
|---|---|---|---|---|---|
| **Functional currency of Group operation** | **Sterling £m** | **US Dollar £m** | **Euro £m** | **Other £m** | **Total £m** |
| Sterling | n/a | 3 | 8 | (2) | 9 |
| Euro | 4 | – | n/a | – | 4 |
| **Total** | **4** | **3** | **8** | **(2)** | **13** |

Transactional currency exposures as at 31 December 1998
Non-Trading book

| | Net foreign currency monetary assets/(liabilities) | | | | |
|---|---|---|---|---|---|
| **Functional currency of Group operation** | **Sterling £m** | **US Dollar £m** | **Euro £m** | **Other £m** | **Total £m** |
| Sterling | n/a | 5 | 19 | – | 24 |
| Euro | – | – | n/a | – | – |
| **Total** | **–** | **5** | **19** | **–** | **24** |

The Wholesale Banking and Wealth Management business segments generate a significant proportion of their income in currencies other than the functional currency, and may use forward foreign exchange contracts to fix the functional currency equivalent of their forecast income. The outstanding nominal of such transactions at 31 December 1999 was £120m, all with a maturity of less than one year.

**50. Derivatives**
Derivatives are contracts or agreements whose value is derived from one or more underlying indices or asset values inherent in the contract or agreement. Derivatives are used for trading and non-trading purposes. These terms are defined in Accounting policies: Derivatives on page 42.

**Non-trading derivatives**
The main non-trading derivatives are interest rate and cross-currency swaps, which are used to hedge the Group's exposures to interest rates and exchange rates inherent in non-trading assets, liabilities and positions, including fixed rate lending and structured savings products within UK Retail Banking, Finance House and Continental Europe, and medium term note issues, capital issues and fixed rate asset purchases within Wholesale Banking.

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

**50. Derivatives** continued

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

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

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

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

**Trading derivatives**

Abbey National Financial Products (ANFP) is the only business within the Abbey National Group actively trading derivative products and is additionally responsible for implementing Group hedging activities involving derivative contracts with the external market. ANFP's objective is to gain margin value by marketing derivatives to end-users and hedging the resulting exposures efficiently. Products offered by ANFP include interest rate and cross-currency swaps, caps, floors and swaptions and variations on these products. ANFP has established clear guidelines for staff to ensure that end-users are aware of the potential risk of entering into complex derivative transactions.

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

ANTS additionally holds trading derivatives to hedge interest rate exposures created within trading portfolios of asset backed and other securities.

Derivatives used in trading activities are stated at fair value.

**Quantitative disclosures**

The table below shows the contract or underlying principal amounts, and positive and negative market values of non-trading and trading derivatives analysed by type of contract. Contract or underlying principal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The market value represents the amount at which a contract could be exchanged in an arm's length transaction, calculated at market rates current at the balance sheet date.

| **50. Derivatives** continued | **Contract or underlying principal amounts 1999 £m** | **Positive market values 1999 £m** | **Negative market values 1999 £m** |
|---|---|---|---|
| | | | **Group** |
| **Non-trading derivatives:** | | | |
| Exchange rate contracts: | | | |
| Cross-currency swaps | 14,090 | 468 | 964 |
| Forward foreign exchange | 6,954 | 19 | 15 |
| Foreign exchange options | 29 | 2 | – |
| | 21,073 | 489 | 979 |
| Interest rate contracts: | | | |
| Interest rate swaps | 85,595 | 1,967 | 1,452 |
| Caps, floors and swaptions | 9,069 | 283 | 33 |
| Futures (exchange traded) | 1,029 | – | – |
| Forward rate agreements | 1,648 | 1 | – |
| | 97,341 | 2,251 | 1,485 |
| Equity contracts: | | | |
| Equity index options | 448 | 24 | – |
| Equity index swaps | 394 | 7 | 16 |
| | 842 | 31 | 16 |
| **Total** | 119,256 | 2,771 | 2,480 |

| | Contract or underlying principal amounts 1998 £m | Positive market values 1998 £m | Negative market values 1998 £m |
|---|---|---|---|
| | | | Group |
| **Non-trading derivatives:** | | | |
| Exchange rate contracts: | | | |
| Cross-currency swaps | 13,251 | 600 | 592 |
| Forward foreign exchange | 5,525 | 33 | 194 |
| | 18,776 | 633 | 786 |
| Interest rate contracts: | | | |
| Interest rate swaps | 76,681 | 1,866 | 1,531 |
| Caps, floors and swaptions | 9,294 | 110 | 31 |
| Futures (exchange traded) | 7,097 | 1 | 2 |
| Forward rate agreements | 295 | – | – |
| | 93,367 | 1,977 | 1,564 |
| Equity contracts: | | | |
| Caps, floors and swaptions | 281 | 39 | 19 |
| Equity index options | 202 | – | 1 |
| | 483 | 39 | 20 |
| **Total** | **112,626** | **2,649** | **2,370** |

Included in the above analysis of non-trading derivatives are exchange rate contracts, interest rate contracts and equity contracts with underlying principal amounts of £2,098m (£1,427m), £54,025m (£49,321m) and £152m (£202m) respectively, which were undertaken by Group entities with ANFP. The total net positive market value of such contracts amounted to £209m (net negative £151m).

Associated contracts which ANFP has transacted with external counterparties are included in the analysis of trading derivatives. Net negative market values of £209m (net positive £151m) on all contracts held by ANFP with other Group entities are included within Other liabilities, as shown in the following table:

| | **Contract or underlying principal amounts 1999 £m** | **Positive market values 1999 £m** | **Negative market values 1999 £m** |
|---|---|---|---|
| | | | **Group** |
| **Trading derivatives:** | | | |
| Exchange rate contracts: | | | |
| Cross-currency swaps | 4,851 | 110 | 135 |
| Forward foreign exchange | 3,310 | 1 | 12 |
| | 8,161 | 111 | 147 |
| Interest rate contracts: | | | |
| Interest rate swaps | 145,389 | 1,969 | 2,145 |
| Caps, floors and swaptions | 31,355 | 361 | 270 |
| Futures (exchange traded) | 13,644 | – | – |
| Forward rate agreements | 4,828 | 4 | 3 |
| | 195,216 | 2,334 | 2,418 |
| Equity contracts: | | | |
| Equity index options | 6,171 | 267 | 1,447 |
| | 6,171 | 267 | 1,447 |
| **Total** | 209,548 | 2,712 | 4,012 |
| Effect of netting | | (1,782) | (1,782) |
| Fair values of contracts between ANFP and other Group entities | | | 209 |
| Amount included in Other assets/Other liabilities | | 930 | 2,439 |

| **50. Derivatives** continued | Contract or underlying principal amounts 1998 £m | Positive market values 1998 £m | Negative market values 1998 £m |
|---|---|---|---|
| **Trading derivatives** continued: | | | |
| Exchange rate contracts: | | | |
| Cross-currency swaps | 3,148 | 98 | 117 |
| Forward foreign exchange | 71 | – | 8 |
| | 3,219 | 98 | 125 |
| Interest rate contracts: | | | |
| Interest rate swaps | 94,288 | 2,136 | 2,459 |
| Caps, floors and swaptions | 29,266 | 329 | 200 |
| Futures (exchange traded) | 20,677 | – | – |
| Forward rate agreements | 13,747 | 16 | 14 |
| | 157,978 | 2,481 | 2,673 |
| Equity contracts: | | | |
| Equity index options | – | – | – |
| | – | – | – |
| **Total** | **161,197** | **2,579** | **2,798** |
| Effect of netting | | (2,338) | (2,338) |
| Fair values of contracts between ANFP and other Group entities | | 151 | – |
| Amount included in Other assets/Other liabilities | | 392 | 460 |

Positive market values arise where gross positive market values exceed gross negative market values on a contract by contract basis. This equates to net replacement cost. Negative market values arise where gross negative market values exceed gross positive market values on a contract by contract basis. The totals of positive and negative market values arising on trading derivatives as at 31 December 1999 have been netted where the Group has a legal right of offset with the relevant counterparty.

As at the balance sheet date, the Company held non-trading interest rate contracts, exchange rate contracts and equity contracts with underlying principal amounts as follows: interest rate swaps £45,346m (£40,040m), interest rate caps, floors and swaptions £5,770m (£4,327m), forward rate agreements £247m (nil), cross-currency swaps £619m (nil), forward foreign exchange contracts £4,330m (£460m) and equity index options £388m (£484m).

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

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

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

| | **Contract or underlying principal amounts 1999 £m** | **Net replacement cost 1999 £m** | Contract or underlying principal amounts 1998 £m | Net replacement cost 1998 £m |
|---|---|---|---|---|
| Derivatives maturing: | | | | |
| In not more than 1 year | **31,789** | **551** | 29,916 | 187 |
| In more than 1 year but not more than 5 years | **62,798** | **1,401** | 56,940 | 1,407 |
| In more than 5 years | **23,640** | **819** | 18,673 | 1,054 |
| | **118,227** | **2,771** | 105,529 | 2,648 |

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

| | **Contract or underlying principal amounts 1999 £m** | **Net replacement cost 1999 £m** | Contract or underlying principal amounts 1998 £m | Net replacement cost 1998 £m |
|---|---|---|---|---|
| Trading derivatives maturing (before netting): | | | | |
| In not more than 1 year | **39,365** | **233** | 38,882 | 683 |
| In more than 1 year but not more than 5 years | **100,983** | **1,367** | 73,342 | 1,078 |
| In more than 5 years | **55,556** | **1,112** | 28,296 | 818 |
| | **195,904** | **2,712** | 140,520 | 2,579 |

**50. Derivatives** continued

**Unrecognised gains and losses on financial assets resulting from hedge accounting**

Gains and losses on financial instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised gains and losses on instruments used for hedging are as follows:

| | | Group | |
|---|---|---|---|
| **Gains and losses expected to be recognised:** | Gains £m | Losses £m | Total Net gains (losses) £m |
| At 31 December 1999 | | | |
| In 1 year or less | 394 | (433) | (39) |
| After 1 year | 1,067 | (1,044) | 23 |
| | 1,461 | (1,477) | (16) |
| At 31 December 1998 | | | |
| In 1 year or less | 782 | (571) | 211 |
| After 1 year | 1,478 | (1,168) | 310 |
| | 2,260 | (1,739) | 521 |

The net gain unrecognised at 31 December 1998 and recognised during the year was £203m. The net book value of these contracts was £(274)m (1998: (£311m)).

**Deferred gains and losses on financial assets resulting from hedge accounting**

Deferred balances relating to settled derivatives and other financial transaction provisions, used as hedges, will be released to the profit and loss account in the same periods as the income and expense flows from the underlying hedged transactions. The movement in the period is as follows:

| | | Group | |
|---|---|---|---|
| | Gains £m | Losses £m | Total Net gains (losses) £m |
| At 1 January 1999 | 58 | (24) | 34 |
| Previous years deferred gains and losses recognised in the year | (13) | 9 | (4) |
| Gains and losses deferred in the year | 19 | (14) | 5 |
| At 31 December 1999 | 64 | (29) | 35 |
| **Gains and losses expected to be recognised:** | | | |
| In 1 year or less | 10 | (8) | 2 |
| After 1 year | 54 | (21) | 33 |

**51. Consolidated cash flow statement**

| **a) Reconciliation of profit before tax to net cash inflow from operating activities** | **1999 £m** | 1998 £m |
|---|---|---|
| Profit on ordinary activities before tax | **1,783** | 1,520 |
| Decrease (Increase) in interest receivable and prepaid expenses | **342** | (1,157) |
| (Decrease) Increase in interest payable and accrued expenses | **(155)** | 245 |
| Provisions for bad and doubtful debts | **303** | 201 |
| Provisions for contingent liabilities and commitments | **23** | 16 |
| Net advances written off | **(317)** | (176) |
| Increase in the value of long term assurance business | **(196)** | (155) |
| Depreciation and amortisation | **171** | 126 |
| Income from Associated Undertakings | **(12)** | – |
| Profit on sale of tangible fixed assets and investments | **(108)** | (30) |
| Effect of other deferrals and accruals of cash flows from operating activities | **98** | 16 |
| Net cash inflow from trading activities | **1,932** | 606 |
| Net increase in loans and advances | **(5,504)** | (1,811) |
| Net (increase) decrease in investment in finance leases | **(100)** | 20 |
| Net increase in bills and securities | **3,314** | (2,678) |
| Net increase in deposits and customer accounts | **445** | 5,616 |
| Net increase in debt securities in issue | **8,404** | 3,005 |
| Net increase in other liabilities less assets | **2,243** | 487 |
| Exchange movements | **(207)** | (557) |
| Net cash inflow from operating activities | **10,527** | 4,688 |

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

**51. Consolidated cash flow statement** continued

**b) Analysis of the balance of cash as shown in the balance sheet**

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

| | **Cash & balances with central banks 1999 £m** | **Loans & advances to other banks repayable on demand 1999 £m** | **Total 1999 £m** |
|---|---|---|---|
| At 1 January | 329 | 1,337 | 1,666 |
| Net cash inflow | 372 | 1,146 | 1,518 |
| At 31 December | 701 | 2,483 | 3,184 |

| | Cash & balances with central banks 1998 £m | Loans & advances to other banks repayable on demand 1998 £m | Total 1998 £m |
|---|---|---|---|
| At 1 January | 329 | 1,034 | 1,363 |
| Net cash inflow | – | 303 | 303 |
| At 31 December | 329 | 1,337 | 1,666 |

Loans and advances to other banks repayable on demand excludes £1,918m (£2,374m) of loans and advances relating to stock lending and sale and repurchase business, which are repayable on demand, but matched by corresponding balances in deposits by banks. Such balances have not been classified as cash for the purposes of the cash flow statement.

The Group is required to maintain balances with the Bank of England which at 31 December 1999 amounted to £98m (£101m). These are shown in loans and advances to banks, and are not included in cash for the purposes of the cash flow statement.

| **c) Analysis of changes in financing during the year** | **Share capital inc. Share premium 1999 £m** | **Subordinated liabilities 1999 £m** | **Total 1999 £m** |
|---|---|---|---|
| At 1 January | 1,960 | 3,333 | 5,293 |
| Net cash inflow from financing | 18 | 1,330 | 1,348 |
| Effect of foreign exchange rate changes | – | (21) | (21) |
| Capitalised on exercise of share options | 25 | – | 25 |
| At 31 December | 2,003 | 4,642 | 6,645 |

| | Share capital inc. Share premium 1998 £m | Subordinated liabilities 1998 £m | Total 1998 £m |
|---|---|---|---|
| At 1 January | 1,926 | 2,463 | 4,389 |
| Net cash inflow from financing | 17 | 857 | 874 |
| Effect of foreign exchange rate changes | – | 13 | 13 |
| Capitalised on exercise of share options | 17 | – | 17 |
| At 31 December | 1,960 | 3,333 | 5,293 |

| **d) Acquisitions of subsidiary and associated undertakings and purchase of businesses** | **1999 £m** | 1998 £m |
|---|---|---|
| Net assets acquired: | | |
| Loans and advances to banks | – | 4 |
| Loans and advances to customers | – | 3,386 |
| Net investment in finance leases | – | 691 |
| Tangible fixed assets | **36** | 68 |
| Operating lease assets | – | 85 |
| Other assets | **30** | 255 |
| Deposits by banks | – | (3,992) |
| Other liabilities | – | (265) |
| Goodwill on acquisitions | – | 202 |
| | **66** | 434 |
| Satisfied by: Unsecured interest bearing loan notes | – | 5 |
| Cash | **30** | 364 |
| Deferred consideration | – | 4 |
| Loan prepayment | **36** | 61 |
| | **66** | 434 |

**51. Consolidated cash flow statement** continued

| **e) Analysis of the net outflow of cash in respect of acquisitions of subsidiary and associated undertakings and purchase of businesses** | **1999 £m** | 1998 £m |
|---|---|---|
| Cash consideration | **30** | 364 |
| Cash acquired | – | (7) |
| Net outflow of cash in respect of acquisitions of subsidiary and associated undertakings/purchase of business | **30** | 357 |

| **f) Sale of subsidiary and associated undertakings** | **1999 £m** | 1998 £m |
|---|---|---|
| Net assets disposed of: | | |
| Tangible fixed assets | – | 5 |
| Loans and advances | – | 327 |
| Other assets | – | 8 |
| Cash at bank and in hand | – | 4 |
| Deposits by banks and customer accounts | – | (214) |
| Other liabilities | – | (5) |
| Provisions for liabilities and charges | – | (1) |
| Goodwill written back | – | 19 |
| | – | 143 |
| Profit on disposal | – | 4 |
| Consideration received | – | 147 |
| Satisfied by: | | |
| Cash | – | 147 |
| Other assets | – | – |
| | – | 147 |

| **g) Analysis of the net inflow of cash in respect of the sale of subsidiary and associated undertakings** | **1999 £m** | 1998 £m |
|---|---|---|
| Cash received as consideration | – | 147 |
| Cash disposed of | – | (4) |
| Net inflow of cash in respect of sale of subsidiary and associated undertakings | – | 143 |

**52. Retirement benefits**

The Abbey National Amalgamated Pension Fund, Abbey National Group Pension Scheme and National and Provincial Building Society Pension Fund are the principal pension schemes within the Group, covering 80% (76%) of the Group's employees, and are all funded defined benefits schemes.

The latest formal actuarial valuation carried out by an independent professionally qualified actuary was made as at 31 March 1999 for the Amalgamated Fund and Group Pension Scheme and 31 March 1997 for the National and Provincial Building Society Pension Fund.

The main long term financial assumptions used in the 1999 Actuarial Valuations were:

| | % Nominal per annum |
|---|---|
| Investment return | 6.25 |
| Pension increases | 3.0 |
| General salary increases | 4.5 |
| General price inflation | 3.0 |

Formal actuarial valuations of the assets and liabilities of the schemes are carried out on a triennial basis and, in addition, there is an annual review by the appointed actuary. The results of these reviews are included in the accounts.

Including the review of the National and Provincial Pension Fund carried out as at 31 March 1999, the combined market value of the schemes' assets was £1,626m, and the combined funding level 104%.

**52. Retirement benefits** continued

The pension cost of £67m (£46m) reflects the regular contribution rate less an amount in respect of the year to 31 December 1999 in respect of the surplus being recognised over the expected remaining service lives of the members of all the Group's schemes in accordance with SSAP 24, 'Accounting for Pension Costs'.
An asset of £9m (£2m) has been included in the balance sheet accordingly.

In addition, included in Other assets as at 31 December 1999 was an amount of £23m (£25m) in respect of the unamortised pension scheme surplus assessed at the date the business of N&P was purchased. This was based on an actuarial assessment of the scheme at that date and is included in the balance sheet in accordance with FRS7, 'Fair values in acquisition accounting'. This balance is being amortised over the average remaining service lives of employees in the scheme, and £2m (£1m) was charged to the profit and loss account in the year ended 31 December 1999.

**53. Directors' emoluments and interests**

Further details of directors' emoluments and interests are included in the Board Report of the Personnel and Remuneration Committee on pages 30 to 35. These details include, as specified for audit by the London Stock Exchange, an analysis, by director, of salary and other payments and benefits on page 31, an analysis of directors' share options on pages 33 and 34 and details of the directors' conditional rights over the Company's shares under the Long Term Incentive Plan on page 35, all of which form part of these audited financial statements.

Ex gratia pensions paid to former directors of Abbey National plc in 1999, which have been provided for previously, amounted to £157,900 (£154,633). The Board no longer awards any new such ex gratia pensions and accordingly, no charge (nil) to the profit and loss account has been made in respect of them.

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

| | Number of persons | Aggregate amount outstanding £000 |
|---|---|---|
| **Directors** | | |
| Loans | 9 | 1,269 |
| Quasi loans | 4 | 7 |
| Credit transactions | – | – |
| **Officers** | | |
| Loans | 26 | 2,592 |
| Quasi loans | 12 | 12 |
| Credit transactions | 17 | 281 |

No director had a material interest in any contract of significance, other than a service contract, with the Company or any of its subsidiaries at any time during the year. The directors did not have any interests in shares or debentures of subsidiaries. Further disclosures relating to these transactions, as required under FRS 8, 'Related party disclosures' are given in note 54.

**54. Related party disclosures**

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

Directors, executive officers and members of their close families have undertaken the following transactions with the Abbey National Group in the course of normal banking and life assurance business.

| | Number of directors and executive officers (1) | 1999 Amounts in respect of directors, executive officers (1) and their close family members £000 |
|---|---|---|
| **Secured loans, unsecured loans and overdrafts** | | |
| Net movements in the year | **12** | **(16)** |
| Balances outstanding as at 31 December | **11** | **1,276** |
| **Deposit, investment, bank and instant access accounts** | | |
| Net movements in the year | **14** | **709** |
| Balances outstanding as at 31 December | **15** | **3,644** |
| **Life assurance policies and investments** | | |
| Net movements in the year | **3** | **(5)** |
| Total sum insured/ value of investment | **2** | **171** |

## 54. Related party disclosures continued

| **a) Transactions with directors, executive officers and their close family members** continued | Number of directors and executive officers (1) | 1998 Amounts in respect of directors, executive officers (1) and their close family members £000 |
|---|---|---|
| **Secured loans, unsecured loans and overdrafts** | | |
| Net movements in the year | 15 | 191 |
| Balances outstanding as at 31 December | 12 | 1,259 |
| **Deposit, investment, bank and instant access accounts** | | |
| Net movements in the year | 16 | 1,269 |
| Balances outstanding as at 31 December | 16 | 2,935 |
| **Life assurance policies and investments** | | |
| Net movements in the year | 2 | (37) |
| Total sum insured/ value of investment | 3 | 176 |

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

Three directors have also undertaken sharedealing transactions through two subsidiary companies of an aggregate net value of £54,383. The transactions were on normal business terms and standard commission rates were payable.

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

Amounts deposited by directors, executive officers and their close family members earn interest at the same rates as those offered to the market or on the same terms and conditions applicable to other employees within the Group.

Life assurance policies and investments are entered into by directors, executive officers and their close family members on normal market terms and conditions, or on the same terms and conditions as applicable to other employees within the Group.

**b) Transactions with associated undertakings**

Abbey National plc acts as agent for CGUUL, under which it passes insurance premiums to CGUUL and earns an agent's margin. The agency margin amounted to £132m (£130m) for the year ended 31 December 1999.

Abbey National plc has a joint venture agreement with CGU plc. During the year CGU plc contributed £5m (nil) for developing a new software capability.

Abbey National Independent Consulting Group Ltd holds a 49% share in Willis National Holdings Ltd, a company offering independent financial advice. The Group earns a commission on insurance premiums, for which it pays professional service fees. The net income from such fees amounted to nil (nil) for the year ended 31 December 1999.

Abbey National plc has a joint venture agreement with Safeway plc which includes various savings products and an in-store banking network. Customer accounts are all managed by Abbey National plc, with a share of profits being paid to Safeway. During the year ended 31 December 1999, nil (nil) was paid to Safeway plc.

First National Bank plc holds a 50% share in PSA Wholesale (a subsidiary of Peugeot SA), known as PSA Finance plc (PSA). This is a finance organisation providing financial services to the Peugeot-Citroen car dealership network. The income receivable from the Group's interest in PSA amounted to £11m in the year. As at 31 December 1999, £10m was outstanding from PSA.

Abbey National Jersey International Limited holds 9.9% of the 'A' ordinary shares and 50% of the 'B' convertible ordinary shares in DAH Holdings Limited (DAH). DAH is the holding company of a private banking organisation, and is registered in Bermuda. The income receivable from the Group's interest in DAH amounted to £1m in the year.

Balances outstanding between the Group and associated companies as at 31 December 1999 are detailed in notes 17 and 33. Further details of the Group's interests in associated undertakings are shown in note 23.

## Differences between UK GAAP and US GAAP

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

### Depreciable Assets

**a) Goodwill/core deposit intangible**

**UK GAAP** Goodwill arising on consolidation as a result of the acquisitions of subsidiary and associated undertakings after 1 January 1998, and goodwill arising on the purchase of businesses after 1 January 1998, is capitalised under the heading, Intangible fixed assets, and amortised over its expected useful economic life. Such goodwill is subject to review for impairment in accordance with FRS 11, 'Impairment of fixed assets and goodwill'. The useful economic life is calculated using a valuation model which determines the period of time over which returns are expected to exceed the cost of capital, subject to a maximum period of 20 years. Goodwill arising on consolidation as a result of the acquisitions of subsidiary and associated undertakings prior to 1 January 1998, and goodwill which arose on the purchase of businesses prior to 1 January 1998, has previously been taken to reserves. On disposal of subsidiary and associated undertakings and businesses, such goodwill is charged to the profit and loss account balanced by an equal credit to reserves. Where such goodwill in continuing businesses has suffered an impairment, a similar charge to the profit and loss account and credit to reserves is made.

**US GAAP** Goodwill is capitalised and amortised in the consolidated statement of income over the period in which the benefits are estimated to accrue. In Abbey National's case, a period of no longer than 20 years has been used. Goodwill is written off when judged to be impaired.

The asset representing the value of retail depositor relationships associated with an acquisition of a savings entity, termed the core deposit intangible, is capitalised separately and amortised in the consolidated statement of income over the estimated average life of the retail customer relationships.

**b) Computer software expenses**

**UK GAAP** Expenses incurred on the purchase or development of computer software are charged to the profit and loss account immediately.

**US GAAP** Under Statement of Principle (SOP) 98-1, software developed or obtained for internal use is accounted for depending on the stage of development of the project to which it relates. Where the project is in the preliminary stage all costs are expensed. Where the project is in the application development stage some costs are capitalised. Post-implementation costs are expensed. Costs capitalised during the application development stage include the costs of design, coding, installation of software, and testing. All other costs are expensed. The capitalised costs are amortised on a straight-line basis.

### Pension costs

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

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

### Leasing

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

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

### Shareholders' interest in long term assurance business

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

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

For contracts valued in accordance with SFAS No. 60, which covers conventional products such as endowment and term assurance policies, premiums are recognised as revenue when due from the policyholders. Costs of claims are recognised when insured events occur. A liability for future policy benefits to be paid to or on behalf of policyholders is established based upon the present value of future benefits less the present value of future net premiums. Acquisition costs are charged to the profit and loss account in proportion to premium revenue recognised. For contracts valued under SFAS No. 97, which covers unit-linked products, premiums and front-end load type charges receivable from customers and acquisition costs relating to the acquisition of new contracts are capitalised and amortised in proportion to the present value of estimated gross profits.

Estimated gross profits are projected on best estimate assumptions with no provisions for adverse deviation. The liability for policy benefits is set equal to the nominal policyholders' account balance. Costs of claims are recognised when insured events occur.

### Stock-Based Compensation

**UK GAAP** The costs of equity-based instruments, such as share options, issued to employees under compensation schemes (except Inland Revenue approved Save as You Earn (SAYE) schemes) must be recognised through the profit and loss account over the vesting period. For Inland Revenue approved SAYE schemes, equity-based instruments are accounted for within the called-up share capital and share premium accounts on the balance sheet when exercised.

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

### Other

Other differences include:

**a) Loan origination fees**

**UK GAAP** Loan origination fees received in respect of services provided are recognised in the profit and loss account as the services are performed. Where loan origination fees are in the nature of interest, they are recognised in the profit and loss account over the life of the loan.

**US GAAP** Under SFAS No. 91, to the extent that loan origination fees are not offset by related direct costs, they are deferred and amortised through the profit and loss account over the life of the loan.

**b) Securitised assets**

**UK GAAP** Under FRS 5, 'Reporting the substance of transactions', where assets are financed in such a way that the maximum loss that Abbey National can suffer is limited to a fixed monetary amount and which do not result in any significant changes to the entity's access to the benefits or risks of holding those assets, then providing certain conditions are met the assets remain on balance sheet and any finance received deducted from the assets. The treatment is referred to as 'linked presentation'. Special purpose vehicles are treated as quasi-subsidiaries and are consolidated where the risks and rewards from operations are similar to those which would be obtained for a subsidiary.

**US GAAP** SFAS No. 125, 'Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities' requires that after a transfer of financial assets, an entity recognises the financial and servicing assets it controls and the liabilities it has incurred, de-recognises financial assets when control has been surrendered, and de-recognises liabilities when extinguished. The statement contains rules for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. Under this standard Abbey National treats its securitisations of mortgage and debt securities portfolios as sales, and, where appropriate, recognises a servicing asset and an interest receivable asset, and amortises them over the periods in which the benefits are expected to be received.

**Unrealised gains (losses) on derivative contracts with in-house trading operations**

**UK GAAP** The majority of the Group's hedging contracts are transacted with an in-house risk management and trading operation, ANFP, in order to manage financial risks with external markets efficiently. ANFP transfers substantially all such risks into external markets on a portfolio basis in order to benefit from economies of scale, managing risk within predetermined limits (see note 50 to the accounts, 'Derivatives'). In the Group accounts, the hedging contracts are accounted for on an accruals basis as non-trading instruments.

**US GAAP** Such non-trading contracts designated after 1 January 1999 will only qualify at Group level for hedge accounting treatment where risks are transferred to the external markets on a matched offsetting contract basis. It is commercially viable for ANFP to hedge risks on a portfolio basis, not a matched contract basis. For this reason, such contracts are restated at market value for the purposes of the US/UK GAAP reconciliation.

### Dividend payable

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

**US GAAP** Dividends are recorded in the period in which they are declared.

### Investments in securities

**UK GAAP** Securities held for investment purposes are stated at cost adjusted for any amortisation of premium or discount.

All securities not held for investment purposes are stated at market value and profits and losses arising from this revaluation are taken to the profit and loss account.

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

**Deferred tax**

**UK GAAP** Deferred taxation is accounted for only where it is probable that a liability or asset will arise. Provision is calculated at rates expected to be applicable when the liability or asset crystallises. No deferred tax asset is created in respect of general allowances for lending losses which are not deductible in arriving at UK taxable profits.

**US GAAP** Provision for deferred tax under the liability method is required in full for all timing differences, including general allowances for loan losses and tax loss carry forwards. Deferred tax assets are recognised subject to any adjustment for valuation allowances.

**Provisions against lending losses**

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

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

**Future developments**

**UK GAAP** In 1999, the Accounting Standards Board issued FRS 15, 'Tangible Fixed Assets'. FRS 15 sets out the principles of accounting for the initial measurement, valuation and depreciation of tangible fixed assets, with the exception of investment properties, and is effective for accounting periods ending on or after 23 March 2000. FRS 15 sets out the principles to be applied to the initial measurement of tangible fixed assets, including guidance on the types of costs eligible for capitalisation, valuation guidelines where a policy of revaluation is adopted, and a description of the accounting objective and methods of accounting for depreciation. Abbey National is currently reviewing the standard to determine its impact on the reconciliation of net income and shareholders' funds between UK and US GAAP.

**US GAAP** SFAS No. 133 'Accounting for Derivative Instruments and Hedging Activities' is now applicable for all fiscal quarters of all fiscal years beginning after 15 June 2000 (1 January 2001 for the Group). SFAS No. 133 requires that all derivatives instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. For fair value hedge transactions in which the Group is hedging changes in the fair value of an asset, liability, or firm commitment, changes in the fair value of the derivative will generally be offset in the income statement by changes in the hedged item's fair value. For cash flow hedge transactions, in which the Group is hedging the variability of cash flows related to a variable rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative instrument will be reported in other comprehensive income. The gains and losses on the derivative instrument that are reported in other comprehensive income will be reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges will be recognised in current period earnings. Abbey National has not yet determined the impact that the adoption of SFAS No. 133 will have on its earnings or statement of financial position.

| Differences between UK and US accounting principles | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| Profit attributable to the shareholders of Abbey National plc | **1,261** | 1,058 | 954 |
| Preference dividends | **(38)** | (34) | (35) |
| Consolidated Net Income of Abbey National plc (UK GAAP) | **1,223** | 1,024 | 919 |
| Depreciation and amortisation | **(21)** | (89) | (89) |
| Pensions cost | **(39)** | 2 | (26) |
| Leasing | **(17)** | 10 | (13) |
| Shareholders' interest in long term insurance business | **(165)** | (195) | (35) |
| Other | **4** | (13) | (12) |
| Unrealised gains/(losses) on derivative contracts with in-house trading operations | **(28)** | – | – |
| Deferred tax | **54** | 86 | 37 |
| Consolidated Net Income of Abbey National plc (US GAAP) | **1,011** | 825 | 781 |
| per 10 pence ordinary share – basic | **71.3p** | 58.3p | 55.4p |
| – diluted | **70.8p** | 57.9p | 55.0p |

| Statement of comprehensive income | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| Consolidated net income of Abbey National plc | **1,011** | 825 | 781 |
| Consolidated other comprehensive income of Abbey National plc: | | | |
| Unrealised surplus on securities available for sale | **(216)** | (343) | (156) |
| Unrealised deficit on derivatives hedging securities available for sale | **305** | 207 | 134 |
| Shareholders' interest in long term insurance business | **(79)** | 37 | 56 |
| Deferred tax | **28** | 38 | 20 |
| Other comprehensive income | **24** | – | – |
| Translation differences on foreign currency net investment | **(1)** | – | (5) |
| Consolidated total income of Abbey National plc | **1,072** | 764 | 830 |

| | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| Shareholders' funds including non-equity interests (UK GAAP) | **6,078** | 5,407 | 4,878 |
| Depreciable assets | **1,012** | 920 | 998 |
| Pensions cost | **(107)** | (62) | (64) |
| Leasing | **(88)** | (71) | (81) |
| Shareholders' interest in long term insurance business | **(559)** | (315) | (157) |
| Share premium | **21** | 16 | 11 |
| Other | **(34)** | (50) | (37) |
| Unrealised gains/(losses) on derivative contracts with in-house trading operations | **(28)** | – | – |
| Dividend payable | **382** | 334 | 290 |
| Net unrealised surplus/(deficit) on available for sale securities and related hedging contracts | **(16)** | (105) | 31 |
| Deferred tax | **286** | 299 | 175 |
| Shareholders' funds including non-equity interests (US GAAP) | **6,947** | 6,373 | 6,044 |

Designed by Addison


The Abbey National Group comprises
Abbey National plc and its subsidiary
companies

Abbey National plc Registered Office:
Baker Street London NW1 6XL
Registered Number: 2294747
Registered in England

## Contact information

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Carbrook House
5 Carbrook Hall Road
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0870 532 9430

www.abbeynational.plc.uk

## Shareholder analysis – 1999 figures as at 31 December 1999

| | Ordinary shares of 10p | | Preference shares of £1 | |
|---|---|---|---|---|
| Size of shareholding | Shareholders | Shares | Shareholders | Shares |
| 1-100 | 1,324,857 | 128,511,709 | – | – |
| 101-1,000 | 717,587 | 303,512,291 | 19 | 14,363 |
| 1,001+ | 32,765 | 989,929,408 | 1,061 | 324,985,637 |
| | 2,075,209 | 1,421,953,408 | 1,080 | 325,000,000 |

## Financial calendar

| | |
|---|---|
| 6 March 2000 | Ex-dividend date |
| 10 March 2000 | Record date |
| 27 April 2000 | Annual General Meeting, Barbican Centre, London |
| 2 May 2000 | Final dividend payment |
| 26 July 2000 | Interim results announced |
| 11 August 2000 | Record date for interim dividend |
| 2 October 2000 | Interim dividend payment |

## No1 for private investors

Abbey National has won the 1999 ProShare award for 'Best Overall Performance in Meeting the Needs of Private Investors'. The award was presented at a ceremony in December, praising Abbey National's 'genuine commitment' to its shareholders.

## Disability awareness

One of the aims of the Disability Discrimination Act is to ensure equal access to services and provisions for all of the UK's 11 million disabled people. Abbey National has decided not just to comply with the letter of the law, but to actively embrace the spirit behind it.
If you would like to receive shareholder communications in large print, Braille, audio tape, or on pc disk, please contact Shareholder Services. Our textphone number is 0845 600 1207.

## Direct payment of the dividend

Shareholders who receive payment of the dividend by cheque may wish to have their money paid direct into a bank or building society account.
If you do this, you will still be sent a tax voucher at your home address, giving full details of the dividend paid. Shareholder Services can set up the direct payment for you.

## Amalgamating your shares

If you were mailed with more than one copy of this Directors' Report and Accounts, it may be because Abbey National has more than one record of shareholdings in your name. To ensure that you do not receive duplicate mailings in future, you can have all your shares amalgamated into one account by contacting Shareholder Services.

**Shareholder Services**
0870 532 9430 #
**Share Price Information Line**
0800 556 655 †
**Abbey National Share Dealing Service**
0870 737 3377 #

# Calls to the Share Dealing Service and Shareholder Services are charged at the national rate.

† Calls to the Abbey National Share Price Line are free.

To help us improve our service, we may record or monitor all calls.

Abbey National is regulated by the Personal Investment Authority. The value of shares may go down as well as up.

The Abbey National Group comprises Abbey National plc and its subsidiary companies.
Abbey National plc
Registered office:
Abbey House, Baker Street,
London NW1 6XL
Registered Number 2294747
Registered in England

The Abbey National Group