SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

(Mark One)

FORM 20-F

[] **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

[X] **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 1999

OR

[] **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from .... to ....

Commission file number ....

Abbey National plc
(Exact name of Registrant as specified in its charter)

England
(Jurisdiction of incorporation or organization)

Abbey House, Baker Street, London NW1 6XL, England
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	**Name of each exchange on which registered**
Non-cumulative Dollar-denominated Preference Shares of nominal value $0.01 each, Series A	New York Stock Exchange*
American Depositary Shares, each representing one Non-cumulative Dollar-denominated Preference Share of nominal value $0.01, Series A	New York Stock Exchange

* Not for trading, but only in connection with the listing of American Depositary Shares

Securities registered or to be registered pursuant to Section 12(g) of the Act.

Ordinary Shares of nominal value 10 pence each

American Depositary Shares, each representing two Ordinary Shares of nominal value 10 pence each

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

Ordinary Shares of nominal value 10 pence each	1,421,953,408
10⅜% Non-cumulative Preference Shares of nominal value £1 each	200,000,000
8⅝% Non-cumulative Preference Shares of nominal value £1 each	125,000,000
8¾% Non-cumulative Dollar-denominated Preference Shares of nominal value $0.01 each, Series A	8,000,000

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ......

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 ...... Item 18 X

Abbey National plc
Annual Report on Form 20-F
for the year ended December 31, 1999

The Abbey National Group

This report is an Annual Report on Form 20-F pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (the Act), filed with the Securities and Exchange Commission, Washington, DC 20549, United States of America, by Abbey National plc, Abbey House, Baker Street, London NW1 6XL, England.

Commission file number: 0-25670

The following securities are registered pursuant to Section 12(b) of the Act:

American Depositary Shares, each representing one Non-cumulative Dollar-denominated Preference Share of nominal value $0.01, Series A.

Non-cumulative Dollar-denominated Preference Shares of nominal value $0.01 each, Series A.

The following securities are registered pursuant to Section 12(g) of the Act:

Ordinary Shares of nominal value 10 pence each.

American Depositary Shares, each representing two Ordinary Shares of nominal value 10 pence each.

The following table sets forth the share capital of Abbey National plc outstanding as of December 31, 1999:

Class of shares	Number outstanding
• Ordinary Shares of 10 pence each	1,421,953,408
• 10⅜% Non-cumulative Preference Shares of nominal value £1	200,000,000
• 8⅝% Non-cumulative Preference Shares of nominal value £1	125,000,000
• 8¾% Non-cumulative Dollar-denominated Preference Shares of nominal value $0.01, Series A	8,000,000

Abbey National plc has filed all reports required to be filed by Section 13 or 15(d) of the Act during the preceding 12 months and has been subject to such filing requirements for the past 90 days.

Abbey National plc has elected to follow financial statement item 18 in preparing this report.

ABBEY NATIONAL plc

CROSS REFERENCE SHEET

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DEFINITIONS

This is the Annual Report on Form 20-F (the "Annual Report") for Abbey National plc which is a public limited company incorporated under the laws of England. The principal office is situated at Abbey House, Baker Street, London NW1 6XL. The Directors' Report and Accounts of Abbey National plc in the format required to be published in the United Kingdom are available from the Company Secretary at the above address.

In this Annual Report references to "ANTS" are references to Abbey National Treasury Services plc; references to "Abbey National" are references to Abbey National plc; references to the "Society" are references to Abbey National Building Society; and references to the "Group" are references to Abbey National and its subsidiaries or, where the context so requires, to the Society and its subsidiaries. References to the "Board" are references to the Board of Directors of Abbey National. References to "Conversion" are references to the transfer of the business of the Society to Abbey National under Section 97 of the Building Societies Act 1986 which became effective on July 12, 1989 on the completion of the offer of shares in Abbey National and the admission of the share capital of Abbey National to the Official List of the London Stock Exchange.

In this Annual Report, unless otherwise specified or unless the context otherwise requires, all references to "pounds", "sterling", "£", "p" and "pence" are to the lawful currency of the United Kingdom of Great Britain and Northern Ireland (the "United Kingdom" or the "U.K."). In this Annual Report, all references to "dollars", "U.S.$" or "$" are to United States dollars and all references to "¢" are to cents. Amounts stated in dollars, unless otherwise indicated, have been translated from sterling at an assumed rate solely for convenience, and should not be construed as representations that the sterling amounts actually represent such dollar amounts or could be converted into dollars at the rate indicated or any other rate. Unless otherwise indicated, such dollar amounts have been translated from sterling at the rate of £1.00 = $1.6150, the noon buying rate in the City of New York for cable transfers in sterling as certified by the Federal Reserve Bank of New York for customs purposes (the "Noon Buying Rate") on December 31, 1999. In this Annual Report, all references to "euros" or "€" are to the lawful currency of the member states of the European Union that adopt a single currency in accordance with the Treaty establishing the European Communities, as amended by the Treaty on European Union.

Unless otherwise indicated, the financial information contained in this Annual Report has been prepared in accordance with accounting principles generally accepted in the United Kingdom ("U.K. GAAP") which, as described in Note 54 to Abbey National's Consolidated Financial Statements included elsewhere in this Annual Report, differ in certain significant respects from accounting principles generally accepted in the United States ("U.S. GAAP"). Unless otherwise indicated, any reference in this Annual Report to Consolidated Financial Statements is to the audited Consolidated Financial Statements of Abbey National (including the notes thereto) included herein. Unless otherwise indicated, financial information for the Group included in this Annual Report is presented on a consolidated basis, as described in the "Accounting Policies" section of the Consolidated Financial Statements included elsewhere in this Annual Report. In this Annual Report, all references to Tier 1, Tier 2 and Tier 3 capital refer to the Group's Tier 1, Tier 2 and Tier 3 capital calculated in accordance with the standards of the Bank for International Settlements, European Community directives and the Financial Services Authority ("FSA"). In this Annual Report, all references to billions are references to one thousand millions.

For 1995, averages in this Annual Report are based on monthly data for all operations. For 1996, 1997, 1998 and 1999, averages are based upon daily data for ANTS and its subsidiaries excluding Cater Allen Holdings Limited and its subsidiaries, and upon monthly data for all other operations. Management believes that all daily and monthly average balances provide a fair representation of the average balances for the operations of the Group. Unless otherwise specified, statistics regarding loans have been calculated without giving effect to allowances for loan losses.

In this Annual Report amounts classified as U.K. business reflect transactions by U.K. domiciled offices. Non-U.K. business reflects transactions booked in operations domiciled outside the United Kingdom. U.K. statistical and market-share information contained in this Annual Report has been derived from the financial statistics of the Central Statistical Office of Her Majesty's Government, the Council of Mortgage Lenders, the Handbook of the Building Societies Association and, with respect to amounts shown for Abbey National, Abbey National's own data. Statistics given in this Annual Report for the United Kingdom exclude Jersey and the Isle of Man except for the statistical market-share data concerning the U.K. mortgage market and the U.K. liquid savings market.

In this Annual Report, references to "Rating Organizations" are references to "nationally recognized statistical rating organizations" within the meaning of the United States Securities Exchange Act of 1934, as amended (the "Exchange Act"). In this Annual Report references to the "Commission" are references to the Securities and Exchange Commission.

FORWARD-LOOKING STATEMENTS

Abbey National may from time to time make written or oral forward-looking statements. Written forward-looking statements may appear in documents filed with the U.S. Securities and Exchange Commission, including this Annual Report, reports to shareholders and other communications. The U.S. Private Securities Litigation Reform Act of 1995 contains a safe harbor for forward-looking statements on which we rely in making such disclosures. Examples of such forward-looking statements include, but are not limited to:

- projections or expectations of revenues, income (or loss), earnings (or loss) per share, dividends, capital structure or other financial items or ratios;
- statements of plans, objectives or goals of Abbey National or its management, including those related to products or services;
- statements of future economic performance; and
- statements of assumptions underlying such statements.

Words such as "believes," "anticipates," "expects," "intends," "aims," and "plans" and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. Abbey National cautions readers that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements made by us or on our behalf. These factors include:

- inflation, interest rate, exchange rate, market and monetary fluctuations;
- the effect of, and changes in, regulation and government policy;
- the effects of competition in the geographic and business areas in which Abbey National conducts operations;
- changes in consumer spending, saving and borrowing habits in the United Kingdom and in other countries in which Abbey National conducts operations;
- the effects of changes in laws, regulations, taxation or accounting standards or practices;
- the ability to increase market share and control expenses;
- the timely development of and acceptance of new products and services of Abbey National and the perceived overall value of these products and services by users;
- acquisitions;
- technological changes, including those affecting European Economic and Monetary Union ("EMU") compliance;
- the possibility of foreign exchange controls, expropriation, nationalization or confiscation of assets in countries in which Abbey National conducts operations; and
- Abbey National's success at managing the risks of the foregoing.

Abbey National cautions that the foregoing list of important factors is not exhaustive; when relying on forward-looking statements to make decisions with respect to Abbey National, investors and others should carefully consider the foregoing factors and other uncertainties and events. Such forward-looking statements speak only as of the date on which they are made, and Abbey National does not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise.

SELECTED CONSOLIDATED FINANCIAL AND STATISTICAL DATA

The financial information set forth below for the twelve month periods ended December 31, 1999, 1998 and 1997, and as at December 31, 1999 and 1998 has been derived from the Consolidated Financial Statements of the Group included elsewhere in this Annual Report. The information should be read in connection with, and is qualified in its entirety by reference to, the Group's Consolidated Financial Statements and the notes thereto included elsewhere in this Annual Report. Financial information set forth below for the twelve month periods ended December 31, 1996 and 1995, and as at December 31, 1997, 1996 and 1995, has been derived from the audited consolidated financial statements of the Group for 1997, 1996 and 1995. The financial information in this Selected Consolidated Financial and Statistical Data does not constitute statutory accounts within the meaning of the Companies Act 1985. The auditors' report in the accounts for each of the five years ended December 31, 1999 was unqualified and did not include a statement under sections 237(2) and 237(3) of the Companies Act 1985. The consolidated financial statements of the Group for each of the past four years ended December 31, 1998 have been audited by PricewaterhouseCoopers, independent accountants, and its predecessor firm, Coopers & Lybrand. The consolidated financial statements of the Group, as at December 31, 1999, were audited by Deloitte & Touche, independent accountants. The Group's Consolidated Financial Statements included elsewhere in this Annual Report have been prepared in accordance with U.K. GAAP, which differ in certain significant respects from U.S. GAAP. Certain significant differences between U.K. GAAP and U.S. GAAP are discussed in Note 54 to the Consolidated Financial Statements, and Note 55 to the Consolidated Financial Statements includes reconciliations of certain amounts calculated in accordance with U.K. GAAP to U.S. GAAP.

	Year ended/as at December 31,					
	1999 (1)	**1999**	**1998**	**1997**	**1996**	**1995**
	(in millions, except per share data)					
U.K. GAAP income statement data						
Net interest income (6)	$4,298	£2,661	£2,241	£2,038	£1,815	£1,579
Commissions, fees and other income (6)	1,768	1,095	877	722	534	404
Total operating Income	6,066	3,756	3,118	2,760	2,349	1,983
Other operating expenses	(2,574)	(1,594)	(1,285)	(1,168)	(977)	(870)
Provisions for bad and doubtful debts	(489)	(303)	(201)	(121)	(127)	(72)
Provisions for contingent liabilities and commitments	(37)	(23)	(16)	(16)	(4)	(7)
Amounts written off fixed asset investments	(42)	(26)	(28)	(3)	(13)	(8)
Income before taxes and exceptional items	2,924	1,810	1,588	1,452	1,228	1,026
Exceptional items (2)	(44)	(27)	(68)	(173)	(61)	—
Income before taxes	2,880	1,783	1,520	1,279	1,167	1,026
Net income (3)	1,975	1,223	1,024	919	754	681
Per ordinary share information (basic) (including exceptional items) (4)	139.2¢	86.2p	72.4p	65.2p	56.5p	51.7p
Per ordinary share information (diluted) (including exceptional items) (4)	138.1¢	85.5p	71.7p	64.7p	56.0p	51.3p
Dividends	65.0¢	40.25p	35.3p	30.7p	26.1p	21.8p
U.S. GAAP income statement data						
Net income (3)	$1,633	£1,011	£825	£781	£636	£615
Per ordinary share (basic) (including exceptional items) (4)	115.1¢	71.3p	58.3p	55.4p	47.6p	46.7p
Per ordinary share (diluted) (including exceptional items) (4)	114.3¢	70.8p	57.9p	55.0p	47.4p	46.5p
U.K. GAAP balance sheet data						
Loans and advances to banks and customers and net investment in finance leases	$149,686	£92,685	£85,015	£79,804	£71,362	£57,513
Total assets (5)	291,902	180,744	162,753	144,130	124,011	103,132
Deposits by banks, customer accounts and debt securities in issue	227,944	141,142	131,523	119,734	102,589	86,450
Subordinated liabilities	7,495	4,641	3,333	2,463	2,374	2,127
Shareholders' funds	9,816	6,078	5,407	4,878	4,393	3,941
Book value of equity shareholders' funds per ordinary share	639.2¢	395.8p	349.8p	313.4p	289.4p	290.8p
U.S. GAAP balance sheet data						
Shareholders' funds	$11,219	£6,947	£6,373	£6,044	£5,456	£4,874
Book value of equity shareholders' funds per ordinary share	737.9¢	456.9p	418.0p	395.9p	365.0p	361.5p
Total assets (5)	$283,906	£175,793	£163,267	£145,009	£124,830	£104,095

(1) Amounts stated in dollars have been translated from sterling at the rate of £1.00 = $1.6150, the Noon Buying Rate on December 31, 1999.

(2) In 1999, 1998 and 1997, costs incurred in preparing the Group for Year 2000 and Economic and Monetary Union have been treated as exceptional items. Prior year comparatives were restated for consistency. In addition, in 1997, the U.K. Government announced a package of measures which represented a significant change to the U.K. tax regime. The effects of these measures were shown as exceptional items in the profit and loss account. In 1996, exceptional items represented costs incurred on the integration of the business of the National and Provincial Building Society.

(3) Net income equals profit on ordinary activities after tax, minority interests and dividends attributable to non-equity interests.

(4) Net income divided by the average number of ordinary shares outstanding, unless diluted which includes effect of share options outstanding.

(5) Following an accounting presentation change, Assets and Liabilities under stock borrowing and lending agreements are no longer reported as on-balance sheet items, but as contractual commitments. Accordingly, total assets have been reduced by £15,026 million as at December 31, 1998, and £6,678 million as at December 31, 1997, with an equivalent reduction in Total liabilities. No restatement prior to 1997 is necessary, because the Group did not have any stock borrowing and lending business prior to 1997.

(6) In prior years, dealing profits (included within commissions, fees and other income) 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 net interest income. The prior year comparative balances have been restated with the effect being a £12 million increase (1998), £16 million increase (1997), £21 million increase (1996), and a £5 million decrease (1995) in net interest income and a corresponding increase/decrease in dealing profits for these years.

	Year ended/as at December 31,				
	1999	1998	1997	1996	1995
	(percent, except ratio of earnings to fixed charges)				
Selected U.K. GAAP financial statistics					
Profitability ratios:					
Return on average total assets (1)(9)	0.69	0.66	0.69	0.66	0.67
Return on average ordinary shareholders' funds (2)	22.48	21.07	20.85	18.52	17.65
Return on average risk weighted assets (3)	1.65	1.60	1.70	1.58	1.55
Net interest margin (excluding exceptional items) (4)(9)	1.76	1.66	1.71	1.76	1.71
Cost:income ratio (including exceptional items) (5)	43.07	43.27	45.69	44.19	43.87
Cost:income ratio (excluding exceptional items) (5)	42.44	41.21	42.32	41.59	43.87
Capital ratios:					
Ordinary Dividends as a percentage of net income	46.77	48.93	47.23	47.75	42.29
Average ordinary shareholders' funds as a percentage of average total assets (9)	3.09	3.15	3.30	3.57	3.81
Risk asset ratios:					
Total	11.6	10.2	11.1	11.7	11.7
Tier 1	7.7	7.3	8.4	8.5	8.4
Credit quality data: (6)					
Non-performing loans as a percentage of loans and advances to customers excluding finance leases (6)(7)	2.90	3.69	3.44	4.22	5.47
Allowances as a percentage of loans and advances to customers excluding finance leases (6)	0.69	0.77	0.69	0.82	0.94
Allowances as a percentage of non-performing loans (6)(7)	24.11	20.86	19.73	19.55	17.12
Provisions charge for bad and doubtful debts as a percentage of average loans and advances to customers excluding finance leases (6)	0.41	0.29	0.18	0.22	0.14
Ratio of earnings to fixed charges: (8)					
Excluding interest on retail deposits	1.38	1.31	1.30	1.40	1.35
Including interest on retail deposits	1.27	1.20	1.19	1.24	1.21
Selected U.S. GAAP financial statistics					
Return on average total assets (1)(9)	0.58	0.53	0.58	0.55	0.60
Return on average ordinary shareholders' funds (2)	16.28	13.92	14.14	12.54	13.65
Dividends as a percentage of net income	51.83	55.39	49.81	48.11	41.46
Average ordinary shareholders' funds as a percentage of average total assets (9)	3.57	3.82	4.11	4.41	4.43
Ratio of earnings to fixed charges: (8)					
Excluding interest on retail deposits	1.32	1.24	1.25	1.35	1.31
Including interest on retail deposits	1.22	1.16	1.16	1.21	1.19

(1) Net income divided by average total assets.

(2) Net income divided by average equity shareholders' funds.

(3) Net income divided by average risk weighted assets.

(4) Net interest margin represents net interest income as a percentage of average interest-earning assets.

(5) Cost: income ratio equals operating expenses divided by total operating income.

(6) All credit quality data is calculated using period-end balances, except for provisions for bad and doubtful debts as a percentage of average loans and advances to customers.

(7) The non-performing loans used in these statistics are calculated in accordance with conventional U.S. definitions. The value of non-performing loans represents the aggregate outstanding balance of all loans and advances 90 days or more overdue or, for unsecured loans less than 90 days overdue, the balance of loans where a provision has been made or interest suspended. Interest continues to be debited to substantially all of these loans and advances for collection purposes. The proportion of this interest whose collectability is in doubt is then suspended and excluded from the income statement. Accordingly, the interest income figures included in the income statement are the same as would be reported in the United States. However, the value of non-performing loans is higher by the cumulative amount of this suspended interest.

In cases where borrowers have made arrangements to pay off their arrears over a period of time, the arrears remain on the loan accounts until cleared and as a result the loans are included in non-performing loans even though the customers are currently performing and many will ultimately discharge their loans fully.

Abbey National generally holds a first mortgage over the properties securing the U.K. residential mortgage loans. The value of the security will in many cases completely cover the value of the loan and the arrears and in the remainder will considerably reduce the size of the loss incurred.

Non-performing loans also include the full value of loans for which Abbey National has enforced its security by taking into possession the borrowers' properties. In many such cases the value of the losses expected to result on sale of the security is known with some certainty and is included in the specific allowances. However, the value of the losses is not charged off until the properties are sold and the losses have thus been determined precisely. Other banks, including those in the United States, may charge off losses more rapidly. Although Abbey National's practice does not affect net income or the carrying value of loans and advances to customers, it does increase the reported value of non-performing loans.

For these reasons, the value of the non-performing loans is not necessarily indicative of the value of losses which Abbey National is likely to suffer. Management believes that it is important to consider the quality of Abbey National's U.K. residential mortgage portfolio compared with those of its competitors. Over the reporting periods covered by this table, the number of mortgage loans which are six months or more in arrears as a percentage of the total number of outstanding mortgage loans has been broadly comparable with the U.K. Council of Mortgage Lenders' ("CML") industry average. As at December 31, 1999, Abbey National's percentage was 1.01% compared with a CML percentage of 0.79%. The value of these Abbey National non-performing loans as a percentage of its total U.K. residential mortgage loan assets was 1.18%. Non-performing loans in this table also include the value of arrears cases between three and six months in arrears and the value of properties in possession. On this basis, the non-performing U.K. residential mortgage loans are 1.9% of its total U.K. residential loans and advances. If the remainder of the Group's loans and advances (excluding finance leases) are included, this ratio increases to 2.75%.

(8) For the purpose of calculating the ratios of earnings to fixed charges, earnings consists of income before taxes plus fixed charges. Fixed charges consists of interest payable, which includes the amortization of discounts and premiums on debt securities in issue and interest payable on finance lease obligations.

(9) These ratios have been restated for years ending December 31, 1997 and 1998. The restatement is to reflect the change in accounting policy whereby the stock lending and borrowing balances are now treated as off-balance sheet items (see note (5) on page 4).

EXCHANGE RATES

The following table sets forth, for the periods indicated, certain information concerning the exchange rate for pounds sterling based on the Noon Buying Rate in New York City expressed in U.S. dollars per £1.00. No representation is made that amounts in pounds sterling have been, could have been or could be converted into U.S. dollars at the Noon Buying Rate or at any other rate.

Calendar Period	**High**	**Low**	**Average (1)**	**Period End**
		(dollars per pound)		
2000, through March 17	1.65	1.57	1.59	1.57
1999	1.68	1.56	1.61	1.62
1998	1.72	1.61	1.66	1.66
1997	1.70	1.58	1.64	1.64
1996	1.71	1.49	1.57	1.71
1995	1.64	1.53	1.58	1.55

(1) The average of the Noon Buying Rates on the last business day of each month during the relevant period and, with respect to March 2000, on March 17.

BUSINESS DESCRIPTION

This section contains forward-looking statements that involve inherent risks and uncertainties. Actual results may differ materially from those contained in such forward-looking statements. See "Forward-Looking Statements" above.

General

Abbey National and its subsidiaries constitute a major financial services group in the United Kingdom. With total assets of £180.7 billion (1998: £162.8 billion) and income before taxes of £1,783 million (1998: £1,520 million) as at and for the year ended December 31, 1999, the Abbey National Group ranked as the fourth largest banking group incorporated in the United Kingdom in terms of total assets. It is the U.K.'s second largest residential mortgage lender and third largest retail deposit taker.

The Group's principal businesses are U.K. Retail Banking, Wholesale Banking, Life Insurance, Finance House, and General Insurance which are described below. The Group's other business segments are Continental Europe (consisting primarily of the Group's retail banking businesses in France and Italy), Wealth Management, cahoot and Group Central Holdings.

The Group currently has no exposure to highly leveraged transactions which is not either hedged or collateralized and only insignificant exposures to countries which are not members of the Organization for Economic Cooperation and Development ("OECD"). The security on the Group's U.K. residential mortgage loans, together with the strong credit ratings of the assets held in Wholesale Banking, provide the Group with strong asset quality.

The principal executive offices of Abbey National and ANTS are located at Abbey House, Baker Street, London NW1 6XL, England. The telephone number of Abbey National is 44-870-607-6000. The telephone number of ANTS is 44-20-7612-4000.

Summary History of Abbey National

The Abbey National Building Society ("the Society") was formed in 1944 with the merger of two long-standing building societies. In 1988, Abbey National was incorporated as a bank and in 1989 the Society transferred business to Abbey National as part of the Conversion. Since incorporation, Abbey National has continued to develop all its principal businesses organically and through acquisitions.

Corporate Purpose and Strategy

Abbey National's vision continues to aim to be the outstanding financial services company in the U.K., with the purpose of achieving above average growth in shareholder value over the long-term.

Abbey National's strategy is focused on delivering increased shareholder value through carefully managed organic growth. The Group has also made acquisitions, but only where these enabled it to achieve critical mass in important new product and service areas, where they delivered its strategy more quickly, or where they provided skills and capabilities which the Group believes are important to its future development.

Complementing these strategic goals are the Group's three-fold priorities of growing revenue in its traditional and diversified businesses, improving efficiency and productivity by changing the shape of the business and continuing to deliver strong returns on capital.

In particular, management aims to grow income faster than costs over the next three years, increasing revenue through organic growth and, where possible, through acquisitions, which will enable the Group to fulfil its strategic objectives more quickly and deliver value to shareholders. Management also aims to improve cost efficiency by re-engineering business processes, making greater use of shared resources and common platforms. Management will not hesitate to re-invest cost savings into new propositions, new initiatives and new businesses which will enable exploitation of growth opportunities and grow revenue.

The major objective of the Group is to grow top line revenue. Significant growth opportunities exist in retail banking, life insurance, wholesale banking, consumer finance, wealth management and long term savings. This will be achieved through organic development, acquisitions, joint ventures and partnerships – whatever means are most appropriate.

Management intends to pursue capital and balance sheet management opportunities.

U.K. Retail Banking

U.K. Retail Banking is the Group's largest business, with total assets of £64.8 billion and income before taxes of £996 million, as at and for the year ended December 31, 1999. U.K. Retail Banking manages the design, pricing, sales and marketing, and distribution of the majority of the Group's retail products.

U.K. Retail Banking's distribution network comprises a national network of 765 branches, 2,724 automated teller machines ("ATMs"), of which 888 are at non-branch locations and an additional 25 in-store branches within Safeway supermarkets, a major U.K. food retailer. These are combined with Abbey National Direct (a telephone sales and marketing operation), and business development units which directly service the mortgage intermediary market.

U.K. Retail Banking has three strategic priorities. These include maintaining its position in the traditional mortgage and savings markets, whilst broadening the services offered to customers and continuing to diversify earnings. It also includes building the strength of its brand and changing the way business is conducted with customers, focusing on customer value management and cost effectiveness.

In particular, cost efficiencies will continue to be pursued by re-engineering key processes, by re-configuring the branch network and by encouraging more customers to move to self-service and lower cost methods of transacting with Abbey National. Reduced transactions costs are being achieved by promoting ATM usage and focusing on direct distribution.

Residential Mortgages

The total amount of mortgage loans outstanding in the United Kingdom taking into account the effect of house price inflation, increased from £390.3 billion at December 31, 1995 to £493.8 billion at December 31, 1999.

At December 31, 1999, Abbey National had £64.7 billion of the total outstanding amount of U.K. residential mortgage loans (including housing association loans), representing an estimated 13.1% share of the total outstanding amount of all such residential mortgage loans as at that date (1998: 13.6%). As at December 31, 1999, the proportion of Abbey National's total U.K. mortgage assets funded by U.K. retail liabilities was approximately 78% (1998: 80%).

Abbey National Mortgage Products. Abbey National provides mortgage loans for house purchases as well as home improvement loans and secured personal loans to existing mortgage customers. Mortgage loans are offered in two payment types, repayment and interest only. Repayment mortgages require both principal and interest to be repaid in monthly installments over the life of the mortgage. Interest only mortgages require monthly interest payments and the repayment of principal at the end of the mortgage term (which can be arranged via a number of investment products including endowment policies and pension policies, or by the sale of the property).

Abbey National launched a flexible mortgage in July 1999. This type of mortgage gives a borrower the discretion to vary the payments according to circumstances. A major feature of this product is that it tracks U.K. base rates, with any changes being immediately passed on to the customer. The product was made available to new customers from the beginning of October 1999.

Abbey National's mortgage loans are almost always secured by a first mortgage over property and are typically arranged for a 25 year term, with no minimum term and a normal maximum term of 35 years. Abbey National's mortgage loans currently have an average life of approximately 6 years depending on, among other factors, housing market conditions. Interest on mortgage loans is charged predominantly at floating rates, determined at the discretion of Abbey National by reference to the general level of market interest rates and competitive forces in the U.K. mortgage market.

Fixed-rate products generally offer a pre-determined interest rate for between two and five years, after which they bear interest at floating rates. Abbey National's fixed-rate products generally are designed so that prepayment during a fixed-rate term includes a pre-payment charge. Fixed-rate mortgages comprised approximately a quarter of Abbey National's U.K. residential mortgage portfolio at December 31, 1999. The interest rate risk on such mortgages is managed as part of the Group's asset and liability management procedures. See "Financial Risk Management — Market Risk" below.

Discounted mortgage products have become a common feature of the U.K. market. Mortgages may be discounted by reducing the relevant rate for a limited period of time, typically for between one and five years. After the discount period ends, the loan reverts to the full floating rate. Abbey National also offers cashbacks, an upfront cash payment granted to a customer as an incentive to take out a loan. In the event of redemption of fixed and discounted mortgage products, within a specified period, early redemption penalty charges are payable by the customer.

Liquid Savings Products

At December 31, 1999, Abbey National had approximately 11.95 million deposit accounts with personal customers providing a funding base of £43.4 billion. Abbey National provides a full range of retail savings accounts, including demand deposit accounts, notice accounts, investment accounts and Individual Savings Accounts ("ISAs"). ISAs permit individuals to invest a combination of cash, equities and life insurance up to £7,000 per annum, free of tax. ISAs have been available since April 6, 1999, and the U.K. Government has guaranteed that these will be available for a minimum of 10 years.

Interest rates on savings in the United Kingdom are primarily set with reference to the general level of market interest rates and the level of competition for such funds. Abbey National also from time to time offers investors the opportunity of fixing their rate of return for given periods with structured products which are only available for a limited period. During 1999, Abbey National increased its offering of these structured products. However, for the majority of Abbey National's retail liabilities, interest is paid on a floating-rate basis.

Personal Banking Services

At the end of 1999 the Group had approximately 1.98 million Abbey National Bank Account checking accounts. Behavioral scoring is used to determine whether to grant customers overdrafts on their checking accounts and whether to issue them check guarantee and "multifunction" cards (combined check guarantee, debit and ATM cards). U.K. Retail Banking has centrally controlled credit scoring to enable it to manage the risks associated with overdrafts on its checking account products. In addition, Abbey National offers an Instant Plus Account and Electron Card. This offers a combined cash withdrawal and debit card facility.

Abbey National's VISA credit card is available to customers subject to credit status.

Abbey National also offers unsecured personal loans and as at December 31, 1999 the loan asset was £1.3 billion.

Abbey National has a co-operation arrangement with Safeway, one of the U.K.'s largest food retailers, to offer personal banking services to holders of Safeway's ABC loyalty card. There is an ABC Bonus Account, a household management account and a direct savings account, available to Safeway customers through the mail or by telephone. By the end of 2000, it is planned to have 45 in-store banks available in Safeway branches. These in-store banks provide a range of self service functions for transactions and enquiries and access to a licensed Abbey National Financial Adviser who is available to discuss more complex financial issues.

Abbey National is continuing to broaden distribution to make its customers' lives easier. On November 1, 1999, the Abbey National brand was launched on Open, the shopping channel available through Sky digital television. Customers can now use on-line calculators, review products, order literature and book telesales interviews from their living rooms. During 2000, customers will be able to transfer money, pay bills, order check books and access their account information using interactive digital TV. In late Spring of 2000 internet access will be provided for banking, savings and credit cards, giving customers with these products the ability to access account information on line.

Wholesale Banking

ANTS is the wholesale bank of the Group and also the Group's treasury. ANTS is an authorised banking institution under the United Kingdom Banking Act 1987. Wholesale Banking participates in a range of international markets which can be grouped as follows: wholesale lending; asset financing; asset-backed investments; risk management and financial products and securities lending.

Wholesale Banking has four main objectives. These are: to extend Wholesale Banking's presence and competitive advantage in markets which deliver profit growth and attractive risk adjusted returns; maximise return on equity; optimize risk-reward trade off and maximise efficiency and economies of scale.

Abbey National has fully and unconditionally guaranteed the obligations of ANTS that have been or will be incurred before July 31, 2004. The guarantee is reviewed from time to time by Abbey National with a view to extending it. The last time this occurred was on February 9, 1998 when the guarantee was extended by five years from July 31, 1999 to July 31, 2004. The effect of this guarantee is that creditors of ANTS would rank *pari passu* with Abbey National's direct creditors in the event of the insolvency of the Group. Each guarantee is of any obligation issued or incurred before its expiration, and covers payments through maturity, even if the guarantee is no longer in effect for subsequent obligations. As a result of the guarantee from Abbey National, ANTS has the same short- and long-term credit ratings as Abbey National. In turn, under the terms of a guarantee dated January 28, 1998, ANTS agreed to guarantee the unsecured and unsubordinated obligations of Abbey National that have been or will be incurred before July 31, 2004.

Wholesale Lending

Wholesale Banking has a well-established business lending to banks, other financial institutions, corporations and governments. The majority of these institutions are rated AA- or better and Wholesale Banking undertakes lending through a range of financing instruments including debt securities, asset swaps, and direct and syndicated loans. Wholesale Banking has wide-ranging relationships in the market, and these give Wholesale Banking the flexibility to participate in transactions specifically attractive to the business.

In 1999, Wholesale Banking increased its level of participation in providing finance for leveraged buy-outs and major mergers and acquisitions, particularly in Continental Europe where there was exceptional market activity during the year. In 1999, Wholesale Banking increased its total wholesale lending by 39% to £21.1 billion as at December 31, 1999. These assets continued to provide strong returns on equity and are a significant and stable source of income.

Asset Financing

Wholesale Banking participates in the leasing, social housing finance and project finance markets and invests in private equity funds. These activities predominantly earn a combination of interest and fee income.

During 1999, transaction volumes within the finance leasing industry remained low. Wholesale Banking entered into new leasing arrangements for £171 million, increasing the investment in finance leasing assets to £5.0 billion. There were continuing drawdowns under Wholesale Banking's existing commitments. Wholesale Banking transacted its first operating lease in December 1998 and had a strong year in the sector with investments totalling £93 million as at December 31, 1999. This business offers potential growth and Wholesale Banking is able to leverage off its existing expertise in the finance leasing of rolling stock and aircraft. Wholesale Banking will only undertake investments in assets with sustainable residual market value.

Wholesale Banking provides funding to the social housing sector. Loan commitments increased from £1.7 billion in 1998, to £2.2 billion as at December 31, 1999. These loans are secured on that part of the property owned by the provider of the social housing.

Wholesale Banking has achieved strong market presence in the U.K. and international project finance markets. The U.K. Government's Private Finance Initiative ("PFI") continued to deliver a number of new infrastructure transactions and Wholesale Banking completed nine PFI transactions which included partnerships in the environment, defence and transport sectors. Wholesale Banking also financed 26 project finance deals in the telecommunications, power and energy sectors. As at December 31, 1999, Wholesale Banking's total book value of commitments stood at £1.2 billion – a fivefold increase on 1998.

Wholesale Banking's investments in private equity funds focus on funds whose strategies concentrate on the management buy-out of small and medium sized businesses in the U.K., rest of Europe and the U.S. Wholesale Banking has only a low level of interest in start-up businesses. Since 1997, Wholesale Banking has attained a strong record as an investor in this market and as at December 31, 1999 had investments in 24 funds and a number of co-investments. These investments increased from £52 million to £185 million, with a further £325 million committed, as at December 31, 1999.

In recent years the number of market opportunities in structured finance has declined due to a combination of low interest rates, low corporate tax rates and changes to legislation. Although Wholesale Banking continues to maintain its existing portfolio, the decision was made not to target proactively any new business opportunities in the private placement structured finance market.

Asset-backed Investments

Wholesale Banking manages substantial portfolios of asset-backed investments, including mortgage-backed securities which are predominantly rated AAA, or its equivalent, by Moody's, Standard and Poor's or Fitch IBCA. Wholesale Banking's portfolios of asset-backed credit card receivables, student loans and collateralised debt obligations increased to £10.9 billion at the year end. This included a portfolio of asset-backed securities managed by Wholesale Banking on behalf of Moriarty Limited (see "Capital Management" below) and its associated companies. Wholesale Banking's portfolio of mortgage-backed securities, backed by loans with a first charge on residential property, totalled £7.9 billion as at December 31, 1999.

Wholesale Banking's investment strategy is to identify and purchase highly rated securities with a favourable risk return profile over the life of the investment. These portfolios provide non-volatile income streams and Wholesale Banking will continue to actively seek new investments, and aims to increase the return on equity of the portfolios.

Risk Management & Financial Products

The risk management & financial products business is undertaken by Abbey National Financial Products ("ANFP") and provides external counterparties and the Group with derivative products which have recognisable benefit and value to Wholesale Banking and its counterparties. ANFP executes transactions in the market and undertakes hedging operations to minimize risk within predetermined and approved limits. See "Financial Risk Management" below. ANFP offers interest rate and currency swaps, interest rate options, swap options and exotic options in all major currencies and has particular expertise in the sterling markets. Exotic options include Bermudan/ American swaptions, constant maturity swaps ("CMS"), options on CMS and diff/quanto products. In 1998, ANFP established a specialist team to provide equity derivative products which has increased the range of risk management tools ANFP can offer to the U.K. retail lending and structured saving markets. Wholesale Banking has a U.S. subsidiary, ANFP (US) LLC, which enables ANFP to offer derivative products to counterparties in the United States.

Wholesale Banking intends to maintain the growth of its derivative structuring businesses and in 2000 is developing a credit derivatives team which will further increase risk management expertise and the services ANFP can provide.

Securities Lending

Cater Allen International Limited ("CAIL"), Wholesale Banking's securities lending business, participates in a range of markets including the sale and repurchase ("repo") of domestic and international securities; securities borrowing; the lending of equity, fixed income and government securities and money markets. CAIL is a significant participant in the gilt repo markets, is broadening its client base in Europe and in 1999 established a U.S. limited liability company which will enable repo deals to be carried out with companies in the U.S. As at December 31, 1999, CAIL's total assets had increased from £16.4 billion to £19.4 billion on a restated basis. CAIL's obligations are fully and unconditionally guaranteed by Abbey National.

Treasury Services

As the Group's treasury, Wholesale Banking ensures diverse sources of wholesale funding and capital are available to the Group, manages the Group's liquidity needs and contributes to the management of risk arising on the Group's balance sheet.

Liquidity Management

Wholesale Banking, through its holdings of financial instruments, provides the Group with access to significant liquidity. Immediately available liquidity is held in the form of negotiable instruments. See "Financial Risk Management – Liquidity Risk" below for further details of the Group's liquidity policy.

Wholesale Funding

Wholesale Banking provides the Group with significant capital and funding which is used to finance the growth in ANTS' assets and activities across the Group. Funding from the wholesale markets, including subordinated liabilities, as a proportion of Group funding was 53% at December 31, 1999.

Wholesale Banking seeks to ensure diversified sources of wholesale funding in a range of maturities to reduce the dependence on any one funding sector. Wholesale Banking is active in a number of private and public markets world-wide and manages a range of short and medium term debt programs. Wholesale Banking is also active in the market for accepting call and time deposits, with supranationals and central banks remaining important providers of Wholesale Banking's short term deposits. Wholesale Banking has established relationships with over 1,000 investing counterparties around the world. The primary focus of this group is Europe, the United States and Asia. As part of ongoing efforts to diversify wholesale funding sources, Wholesale Banking has a branch in Paris and a representative office in Hong Kong.

At December 31, 1999, the Group's debt securities outstanding totalled a dollar equivalent of over $83 billion. During 1999, Wholesale Banking raised over $20 billion in a range of currencies, maturities and geographical areas. The majority of such funding has been swapped into U.S. dollars, sterling or euros. The strategy in respect of public issues has been to create large benchmark issues. In 1999, Wholesale Banking issued 13 public bonds totalling over $10 billion. 64% of this issuance was denominated in euros and included a €2 billion floating rate note ("FRN") issued in January 1999 – the first euro issue by a U.K. financial institution and at the time the largest ever private sector issue in the eurobond markets. Confirming Wholesale Banking's commitment to the euro capital markets, and meeting the strength of European institutional investor demand for Wholesale Banking's paper, this was then followed by a €2.5 billion FRN issued in September 1999.

Major debt issuance programs managed by Wholesale Banking(1):

Program	Outstanding as at December 31, 1999	Comments
$15 billion medium term notes	$8.16 billion	Issued into European markets
$15 billion U.S. medium term notes	$8.45 billion senior debt $3.15 billion subordinated debt(2)	Registered with the Commission
$4 billion commercial paper	$0.98 billion	Issued into European markets
$8 billion U.S. commercial paper(3)	$6.97 billion	Issued into the United States

(1) Securities issued by ANTS unless otherwise stated.

(2) Issued by Abbey National and Abbey National First Capital B.V.

(3) Managed for Abbey National North America Corporation, a guaranteed subsidiary of Abbey National.

Abbey National first registered with the Commission in October 1994. Abbey National, ANTS and Abbey National First Capital B.V. have registered various shelf facilities with the Commission, the most recent being in January 2000, permitting preference shares and debt securities, including medium term notes and other subordinated securities, to be issued from the date of registration in an aggregate principal amount of approximately $7 billion.

Under the shelf facility registered with the Commission, ANTS may issue senior debt securities, and Abbey National and Abbey National First Capital B.V. may issue subordinated debt securities. Abbey National acts as guarantor on a senior basis of the debt securities issued by ANTS, and as guarantor on a subordinated basis of the debt securities issued by Abbey National First Capital B.V. Various Group-related entities may issue other subordinated securities under the shelf facility.

As at December 31, 1999, the aggregate amount of outstanding claims of creditors senior to the holders of subordinated debt of the following entities (and, in the case of Abbey National, senior to the holders of subordinated debt guaranteed by Abbey National) was as follows:

Abbey National and its subsidiaries	£170,025 million
Abbey National First Capital B.V.	£47 million
Abbey National	£66,047 million

As at December 31, 1999, the aggregate amount of outstanding claims of creditors of the following entities that will rank *pari passu* with the subordinated debt issued by those entities (and, in the case of Abbey National, with the subordinated debt guaranteed by Abbey National) was as follows:

Abbey National First Capital B.V..	£582 million
Abbey National	£4,465 million

The above amount for Abbey National excludes certain short term junior subordinated issues amounting to £203 million, which are junior in right of repayment to the above subordinated debt issues.

Capital Management

Wholesale Banking used its expertise and market presence to manage a number of initiatives which increased the flexibility of the Group in managing its balance sheet. Issues to raise capital for the Group during 1999 totalled $2.4 billion and included two issues of euro-denominated bonds and $1 billion thirty year term subordinated securities.

Wholesale Banking also managed the issue, through special purpose vehicles, of two £1 billion equivalent floating rate notes secured on Abbey National residential mortgages. These issues increased the flexibility of the Group to manage its balance sheet and continued to access an additional source of funding for the Group.

1999 was Wholesale Banking's first full year of sponsorship of an asset-backed commercial paper ("CP") programme which provides the Group with an additional and flexible source of funding. Secured by highly rated asset-backed securities, the CP is issued by Moriarty Limited and Moriarty LLC, and is rated P-1, A-1+ and F1+ by Moody's, Standard and Poor's and Fitch IBCA respectively. Moriarty is a bankruptcy remote funding vehicle. The authorised size of the facility was increased from $5 billion to $10 billion during the year, and as at December 31, 1999, CP outstanding totalled $8.6 billion.

Life Insurance

U.K. Life Insurance Industry

The U.K. life insurance industry consists of three principal segments: protection, investment and savings, and pensions.

Protection. The traditional form of protection policy, known as term insurance, provides a lump sum benefit payable on death within a specified term to a named party, typically a relative. Policies are also available to provide protection against ill health.

Investment and Savings. Investment bonds make up the bulk of this category. The current economic climate of low interest rates has resulted in a switch from deposit based products to investment type products, particularly those backed up by equity investments, potentially offering better returns. Unit Trusts, ISAs and endowment life insurance policies are also included in this category.

Pensions. In the United Kingdom pensions are a tax-efficient way of saving to provide benefits on retirement. This is a result of the tax deductibility of contributions made and the generally tax-free growth granted to pension funds. In late 1998 the UK Government produced a green paper (consultative document) on pensions reform that is due to be introduced in April 2001. This paper, "A New Contract for Welfare: Partnership in Pensions (Stakeholder Pensions)", sets out the intention for a radical change to the shape, distribution and charging structure that should apply to pensions. In particular, the paper proposes a much simplified product with greater flexibility and a lower charging structure. Although the regulations governing the proposed products have yet to be finalised, the Group's current intention is to participate in this market.

Distribution. Under the terms of the United Kingdom Financial Services Act 1986 (the "Financial Services Act"), financial advisers are required to be an "appointed representative", "marketing associate" or an "independent financial adviser". These financial advisers are required to provide "best advice", based on an assessment of the client's financial position and requirements. The appointed representative or marketing associate is required to recommend the most suitable products from the product range of the company for which it acts as representative or with which it is associated, while the independent financial advisers must provide best advice on the complete product range that exists in the marketplace.

Life Insurance in the Abbey National Group

The Group is an active participant in each of the three principal segments of the U.K. life insurance industry outlined above. As at December 31, 1999, Abbey National's life insurance and pensions subsidiaries had £18.5 billion of funds under management, largely invested in U.K. equities, overseas equities (mainly in Continental Europe, the U.S. and Japan), U.K. Government bonds, cash and property.

The acquisition of Scottish Mutual in 1992 enabled Abbey National to launch its own life insurance company in 1993, Abbey National Life, for which Abbey National is a marketing associate. While Scottish Mutual and Abbey National Life service distinct market segments, they share resources and facilities through Abbey National Financial & Investment Services plc.

Abbey National Independent Consulting Group ("ANICG") has provided independent financial advice to private clients through its associate, Willis National. As an independent financial adviser, Willis National is an alternative for Abbey National customers and other private individuals who do not want to be restricted to the products offered by Abbey National Life. ANICG's results are included in the Wealth Management business segment, described below.

Scottish Mutual Assurance plc ("Scottish Mutual")

Scottish Mutual and its predecessors have been in the insurance business since 1883. Under the terms of the acquisition of Scottish Mutual in 1992, Abbey National receives 10% of all surpluses arising in Scottish Mutual's With-Profits Sub-Fund and 100% of all surpluses arising from other business generated by Scottish Mutual Other Business Sub-Fund.

Scottish Mutual distributes its products solely through independent financial advisers in the United Kingdom, of which there are approximately 3,700 firms registered with the Personal Investment Authority.

Scottish Mutual markets a broad range of products including personal pensions, conventional and unit-linked protection plans, regular investment plans, single premium products such as investment bonds and with-profit bonds and annuities, and products linked to mortgages.

Scottish Mutual International sells both single and regular premium policies and focuses on the expatriate and international markets.

Pegasus Assurance Group Ltd. ("Pegasus"), a U.K. healthcare provider, provides insurance policies to cover critical illness and income protection.

Abbey National Life plc

Abbey National Life plc underwrites and services a wide range of life insurance products including pension, protection, investment and savings products. These products are sold exclusively through Abbey National's retail distribution network. A financial planning service is offered to customers in almost all of the Group's branches. Advisers examine the financial circumstances and needs of customers identifying pension, protection, investment and savings requirements and recommend to them the appropriate products from the Abbey National brands.

Abbey National Unit Trust Managers Ltd. ("ANUTM") and Abbey National PEP and ISA Managers Ltd.

A subsidiary of Abbey National Life plc, ANUTM, manages the Abbey National U.K. Growth Unit Trust, drawing on the fund management expertise of the life insurance business. Abbey National PEP and ISA Managers Ltd. manages the PEP and ISA businesses of Abbey National. The trustee of the unit trust is Citicorp and the investment manager is Scottish Mutual Portfolio Managers Ltd.

Finance House

Finance House comprises four businesses:

- Consumer finance – which consists of: (i) the provision of unsecured personal loans under the First National Bank ("FNB") brand, using the introducer distribution channel; and (ii) the provision of secured loans through Household Mortgage Corporation ("HMC"), a centralized mortgage lending brand aimed at specialized market segments;

- Motor finance;
- Business finance – operating in the areas of commercial mortgages, small ticket leasing, vehicle contracting and factoring; and
- Retail finance – the provision of unsecured personal loans under the First National Tricity Finance brand using the point-of-sale distribution channel.

As at December 31, 1999, Finance House had loan assets of £8.6 billion (1998: £7.7 billion).

In May 1999, Abbey National purchased NatWest's 50% shareholding in PSA Finance PLC, the motor finance joint venture between Lombard North Central PLC, Peugeot Motor Company PLC and Citroen UK Limited. The transaction did not have a material effect on Abbey National's financial figures.

General Insurance

The range of non-life insurance products sold by Abbey National includes property, buildings and contents, motor, payment protection, travel and health insurance. Residential mortgage-related insurance remains the primary type of policy sold and is offered to customers through the branch network and over the telephone, often at the same time that a mortgage is being taken out.

Abbey National and CGU plc have a joint venture providing building and contents insurance and motor insurance products to Abbey National customers. As part of the joint venture, the underwriting risk for buildings and contents insurance and motor insurance is borne by CGU Underwriting Ltd. in which Abbey National currently holds 15% of the voting share capital. The joint venture's operations business unit is a division of Abbey National and is responsible for providing quotations, collecting premiums and issuing policies on behalf of the underwriting company. Abbey National markets general insurance products to savings customers both through branches and through its telephone service operation, which enables customers to buy buildings and contents insurance and a range of motor insurance products directly over the telephone.

Abbey National has a joint venture with Norwich Union Healthcare to sell private medical insurance products through the Group's retail network. Under the joint venture, Abbey National designs, markets and underwrites these products and Norwich Union provides claims management and customer service facilities.

Wealth Management

The Wealth Management division comprises the offshore retail financial services businesses of Abbey National; the onshore retail banking business of Cater Allen; City Deal Services, the Group's execution-only stockbroker; the Abbey National Independent Consulting Group ("ANICG"); and Project Prosper, a new business which will be launched later in 2000.

Abbey National's offshore operations use both the Abbey National Offshore and Cater Allen Offshore brands. The former is centered on Abbey National Treasury International Limited ("ANTIL"), a wholesale and retail banking operation. ANTIL's retail activities focus on attracting deposits by offering savings accounts denominated in a range of currencies. ANTIL also raises wholesale funds and invests in wholesale assets. Cater Allen Offshore provides personal banking and investment management services to higher net worth individuals.

Cater Allen Ltd offers onshore banking services through its trading name, Cater Allen Bank ("CAB"). CAB's objective is to provide a high quality, personal banking service. It does not have a branch network and its customers are serviced by correspondence and by telephone. A small sales force markets directly to independent financial advisors.

City Deal Services Limited offers execution-only stockbroking under its own brand and also manages the operations for the Abbey National Sharedealing Service.

ANICG consists of three businesses: Abbey National Benefit Consultants ("ANBC"), James Hay Pension Trustees ("JHPT") and Willis National. ANBC provides a range of services in connection with the setting-up and running of employee benefit arrangements and pension schemes, including administration and actuarial work. JHPT offers advice and a range of services in connection with small self-administered schemes and self-invested personal pensions. Willis National offers advice to individuals, partnerships and small companies, and is able to recommend investments and products from a wide range of providers. The advice provided by Willis National encompasses investments, life assurance, tax planning, personal pensions, phased retirement and income drawdown.

During 2000, Abbey National will launch a new service for U.K. customers with more than £50,000 of net assets. This service, currently known as Project Prosper, will offer a combination of advice, discretionary fund management and cash management.

Continental Europe

Abbey National's operations in France, and Italy, which together constitute the Group's Continental Europe segment, are managed locally. The principal activity of these operations is providing mortgage finance. The strategy in Continental Europe centers on the management of the existing commercial loan portfolio in France together with new residential mortgage lending, and the continued development of the mortgage lending operation in Italy. A summary of these businesses is provided below.

Abbey National France SA's key activity is to provide a range of French franc-denominated fixed and variable repayment mortgages, primarily to French nationals. Abbey National France SA also offers unsecured lending to individuals. The company, in the past, provided commercial loans but no longer undertakes this activity.

Abbey National Bank (Italy), a branch of Abbey National, provides lire-denominated mortgage finance and related insurance products and unsecured personal loans, primarily to Italian nationals.

The French and Italian businesses have been refocused and are concentrating on profitable niche markets.

cahoot

cahoot is Abbey National's separately-branded, multi channel e-commerce financial service provider, which will be launched in 2000. cahoot will be targeted at new customers who are ready and eager to embrace e-commerce giving customers access through their PCs, telephones, including WAP enabled mobile phones, and digital televisions.

cahoot will provide high quality, attractively priced services extending beyond financial services through link-ups with innovative providers. It will be 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.

Group Central Holdings

Group Central Holdings comprises Central Services, Financial Holdings (which contains the earnings on the difference between the Group's statutory capital and the target regulatory capital allocated to segments) and the results of certain small non-core businesses.

COMPETITION

This section contains forward-looking statements that involve inherent risks and uncertainties. Actual results may differ materially from those contained in such forward-looking statements. See "Forward-Looking Statements" above.

Industry Background

Abbey National's main competitors have traditionally been providers of personal financial services in the U.K. These include: banks, building societies, life insurance companies and mutual insurance organizations.

In recent years, competitive pressures and consolidation have lead to a blurring of the boundaries between banks, building societies and insurance companies in the United Kingdom. In addition, new providers of financial services have emerged, providing sophisticated investment and banking products.

Competitive Environment

The trend towards further consolidation in the U.K. and European financial services markets has continued, the most significant recent example being the acquisition of National Westminster Bank by The Royal Bank of Scotland in early 2000. This consolidation has focused particularly on achieving cost efficiencies through greater economies of scale, and may be expected to increase competition in the future.

Furthermore, the financial services sector faces an increasing amount of competition from new financial service providers including supermarket chains, large retailers and utilities, which have launched financial services. In addition, both new and traditional competitors are seeking new ways of doing business, particularly using e-commerce technology.

Abbey National is using its strong market position and track record of innovation to align its business platforms to e-commerce. This includes extending its digital TV banking service through Open, the shopping channel available through Sky digital television, and joint ventures with cable operators NTL and Telewest. Abbey National plans to offer a fully interactive internet banking service to all retail customers during the first half of 2000.

In addition, full business-to-business web-based systems are being developed for all Abbey National Group intermediary businesses. A separately branded multi channel e-commerce financial services provider, cahoot, is intended to be launched in summer 2000.

Competition Outlook

Abbey National has experienced substantial competitive pressure in its traditional U.K. retail markets of mortgages and savings in recent years. Management believes that Abbey National, with its large customer base, powerful brand, established products and services, integrated distribution network, and access to both the wholesale and retail liability markets, is well positioned to respond to changes in competitive pressures while achieving a balance between market share and profitability. Abbey National continues to diversify its earnings, moving into newer, fast growing markets, in order to reduce its dependence on its traditional mortgages and savings businesses while developing an integrated multi channel distribution network in the retail business in order to give customers more opportunities to conduct business with Abbey National in ways that suit them.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF THE GROUP

The following discussion is based on the Consolidated Financial Statements included elsewhere in this Annual Report. Such financial statements have been prepared in accordance with U.K. GAAP. Certain significant differences between U.K. GAAP and U.S. GAAP are discussed in notes 54 and 55 to the Consolidated Financial Statements, which include reconciliations of certain amounts calculated in accordance with U.K. GAAP to U.S. GAAP. Unless otherwise indicated, financial information for the Group included in this Annual Report is presented on a consolidated basis, as discussed in the "Accounting Policies" section of the Consolidated Financial Statements. This section contains forward-looking statements that involve inherent risks and uncertainties. Actual results may differ materially from those contained in such forward-looking statements. See "Forward-Looking Statements" above. All analysis excludes exceptional items and all comparatives are to December 31, 1998, unless stated otherwise.

Overview

Abbey National's income before tax, after exceptionals, increased by 17% to £1,783 million (1998: £1,520 million). Total operating income before exceptional items grew 20% to £3,756 million (1998: £3,118 million), reflecting 6% revenue growth within U.K. 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 U.K. Retail Banking now contribute 45% of Group profit (1998: 42%), moving further towards the Group target of 60%.

Additional investments of £152 million have been made developing new business streams and re-engineering the existing business. As a result, the Group cost:income ratio was up slightly to 42.4% (1998: 41.2%). The Group's strategy remains focused on growing revenue, improving cost efficiency and managing the business' capital efficiently in order to respond to the rapidly changing competitive environment. The Group has continued to take advantage of favorable economic conditions and overall credit quality improved significantly, reflected in the total number of mortgage accounts in arrears, which fell by 23% from the end of 1998.

Earnings per ordinary share increased 19% to 86.2 pence (1998: 72.4 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 (1998: 23.55 pence) is proposed (full year net dividend 40.25 pence) (1998: 35.30 pence), up 14%, reflecting continued confidence in the future of the business.

Other highlights, including an overview by segment, for the year ended December 31, 1999 and in each case excluding exceptional items are as follows:

- U.K. Retail Banking pre-tax profit rose 8% to £996 million (1998: £926 million). The U.K. Retail Banking net interest spread, excluding unsecured personal lending ("UPL"), increased to 2.20% (1998: 2.10%) and increased to 2.30% (1998: 2.20%) including UPL. The cost:income ratio was reduced to 41.6% (1998: 42.2%).
- Record gross lending of over £12 billion (1998: £10 billion) was achieved. The share of stock of U.K. mortgages outstanding for the year is estimated at 13.1% (1998: 13.6%). The estimated market share of the increase in U.K. retail household liabilities was 1.8% (1998: 4.8%) with significantly improved flows of £1.3 billion in the second half of the year. The share of U.K. retail household liabilities was estimated at 8.6% for 1999 against 9.0% in 1998. Abbey National's share of cash and investment ISA products was 14% and 8% respectively.
- Wholesale Banking pre-tax profit increased 16% to £419 million (1998: £361 million) with assets up 17% to £82 billion (1998: £70 billion). Wholesale Banking improved returns on equity through new business initiatives and successfully exploiting opportunities offered by improving conditions in global financial markets.
- Life Insurance pre-tax profit increased 21% to £229 million (1998: £190 million). Total new business premiums were up 41% to £3,546 million (1998: £2,523 million), with funds under management increasing 34% to £18.5 billion (1998: £13.8 billion). The With Profits Bond market has been particularly successful, with Scottish Mutual taking the second largest market share, with £1.1 billion of new premiums this year.
- Finance House pre-tax profit was up 49% to £140 million (1998: £94 million), reflecting strong growth following the acquisition of the three point-of-sale consumer finance businesses in 1998.

- General Insurance pre-tax profit increased 6% to £104 million (1998: £98 million), as a result of strong new business performance combined with a focus on cost containment.

- Wealth Management pre-tax profit (excluding the cost of new business development) has increased 38% to £36 million (1998: £26 million), helped by strong offshore growth in retail liability.

- Total Group assets have increased 11% since December 31, 1998 to £180.7 billion (1998: £162.8 billion), with an equity Tier 1 capital ratio of 7.1% (1998: 6.7%).

Investment for the future

The following major steps have been taken to enhance the Group's performance over the coming 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 flexible pension, flexible mortgage, and Direct Saver Account products and investment in a number of customer retention initiatives. In Wholesale Banking, new business streams include project finance, acquisition finance, equity derivatives and private equity funds. Finance House, through its recent acquisitions, is now a leading market participant in the U.K. 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 U.K.

The Group has developed a number of new revenue generating businesses for launch in 2000:

A separately-branded, multi channel e-commerce financial service provider, known as "cahoot", targeted at new customers who are ready and eager to embrace e-commerce, is planned to be launched in the first half of 2000 with the following features:

- 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; and

- 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") aims to meet the investment and cash management needs of customers with more than £50,000 in net assets – a potential market in excess of 4 million people in the U.K. 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 the launch of the business later in 2000.

E-banking is planned to be made available to retail banking customers during 2000 – enabling customers to check and transfer balances, make bill payments, set up standing orders and direct debits and provide access to savings accounts. On-line access is planned for all other product areas by the end of the year. The objective is to have more than 0.5 million customers on-line by the end of 2000.

Abbey National intends to become a leading 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 1999. Abbey National plans to offer products and services in 4 million homes by the end of 2000.

In addition, a series of e-commerce initiatives across the Group aim to improve business efficiency. In 2000, U.K. Retail Banking, First National Bank and Scottish Mutual aim to provide full business-to-business web-based systems to intermediaries including 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 are expected to deliver annualised benefits of £70 million. Within U.K. Retail Banking these projects 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. In addition, PC desktop services were outsourced – the largest deal of its type in the U.K.

A series of projects has been initiated to re-engineer other businesses including Finance House where £27 million has been spent on 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 of expenditure was incurred in Wholesale Banking on derivative systems, revising custody arrangements and introducing new front and back office platforms to support revenue growth.

3. Improving capital efficiency

The Group has focused on improving both funding flexibility and capital efficiency. Both these objectives were advanced in 1999 with the launch of two £1 billion equivalent mortgage-related FRNs, and the introduction of a $10 billion asset-backed commercial paper programme. In February 2000, new capital was raised in the form of a $1 billion preferred perpetual security offered over the internet, the international capital market's first electronic offering of capital by a bank. The sale of the equity investment in Irish Permanent in early 1999 provided further capital resources to invest in new businesses.

Restatement of Prior Year Numbers

Prior year comparatives for 1998 and 1997 have been restated to reflect the changes noted below:

The Abbey National-branded unsecured lending business has been reclassified from Finance House to U.K. Retail Banking and City Deal Services Ltd has been transferred from Wholesale Banking to Wealth Management in order to better reflect the structure of management responsibility. This change has no effect on the consolidated net income and shareholders' funds under both U.K. and U.S. GAAP. Prior year comparatives for 1998 and 1997 have been restated to reflect the changes. The numerical effect of the changes has been noted below in each of the relevant tables.

The accounting policy and presentation of interest income on dealing assets has been changed in order to present a more consistent treatment of interest income and expense across the Group's activities. Such interest has previously been presented in dealing profits and is now included in interest receivable and interest payable. This change has no effect on the consolidated net income and shareholders' funds under both U.K. and U.S. GAAP. Prior year comparatives for 1998 and 1997 have been restated to reflect the changes. The numerical effect of the changes has been noted below in each of the relevant tables.

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. This change has no effect on the consolidated net income and shareholders' funds under both U.K. and U.S. GAAP. Prior year comparatives for 1998 and 1997 have been restated to reflect the changes. The numerical effect of the changes has been noted below in each of the relevant tables. Obligations taken on pursuant to entering such agreements are now reported as Commitments.

Segmental net assets have been restated to reflect more fairly the allocation of regulatory capital across business segments.

Results of Operation of the Group by Principal Business Segment

Set out below is a discussion and analysis of the Group's income before taxes and exceptional items for each of the three years ended December 31, 1999, 1998 and 1997. The discussion includes references to the contributions to income before taxes and exceptional items, as well as total assets, by principal business segment.

The segmental analysis is prepared on a basis which ensures the comparability of results across the Group's business segments by assuming a consistent allocation of Group capital across those segments. The results reflect the regulatory capital notionally absorbed by each business, based on Financial Services Authority ("FSA") regulatory requirements applicable to the Group. This is achieved by making a notional adjustment to the income before taxes of each business entity where relevant, by applying an average market-related interest rate to the difference between the capital held in the entity and the capital which would be required if the Group's FSA risk asset ratio was applied to that entity.

The following tables set forth the Group's income before taxes and exceptional items for each principal business segment for the three years ended December 31, 1999, 1998 and 1997 and total assets by principal business segment as at the end of such periods. The segmental analysis was revised at December 31, 1999, to reflect more clearly the results of the Group's business segments and to ensure improved comparability between segments. For a full explanation of these changes, refer to the preceding section "Restatement of Prior Year Numbers."

Income Before Taxes and Exceptional Items by Principal Business Segment

	Year ended December 31,		
	1999	1998 (restated)	1997 (restated)
	(in millions of £)		
U.K. Retail Banking[1]	996	926	819
Wholesale Banking	419	361	297
Life Insurance	229	190	167
Finance House[1]	140	94	100
General Insurance	104	98	105
Wealth Management	17	26	14
Continental Europe	(8)	—	(26)
cahoot	(16)	—	—
Group Central Holdings	(71)	(107)	(24)
Total	1,810	1,588	1,452
Exceptional Items:			
Year 2000 and EMU costs	(27)	(68)	(28)
Adjustment to net investment in finance leases	—	—	(133)
Adjustment to income from long term insurance business	—	—	(12)
	(27)	(68)	(173)
Income before taxes	1,783	1,520	1,279

(1) The Abbey National–branded unsecured lending business has been reclassified from Finance House to U.K. Retail Banking. Prior year numbers have been restated to reflect the reclassification. The effect on prior year numbers has been to increase U.K. Retail Banking income before taxes and exceptional items by £26m and £33m at December 31, 1998 and 1997 respectively. Finance House income before taxes and exceptional items has been reduced accordingly.

Under U.K. GAAP, the amounts shown above as exceptional items, which are described below under "Results of Operations of the Group by Nature of Income and Expense — Exceptional Items," are shown separately within the relevant line item in the profit and loss account (see "Consolidated Profit and Loss Accounts" for the years ended December 31, 1999, 1998 and 1997 elsewhere in this Annual Report). For the purpose of the above table, segmental income before taxes is stated before exceptional items, which are shown separately.

Total Assets by Principal Business Segment

	As at December 31,		
	1999	**1998 (restated)**	**1997 (restated)**
	(in millions of £)		
U.K. Retail Banking[1]	64,838	63,469	61,772
Wholesale Banking[2]	81,741	69,916	61,819
Life Insurance	18,893	14,360	10,915
Finance House[1]	8,697	8,279	3,686
General Insurance	146	137	133
Wealth Management	4,491	4,225	2,059
Continental Europe	1,456	1,289	1,325
cahoot	—	—	—
Group Central Holdings	482	1,078	2,421
Total assets[2]	180,744	162,753	144,130

(1) The Abbey National–branded unsecured lending business has been reclassified from Finance House to U.K. Retail Banking. Prior year numbers have been restated to reflect the reclassification. The effect on prior year numbers has been to increase U.K. Retail Banking's total assets by £1,225m and £1,139m at December 31, 1998 and 1997 respectively. Finance House segment total assets have been reduced accordingly.

(2) Following an accounting presentation change, assets and liabilities under stock borrowing and lending agreements are no longer shown on balance sheet. The obligation to return stock borrowed is now recorded as a contractual commitment. The 1998 and 1997 comparatives have been restated accordingly. The effect on the prior year comparatives of the restatement has been to reduce the total assets for the Wholesale Bank segment by £15,026m and £6,678m for December 31, 1998 and 1997 respectively. There is no effect on net income or shareholders' funds resulting from this change.

Year ended December 31, 1999 compared to year ended December 31, 1998

For a discussion of overall results, see "Management Discussion and Analysis – Overview", above.

U.K. Retail Banking

U.K. Retail Banking increased its income before tax and exceptional items by 8% to £996 million, whilst the cost:income ratio improved for the second year running to 41.6% (1998: 42.2%).

Net interest income increased by 7% to £1,621 million (1998: £1,522 million). The spread between U.K. Retail Banking's average lending rates and average funding rates increased from 2.10% to 2.20% (excluding UPLs) and from 2.20% to 2.30% (including UPLs) at December 31, 1999, 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 increased by 2% to £389 million (1998: £383 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 (1998: £804 million). This reflects an increase in salary and bonus payments, and an additional 365 FTE headcount in U.K. 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 (1998: £154 million) due to increased telephony charges, with a 32% increase in calls handled from customers and increased spending on software costs to create new e-commerce distribution channels through digital television and the internet.

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 remained level. However, provisions and arrears on unsecured personal loans have increased slightly due to an increase of 4% in loan assets.

As at December 31, 1999, Abbey National had a U.K. mortgage asset of £64.7 billion (1998: £62.3 billion), an estimated 13.1% market share (1998: 13.6%). The £2.4 billion increase during the year represents an estimated 6.3% (1998: 5.9%) market share of the increase in U.K. 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 December 31, 1999, Abbey National had retail liabilities of £49.7 billion (1998: £49.3 billion), an estimated 8.6% (1998: 9.0%) share of the total U.K. personal liquid savings stock. Abbey National had a £1.2 billion net inflow of U.K. 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 U.K. 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 Abbey National 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.

Wholesale Banking

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 (1998: £361 million) and continued to develop the business to ensure the sustainability of this performance.

Total operating income increased by 20% to £560 million (1998: £466 million). Net interest income, which at £393 million (1998: £411 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, corporations and governments, where the balance sheet size increased to £21.1 billion (1998: £15.2 billion); and investments in asset backed securities (including mortgage backed securities) which was unchanged 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 the year 2000. 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 (1998: £27 million). This increase reflects the success of 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 full year in the operating lease market. Its private equity funds book of £185 million is relatively immature, however, 1999 saw an increase of £16 million 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 U.K. government's private finance initiative. These are all growing markets in which Wholesale Banking aims to 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 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 U.K. securitisation market, and managed the launch of preferred perpetual securities in February 2000 – the first capital bond to be offered internationally by a bank via the internet.

Wholesale Banking's total assets increased from £70 billion to £82 billion, on a restated basis, and risk weighted assets increased from £25.3 billion to £30.0 billion.

Operating expenses increased by £29 million to £115 million (1998: £86 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 (1998: FTE 500). 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 (1998: £19 million) was added to provisions, reflecting the prudent approach taken in relation to potential credit risks.

Life Insurance

Life Insurance had an excellent year, with profits before tax increasing 21% to £229 million (1998: £190 million) as a result of very strong growth in new business volumes, up 41% to £3,546 million (1998: £2,523 million), particularly in the single premium investment markets. Life Insurance 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 December 31, 1998.

The new business contribution to embedded value of £98 million (1998: £65 million) is up 51% from 1998 showing that despite increased margin pressures throughout the industry, Life Insurance continues to contribute significant earnings. See "Accounting Policies" in the Financial Statements for a definition of embedded value.

Very low total expense ratios in Abbey National Life and Scottish Mutual of 68% and 72% (1998: 78% and 78%) 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 U.K. 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) and increased annualised new premium income by 32% to £179 million (1998: £136 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. 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.

Scottish Mutual increased pre-tax profit by 32% to £102 million (1998: £77 million). Annualised new premium income increased by 26% to £283 million (1998: £224 million). Scottish Mutual new single life business premiums rose 104% to £1,895 million (1998: £927 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 pre-tax profit increased 49% to £140 million (1998: £94 million). Total net interest income increased by 133% (1998: 8%) reflecting asset growth following the acquisition of three new point-of-sale consumer finance businesses at the end of 1998. Commissions, fees and other income increased from a net expense of £15 million to a net expense of £20 million as the benefits of the new point-of-sale consumer finance businesses, increased operating lease income, and increased PSA joint-venture income earned were offset by increased introducer fees expense to third parties. Operating expenses have increased by 149% due to the new point-of-sale consumer finance businesses. Provisions for bad and doubtful debts have increased to £132 million (1998: £26 million), with £98 million of this due to the new point-of-sale consumer finance businesses. The £8 million increase in provisions in the existing First National Bank 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 three point-of-sale 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 profit before tax has increased by 6% to £104 million (1998: £98 million). Overall, new business volumes have increased by 9%, with motor new business volumes in particular growing strongly by 141% to 59,000 policies 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 has decreased by 35% to £17 million (1998: £26 million). However, excluding the costs of Project Prosper from 1999 (see "Investment for the Future", above), profit before tax increased by 38% to £36 million (1998: £26 million). Net interest income increased by 32% to £62 million (1998: £47 million), primarily due to improved performance in the retail deposit business, with a net increase in retail liability of £498 million (1998: £606 million) driven by higher volumes in the offshore banking division. Commissions, fees and other income increased by 21% to £46 million (1998: £38 million), mainly due to increased fee income from business growth in pension scheme administration.

Operating expenses increased by £14 million to £72 million (1998: £58 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.

Continental Europe

Continental Europe made a loss of £8 million in 1999 (1998: break even), although losses were 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 is Abbey National's separately-branded, multi-channel e-commerce financial service provider. For further details, see "Investment for the Future", above. At present only £16 million (1998: nil) of initial costs have been incurred.

Group Central Holdings

Group Central Holding's loss before taxes decreased to £71 million in the year ended December 31, 1999 (1998: loss of £107 million). 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 to £186 million (1998: £150 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 three point-of-sale 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 of the three point-of-sale consumer finance businesses.

Year ended December 31, 1998 compared to year ended December 31, 1997

For a discussion of overall results, see "Management Discussion and Analysis – Overview", above.

U.K. Retail Banking

U.K. Retail Banking's income before tax and exceptional items increased by 13% to £926 million (1997: £819 million). Net interest income increased by 8% to £1,522 million (1997: £1,416 million) with a 13% growth in average interest-earning assets. Despite competitive pressure in traditional markets, the spread between U.K. Retail Banking's average lending rates and average funding rates increased from 1.95% at December 31, 1997 to 2.20% at December 31, 1998, resulting from the management of the retail margin in a changing interest rate environment. U.K. Retail Banking net interest margin increased to 2.5% (1997: 2.38%).

Commissions, fees and other income grew by 50% to £383 million (1997: £255 million) as a result of increased personal banking activity, driven by an expanded bank account and credit card base, an enlarged ATM network and income from mortgage activity, including administration fees generated by strong fixed rate mortgage business. The increase in other income also reflected the release of £39 million (1997: £12 million) of deferred income to cover the relevant proportion of provisions on high LTV loans, and an additional £33 million (1997: £12 million) release made which relates to the lending of certain previous years where credit quality is such that the likelihood of further losses being incurred is considered remote.

Operating expenses increased by 8% to £804 million (1997: £746 million). Excluding normal salary increases, the growth in expenditure is mainly linked to ongoing investment in new products, distribution and customer systems, in particular the telephone network. The cost:income ratio improved to 42.2% (1997: 44.7%).

The provisions charge increased by £61 million to £167 million (1997: £106 million), with £56 million (1997: £12 million) relating to residential mortgages. During 1998, the number of mortgages six months or more in arrears has increased from 14,692 to 17,122.

Provisions charges against overdrafts and credit cards increased to £56 million (1997: £54 million), representing 11% of asset (1997: 13%). At year end, Abbey National's credit card asset was £282 million (1997: £234 million), while the overdraft asset has grown from £197 million to £233 million in 1998.

As at December 31, 1998, Abbey National had U.K. mortgage assets of £62.3 billion (1997: £60.8 billion), representing an estimated 13.6% market share. The £1.5 billion increase in the year represents an estimated 5.9% (1997: 3.3%) market share of the increase in U.K. mortgages outstanding. This reflects an estimated 12.1% (1997: 11.7%) share of gross mortgage lending amounting to £10.9 billion, and an estimated 14.6% (1997: 15.4%) market share of mortgage capital repayments (equating to £9.4 billion).

As at December 31, 1998, Abbey National had retail liabilities of £49.3 billion (1997: £47.7 billion), an estimated 8.9% share of the total U.K. personal liquid savings stock. Abbey National enjoyed a £1.5 billion net inflow of liquid savings during the year (1997: £1.3 billion). This represents an estimated 4.8% (1997: 3.5%) market share of the increase in U.K. liquid savings, reflecting the continued success of the Abbey National Bonus Postal Account and the direct savings account with Safeway and, in part, the successful integration of the Cater Allen businesses together with the success of retention strategies aimed at customers with maturing accounts. This inflow is in addition to Abbey National PEPs, unit trusts and investment bonds which have attracted £801 million of new business premiums (1997: £680 million), the majority of which came from Abbey National savings accounts, indicating changing customer preferences towards longer term savings products. Continued success in cross-selling these products has been a key driver behind growth in Abbey National Life.

Total operating income in the Abbey National-branded unsecured loan business increased 23% to £119 million (1997: £97 million) with income before tax and provisions increasing 34% to £83 million (1997: £62 million). However, provisions increased by £28 million, leading to a fall in income before tax of £7 million to £26 million (1997: £33 million). Much of the increase in provisions can be attributed to the lag effect of the build up of the book in 1996 and 1997. Early action was taken to tighten credit scoring criteria, reassess target customers and enhance collection activities and processes.

Wholesale Banking

In 1998, Wholesale Banking income before tax and exceptional items increased by 22% to £361 million (1997: £297 million). The increase in income principally reflected growth in a diversified portfolio of investment assets and a full year of CAIL's profits. During its first full year of operations within the Group, CAIL's assets grew to £16.6 billion. The integration of CAIL has progressed well and the business as a whole has started to enjoy the benefits of synergies which exist between the respective wholesale money market operations.

Net interest income increased 38% to £411 million (1997:£298 million), reflecting the increased size of the balance sheet and the benefit of a full year's operating income from CAIL. Taking advantage of the attractive levels available in the later part of the year, investment assets have increased by £2.9 billion in 1998 to £47.7 billion (1997: £44.8 billion).

Commissions, fees and other income within Wholesale Banking decreased 13% to £55 million (1997: £63 million). The difficult market conditions, particularly in the autumn, affected dealing profits with adverse market movements mitigated in part by the decision to continue reducing the level of trading securities. Nevertheless, there was a strong performance from ANFP, and as a result, dealing profits only fell £8 million to £27 million (1997: £35 million). The trading securities portfolio fell from £7.6 billion at December 31, 1997 to £5.6 billion at December 31, 1998.

Operating expenses increased by £23 million to £86 million (1997: £63 million). This reflects the inclusion of a full year of CAIL and other Cater Allen costs of £9 million, plus increased systems expenditure and associated headcount increases within core Wholesale Banking businesses to generate new income streams and to ensure smooth implementation of new back office systems. The cost:income ratio increased to 18.5% (1997: 17.3%).

As at December 31, 1998, total assets had increased 13% to £69.9 billion (1997: £61.8 billion). A prudent approach has been taken in relation to the management of potential credit risk. Given the growth in investment assets, £19 million has been added to 'Amounts written off fixed asset investments' during 1998.

Life Insurance

Life Insurance's income before tax and exceptional items increased by 14% to £190 million (1997: £167 million) as a result of growth in business volumes in a strong market. Life and pensions business in the IFA market continues to be highly competitive and as a result, margins have tightened. Funds under management increased from £10.5 billion at December 31, 1997 to £13.8 billion at December 31, 1998.

Abbey National Life increased income before taxes and exceptional items by 11% to £113 million (1997: £102 million). Annualised premium income increased by 5% to £136 million (1997: £129 million) and total new business premium income increased by 17% to £851 million (1997: £727 million). Sales of PEPs and unit trusts grew significantly in 1998, generating £663 million of premium income (1997: £469 million), representing a 7.7% market share of net new business sales. The sale of non mortgage-related investment, pensions and protection products to U.K. Retail Banking customers accounted for 78% of policies sold. These policies represent a major component of the Abbey National Life product offering.

Scottish Mutual increased income before taxes and exceptional items by 18% to £77 million (1997: £65 million). Annualised premium income increased by 30% to £224 million, (1997: £172 million) and total new business premium income increased by 38% to £1,672 million (1997: £1,212 million). Scottish Mutual has continued to diversify its product range and target markets, with significant new business volumes now being generated by Pegasus and Scottish Mutual International.

Finance House

Finance House income before tax and exceptional items fell 6% to £94 million (1997: £100 million). However, income before provisions remained constant at £120 million (1997: £120 million). Total operating income increased 7% to £226 million (1997: £212 million). Net interest income increased by 7% to £241 million (1997: £225 million), with 21% growth in net unsecured lending to £755 million and 6% growth in motor finance loan assets to £590 million since December 31, 1997. Operating expenses increased by 15% to £106 million (1997: £92 million), reflecting the cost of acquiring and integrating new businesses, with income before taxes and provisions unchanged. Provisions increased by £6 million to £26 million (1997: £20 million), reflecting unsecured loan asset growth. The cost:income ratio was 46.9% (1997: 43.3%).

Net loan assets at December 31, 1998 were £7.7 billion (1997: £4.6 billion), including £4.1 billion of point-of-sale finance assets acquired on December 30, 1998 from Natwest Group. The Business Finance area was strengthened during the first half of 1998 by the acquisition of TSB Factors Limited (now re-named First National Invoice Finance) and State Securities Plc (a small ticket leasing company). Secured lending activity includes second mortgage loans by FNB, and the centralised mortgage portfolios of Abbey National Mortgages and HMC. Gross lending under the HMC brand increased 154% from £50.6 million in 1997 to £128.4 million in 1998.

General Insurance

General Insurance income before tax fell 7% to £98 million (1997: £105 million). However, in 1998, costs of developing new operations were £4 million higher than the previous year. In 1997, costs benefited from an £8 million contribution received from the other party to the joint venture relating to costs incurred in setting up a direct operation. As a result, underlying income from continuing activities before tax and exceptional items actually increased 5% to £102 million (1997: £97 million). Insurance income grew 2% to £147 million, reflecting increased non mortgage-related sales (particularly sales of contents policies) and the benefits arising from the joint venture arrangements on the household and creditor portfolios. Total policy sales increased 18% to 214,000 (1997: 182,000) with a 34% increase in sales to non-borrowers.

Wealth Management

Wealth Management income before tax increased 86% to £26 million (1997: £14 million). This reflects strong growth in retail deposits in 1998, both onshore and offshore, and a full year's contribution from the various Cater Allen businesses acquired in 1997. During 1998, the offshore business successfully assimilated the Cater Allen banking, investment management, stockbroking and trust company businesses.

Continental Europe

Continental Europe's income before tax improved from a £26 million loss in 1997 to break even in 1998, following a £13 million profit arising from the sale of the Spanish operation in May 1998 and the improved £2 million operating loss in the 4 months prior to the disposal of the Spanish operation in May 1998 (1997: loss £10 million). The underlying pre-tax loss in France fell to £11 million (1997: loss £14 million). The Italian operation broke even in 1998 (1997: loss £2 million).

Group Central Holdings

Group Central Holdings loss before tax increased to £107 million in the year ended December 31, 1998 (1997: loss £24 million). Group Central Holdings comprises Central Services, Financial Holdings (which contains the earnings on the difference between the Group's statutory capital and the target regulatory capital allocated to segments) and the results of certain small non-core businesses. In Financial Holdings, greater utilisation of regulatory capital in the operating businesses during 1998 reduced the available surplus regulatory capital – thereby reducing income in the segment. In the non-core businesses, the 1997 results benefited from a one-off profit arising from investment activities.

Results of Operations of the Group by Nature of Income and Expense

Net interest income

	Year ended December 31,		
	1999	1998 (restated)	1997 (restated)
	(in millions of £)		
Interest receivable[2]	9,229	9,925	8,658
Interest payable[2]	(6,568)	(7,684)	(6,620)
Net interest income[1]	2,661	2,241	2,038

(1) Excludes exceptional items.

(2) Following an accounting presentation change, dealing interest is now included in interest receivable and interest payable. The restatement has resulted in interest receivable being increased by £447 million and £827 million and interest payable being increased by £435 million and £811 million for December 31, 1998 and 1997 respectively. The net effect being to reduce dealing profits and increase net interest income by £12 million and £16 million for December 31, 1998 and 1997 respectively.

The principal factors affecting the level of net interest income earned by the Group are the volume of interest-earning assets and the net margin earned on such assets.

Management believes that the Group's net interest margin will continue to be influenced by, among other factors, competitive pressures in the U.K. residential mortgage and liquid savings markets, the proportion of the Group's balance sheet represented by Wholesale Banking, Life Insurance and Finance House assets, the general level of U.K. interest rates, the economic cycle and its expected impact on the level of provisions for bad and doubtful debts, the sophistication of the retail products offered to customers and competitive pressures in the markets for high-quality investment assets. The benefit from the investment of shareholders' funds will continue to be affected by the general level of U.K. interest rates, although Abbey National's risk management policies seek to limit the effect of interest rate volatility on net interest income.

Future changes in the retail net interest spread will depend, among other factors, on the demand for residential mortgages and liquid savings products and on the level of competition among suppliers of these retail products. Subject to competitive pressures and market conditions, Abbey National is able to set prices for both retail assets and liabilities unilaterally and expects to use this ability, where appropriate, to limit any further downward pressure on the retail net interest spread. This ability to limit downward pressure on the retail net interest spread will depend, to some extent, on the level of competition in the mortgage market. Abbey National expects that the retail net interest spread, which during 1999 was in the top half of its historic range may become narrower over the next phase in the business cycle. Additionally, the Group utilizes the expertise of Wholesale Banking to design innovative retail products that contribute positively to margin management.

Year ended December 31, 1999 compared to year ended December 31, 1998

Net interest income increased by 19% to £2,661 million. Average interest earning assets grew 12% to £151.2 billion (1998: £135.1 billion), reflecting the increase in Wholesale Banking's investment assets, Finance House assets, and U.K. Retail Banking and mortgage assets. The Group net interest margin increased by 10 basis points to 1.76% (1998: 1.66%), 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 U.K. 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 Bank, the three point-of-sale consumer finance businesses acquired at the end of 1998 have increased volumes adding to higher net interest income. Net interest income has also improved due to growth in Wealth Management retail deposits.

Year ended December 31, 1998 compared to year ended December 31, 1997

In the year ended December 31, 1998, the Group's net interest income increased by 10% to £2,241 million (1997: £2,038 million). Average interest earning assets grew 13% to £135.1 billion (1997: £119.1 billion), reflecting the increase during 1998 in Wholesale Banking investment assets, mortgage assets in U.K. Retail Banking and loan assets in Finance House. The Group net interest margin decreased by 5 basis points to 1.66% (1997: 1.71%), mainly due to the impact of a higher proportion of Wholesale Banking assets in the balance sheet – offset partly by the higher margins achieved in U.K. Retail Banking. The U.K Retail Banking net interest spread rose by 11 basis points despite continuing competitive pressures in the residential mortgage and liquid saving markets.

The following tables set forth prevailing interest rates and yields, spreads and margins for the three years ended December 31, 1999, 1998 and 1997.

	Year ended December 31,		
	1999	**1998 (restated)**	**1997 (restated)**
		(percent)	
Prevailing Average Interest Rates			
United Kingdom:			
U.K. banks base rate	5.35	7.24	6.56
Abbey National base mortgage rate(1)	7.05	8.77	7.95
London inter-bank offered rate:			
three month sterling	5.54	7.34	6.84
three month eurodollar	5.42	5.56	5.72
United States:			
prime rate	8.00	8.35	8.44
Yields, Spreads and Margins			
Gross yield:(2)			
Group(5)	6.10	7.35	7.27
U.K.(5)	6.15	7.39	7.30
Non-U.K.	5.45	6.41	6.49
Interest spread:(3)			
Group(5)	1.55	1.37	1.38
U.K.(5)	1.65	1.38	1.37
Non-U.K.	0.38	0.84	1.03
Net interest margin:(4)			
Group(5)	1.76	1.66	1.71

(1) Abbey National's base mortgage rate represents the rate charged on loans of up to £59,999. Changes in the level of Abbey National's base mortgage rate are influenced by changes in the U.K. base rate as set from time to time by the Monetary Policy Committee of the Bank of England. Abbey National may apply different rates depending upon the amount borrowed and the precise type of mortgage and such rates may not relate to the base mortgage rate.

(2) Gross yield represents the average interest rate earned on average interest-earning assets.

(3) Interest spread is the difference between the average interest rate earned on average interest-earning assets and the average interest rate paid on average interest-bearing liabilities.

(4) Net interest margin represents net interest income as a percentage of average interest-earning assets. The breakdown of net interest margin between U.K. and non-U.K. is not presented because non-U.K. operations largely function either as funding vehicles for U.K. operations or as lending operations financed principally from within the Group, and therefore non-U.K. liabilities in most cases do not have corresponding non-U.K. assets (and vice versa).

(5) The 1998 and 1997 average balance sheets have been restated to separately identify the average balance of other interest bearing liabilities and the interest payable on them. The effect of the restatement on the 1998 comparatives has been to increase gross yields for the Group from 7.32% to 7.35%, for the U.K. from 7.35% to 7.39%, increase interest spread for the Group from 1.29 to 1.37, for the U.K. from 1.29 to 1.38 and increase net interest margin from 1.61 to 1.66. The effect of the restatement on the 1997 comparatives has been to change the interest spread for the Group from 1.36 to 1.38, for the U.K. from 1.35 to 1.37 and for the Non-U.K. from 1.04 to 1.03.

The following table sets forth average interest-earning assets and average interest-bearing liabilities for the three years ended December 31, 1999, 1998 and 1997.

	Year ended December 31,		
	1999	1998 (restated)	1997 (restated)
	(in millions of £)		
Average interest-earning assets:			
Group	151,178	135,117	119,100
U.K.	141,950	129,581	114,634
Non-U.K.	9,228	5,536	4,466
Average interest-bearing liabilities:			
Group(1)	144,436	128,510	112,370
U.K.(1)	131,335	119,578	103,752
Non-U.K.	13,101	8,932	8,618

(1) The 1998 and 1997 average balance sheets have been restated to separately identify the average balance of other interest bearing liabilities and the interest payable on them. The effect on the 1998 comparatives has been to increase average interest bearing liabilities for the Group from £127,649 million to £128,510 million and for the U.K. from £118,717 million to £119,578 million. The effect on the 1997 comparatives has been to increase average interest bearing liabilities for the Group from £112,056 million to £112,370 million and for the U.K. from £103,438 million to £103,752 million.

Commissions, Fees and Other Income

	Year ended December 31,		
	1999	1998 (restated)	1997 (restated)
	(in millions of £)		
Insurance income receivable(3)	210	176	175
Other net fees and commissions receivable(3)	281	331	276
Income from long-term life insurance business(2)	202	162	149
Other operating income(4)	402	208	122
Total(1)	1,095	877	722

(1) All numbers are stated pre-exceptional items.

(2) Income from long-term life insurance business represents the present value of profits expected to emerge in the future from policies currently in force, together with the Group's interest in the surplus retained within the long-term insurance funds. See the "Accounting Policies" section of, and Note 21 to, the Consolidated Financial Statements included elsewhere in this Annual Report.

(3) Following a detailed review of the groupings of income account captions, other fee income previously recorded under insurance income receivable is now included in other net fees and commissions receivable. The prior year comparatives have been restated to reflect this presentation change. In 1998 and 1997 £73 million and £48 million were reclassified respectively.

(4) Following an accounting presentation change, dealing interest is now included in interest receivable and interest payable. The restatement has resulted in other operating income being reduced by £12 million and £16 million for December 31, 1998 and 1997 respectively.

Year ended December 31, 1999 compared to year ended December 31, 1998

In total, commissions, fees and other income increased by 25% to £1,095 million. Insurance income receivable and other net fees and fees and commissions receivable amounted to £491 million (1998: £507 million). Included within this amount are gross fees and commissions receivable which grew by 15% to £737 million (1998: £643 million), driven by a 19% growth in insurance income to £210 million (1998: £176 million) as a result of increased motor business, growth in life insurance commissions in U.K. Retail Banking and creditor protection sales in First National. Loan and deposit administration, survey and legal fees, increased 10% to £197 million (1998: £179 million), as a result of increased administration fees in Finance House, new business growth, administration fees from the growth in life business, and growth in pension schemes under administration in Wealth Management. Wholesale Banking fees have been generated through a number of project finance initiatives and the provision of acquisition finance, resulting in a 96% increase to £55 million (1998: £28 million). Other commissions receivable were up 12% to

£93 million (1998: £83 million), driven by increases in the Finance House and Wealth Management. The increases described above were offset by fees and commissions payable which increased 81% to £(246) million (1998: £(136) 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.

Income from long-term insurance business increased by 25% to £202 million, which was underpinned by growth from both Scottish Mutual and Abbey National Life.

Other operating income increased by 93% to £402 million, including dealing profits, which increased by £66 million to £98 million (1998: £32 million), largely reflecting the success of the risk management and financial products business. The deferred income release in respect of high loan-to-value ratio loans increased by 7% to £77 million (1998: £72 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. Also included is £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.

Year ended December 31, 1998 compared to year ended December 31, 1997

In the year ended December 31, 1998, total commissions, fees and other income increased by 21% to £877 million compared to £722 million for 1997. Insurance income receivable and other net fees and commissions grew by 12% to £507 million (1997: £451 million), as a result of increased banking income derived from the Abbey National Bank Account and Abbey National Credit Card, increased mortgage-related fee income (including survey and administration fees) and increased sales of insurance products to non-borrowing customers. Income from long-term insurance business increased by 9%, with growth in new business premiums from both Scottish Mutual Assurance and Abbey National Life. Other operating income rose 70% to £208 million, mainly reflecting the release of £39 million (1997: £12 million) deferred income to cover the relevant proportion of provisions on high loan-to-value ("LTV") loans, and an additional £33 million (1997: £12 million) release made in respect of previous years' lending, where credit quality is such that the likelihood of further losses being incurred is considered remote. It also reflected the sale of Abbey National's Spanish operation and profit on sale of several properties.

Operating Expenses

	Year ended December 31,		
	1999	1998 (restated)	1997 (restated)
	(in millions of £)		
Salaries	607	504	453
Other staff costs	118	95	79
Property and equipment expenses(2)	151	141	146
Other administrative expenses(2)	599	439	392
Depreciation and amortisation	119	106	98
Total operating expenses(1)	1,594	1,285	1,168
Average headcount (full-time equivalent)	26,747	24,433	23,498

(1) Total operating expenses are before exceptional items.

(2) Property and equipment expense comparative for 1998 has been restated down by £29 million. The restatement results from a review of expense caption groupings resulting in general expenses previously grouped in property and equipment expenses now being grouped in other administrative expenses.

Year ended December 31, 1999 compared to year ended December 31, 1998

Total operating expenses increased by 24% from £1,285 million to £1,594 million. This increase included £152 million of additional investment on new business initiatives, as well as expenditure on improving business infrastructure and process efficiency. Investment in new businesses comprises Project 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. 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 1999 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. Salaries and other staff costs increased 21% to £725 million (1998: £599 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.

Other administrative expenses increased by 36% to £599 million (1998: £439 million). £42 million of the increase relates to the additional investments and £4 million to acquisitions. £104 million of the increase relates to software, computer and other administrative expenses due primarily to acquisitions and increased expenditure on telephony, reflecting the migration of transactions away from the counter, and additional software costs relating to e-commerce. The remaining increase is accounted for by additional marketing expenditure, primarily in U.K. Retail Banking. 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 point-of-sale consumer finance businesses.

Year ended December 31, 1998 compared to year ended December 31, 1997

Total operating expenses for the year ended December 31, 1998 increased by 10% to £1,285 million. Combined salaries and other staff costs increased by 13% to £599 million (1998: £532 million). The main components of this rise were: the impact of last year's pay round and other changes to the salary structure of the Group (7%); an increase of 935 (4%) in average full time equivalent headcount – most of which arose from the inclusion of Cater Allen staff for a full year; around 200 new staff added as a result of the smaller acquisitions made by FNB Group earlier in the year; and a decrease in the amount of pensions surplus write-back.

Other administrative expenses increased by £47 million to £439 million, largely reflecting increased ongoing investment in new products, as well as investment in distribution and customer systems.

The Group's cost:income ratio excluding the impact of exceptional items improved to 41.2% (1997: 42.3%).

Provisions

	Year ended December 31,		
	1999	1998 (restated)	1997 (restated)
	(in millions of £)		
Provisions for bad and doubtful debts			
Credit risk provisions charge:			
Specific	273	173	98
General	30	28	23
Total	303	201	121

	Year ended December 31,		
	1999	1998 (restated)	1997 (restated)
	(in millions of £)		
Credit risk provisions charge:			
U.K. Retail Banking[(1)]	167	167	95
Finance House[(1)]	132	26	20
Continental Europe	4	4	6
Group Central Holdings	—	4	—
Total	303	201	121
Provisions for contingent liabilities and commitments	23	16	16
Amounts written off fixed asset investments	26	28	3

(1) The Abbey National-branded unsecured lending business has been reclassified from Finance House to U.K. Retail Banking. Prior year numbers have been restated to reflect the reclassification. The effect on prior year numbers has been to increase U.K. Retail Banking credit risk charge provision by £57 million and £29 million at December 31, 1998 and 1997 respectively.

Year ended December 31, 1999 compared to year ended December 31, 1998

The total provisions charge increased 51% to £303 million. Excluding the three new point-of-sale consumer finance businesses, provisions for bad and doubtful debts increased by only £4 million to £205 million (1998: £201 million).

Provisions against secured lending on residential properties in U.K. Retail Banking have fallen by 43% to £31 million in 1999 (1998: £54 million), reflecting a significant improvement in arrears. Non-performing mortgages (those 3 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 (1998: 2,070 cases). Increased house prices contributed to the lower loss per case and ultimately reduced provisions charge.

Provisions against personal banking products (which include overdraft and credit card balances) were similar in the second half of the year 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 continued 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", above). Suspended interest fell due to the significant reduction in arrears.

A prudent approach continues to be taken by Wholesale Banking and £26 million (1998: £19 million) has been added to provisions for amounts written off fixed asset investments.

Year ended December 31, 1998 compared to year ended December 31, 1997

In the year ended December 31, 1998, provisions for bad and doubtful debts increased by 66% from £121 million in 1997 to £201 million in 1998.

The provisions charge for U.K. Retail Banking increased by £72 million to £167 million, with £56 million (1997: £12 million) relating to residential mortgages and £57 million relating to provisions for Abbey National-branded unsecured loans (1997: £29 million), the latter reflecting the strong asset growth over the last two years as well as increased arrears. Origination standards have been improved, loan collection activities enhanced and loan growth has slowed. Early arrears are now falling. Since the end of 1997, the number of mortgages six months or more in arrears has increased from 14,692 to 17,122.

In Finance House provisioning increased by £6 million to £26 million, reflecting asset growth of 3% during the year and growth in unsecured personal, motor and business finance assets in the past few years. No significant deterioration in arrears has been seen in these books.

As a result of the growth in investment assets, £19 million has been added to provisions for amounts written off fixed asset investments during the year. The remaining £9 million in amounts written off fixed asset investments represents the loss incurred in disposing of our one-third share in Travelex.

In Continental Europe, provisions for bad and doubtful debts were £4 million, compared to £6 million in 1997.

Allowances for lending losses as a percentage of loans and advances to customers (excluding finance leases) increased from 0.69% to 0.77%. Allowances for lending losses as a percentage of non-performing loans were 20.86% compared to 19.73% for 1997. See "Selected Statistical Information – Analysis of Allowances for Lending Losses" below.

Taxes

The following table provides a reconciliation of taxes payable at the standard U.K. corporation tax rate and the Group's effective tax rate for the three years ended December 31, 1999, 1998 and 1997.

	Year ended December 31,		
	1999	1998	1997
	(in millions of £)		
Taxation at standard U.K. corporation rate of 30.25%, 31% (1998) and 31.5% (1997)	548	492	449
Effect of non-allowable provisions and other non-equalised items	22	9	35
Effect of non-U.K. profits and losses	(9)	(8)	(1)
Adjustment to prior year tax provisions	(12)	(10)	(17)
Effect of dividend income taxed at different rates	—	—	(3)
Effect of loss utilisation	(19)	—	—
Taxes before the effect of exceptional items	530	483	463
Effective tax rate before the effect of exceptional items(1)	29.3%	30.4%	32.5%

(1) The effective tax rate is obtained by dividing taxes before the effect of exceptional items by income before taxes and exceptional items.

Year ended December 31, 1999 compared to year ended December 31, 1998

In the year ended December 31, 1999 taxes before the effect of exceptional items increased by 10% to £530 million compared to £483 million in the year ended December 31, 1998. This was the result of the increase in income before taxes and exceptional items, offset partially by a reduction in the Group's effective tax rate, before the effect of exceptional items, to 29.3% in 1999 compared to 30.4% in 1998. The decrease in the effective rate of tax was due mainly to the reduction in the standard rate of U.K. corporation tax applying for the year (reduced from 31% to 30.25%), and to the net effects of non-allowable provisions and other non-equalised items, non-U.K. losses, adjustments to prior year tax provisions and the effect of loss utilisation.

In 1996, the directors of Abbey National received a demand against its subsidiary, ANTS, by an overseas tax authority relating to the repayment of certain tax credits received and related charges. At market exchange rates prevailing at December 31, 1999, this amounted to approximately £100 million (1998: £113 million). As at December 31, 1999, additional interest in relation to the demand could amount to £13 million (at the balance sheet exchange rate) (1998: £10 million). 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.

Year ended December 31, 1998 compared to year ended December 31, 1997

In the year ended December 31, 1998 taxes before the effect of exceptional items increased by 4% to £483 million compared to £463 million in the year ended December 31, 1997. This was the result of the increase in income before taxes and exceptional items, offset partially by a reduction in the Group's effective tax rate, before the effect of exceptional items, to 30.4% in 1998 compared to 32.5% in 1997. The decrease in the effective tax rate was due mainly to the reduction in the standard rate of U.K. corporation tax applying for the year (reduced from 31.5% to 31%), and to the net effects of non-allowable provisions and other non-equalised items, non-U.K. losses, adjustments to prior year tax provisions and dividend income taxed at different rates.

Exceptional Items

	Year ended December 31,		
	1999	1998	1997
	£m	£m	£m
Year 2000 and EMU costs[(1)]	27	68	28
Adjustment to net investment in finance leases	—	—	133
Adjustment to income from long-term insurance business	—	—	12
	27	68	173

(1) Year 2000 and EMU costs were not recognised as exceptional in 1997, but for the purposes of comparability are now included as such.

Year ended December 31, 1999 compared to year ended December 31, 1998

In the year ended December 31, 1999 exceptional items decreased to £27 million compared to £68 million in the year ended December 31, 1998. The reduction is due to two factors: EMU preparations were completed in 1998; and the Group had fully implemented its Year 2000 issue plans by September 1999 resulting in lower expenditure in 1999 compared to 1998.

Year ended December 31, 1998 compared to year ended December 31, 1997

In the year ended December 31, 1998 Year 2000 and EMU costs increased to £68 million compared to £28 million in the year ended December 31, 1997. The increase is due to the fact that the majority of the Group's plans relating to the Year 2000 issue and EMU were carried out during 1998.

In 1997 the U.K. Government announced a number of measures which represented significant changes to the U.K. corporation tax regime. In particular, in the Finance (No. 2) Act 1997, the U.K. Government reduced the main U.K. corporation tax from 33% to 31%, and abolished the reclaim of tax credits on dividends from U.K. equity investments by pension funds. In November 1997, the U.K. Government announced a further reduction in the main rate of corporation tax to 30%, effective April 1999, and announced proposals to change from annual to quarterly tax payment dates. Best estimates of the likely effects of all of these changes on the accounts are shown as exceptional items.

In common with the industry as a whole, the changes in corporation tax result in the reduction in value of the Group's net investment in finance leases. The effect for the Group is an estimated reduction in interest receivable on finance leases of £133 million for 1997. Tax variation clauses in the leases, which preserve the lessors' post tax rate of return over the life of the leases, result in lower gross rental income when tax rates are reduced. A compensating reduction in the deferred tax liability has been recognized and shown as a reduction in the tax charge in 1997. Group profit after tax and earnings per ordinary share are unaffected.

As a result of the abolition of the reclaim of tax credits on dividends from U.K equity investments by pension funds, a provision of £12 million before tax (£8 million after tax) has been made against the embedded value profits for the Life Insurance business in 1997.

Capital Management and Resources

Capital Management

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. Significant securitisations of mortgage assets were undertaken in 1999, with £1.9 billion of mortgage assets securitised as at December 31, 1999. A $10 billion asset-backed commercial paper program has also been introduced, and $8.3 billion is currently outstanding on the program as at December 31, 1999. At the start of 2000 the Group raised $1 billion of perpetual preferred securities, adding Tier 1 capital in order to finance growth in new business streams including those within Life Insurance, Finance House and Wholesale Banking. The Group will continue to manage its balance sheet capital ratios and to monitor its capital efficiency to ensure that appropriate levels of capital are allocated to each of the business segments.

Abbey National's risk asset ratio remains above the minimum standards for the Group set by the FSA (see below). Going forward, Abbey National intends to continue to balance the interests of shareholders and debt holders in determining the capital resources required for the business.

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 stronger 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 pre-exceptional items 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.

Capital Adequacy Requirements

Capital adequacy and capital resources are monitored by the Group on the basis of techniques developed by the Basel Committee on Banking Regulations and Supervisory Practices (the "Basel Committee") and subsequently implemented in the United Kingdom by the Supervision and Surveillance Division of the Bank of England (now part of the FSA).

The basic instrument of capital monitoring is the risk asset ratio as developed by the Basel Committee. This ratio derives from a consideration of capital as a cover for the credit risk inherent in bank assets. The Basel Committee sets a minimum risk asset ratio for international banks of 8%. The FSA sets minimum risk asset ratios on an individual basis for the banks it supervises. These are set with regard to the minimum standard set by the Basel Committee and the particular circumstances of each bank.

The supervision of capital adequacy for banks in the EC is governed by the Capital Adequacy Directive ("CAD"). The CAD contains detailed rules for the regulatory capital treatment of the trading book and, for the definition of capital and treatment of other risks, refers to the other EC Directives described below.

Capital is defined by reference to the EC Own Funds Directive, and divided into "Tier 1" capital — consisting of ordinary and preference shareholders' funds after deducting goodwill; and "Tier 2" capital — including general provisions and certain debt capital instruments, particularly subordinated debt. "Tier 3" capital is a restricted class of shorter term subordinated debt available for inclusion in the capital base.

Trading book assets are those held for resale or in order to benefit in the short-term from movements in their price or interest rate, or are positions taken in order to hedge other elements of the trading book, while the remaining assets, relating to standard retail and wholesale banking activities, are regarded as banking book assets.

Banking book assets (both on- and off-balance sheet) are weighted to allow for relative risk according to rules derived from the EC Solvency Ratio Directive using a series of risk-weighting factors ranging from 0% to 100%. Abbey National's main class of asset, mortgage loans secured on residential property, is assigned a weighting of 50%.

In June 1999, the Basel Committee set out proposals for a new capital adequacy framework to replace the 1988 Accord. The objective of the proposals is to improve the way in which regulatory capital requirements reflect underlying risks. The European Commission commenced a consultation process on changes to the capital adequacy framework for banks and investment firms in November 1999, which is intended to result in legislation covering both EU banks operating internationally and also domestic banks, building societies and investment firms. The EC proposals are intended to complement, and will take into account, the Basel Committee's proposals. On the basis of the proposals as developed to date, management do not expect any material adverse impact on the business of the Abbey National Group to arise from the new capital adequacy framework.

Capital Ratios

The following capital ratios, which exceed both the Basel Committee minimum risk asset ratio of 8% and the FSA's specific recommendation for Abbey National, are calculated for the Group as supervised by the Complex Groups Division of the FSA. Abbey National recognizes the additional security inherent in Tier 1 capital, and hence also presents a Tier 1 to risk-weighted assets ratio. An equity Tier 1 ratio (Tier 1 excluding preference shares) is also presented.

Capital Adequacy Data

	Year ended December 31,		
	1999	**1998**	**1997**
	(in millions of £ except percentages)		
Tier 1	5,871	5,205	4,878
Tier 2 and Tier 3	4,532	3,146	2,500
less supervisory deductions	(1,606)	(1,107)	(947)
Total capital resources	8,797	7,244	6,431
Risk weighted assets			
Banking Book			
On balance sheet	69,598	65,380	53,413
Off balance sheet	2,108	2,109	1,267
	71,706	67,489	54,680
Trading book	4,170	3,787	3,297
Total	75,876	71,276	57,977
Capital ratios			
Risk asset ratio	11.6%	10.2%	11.1%
Tier 1 ratio	7.7%	7.3%	8.4%
Equity Tier 1 ratio	7.1%	6.7%	7.6%

Total Tier 2 and Tier 3 capital as a percentage of Tier 1 capital as at December 31, 1999 was 77.2% (1998: 60.4%). At December 31, 1999, the Group had no Tier 3 capital (1998: nil). Supervisory deductions mainly represent investments in life assurance and insurance companies within the Group.

Tier 1 capital at December 31, 1999, differs from total shareholders' funds as stated in the Consolidated Balance Sheet mainly because under U.K. GAAP goodwill incurred on the purchase of businesses after January 1, 1998 is capitalised as an intangible fixed asset, whereas such goodwill continues to be deducted from Tier 1 capital for regulatory purposes.

Year ended December 31, 1999 compared to year ended December 31, 1998

The Group's Tier 1 capital increased by £666 million to £5,871 million. The main element of this increase was £651 million of retained earnings and transfers to reserves. There was an increase in Tier 2 capital of £1,386 million, principally due to the issue of subordinated capital securities during the year.

Year ended December 31, 1998 compared to year ended December 31, 1997

The Group's Tier 1 capital increased by £327 million to £5,205 million. The main elements of this increase were £523 million of retained earnings and transfers to reserves less an increase in goodwill of £213 million, £167 million of which was incurred in the purchase of the three point-of-sale consumer finance businesses. There was an increase in Tier 2 capital of £646 million, including the issue of DM 1 billion of term subordinated debt and US$500 million of perpetual subordinated capital securities.

Capital Expenditure

	Year ended December 31,		
	1999	1998	1997
	(in millions of £)		
Capital expenditure	138	111	187

Capital expenditure to December 31, 1999 amounted to £138 million (1998: £111 million), with U.K. 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 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 to build infrastructure for the new business streams.

Year 2000 Disclosure

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 the Board will 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 January 4, 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 March 31. 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 U.K. entering EMU.

Analysis of Year 2000 and EMU Expenditure

The total estimated 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 (in millions of £)							
	Capital		Revenue		Internal		Total	
	Projected	Actual	Projected	Actual	Projected	Actual	Projected	Actual
Year 2000	20	21	96	98	18	17	134	136
EMU	2	—	7	9	1	—	10	9
Total	22	21	103	107	19	17	144	145

	1999	1998	1997
	(in millions of £)		
Revenue expenditure	27	68	28
Capital expenditure	2	6	14
Total	29	74	42

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

U.S. GAAP Reconciliation

The principal differences between U.S. GAAP and U.K. GAAP, as they relate to the Abbey National Group, are the treatment of shareholders' interest in the long term insurance business, the methods of accounting for goodwill for acquisitions completed before December 31, 1997, the unrealised surplus/(deficit) on securities available for sale and derivatives which hedge those securities and the treatment of dividends declared or proposed after the year end by the Board of directors.

For a further explanation of the differences between U.S. GAAP and U.K. GAAP, see Note 54 to the Consolidated Financial Statements included elsewhere in this Annual Report.

Current Developments in U.K. and U.S. GAAP

U.K. GAAP. In 1998, the Accounting Standards Board issued FRS 12, "Provisions, Contingent Liabilities and Contingent Assets", and FRS 13, "Derivatives and Other Financial Instruments: Disclosures".

FRS 12 sets out principles, recognition criteria and measurement bases of accounting for provisions, contingent liabilities and contingent assets and was effective for accounting periods ending on or after March 23, 1999. Under FRS 12, a provision should be recognised only when an entity has a present obligation, whether legal or constructive, as a result of a past event, that is likely to result in a transfer of economic benefits, an estimate of which can be measured with sufficient reliability. Note 38 included elsewhere in this Annual Report contains further details as to the impact of FRS 12 under U.K. GAAP. Net income and Shareholders funds under U.S. GAAP were unaffected.

FRS 13 requires narrative disclosures about an entity's objectives, policies and strategies in respect of financial instruments. These are supplemented by a range of numerical disclosures. FRS 13 was effective for accounting periods ending on or after March 23, 1999. Disclosures required by FRS 13 can be found in Note 48 included elsewhere in this Annual Report.

Future Developments in U.K. and U.S. GAAP

U.K. 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 March 23, 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 U.K. and U.S. GAAP.

U.S. GAAP. SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" is now applicable for all fiscal quarters of all fiscal years beginning after June 15, 2000 (i.e. January 1, 2001 for the Group). SFAS 133 requires that all derivative 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 is currently reviewing SFAS 133 to determine the impact it will have on the Group's earnings and statement of financial position.

SELECTED STATISTICAL INFORMATION

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

Average Balance Sheet

	1999 Average balance (1)	1999 Interest (2)	1999 Average rate %	1998 (restated) Average balance (1)(5)	1998 Interest (2)	1998 Average rate %	1997 (restated) Average balance (1)(5)	1997 Interest (2)	1997 Average rate %
	(in millions of £, except percentages)								
Assets									
Treasury bills and other eligible bills									
U.K.	1,831	91	4.96	2,074	147	7.10	811	28	3.51
Non-U.K.	—	—	—	5	—	5.91	21	2	7.02
Loans and advances to banks									
U.K.	10,832	466	4.30	9,194	511	5.56	3,997	230	5.75
Non-U.K.	281	17	6.42	316	25	7.85	308	23	7.39
Loans and advances to customers(3)									
U.K.	73,262	5,335	7.28	67,260	5,714	8.50	65,126	5,097	7.83
Non-U.K.	1,453	81	5.56	1,368	85	6.23	1,273	82	6.50
Lease receivables									
U.K.	5,341	336	6.29	4,679	339	7.24	4,500	306	6.81
Non-U.K.	26	1	4.94	29	1	4.19	31	1	2.81
Debt securities									
U.K.	50,684	2,499	4.93	46,374	2,859	6.16	40,200	2,707	6.73
Non-U.K.	7,468	403	5.39	3,818	244	6.38	2,833	182	6.42
Total average interest-earning assets and interest income	151,178	9,229	6.10	135,117	9,925	7.35	119,100	8,658	7.27
Allowance for loan losses	(694)	—	—	(614)	—	—	(663)	—	—
Non-interest earning assets:									
Long term insurance fund assets	14,687	—	—	11,264	—	—	8,737	—	—
Other	11,062	—	—	8,554	—	—	6,372	—	—
Total average assets and interest income	176,233	9,229	5.24	154,321	9,925	6.43	133,546	8,658	6.48
Non-U.K. assets as a percentage of total	5.67%	—	—	3.52%	—	—	3.50%	—	—
Total average interest-earning assets and net interest income	151,178	2,661	1.76	135,117	2,241	1.66	119,100	2,038	1.71

Average Balance Sheet (Continued)

	1999 Average balance (1)	1999 Interest (2)	1999 Average rate %	1998 (restated) Average balance (1)(5)	1998 Interest (2)	1998 Average rate %	1997 (restated) Average balance (1)(5)	1997 Interest (2)	1997 Average rate %
	(in millions of £, except percentages)								
Liabilities and shareholders' funds									
Deposits by banks									
U.K.	29,715	1,425	4.80	29,507	1,837	6.23	19,105	1,178	6.16
Non-U.K.	750	33	4.66	748	25	3.27	650	39	5.94
Retail customer accounts — demand deposits(4)									
U.K.	28,922	862	2.98	23,234	997	4.29	24,559	961	3.91
Non-U.K.	1,298	58	4.43	848	46	5.37	445	22	4.94
Retail customer accounts — time deposits(4)									
U.K.	16,654	882	5.30	22,420	1,577	7.03	19,353	1,328	6.86
Non-U.K.	2,027	129	6.35	2,000	138	6.88	1,552	96	6.22
Customer accounts — wholesale deposits(4)									
U.K.	10,013	510	5.09	5,017	353	7.04	5,871	370	6.30
Non-U.K.	330	19	5.61	210	9	4.45	181	11	6.28
Bonds and medium-term notes									
U.K.	27,702	1,221	4.41	24,361	1,420	5.83	21,176	1,432	6.76
Non-U.K.	156	5	3.45	270	17	6.38	253	14	5.44
Other debt securities in issue									
U.K.	13,572	716	5.28	12,142	790	6.50	11,595	724	6.25
Non-U.K.	7,918	382	4.82	4,221	221	5.24	4,869	245	5.04
Dated and undated loan capital and other subordinated liabilities									
U.K.	3,450	205	5.94	2,036	158	7.77	1,779	136	7.63
Non-U.K.	622	37	5.89	635	42	6.58	668	43	6.42
Other interest bearing liabilities									
U.K.	1,307	84	6.43	861	54	6.27	314	21	6.53
Non-U.K.	—	—	—	—	—	—	—	—	—
Total average interest-bearing liabilities and interest expense	144,436	6,568	4.55	128,510	7,684	5.98	112,370	6,620	5.89
Non-interest bearing liabilities:									
Long term insurance fund liabilities	14,687	—	—	11,264	—	—	8,737	—	—
Other	11,219	—	—	9,236	—	—	7,645	—	—
Shareholders' funds	5,891	—	—	5,311	—	—	4,794	—	—
Total average liabilities, shareholders' funds and interest expense	176,233	6,568	3.73	154,321	7,684	4.98	133,546	6,620	4.96
Non-U.K. liabilities as a percentage of total	8.29%	—	—	6.41%	—	—	7.48%	—	—
Net interest margin									
Interest income as a percentage of average interest-earning assets			6.10			7.35			7.27
Interest expense as a percentage of average interest-bearing liabilities			4.55			5.98			5.89
Interest spread			1.55			1.37			1.38
Net interest margin			1.76			1.66			1.71

(1) Average balances for 1999 are based upon daily data for ANTS and its subsidiaries and upon monthly data for all other operations. Average balances for 1998 and 1997 are based upon daily data for ANTS and its subsidiaries and upon monthly data for all other operations.

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

(3) Loans and advances to customers includes non-performing loans. See "— Analysis of Allowance for Lending Losses" and "— Potential Credit Risk Elements in Lendings" below.

(4) Demand deposits, time deposits and wholesale deposits are defined under "— Deposits" below.

(5) Following an accounting presentation change, Assets and Liabilities under stock borrowing and lending arrangements are no longer shown on balance sheet. Accordingly total average assets and total average liabilities for 1998 and 1997 have been reduced by £13,536 million and £2,341 million respectively.

Interest Rate Sensitivity

Interest rate sensitivity refers to the relationship between interest rates and net interest income resulting from the periodic repricing of assets and liabilities. The largest single administered rate items in the Abbey National Group balance sheet are residential mortgages and retail deposits, the majority of which bear interest at variable rates. The contractual maturity of mortgage loans is generally more than five years but the maturity of the majority of retail deposits are primarily within three months. This apparent mismatch gives rise to issues which are addressed by the Group in its liquidity management (see "Financial Risk Management" below). However, their effect on interest rate management is less significant. Abbey National has the ability to reprice both its retail variable-rate liabilities and variable-rate mortgage assets, subject to the constraints imposed by the competitive situation in the market place. Management believes this ability enables Abbey National to mitigate the impact of interest rate movements on net interest income in U.K. Retail Banking. Abbey National also offers fixed-rate mortgages and savings products on which the interest rate paid by or to the customer is fixed for an agreed period of time at the start of the contract. Abbey National manages the margin on fixed rate products by the use of derivatives matching the fixed rate maturity profiles. The risk of prepayment is reduced by imposing penalty charges if the customers terminate their contracts early.

Wherever possible, the Group seeks to minimize the risks associated with movements in market prices such as interest rates or exchange rates. However, given the nature of financial activities, a level of market risk is inevitable. Abbey National has developed and implemented structures and systems to manage this market risk exposure. See "Financial Risk Management" below.

Changes in Net Interest Income — Volume and Rate Analysis

The following tables allocate changes in interest income, interest expense and net interest income between changes in volume and changes in rate for the years ended December 31, 1999 and December 31, 1998. Volume and rate variances have been calculated on the movement in the average balances and the change in the interest rates on average interest-earning assets and average interest-bearing liabilities. The variance caused by changes in both volume and rate has been allocated to rate changes.

	1999/1998			1998/1997 (restated)		
	Total change	Changes due to increase/(decrease) in:		Total change	Changes due to increase/(decrease) in: (1)	
		Volume	Rate		Volume	Rate
			(in millions of £)			
Interest income						
Treasury bills and other eligible bills						
U.K.	(56)	(17)	(39)	119	44	75
Non-U.K.	—	—	—	(2)	(1)	(1)
Loans and advances to banks						
U.K.	(45)	91	(136)	281	299	(18)
Non-U.K.	(8)	(3)	(5)	2	1	1
Loans and advances to customers						
U.K.	(379)	510	(889)	617	167	450
Non-U.K.	(4)	5	(9)	3	6	(3)
Lease receivables						
U.K.	(3)	48	(51)	33	12	21
Non-U.K.	—	—	—	—	—	—
Debt securities						
U.K.	(360)	265	(625)	152	416	(264)
Non-U.K.	159	233	(74)	62	63	(1)
Total interest income						
U.K.	(843)	897	(1,740)	1,202	938	264
Non-U.K.	147	235	(88)	65	69	(4)
Total	(696)	1,132	(1,828)	1,267	1,007	260

	1999/1998 Total change	1999/1998 Changes due to increase/(decrease) in: Volume	Rate	1998/1997 (restated) Total change	1998/1997 (restated) Changes due to increase/(decrease) in: (1) Volume	Rate
			(in millions of £)			
Interest expense						
Deposits by banks						
U.K.	(412)	13	(425)	659	641	18
Non-U.K.	8	—	8	(14)	6	(20)
Customer accounts — retail demand deposits						
U.K.	(135)	244	(379)	36	(52)	88
Non-U.K.	12	24	(12)	24	20	4
Customer accounts — retail time deposits						
U.K.	(695)	(405)	(290)	249	210	39
Non-U.K.	(9)	2	(11)	42	28	14
Customer accounts — wholesale deposits						
U.K.	157	352	(195)	(17)	(54)	37
Non-U.K.	10	5	5	(2)	2	(4)
Bonds and medium-term Notes						
U.K.	(199)	195	(394)	(12)	215	(227)
Non-U.K.	(12)	(7)	(5)	3	1	2
Other debt securities in issue						
U.K.	(74)	93	(167)	66	34	32
Non-U.K.	161	194	(33)	(24)	(33)	9
Dated and undated loan capital and other subordinated liabilities						
U.K.	47	110	(63)	22	20	2
Non-U.K.	(5)	(1)	(4)	(1)	(2)	1
Other interest bearing liabilities						
U.K.	30	28	2	33	36	(3)
Non-U.K.	—	—	—	—	—	—
Total interest expense						
U.K.	(1,281)	630	(1,911)	1,036	1,050	(14)
Non-U.K.	165	217	(52)	28	22	6
Total	(1,116)	847	(1,963)	1,064	1,072	(8)
Net interest income before exceptional items	420	285	135	203	(65)	268

(1) The 1998 and 1997 average balance sheets have been restated to separately identify the average balance of other interest bearing liabilities and the interest payable on them.

Deposits

The following tables set forth the average balances of deposits for each of the three years ended December 31, 1999. Average deposits are based on the location of the office in which the deposits are recorded.

	Average: Year ended December 31,		
	1999	1998	1997
	(in millions of £)		
Deposits by banks			
U.K.	29,715	29,507	19,105
Non-U.K.	750	748	650
Total	30,465	30,255	19,755
Customers' accounts (all interest bearing)			
U.K.	55,589	50,671	49,783
Non-U.K.	3,655	3,058	2,178
Total	59,244	53,729	51,961

Customers' Accounts — By Type

	Average: Year ended December 31,		
	1999	1998	1997
	(in millions of £)		
U.K.			
Retail Demand deposits	28,922	23,234	24,559
Retail Time deposits	16,654	22,420	19,353
Wholesale deposits	10,013	5,017	5,871
	55,589	50,671	49,783
Non-U.K.			
Retail Demand deposits	1,298	848	445
Retail Time deposits	2,027	2,000	1,552
Wholesale deposits	330	210	181
	3,655	3,058	2,178
Total	59,244	53,729	51,961

Substantially all retail demand deposits and retail time deposits are obtained through, and administered by, the U.K. Retail Banking branch network. In addition, retail demand and time deposits are obtained outside the U.K., principally through the Jersey operations of Wealth Management. They are all interest-bearing and interest rates are varied from time to time in response to competitive conditions. Demand deposits largely consist of passbook based accounts whose balances are available on demand. The category also includes ISAs, checking accounts, remote access accounts, such as Direct Saver and Postal accounts, and a number of other accounts which are passbook based but which allow the customer a limited number of notice-free withdrawals per year depending on the balance remaining in the account. These accounts are treated as demand deposits because the entire account balance may be withdrawn on demand without penalty as one of the notice-free withdrawals.

The main constituents of retail time deposits are notice accounts which require customers to give notice of an intention to make a withdrawal and bond accounts which have a minimum deposit requirement. In each of these accounts early withdrawal incurs an interest penalty. This category also includes TESSAs which provide a tax-free return if held for five years. Investment limits are set by the U.K. Government, with early withdrawal leading to a loss of tax-free status and an interest penalty.

Wholesale deposits are those which either are obtained through the London money markets or for which interest rates are quoted on request rather than being publicly advertised. These deposits are of fixed maturity and bear interest rates which reflect the inter-bank money market rates.

Short-term Borrowings

The following tables set forth certain information regarding short-term borrowings (composed of deposits by banks, commercial paper and negotiable certificates of deposit) for each of the three years ended December 31, 1999. While deposits by banks are reported in the "Deposits" section above, they are also shown under "Short-term borrowings" because of their importance as a source of funding to the Group.

Deposits by Banks

	Year ended December 31,		
	1999	**1998**	**1997**
	(in millions of £, except percentages)		
Year-end balance[(1)]	29,824	35,610	23,814
Average balance[(2)]	30,465	30,255	19,755
Maximum balance	35,610	37,879	24,816
Average interest rate during year	4.79%	6.15%	6.16%
Year-end interest rate[(3)]	5.05%	5.57%	6.24%

As at December 31, 1999, deposits by foreign banks amounted to £6,965 million (1998: £9,696 million).

Commercial Paper

	Year ended December 31,		
	1999	**1998**	**1997**
	(in millions of £, except percentages)		
Year-end balance	10,082	3,595	4,251
Average balance[(2)]	7,974	3,314	3,502
Maximum balance	10,082	4,555	4,251
Average interest rate during year	4.68%	5.71%	5.53%
Year-end interest rate[(3)]	6.21%	5.28%	5.82%

Commercial paper is issued by the Group generally in denominations of not less than $50,000, with maturities of up to 365 days. Commercial paper is issued by ANTS and Abbey National North America Corporation, a subsidiary of Abbey National.

Included in the above year end balance for 1999 is £5.3 billion (1998: £0.9 billion) in respect of commercial paper issued by Moriarty Limited and Moriarty LLC. Moriarty is a bankruptcy-remote asset-backed commercial paper program sponsored by ANTS. The liabilities (and the assets so funded) are included in the Group balance sheet under U.K. GAAP, but are excluded under U.S. GAAP.

Negotiable Certificates of Deposit

	Year ended December 31,		
	1999	1998	1997
	(in millions of £, except percentages)		
Year-end balance	13,307	13,182	14,229
Average balance(2)	14,078	12,888	12,705
Maximum balance	15,567	16,170	14,903
Average interest rate during year	5.06%	6.09%	5.90%
Year-end interest rate(3)	4.96%	5.99%	6.29%

(1) The year-end deposits by banks balance includes non-interest bearing items in the course of transmission of £262 million (1998: £277 million; 1997: £314 million).

(2) Average balances for 1999, 1998 and 1997 are based upon daily data for ANTS and its subsidiaries and monthly data for all other operations.

(3) Year-end interest rates are weighted averages calculated on amounts outstanding at the applicable year-end.

Certificates of Deposit and Certain Time Deposits

The following table sets forth the maturities of the Group's certificates of deposit and other large wholesale time deposits from non-bank counterparties in excess of £50,000 (or the non-sterling equivalent of £50,000) at December 31, 1999. A proportion of the Group's retail time deposits also exceed £50,000 at any given date; however, the ease of access and other terms of these accounts means that they may not have been in excess of £50,000 throughout 1999. Furthermore, the customers may withdraw their funds on demand upon payment of an interest penalty. For these reasons, no maturity analysis is presented for such deposits. See "— Short-term Borrowings" above for information on amounts and maturities of claims under issues of commercial paper.

	Not more than three months	In more than three months but not more than six months	In more than six months but not more than one year	In more than one year	Total
			(in millions of £)		
Certificates of deposit:					
U.K.	9,280	1,284	1,892	—	12,456
Non-U.K.	851	—	—	—	851
Wholesale time deposits:					
U.K.	7,492	148	201	1,097	8,938
Non-U.K.	335	—	—	12	347
Total	17,958	1,432	2,093	1,109	22,592

As at December 31, 1999, there were an additional £708 million of wholesale deposits which were repayable on demand. All wholesale time deposits exceeded £50,000 as at December 31, 1999.

Securities

The following table sets forth the book and market values of securities as at December 31 for each of the three years indicated. Investment securities are valued at cost, adjusted for the amortization of premiums or discounts to redemption, less provision for any permanent diminution in value. For further information, see Notes 19 and 20 to the Consolidated Financial Statements included elsewhere in this Annual Report.

	1999 Book Value	1999 Market Value (1)	1998 Book Value	1998 Market Value (1)	1997 Book Value	1997 Market Value (1)
			(in millions of £)			
Investment securities[2][3]						
Debt securities:						
U.K. Government	31	31	1,804	1,825	2,323	2,359
U.S. Treasury and other U.S. Government agencies and corporations	2,660	2,648	3,776	3,772	2,978	3,017
Other public sector securities	3,303	3,446	2,945	3,112	5,113	5,460
Bank and building society certificates of deposit	399	400	401	405	257	257
Other issuers[4]:						
Floating rate notes	6,222	6,230	4,934	4,932	2,904	2,896
Mortgage-backed securities	6,897	6,894	8,160	8,128	5,946	5,962
Other asset-backed securities[6]	11,108	10,972	8,728	8,629	4,730	4,728
Other	13,133	13,109	7,889	8,029	8,007	8,158
Shares of common stock and similar securities	248	267	121	164	78	99
Provisions	(72)	—	(46)	—	(27)	—
Sub Total	43,929	43,997	38,712	38,996	32,309	32,936
Other securities[5]						
Debt securities:						
U.K. Government	648	648	335	335	131	131
Other public sector securities	970	970	1,528	1,528	504	504
Bank and building society certificates of deposit	10,506	10,506	9,724	9,724	6,429	6,429
Other Issuers[4]:						
Floating rate notes	15	15	1,251	1,251	587	587
Mortgage-backed securities	45	45	36	36	98	98
Other asset-backed securities	229	229	567	567	1,743	1,743
Other	3,351	3,351	2,170	2,170	4,731	4,731
Shares of common stock and similar securities	47	47	3	3	5	5
Sub Total	15,811	15,811	15,614	15,614	14,228	14,228
Total	59,740	59,808	54,326	54,610	46,537	47,164

(1) There are hedges in place in respect of certain securities where the rise or fall in their market value will be offset by a substantially equivalent reduction or increase in the value of the hedges.

(2) Investment securities include government securities held as part of the Group's treasury management portfolio for asset/liability management, liquidity and regulatory purposes and are for use on a continuing basis in the activities of the Group. In addition, the Group holds as investment securities listed and unlisted corporate securities. As at December 31, 1999, most of the Group's securities portfolio was held through ANTS. A substantial majority of ANTS' securities portfolio was rated AA– or better (or the equivalent) by one or more Rating Organizations.

(3) Abbey National complies with the requirements of Statement of Financial Accounting Standard 115 on "Accounting for Certain Investments in Debt and Equity Securities." Under this standard the majority of investments classified as investment securities are classified as "available for sale" securities and reported at fair value at December 31, 1999, with unrealized gains and losses reported in a separate component of shareholders' funds. Further details are provided in Note 54 to the Consolidated Financial Statements included elsewhere in this Annual Report.

(4) As at December 31, 1999, 91% of other issuers constituted securities issued or guaranteed by banks or other financial institutions.

(5) Other securities comprise securities held for trading purposes and securities used for the stock borrowing and lending business. These securities are carried at market value.

(6) This includes a portfolio of asset backed securities managed by ANTS on behalf of Moriarty and its associated companies. See "Short Term Borrowings – Commercial Paper" included elsewhere in this Annual Report.

A description of the characteristics of the securities held under each of the subcategories of securities in the table above is provided below.

U.K. Government Securities

The holdings of U.K. government securities ("gilts") are primarily at fixed rates. Abbey National's assets and liabilities are predominantly floating rate (as described under "Financial Risk Management — Market Risk" below) which is used as the benchmark for risk management. Fixed-rate securities (including gilts) are generally hedged into floating rate, on either an individual or an aggregate basis within the overall management of the appropriate book.

U.S. Treasury and Other U.S. Government Agencies and Corporations

This category comprises U.S. Treasury securities, mortgage-backed securities ("MBSs") issued or guaranteed by the U.S. Government National Mortgage Association, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation (collectively, "Agency MBSs").

The MBSs are predominantly adjustable rate securities. Any fixed-rate securities are hedged by instruments of a short duration, generally on an aggregate basis within the fixed-rate dollar MBS investment portfolio.

Specific risks from investing in dollar MBSs relate to embedded options within the securities including prepayment options and periodic or absolute caps. Prepayment risk arises from uncertainty about the rate at which early repayment will take place on the underlying mortgages on which these securitized assets are based. The rate of prepayment is partly related to underlying demographic and economic conditions (for example, the income level of mortgage holders) and partly to current market interest rates. These risks are modelled using scenario analysis and option cover is arranged as appropriate. Specific limits have been developed for prepayments along with the range of other risks; these risks are included within the set of limits comprising the Treasury Mandate (the framework for managing Wholesale Banking's market risks) as described more fully under "Financial Risk Management" below.

Other Public Sector Securities

This category comprises issues by governments other than the U.S. and U.K. governments, issues by supranationals and issues by U.K. public sector bodies. These are a mixture of fixed-rate and floating-rate securities.

Bank and Building Society Certificates of Deposit

Bank and building society certificates of deposit are fixed-rate securities with relatively short maturities. These are managed within the overall position for the relevant book.

Other Issuers : Floating-Rate Notes

Floating-rate notes have simple risk profiles and are either managed within the overall position for the relevant book or are hedged into one of the main currencies.

Other Issuers : Mortgage-backed Securities

This category comprises U.S. MBSs (other than Agency MBSs) and European MBSs. The non-Agency MBSs have similar characteristics to the Agency MBSs discussed above and are managed along with the Agency MBSs for market risk purposes. European MBSs have prepayment risks but few have cap features.

Other Issuers : Asset-backed Securities

This category comprises a range of mostly floating-rate asset-backed securities including home equity loans, commercial mortgages, auto, dealer, lease and credit card receivables and student loans. A number of the credit card receivables incorporate cap features.

Other Issuers : Other Securities

This category comprises mainly synthetic floating-rate notes (which are fixed-rate bonds packaged into floating rate by means of swaps tailored to provide an exact match to the characteristics of the underlying bond), along with a number of structured transactions which are hedged, as appropriate, either on an individual basis or as part of the overall management of the books. The synthetic floating-rate notes comprise bonds issued by banks, financial institutions and corporations, the latter being largely guaranteed by banks and financial institutions.

The following table sets forth the maturities and weighted average yields of investment securities at December 31, 1999.

	Maturing within one year:		Maturing after one but within five years:		Maturing after five years but within ten years:		Maturing after ten years:		Total	
	Amount	**Yield (1)**	**Amount**	**Yield (1)**	**Amount**	**Yield (1)**	**Amount**	**Yield (1)**	**Amount**	**Yield (1)**
					(in millions of £, except percentages)					
U.K. Government	—	—	23	5.12	8	9.00	—	—	31	6.15
U.S. Treasury and other U.S. Government agencies and corporations(2)	121	5.05	169	5.76	245	6.38	2,125	6.79	2,660	6.60
Other public sector securities	272	6.00	1,971	5.16	1,060	7.35	—	—	3,303	5.94
Bank and building society certificates of deposit	393	5.50	6	6.47	—	—	—	—	399	5.52
Other issuers(2)	1,331	5.22	11,780	6.01	7,826	6.21	16,423	6.57	37,360	6.46
Sub-total	2,117	5.36	13,949	5.88	9,139	6.35	18,548	6.59	43,753	6.42
Shares of common stock(3)	—		—		—		248		248	
Total book value before provisions	2,117		13,949		9,139		18,796		44,001	
Provisions									(72)	
Total book value									43,929	
Total market value	2,154		14,064		9,004		18,775		43,997	

(1) The weighted average yield for each range of maturities is calculated by dividing the annualized interest income prevailing at December 31, 1999 by the book value of securities held at that date.

(2) Included within U.S. Treasury and other U.S. Government agencies and corporations and Other issuers are a number of asset-backed securities. These securities are classified in the table according to their contractual maturity dates; however, redemption of these securities is expected on average to take place between four and ten years from date of issue. As with the underlying assets, asset-backed securities involve prepayment risks; however, the Group's exposure to this type of risk is significantly reduced due to the high proportion of floating rate assets in this category. A further explanation of the Group's risk management and hedging strategy is set out under "Financial Risk Management" below.

(3) Shares of common stock by their nature do not permit the calculation of yields which are meaningful in the same way as yields on debt securities; accordingly, these are omitted.

The following table sets forth the book and market values of those securities of individual counterparties where the aggregate amount of those securities exceeded 10% of Abbey National's shareholders' funds at December 31, 1999.

	Book Value	**Market Value**
	(in millions of £)	
Republic of Italy	2,758	2,843
U.S. Treasury	2,297	2,277
Deutsche Bank AG Group	1,729	1,716
Dresdner Bank AG Group	1,077	1,076
Bank of Scotland Group	1,065	1,065
European Investment Bank	948	948
Halifax Plc	929	900
Westdeutsche Landesbank Girozentrale Group	862	862
U.K. Government	679	679
The Royal Bank of Scotland Group plc	677	619
Bayerische Hypotheken-und Vereinsbank	666	667
Bank One Corporation	646	622
Asian Development Bank	644	617

For the purposes of determining the above, shareholders' funds amounted to £6,078 million at December 31, 1999.

Loans and Advances to Banks

Loans and advances to banks includes loans to banks and building societies and balances with central banks (excluding those balances which can be withdrawn on demand).

The geographical analyses of loans and advances presented in the following table are based on the location of the office from which the lendings are made.

Loans and Advances to Banks

	Year ended December 31,				
	1999	1998	1997	1996	1995
	(in millions of £)				
U.K.	11,216	7,054	7,883	2,449	2,921
Non-U.K.	256	374	388	376	658
Total	11,472	7,428	8,271	2,825	3,579

The following tables set forth loans and advances to banks by maturity and interest rate sensitivity at December 31, 1999.

Maturity Analysis of Loans and Advances to Banks

	On demand	In not more than three months	In more than three months but not more than one year	In more than one year but not more than five years	In more than five years	Total
	(in millions of £)					
U.K.	4,816	5,524	217	470	189	11,216
Non-U.K.	126	119	—	11	—	256
Total	4,942	5,643	217	481	189	11,472

Interest Rate Sensitivity of Loans and Advances to Banks

	Fixed rate	Variable rate	Total
	(in millions of £)		
Interest-bearing loans and advances to banks:			
U.K.	6,730	4,227	10,957
Non-U.K.	177	79	256
	6,907	4,306	11,213
Items in the course of collection (non-interest bearing)			
U.K.			259
Non-U.K.			—
			259
Total			11,472

Loans and Advances to Customers

The Group provides lending facilities primarily to personal customers in the form of mortgages secured on residential properties and in the form of consumer credit and also provides finance lease facilities and a limited number of lending facilities to corporate customers.

The geographical analyses of loans and advances presented in the following table are based on the location of the office from which the lendings are made.

Loans and Advances to Customers

	Year ended December 31,				
	1999	1998	1997	1996	1995
	(in millions of £)				
U.K.					
Advances secured on residential properties	63,693	62,338	61,023	59,561	47,987
Purchase and resale agreements	77	749	701	—	—
Other secured advances	2,539	2,018	449	1,094	579
Corporate lending	3,780	1,402	1,046	571	471
Unsecured personal lending	4,724	5,009	2,843	2,346	1,228
Finance lease receivables	5,420	5,296	4,626	4,279	2,804
	80,233	76,812	70,688	67,851	53,069
Non-U.K.					
Advances secured on residential properties	1,270	1,071	1,025	922	950
Other secured advances	115	143	189	255	348
Unsecured lending	103	92	59	12	10
Finance lease receivables	21	30	29	31	40
	1,509	1,336	1,302	1,220	1,348
Total	81,742	78,148	71,990	69,071	54,417

No single concentration of lendings, with the exception of advances secured on residential properties in the United Kingdom, as disclosed above, accounts for more than 10% of Group lendings and no individual country, other than the United Kingdom, accounts for more than 5% of total Group lendings.

The following tables set forth loans and advances to customers by maturity and interest rate sensitivity at December 31, 1999. In the maturity analysis, overdrafts are included in the "On demand" category. Advances secured by residential properties are included in the maturity analysis at their stated maturity; however, such advances may be repaid early. Abbey National's mortgage loans currently have an average life of 6 years depending on, among other factors, housing market conditions.

Maturity Analysis of Loans and Advances to Customers

	On demand	In not more than three months	In more than three months but not more than one year	In more than one year but not more than five years	In more than five years	Total
			(in millions of £)			
U.K.						
Advances secured on residential properties	1,984	948	868	4,142	55,751	63,693
Purchase and resale agreements	8	69	—	—	—	77
Other secured advances	95	113	347	1,858	126	2,539
Corporate lending	1,039	1,549	244	153	795	3,780
Unsecured personal lending	409	663	1,439	2,045	168	4,724
Finance lease receivables	—	167	381	657	4,215	5,420
Total U.K.	3,535	3,509	3,279	8,855	61,055	80,233
Non-U.K.						
Advances secured on residential properties	43	19	59	310	839	1,270
Other secured advances	63	2	6	24	20	115
Unsecured lending	3	4	29	67	—	103
Finance lease receivables	—	1	2	9	9	21
Total Non-U.K.	109	26	96	410	868	1,509
Total	3,644	3,535	3,375	9,265	61,923	81,742

Interest Rate Sensitivity of Loans and Advances to Customers

	Fixed rate	Variable rate	Total
		(in millions of £)	
U.K.	23,221	57,012	80,233
Non-U.K.	420	1,089	1,509
Total	23,641	58,101	81,742

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 "Derivatives — Non-Trading Derivatives" below for further information.

Allowances for Lending Losses

The Group's provisioning policy is in accordance with U.K. industry best practice as expressed in the British Bankers' Association Statement of Recommended Practice on Advances. A substantial proportion of the Group's allowances for lending losses relates to loans and advances secured by a first charge on residential property in the United Kingdom. For such loans, the Group's provisioning policy is as follows:

Suspended interest — loans are deemed to be impaired or non-performing when they are 90 days overdue. Interest continues to be debited to all impaired loans. The homogeneous nature of the loans, together with the size of the loan portfolio, permits a reasonably accurate estimate to be made of the amount of this interest for which eventual recovery is doubtful. This amount is omitted from the profit and loss account and placed in suspense. Interest is no longer accrued when it is determined that there is no realistic prospect of recovery.

Specific allowance — a specific allowance is established for all impaired loans where it is likely that some of the capital will not be repaid or recovered through enforcement of security. All loans over three contractual payments in arrears are considered to be impaired and an assessment of the likelihood of collecting the principal of these loans is made. This assessment is made using statistical techniques developed based on previous experience and on management judgement of economic conditions. These techniques estimate the propensity of loans to become repossessions and to result in losses.

General allowance — a general allowance is established to cover losses which are from experience known to exist at the balance sheet date but which have not yet been identified as impaired. The general allowance is determined using management judgment given past loss experience, lending quality and economic prospects, and is supplemented by formulaic calculations which corroborate the conclusions reached.

Amounts charged off — losses are charged-off when it becomes certain how much is not going to be recovered either from repayment, from realizing the security, or from claiming on any mortgage indemnity guarantee insurance. This charge-off, which is determined on a case-by-case basis, is made when the security has been realized, and since the values can then be calculated with some certainty, the instances for further charge-offs or recoveries are minimal. The charge-off policy is regularly reviewed to assist in determining the adequacy of allowances.

Security is realized in accordance with Abbey National's internal debt management program. Contact is made with customers at an early stage of arrears with counseling made available to achieve a realistic and sustainable repayment arrangement. Litigation and/or enforcement of security is usually carried out only when the steps described above have been undertaken without success.

A similar provisioning policy is applied to other categories of loans and advances that comprise a large number of small, relatively homogenous advances e.g. unsecured personal lending.

As a result of the charge-off policy, the allowances may be made a significant time in advance of the related charge-off. This is particularly the case for the other secured advances category which consists largely of loans secured on commercial properties. The complexity of the legal proceedings to take possession and the depressed state of the commercial property markets in Continental Europe mean that, although the likely losses have been identified and appropriate allowances made on a case-by-case basis, a smaller proportion of losses have been determined precisely and have been charged off compared to other classes of lending. Abbey National's new commercial property lending has ceased in both the U.K. and France.

Analysis of End of Year Allowances for Lending Losses

	1999	1998	1997	1996	1995
	(in millions of £)				
Specific					
Advances secured on residential properties — U.K.	64	91	85	127	124
Other secured advances — U.K.	50	50	56	112	86
Unsecured personal lending — U.K.	160	136	109	89	71
Advances secured on residential properties — Non-U.K.	12	15	15	18	24
Other secured advances — Non-U.K.	47	68	74	90	108
Unsecured personal lending — Non-U.K.	3	2	1	3	4
Total specific allowances	336	362	340	439	417
General					
Advances secured on residential properties — U.K.	128	107	81	64	39
Other secured advances — U.K.	18	18	6	6	3
Unsecured personal lending — U.K.	38	67	20	17	14
Advances secured on residential properties — Non-U.K.	3	2	3	3	4
Other secured advances — Non-U.K.	5	5	7	5	6
Unsecured personal lending — Non-U.K.	1	—	—	—	—
Total general allowances	193	199	117	95	66
Total allowances	529	561	457	534	483

Ratios	(percentages)				
Allowances at the year end as a percentage of year-end loans and advances to customers					
Advances secured on residential properties — U.K.	0.30	0.32	0.27	0.32	0.34
Other secured advances — U.K.	2.64	3.37	13.81	10.79	15.37
Unsecured personal lending — U.K.	4.19	4.05	4.54	4.52	6.92
Advances secured on residential properties — Non-U.K.	1.18	1.68	1.76	2.28	2.95
Other secured advances — Non-U.K.	45.28	51.05	42.86	37.25	32.76
Unsecured personal lending — Non-U.K.	3.89	2.17	1.69	25.00	40.00
Total loans and advances to customers	0.69	0.77	0.69	0.82	0.94
Amounts charged off (net of recoveries)(1)	0.43	0.26	0.28	0.27	0.26
Percent of loans in each category to total loans					
Advances secured on residential properties — U.K.	77.92	79.77	84.77	86.23	88.18
Purchase and resale agreements — U.K.	0.09	0.96	0.97	0.00	0.00
Other secured advances — U.K.	3.10	2.58	0.62	1.58	1.06
Corporate lending — U.K.	4.63	1.79	1.45	0.83	0.87
Unsecured personal lending — U.K.	5.78	6.41	3.95	3.40	2.26
Finance lease receivables — U.K.	6.63	6.78	6.43	6.20	5.15
Advances secured on residential properties — Non-U.K.	1.55	1.37	1.43	1.33	1.75
Other secured advances — Non-U.K.	0.14	0.18	0.26	0.37	0.64
Unsecured lending — Non-U.K.	0.13	0.12	0.08	0.02	0.02
Finance lease receivables — Non-U.K.	0.03	0.04	0.04	0.04	0.07

(1) Amounts charged off (net of recoveries) ratio as a percentage of average loans and advances to customers excluding finance leases.

Movements in Allowances for Lending Losses

	1999	1998	1997	1996	1995
	(in millions of £)				
Allowances at the beginning of the year	561	457	534	483	361
Acquisition of subsidiary undertakings	—	86	—	101	162
	561	543	534	584	523
Amounts charged off — net of recoveries					
Advances secured on residential properties — U.K.	(38)	(28)	(44)	(75)	(58)
Other secured advances — U.K.	(46)	(38)	(53)	(13)	(5)
Unsecured personal lending — U.K.	(224)	(108)	(75)	(52)	(24)
	(308)	(174)	(172)	(140)	(87)
Advances secured on residential properties — Non-U.K.	(2)	(1)	(2)	(5)	(14)
Other secured advances — Non-U.K.	(13)	(5)	(9)	(10)	(27)
Unsecured lending — Non-U.K.	(1)	—	(3)	—	—
Total amounts charged off	(324)	(180)	(186)	(155)	(128)
Specific provisions charged against income					
Advances secured on residential properties — U.K.	12	33	1	31	53
Other secured advances — U.K.	49	1	(2)	4	5
Unsecured personal lending — U.K.	209	134	95	57	21
	270	168	94	92	79
Advances secured on residential properties — Non-U.K.	—	2	1	2	2
Other secured advances — Non-U.K.	1	2	3	9	4
Unsecured lending — Non-U.K.	2	1	—	—	1
	3	5	4	11	7
Total specific provisions charged against income	273	173	98	103	86
General provisions charged against income	30	28	23	24	(14)
Exchange and other adjustments	(11)	(3)	(12)	(22)	16
Allowances at the end of the year	529	561	457	534	483

Total allowances for lending losses, at £529 million, are 6% lower than in 1998 (£561 million) due to a combination of lower arrears as a result of continuing improvement in economic conditions and improved debt management procedures.

Allowances on U.K. advances secured on residential properties have remained relatively constant at 0.30% of the total portfolio as the benefit of improved arrears and increased house prices has been largely offset by asset growth and an increase in the level of general provision. The ratio for non-U.K. has improved steadily due to continuing improvement in arrears in both France and Italy.

Allowances on other U.K. secured advances as a percentage of the total portfolio have remained at levels similar to 1998 as the additional allowances required due to asset growth have been largely offset by amounts charged off within Finance House.

Other non-U.K. secured allowances as a percentage of the total portfolio have reduced since 1998 due to an increase in amounts charged off in France in respect of certain historic commercial lending.

Unsecured personal lending allowances as a percentage of the total portfolio have remained at similar levels to 1998 as improvements in arrears and debt management processes have been offset by the continued growth in personal banking products and unsecured personal loans.

Interest in Suspense

	1999	1998	1997	1996	1995
			(in millions of £)		
Interest in suspense at the beginning of the year	150	181	197	183	136
Acquisition of subsidiary undertakings	—	1	—	46	58
Net interest suspended during the year	26	47	35	49	66
	176	229	232	278	260
Interest written off	(51)	(84)	(42)	(65)	(87)
Exchange and other adjustments	(11)	5	(9)	(16)	10
Interest in suspense at the end of the year	114	150	181	197	183

Potential Credit Risk Elements in Lendings

U.S. banks typically stop accruing interest when loans become overdue by 90 days or more, or when recovery is doubtful. In accordance with the U.K. British Bankers' Association Statement of Recommended Practice on Advances, Abbey National continues to charge interest for collection purposes, where appropriate, to accounts whose recovery is in doubt, but the interest is suspended as it accrues and is excluded from interest income in the profit and loss account. This suspension of interest continues until such time as its recovery is considered to be unlikely at which time the advance is written off. While such practice does not affect net income in comparison with the practice followed in the United States, it has the effect of increasing the reported level of potential credit risk elements in lendings. The amount of this difference as at December 31, 1999 was £114 million. Other than for the net interest suspended during the year, interest income in the income statement is the same as would have been credited if all loans had been current in accordance with their original terms. The amount of this difference for the year ended December 31, 1999 was £26 million.

The following table presents the potential credit risk elements in Group lendings. Additional categories of disclosure are included, however, to record lendings where interest continues to be accrued and where either interest is being suspended or specific provisions have been made. Normal U.S. banking practice would be to place such lendings on non-accrual status. However, as at December 31, 1999, 1998 and 1997 there was a small amount of loan assets placed on non-accrual status within the Group, including amounts within First National Finance Corporation, where such treatment is viewed as more appropriate given the nature of the business and the particular circumstances of the loans. The amounts are stated before deductions of the value of security held and the specific allowances provided or interest suspended.

The Group has no loans that constitute "troubled debt restructurings" as defined in Statement of Financial Accounting Standards, No. 15.

Group Non-Performing Lendings

	1999	1998	1997	1996	1995
	(in millions of £, except percentages)				
Accruing lendings on which a proportion of interest has been suspended and/or on which specific allowance has been made:					
U.K.	789	985	707	816	738
Non-U.K.	149	199	185	218	274
	938	1,184	892	1,034	1,012
Accruing lendings 90 days overdue on which no interest has been suspended and on which no specific allowance has been made:					
U.K.	1,100	1,334	1,214	1,382	1,517
Non-U.K.	11	1	2	3	4
	1,111	1,335	1,216	1,385	1,521
Non-accruing lendings:					
U.K.	103	107	130	203	151
Non-U.K.	42	63	78	109	138
	145	170	208	312	289
Total non-performing lendings:					
U.K.	1,992	2,426	2,051	2,401	2,406
Non-U.K.	202	263	265	330	416
	2,194	2,689	2,316	2,731	2,822
Non-performing lendings as a percentage of loans and advances to customers excluding finance leases	2.90%	3.69%	3.44%	4.22%	5.47%
Allowances as a percentage of total non-performing lendings	24.11%	20.86%	19.73%	19.55%	17.12%

Overall, non-performing lendings as a percentage of loans and advances to customers excluding finance leases has reduced from 3.69% to 2.90% due to a continued improvement in arrears across all categories of advance due to a combination of favourable economic conditions and improved debt management procedures on unsecured lending.

Allowances as a percentage of total non-performing lendings have increased from 20.86% to 24.11%. This increase was principally due to the lower levels of arrears at the end of the year. This continued improvement in arrears led to a reduction in the amount of specific allowance required, however, this was largely offset by increases in the level of general allowances on advances secured on residential property, which increased in line with the growth in the asset. As a result, total allowances were not reduced in proportion to the reduction in non-performing lendings.

Potential problem lendings

The large number of relatively homogeneous residential mortgage loans has enabled the Group to develop statistical techniques to estimate capital and interest losses with reasonable accuracy.

These techniques are used to establish the amount of allowances for loan losses and interest suspensions. In addition, Abbey National's policy of initiating prompt contact with customers in arrears, together with the nature of the security held, means that a significant proportion of non-performing loans will not result in a loss to the Group.

The categories of non-performing lendings which are statistically most likely to result in losses are cases from 6 months to 12 months in arrears and 12 months or more in arrears. Losses on cases for which the property securing the loan has been taken into possession are evaluated on a case-by-case basis with the amounts expected to be lost on realization of the security being established with a high degree of certainty. The following table sets forth the values for each of these categories included in the non-performing lendings table above for each of the last five years.

	1999	1998	1997	1996	1995
			(in millions of £)		
6 months to 12 months in arrears	466	578	512	618	636
12 months or more in arrears	297	348	293	434	419
Properties in possession	80	102	112	139	207

Country Risk Exposure

The Group does not have any exposure to countries currently experiencing liquidity problems.

Cross Border Outstandings

The operations of Abbey National involve significant operations in non-local currencies. These cross border outstandings are controlled through a well-developed system of country limits, which are frequently reviewed to avoid concentrations of transfer, economic or political risks.

Cross border outstandings, which exclude finance provided within the Group, are based on the country of domicile of the borrower or guarantor of ultimate risk and comprise loans and advances to customers and banks, finance lease receivables, interest-bearing investments and other monetary assets denominated in currencies other than the borrower's local currency, but exclude balances arising from off-balance sheet financial instruments.

At December 31, 1999, the country where cross border outstandings exceeded 1% of adjusted assets (as defined below) was the United States and consisted substantially of balances with banks and other financial institutions and governments and official institutions. In this context, adjusted assets are total assets, as presented in the consolidated balance sheet, excluding long-term insurance fund assets and balances arising from off-balance sheet financial instruments. On this basis, adjusted assets amounted to £161.8 billion as at December 31, 1999 compared to £148.3 billion as at December 31, 1998 and £133.4 billion as at December 31, 1997.

Cross Border Outstandings Exceeding 1% of Adjusted Assets

	As % of adjusted assets (restated) (1)	Total	Banks and other financial institutions	Governments and official institutions	Commercial, industrial and other private sector
		(in millions of £, except percentages)			
At December 31, 1999:					
United States	1.26	2,046	1,127	39	880
At December 31, 1998:					
France	1.24	1,840	1,821	19	—
Germany	1.13	1,671	1,503	—	168
United States	1.25	1,854	1,046	—	808
At December 31, 1997:					
France	1.25	1,663	1,644	19	—
Germany	1.36	1,809	1,636	—	173
Japan	1.35	1,804	1,720	25	59
United States	2.46	3,287	2,232	—	1,055

(1) Following a change in accounting policy, stock lending and borrowing arrangements are no longer reported on-balance sheet. The effect on the percentages reported in 1998 for France, Germany, Japan and the U.S. was to increase the reported percentages to those reported above from 1.13% (1997: 1.19%), 1.02% (1997: 1.29%), 0% (1997: 1.29%) and 1.13% (1997: 2.35%) respectively.

Cross Border Outstandings Between 0.75% and 1% of Adjusted Assets

As at December 31, 1999 the Group had aggregate cross border outstandings with Germany of 0.84%, Japan of 0.84% and Hong Kong of 0.76% of adjusted assets with aggregate outstandings of £1,359 million, £1,366 million and £1,226 million respectively.

As at December 31, 1998, the Group had aggregate cross border outstandings with Japan of 0.83% of adjusted assets with aggregate outstandings of £1,233 million. At December 31, 1997 the Group had no aggregate cross border outstandings between 0.75% and 1% of adjusted assets.

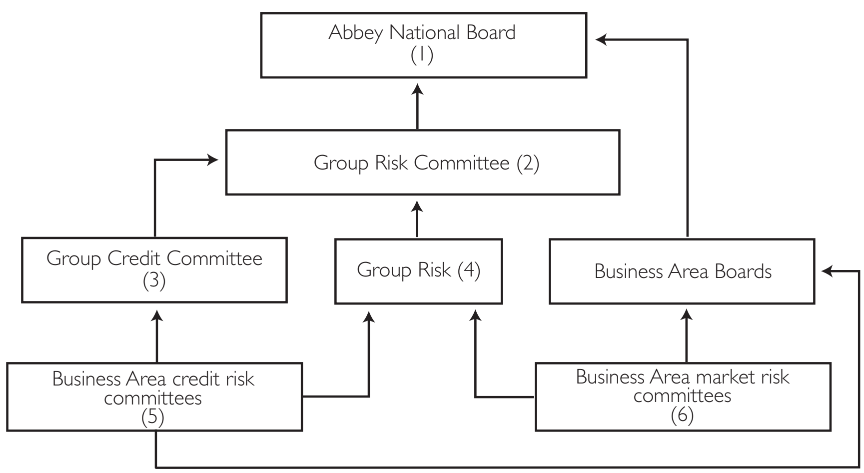
FINANCIAL RISK MANAGEMENT

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 Group Risk Committee ("GRC"), formerly known as 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.

Management Structure

The following chart shows the interrelationship of those of the Group's boards and committees that deal with risk management.



(1) Approves and authorizes overall Group market risk and credit policies.

(2) Monitors and controls the level of financial risk of the Group.

(3) Monitors and reviews credit exposure and recommends Group credit policies to the GRC for approval.

(4) The independent risk function is responsible for ensuring that policies and mandates are established for the Group as a whole. The department monitors and reports Group risk positions to the Board, sets standards for financial risks and data integrity and ensures that the financial risks are fully considered in the planning process.

(5) Approves credit transactions within mandates authorized by GCC. Business Area credit risk committees include Retail Credit Committee, ANTS Board Credit Committee, Treasury Credit Committee and credit committees of other business areas generating material credit risks.

(6) Authorizes dealer mandates and monitors market risk exposures against limits agreed by GRC and business area boards. Business Area market risk committees include Retail Pricing & Risk Committee, ANTS' Market Risk Committee and market risk committees of other business areas generating material market risks.

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 loans and investment assets, and in derivative contracts.

Managing Credit Risk in U.K. Retail Banking

Secured Lending. Abbey National lends on many types of property but only after a credit risk assessment of the borrower and an assessment of the property is undertaken. The systems used to manage and monitor the quality of the mortgage asset are under continual review within the Group.

The majority of residential lending is subject to National Lending Policy and National Lending Authority Levels which are used to structure lending decisions to the same high standard across the retail network, a process further improved by the addition of mortgage credit scoring. Details concerning the prospective borrower and the mortgage are subject to a criteria-based decision making process including credit references, loan to value ratio, status and loan size information and mortgage credit scoring.

The majority of loans provided by Abbey National are secured on U.K. properties. All properties must be permanent in construction; mobile homes, riverboats and commercial property are not generally acceptable. Abbey National can provide a mortgage for the purchase of properties outside the U.K., where the property is a second home and the loan is secured on the main property located in the U.K., or where Abbey National operates a European Branch or Subsidiary. Abbey National introduced a euro mortgage in 1999 where the loan and repayments are denominated in euros, although the property used as security may be in the U.K..

Prior to granting any loan on a property, Abbey National has the property valued by an approved and qualified surveyor who is often an Abbey National employee. The valuation is based on set Abbey National guidelines.

The basic advance value is 75% of the lower of the valuation or the purchase price of the property. All loans in excess of this loan-to-value ("LTV") ratio require additional security which is usually in the form of mortgage indemnity guarantee insurance. This provides insurance cover to the lender. The maximum LTV ratio is usually no more than 95% where the maximum loan is £250,000. In common with experience throughout the U.K. mortgage market, Abbey National has a considerable number of customers who wish to provide the minimum deposit. As a result, a substantial portion of new lending has an LTV ratio above 90%.

Mortgage Indemnity Guarantee Insurance ("MIG") and High Loan to Value Fee. MIG insurance is an agreement between a lender and an insurance company to underwrite the amount of every mortgage advance which exceeds the lender's basic advance LTV ratio (for Abbey National, an LTV ratio above 75%). Abbey National may make a charge to the customer in this connection, typically where the advance LTV ratio is at or above 90%.

The MIG insurance arrangements for Abbey National are as follows:

- For loans originated prior to 1993, the credit risk on the amount of every mortgage advance which exceeded an LTV ratio of 75% at the time originated are fully insured with third party insurance companies. The expected insurance recovery is taken into account in calculating the allowance for lending losses.
- For loans originated thereafter, Abbey National has obtained significantly all of its MIG insurance from its insurance subsidiary Carfax Insurance Limited ("Carfax"). It is Carfax's policy to reinsure a portion of the credit risk where commercially appropriate. Such reinsurance covers a layer of risk above a level of losses which Carfax believes it can prudently bear itself. At Group level, the only external insurance purchased is the reinsurance purchased by Carfax; accordingly the Group allowance for lending losses includes an allowance for losses insured by Carfax unless reinsurance recovery is expected. The fees charged to the customer to compensate for the additional risk of mortgage advances are deferred and taken to "Other Operating Income" in the profit and loss account to match the expiry of risk or, where the loans become impaired, to match the provisions charge.

Mortgage Arrears and Repossessions. Like other lenders, Abbey National experienced a significant rise in arrears and bad debts in the early 1990s. This was due to falling house prices, high interest rates and the rapid growth in unemployment brought about by the worst recession experienced in the U.K. in recent history. However, as a result of an improvement in economic conditions, and a tightening of controls on lending as described below, Abbey National's performance from 1993 onwards has improved significantly.

- If a mortgage is in arrears for one or two months, action is taken by the centralised mortgage operations site. Initial contact is often made by telephone and professional advisers are available to help resolve any difficulties.

- If the arrears are not cleared, and exceed three months, they are referred to Debt Management Operations for specialist action with the aim of making contact with the borrower to put an acceptable arrangement in place.
- If the arrangement is not maintained, legal proceedings may be taken which may result in the property being taken into possession. Abbey National sells the repossessed property at market price and uses the sale proceeds less costs to pay off the outstanding value of the loan previously secured by the property. The number of repossessed properties held by Abbey National varies according to the number of new possessions and the buoyancy of the housing market.

Abbey National's stock of repossessed properties in the U.K. Retail Banking segment decreased from 2,070 properties at December 31, 1998 to 1,783 at December 31, 1999.

The following table sets forth information on U.K. residential mortgage arrears and properties in possession as at December 31, 1999, 1998 and 1997 for Abbey National.

	Abbey National	**CML**
	(percentage of total mortgage loans by number)	
6 months to 12 months in arrears		
December 31, 1997	0.72	0.69
December 31, 1998	0.83	0.68
December 31, 1999	0.70	0.52
12 months or more in arrears		
December 31, 1997	0.28	0.42
December 31, 1998	0.37	0.32
December 31, 1999	0.31	0.27
Properties in possession		
December 31, 1997	0.13	0.13
December 31, 1998	0.14	0.13
December 31, 1999	0.12	0.10

Abbey National figures shown above exclude the Finance House. These subsidiaries account for 3% of the Group's total U.K. residential mortgage assets.

Bank Account and Unsecured Personal Lending. Abbey National uses many systems and processes to manage the risks involved in providing unsecured personal loans, overdraft lending on bank accounts and customer borrowing on the credit card product. These include regular monitoring of the quality of the unsecured lending portfolio and associated scorecards and the use of credit scoring and behavioral scoring systems to assist in the granting of credit facilities on these products.

Behavioral scoring examines all the relationships that a customer has with Abbey National and how the customer uses their bank account or credit card. This information generates a score which is used to assist in deciding the level of risk (in terms of overdraft facility amount, preferred unsecured personal loan value, and credit card facility limit amount), that the Group wishes to be exposed to for each customer. Individual customer scores are normally updated on a monthly basis.

Abbey National has successfully extended the use of behavioral scoring into other areas of the business, including the refinement of bad debt collection, bank account transaction processing and the upgrade strategy for Instant Plus customers to full banking facilities.

Managing Credit Risk in Finance House

Since acquisition in 1995, when First National Bank was brought into the Abbey National Group risk control framework, greater emphasis has been placed on the assessment and monitoring of risk. In December 1998, Finance House made a number of acquisitions which have been integrated by accommodating all activities into four distinct divisions: motor, retail, consumer and business.

Finance House activities are generally more risky than those of a residential mortgage lender. This, together with the relative diversity of a Finance House's business requires a system of risk control which is sensitive and close to the business generation, e.g. to monitor intermediaries' credit quality.

The risk management framework reflects this divisional structure and the nature of the advances provided, which are predominantly introduced to the Group by third parties. Each divisional risk management unit is also responsible for ensuring the adoption of elements of best practice within and across Finance House.

The motor finance division provides funds via motor dealers acting as introducers to individuals and businesses. All such arrangements are secured on the vehicle involved. In the course of these operations, advances are also provided to participating dealers. Credit risk management policies are in place which mirror the varying forms of financial products provided by the business, including the use of credit scoring.

The retail division provides unsecured point of sale finance facilities to customers of participating retailers. Various processes are utilised to assess the credit risk associated with such transactions, including credit scoring. In addition, contingent exposure to the retailer arises which is managed via an assortment of methods appropriate to the quality of the retailer and the nature of the exposure.

The consumer division provides secured and unsecured finance arrangements to personal customers. Credit policies pertinent to the product and delivery channel are in place, which include the use of credit scoring.

The business finance division provides a varied range of products to assist with the finance requirements of businesses including leasing, lease purchase, contract hire, invoice finance, property finance and secured loans. Risk management policies are aligned to the new business generation activities of the division and the inherent risks of the specific product set.

Managing Credit Risk in Wholesale Banking. With respect to asset quality in Wholesale Banking, a clear set of credit mandates and policies has been established by GRC which is designed to ensure that a substantial majority of credit exposures are rated AA- or better (or equivalent) by one or more Rating Organizations. All transactions falling within these mandates and policies are scrutinized by the appropriate Treasury Credit Committee. Specific approval is required for all transactions which fall outside these mandates. ANFP operates within Wholesale Banking's overall mandates. The controls over, and risk assumed by, ANFP are closely monitored and tight risk control limits are consistently applied. Analyses of credit exposures and credit risk trends are provided in summary for the ANTS Board each month, and more detailed reports are provided to GCC on a regular basis. Large exposures (as defined by the FSA) are reported monthly internally and quarterly to GRC and the FSA.

Credit risk on derivative instruments is assessed by using scenario analysis to determine the potential future mark-to-market exposure of the instruments at a 95% statistical confidence level and adding this value to the current mark-to-market value. The resulting "loan equivalent" credit risk is then included against credit limits along with other non-derivative exposures.

In addition, a policy framework to enable the collateralization of certain derivative instruments (in particular swaps) has been approved by GCC. If collateral is deemed necessary to reduce credit risk, then the amount and nature of the collateral to be obtained is based upon management's credit evaluation of the customer.

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 U.K. Retail Banking, primarily from the provision of fixed rate and structured mortgage and savings products. Within the Life 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. For a description of the sources of risk see "Derivatives—Non-Trading Derivatives" below.

Abbey National recognizes that market risk is an inevitable result of being an active participant in financial markets. The Group manages its market risk 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 short-term market risks daily and GRC and the Board reviewing the consolidated position at least monthly.

Senior management have recognized 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, the Group uses a sensitivity analysis approach, covering both value and earnings as appropriate, as a central common tool within their risk management process. The market risk disclosures shown below are calculated using a 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 to achieve consistency in measurement across business areas, GRC, at the request of the Board, has approved a series of market risk measurement standards to which business areas are required to adhere.

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

Short Term Market Risk. The category 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. The category 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, out of 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 positions arising, this can only be achieved over a longer time horizon. Although most long-term balance sheet positions are hedged, the Group remains exposed to variances in customer behavior (often caused by market rate movements) impacting new business take-up and early redemption and causing unfavorable 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 1 week to 3 months).

The following table shows the sensitivity based consolidated exposures for the major risk classes run by all Group companies as at December 31, 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, for example, interest rate risks include the impact of absolute rate movements, movements between interest rate bases and movements in implied volatility on interest rate options. 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 potential change in the value of the portfolio over a specified time horizon and within a given confidence interval.

From time to time, losses may exceed the amounts stated where the 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 period in twenty. The Group addresses this risk by monitoring stress testing measures across the different business areas as appropriate.

The figures below are all calculated to a 95% level of confidence and are based upon overnight market movements for short term market risks, and market movements of between one week and three months (as appropriate to the management of the portfolio) for structural market risk positions.

	Exposure as at December 31		Exposure for the year ended December 31					
			Average Exposure		Highest Exposure		Lowest Exposure	
	1999	1998	1999	1998	1999	1998	1999	1998
	(in millions of £)							
Trading Instruments								
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(1)	0.1	0.1	0.3	0.1	0.6	0.2	—	—
Structural Market Risk								
Interest Rate Risks	0.8	—	0.6	—	1.6	—	—	—
Equity Risk	9.8	—	4.8	—	9.8	—	1.2	—
Spread Risks	2.2	5.7	3.1	2.6	5.5	5.7	2.2	1.6

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

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

	Exposure as at December 31		Exposure for the year ended December 31					
			Average Exposure		Highest Exposure		Lowest Exposure	
	1999	1998	1999	1998	1999	1998	1999	1998
	(in millions of £)							
Non-Trading Instruments								
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 Risk	0.6	2.2	1.1	2.4	2.4	3.2	0.3	1.7
Spread Risk	0.8	—	0.2	—	1.1	—	—	—

Trading instruments are held only in Wholesale Banking.

The above sensitivity exposures should not be aggregated, as no account has been taken of the correlation between risk classes.

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 out 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. The figures preceding this change in April 1999 have been restated accordingly.

Managing Market Risk in U.K. Retail Banking. Abbey National is able to mitigate the impact of interest rate movements on net interest income in U.K. Retail Banking by re-pricing separately the administered variable rate mortgages and variable rate retail deposits, subject to competitive pressures. However, to the extent that variable rate assets and liabilities are not precisely matched, the U.K. Retail Banking balance sheet is exposed to changes in the relationship between administered rates and market rates resulting in basis risk exposure included in the table below.

In addition to administered variable rate products, Abbey National has also a significant volume of fixed rate and structured mortgage and savings products. Abbey National has a policy of fully hedging its fixed rate and structured product exposures. Where on-balance sheet mismatches occur between fixed rate mortgage and savings products or where structured products are held, hedging activity is carried out using derivative financial instruments, transacted with ANTS or ANFP, and the related market risks of such contracts are managed within the Treasury Mandate (as defined below). However, during the period of product launches it is not possible to hedge actual volumes exactly and limits on the maximum exposure are maintained during that period. The business also remains exposed to variances from the expected redemption level of fixed rate and structured products by customers in advance of the contractual maturity, with measures and limits in place to control the exposure.

The following table shows the sensitivity based exposures for U.K. Retail Banking as at December 31, 1999 together with the highest, lowest and average exposures for the year. They are all calculated to a 95% level of confidence and are based upon overnight market movements for short term market risks, and market movements of between one month and three months (as appropriate to the management of the portfolio) for structural market risk positions.

			Exposure for the year ended December 31					
	Exposure as at December 31		Average Exposure		Highest Exposure		Lowest Exposure	
	1999	1998	1999	1998	1999	1998	1999	1998
			(in millions of £)					
Non-Trading Instruments								
Short Term Market Risk								
Interest Rate Risks	0.5	0.6	0.6	0.6	1.9	1.3	—	—
Structural Market Risk								
Interest Rate Risks	20.0	9.6	21.0	11.9	28.9	17.0	11.8	8.4
Equity Risks	0.6	—	0.6	0.1	0.9	0.5	—	—

Managing Market Risk in Wholesale Banking. As described under "Selected Statistical Information—Securities" above, Wholesale Banking organizes its investment activities by means of matched currency investment books in a number of currencies. The matching process is achieved either by (i) raising funding directly in the currency of assets or (ii) hedging assets or liabilities mainly through the use of cross-currency swaps.

The Treasury Mandate, approved by both ANTS Board and GRC, specifies the maximum level of market risk that may be taken. This is subject to an annual review, the last of which was undertaken in 1999. The level of risk is monitored against the Treasury Mandate and reported daily to the ANTS executive directors. ANTS operates consistently within the approved limits.

Risk exposures are calculated on individual portfolios with limits placed on the overall level of risk in each portfolio, and on the individual risk types within the portfolio. Typically a combination of value at risk and stress testing measures are used.

The following table sets forth the sensitivity based exposures at 95% confidence levels for the trading and non-trading portfolios within Wholesale Banking as at December 31, 1999 and 1998, together with the highest, lowest and average exposures for those years. The measures are based upon overnight market movements for short term market risks, and market movements of between one week and one month (as appropriate to the management of the portfolio) for structural market risk positions. These numbers are taken from the Group consolidated market risk measurement, and do not take account of correlation between risk factors, or between trading and non-trading portfolios.

	Exposure as at December 31		Exposure for the year ended December 31: Average Exposure		Highest Exposure		Lowest Exposure	
	1999	1998	1999	1998	1999	1998	1999	1998
	(in millions of £)							
Trading instruments								
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	—	—
Structural Market Risk								
Interest Rate Risk	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
Non-Trading Instruments								
Short Term Market Risk								
Interest Rate Risks	0.8	1.0	0.9	1.4	0.9	2.1	0.3	1.0
Structural Market Risk								
Interest Rate Risks	4.4	3.2	3.8	2.1	6.6	4.1	1.3	1.0
Foreign Exchange Risk	0.3	1.5	0.8	1.6	2.1	2.4	0.2	1.0

Managing Market Risk In Other Segments. Other segments also generate market risk exposures, predominantly interest rate risk, in the course of their normal business activities. The most significant areas are as follows:

- fixed rate and structured lending within the Finance House and Continental Europe segments;
- exposures borne by the shareholder from the launch of retail investment products and the management of unit linked business within the Life Insurance segment; and
- the management of long term structural positions within the Group balance sheet.

These risks are controlled in accordance with policies approved by Business Area Boards and reported to GRC.

The following table sets forth the sensitivity based exposures for the major risk classes run by these businesses as at December 31, 1999 and 1998, together with the highest, lowest and average exposures for those years. They are all calculated to a 95% level of confidence and are based upon overnight market movements for short term market risks, and market movements of between one week and three months (as appropriate to the management of the portfolio) for structural market risk positions.

	Exposure as at December 31		Exposure for the year ended December 31					
			Average Exposure		Highest Exposure		Lowest Exposure	
	1999	1998	1999	1998	1999	1998	1999	1998
	(in millions of £)							
Non-trading Instruments								
Short Term Market Risk								
Interest Rate Risks	0.1	0.3	0.3	0.2	0.5	0.3	0.1	0.1
Equity Risks	0.2	—	0.1	—	0.2	—	—	—
Structural Market Risk								
Interest Rate Risks	21.8	2.7	11.0	4.2	26.7	6.8	5.9	2.1
Other Risks	0.3	0.7	0.4	0.7	0.6	1.1	0.2	0.6

Liquidity Risk

Liquidity risk arises across the Group balance sheet. Liquidity is managed on behalf of the Group by Wholesale Banking in accordance with policy guidelines set by the Board and monitored by GRC. 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. Wholesale Banking management focuses on cashflow planning and day-to-day cashflow control, and on balancing the maturity profiles of Wholesale Banking's 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 December 31, 1999 amounted to £281m.

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

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

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

Impact of Repricing Risks on the Group

The interest rate repricing gap information is shown in Note 48 to the Consolidated Accounts.

Non-Trading Activity

A significant part of Abbey National's exposures can be hedged internally by offset against other categories of exposure in the balance sheet. See "Derivatives — Non-Trading Derivatives" below.

DERIVATIVES

Derivative financial instruments ("derivatives") are contracts or agreements whose value is derived from one or more underlying indices or asset values inherent in the contract or agreement. They include interest rate, cross-currency and equity related swaps, forward rate agreements, futures, caps, floors, options and swaptions. Derivatives are used for trading and non-trading purposes.

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 fair values in the balance sheet within Other assets and Other liabilities, with all gains and losses 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. Non-trading derivatives are measured on an accruals basis, equivalent to that used for the asset, liability or position being hedged.

As described under "Financial Risk Management — Management Structure" above, Abbey National has a formal structure for managing risk, comprising limits, reporting lines, mandates and other control procedures. This structure is reviewed regularly by GRC.

In order to manage the market risks arising within the Group, authorized personnel within each subsidiary are able to use specified derivative instruments within mandated limits. The GCC regularly monitors and reviews credit exposures arising in subsidiary companies, and approves all Group credit policies. 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. Other derivatives, where not specifically collateralized, are not subject to such cash requirements.

Risk Management of Derivatives

The control of market risk is usually applied to portfolios in total rather than to the derivatives elements of portfolios in isolation. The use of derivatives is controlled by specific policies and mandates, approved by business area risk committees and GRC. These mandates control the purpose of the portfolio, the instruments which can be included and the maximum amount of exposure which can be taken. For the accounting policy on derivatives, see "Consolidated Financial Statements — Accounting Policies — Derivatives" included elsewhere in this Annual Report.

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 U.K. 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 sets forth certain activities undertaken by the Group, the related risks associated with such activities and provides details of 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.

Activity	Risk	Type of Hedge
Management of the return on variable rate assets funded by shareholders' funds and net non-interest bearing liabilities.	Reduced profitability due to falls in interest rates.	Receive fixed interest rate swaps. Purchase interest rate floors.
Fixed-rate lending.	Sensitivity to increases in interest rates.	Pay fixed interest rate swaps. Purchase interest rate caps.
Fixed-rate retail and wholesale funding.	Sensitivity to falls in interest rates.	Receive fixed interest rate swaps.
Equity-linked retail funding.	Sensitivity to increases in equity market indices.	Receive equity swaps.
Management of other net interest income on retail activities.	Sensitivity of returns to changes in interest rates.	Interest rate swaps and caps/floors according to the type of risk identified.
Fixed-rate asset investments.	Sensitivity to increases in interest rates.	Pay fixed interest rate swaps.
Investment in foreign currency assets.	Sensitivity to strengthening of sterling against other currencies.	Cross-currency swaps. Foreign currency funding.
Profits earned in foreign currencies.	Sensitivity to strengthening of sterling against other currencies.	Forward foreign exchange contracts. Purchase options.
Investment in, and issuance of, products with embedded options.	Sensitivity to changes in underlying rate and rate volatility causing option exercise.	Interest rate swaps plus caps/floors, and other matched options.
Investment in, and issuance of, bonds with put/call features.	Sensitivity to changes in rates causing option exercise.	Swaptions[(1)].
Firm commitments (e.g. asset purchases, issues arranged)	Sensitivity to changes in rates between arranging a transaction and completion.	Hedges are arranged at the time of commitments if there is exposure to rate movements.

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

Exchange-traded futures may be used as hedges in any of the above activities in lieu of interest rate swaps.

Derivatives 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, for example medium-term note issues based on equity indices or a multiple of an underlying floating market rate. 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 fully hedged. Credit risk on these contracts is monitored within tightly defined risk limits on the basis of the contractual terms of the instruments, rather than the face or contract amount.

The following tables set forth the nominal amounts, the positive market values and negative market values of derivatives held for non-trading purposes as at December 31, 1999 and 1998. Derivatives classified as non-trading are entered into for the purposes of matching or eliminating risk from potential movements in interest rates and exchange rates. Accordingly, they are measured on an accruals basis, equivalent to that used for the asset, liability or position being hedged. The positive and negative market values reported in the following table should not be viewed in isolation, therefore, because they are substantially matched by negative and positive market values on the assets, liabilities and positions being hedged.

	At December 31, 1999		
	Nominal Amounts (1)(3)	Positive Market Values (2)	Negative Market Values (2)
		(in millions of £)	
Non-trading derivatives			
Exchange rate related contracts	21,073	489	979
Interest rate related contracts	97,341	2,251	1,485
Equity contracts	842	31	16
	119,256	2,771	2,480

	At December 31, 1998		
	Nominal Amounts (1)(3)	**Positive Market Values (2)**	**Negative Market Values (2)**
		(in millions of £)	
Non-trading derivatives			
Exchange rate related contracts	18,776	633	786
Interest rate related contracts	93,367	1,977	1,564
Equity contracts	483	39	20
	112,626	2,649	2,370

(1) Nominal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk.

(2) Positive market values arise where the present value of cash inflows exceeds the present value of cash outflows on a contract by contract basis. Negative market values arise where the present value of cash outflows exceeds the present value of cash inflows on a contract by contract basis.

(3) Included in the above analysis of non-trading derivatives are exchange rate related contracts, interest rate related contracts and equity contracts, with nominal amounts totalling £2,098 million, (1998: £1,427 million), and £54,025 million (1998: £49,321 million), and £152 million (1998: £202 million) respectively, which were undertaken by Group entities for non-trading purposes with ANFP. The total net positive market value of such contracts amounted to £209 million (1998: net negative £151 million). Associated contracts which ANFP transacted with external counterparties are included in the analysis of trading derivatives. Net negative market values of £209 million (1998: net positive £151 million) on all contracts held by ANFP with other Group entities are included within Other liabilities.

For disclosures of activity in interest rate and cross-currency swaps entered into for hedging purposes, weighted average rates payable and receivable on such swaps analysed by maturity and contract amount, and currency denomination of other derivative contracts as at December 31, 1999, see Note 49 of the Consolidated Accounts elsewhere in this Annual Report.

Wholesale Banking has a mandate to transact in credit default swaps, total return swaps, spread put options and credit linked notes. Limits are set per deal and there is also a total portfolio limit. Market risk mandates have also been approved for each credit derivative type, which sets out instrument definition, consideration of market risk sensitivities and reporting requirements. Wholesale Banking acts as principal under this mandate, and takes a fee for guaranteeing the counterparty against the default of the senior obligations of a third party. Amounts in respect of credit derivative contracts are included under Guarantees and assets pledged as collateral security in Note 44 to the Consolidated Accounts, elsewhere in this Annual Report.

Trading Derivatives

Wholesale Banking is the only business within the Abbey National Group with a mandate to actively trade derivatives on its own account. ANFP is responsible for implementing Group hedging activities involving derivatives 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, variations on these products, equity swaps and equity option contracts. ANFP has established clear guidelines for staff to ensure that end-users are aware of the potential risk of entering into complex derivative transactions.

Comprehensive limit structures have been established for ANFP which includes both interest rate and equity derivatives, measured using a historical simulation approach to value at risk. The effects of instruments whose value does not change linearly with changes in interest rates are fully incorporated into the risk measures. Sensitivity controls are supplemented by stress testing the portfolios to large instantaneous shocks in market rates and volatilities. The volatilities and correlations applied to the portfolios are revised periodically, and are generally set using one year's historic data (where available), equally weighted. Shorter periods may be used where appropriate to reflect the increased risk associated with periods of market turbulence. Foreign exchange risk is only generated from profits earned in currencies other than sterling. These exposures are monitored and hedged on a regular basis. The overall management and control policy framework at ANFP is consistent with the Group of 30 recommendations regarding derivatives.

The following tables set forth the nominal amounts, positive market values and negative market values of derivatives held for trading purposes as at December 31, 1999 and 1998.

	At December 31, 1999		
	Nominal Amounts	**Positive market Values**	**Negative market Values**
	(in millions of £)		
Trading derivatives			
Exchange rate related contracts	8,161	111	147
Interest rate related contracts	195,216	2,334	2,418
Equity contracts	6,171	267	1,447
	209,548	2,712	4,012

	At December 31, 1998		
	Nominal Amounts	**Positive market Values**	**Negative market Values**
	(in millions of £)		
Trading derivatives			
Exchange rate related contracts	3,219	98	125
Interest rate related contracts	157,978	2,481	2,673
	161,197	2,579	2,798

For further disclosures relating to trading derivative activity, see Note 49 to the Consolidated Accounts, elsewhere in this Annual Report.

DESCRIPTION OF PROPERTIES

The property interests of the Group at December 31, 1999 consisted of the following:

	Freehold	Leasehold	Total
U.K. Retail Banking branches	339	472	811
Mortgage administration centers	5	23	28
Banking administration centers	2	13	15
Life Insurance offices	0	14	14
Continental Europe	0	22	22
Wholesale Banking	0	6	6
Wealth Management	14	9	23
ANICG	1	14	15
Finance House	10	101	111
Head offices and other administration centers	18	39	57
Other sites	4	56	60
Total	393	769	1,162

Included in the above table are 109 branches and other sites which were not occupied by the Group as at December 31, 1999.

The two main head office sites and main computer center are freehold properties. The Group's leasehold properties are subject to leases ranging from 1 to 999 years in maturity with the majority being 25 years in duration and subject to rolling five-year rent reviews. The Group currently has a number of property interests either in the course of development or disposal as part of the continuing branch development program, which are included above.

LEGAL PROCEEDINGS

Abbey National and its subsidiaries are party to various legal proceedings in the ordinary course of business, the ultimate resolution of which is not expected to have a material adverse effect on the financial position or the results of operations of the Group.

MONETARY AND FISCAL POLICIES AND EUROPEAN ECONOMIC AND MONETARY UNION

U.K. Monetary and Fiscal Policies

The profitability and operations of U.K. banks, including Abbey National, are affected significantly by the U.K. government's monetary and fiscal policies. The Bank of England, the Government-owned central bank, influences conditions in the money and credit markets, which affect the growth in lending, the distribution of lending between various industry sectors, interest rates and the growth of deposits. Likewise, the monetary and fiscal policies of governments in countries in which Abbey National operates influence the operations and profitability of the Group in those countries.

The U.K. Government has stated that its central economic objective is to achieve high and stable levels of growth and employment. The Government has established a framework for policy-making under which the Government has set the economic objectives (in particular, the inflation target) and the Bank of England takes the operational decisions needed to meet the inflation target. Operational responsibility for setting interest rates resides with the Monetary Policy Committee of the Bank of England. The monetary policy objective is to maintain price stability and, subject to that, to support the Government's economic policy. Low inflation is central to the Government's economic policy.

As described below, one of the most important issues facing the conduct of U.K. monetary and fiscal policy is EMU and, in particular, the adoption of a single currency among member states of the EU.

European Economic and Monetary Union

The process of EMU began in 1990 and has seen the completion of an internal EU market and substantial convergence of the domestic economies within the EU. This culminated in the third stage of EMU which began on January 1, 1999 with the rates of conversion between the euro and the participating national currencies being fixed and the euro becoming the single currency in the participating member states. The following 11 member states are the initial participants in the third stage of EMU: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. Four EU member states, namely Denmark, Greece, Sweden and the U.K., are not in the first wave of participants. The Greek Government has formally applied to participate in the euro and the Danish and Swedish Governments have indicated that they support such a move subject to holding referenda.

Under the Maastricht Treaty (the "Treaty"), the United Kingdom secured an "opt-in" which allows it to choose whether it wishes to be considered for joining the euro. The U.K. Government has stated that it would support adopting the euro if that is clearly in the national economic interest, although it does not expect that to be the case during the term of the present parliament (due to end before May 2002). The Government has stated that it will consider a number of factors in determining whether or not adopting the euro will be in the national economic interest, including whether it would help to promote economic growth, stability and employment. If the Government were to be in favour of the U.K. adopting the euro, it has said that the final decision would be made by the British people in a referendum. The procedures, under the Treaty, for member states adopting the euro at subsequent stages are essentially the same as for the initial participants in that they will need to meet the conditions laid down in the Treaty. At this stage, it is not possible to predict with any certainty whether or when the U.K. will adopt the euro.

A new voluntary exchange rate mechanism (known as ERM 2) was introduced on January 1, 1999 to encourage convergence between the currencies of the non-participating member states and the euro. This mechanism operates within fairly broad bands anchored around the euro along the lines of the former Exchange Rate Mechanism. At present, the U.K. is not a member of ERM 2. The Eurosystem (namely the ECB and the national central banks of the participating member states) is responsible for the monetary policy for the euro area, in particular the setting of short term interest rates. The ECB also oversees and seeks to encourage sustained convergence of the economies of the participating member states. The ECB and national central banks, among others, co-ordinate the setting of interest rates to encourage member states to align their policies towards stability and faster convergence. A stability and growth pact ensures national budgetary discipline on a sustained basis by co-ordinating monetary and fiscal policy. In particular, this involves a system designed to avoid excessive budget deficits (in excess of 3% of GDP) and to monitor participating member states carefully to ensure stability. Breach of the stability and growth pact could ultimately result in sanctions and fines. However, the rules will be mitigated in certain circumstances, such as a deep recession.

The main elements of EMU will be concluded in 2002 with the adoption of euro notes and coins in the participating states.

SUPERVISION AND REGULATION

European Union Directives

General

The framework for supervision of banking and financial services in the U.K. is largely formed by EU Directives which are required to be implemented in member states through national legislation. Directives aim to harmonize banking and financial services regulation and supervision throughout the EU by laying down minimum standards in key areas, and requiring member states to give mutual recognition to each other's standards of prudential supervision. This has led to the "passport" concept enshrined in the Second Banking Co-ordination Directive ("2BCD") and the Investment Services Directive ("ISD"): that is, freedom to establish branches in, and freedom to provide cross-border services into, other EU member states once a bank or investment firm is authorised in its "home" state.

Prudential Supervision and Capital Adequacy

The First Banking Co-ordination Directive and 2BCD set out minimum conditions for authorization and the ongoing prudential supervision of banks. Minimum conditions for the authorization and prudential supervision of investment firms are set out in the ISD. The overall responsibility for prudential supervision falls on the home state regulator of a bank or investment firm. Supervision of capital adequacy for both banks and investment firms is governed by the Capital Adequacy Directive ("CAD"). The CAD contains detailed rules for the regulatory capital treatment of risks on the trading book, that is positions in securities which a bank or investment firm holds for dealing purposes. For other risks, the CAD refers to the Own Funds Directive, which regulates the quality and proportions of different types of capital to be held by an institution and the Solvency Ratio Directive, which regulates the amount of capital to be held for counterparty exposures outside the trading book. In addition, the Consolidated Supervision Directive requires consolidated supervision of financial groups. The permitted exposure of an institution to an individual counterparty or group of connected counterparties is subject to the Large Exposures Directive.

U.K. Regulations

Banking

The principal statute is the Banking Act 1987. Except for banks incorporated and authorized in EU member states ("European institutions") other than the U.K., the Banking Act prohibits any person from accepting a deposit in the U.K. in the course of a deposit-taking business without prior authorization from the FSA and provides that the FSA is responsible for the supervision of persons authorized by it. European institutions are not authorized by the FSA and responsibility for their prudential supervision rests with the authorities in their home member state. The FSA does, however, have certain powers over their activities in the U.K., and a responsibility (in co-operation with the home member state authorities) to supervise the liquidity of U.K. branches of such institutions.

Abbey National, ANTS, FNB and Cater Allen Limited are all authorized under the Banking Act.

Deposit compensation under the statutory deposit protection scheme is available to depositors. Depositors with a failed institution are entitled to receive a certain percentage of the aggregate amount of their deposits, subject to a cap, from the Deposit Protection Fund.

Insurance

U.K. banking groups may provide insurance services through other group companies. Insurance business in the U.K. is divided into two main categories: long-term insurance (which is primarily investment-related) and general insurance (which includes, for example, building and contents cover and automobile insurance). Insurance business in the U.K. is regulated under the Insurance Companies Act 1982, which requires insurers to be authorized and supervised by Her Majesty's Treasury. As with banking regulation, a number of these regulations have been adopted pursuant to EU Directives.

Abbey National currently acts, in relation to building and contents insurance, as a broker for CGU Underwriting Limited, the underwriting company which forms part of Abbey National's joint venture with CGU, receiving commissions for the policies arranged. The sale of such policies is governed by a voluntary code, to which Abbey National conforms, formulated by the Association of British Insurers, a trade body composed of insurance companies.

The marketing and sale of most long-term insurance (other than some term life insurance) is regulated by the Financial Services Act 1986 and the rules of the Personal Investment Authority. See "Investment Business" below.

Policyholders' Protection Acts 1975 and 1997. The 1975 Act imposes a levy on the insurance industry to guarantee percentages of policyholder claims in the case of insurance company default. Protection is only given to persons holding policies issued by an authorised insurer. The 1997 Act extended the protection to include insurance business written in the U.K. by EU insurance companies operating under the single European passport.

Investment Business

General. Investment business (other than the wholesale money markets) in the U.K. is primarily regulated under the provisions of the Financial Services Act 1986. Under that Act, it is a criminal offence for any person to carry on investment business in the U.K. unless he is an authorised person or exempted person for the purposes of the Act. The Act requires that firms involved in investment business must be authorised and then conform to the applicable rules relating to conduct of business and financial resources, unless certain exemptions apply. Authorisation is normally granted by one of the self regulating organisations ("SROs") recognised by the Financial Services Authority, formerly known as the Securities and Investment Board, to whom responsibility for supervising investment business has been delegated by Her Majesty's Treasury under the Act. ANTS has obtained authorisation from, and is regulated by, the Securities and Futures Authority ("SFA") in respect of its investment business activities. CAIL has also obtained authorisation from, and is regulated by, the SFA in respect of all its activities.

Personal Investment Authority ("PIA"). The PIA regulates those companies involved in marketing and selling retail investment products. Set out below are the principal entities within the Group regulated by the PIA.

- The PIA is the regulator of Abbey National in relation to selling certain life insurance, pension products, unit trust products and personal equity plans (tax exempt saving products) of the Life Insurance division, and in relation to certain retail equity services.
- The PIA additionally regulates the sales and marketing activities of Abbey National Life, Scottish Mutual and Pegasus. Scottish Mutual and Pegasus market their own life insurance products separately from Abbey National Life and solely through independent financial advisors.
- The PIA also regulates James Hay Investment Services Limited, a subsidiary of ANICG, and Willis National, an associate of ANICG, both of which operate as independent financial advisors.

Investment Management Regulatory Organisation ("IMRO"). IMRO regulates those companies that are involved in fund management.

- IMRO regulates ANUTM in respect of the management, marketing and sale of unit trust products and Abbey National PEP & ISA Managers in respect of the management, marketing and sale of personal equity plans.
- IMRO also regulates two other subsidiary companies – Scottish Mutual Investment Managers and Scottish Mutual Portfolio Managers.

A statutory investors' compensation scheme is available to the private customers of authorised persons which default. Compensation is subject to a cap.

Listed Money Market Institutions. ANTS has been granted listed money market institution status by the FSA to carry on its wholesale money market activities. The FSA requires it to observe the "London Code of Conduct" for these markets.

Current and Future Developments

The U.K. Government is currently finalising legislation to support the establishment of the FSA as the single regulator for all the main categories of financial services, including those categories discussed above. The process of reform is occurring in two stages, involving two pieces of new legislation.

First, the Bank of England Act 1998, which came into effect in June 1998, transferred the responsibility for supervising banks and listed money market institutions to the FSA.

Secondly, the Financial Services and Markets Bill ("the Bill"), when enacted, will create a new statutory regime under which the FSA will, in broad terms, acquire the regulatory functions currently exercised by the SROs (including PIA, SFA and IMRO), Her Majesty's Treasury in respect of insurance companies, the Building Societies Commission and other regulators not mentioned in the context of this discussion. Enactment is expected in the first half of 2000 with implementation of the main provisions to follow at the end of 2000 or in the first half of 2001.

However, practical integration of financial services supervision under the FSA has not been delayed prior to enactment of the Bill. Operational integration of staff was substantially completed in 1999 with the FSA discharging the formal functions of the various existing regulators as a sub-contractor. The regulatory implication for the Abbey National Group of the reforms is that it will have one regulator for all the activities described above.

The reforms also envisage that mortgage lending will become a regulated activity. It is expected that this will involve, amongst other things, specific disclosure of certain features regarding a loan, and some regulation of mortgage advertising by lenders. It is currently expected that the new regime concerning mortgages will become operational towards the end of 2001. In addition, the U.K. Government has announced proposals for new voluntary benchmark standards for certain types of mortgages.

In November 1998, Her Majesty's Treasury appointed Don Cruickshank to chair a review of banking services in the U.K., with a particular focus on competition. The report resulting from this review was published in March 2000. The main recommendations of the report are that:

- the provision of banking services to small and medium-sized enterprises be the subject of an urgent complex monopoly investigation by the Competition Commission;
- the market for money transmission systems be reformed, including the introduction of a licensing system supervised by a regulator;
- in personal banking services, better information and redress procedures will be sufficient, when taken with the effects of new market entrants and technological changes, to accelerate the process towards effective competition. Product regulation is not recommended. Any U.K. Government intervention should be focused on setting standards for the availability and quality of information on products, and benchmarking basic low cost products.

The U.K. Government is currently reviewing the report, but has already confirmed that banking services to small and medium-sized enterprises will be the subject of a Competition Commission enquiry. Abbey National will review any proposals which may result from the report for the potential impact they may have on the Group's businesses.

Other Relevant Legislation

The Consumer Credit Act 1974 regulates both brokerage and lending activities in the provision of personal secured and unsecured lending. The Data Protection Act 1998 was brought into force on March 1, 2000 and regulates the retention and use of data held on computer relating to individual customers. The Unfair Terms in Consumer Contracts Regulations 1999, together with the Unfair Contract Terms Act 1977, apply to certain contracts for goods and services entered into with consumers. The main effect of the Regulations is that a contractual term covered by the Regulations which is "unfair" will not be enforceable against a consumer. These Regulations apply, inter alia, to mortgages and related products and services.

Non-Statutory Practice Recommendations

Codes of Practice

The U.K. Council of Mortgage Lenders introduced a voluntary Code of Mortgage Lending Practice in 1997 (updated 1998), which is followed by lenders in their relations with personal customers in the U.K. and to which Abbey National subscribes. Abbey National also subscribes to the Banking Code, sponsored by the British Bankers' Association, which sets minimum standards for the provision of banking services to personal customers.

Combined Code

The Listing Rules of the London Stock Exchange require listed companies to disclose how they comply with the code of practice for corporate governance known as the Combined Code. The release in April 1999 of the Turnbull Report provided guidance on implementation of the internal control requirements of the Combined Code.

CONTROL OF THE REGISTRANT

As at December 31, 1999, Abbey National did not know, and had not been notified of any interest in the register maintained under Section 211 of the Companies Act, of any corporation or foreign government that directly or indirectly owned a controlling interest in it.

The following table sets forth the aggregate shareholdings, as at December 31, 1999, of the directors and executive officers of Abbey National as a group.

Title of Class	Owner	Number Owned	% of Class
Ordinary shares of nominal value 10p each	Directors and executive officers of Abbey National	382,119	0.03

MANAGEMENT

The following table sets forth the directors and executive officers of Abbey National as at March 17, 2000, their current positions at Abbey National, their principal external directorships and the years when their positions with Abbey National were assumed.

Name	Current position	Principal external directorships/other activities	Year appointed
The Lord Tugendhat	Chairman (since 1991)	Director, Eurotunnel plc Chairman, Blue Circle Industries PLC Director, Rio Tinto PLC	1991
Executive Directors			
Ian Harley, F.C.A., F.C.I.B.	Chief Executive (since 1998)	Chairman, Association of Payment Clearing Services Director, Rentokil Initial plc	1993
Timothy C W Ingram, F.C.I.B.	Managing Director, Consumer Finance (since 1995)	Director, Hogg Robinson plc	1996
D Gareth Jones, F.C.A., F.C.T.	Managing Director, Wholesale Banking (since 1993)	Director, Somerfield plc	1993
John King, J.P.	Human Resources Director (since May 1999)		1999
Malcolm Millington	IT Director (since January 1999)		1999
Mark A Pain, F.C.A.	Finance Director (since 1998)		1998
Andrew H Pople	Managing Director, Retail Division (since 1996)		1996
Ian K Treacy, F.C.A.	Director and Secretary (since 1998)		1998
Charles N Villiers, F.C.A.	Deputy Chairman (since April 1999)	Director, DTZ Holdings PLC	1989
Non-executive Directors			
Leon Allen		Chairman, Braes Group Ltd	1998
Mair Barnes		Director, Scottish Power plc	1992
Richard Hayden		Chairman, GSC Partners, Europe Ltd	1999
Sir Terence Heiser, G.C.B.		Director, J Sainsbury plc Director, Personal Investment Authority	1992
Peter J Ogden		Director, Computacenter PLC Chairman, Computasoft Limited Chairman, Omnia Ltd.	1994
The Lord Shuttleworth, J.P., F.R.I.C.S.			1996
James L Tuckey, F.R.I.C.S.		Vice-President, British Property Federation	1990
Keith Woodley, F.C.A.	Deputy Chairman and Senior Independent Non-executive Director (since April 1999)	Complaints Commissioner for the London Stock Exchange, the Personal Investment Authority and the Securities & Futures Authority	1996

The following table sets forth the directors of ANTS as at March 17, 2000, their current positions at ANTS and their other principal activities.

Name	Current position	Other principal activities
Ian Harley, F.C.A., F.C.I.B.	Chairman	Chief Executive, Abbey National plc
D Gareth Jones, F.C.A., F.C.T.	Chief Executive	Managing Director, Wholesale Banking, Abbey National plc Chairman, Cater Allen International Limited Non-executive Director, Somerfield plc
Gwen M Batchelor, F.C.C.A., F.C.T.	Finance Director	Non-executive Director, Office for National Statistics
Alex S Braun, A.C.A., M.C.T.	Director, Funding & Asset Management	
Fenella J Edge	Director, Market Risk	
Robin Garratt, A.C.A., M.C.T.	Director, Credit and Corporate Development	
John Hasson	Director, IT and Treasury Operations	Non-executive Director, CHAPS Clearing Co. Ltd.
Tony Hibbitt	Executive Director	Chief Executive, Cater Allen International Limited
Anna Merrick	Director, Special Finance	
Brian W Morrison	Director, Treasury Services & International	
Steven M Warr, A.C.A., M.C.T.	Director, Abbey National Financial Products	
Antony W Elliott, F.C.I.B.	Non-executive Director	Group Risk Director, Abbey National plc
Rodney D Galpin, F.C.I.B	Independent non-executive Director	Non-executive Director, The Peninsular & Oriental Steam Navigation Company Chairman, Alpha Airports Group plc
Mark A Pain, F.C.A.	Non-executive Director	Finance Director, Abbey National plc
Keith Woodley, F.C.A.	Independent non-executive Director	Deputy Chairman and Senior Independent Non-executive Director, Abbey National plc
Dr. Jeremy R F Fairbrother, F.C.I.B., F.C.T.	Independent non-executive Director	Senior Bursar, Trinity College, Cambridge
Raphael W Hodgson	Independent non-executive Director	Non-executive Director, General Re Financial Products Corporation

The business address of each of the directors and officers in the two tables above is Abbey House, Baker Street, London NW1 6XL, England.

Committees of Directors

The Board of Abbey National plc met on twelve occasions during 1999, including a separate session specifically devoted to the long term strategic direction of the Group. 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 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 and 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.

Nomination Committee

The Nomination Committee is chaired by Lord Tugendhat and met three times during 1999. 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.

Directors' Remuneration

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 Lord Shuttleworth and Peter Ogden. 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 ("LTIP") 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 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 LTIP is currently open only to the nine members of the Executive Committee. Details of the grants to directors under the LTIP are set out below. The LTIP 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 January 1, 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 January 1, 1997, and in future, participation by way of new grants in the Company's Executive Share Option Scheme has been and will 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.

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 subsidized 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, the executive director 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 detailed 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 LTIP 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 ANTS 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.

Analysis of Directors' Remuneration

The following table shows an analysis of directors' remuneration excluding pensions:

	Salary/ Fee	Performance related annual bonus	Other payments	Taxable benefits	1999 Total	1998 Total
			(in £)			
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 May 1, 1999)	200,000	37,000		1,177	238,177	—
M J Millington (appointed January 1, 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 April 22, 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 September 21, 1999)	6,935			—	6,935	—
Sir Terence Heiser	30,000			952	30,952	28,183
M E Llowarch (retired April 22, 1999)	27,500			553	28,053	49,602
P J Ogden	28,333			339	28,672	22,500
The Lord Rockley (retired April 22, 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 December 31, 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 51 to the accounts.

	Contributions from directors during 1999(7)	Increase in accrued pension during 1999(1)(5)	Transfer value of the increase in accrued pension during 1999(2)	Total accrued pension as at December 31, 1999(3)	Total accrued pension as at December 31, 1998(4)
			(in £)		
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 May 1, 1999)	30,000	15,565	238,425	124,667	109,102
M J Millington (appointed January 1, 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 April 22, 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 December 31, 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 December 31, 1999 represents the annual pension which each director would be entitled to receive from normal retirement age if he had left service voluntarily at December 31, 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 December 31, 1999, and the total accrued pension as at December 31, 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 director's 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 May 1, 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

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	Number of shares		
	At January 1, 1999 or date of appointment if later	At December 31, 1999	At March 17, 2000
L R Allen.	1,000	4,000	4,000
M Barnes.	1,000	1,000	1,000
I Harley	51,037	58,782	68,782
R M Hayden (appointed September 21, 1999)	—	4,000	4,000
Sir Terence Heiser.	1,000	1,000	1,000
T C W Ingram	19,012	30,636	35,636
D G Jones	41,169	31,189	31,189
J King (appointed May 1, 1999)	36,577	39,897	39,898
M J Millington (appointed January 1, 1999).	22,916	32,916	32,916
P J Ogden	4,000	4,000	4,000
M A Pain.	16,064	17,964	22,964
A H Pople	37,141	50,661	50,661
The Lord Shuttleworth	816	816	816
I K Treacy	41,372	46,079	46,079
J L Tuckey	12,000	12,000	12,000
The Lord Tugendhat	17,858	18,867	19,867
C N Villiers.	29,000	26,152	26,152
K S Woodley	2,160	2,160	5,160

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

Share options:	At January 1, 1999*	Granted	Exercised	At December 31, 1999	Exercise price £	Market price at date of exercise £	Date from which exercisable	Expiry date	Notes
	Number of share options								
I Harley	2,418			2,418	4.28		10/01/00	03/31/01	Sharesave
	568			568	6.07		04/01/02	09/30/02	Sharesave
	349			349	9.88		04/01/03	09/30/03	Sharesave
	7,745		7,745		3.98	13.04	04/11/99	04/10/04	Executive†
	38,053			38,053	5.65		03/25/99	03/24/06	Executive
	36,379			36,379	5.91		09/09/99	09/08/06	Executive#
	150			150	5.91		09/09/99	09/08/06	Employee
	85,662		7,745	77,917					
T C W Ingram	3,701			3,701	4.66		04/01/01	09/30/01	Sharesave
	4,180		4,180		4.0975	14.35	08/31/96	08/30/03	Executive#
	25,663		25,663		5.65	14.35	03/25/99	03/24/06	Executive
	150			150	5.91		09/09/99	09/08/06	Employee
	33,694		29,843	3,851					
D G Jones	2,418			2,418	4,28		10/01/00	03/31/01	Sharesave
	568			568	6.07		04/01/02	09/30/02	Sharesave
	179			179	10.87		04/01/01	09/30/01	Sharesave
	8,012			8,012	4.68		04/11/97	04/10/04	Executive†
	36,106			36,106	5.65		03/25/99	03/24/06	Executive
	22,829			22,829	5.91		09/09/99	09/08/06	Executive#
	150			150	5.91		09/09/99	09/08/06	Employee
	70,262			70,262					
J King (appointed May 1, 1999)	291			291	6.68		04/01/00	09/03/00	Sharesave
	2,418			2,418	4.28		10/01/00	03/31/01	Sharesave
	349			349	9.88		04/01/03	09/30/03	Sharesave
	4,455			4,455	4.68		04/11/97	04/10/04	Executive†
	13,929		13,929		5.65	13.23	03/25/99	03/24/06	Executive
	23,181			23,181	5.91		09/09/99	09/08/09	Executive
	150			150	5.91		09/09/99	09/08/06	Employee
	44,773		13,929	30,844					
M J Millington	4,204			4,204	4.28		10/01/00	03/31/01	Sharesave
(appointed	19,000			19,000	4.86		04/10/98	04/09/05	Executive
January 1, 1999)	20,353			20,353	5.65		03/25/99	03/24/06	Executive
	6,000			6,000	5.64		04/04/99	04/03/06	Executive
	17,451			17,451	7.22		03/24/00	03/23/07	Executive
	10,769			10,769	11.07		03/13/01	03/12/08	Executive
	300			300	5.91		09/09/99	09/08/06	Employee
	150			150	11.95		04/01/03	04/01/08	Employee
	78,227			78,227					
M A Pain	1,285			1,285	6.07		04/01/04	09/30/04	Sharesave
	698			698	9.88		04/01/03	09/30/03	Sharesave
		371		371	9.89		04/01/06	10/01/06	Sharesave
	13,008			13,008	5.65		03/25/99	03/24/06	Executive
	13,850			13,850	7.22		03/24/00	03/23/07	Executive
	150			150	5.91		09/09/99	09/08/06	Employee
	28,991	371		29,362					
A H Pople	1,882		1,882		2.39	13.07	06/01/99	11/30/99	Sharesave
	2,418			2,418	4.28		10/01/00	03/31/01	Sharesave
	568			568	6.07		04/01/02	09/30/02	Sharesave
	349			349	9.88		04/01/03	09/30/03	Sharesave
	23,008		23,008		5.65	14.15	03/25/99	03/24/06	Executive
	150			150	5.91		09/09/99	09/08/06	Employee
	28,375		24,890	3,485					
I K Treacy	4,707		4,707		2.39	13.07	06/01/99	11/30/99	Sharesave
	25,042			25,042	5.91		09/09/99	09/08/06	Executive
	18,353		18,353		5.65	12.41	03/25/99	03/24/06	Executive
	150			150	5.91		09/09/99	09/08/06	Employee
	48,252		23,060	25,192					
The Lord Tugendhat . .	1,745			1,745	9.88		04/01/03	09/30/03	Sharesave
	1,745			1,745					

Share options (continued)	Number of share options: At January 1, 1999*	Granted	Exercised	At December 31, 1999	Exercise price £	Market price at date of exercise £	Date from which exercisable	Expiry date	Notes
C N Villiers	2,418			2,418	4.28		10/01/00	03/31/01	Sharesave
	568			568	6.07		04/01/02	09/30/02	Sharesave
	349			349	9.88		04/01/03	09/30/03	Sharesave
	9,612			9,612	4.68		04/11/97	04/10/04	Executive
	3,204			3,204	4.68		04/11/97	04/10/04	Executive†
	32,086			32,086	4.83		04/10/98	04/09/05	Executive
	10,055		10,055		5.65	12.41	03/25/99	03/24/06	Executive
	36,988			36,988	5.91		09/09/99	09/08/06	Executive#
	150			150	5.91		09/09/99	09/08/06	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 4.11.1999 to 4.10.2004. 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 40 to the accounts.

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 December 31, 1999 was 990p (December 31, 1998: 1287p) and the range during 1999 was 939p to 1435p.

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 January 1, 1999	Conditional rights granted during year	Shares awarded during year	Conditional rights lapsed during year	Conditional rights held under plan at December 31, 1999
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 January 1, 1999	Shares awarded during year	Shares transferred during year	Shares held in trust at December 31, 1999	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 December 31, 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 December 31, 1999, the Trust held 389,320 ordinary shares (1998: 268,936 ordinary shares) for the above-named directors.

Aggregate Pension Amounts and Share Options

The aggregate amount set aside or accrued by the Group for pension, retirement and similar benefits for all directors of Abbey National as a group at December 31, 1999 was £1,134,555. The accrued pension represents the annual pension which each director would be entitled to receive from normal retirement age if he had left service voluntarily at December 31, 1999, or at his actual retirement date if earlier.

The aggregate amount set aside or accrued by the Group for pension, retirement and similar benefits for executive officers of Abbey National in the year ended December 31, 1999 was £nil, based upon the contributions paid by Abbey National.

At March 17, 2000, directors and executive officers of Abbey National as a group held options to purchase 360,742 ordinary shares of Abbey National at prices ranging from £4.28 to £10.87 under the Sharesave scheme, from £3.98 to £11.70 under the Executive Share Option scheme and at £5.91 and £11.95 under the Employee Share Option scheme, and are exercisable in the period to 2007.

Terms of Office of Directors

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 a total length of service which 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 Memorandum and 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.

Interests of Directors and Officers

In 1999, loans were made by the Group to 11 directors and the executive officers of the Group and connected persons and of these loans, principal amounts of £1,276,000 were outstanding as at December 31, 1999. See Note 53 to the Consolidated Financial Statements included elsewhere in this Annual Report for disclosures of deposits and investments made and insurance policies entered into by directors, executive officers and connected persons with the Group as at December 31, 1999.

In 1999 there were no other transactions, arrangements or agreements with Abbey National or its subsidiaries in which directors or executive officers or persons connected with them had a material interest, other than options to subscribe for ordinary shares under the Abbey National Executive Share Option scheme, the Employee Sharesave scheme and the Employee Share Option scheme. No director had a material interest in any contract of significance other than a service contract with the Group, or any of its subsidiaries, at any time during the year.

SHAREHOLDER INFORMATION

Dividends on Ordinary Shares

Abbey National has paid dividends on its Ordinary Shares (defined below) every year without interruption since its incorporation in 1989.

The dividends (including interim dividends) declared for each of the last five years were as follows:

Pence per 10 pence Ordinary Share

	1999	1998	1997	1996	1995
Interim	13.40	11.75	10.20	8.70	7.25
Final	26.85	23.55	20.50	17.40	14.50
Total	40.25	35.30	30.70	26.10	21.75

Cents per 10 pence Ordinary Share

	1999	1998	1997	1996	1995
Interim	21.64	19.54	16.45	13.60	11.42
Final	43.36	39.80	33.68	29.79	22.53
Total	65.00	59.34	50.13	43.39	33.95

Dividends expressed in cents are translated from sterling at the Noon Buying Rate on December 31 of the year to which they relate. No representation is made that pounds sterling amounts have been, or could have been, or could be, converted into dollars at these rates.

Dividends on Dollar-denominated Preference Shares

Dividends on the Non-cumulative Dollar-denominated Preference Shares, Series A, are paid quarterly at such rates as will, including the U.K. associated tax credit and before deduction of U.K. withholding tax (see "Taxation" below), result in annual dividends to holders amounting to 8¾% of the $25.00 issue price.

Trading Market for Ordinary Shares and American Depositary Shares

The authorized ordinary share capital of Abbey National consists of 1,750,000,000 Ordinary Shares of nominal value 10 pence each (the "Ordinary Shares"). At the close of business on December 31, 1999, 1,421,953,408 Ordinary Shares were issued and outstanding.

There were 2,035 recorded holders of Ordinary Shares with U.S. addresses at December 31, 1999 whose shareholdings represented approximately 0.03% of total issued and outstanding Ordinary Shares on that date.

The sole trading market for Abbey National Ordinary Shares is the London Stock Exchange. American Depositary Shares ("ADSs"), each representing two Ordinary Shares, may be traded in the U.S. over-the-counter market. As at the close of business on December 31, 1999, there were 1,045,188 ADSs outstanding for which one holder was registered.

The following tables show the high and low sale prices for the Ordinary Shares during the periods indicated, based on mid-market prices at the close of business on the London Stock Exchange for each business day during the calendar quarters indicated.

	Ordinary Shares	
	High	Low
	(pence)	
1999		
Fourth quarter	1,201	939
Third quarter	1,241	974
Second quarter	1,435	1,191
First quarter	1,358	1,134
1998		
Fourth quarter	1,390	860
Third quarter	1,295	999
Second quarter	1,263	951
First quarter	1,346	1,040

Trading Market for Dollar-denominated Preference Shares and American Depositary Shares

At December 31, 1999, Abbey National had outstanding 8,000,000 Series A Non-cumulative Dollar-denominated Preference Shares, nominal value $.01 each. The Preference Shares were issued in November 1996. Currently, the only trading market for these shares is the New York Stock Exchange where they are traded in the form of Series A American Depositary Shares, each representing one Preference Share.

At December 31, 1999, the Series A American Depositary Shares were held by 41 holders of record, all with U.S. addresses.

The Series A American Depositary Shares traded on the New York Stock Exchange at prices ranging from a high of $26.75 to a low of $23.88 during 1999.

Note: Past performance of the Ordinary Shares, Preference Shares and related American Depositary Shares cannot be relied upon as a guide to future performance.

EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS

There are currently no U.K. laws, decrees or regulations which would affect the transfer of capital or remittance of dividends, interest or other payments to holders of Abbey National securities who are not residents of the United Kingdom. There are also no restrictions under the Articles of Association of Abbey National or under current U.K. laws which limit the right of non-resident or foreign owners to hold Abbey National securities or, when entitled to vote, to do so.

TAXATION

Taxation of Ordinary Shares, American Depositary Shares, Preference Shares and Series A American Depositary Shares

The following is a summary of certain U.S. federal and U.K. tax considerations relevant to the acquisition, ownership and disposition of Ordinary Shares, non-cumulative dollar-denominated Preference Shares ("Preference Shares"), ADSs and Preference Shares traded in the form of Series A American Depositary Shares by a holder that is a resident of the United States for purposes of, and is fully entitled to benefits under, the income tax convention between the United States and the United Kingdom (the "Treaty"). A holder entitled to Treaty benefits (an "Eligible U.S. Holder") is defined below.

For purposes of this summary, the term "Eligible U.S. Holder" means a beneficial owner of an Ordinary Share, Preference Share, ADS or Series A ADS (and of the dividends paid thereon) that (i) is an individual resident of the United States, a U.S. corporation, or a partnership, estate or trust (but only to the extent the income derived by the partnership, estate or trust is subject to U.S. taxation as the income of a resident, either in its hands or in the hands of its partners or beneficiaries); and (ii) is not subject to one of the limitations on Treaty benefits listed below. Limitations on Treaty benefits apply to, and the term "Eligible U.S. Holder" does not include, a holder (i) that is also resident in the United Kingdom for U.K. tax purposes; (ii) that controls, directly or indirectly, 10% or more of the voting stock of Abbey National; or (iii) whose holding of Ordinary Shares, Preference Shares, ADSs or Series A ADSs is effectively connected with a permanent establishment in the United Kingdom through which it carries on business or with a fixed base in the United Kingdom from which it performs independent personal services. Limitations on Treaty benefits also apply in certain circumstances to, and the term "Eligible U.S. Holder" does not include, a holder that (A) is an investment or holding company, 25% or more of the capital of which is owned, directly or indirectly, by persons that are not individual citizens or residents of the United States; (B) is exempt from federal income tax on dividends received from Abbey National; or (C) owns 10% or more of the class of shares of Abbey National in respect of which a dividend is paid. Prospective investors that are not Eligible U.S. Holders should consult their own tax advisers.

This summary deals only with original purchasers that will hold Ordinary Shares, Preference Shares, ADSs or Series A ADSs as capital assets, and does not address tax considerations applicable to investors that may be subject to special tax rules, such as banks, insurance companies, tax-exempt entities, dealers in securities, persons holding Ordinary Shares, Preference Shares, ADSs or Series A ADSs as a position in a "straddle" for U.S. tax purposes and persons that have a "functional currency" other than the U.S. dollar. Investors should consult their own advisers as to the tax consequences of the purchase, ownership and disposition of Ordinary Shares, Preference Shares, ADSs or Series A ADSs in light of their particular circumstances, including the effect of any state, local or other national laws.

The statements regarding U.S. and U.K. tax laws set forth below are based on the Treaty and laws in force on the date hereof, which are subject to change. In this regard, the United States and the United Kingdom have recently announced their intention to enter into negotiations concerning a new treaty.

For purposes of the Treaty and the U.S. Internal Revenue Code of 1986, as amended, (the "Code"), Eligible U.S. Holders of ADSs or Series A ADSs will be treated as the beneficial owners of the Ordinary Shares or Preference Shares represented thereby.

Dividends

Procedures for Claiming Treaty Payments. Under existing U.K. law, individual shareholders receiving a dividend from Abbey National who are resident in the United Kingdom are entitled to a tax credit (the "associated U.K. tax credit") equal to one ninth of the cash dividend (i.e., the equivalent of 10% of the sum of the dividend and the associated U.K. tax credit).

The Treaty contains provisions that are intended to extend the benefits of the U.K. integrated tax system to Eligible U.S. Holders. The Treaty provides that Eligible U.S. Holders are entitled to receive a payment from the U.K. Inland Revenue equal to the amount of the associated U.K. tax credit, reduced by the U.K. withholding tax. As a result of recent changes in U.K. tax law, the amount of the associated U.K. tax credit will be fully offset by the U.K. withholding tax. Accordingly, Eligible U.S. Holders are no longer entitled to receive a net cash payment from the U.K. Inland Revenue. It is no longer necessary to provide information to the U.K. Inland Revenue to establish a holder's entitlement to Treaty benefits.

Taxation of U.S. Holders. Under new procedures announced by the Internal Revenue Service on January 20, 2000, to claim credits for U.K. withholding tax, an Eligible U.S. Holder must file an election on form 8833 with the holder's income tax return for the relevant year. An Eligible U.S. Holder who makes such an election will be subject to U.S. taxation on the sum of the distributions received with respect to the Ordinary Shares or the Preference Shares and the associated U.K. tax credit (the "gross dividend'). The gross dividend will constitute foreign source dividend income and will not be eligible for the dividend received deduction.

If an Eligible U.S. Holder makes the election discussed above, the holder will be treated as paying U.K. withholding tax equal to the associated U.K. tax credit that, subject to generally applicable restrictions and limitations, may be claimed as a credit against the holder's U.S. federal income tax liability or, at the election of the holder, may be deducted in computing taxable income. Foreign tax credits are not allowed for withholding taxes imposed in respect of certain short-term or hedged positions in securities or in respect of arrangements in which a holder's expected economic profit, after non-U.S. taxes, is insubstantial. U.S. holders should consult their own advisers concerning the implications of these rules in light of their particular circumstances.

The amount of any dividend paid in pounds will equal the U.S. dollar value of the pounds received calculated by reference to the exchange rate in effect on the date the dividend is received by the Eligible U.S. Holder, in the case of Ordinary Shares, or Preference Shares or by the depositary, in the case of ADSs or Series A ADSs, regardless of whether converted into U.S. dollars. Foreign currency exchange gain or loss, if any, realized on the sale or other disposition of the pounds will be ordinary income or loss to the Eligible U.S. Holder.

Capital Gains

A Holder of an Ordinary Share, Preference Share, ADS or Series A ADS that is not resident (nor, in the case of an individual, ordinarily resident) in the United Kingdom for tax purposes normally will not be liable for U.K. taxation on any capital gain realized on the disposal of an Ordinary Share, Preference Share, ADS or Series A ADS unless such Holder carries on a trade, profession or vocation in the United Kingdom through a branch or agency and such Share or ADS is or has been used, or acquired, for the purposes of such trade, profession or vocation, or such branch or agency.

Upon the sale or exchange of an Ordinary Share, Preference Share, ADS or Series A ADS, an Eligible U.S. Holder will generally recognize capital gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized and the holder's tax basis in the Ordinary Share, Preference Share, ADS or Series A ADS.

An Eligible U.S. Holder normally will not be liable for U.K. taxation on redemption by Abbey National of a Preference Share.

The redemption by Abbey National of a Preference Share will constitute a taxable transaction for U.S. federal income tax purposes on which an Eligible U.S. Holder generally will recognize capital gain or loss (assuming that such holder does not own, and is not deemed to own, any other equity interest in the Company). U.S. holders are advised to consult their own tax advisers as to the U.K. tax and U.S. federal income tax consequences of a redemption of the Preference Shares.

U.K. Stamp Taxes

No U.K. stamp duty will be payable on the transfer of, or agreement to transfer, an ADS or Series A ADS or beneficial ownership of an ADS or Series A ADS, provided that the ADS or Series A ADS and any separate instrument of transfer or written agreement to transfer is executed and remains at all times outside the United Kingdom. No U.K. stamp duty reserve tax will be payable in respect of an agreement to transfer ADSs or Series A ADSs or beneficial ownership of ADSs or Series A ADSs.

U.K. stamp duty or stamp duty reserve tax will normally be payable on or in respect of transfers of the Ordinary Shares or Preference Shares and accordingly any holder who acquires or intends to acquire Ordinary Shares or Preference Shares is advised to consult his own professional advisers in relation to U.K. stamp duty and stamp duty reserve tax.

Taxation of Notes

The following comments relating to the withholding of interest on the notes issuable under the shelf facility registered with the Commission (the "Notes") on account of tax are summary in nature and based on current U.K. law and Inland Revenue practice. Payments of principal in respect of any of the Notes will not be subject to withholding tax in the United Kingdom. Payments of interest by Abbey National First Capital B.V. under its 8.20% Subordinated Notes due 2004 and its Subordinated Medium-Term Notes, Series 1B, will not be subject to U.K. withholding tax provided the payment is not made through a U.K. paying or collecting agent. Payments of interest by ANTS under any of the outstanding Senior Medium-Term Notes, Series 1A, will not be subject to U.K. withholding tax while ANTS remains an institution authorized under the Banking Act 1987 and pays the interest in the ordinary course of its business. Payments by Abbey National with respect to its guarantees of such obligations, except to the extent that such payments by Abbey National are regarded as payments of interest, will not be subject to U.K. withholding tax. Payments of interest made by Abbey National on its 6.69% Subordinated Notes due 2005, or its 7.35% Perpetual Subordinated Reset Capital Securities, and its Subordinated Medium Term Notes, Series 1B may normally be made free of withholding on account of U.K. tax where the Notes are in bearer form, are listed on a stock exchange recognized for the purposes of U.K. tax legislation and payment is made by or through a non-U.K. paying agent. Where payment is made by or through a U.K. paying agent, such payment can also be made without withholding if such Notes are held in a clearing system recognized for the purposes of U.K. tax legislation (such as Euroclear or Clearstream, Luxembourg) or if the Note and the interest on it are both beneficially owned by a non U.K. resident and in both cases the U.K. paying agent has received a declaration in the form prescribed by U.K. law that one of those conditions is satisfied.

INDEX TO FINANCIAL INFORMATION

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The following statement, which should be read in conjunction with the Auditors' reports set out below, is made with a view to distinguishing for shareholders the respective responsibilities of the directors and of the Auditors in relation to the 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 Abbey National plc and the Group as at the end of the financial year, and of the profit for the year. They are also responsible for ensuring that proper and adequate accounting records have been maintained and that reasonable procedures have been followed for safeguarding the assets of the Group and for preventing and detecting fraud and other irregularities.

In respect of the accounts the directors are required to:

- ensure that appropriate accounting policies, which follow generally accepted accounting practice, have been applied consistently;
- ensure that reasonable and prudent judgements and estimates have been used in the preparation of the accounts;
- prepare the accounts on the going concern basis unless it is inappropriate to presume that Abbey National plc 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

The consolidated accounts of Abbey National plc and its subsidiary undertakings for the year ended December 31, 1999 were audited by Deloitte & Touche.

The consolidated accounts of Abbey National plc and its subsidiary undertakings for the two years ended December 31, 1998 and December 31, 1997 were audited by PricewaterhouseCoopers and its predecessor firm, Coopers & Lybrand, respectively.

REPORT OF INDEPENDENT ACCOUNTANTS TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF ABBEY NATIONAL plc

We have audited the consolidated accounts of Abbey National plc and its subsidiary undertakings for the year ended December 31, 1999 on pages F-5 to F-89 inclusive. These accounts are the responsibility of the Company's management. Our responsibility is to express an opinion on these accounts based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United Kingdom, which do not differ in any material respects from auditing standards generally accepted in the United States. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the accounts. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall account presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounts referred to above present fairly, in all material respects, the consolidated financial position of Abbey National plc and its subsidiary undertakings at December 31, 1999 and the results of their operations and their cash flows for the year ended December 31, 1999, in conformity with accounting principles generally accepted in the United Kingdom.

Accounting principles generally accepted in the United Kingdom vary in certain significant respects from accounting principles generally accepted in the United States as set out in Note 54 to the consolidated accounts.

Deloitte & Touche
Chartered Accountants and Registered Auditors
London, England.
April 7, 2000

REPORT OF INDEPENDENT ACCOUNTANTS
TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF ABBEY NATIONAL plc

We have audited the consolidated accounts of Abbey National plc and its subsidiary undertakings for each of the two years in the period ended December 31, 1998 on pages F-5 to F-89 inclusive. These accounts are the responsibility of the Company's management. Our responsibility is to express an opinion on these accounts based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United Kingdom, which do not differ in any material respects from auditing standards generally accepted in the United States. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the accounts. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall account presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the accounts referred to above present fairly, in all material respects, the consolidated financial position of Abbey National plc and its subsidiary undertakings at December 31, 1998, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 1998, in conformity with accounting principles generally accepted in the United Kingdom.

Accounting principles generally accepted in the United Kingdom vary in certain significant respects from accounting principles generally accepted in the United States as set out in Note 54 to the consolidated accounts.

PricewaterhouseCoopers
Chartered Accountants
London, England.
April 9, 1999, except for the paragraphs headed "Restatement of prior year numbers" on page F-14, as to which the date is April 7, 2000.

CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEARS ENDED 31 DECEMBER 1999, 1998 AND 1997

	Notes	1999 Before exceptional items	1999 Exceptional items (see note 3)	1999 Total	1998 (restated) Total	1997 (restated) Total
		£m	£m	£m	£m	£m
Interest receivable:						
Interest receivable and similar income arising from debt securities		2,902		2,902	3,103	2,889
Other interest receivable and similar income	2	6,327		6,327	6,822	5,769
Adjustment to net investment in finance leases		—		—	—	(133)
Interest payable	4	(6,568)		(6,568)	(7,684)	(6,620)
Net interest income		2,661		2,661	2,241	1,905
Dividend income	5	2		2	4	3
Fees and commissions receivable		737		737	643	547
Fees and commissions payable		(246)		(246)	(136)	(96)
Dealing profits	6	98		98	32	36
Other operating income:						
Income from long term assurance business	21	202	(6)	196	155	147
Adjustment to income from long term assurance business		—		—	—	(12)
Other operating income	7	302		302	172	83
Total operating income		3,756	(6)	3,750	3,111	2,613
Administrative expenses	8	(1,475)	(21)	(1,496)	(1,240)	(1,096)
Depreciation and amortisation	9	(119)		(119)	(106)	(98)
Provisions:						
Provisions for bad and doubtful debts	10	(303)		(303)	(201)	(121)
Provisions for contingent liabilities and commitments	38	(23)		(23)	(16)	(16)
Amounts written off fixed asset investments		(26)		(26)	(28)	(3)
Profit on ordinary activities before tax		1,810	(27)	1,783	1,520	1,279
Tax on profit on ordinary activities	11	(530)	8	(522)	(462)	(326)
Profit on ordinary activities after tax		1,280	(19)	1,261	1,058	953
Minority Interest – equity				—	—	1
Profit attributable to the shareholders of Abbey National plc				1,261	1,058	954
Transfer to non-distributable reserve	41			(13)	(125)	(78)
Dividends including amounts attributable to non-equity interests	12			(610)	(535)	(469)
Profit retained for the financial year				638	398	407
Earnings per ordinary share – basic	13			86.2p	72.4p	65.2p
Earnings per ordinary share – diluted	13			85.5p	71.7p	64.7p

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 AND 1998

	Notes	1999	1999	1998 (restated)	1998 (restated)
		£m	£m	£m	£m
Assets					
Cash and balances at central banks			701		329
Treasury bills and other eligible bills	14		1,114		2,057
Loans and advances to banks	15		11,472		7,428
Loans and advances to customers	16		75,221		72,257
Loans and advances to customers subject to securitisation	17	1,930		217	
Less: non-returnable finance		(1,379)		(213)	
			551		4
Net investment in finance leases	18		5,441		5,326
Debt securities	19		59,445		54,203
Equity shares and other variable yield securities	20		295		123
Long term assurance business	21		1,042		760
Interests in associated undertakings	22		59		20
Intangible fixed assets	25		203		201
Tangible fixed assets	26		759		731
Operating lease assets	27		358		223
Other assets	28		3,930		3,332
Prepayments and accrued income	29		2,714		2,376
Assets of long term assurance funds	21		17,439		13,383
Total assets			180,744		162,753
Liabilities					
Deposits by banks	31		29,824		35,610
Customer accounts	32		59,911		52,924
Debt securities in issue	33		51,407		42,989
Dividend proposed			382		334
Other liabilities	34		6,930		4,564
Accruals and deferred income	35		2,857		3,015
Provisions for liabilities and charges	36		1,275		1,194
Subordinated liabilities including convertible debt	39		4,641		3,333
Liabilities of long term assurance funds	21		17,439		13,383
			174,666		157,346
Called up share capital—ordinary shares	40	142		142	
—preference shares		325		325	
Share premium account	40	1,536		1,493	
Reserves	41	449		433	
Profit and loss account	41	3,626		3,014	
Shareholders' funds including non-equity interests	42		6,078		5,407
Total liabilities			180,744		162,753
Memorandum items					
Contingent liabilities					
Guarantees and assets pledged as collateral security	44		2,214		1,844
Other contingent liabilities	45		477		552
			2,691		2,396
Commitments					
Obligations under stock borrowing and lending agreements	46		17,024		15,026
Other commitments	46		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 F-11.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
FOR THE YEARS ENDED 31 DECEMBER 1999, 1998 AND 1997

	Notes	1999	1998	1997
		£m	£m	£m
Profit attributable to the shareholders of Abbey National plc		1,261	1,058	954
Translation differences on foreign currency net investment	41	(1)	—	(5)
Exchange adjustments on US dollar preference shares		—	—	(4)
Unrealised surplus on revaluation of investment properties	41	3	—	—
Total recognised gains relating to the year		1,263	1,058	945

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEARS ENDED 31 DECEMBER 1999, 1998 AND 1997

	Notes	1999	1998	1997
		£m	£m	£m
Net cash inflow from operating activities	50a	10,527	4,688	7,658
Returns on investments and servicing of finance:				
Interest paid on subordinated liabilities		(198)	(195)	(176)
Preference dividends paid		(41)	(36)	(23)
Net cash outflow from returns on investments and servicing of finance		(239)	(231)	(199)
Taxation:				
UK corporation tax paid		(316)	(236)	(163)
Overseas tax paid		(3)	(52)	(21)
Total taxation paid		(319)	(288)	(184)
Capital expenditure and financial investment:				
Purchases of investment securities		(20,384)	(26,335)	(18,577)
Sales of investment securities		4,166	14,314	6,583
Redemptions and maturities of investment securities		7,383	8,102	5,866
Purchases of tangible fixed assets		(364)	(219)	(182)
Sales of tangible fixed assets		95	70	38
Transfers to life assurance funds		(145)	(4)	(14)
Net cash outflow from capital expenditure and financial investment		(9,249)	(4,072)	(6,286)
Acquisitions and disposals	50e,g	(30)	(214)	(237)
Equity dividends paid		(520)	(454)	(387)
Net cash inflow (outflow) before financing		170	(571)	365
Financing:				
Issue of ordinary share capital		18	17	15
Issue of preference share capital		—	—	125
Issue of loan capital		1,525	857	70
Repayments of loan capital		(195)	—	(8)
Net cash inflow from financing	50c	1,348	874	202
Increase in cash	50b	1,518	303	567

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.

ACCOUNTING POLICIES

Basis of presentation

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

Accounting convention

The Group prepares its accounts under the historical cost convention, 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 associated undertakings

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 and 1997, 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. For a quantification of the effect of this restatement, see "Restatement of prior year numbers" below.

Deferred income

The Group companies involved in retail lending have 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 derecognition of the associated right to receive stock and obligation to return stock balances. Obligations taken on pursuant to entering into such agreements are now reported as Commitments. For a quantification of the effects of this restatement, see "Restatement of prior year numbers" below.

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 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.

Restatement of prior year numbers

Prior year comparatives for 1998 and 1997 have been restated to reflect the changes noted below:

1. The Abbey National-branded unsecured lending business has been reclassified from Finance House to U.K. Retail Banking and City Deal Services Ltd has been transferred from Wholesale Banking to Wealth Management in order to better reflect the structure of management responsibility. The effect on the 1999 balances is a £126 million increase in U.K. Retail Banking's total operating income and a £29 million increase in profit before tax, with corresponding decreases in Finance House. The 1998 and 1997 comparative balances have been restated with the effect being a £119 million (1997: £97 million) increase in total operating income and a £26 million (1997: £33 million) increase in profit before tax for U.K. Retail Banking and corresponding decreases for Finance House. See note 1.

2. The accounting policy and presentation of interest income on dealing assets has been changed in order to present a more consistent treatment of interest income and expense across the Group's activities. Such interest is now included in interest receivable and interest payable. The effect on the 1999 balances is an £8 million reduction in dealing profit, a £321 million increase in interest receivable, and a £313 million increase in interest payable. The 1998 and 1997 comparative balances have been restated with the effect being a £12 million (1997: £16 million) reduction in dealing profits, a £447 million (1997: £827 million) increase in interest receivable, and a £435 million (1997: £811 million) increase in interest payable. These changes have no effect on net income and shareholders' funds under both U.K. and U.S. GAAP.

3. 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 effect on the 1999 balances is that Total assets and Total liabilities in the consolidated balance sheet have reduced by £17,024 million. The 1998 and 1997 comparative balances 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 (1997: £6,678 million). This change has no effect on net income and shareholders' funds under both U.K. and U.S. GAAP. Obligations taken on pursuant to entering such agreements are now reported as Commitments.

4. Segmental net assets have been restated to reflect more fairly the allocation of regulatory capital across business segments. See note 1 for additional information.

NOTES TO THE ACCOUNTS

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	Group 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 (as restated)	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
1997										
Net interest income before exceptional items	1,416	298	(10)	224	(3)	23	16	74	—	2,038
Other income and charges	255	63	183	(12)	144	31	2	56	—	722
Total operating income	1,671	361	173	212	141	54	18	130	—	2,760
Profit (loss) before taxation and exceptional items	819	297	167	100	105	14	(26)	(24)	—	1,452
Year 2000 and EMU costs	(21)	—	(2)	—	(1)	—	(4)	—	—	(28)
Finance lease adjustment	—	(133)	—	—	—	—	—	—	—	(133)
Adjustment to income from long term assurance business	—	—	(12)	—	—	—	—	—	—	(12)
Profit (loss) before taxation	798	164	153	100	104	14	(30)	(24)	—	1,279
Includes for: acquired operations	—	4	—	—	—	3	—	—	—	7
discontinued operations	—	—	—	—	—	—	(1)	—	—	(1)
Total assets	61,772	61,819	10,915	3,686	133	2,059	1,325	2,421	—	144,130
Net assets (as restated)	2,270	1,434	542	206	7	86	53	280	—	4,878
The average number of staff employed by the Group during the year was as follows:										
Employees	16,498	528	1,736	1,917	798	500	468	3,019	—	25,464

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. The effect on the 1998 and 1997 net assets by segment is shown below.

	UK Retail Banking £m	Wholesale Banking £m	Life Assurance £m	Finance House £m	General Insurance £m	Wealth Management £m	Continental Europe £m	Group Central Holdings £m	cahoot £m	Group Total £m
1998										
Net assets	554	1,669	713	577	107	128	182	1,477	—	5,407
Net adjustments	1,867	253	(70)	(355)	(85)	(30)	(132)	(1,448)	—	—
Net assets (as restated)	2,421	1,922	643	222	22	98	50	29	—	5,407
1997										
Net assets	472	1,331	563	406	244	24	288	1,550	—	4,878
Net adjustments	1,798	103	(21)	(200)	(237)	62	(235)	(1,270)	—	—
Net assets (as restated)	2,270	1,434	542	206	7	86	53	280	—	4,878

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 represents less than 5% of total assets.

2. Other interest receivable and similar income

	1999 £m	1998 (restated) £m	1997 (restated) £m
On secured advances	4,550	5,171	4,715
On unsecured advances	839	582	464
On finance leases	337	340	307
On other interest earning assets and investments	601	729	283
	6,327	6,822	5,769

Interest receivable on secured advances has been reduced by £235m (1998: £207m, 1997: £227m) 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:

	Interest rate discounts £m	Cashbacks £m	Total £m
At 1 January 1999	113	435	548
Expenditure incurred in the year	107	160	267
Transfer to profit and loss account	(110)	(125)	(235)
At 31 December 1999	110	470	580

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**	**EMU**	**Total**
	£m	**£m**	**£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**	**EMU**	**Total**
	£m	**£m**	**£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

Year ended 31 December 1997	**Year 2000**	**EMU**	**Total**
	£m	**£m**	**£m**
Expenditure charged to the profit and loss account:			
Included within Other administrative expenses	23	3	26
Income from long term assurance business	2	—	2
Capital expenditure (included within Tangible fixed assets)	12	2	14

Further information on Year 2000 and EMU can be found on page 39 of the Management Discussion and Analysis section.

1997: Corporation tax changes

In 1997, the UK Government announced a package of measures which represented a significant change to the UK corporation tax regime. A number of these measures had an effect on the accounts of Abbey National. In particular, in the Finance (No. 2) Act 1997, the Government reduced the main rate of corporation tax from 33% to 31%, and abolished the reclaim of tax credits on dividends from UK equity investments by pension funds. In November 1997, the Government announced a further reduction in the main rate of corporation tax to 30% from April 1999, and announced proposals to change from annual to quarterly tax payment dates. These proposals were subsequently enacted.

Adjustment to net investment in finance leases

In common with the industry, the changes in corporation tax resulted in a reduction in value of the Group's net investment in finance leases. The effect for the Group was an estimated reduction in interest receivable on finance leases of £133 million. Tax variation clauses in the leases, which preserve the lessors' post tax rate of return over the life of the leases, resulted in lower gross rental income when tax rates were reduced. A compensating reduction in the deferred tax liability was recognised and shown as a reduction in the tax charge. Group profit after tax and earnings per ordinary share were unaffected.

Adjustment to income from long term assurance business

As a result of the abolition of the reclaim of tax credits on dividends from UK equity investments by pension funds, a provision of £12 million before tax (£8 million after tax) was made against the embedded value profits for the Life Assurance subsidiaries in 1997.

NOTES TO THE ACCOUNTS (Continued)

4. Interest payable

	1999	1998 (restated)	1997 (restated)
	£m	£m	£m
On retail customer accounts	1,930	2,757	2,407
On sale and repurchase agreements	776	1,000	280
On other deposits and loans	3,621	3,727	3,754
On subordinated liabilities including convertible debt	241	200	179
	6,568	7,684	6,620

5. Dividend income

	1999	1998	1997
	£m	£m	£m
Income from equity shares and other variable yield securities	2	4	3

6. Dealing profits

	1999	1998 (restated)	1997 (restated)
	£m	£m	£m
Debt securities	20	2	17
Interest rate and equity derivatives	78	30	19
	98	32	36

7. Other operating income

	1999	1998	1997
	£m	£m	£m
Deferred income release (see note 35)	77	70	24
Profits less losses on disposal of investment securities	33	17	10
Profit on disposal of equity shares	60	—	—
Income from operating lease assets	78	31	13
Depreciation on operating lease assets	(52)	(20)	(8)
Income from associated undertakings	12	—	—
Other	94	74	44
	302	172	83

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	1998	1997
	£m	£m	£m
Staff costs[1]:			
Wages and salaries	621	516	455
Social security costs	49	42	39
Other pension costs	69	53	40
	739	611	534
Property and equipment expenses:			
Rents payable	72	61	60
Rates payable	27	25	26
Hire of equipment	5	6	6
Other property and equipment expenses	50	50	69
	154	142	161
Other administrative expenses[2]	603	487	401
	1,496	1,240	1,096

Notes:

(1) Excludes the following staff costs incurred by the Life Assurance division, which are charged to income from long term assurance business:

	1999	1998	1997
	£m	£m	£m
Staff costs:			
Wages and salaries	39	37	36
Social security costs	3	3	3
Other pension costs	4	4	4
	46	44	43

(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	1998	1997
	£m	£m	£m
Audit services	3.2	3.2	2.1
Reporting accountants and other regulatory reporting	0.9	1.0	2.2
Sub-total: Audit and similar services	4.1	4.2	4.3
Tax services	0.1	0.6	0.7
Consultancy and advisory services	1.9	2.2	1.9
Sub-total: Other services	2.0	2.8	2.6
	6.1	7.0	6.9

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	1998	1997
	£m	£m	£m
Amortisation of intangible fixed assets—purchased goodwill (see note 25)	11	1	—
Depreciation of tangible fixed assets (see note 26)	108	105	98
	119	106	98

10. Provisions for bad and doubtful debts

	On advances secured on residential properties	On other secured advances	On unsecured advances	Total
	£m	£m	£m	£m
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
At 1 January 1998				
General	84	13	20	117
Specific	100	130	110	340
Exchange adjustments	1	4	—	5
Acquisitions of subsidiary undertakings/purchases of business	—	40	46	86
Disposal of subsidiary undertakings	(1)	(7)	—	(8)
Transfer from profit and loss account	60	4	137	201
Irrecoverable amounts written off	(29)	(43)	(108)	(180)
At 31 December 1998	215	141	205	561
Being for the Group:				
General	109	23	67	199
Specific	106	118	138	362
At 1 January 1997				
General	67	11	17	95
Specific	145	202	92	439
Exchange adjustments	(2)	(10)	—	(12)
Transfer from profit and loss account	20	2	99	121
Irrecoverable amounts written off	(46)	(62)	(78)	(186)
At 31 December 1997	184	143	130	457
Being for the Group:				
General	84	13	20	117
Specific	100	130	110	340

NOTES TO THE ACCOUNTS (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
	%	%	%	%
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
At 31 December 1997				
UK	0.3	0.9	3.5	0.5
Non-UK	1.8	38.7	1.3	7.7

Analysis of movements on suspended interest

	£m	£m	£m	£m
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
At 1 January 1998	50	122	9	181
Exchange adjustments	1	4	—	5
Acquisitions of subsidiary undertakings/purchase of business	—	1	—	1
Amounts suspended in the period	30	7	10	47
Irrecoverable amounts written off	(20)	(56)	(8)	(84)
At 31 December 1998	61	78	11	150
At 1 January 1997	73	115	9	197
Exchange adjustments	(3)	(6)	—	(9)
Amounts suspended in the period	6	23	6	35
Irrecoverable amounts written off	(26)	(10)	(6)	(42)
At 31 December 1997	50	122	9	181
The value of loans and advances at 31 December 1999 on which interest is suspended is as follows:				
Loans and advances to customers	466	131	207	804
Provisions on these amounts	(76)	(97)	(110)	(283)
The value of loans and advances at 31 December 1998 on which interest is suspended is as follows:				
Loans and advances to customers	684	206	185	1,075
Provisions on these amounts	(106)	(118)	(46)	(270)
The value of loans and advances at 31 December 1997 on which interest is suspended is as follows:				
Loans and advances to customers	540	382	122	1,044
Provisions on these amounts	(100)	(130)	(83)	(313)

NOTES TO THE ACCOUNTS (Continued)

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	1998	1997
	£m	£m	£m
Loans and advances on which a proportion of interest has been suspended and/or on which specific provision has been made	938	1,184	892
Loans and advances 90 days overdue on which no interest has been suspended and on which no specific provision has been made	1,111	1,335	1,216
Non-accruing loans and advances	145	170	208
Total non-performing loans and advances	2,194	2,689	2,316
Non-performing loans and advances as a percentage of total loans and advances to customers	2.90%	3.69%	3.44%
Provisions as a percentage of total non-performing loans and advances	24.11%	20.86%	19.73%

11. Tax on profit on ordinary activities

	1999	1998	1997
	£m	£m	£m
UK Corporation tax:			
Current year at 30.25% (31%)	460	387	319
Prior years	(53)	113	(159)
Double tax relief	(1)	(58)	(18)
Deferred tax:			
Current year	73	90	10
Prior years	41	(123)	142
Tax on franked investment income	—	—	4
Overseas taxation	2	53	28
	522	462	326

12. Dividends

	1999	1998	1997	1999	1998	1997
	Pence per share	Pence per share	Pence per share	£m	£m	£m
Ordinary shares (equity)						
Interim (paid)	13.40	11.75	10.20	190	167	144
Final (proposed)	26.85	23.55	20.50	382	334	290
	40.25	35.30	30.70	572	501	434
Preference shares (non-equity)				38	34	35
				610	535	469

13. Earnings per ordinary share

	1999	1998	1997
Profit attributable to the shareholders of Abbey National plc (£m)	1,261	1,058	954
Preference dividends (£m)	(38)	(34)	(35)
Profit attributable to the ordinary shareholders of Abbey National plc (£m)	1,223	1,024	919
Weighted average number of ordinary shares in issue during the year – basic (million)	1,418	1,414	1,409
Basic earnings per ordinary share (pence)	86.2	72.4	65.2
Profit attributable to the ordinary shareholders of Abbey National plc (£m)	1,223	1,024	919
Weighted average number of ordinary shares in issue during the year – basic (million)	1,418	1,414	1,409
Dilutive effect of share options outstanding (million)	12	13	12
Weighted average number of ordinary shares in issue during the year – diluted (million)	1,430	1,427	1,421
Diluted earnings per ordinary share (pence)	85.5	71.7	64.7

14. Treasury bills and other eligible bills

	1999		1998	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£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.

15. Loans and advances to banks

	1999	1998
	£m	£m
Items in the course of collection	259	216
Purchase and resale agreements	6,397	4,983
Other loans and advances	4,816	2,229
	11,472	7,428
Repayable:		
On demand	4,942	3,711
In not more than 3 months	5,643	2,890
In more than 3 months but not more than 1 year	217	295
In more than 1 year but not more than 5 years	481	461
In more than 5 years	189	71
	11,472	7,428

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

	1999	1998
	£m	£m
Fixed rate	6,907	5,924
Variable rate	4,306	1,288
Items in the course of collection (non-interest bearing)	259	216
	11,472	7,428

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 49, Derivatives, Non-trading derivatives' for further information.

16. Loans and advances to customers

	1999	1998
	£m	£m
Advances secured on residential properties	64,756	63,194
Purchase and resale agreements	77	749
Other secured advances	2,534	2,019
Unsecured advances	8,310	6,188
Collateralised and guaranteed mortgage loans	95	111
	75,772	72,261
Repayable:		
On demand or at short notice	3,644	3,575
In not more than 3 months	3,367	2,482
In more than 3 months but not more than 1 year	2,992	2,697
In more than 1 year but not more than 5 years	8,599	7,006
In more than 5 years	57,699	57,062
Less: provisions (see note 10)	(529)	(561)
	75,772	72,261

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:

	1999	1998
	£m	£m
Fixed rate	22,508	22,182
Variable rate	53,793	50,640
Provisions	(529)	(561)
	75,772	72,261

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 49, Derivatives, 'Non-trading derivatives' for further information.

17. 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 and ANTS have 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.

Securitisation company	Date of securitisation	Gross assets securitised	Non-returnable finance	Subordinated loans made by the Group
		£m	£m	£m
ILSE No1 plc	26 February 1998	138	97	6
Holmes Funding No 1 plc	25 February 1999	824	577	12
Holmes Funding No 2 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	1998
	£m	£m
Net interest income	8	3
Other operating income	1	—
Administrative expenses	(2)	(3)
Provisions	(7)	—
Profit for the financial year	—	—

NOTES TO THE ACCOUNTS (Continued)

18. Net investment in finance leases

	1999	1998
	£m	£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.

19. Debt securities

	1999		1998	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£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

Investment securities held by the Group include £20m (nil) of subordinated investments in associates and are included within Other debt securities.

NOTES TO THE ACCOUNTS (Continued)

	1999		1998	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£m
Analysed by listing status:				
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

	1999	1998
	£m	£m
Book value analysed by maturity:		
Due within 1 year	12,985	13,925
Due in more than 1 year but not more than 5 years	18,355	17,191
Due in more than 5 years but not more than 10 years	9,545	7,778
Due in more than 10 years	18,632	15,354
Less: provisions	(72)	(45)
	59,445	54,203

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

	Cost	Provisions	Net book value
	£m	£m	£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

The total net book value of debt securities held for investment purposes at 31 December 1999 includes unamortised discounts of £134m (£262m).

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.

NOTES TO THE ACCOUNTS (Continued)

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 years ended 31 December 1999 and 1998 and an aggregated balance sheet as at 31 December 1999 and 1998 for these entities are shown below.

Profit and loss account

	1999	1998
	£m	£m
Interest receivable	166	2
Interest payable	(156)	(2)
Net interest income	10	—
Profit for the financial year	10	—

Balance sheet

	1999	1998
Investment debt securities	5,160	918
Prepayments and accrued income	192	10
Total assets	5,352	928
Debt securities in issue	5,347	919
Accruals and deferred income	5	9
Total liabilities	5,352	928

NOTES TO THE ACCOUNTS (Continued)

20. Equity shares and other variable yield securities

	1999		1998	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£m
Listed in the UK	66	70	31	87
Listed elsewhere	36	35	39	24
Unlisted	193	209	53	56
	295	314	123	167

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.

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

	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

21. Long term assurance business

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

	1999	1998
	£m	£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.

NOTES TO THE ACCOUNTS (Continued)

Business in force is defined as all live policies where the first premium has been paid. Recurrent single premium policies are treated as single premium policies, with the exception of Department of Social Security rebate policies, which are treated as regular premium policies. Shareholders are entitled to 10% of the value of bonuses declared in any particular year derived from the Scottish Mutual with profits fund, 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	1998
	£m	£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.

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

	1999	1998
	£m	£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

NOTES TO THE ACCOUNTS (Continued)

22. Interests in associated undertakings

The movement in interests in associated undertakings for 1999 and 1998 was as follows:

	£m
At 1 January 1999	20
Acquisitions	30
Additions	4
Disposals	(3)
Retained profits	8
At 31 December 1999	59

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

	£m
At 1 January 1998	21
Additions	2
Disposals	(3)
At 31 December 1998	20

On 30 December 1998, Abbey National plc disposed of its interest in Travellers Exchange Corporation plc. The amount receivable for the issued share capital was £11m and was received in cash. The Group loss on disposal of £9m, calculated after transferring from reserves £14m of goodwill previously written off, is included within Amounts written off fixed asset investments.

The principal associated undertakings at 31 December 1999 are:

Name and nature of business	Issued share capital	Interest (%)
CGU Underwriting Ltd, Insurance underwriting services	100 £1 ordinary A shares	15
	80,000,000 £1 ordinary B shares	15
DAH Holdings Ltd, Private banking	635,910 US$1 ordinary A shares	9.9
	364,090 US$1 ordinary convertible B shares	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.

23. Shares in Group undertakings

	1999 Cost & Book value	1998 Cost & Book value
	£m	£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:

	£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.

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 24, Summary of the effect of acquisitions and note 50, 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.

Name	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.

NOTES TO THE ACCOUNTS (Continued)

All the above companies are included in the consolidated accounts. 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.

24. 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.

25. Intangible fixed assets

	Purchased goodwill
	£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).

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

NOTES TO THE ACCOUNTS (Continued)

26. Tangible fixed assets

	Investment properties	Other premises	Equipment	Total
	£m	£m	£m	£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.

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

NOTES TO THE ACCOUNTS (Continued)

27. 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

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

28. Other assets

	1999	1998
	£m	£m
Foreign exchange and interest rate contracts:		
Positive market values of trading derivative contracts (see note 49)	930	392
Translation differences on foreign exchange derivatives used for hedging purposes	565	366
Debtors and other settlement balances	1,905	1,752
Introducer fees	305	264
Other	225	558
	3,930	3,332

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

29. Prepayments and accrued income

	1999	1998
	£m	£m
Unamortised lending-related fees (see note 2)	580	548
Other accrued interest	1,897	1,788
Prepayments and other accruals	237	40
	2,714	2,376

NOTES TO THE ACCOUNTS (Continued)

30. Assets subject to sale and repurchase transactions

	1999	1998
	£m	£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 19, Debt securities.

31. Deposits by banks

	1999	1998
	£m	£m
Items in the course of transmission	262	277
Sale and repurchase agreements	18,127	21,862
Other deposits	11,435	13,471
	29,824	35,610
Repayable:		
On demand	15,156	15,273
In not more than 3 months	11,709	14,533
In more than 3 months but not more than 1 year	2,327	4,452
In more than 1 year but not more than 5 years	117	143
In more than 5 years	515	1,209
	29,824	35,610

32. Customer accounts

	1999	1998
	£m	£m
Retail deposits	49,914	49,258
Sale and repurchase agreements	97	214
Other customer accounts	9,900	3,452
	59,911	52,924
Repayable:		
On demand	40,305	40,101
In not more than 3 months	16,523	10,245
In more than 3 months but not more than 1 year	1,179	1,064
In more than 1 year but not more than 5 years	258	210
In more than 5 years	1,646	1,304
	59,911	52,924

Included in Group customer accounts are amounts due to associated undertakings of £4m (£16m).

NOTES TO THE ACCOUNTS (Continued)

33. Debt securities in issue

	1999		1998	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£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.

	1999	1998
	£m	£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
Other debt securities in issue are repayable:		
In not more than 3 months	20,103	13,243
In more than 3 months but not more than 1 year	3,298	3,476
In more than 1 year but not more than 2 years	—	86
In more than 2 years but not more than 5 years	—	—
In more than 5 years	20	22
	23,421	16,827

34. Other liabilities

	1999	1998
	£m	£m
Creditors and accrued expenses	1,573	1,927
Short positions in government debt securities	1,521	1,199
Taxation	481	563
Foreign exchange and interest rate contracts:		
Negative market value of trading derivative contracts (see note 49)	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
1 year to 5 years	5	—
	6,930	4,564

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

NOTES TO THE ACCOUNTS (Continued)

35. Accruals and deferred income

	1999	1998
	£m	£m
Other accrued interest	2,499	2,722
Deferred income from residential mortgage lending	277	279
Other deferred income	81	14
	2,857	3,015

See Accounting policies, page F-10, 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).

36. Provisions for liabilities and charges

	1999	1998
	£m	£m
Deferred taxation (see note 37)	1,173	1,074
Other provisions for liabilities and charges (see note 38)	102	120
	1,275	1,194

37. Deferred taxation

	£m
At 1 January 1999	1,074
Transfer from profit and loss account	114
Other movements	(15)
At 31 December 1999	1,173

The amounts provided and total potential liability are:

	Amount provided	Total potential liability
	£m	£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	73
	1,173	1,173

NOTES TO THE ACCOUNTS (Continued)

38. Other provisions for liabilities and changes

	Pension and other similar obligations (1)	Provisions for commitments (2)	Pension misselling compensation (3)	Other provisions (4)	Total
	£m	£m	£m	£m	£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

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.

39. Subordinated liabilities including convertible debt

	1999	1998
	£m	£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 (Euro 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 (Euro £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

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

The 7.35% 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 U.K. at their principal amount together with any accrued interest.

Subordinated liabilities including convertible debt securities in issue are repayable:

	1999	1998
	£m	£m
In one year or less	203	274
In more than one year but not more than two years	—	—
In more than two years but not more than five years	832	286
In more than five years	2,250	1,842
Undated	1,356	931
	4,641	3,333

Subordinated liabilities including convertible debt issued by the Group have a market value, calculated using quoted market prices where available, of £4,886m (£3,932m).

NOTES TO THE ACCOUNTS (Continued)

40. Called up share capital and share premium account

	Ordinary shares of 10 pence each	Preference shares of £1 each	Preference shares of US$0.01 each	Total
	£m	£m	£m	£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
Issued and fully paid share capital				
At 1 January 1998	141	325	—	466
Issued under employee share option schemes	1	—	—	1
At 31 December 1998	142	325	—	467
Share premium account				
At 1 January 1998	1,335	9	116	1,460
Shares issued	16	—	—	16
Capitalisation of reserves in respect of shares issued via QUEST	17	—	—	17
At 31 December 1999	1,368	9	116	1,493

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.

NOTES TO THE ACCOUNTS (Continued)

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

Size of shareholding	Shareholders	Number of ordinary shares of 10 pence each	Shareholders	Number of preference shares of £1 each	Shareholders	Number of preference shares of US$0.01 each
1–100	1,324,857	128,511,709	—	—	7	700
101–1,000.	717,587	303,512,291	19	14,363	27	12,845
1,001+	32,765	989,929,408	1,061	324,985,637	7	7,986,455
	2,075,209	1,421,953,408	1,080	325,000,000	41	8,000,000

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.

41. Reserves and profit and loss account

	Profit and loss account
	£m
At 1 January 1999	3,014
Profit retained for the financial year	638
Exchange adjustments	(1)
Capitalised on exercise of share options issued via QUEST	(25)
At 31 December 1999	3,626

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. 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.

	Non-distributable reserve
	£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
	£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.

NOTES TO THE ACCOUNTS (Continued)

42. Reconciliation of movements in shareholders' funds

	1999	1998	1997
	£m	£m	£m
Profit attributable to the shareholders of Abbey National plc	1,261	1,058	954
Dividends (see note 12)	(610)	(535)	(469)
	651	523	485
Other recognised net gains and losses relating to the year	(1)	—	(5)
Increases in ordinary share capital including share premium	43	34	15
Increase in preference share capital including share premium	—	—	129
Capitalised reserves on exercise of share options	(25)	(17)	—
Movement on other reserves	3	—	—
Goodwill transferred from (taken to) profit and loss account reserve during the year	—	(11)	(139)
Net addition to shareholders' funds	671	529	485
Shareholders' funds at 1 January	5,407	4,878	4,393
Shareholders' funds at 31 December	6,078	5,407	4,878
Equity shareholders' funds	5,628	4,957	4,428
Non-equity shareholders' funds	450	450	450
At 31 December	6,078	5,407	4,878

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

Non-equity shareholders' funds comprise called-up preference share capital and preference share premium account.

43. Assets and liabilities denominated in foreign currency

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

	1999	1998
	£m	£m
Assets	50,747	43,364
Liabilities	57,425	46,921

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.

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

	1999	1998
	£m	£m
Guarantees given to third parties	1,183	813
Mortgaged assets granted	1,031	1,031
	2,214	1,844

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.

45. Memorandum items: Other contingent liabilities

	1999	1998
	£m	£m
Other contingent liabilities	477	552

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.

46. 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 49).

	1999	1998
	£m	£m
Formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year	999	1,225
1 Year and over	2,591	1,474
Forward sale and repurchase agreements	2,644	—
Other commitments	1	111
	6,235	2,810

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

47. Operating leases

	1999 Property	1999 Equipment	1998 Property	1998 Equipment
	£m	£m	£m	£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

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:

	1999
	£m
Year ended 31 December	
2000	70
2001	68
2002	65
2003	60
2004	56
Total thereafter	398

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

48. 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.

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', Page 61.

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 predominately 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.

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. ANFP 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.

For a more detailed description of the Group's use of derivatives, see pages F-52 and F-53 of the accounts. The accounting policy and financial disclosures for derivatives are given on pages F-11 and pages F-54 to F-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, Page 69.

Other disclosures are as follows: Financial risk management policies: see 'Financial risk management', Pages 61 to 69. Trading financial instrument exposure sensitivity analysis: see 'Financial risk management – Market risk of financial instruments – Trading Instruments, page 66.

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 49, '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 14, Treasury bills and other eligible bills; note 19, Debt securities; note 20, Equity shares and other variable yield securities; note 33, Debt securities in issue; note 39, Subordinated liabilities; and note 49, 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.

NOTES TO THE ACCOUNTS (Continued)

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 1999

	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	Non-trading Total £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	—		
1998 Cumulative gap	(3,178)	(1,145)	(1,546)	4,579	4,946	—		

(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.

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 Financial Risk Management section elsewhere in this document.

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	Borrowings hedging net investments in overseas operations 1999	Net structural currency exposures 1999	Net structural currency exposures 1998
	£m	£m	£m	£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)				
	Sterling	**US Dollar**	**Euro**	**Other**	**Total**
Functional currency of Group operation	**£m**	**£m**	**£m**	**£m**	**£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)				
	Sterling	**US Dollar**	**Euro**	**Other**	**Total**
Functional currency of Group operation	**£m**	**£m**	**£m**	**£m**	**£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.

49. 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 F-11.

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.

NOTES TO THE ACCOUNTS (Continued)

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.

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

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

Derivative products which are combinations of more basic derivatives (such as swaps with embedded option features), or which have leverage features, may be used in circumstances where the underlying position being hedged contains the same risk features. In such cases the derivative used will be 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 on its own account 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.

	Contract or underlying principal amounts 1999	Positive market values 1999	Negative market values 1999	Contract or underlying principal amounts 1998	Positive market values 1998	Negative market values 1998
	£m	£m	£m	£m	£m	£m
Non-trading derivatives:						
Exchange rate contracts:						
Cross-currency swaps	14,090	468	964	13,251	600	592
Forward foreign exchange	6,954	19	15	5,525	33	194
Foreign exchange options	29	2	—	—	—	—
	21,073	489	979	18,776	633	786
Interest rate contracts:						
Interest rate swaps	85,595	1,967	1,452	76,681	1,866	1,531
Caps, floors and swaptions	9,069	283	33	9,294	110	31
Futures (exchange traded)	1,029	—	—	7,097	1	2
Forward rate agreements	1,648	1	—	295	—	—
	97,341	2,251	1,485	93,367	1,977	1,564
Equity contracts:						
Equity index options	448	24	—	202	—	1
Equity index swaps	394	7	16	—	—	—
Caps, floors and swaptions	—	—	—	281	39	19
	842	31	16	483	39	20
Total	119,256	2,771	2,480	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

NOTES TO THE ACCOUNTS (Continued)

(£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	Positive market values 1999	Negative market values 1999	Contract or underlying principal amounts 1998	Positive market values 1998	Negative market values 1998
	£m	£m	£m	£m	£m	£m
Trading derivatives:						
Exchange rate contracts:						
Cross-currency swaps	4,851	110	135	3,148	98	117
Forward foreign exchange	3,310	1	12	71	—	8
	8,161	111	147	3,219	98	125
Interest rate contracts:						
Interest rate swaps	145,389	1,969	2,145	94,288	2,136	2,459
Caps, floors and swaptions	31,355	361	270	29,266	329	200
Futures (exchange traded)	13,644	—	—	20,677	—	—
Forward rate agreements	4,828	4	3	13,747	16	14
	195,216	2,334	2,418	157,978	2,481	2,673
Equity contracts:						
Equity index options	6,171	267	1,447	—	—	—
	6,171	267	1,447	—	—	—
Total	209,548	2,712	4,012	161,197	2,579	2,798
Effect of netting		(1,782)	(1,782)		(2,338)	(2,338)
Fair values of contracts between ANFP and other Group entities		—	209		151	—
Amount included in Other assets/Other liabilities		930	2,439		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.

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.

NOTES TO THE ACCOUNTS (Continued)

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	Net replacement cost 1999	Contract or underlying principal amounts 1998	Net replacement cost 1998
	£m	£m	£m	£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	Net replacement cost 1999	Contract or underlying principal amounts 1998	Net replacement cost 1998
	£m	£m	£m	£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

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:

	Gains	Losses	Total Net gains (losses)
	£m	£m	£m
Gains and losses expected to be recognised:			
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)).

NOTES TO THE ACCOUNTS (Continued)

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 year is as follows:

	Gains	Losses	Total Net gains (losses)
	£m	£m	£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

In addition, unamortised deferred cap and option premium expense amounted to £227m as at 31 December (1998: £225m). Of this balance, £60m will be released to the profit and loss account within one year (1998: £50m), and £167m will be released to the profit and loss account after one year (1998: £175m).

Non-trading Swap Activity

The tables below set forth, by nominal amount, the activity in interest rate and cross currency swaps entered into for hedging purposes, with third parties and ANFP.

	1999			1998		
	Interest rate swaps	Cross-currency swaps	Total	Interest rate swaps	Cross-currency swaps	Total
	£m	£m	£m	£m	£m	£m
At 1 January (third party contracts)	32,449	11,824	44,273	34,323	11,850	46,173
At 1 January (contracts with ANFP)	44,232	1,427	45,659	24,524	1,323	25,847
New contracts	21,264	6,535	27,799	20,149	2,717	22,866
Matured and amortised contracts	(14,593)	(6,115)	(20,708)	(20,902)	(2,878)	(23,780)
Terminated contracts	(297)	(20)	(317)	(1,714)	(308)	(2,022)
Effect of foreign exchange rate and other movements	(536)	(131)	(667)	592	443	1,035
Net increase in contracts with ANFP	3,076	570	3,646	19,709	104	19,813
At 31 December	85,595	14,090	99,685	76,681	13,251	89,932

NOTES TO THE ACCOUNTS (Continued)

The Group uses interest rate swaps and cross-currency swaps predominantly for hedging fixed-rate assets and liabilities so that they become, in effect, floating rate assets and liabilities. For interest rate swaps and cross-currency swaps used for these purposes, the weighted average pay fixed rates, receive fixed rates, pay variable rates and receive variable rates by maturity and contract amount as at 31 December 1999 were as follows:

	Pay fixed		**Receive fixed**		**Pay variable**		**Receive variable**	
	Nominal amount	**Rate**	**Nominal amount**	**Rate**	**Nominal amount**	**Rate**	**Nominal amount**	**Rate**
	(£m)	**(%)**	**(£m)**	**(%)**	**(£m)**	**(%)**	**(£m)**	**(%)**
Contracts maturing:(1)								
Less than 1 year. . .	4,808	6.04	15,427	5.70	17,746	5.60	7,092	4.81
1 to 3 years	10,772	6.52	13,584	6.51	19,062	5.11	16,033	5.45
3 to 5 years	8,019	6.44	11,009	6.33	18,853	4.76	15,780	5.70
Over 5 years	8,961	5.94	7,654	5.56	11,910	4.48	13,106	5.48
Total	32,560		47,674		67,571		52,011	

(1) For the purpose of this analysis, the maturity date has been taken to be the date when the contract expires.

(2) The total pay fixed nominal amount comprises £31,031 million in respect of interest rate swaps and £1,529 million in respect of cross-currency swaps. The total receive fixed nominal amount comprises £43,423 million in respect of interest rate swaps and £4,251 million in respect of cross-currency swaps. The total pay variable nominal amount comprises £54,564 million in respect of interest rate swaps and £13,007 million in respect of cross-currency swaps. The total receive variable nominal amount comprises £42,172 million in respect of interest rate swaps and £9,839 million in respect of cross-currency swaps.

A difference arises when comparing nominal contract assets and nominal contract liabilities. Whereas with single currency swaps there are equal and opposite nominal balances on either side of the swap leg, this is not necessarily the case with cross-currency swaps. At contract date sterling equivalent nominal amounts should be equal and opposite, however, subsequent exchange rate movements will result in divergence in the nominal amounts. This exchange rate divergence explains the difference between nominal contract asset balances and nominal contract liability balances.

The weighted average interest rates presented in the tables above reflect interest rates in a range of currencies. These rates should not be analysed in isolation from the rates on the underlying instruments. The effect of hedges has been included in the average interest rates presented in the average balance sheet set forth above.

NOTES TO THE ACCOUNTS (Continued)

The contract amount of each type of end-use contract (excluding cross-currency swaps and interest rate swaps which are included in the swaps detailed above) as at 31 December 1999 are set forth by currency in the table below. Of these contracts £10,298 million mature within one year and £9,273 million mature after one year.

	Contract type by nominal amount				
	Forward Foreign Exchange	Forward Rate Agreements	Options Caps and Floors (OTC)(1)	Futures (Exchange-Traded)	Equity Contracts
			(in millions of £)		
Sterling	1,121	272	6,098	485	487
U.S. dollars	3,728	1,376	2,740	544	184
European currency units	128	—	78	—	94
Swiss francs	198	—	—	—	4
Canadian dollars	34	—	—	—	—
Deutschemarks	—	—	—	—	6
French francs	—	—	3	—	14
Spanish pesetas	—	—	12	—	—
Italian lire	—	—	167	—	50
Portugese escudo	—	—	—	—	3
Japanese yen	1,745	—	—	—	—
Total	6,954	1,648	9,098	1,029	842

(1) All OTC option contracts are in respect of interest related instruments.

The impact on the income statement attributable to non-trading derivative activities for the year ended 31 December 1999 was a £7 million increase in interest receivable. There was no material impact on interest receivable. However, these figures should not be analyzed in isolation since there are compensating movements arising from the assets, liabilities and positions against which the hedges were placed.

Included within trading derivatives are contracts used in portfolio management within the ANTS trading books, with net negative fair value of £161 million as at 31 December 1999. These contracts principally relate to synthetic floating rate notes, which are packages of fixed rate debt securities and swaps with precisely matched interest rate and other characteristics (see "Selected Statistical Information – Securities" above). This figure, which related only to the swaps in such packages, should not be analyzed in isolation, therefore, because it is substantially matched by a corresponding surplus of net positive fair value over cost on the related trading securities.

For the year ended 31 December 1999, ANFP contributed £78 million (1998: £30 million) to the dealing profits of the Group.

For a discussion of risk management of derivatives within the trading and non-trading portfolios see "Financial Risk Management" included elsewhere in this Document.

50. Consolidated cash flow statement

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

	1999	1998	1997
	£m	£m	£m
Profit on ordinary activities before tax	1,783	1,520	1,279
Decrease (Increase) in interest receivable and prepaid expenses	342	(1,157)	(181)
(Decrease) Increase in interest payable and accrued expenses	(155)	245	265
Provisions for bad and doubtful debts	303	201	121
Provisions for contingent liabilities and commitments	23	16	16
Net advances written off	(317)	(176)	(186)
Increase in the value of long term assurance business	(196)	(155)	(129)
Depreciation and amortisation	171	126	106
Income from Associated Undertakings	(12)	—	—
Profit on sale of tangible fixed assets and investments	(108)	(30)	(18)
Exceptional items	—	—	145
Effect of other deferrals and accruals of cash flows from operating activities	98	16	32
Net cash inflow from trading activities	1,932	606	1,450
Net increase in loans and advances	(5,504)	(1,811)	(1,372)
Net (increase) decrease in investment in finance leases	(100)	20	(480)
Net decrease (increase) in bills and securities	3,314	(2,678)	3,197
Net increase (decrease) in deposits and customer accounts	445	5,616	(169)
Net increase in debt securities in issue	8,404	3,005	4,784
Net increase (decrease) in other liabilities less assets	2,243	487	(127)
Exchange movements	(207)	(557)	375
Net cash inflow from operating activities	10,527	4,688	7,658

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.

NOTES TO THE ACCOUNTS (Continued)

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

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

	Cash & balances with central banks	Loans & advances to other banks repayable on demand	Total
	£m	£m	£m
At 1 January 1999	329	1,337	1,666
Net cash inflow	372	1,146	1,518
At 31 December 1999	701	2,483	3,184
At 1 January 1998	329	1,034	1,363
Net cash inflow	—	303	303
At 31 December 1998	329	1,337	1,666
At 1 January 1997	228	568	796
Net cash inflow	101	466	567
At 31 December 1997	329	1,034	1,363

Loans and advances to other banks repayable on demand excludes £1,918m (1998: £2,374m, 1997: £1,894m) 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 (1998: £101m, 1997: £240m). 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	Subordinated liabilities	Total
	£m	£m	£m
At 1 January 1999	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 1999	2,003	4,642	6,645
At 1 January 1998	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 1998	1,960	3,333	5,293
At 1 January 1997	1,782	2,374	4,156
Net cash inflow from financing	140	62	202
Effect of foreign exchange rate changes	4	27	31
At 31 December 1997	1,926	2,463	4,389

NOTES TO THE ACCOUNTS (Continued)

d) Acquisitions of subsidiary and associated undertakings and purchase of businesses

	1999	1998	1997
	£m	£m	£m
Net assets acquired:			
Treasury bills and other eligible bills	—	—	542
Loans and advances to banks	—	4	5,813
Loans and advances to customers	—	3,386	7,029
Net investment in finance leases	—	691	—
Debt securities	—	—	5,540
Tangible fixed assets	36	68	4
Operating lease assets	—	85	—
Other assets	30	255	185
Deposits by banks	—	(3,992)	(8,250)
Customer accounts	—	—	(10,569)
Other liabilities	—	(265)	(184)
Goodwill on acquisitions	—	202	129
	66	434	239
Satisfied by:			
Unsecured interest bearing loan notes	—	5	2
Cash	30	364	237
Deferred consideration	—	4	—
Loan prepayment	36	61	—
	66	434	239

e) Analysis of the net outflow of cash in respect of acquisitions of subsidiary and associated undertakings and purchase of businesses

	1999	1998	1997
	£m	£m	£m
Cash consideration	30	364	237
Cash acquired	—	(7)	(1)
Net outflow of cash in respect of acquisitions of subsidiary and associated undertakings/purchase of business	30	357	236

f) Sale of subsidiary and associated undertakings

	1999	1998	1997
	£m	£m	£m
Net assets disposed of: Tangible fixed assets	—	5	1
Loans and advances	—	327	—
Other assets	—	8	9
Cash at bank and in hand	—	4	1
Deposits by banks and customer accounts	—	(214)	(5)
Other liabilities	—	(5)	(4)
Provisions for liabilities and charges	—	(1)	—
– Goodwill written back	—	19	—
	—	143	2
Profit on disposal	—	4	2
Consideration received	—	147	4
Satisfied by:			
Cash	—	147	—
Other assets	—	—	4
	—	147	4

g) Analysis of the net inflow of cash in respect of the sale of subsidiary and associated undertakings

	1999	1998	1997
	£m	£m	£m
Cash received as consideration	—	147	—
Cash disposed of	—	(4)	(1)
Net inflow/(outflow) of cash in respect of sale of subsidiary and associated undertakings	—	143	(1)

51. 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%.

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.

52. Directors' emoluments and interests

Further details of directors' emoluments and interests are included in the Management section on pages 80 to 91. 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 85, an analysis of directors' share options on pages 88 and 89 and details of the directors' conditional rights over the Company's shares under the Long Term Incentive Plan on page 89, 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	—	—

	Number of persons	Aggregate amount outstanding
		£000
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 53.

53. 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.

	No. of directors and executive officers (1)	Amounts in respect of directors, executive officers (1) and their close family members
		£000
1999		
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
1998		
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 share dealing 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 (1998: £130m, 1997: £120m) 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 (1998: 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 16 and 32. Further details of the Group's interests in associated undertakings are shown in note 22.

c) *Transactions with long term assurance funds*

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

As at 31 December 1999, Group entities owed £232m (£206m) to, and were owed £31m (£41m) by, the long term assurance funds. Of these respective amounts £230m (£204m) relates to amounts deposited by the long term assurance funds with Abbey National plc or Abbey National Treasury Services plc (ANTS), and £4m (£5m) relates to amounts owed by the long term assurance funds to Abbey National plc. The remaining amounts represent balances between the long term assurance funds and the shareholders' funds of the life assurance businesses within the Group. In addition, the long term assurance funds have lent £897m (£645m) of investment assets to a subsidiary of ANTS under stock lending agreements as at 31 December 1999.

Included in fees and commissions receivable in the year is an amount of £32m (£26m) receivable from the long term assurance fund of Abbey National Life plc in respect of life assurance products sold through the retail branch network.

During the year Abbey National Financial Investment Services plc incurred costs amounting to £96m (£90m) on behalf of the long term assurance funds. All such costs were recharged to the long term assurance funds.

Details of transfers of funds between shareholders' funds and long term assurance funds are provided in note 21. Included within Assets of long term assurance funds and Liabilities of long term assurance funds are amounts owing between the long term assurance funds of £6m (£11m).

The value of the funds' holdings in internally managed unit trusts amounted to £4,431m (£798m) at 31 December 1999. The unit trusts are managed by Abbey National Unit Trust Management Ltd, Scottish Mutual International Fund Managers Ltd and Scottish Mutual International Managers Ltd.

54. 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 service 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.

Investments in securities

UK GAAP Securities held for investment purposes are stated at cost adjusted for any amortisation of premium or discount. Provision is made for any impairment in value.

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.

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 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, derecognises financial assets when control has been surrendered, and derecognises 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.

c) 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 49 to the accounts, 'Derivatives'). In the Group accounts, the hedging contracts are accounted for on an accruals basis as non-trading instruments.

NOTES TO THE ACCOUNTS (Continued)

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.

d) 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.

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

Where applicable, the adjustments are stated gross of tax with the tax effect being included within the deferred tax effects of US/UK GAAP adjustments to net income and shareholders' funds.

	1999	1998	1997
	£m	£m	£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 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			
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
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 losses on derivative contracts with in-house trading operations	(28)	—	—
Dividend payable	382	334	290
Net unrealised (deficit)/surplus 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

NOTES TO THE ACCOUNTS (Continued)

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 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 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 133 will have on its earnings or statement of financial position.

55. Further note disclosures on differences between U.K. and U.S. GAAP, and certain additional U.S. disclosures

a) Depreciable Assets

The following tables provide analyses of intangible fixed assets and tangible fixed assets included in the balance sheet under U.S. GAAP for the three years ended 31 December 1999, 1998 and 1997.

Intangible Fixed Assets	**Year ended 31 December**		
	1999	**1998**	**1997**
	£m	**£m**	**£m**
Arising on Consolidation			
At 1 January	1,447	1,235	1,132
Acquisitions of subsidiary undertakings	13	212	103
Adjustment for deferred tax on core deposit intangible	83	—	—
At 31 December	1,543	1,447	1,235
Amortisation			
At 1 January	277	188	99
Charge for the year	102	89	89
At 31 December	379	277	188
Net Book Value			
Total intangible assets capitalised per US GAAP	1,164	1,170	1,047
Total intangible assets capitalised per UK GAAP	203	201	—
US/UK GAAP difference	961	969	1,047
Net assets of businesses acquired	(20)	(49)	(49)
US/UK GAAP adjustments to shareholders' funds	941	920	998

Tangible Fixed Assets	**Year ended 31 December**		
	1999	**1998**	**1997**
	£m	**£m**	**£m**
Total tangible assets capitalised per US GAAP	830	731	698
Total tangible assets capitalised per UK GAAP	759	731	698
US/UK GAAP adjustment to shareholders' funds	71	—	—
Total Depreciable Assets – Net Book Value			
Total depreciable assets capitalised per US GAAP	1,974	1,852	1,696
Total depreciable assets capitalised per UK GAAP	962	932	698
US/UK GAAP adjustments to shareholders' funds	1,012	920	998

NOTES TO THE ACCOUNTS (Continued)

b) Pension Costs

For the reconciliation above, the Group adopts the provisions of SFAS No. 87, "Employers Accounting for Pensions", as amended by SFAS No. 132, "Employers' Disclosures about Pensions and Other Post-retirement Benefits", in respect of its principal pension plans, The Abbey National Amalgamated Pension Fund, the Scottish Mutual Assurance plc Staff Pension Scheme, the First National Finance Corporation Pension and Life Assurance Plan, the N&P Pension Fund and the Abbey National Group Pension Scheme. The components of the estimated net period pension cost computed under SFAS No. 87 are as follows:

	Year ended 31 December		
	1999	**1998**	**1997**
	£m	**£m**	**£m**
Service cost	121	92	82
Interest cost	89	79	88
Expected return on assets	(100)	(101)	(94)
Amortisation of initial transition gain	(8)	(8)	(8)
Recognised gain	—	(8)	—
Recognised prior service cost	2	1	2
Net periodic pension cost	104	55	70

The following table sets forth a reconciliation of beginning and ending balances of the projected benefit obligation.

	Year ended 31 December	
	1999	**1998**
	£m	**£m**
Benefit obligation at the beginning of the year	1,499	1,139
Service cost	121	92
Interest cost	89	79
Members' contributions	12	10
Actuarial (loss)/gain	(40)	211
Benefits paid	(38)	(32)
Benefit obligation at end of year	1,643	1,499

The following table sets forth a reconciliation of the fair value of plan assets for the period 1 January to 31 December.

	Year ended 31 December	
	1999	**1998**
	£m	**£m**
Fair value of plan assets at beginning of year	1,523	1,492
Actual return on plan assets	299	(17)
Employer contributions	74	70
Employee contributions	12	10
Benefits paid	(38)	(32)
Fair value of plan assets at end of year	1,870	1,523

NOTES TO THE ACCOUNTS (Continued)

The following table sets forth the funded status of the plans.

	Year ended 31 December	
	1999	**1998**
	£m	**£m**
Funded status	227	24
Unrecognised prior service cost	9	11
Unrecognised gain	(302)	(62)
Unamortized initial transition gain	(32)	(40)
Accrued liabilities	(98)	(67)

The estimated accumulated benefit obligation at 30 September 1999 amounted to £1,530m (30 September 1998: £1,295m), of which £1,368m was vested (30 September 1998: £1,148m). The actuarial value placed upon the vested benefit obligation (VBO) is lower than that placed upon the accumulated benefit obligation primarily because the statistical assumptions used in calculating the projected and accumulated benefit obligations made provision for members to retire prior to the age from which vested benefits are payable, in view of the terms on which such retirement may, with the consent of the relevant Group company, take place. It is not appropriate to reflect such an assumption in the calculation of the VBO.

Under SFAS No. 87, the excess of plan assets over the projected benefit obligation at the transition date would be recognised as a reduction to pension expense on a prospective basis over approximately 14 years. The financial assumptions used to calculate the projected benefit obligations for the principal pension plans listed above, at 30 September 1999 and 1998 were as follows:

	Year ended 31 December	
	1999	**1998**
	% pa	**% pa**
Discount rate	6.5	6.0
Rate of pay escalation	4.5	4.5
Rate of pension increase	3.0	2.5
Rate of return on assets	7.0	6.5

The assets of the schemes are invested primarily in equities and fixed interest securities.

The schemes' retirement benefits are generally based on the final year's pensionable salary and the number of years pensionable service with the Group at retirement.

The £104m US GAAP pension cost (1998: £55m, 1997: £70m) compares with £65m (1998: £57m, 1997: £44m) under UK GAAP. The difference net of UK corporation tax is a decrease to net income of £28m (1998: £1m increase, 1997: £18m charge) under US GAAP.

Abbey National plc operates other pension schemes within the Group. These schemes are small and the difference in pension costs under UK and US accounting principles is not material.

c) Leasing

Under US GAAP, SFAS No. 13 requires the following disclosures relating to finance leases as at 31 December 1999 and 1998.

	1999 £m	1998 £m
Total minimum lease payments to be received	10,930	10,666
Provision for impairment	(12)	(14)
Amounts representing estimated executory costs	(45)	(41)
Minimum lease payments receivable	10,873	10,611
Unearned income	(5,520)	(5,356)
Net investment in direct financing leases	5,353	5,255

At 31 December 1999, minimum lease payments for each of the next five years are as follows: £886m in 2000, £614m in 2001, £522m in 2002, £500m in 2003 and £490m in 2004.

d) Stock-based compensation costs

Abbey National grants share options to executive officers and employees under the Executive Share Option scheme, Sharesave scheme and the Employee Share Option scheme.

Options granted under the Executive Share Option scheme are generally exercisable between the third and tenth anniversaries of the grant date, provided that certain performance criteria are met. See "Management — Directors' remuneration" elsewhere in this Annual Report for a description of this scheme.

Under the Sharesave scheme, eligible employees can elect to exercise their options either three, five or seven years after the grant date. See Note 40 to the Consolidated Financial Statements for a description of the options granted under this scheme.

The number of options authorised to be granted is currently limited to 10% of the total number of shares issued since conversion.

Proforma net income and Earnings Per Share Ratio

Abbey National has adopted the intrinsic value-based method to measure compensation cost, for the purposes of the reconciliation of net income between UK and US GAAP.

If the compensation cost for the three plans had been determined based on the fair value at the grant dates consistent with the method encouraged by SFAS No. 123, net income and earnings per share would have been as shown on a pro forma basis below:

		1999 £m	1998 £m
Net income under U.S. GAAP	As reported	1,011	825
	Proforma	1,006	821
Earnings per share under U.S. GAAP	As reported	71.3p	58.3p
	Proforma	70.9p	58.1p

NOTES TO THE ACCOUNTS (Continued)

The fair value of each option for 1999 has been estimated as at the grant date using the Black-Scholes option pricing model using the following assumptions:

Risk free interest rate	4.5%-8.0%
Dividend growth, based solely upon average growth since 1989	14%
Volatility of underlying shares based upon historical volatility over 5 years	23.4%-27.9%
Expected lives of options granted under:	
Employee Sharesave scheme	3, 5 and 7 years*
Executive Share Option scheme	6 years
Employee Share Option scheme	5 years

The fair value of each option for 1998 has been estimated as at the grant date using the Black-Scholes option pricing model using the following assumptions:

Risk free interest rate	5.8%-8.0%
Dividend growth, based solely upon average growth since 1989	15%
Volatility of underlying shares based upon historical volatility over 5 years	23.4%-24.7%
Expected lives of options granted under:	
Employee Sharesave scheme	3, 5 and 7 years*
Executive Share Option scheme	6 years
Employee Share Option scheme	5 years

The fair value of each option for 1997 has been estimated as at the grant date using the Black-Scholes option pricing model using the following assumptions:

Risk free interest rate	6.4%-8.0%
Dividend growth, based solely upon average growth since 1989	15%
Volatility of underlying shares based upon historical volatility over 5 years	23.4%-24.7%
Expected lives of options granted under:	
Employee Sharesave scheme	3, 5 and 7 years*
Executive Share Option scheme	6 years
Employee Share Option scheme	5 years

* For three, five and seven year schemes respectively.

The following table summarises the movement in the number of share options between those outstanding at the beginning and end of the year, together with the changes in weighted average exercise price over the same period.

	Executive Share Option scheme (1)		Employee Sharesave scheme		Employee Share Option scheme	
	Number of options granted	Weighted average Exercise Price (2)	Number of options granted	Weighted average Exercise Price (2)	Number of options granted	Weighted average Exercise Price
1999						
Options outstanding at the beginning of the year	4,062,500	7.10	17,546,639	5.61	6,300,600	9.15
Options granted during the year	801,925	12.91	3,752,210	10.06	—	—
Options exercised during the year	(873,642)	5.67	(3,325,681)	3.08	(380,400)	5.93
Options forfeited during the year	(35,829)	8.24	(1,296,610)	8.10	(529,200)	9.03
Options expired during the year	(7,877)	9.69	(1,039)	2.88	—	—
Options outstanding at the end of the year	3,947,077	8.57	16,675,519	6.92	5,391,000	9.39
Options exercisable at the end of the year	1,294,839	5.29	57,150	3.15	—	—
The weighted-average grant-date fair value of options granted during the year	12,108,895		47,794,669		—	
1998						
Options outstanding at the beginning of the year	5,312,101	5.68	17,690,506	4.28	2,901,150	5.91
Options granted during the year	796,940	11.69	3,916,307	10.00	3,887,100	11.54
Options exercised during the year	(1,940,759)	5.08	(2,768,606)	2.98	(42,125)	5.91
Options forfeited during the year	(105,782)	7.34	(1,291,568)	6.34	(445,525)	9.24
Options expired during the year	—	—	—	—	—	—
Options outstanding at the end of the year	4,062,500	7.10	17,546,639	5.61	6,300,600	9.15
Options exercisable at the end of the year	747,629	4.69	60,877	2.86	—	—
The weighted-average grant-date fair value of options granted during the year	11,447,291		47,846,712		54,555,692	
1997						
Options outstanding at the beginning of the year	4,978,178	5.43	18,841,693	3.27	3,326,100	5.91
Options granted during the year	1,300,640	7.22	4,734,510	6.15	—	—
Options exercised during the year	(779,495)	3.61	(4,681,433)	1.91	(18,750)	5.91
Options forfeited during the year	(124,237)	5.93	(1,204,264)	4.56	(406,200)	5.91
Options expired during the year	(62,985)	13.53	—	—	—	—
Options outstanding at the end of the year	5,312,101	5.68	17,690,506	4.28	2,901,150	5.91
Options exercisable at the end of the year	1,385,976	4.90	18,115	1.87	—	—
The weighted-average grant-date fair value of options granted during the year	11,250,689		37,964,869		—	

(1) The information presented above for the Executive Share Option scheme includes replacement options granted to executive officers of FNFC upon the acquisition of FNFC by Abbey National in 1995. As at 31 December, 1999, there were 10,583 such options outstanding (1998: 39,594), with an exercise price of £8.25 (1998: ranging from £4.02 to £9.69). Substantially all of these share options have exercise prices set at more than the market prices of the stock on the relevant grant dates. These options expired in February 2000.

(2) Where there are parallel discounted options offered to executive officers, the weighted average exercise price for such options reflects the option price which is the most likely outcome. See "Management — Directors' share interests" elsewhere in this Annual Report for a description of such options.

NOTES TO THE ACCOUNTS (Continued)

The following table summarises information about the options outstanding at 31 December 1999.

Executive Share Option	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 31/12/99	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Prices (£)	Number Exercisable at 31/12/99	Weighted-Average Exercise Prices (£)
Between £2 and £3	5,000	2.33	2.99	5,000	2.99
Between £3 and £4	82,666	3.24	3.69	82,666	3.69
Between £4 and £5	434,124	4.97	4.79	434,124	4.79
Between £5 and £6	762,466	5.33	5.72	762,466	5.72
Between £7 and £8	1,110,594	7.25	7.22	—	—
Between £8 and £9	10,583	0.58	8.25	10,583	8.25
Between £9 and £12	783,909	8.19	11.62	—	—
Between £12 and £15	757,735	9.16	13.06	—	—

Employee Sharesave	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 31/12/99	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Prices (£)	Number Exercisable at 31/12/99	Weighted-Average Exercise Prices (£)
Between £3 and £4	950,404	1.65	3.18	57,150	3.15
Between £4 and £5	5,550,576	1.73	4.43	—	—
Between £6 and £7	3,649,547	2.83	6.14	—	—
Between £9 and £11	6,524,992	4.27	10.03	—	—

Under the Employee Sharesave scheme, the weighted-average exercise prices of options are less than the market prices of the stock on the relevant grant dates.

Employee share option scheme	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 31/12/99	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Prices (£)	Number Exercisable at 31/12/99	Weighted-Average Exercise Prices (£)
Between £5 and £6	2,061,750	6.67	5.91	—	—
Between £9 and £11	3,329,250	8.25	11.54	—	—

e) Taxes

(i) No significant element of the tax expense in each of the three years ended 31 December 1999, 1998 and 1997 is attributable to discontinued operations.

(ii) The significant components of tax expense attributable to continuing operations are shown in Note 11.

(iii) A reconciliation of taxes payable at the standard U.K. corporation tax rate and the Group's effective tax rate for each of the three years ended 31 December 1999, 1998, and 1997 is shown as follows.

	Year ended 31 December		
	1999	**1998**	**1997**
	£m	**£m**	**£m**
Taxation at standard U.K. corporation tax rate (30.25%, 31%, 31.5%)	548	492	449
Effect of non-allowable provisions and other non-equalized items	22	9	35
Effect of non-U.K. profits and losses	(9)	(8)	(1)
Adjustment to prior year tax provisions	(12)	(10)	(17)
Effect of dividend income taxed at different rates	—	—	(3)
Effect of loss utilisation	(19)	—	—
Taxes before the effect of exceptional items	530	483	463
Effective tax rate before the effect of exceptional items	29.3%	30.4%	32.5%

(iv) The tax effects of the principal components of deferred tax liabilities and deferred tax assets at 31 December 1999 and 1998 were as follows:

	1999	**1998**
	£m	**£m**
Deferred Tax Liabilities recognised in U.K. financial statements		
Excess of capital allowances over depreciation	16	13
Capital allowances on finance lease receivables	1,084	1,007
Other	73	54
	1,173	1,074
Additional Deferred tax assets arising from application of U.S. GAAP		
Operating loss carry forwards	87	110
Deductible temporary differences	81	76
	168	186
Less valuation allowance	(101)	(110)
Deferred tax assets (U.S. GAAP)	67	76
Deferred tax assets arising from U.S. GAAP adjustments	219	202
Net deferred tax liabilities	887	796

Of the additional deferred tax asset in respect of operating loss carry forwards shown above, £2m is expected to expire at the end of 2003.

£42m of the valuation allowance at 31 December 1999 (£47m at 31 December 1998) in respect of the operating loss carry forwards of acquired entities will be allocated to reduce goodwill relating to those acquisitions if the benefit is subsequently realised.

f) Earnings per share ("EPS")

Under U.S. GAAP, SFAS No. 128 requires certain disclosures relating to earnings per share in addition to the presentation of diluted earnings per share on the face of the income statement. The following tables provide reconciliations of the income and number of shares used in the calculation of basic and diluted EPS for the years ended 31 December 1999, 1998 and 1997.

	Year ended 31 December 1999		
	Income £m	Shares m	EPS pence
Basic EPS			
Income available to ordinary shareholders	1,011	1,418	71.3
Effect of dilutive securities:			
Share options	—	10	—
Diluted EPS	1,011	1,428	70.8

	Year ended 31 December 1998		
	Income £m	Shares m	EPS pence
Basic EPS			
Income available to ordinary shareholders	825	1,414	58.3
Effect of dilutive securities:			
Share options	—	12	—
Diluted EPS	825	1,426	57.9

	Year ended 31 December 1997		
	Income £m	Shares m	EPS pence
Basic EPS			
Income available to ordinary shareholders	781	1,409	55.4
Effect of dilutive securities:			
Share options	—	12	—
Diluted EPS	781	1,421	55.0

Options to purchase 8.0m ordinary shares (1998: 4.3m; 1997: 0.2m) at prices ranging from £9.88 to £13.06 (1998: £11.54 to £11.95; 1997: £9.41 to £9.69) were outstanding throughout the year ended 31 December 1999 but were not included in the computation of diluted EPS because the options' assumed proceeds were greater than the average market price of the common shares. These options expire at various dates ranging from March 2007 to March 2008.

EPS, assuming full dilution, is computed based on the average number of common shares outstanding during the period, plus the dilutive effect of stock options. The dilutive effect of stock options is computed using the average market price of the company's stock for the period.

NOTES TO THE ACCOUNTS (Continued)

g) Securities and Investments

(i) Under U.S. GAAP, SFAS No. 115 requires certain disclosures relating to securities and investments as at 31 December 1999 and 1998. The following table provides an analysis of the relevant balance sheet totals under both U.S. and U.K. GAAP.

	As at 31 December			
	1999		1998	
	UK GAAP	US GAAP	UK GAAP	US GAAP
	£m	£m	£m	£m
Trading securities	15,811	15,811	15,614	15,614
Available for sale securities (ii)	43,981	43,977	38,510	38,748
Securities held to maturity (iii)	20	20	248	248
	59,812	59,808	54,372	54,610
Less provision against available for sale securities	(72)	—	(46)	—
	59,740	59,808	54,326	54,610

Further disclosures required by SFAS No. 115 are as follows:

(ii) Available for sale securities

	Amortised cost	Gross unrealised gains	Gross unrealised losses	Fair value
As at 31 December 1999	£m	£m	£m	£m
Equity securities	248	20	(1)	267
Debt securities issued or backed by U.S. Treasury and other U.S. government corporations and agencies	2,660	9	(21)	2,648
Debt securities issued or backed by foreign governments	3,331	162	(19)	3,474
Corporate debt securities	19,715	162	(179)	19,698
Mortgage backed securities other than those issued or backed by U.S. government agencies	6,896	26	(28)	6,894
Other debt securities	11,131	23	(158)	10,996
	43,981	402	(406)	43,977
Provision against available for sale debt securities	(72)			—
	43,909			43,977
As at 31 December 1998				
Equity securities	121	59	(16)	164
Debt securities issued or backed by U.S. Treasury and other U.S. government corporations and agencies	3,776	20	(24)	3,772
Debt securities issued or backed by foreign governments	4,749	189	(1)	4,937
Corporate debt securities	13,149	288	(110)	13,327
Mortgage backed securities other than those issued or backed by U.S. government agencies	8,160	41	(73)	8,128
Other debt securities	8,555	31	(166)	8,420
	38,510	628	(390)	38,748
Provision against available for sale debt securities	(46)			—
	38,464			38,748

NOTES TO THE ACCOUNTS (Continued)

The majority of Corporate debt securities are guaranteed by banks or other financial institutions.

Maturity analysis	**Not more than 1 year**	**In more than 1 year but not more than 5 years**	**In more than 5 years but not more than 10 years**	**In more than 10 years**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
As at 31 December 1999					
Book value before provision. . . .	2,117	13,929	9,139	18,796	43,981
Fair value.	2,154	14,044	9,004	18,775	43,977
As at 31 December 1998					
Book value before provision. . . .	3,503	12,749	7,038	15,220	38,510
Fair value.	3,495	12,924	7,110	15,219	38,748

(iii) Held to maturity securities

	Amortised cost	**Gross unrealised gains**	**Gross unrealised losses**	**Fair value**
	£m	**£m**	**£m**	**£m**
Corporate debt securities				
As at 31 December 1999.	20	—	—	20
As at 31 December 1998.	248	—	—	248

Maturity analysis	**Not more than 1 year**	**In more than 1 year but not more than 5 years**	**In more than 5 years but not more than 10 years**	**In more than 10 years**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
As at 31 December 1999					
Book value	—	20	—	—	20
Fair value.	—	20	—	—	20
As at 31 December 1998					
Book value	248	—	—	—	248
Fair value.	248	—	—	—	248

(iv) Sales of available for sale securities during the year to 31 December 1999 and 1998.

	1999	**1998**
	£m	**£m**
Gross proceeds from sales	4,461	11,454
Gross realised losses on sales	39	31
Gross realised gains on sales	(124)	(43)
Amortised cost of sales.	4,376	11,442

The cost of available for sale securities is determined by using the weighted average cost basis, with premium/discount arising on purchase being amortised to profit and loss over the expected life of the security.

(v) Redemptions and purchases of held to maturity securities during the year ended 31 December:

	1999	1998
	£m	£m
Amortised cost b/f.	248	213
Acquisitions — cost	20	37
Redemptions at maturity	(251)	—
Exchange adjustments	3	(2)
Amortised cost c/f.	20	248

(vi) Unrealised gains and losses on transfers from available for sale securities during the year ended 31 December:

	1999	1998
	£m	£m
Gross unrealised gains	—	5
Gross unrealised losses	(1)	—
	(1)	5

(vii) The net change in unrealised holding gains (losses) on trading securities, before the effect of associated hedges, included in income for the year to 31 December 1999 is a loss of £117m (1998: gain of £99m).

h) Securitisations

Included within other income is a net gain of £38m recognised in relation to the securitisation of certain mortgage assets and investment securities. In accordance with SFAS 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", the assets which have been transferred to special purpose entities (securitised) and meet the criteria required under SFAS 125 for a sale are no longer retained on—balance sheet. Details in relation to the mortgage asset securitisations are included in note 17 of the Consolidated Financial Statements. Details in relation to the investment asset securitisations are included in note 19 of the Consolidated Financial Statements.

Additionally, as required by SFAS 125, an Interest only strip ("IO") asset has been recognised. The IO strip represents the present value of the future income streams expected to be received from the Group's retained interest in the securitised assets. Details in relation to the Group's rights and obligations under the securitisations are detailed in note 17 of the Consolidated Financial Statements. In compliance with SFAS 125, the receivable is treated as an available for sale security which is revalued at the end of each reporting period. Increases and decreases in value are taken to the Statement of Comprehensive Income.

Mortgage asset securitisations

	1999 £m
Value of the interest only strip recognised during the year (1)	50
Decrease in value of the interest only strip	(1)
Value of the interest only strip at December 31(1)	49

(1) The valuation of the interest strip asset is based on the following key assumptions:

– Early repayments are based on actual experience at the valuation date. This was 15% at 31 December 1999.

– The discount rate applied to the future cashflows is Abbey National's weighted average cost of capital.

NOTES TO THE ACCOUNTS (Continued)

i) Consolidated Cash Flow Statement

FRS 1 (Revised), "Cash Flow Statements", is broadly consistent with IAS 7, "Cash Flow Statements", with the exception of the definition for cash and cash equivalents which is disclosed below.

Under SFAS No. 95, "Statement of Cash Flows", the Group experienced an inflow of cash and cash equivalents of £6,559m during the year ended 31 December 1999. Under FRS 1(Revised), the Group experienced an inflow of cash of £1,518m over the same period.

Cash equivalents are defined as short term, highly liquid investments which are readily convertible into known amounts of cash without notice and which were within three months of maturity when acquired.

The following table summarises the movement and composition of cash and cash equivalents for the years ended 31 December 1999, 1998 and 1997.

	1999 £m	1998 £m	1997 £m
Cash and cash equivalents at 1 January	17,204	12,905	3,168
Net cash inflow before adjustment for the effect of foreign exchange rate changes	6,566	4,257	9,742
Effect of foreign exchange rate changes	(7)	42	(5)
Cash and cash equivalents at 31 December	23,763	17,204	12,905
Consisting of:			
Cash and balances with central banks	701	329	329
Treasury and other eligible bills	1,054	1,686	882
Loans and advances to banks	10,984	6,330	5,937
Other advances	70	8	—
Debt securities	10,954	8,851	5,757
	23,763	17,204	12,905

Other principal differences between FRS 1 and SFAS No. 95 relate to the classification of cashflow transactions and are as follows:

	Classification under FRS1	Classification under SFAS No. 95
Dividends received	Returns on investment and servicing of finance	Operating activities
Taxation paid	Taxation paid	Operating activities
Preference dividends paid	Returns on investment and servicing of finance	Financing activities
Equity dividends paid	Equity dividends paid	Financing activities
Purchases/proceeds from disposal of investment securities and fixed assets	Capital expenditure and financial investment	Investing activities
Purchases/proceeds from disposal of subsidary and associated undertakings	Acquisitions and disposals	Investing activities
Net change in loans and advances	Operating activities	Investing activities
Net change in finance lease receivables	Operating activities	Investing activities
Net change in deposits	Operating activities	Financing activities
Net change in debt securities in issue	Operating activities	Financing activities

Under FRS 1, transactions designated as hedges are reported under the same heading as the related assets or liabilities.

j) Cumulative foreign currency translation adjustment

SFAS No. 52, "Foreign Currency Translation," requires disclosure of the cumulative foreign currency translation adjustment taken directly to reserves, on the consolidation of the Group's foreign undertakings and the translation of the Group's U.S. dollar preference shares. These cumulative adjustments were £(28)m, £(27)m and £(27)m at 31 December 1999, 1998 and 1997 respectively.

k) Presentation of the Consolidated Profit and Loss account

The presentation of the profit and loss accounts for the years ended 31 December 1999, 1998 and 1997, as shown on page F-5, would be no different under U.S. GAAP except provisions would be shown as a component of total operating income.

l) Exceptional items

U.S. GAAP does not recognise the classification of items as "exceptional". References to exceptional items relate to items that fall within the scope of exceptional items under U.K. GAAP and are not interchangeable with extraordinary items as defined under U.S. GAAP.

56. Significant group concentrations of credit risk

Under SFAS No. 105 group concentrations of credit risk exist if a number of counterparties are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

The Group's significant exposures to credit risk arise mainly in the residential mortgage portfolio and unsecured lending of U.K. Retail Banking, Finance House's predominantly unsecured lending, and in the wholesale lending and investment activities of Wholesale Banking.

Residential mortgages represented 36% (1998: 39%) of total assets at 31 December 1999; 98% (1998: 98%) of the residential mortgage asset is located in the U.K. In U.K. Retail Banking a national mortgage lending policy is applied, supported by a number of processes, including credit scoring, which enhance the ability to manage and monitor the credit risk quality of mortgage assets, manage arrears and collections and optimise the values raised from properties in possession.

Finance House's £8.6bn portfolio is diversified between consumer (unsecured – 67%, secured – 20%) and corporate lending (13%).

Although the Group's Wholesale Banking operations are based mainly in the U.K., it has built up exposures to various entities around the world.

Of total ANTS credit exposures, 41% was to counterparties from the United States, and 19% was to counterparties from the U.K. The remaining exposures were mainly to counterparties from Europe. ANTS has only insignificant exposures to countries which are not members of the Organization for Economic Co-operation and Development. More than 66% of ANTS assets rated AA- or better, with approximately 37% of exposures being to banks, financial institutions and supranationals.

See "Financial Risk Management — Credit Risk" elsewhere in this Annual Report for further discussion of controls over credit risk.

57. Fair values of financial instruments

The following disclosures are made in accordance with SFAS No. 107 "Disclosures about Fair Value of Financial Instruments".

The fair values have been estimated using quoted market prices where available. Where no ready markets exist and hence quoted market prices are not available, appropriate techniques are used to estimate fair values which typically take account of the characteristics of the instruments, including the future cash flows, market interest rates and prices available for similar instruments. Unless otherwise specified, fair values of financial instruments have been estimated by discounting anticipated future cash flows using market interest rates offered at 31 December 1999 for similar instruments.

By its nature, the estimation of fair values is highly subjective and the results will depend largely upon the assumptions made. Considerable caution should therefore be used in interpreting the fair values and particularly if comparing with fair values presented by other financial institutions.

The Group attaches great value to its branch network, to its profile in the U.K. personal financial services market and to its relationships with its customers. However, such intangible assets are not recognised for the purposes of SFAS No. 107. Furthermore, the concept of fair values assumes that the financial instruments will be realised by way of sale. However, with the exception of certain securities, the Group intends to realise its assets through collection over time. Consequently, the directors believe that the fair values significantly understate the true value of the group as a going concern.

SFAS No. 107 does not apply to non financial assets and liabilities. Accordingly, tangible fixed assets and balances relating to long term assurance business are excluded.

The carrying values and estimated fair values of financial instruments are as follows:

	1999 Carrying Amount	1999 Fair Value(1)	1999 Surplus/ (Deficit)	1998 Carrying Amount	1998 Fair Value(1)	1998 Surplus/ (Deficit)
	£m	£m	£m	£m	£m	£m
Non-Trading Assets						
Cash and balances at central banks	701	701	—	329	329	—
Treasury bills and other eligible bills	1,114	1,114	—	2,057	2,057	—
Loans and advances to banks	11,472	11,485	13	7,428	7,500	72
Related derivatives	86	87	1	—	(41)	(41)
Loans and advances to customers	75,772	75,721	(51)	72,261	73,066	805
Related derivatives	159	352	193	188	(281)	(469)
Debt securities	43,681	43,730	49	38,592	38,832	240
Related derivatives	(243)	(343)	(100)	(138)	(527)	(389)
Equity shares and other variable yield securities	248	267	19	120	164	44
Non-Trading Liabilities						
Deposits by banks	(29,824)	(29,823)	1	(35,610)	(35,599)	11
Related derivatives	(61)	(60)	1	10	(4)	(14)
Customer accounts	(59,911)	(59,960)	(49)	(52,924)	(53,135)	(211)
Related derivatives	(70)	(49)	21	(15)	183	198
Debt securities in issue	(51,407)	(51,247)	160	(42,989)	(43,678)	(689)
Related derivatives	(246)	(232)	14	(143)	640	783
Short positions in government debt securities	(1,521)	(1,521)	—	(1,199)	(1,199)	—
Subordinated liabilities including convertible debt	(4,641)	(4,886)	(245)	(3,333)	(3,932)	(599)
Related derivatives	45	(11)	(56)	(63)	386	449
Other non-trading derivatives(2)	8	15	7	—	(77)	(77)
Trading Assets/Liabilities						
Debt securities	15,764	15,764	—	15,611	15,611	—
Equity shares and other variable yield securities	47	47	—	3	3	—
Derivative contracts with third parties	(1,300)	(1,300)	—	(219)	(219)	
Derivative contracts with ANFP	(209)	(209)	—	151	151	—

(1) Where quoted market prices are not available, fair values of on-balance sheet financial instruments incorporate the discounted value of the principal amounts, whereas, for associated hedges of the underlying interest flows, fair values of derivatives do not reflect principal amounts. Consequently, movements in the fair values of on-balance sheet financial instruments are not necessarily matched by equal and opposite movements in the fair values of related derivatives.

(2) Other non-trading derivatives hedge finance lease receivables. SFAS No. 107 does not require disclosure of the fair value of finance lease receivables. They are therefore excluded from the table.

Fair values include the fair values of derivatives undertaken by Group entities for non-trading purposes with ANFP. Techniques used to estimate fair values of on and off balance sheet financial instruments for which quoted prices are not available have been further refined in 1999. As part of an integrated approach to risk management, the Group uses both off- and on-balance sheet instruments to manage risk. On-balance sheet instruments which are used as hedges of other on-balance sheet instruments are shown in the relevant standard balance sheet headings on the fair value table, and are not offset.

Other assets, Prepayments and accrued income, Dividend proposed, Other liabilities, Accruals and deferred income and Provisions for liabilities and charges may contain financial instruments which fall within the scope of SFAS No. 107. Unless specifically included, these financial instruments have been excluded from the above analysis as their fair values approximate to carrying values.

The surplus (deficit) in the table above represents the surplus (deficit) of fair value compared to carrying amount of those financial instruments for which fair values have been estimated under SFAS No. 107.

The approach to specific categories of financial instruments is described below.

Assets

Debt securities and equity shares and other variable yield securities

Where available, securities and investments 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 has been used.

Loans and advances to customers

Loans and advances to personal customers are made both at variable and at fixed rates. As there is no active secondary market in the U.K. for such loans and advances, there is no reliable market value available for such a significant portfolio. However, if a market value could be ascertained, the directors believe it would reflect the expectation of a long term and continuing relationship with a majority of the customers. Although substantial, this value is intangible and it cannot therefore be included in the fair value under SFAS No. 107. Consequently the directors believe that, for the purposes of SFAS No. 107, the carrying value of the variable rate loans may be assumed to be their fair value.

Certain of the loans secured on residential properties are at a fixed rate for a limited period, typically two to five years from their commencement. At the end of this period these loans revert to the relevant variable rate. The excess of fair value over carrying value of each of these loans has been estimated by reference to the market rates available at 31 December 1999 for similar loans of maturity equal to the remaining fixed period. The fixed element of such loans is substantially hedged such that any movement in the value of the loan as a result of market interest rate changes will be offset by an equivalent movement in the value of the instrument used as a hedge.

Liabilities

Deposits by banks and customers

SFAS No. 107 states that the fair value of deposit liabilities payable on demand is equal to the carrying value. However, given the long term and continuing nature of the relationships with the Group's customers, the directors believe there is significant value to the Group in this source of funds.

Debt securities in issue and subordinated liabilities

Where available the fair value of debt securities in issue and subordinated liabilities has been calculated 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.

Financial commitments and contingent liabilities

The directors believe that, given the lack of an established market, the diversity of fee structures and the estimation required to separate the value of the instruments from the value of the overall transaction, it is generally difficult to estimate the fair value of financial commitments and contingent liabilities. These are therefore excluded from the above table. However, since the majority of these are at floating rates the book value may be a reasonable approximation to fair value. The book values of these instruments are disclosed in notes 44, 45 and 46.

Off-balance sheet derivative financial instruments

The group uses various market-related off-balance sheet financial instruments, as explained in Note 48 above. The fair value of these instruments is measured as the sum of positive and negative fair values at the balance sheet date, which is estimated using market prices where available or pricing models consistent with standard market practice.

58. Summary operating results of Abbey National Treasury Services plc

The following selected information of Abbey National Treasury Services plc ("ANTS") has been included to comply with the filing requirements of the Securities and Exchange Commission. The data has been compiled using U.K. GAAP.

Summary of profit and loss account data

	For the year ended 31 December			
	1999	1999	1998 (restated)	1997 (restated)
	$m	£m	£m	£m
Total interest income	7,821	4,843	5,263	4,437
Total interest expense	(7,246)	(4,487)	(4,893)	(4,275)
Net interest income	575	356	370	162
Other operating income	294	182	73	87
Operating expenses	(200)	(124)	(115)	(80)
Loss on transfer to wealth management	—	—	(11)	—
Amounts written off fixed asset investments	(42)	(26)	(19)	(3)
Income before taxes	627	388	298	166
Taxes	(210)	(130)	(105)	19
Net income	417	258	193	185

Summary of balance sheet data

	As at 31 December		
	1999	1999	1998 (restated)
	$m	£m	£m
Total assets	163,861	101,462	89,633
including:			
Loans to banks and customers	54,849	33,962	27,919
Net investment in finance leases	8,035	4,975	4,715
Securities and investments	90,739	56,185	50,805
Total liabilities excluding shareholders' equity	160,828	99,584	88,015
including:			
Deposits by banks and customers	67,171	41,592	39,188
Debt securities in issue	75,235	46,585	40,117
Subordinated liabilities	4,058	2,513	2,494
Shareholders' equity	3,033	1,878	1,618

The above summary information has been extracted from the consolidated financial statements of ANTS. This information differs from that disclosed for the Wholesale Banking segment in note 1 as a result of the inclusion of certain intra-group transactions in ANTS' consolidated financial statements, and the inclusion of the results of Abbey National North America Corporation in the Wholesale Banking segment.

59. Post balance sheet event

On 3 April 2000 ANTS, through a subsidiary company, reached agreement to acquire Stagecoach Porterbrook Limited ("Porterbrook") from Stagecoach Holdings plc ("Stagecoach"), subject to Stagecoach shareholder approval. The total cash to be paid is £773 million comprising equity of £295 million and debt owing to Stagecoach of no more than £478 million. In addition, it is expected that at completion Porterbrook will have net external debt, including liabilities under new contracts, of £669 million. The deal is expected to be completed on 20 April 2000. Porterbrook is one of the UK's three train operating lease companies providing rolling stock to train operating companies.

NOTES TO THE ACCOUNTS (Continued)

GROUP FINANCIAL SUMMARY — PROFIT AND LOSS ACCOUNTS

	1999 Before exceptional items	1999 Exceptional items	1999	1998 (restated)	1997 (restated)	1996 (restated)	1995 (restated)
	£m	£m	£m	£m	£m	£m	£m
Net interest income	2,661	—	2,661	2,241	1,905	1,815	1,579
Other income and charges	1,095	(6)	1,089	870	708	534	404
Operating expenses	(1,594)	(21)	(1,615)	(1,346)	(1,194)	(1,038)	(870)
Provisions for bad and doubtful debts	(303)	—	(303)	(201)	(121)	(127)	(72)
Provisions for contingent liabilities and commitments	(23)	—	(23)	(16)	(16)	(4)	(7)
Amounts written off fixed asset investments	(26)	—	(26)	(28)	(3)	(13)	(8)
Profit on ordinary activities before tax	1,810	(27)	1,783	1,520	1,279	1,167	1,026
Tax on profit on ordinary activities	(530)	8	(522)	(462)	(326)	(403)	(344)
Profit on ordinary activities after tax	1,280	(19)	1,261	1,058	953	764	682
Minority interests — equity	—	—	—	—	1	3	1
Profit attributable to the shareholders of Abbey National plc			1,261	1,058	954	767	683
Transfer to non-distributable reserve			(13)	(125)	(78)	(67)	(59)
Dividends — ordinary and preference shares			(610)	(535)	(469)	(373)	(290)
Profit retained for the financial year			638	398	407	327	334
Earnings per ordinary share			86.2p	72.4p	65.2p	56.5p	51.7p
Dividends per ordinary share (pence)							
Net			40.25p	35.30p	30.70p	26.10p	21.75p
Gross equivalent			44.72p	40.85p	38.38p	32.63p	27.19p
Dividend cover (times)			2.1	2.0	2.1	2.1	2.4

The Group financial summary is based on the audited consolidated financial statements of the Abbey National Group for the five years ended 31 December 1999, and has been derived from the consolidated financial statements for each of the relevant years.

For a description of exceptional items see note 3 to the accounts. Operating expenses in 1996 include costs of £61m incurred in the integration of the business of N&P.

The figure disclosed in respect of Profit on ordinary activities before tax resulting from operations acquired in the year excludes the results of the business transferred from N&P.

The calculation of the gross equivalent dividend per ordinary share applies a tax rate of 20% for grossing-up purposes for dividends up to and including the interim dividend for 1998. Thereafter the rate of 10% has been applied.

GROUP FINANCIAL SUMMARY — BALANCE SHEETS

	1999	1998 (restated)	1997 (restated)	1996	1995
	£m	£m	£m	£m	£m
Assets					
Cash, treasury bills and other eligible bills	1,815	2,386	1,957	339	391
Loans and advances to banks	11,472	7,428	8,271	2,825	3,579
Loans and advances to customers	75,221	72,257	66,878	64,227	51,090
Loans and advances subject to securitisation	1,930	217			
Less: non-returnable finance	(1,379)	(213)			
	551	4	—	—	—
Net investment in finance leases	5,441	5,326	4,655	4,310	2,844
Securities and investments	59,740	54,326	46,537	39,774	35,297
Long term assurance business	1,042	760	649	555	425
Intangible fixed assets	203	201	—	—	—
Tangible fixed assets	759	731	698	689	585
Operating lease assets	358	223	67	26	—
Other assets	6,703	5,728	4,317	3,397	3,403
Assets of long term assurance funds	17,439	13,383	10,101	7,869	5,518
Total assets	180,744	162,753	144,130	124,011	103,132
Liabilities					
Deposits by banks	29,824	35,610	23,814	17,718	19,393
Customer accounts	59,911	52,924	55,719	49,678	40,962
Debt securities in issue	51,407	42,989	40,201	35,193	26,095
Other liabilities	11,444	9,107	6,954	6,786	5,096
Subordinated liabilities including convertible debt	4,641	3,333	2,463	2,374	2,127
Liabilities of long term assurance funds	17,439	13,383	10,101	7,869	5,518
	174,666	157,346	139,252	119,618	99,191
Non-equity shareholders' funds	450	450	450	321	101
Equity shareholders' funds	5,628	4,957	4,428	4,072	3,840
Total liabilities	180,744	162,753	144,130	124,011	103,132

SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant certifies that it meets all the requirements for filing on Form 20-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized.

ABBEY NATIONAL plc

By

/s/ MARK PAIN

Mark Pain, Finance Director

Date: April 7, 2000

EXHIBIT INDEX

Exhibit

1.1* Memorandum and Articles of Association of Abbey National

* Incorporated by reference to the Registration Statement on Form F-1 (No. 333-11320).

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