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

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

For the fiscal year ended December 31, 2000

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 0-25670

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
7% Perpetual Subordinated Capital Securities	New York Stock Exchange
7.25% Perpetual Subordinated Capital Securities	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	1,431,673,590
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

CROSS REFERENCE SHEET

n/r – not required as this 20-F is filed as an Annual Report

Contents

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. 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.

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."). 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 = $1.4955, 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 29, 2000. 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 55 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.

Averages in this Annual Report 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.

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 FINANCIAL DATA

The financial information set forth below for the twelve month periods ended December 31, 2000, 1999 and 1998, and as at December 31, 2000 and 1999 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. Financial information set forth below for the twelve month periods ended December 31, 1997 and 1996, and as at December 31, 1998, 1997 and 1996, has been derived from the audited consolidated financial statements of the Group for 1998, 1997 and 1996. 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, 2000 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 three 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, 2000 and 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 55 to the Consolidated Financial Statements, and Note 58 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,					
	2000 (1)	**2000**	**1999 (restated)**	**1998 (restated)**	**1997 (restated)**	**1996 (restated)**
	(in millions, except per share data)					
U.K. GAAP income statement data						
Net interest income (6)	$4,008	£2,680	£2,661	£2,241	£2,038	£1,815
Commissions, fees and other income (6)(7)	2,414	1,614	1,147	897	730	539
Total operating income	6,422	4,294	3,808	3,138	2,768	2,354
Other operating expenses excluding depreciation on operating lease assets	(2,714)	(1,815)	(1,594)	(1,285)	(1,168)	(977)
Depreciation on operating lease assets (7)	(266)	(178)	(52)	(20)	(8)	(5)
Provisions for bad and doubtful debts	(408)	(273)	(303)	(201)	(121)	(127)
Provisions for contingent liabilities and commitments	(32)	(21)	(23)	(16)	(16)	(4)
Amounts written off fixed asset investments	(48)	(32)	(26)	(28)	(3)	(13)
Income before taxes and exceptional items	2,954	1,975	1,810	1,588	1,452	1,228
Exceptional items (2)	—	—	(27)	(68)	(173)	(61)
Income before taxes	2,954	1,975	1,783	1,520	1,279	1,167
Net income (3)	1,985	1,327	1,223	1,024	919	754
Per ordinary share information (basic) (including exceptional items) (4)	139.7¢	93.4p	86.2p	72.4p	65.2p	56.5p
Per ordinary share information (diluted) (including exceptional items) (4)	138.8¢	92.8p	85.5p	71.7p	64.7p	56.0p
Dividends	68.0¢	45.50p	40.25p	35.3p	30.7p	26.1p
U.S. GAAP income statement data						
Net income (3)	$1,774	£1,186	£1,011	£825	£781	£636
Per ordinary share (basic) (including exceptional items) (4)	124.9¢	83.5p	71.3p	58.3p	55.4p	47.6p
Per ordinary share (diluted) (including exceptional items) (4)	124.4¢	83.2p	70.8p	57.9p	55.0p	47.4p
U.K. GAAP balance sheet data						
Loans and advances to banks and customers and net investment in finance leases	$153,154	£102,410	£92,685	£85,015	£79,804	£71,362
Total assets (5)	305,667	204,391	180,744	162,753	144,130	124,011
Deposits by banks, customer accounts and debt securities in issue	237,589	158,869	141,142	131,523	119,734	102,589
Subordinated liabilities	8,780	5,871	4,641	3,333	2,463	2,374
Shareholders' funds	10,214	6,830	6,078	5,407	4,878	4,393
Book value of equity shareholders' funds per ordinary share	666.4¢	445.6p	395.8p	349.8p	313.4p	289.4p
U.S. GAAP balance sheet data						
Shareholders' funds	$11,327	£7,574	£6,947	£6,373	£6,044	£5,456
Book value of equity shareholders' funds per ordinary share	744.7¢	498.0p	456.9p	418.0p	395.9p	365.0p
Total assets (5)	$302,368	£202,185	£175,793	£163,267	£145,009	£124,830

(1) Amounts stated in dollars have been translated from sterling at the rate of £1.00 = $1.4955, the Noon Buying Rate on December 29, 2000.

(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. Diluted ratio includes the effect of share options outstanding.

(5) In 1999, following an accounting presentation change, Assets and Liabilities under stock borrowing and lending agreements were no longer reported as on-balance sheet items, but as contractual commitments. Accordingly, total assets were 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) Prior to 1999, 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 in 1999, 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) and a £21 million increase (1996) in net interest income and a corresponding decrease in dealing profits for these years.

(7) Prior to 2000, depreciation on operating lease assets was reported as a charge against income on operating lease assets (within Commissions, fees and other income). Income on such assets continues to be reported within Commissions, fees and other income, however, following an accounting presentation change, depreciation on operating lease assets is now reported within operating expenses, but shown as a separate item within that heading because such assets are used for a different purpose to fixed assets used in administrative functions.

The prior year comparatives have been restated with the effect being a £52 million (1999), £20 million (1998), £8 million (1997) and £5 million (1996) increase in Commissions, fees and other income. The change results from the application of FRS 15, 'Tangible fixed assets', which applies to the financial statements for the year ended December 31, 2000.

	Year ended/as at December 31,				
	2000	1999	1998	1997	1996
	(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	0.69	0.66	0.69	0.66
Return on average ordinary shareholders' funds (2)	21.54	22.48	21.07	20.85	18.52
Return on average risk weighted assets (3)	1.67	1.65	1.60	1.70	1.58
Net interest margin (excluding exceptional items) (4)(9)	1.61	1.75	1.66	1.71	1.76
Cost:income ratio (including exceptional items) (5)	44.10	43.07	43.27	45.69	44.19
Cost:income ratio (excluding exceptional items) (5)	44.10	42.44	41.21	42.32	41.59
Capital ratios:					
Ordinary Dividends as a percentage of net income	48.91	46.77	48.93	47.23	47.75
Average ordinary shareholders' funds as a percentage of average total assets (9)	3.21	3.09	3.15	3.30	3.57
Risk asset ratios:					
Total	13.5	11.6	10.2	11.1	11.7
Tier 1	8.9	7.7	7.3	8.4	8.5
Credit quality data: (6)					
Non-performing loans as a percentage of loans and advances to customers excluding finance leases (6)(7)	2.60	2.90	3.69	3.44	4.22
Allowances as a percentage of loans and advances to customers excluding finance leases (6)	0.70	0.69	0.77	0.69	0.82
Allowances as a percentage of non-performing loans (6)(7)	26.89	24.11	20.86	19.73	19.55
Provisions charge for bad and doubtful debts as a percentage of average loans and advances to customers excluding finance leases (6)	0.35	0.41	0.29	0.18	0.22
Ratio of earnings to fixed charges: (8)					
Excluding interest on retail deposits	1.31	1.38	1.31	1.30	1.40
Including interest on retail deposits	1.23	1.27	1.20	1.19	1.24
Selected U.S. GAAP financial statistics					
Return on average total assets (1)(9)	0.62	0.58	0.53	0.58	0.55
Return on average ordinary shareholders' funds (2)	17.41	16.28	13.92	14.14	12.54
Dividends as a percentage of net income	50.42	51.83	55.39	49.81	48.11
Average ordinary shareholders' funds as a percentage of average total assets (9)	3.55	3.57	3.82	4.11	4.41
Ratio of earnings to fixed charges: (8)					
Excluding interest on retail deposits	1.25	1.32	1.24	1.25	1.35
Including interest on retail deposits	1.18	1.22	1.16	1.16	1.21

(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 excluding depreciation on operating lease assets, divided by total operating income less depreciation on operating lease assets.

(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. Loans and advances to customers exclude assets held under purchase and resale agreements, for the purposes of credit quality ratios.

(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, 2000, Abbey National's percentage was 0.68% compared with a CML percentage of 0.58%. The value of these Abbey National non-performing loans as a percentage of its total U.K. residential mortgage loan assets was 0.86%. 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 0.9% 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 2.6%.

(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 were restated for years ending December 31, 1997 and 1998. The restatement reflects 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 tables set 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)			
Year ended December 31: 2000	1.65	1.40	1.51	1.50
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
Month ended: March 2001(2)	1.47	1.44		
February	1.48	1.44		
January	1.50	1.46		
December	1.50	1.44		
November	1.45	1.40		
October 2000	1.47	1.43		

(1) The average of the Noon Buying Rates on the last business day of each month during the relevant period.

(2) With respect to March 2001, for the period from March 1 through March 15.

BUSINESS OVERVIEW

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 £204.4 billion (1999: £180.7 billion) and income before taxes of £1,975 million (1999: £1,783 million) as at and for the year ended December 31, 2000, the Abbey National Group ranked as the 5th 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 retail deposit taker.

During 2000 Abbey National reorganized its business segments to reflect the changes in the Group's management structure announced in May 2000 – see 'Organizational Structure' below. Further details of this reorganization can be found in Note 1 to the Consolidated Financial Statements included elsewhere in this Annual Report. The Group's business segments are now Retail Banking, Wholesale Banking, Business to Business, Business to Consumer and Group Infrastructure which are described below.

The Group currently has negligible exposure to highly leveraged derivative transactions which is not either hedged or collateralized and less than 2% of exposures are 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 and listing on the London Stock Exchange. Since incorporation, Abbey National has continued to develop all its principal businesses organically and through acquisitions, joint ventures and partnerships.

Organizational Structure

In May 2000, a new management structure was introduced, creating four customer facing divisions responsible for increasing revenue growth. These are Retail Banking, Business to Consumer, Business to Business, and Wholesale Banking. In turn these are supported by a core infrastructure area spanning the whole Group. The reorganization is aimed at delivering our key strategic priorities: the radical transformation of our businesses to sustain revenue growth, whilst increasing cost and capital efficiency.

The principal subsidiaries of the Group are detailed in Note 22 to the Consolidated Financial Statements included elsewhere in this Annual Report.

Corporate Purpose and Strategy

Abbey National's vision continues to aim to be a leading, broadly-based financial services institution, with the objective of achieving above average growth in shareholder value over the medium to long-term.

Abbey National's strategy is focused on delivering increased shareholder value through carefully managed organic growth, joint ventures and partnerships with companies that have skills and expertise in their markets, and acquisitions, where these are complementary, achieve critical mass or contribute key skills and competencies in important new product and service areas.

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. Innovation also plays a key role in improving cost efficiency by re-engineering business processes, making greater use of shared resources and common platforms.

Management intends to pursue capital and balance sheet management opportunities.

Retail Banking

The Retail Banking segment now includes Abbey National's U.K. retail banking network, Abbey National Life plc (part of the Life Insurance segment prior to 2000) and General Insurance.

U.K Retail Bank

The U.K. Retail Bank is the Group's largest business, with total assets of £56.2 billion and income before taxes of £985 million, as at and for the year ended December 31, 2000. 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 714 traditional branches, 3,180 automated teller machines ("ATMs"), of which 1,403 are at non-branch locations, an additional 37 in-store branches within Safeway supermarkets, a major U.K. food retailer, and 4 branches incorporating Costa Coffee shops. In addition, Abbey National uses new technology to service its customers. Over 725,000 retail customers have registered with the Abbey National e-banking service since it was launched in May, providing customers access through the Internet and, more recently, via digital TV and WAP mobile phone technology.

These distribution platforms are combined with Abbey National Direct (a telephone sales and marketing operation), and business development units which directly service the mortgage intermediary market, and now are also supported by a mortgage Introducer Internet service. The branch network has been reorganized to focus on local markets, with the objective of removing £16 million per annum from the cost base from 2001. The branch-franchising pilot program was launched in July, harnessing the entrepreneurial drive of our best sales managers and significantly increasing sales productivity.

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. They also include 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, for example, 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 £410 billion at December 31, 1996 to £535 billion at December 31, 2000.

At December 31, 2000, Abbey National had £67.9 billion of mortgage loans, representing an estimated 12.7% share of the total outstanding amount of U.K. residential mortgage loans (including housing association loans) as at that date (1999: 13.1%). As at December 31, 2000, the proportion of Abbey National's total U.K. mortgage assets funded by U.K. retail liabilities was approximately 75% (1999: 78%).

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 Individual Savings Accounts (ISAs) and pension policies, or by the sale of the property).

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. Fixed-rate mortgages comprised approximately 20% of Abbey National's U.K. residential mortgage portfolio at December 31, 2000. The interest rate risk on such mortgages is managed as part of the Group's asset and liability management procedures. See "Risk Management – Market Risk" included elsewhere in this Annual Report.

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 cashback and discounted mortgage products, within a specified period, early redemption penalty charges are payable by the customer.

Liquid Savings Products

At December 31, 2000, Abbey National had approximately 11.86 million deposit accounts with personal customers (1999: 11.95 million) providing a funding base of £43.1 billion (1999: £43.4 billion). Abbey National provides a full range of retail savings accounts, including demand deposit accounts, notice accounts, investment accounts and ISAs. ISAs permit U.K. individuals to invest in 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 2000, 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 2000 the Group had approximately 2.10 million Abbey National Bank Account checking accounts as a result of a 40% increase in account openings. During 2000, an Internet-based student account was launched, supported by an exclusive agreement with the National Union of Students. 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.

In March 2001 Abbey National entered into a partnership agreement with MBNA Europe Bank Limited ("MBNA"). Under the terms of the arrangement ownership of the Abbey National Retail Banking credit card assets transferred to MBNA, who will develop a range of new cards and manage the operations for the Abbey National

Retail Banking-branded credit card business on an ongoing basis. The total consideration for the sale of Abbey National's credit card asset to MBNA was £290 million.

Abbey National offers unsecured personal loans and as at December 31, 2000 the loan asset was £1.5 billion (1999: £1.3 billion).

Abbey National has a partnership with Safeway, one of the U.K.'s largest food retailers. The main aspects of the relationship being:

- 37 Abbey National in-store banks;
- a range of co-branded telephone and postal savings accounts;
- one of Abbey National's largest hosts of ATMs (282); and
- one of Abbey National's largest portfolio of money transmission accounts.

These continue to expand and develop and Abbey National is exploring with Safeway opportunities and alternate formats for an in-store presence.

Abbey National is continuing to make its customers' lives easier through Convenience Retailing, enabling customers to do business with us through integrated business channels and flexible products. It includes in-branch e-banking facilities, new Costa Coffee branches, more Safeway in-store branch openings, an extended ATM network, and an increasingly flexible product range.

Abbey National Life plc ("Abbey National Life")

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 U.K. 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. The Group will participate in this market. The development of Stakeholder pension products is well underway and a range of products should be available for the Stakeholder launch in April 2001.

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" (IFAs). These financial advisers are required to provide "best advice", based on an assessment of the client's financial position and requirements. The Abbey National Life Group of Companies distribute via the appointed representative route. The appointed representative 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. Independent financial advisers must provide best advice on the complete product range that exists in the marketplace. This arrangement is known as Polarisation. Following a U.K. regulatory sponsored review, the principles of Polarisation are now under review. It is still conjecture as to what may happen in the future as details are now only beginning to become available. It is likely that many IFAs will be tempted by the multi-tied concept, although some may choose to divide their businesses into two i.e. a multi-tied and an independent side.

Abbey National Life 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.

A subsidiary of Abbey National Life plc, ANUTM, manages a range of Unit Trusts, 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 trusts are Citicorp and Clydesdale Bank plc and the investment manager is Abbey National Asset Managers Ltd, previously Scottish Mutual Portfolio Managers prior to re-branding.

General Insurance

The range of non-life insurance products sold by Abbey National includes property (buildings and contents), motor, payment protection, and travel 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 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 and CGNU plc, a leading U.K. insurer, had 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 was borne by CGU Underwriting Ltd. The joint venture's operations business unit was a division of Abbey National and was responsible for providing quotations, collecting premiums and issuing policies on behalf of the underwriting company. On December 29, 2000 Abbey National sold its 15% interest in CGU Underwriting Ltd to CGNU plc.

In January 2001, plans were announced to accelerate the growth of the general insurance business. This will be achieved by using a panel of competing insurers, including ongoing relationships with CGNU plc, to offer a wider choice of products and more competitive retail pricing. In addition, Capita Eastgate will be responsible for the management and development of new systems to support our general insurance business, using its new Consumer Direct platform. This will aim to provide market leading product flexibility and straight through processing, improved customer service and lower costs.

By mid 2001, a full Internet service should be available, including on-line quotes, on-line applications, policy processing and alterations, and on-line claims handling.

Wholesale Banking

ANTS is the wholesale bank of the Group and also the Group's treasury. ANTS is an authorized 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 financing. As the Group's treasury, ANTS provides liquidity, funding, capital management and risk management services to the Group.

ANTS' purpose is to maximize ANTS' contribution to the shareholder value of the Abbey National Group. ANTS achieves this through its activities as one of the world's leading wholesale banks and as the Group's treasury.

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; maximize return on equity; optimize risk-reward trade off and maximize 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 predominantly to well-rated banks, other financial institutions, corporations and governments. In 2000, lending increased from £17 billion to £21 billion.

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 the acquisition finance market, Wholesale Banking increased its commitments from £1.1 billion to £2.0 billion as at December 31, 2000 and deepened its participation to include underwriting and co-arranging selected corporate mergers and acquisitions. It also consolidated its position as an investor in senior debt facilities for leveraged buy-outs in the U.K. and western Europe and extended its mandate to include mezzanine debt for deals where it is also investing in senior debt.

Wholesale Banking's acquisition finance portfolio is diverse, with commitments in 20 of Moody's 32 industrial sectors. This diversification is expected to continue in 2001. As at December 31, 2000, acquisition finance commitments to the telecoms sector totaled £0.7 billion, with over 80% of this investment grade and predominantly with maturities of less than one year. The total Group exposure to the telecoms sector is £2.4 billion of which over 80% is investment grade.

Wholesale Banking also invests in carefully selected high yield assets rated BB and B. Wholesale Banking's investment strategy is to hold these assets for the longer term.

The steady growth of the Wholesale Lending business is expected to continue through increased penetration of growing international markets.

Asset Financing

Asset financing comprises Wholesale Banking's activities in the operating leasing, finance leasing, project finance, private equity and social housing markets. In 2000, it expanded its market presence, successfully developed new businesses and established a substantial pipeline of deals. These activities predominantly earn a combination of interest and fee income.

Wholesale Banking transacted its first operating lease in December 1998 and took a significant step forward on April 20, 2000 with the completion of the purchase of Porterbrook Limited ("Porterbrook"), one of the U.K.'s three rolling stock operating companies. The exercise to integrate Porterbrook is complete and the business made a profit contribution of £40 million in the year.

Since acquisition, Porterbrook has completed transactions to provide funding totaling £0.4 billion for 506 new vehicles to be delivered over the next few years. These leases will bring Porterbrook's rolling stock fleet to 4,180 vehicles.

Porterbrook also provides funding for rail-related infrastructure and is developing this aspect of its business to include providing financial solutions to fund rail infrastructure projects such as stations, depots and track. Porterbrook plans to take advantage of opportunities in Australia, Hong Kong and Europe.

Wholesale Banking's finance leasing operations focus on large capital projects, usually with a minimum outlay cost of £20 million. During 2000, transaction volumes within the finance leasing industry remained low. However, there were continuing drawdowns under Wholesale Banking's existing commitments with a number of lessees taking delivery of assets in 2000. Wholesale Banking's investment in finance leasing assets reduced slightly from £5.0 billion to £4.9 billion as at December 31, 2000, partly reflecting the disposal of a leasing company.

Over the past three years, Wholesale Banking has rapidly developed its profile in the project finance market and its success to date confirms the long-term growth potential of this market. As at December 31, 2000, Wholesale Banking's total book value of commitments to the project and property finance sector stood at £3.6 billion, triple that in 1999.

In 2000, Wholesale Banking participated in a total of 59 project and property finance deals worldwide, including 15 through the U.K. government's private finance initiative (PFI). Wholesale Banking has firmly established itself as a leading provider of PFI finance in the U.K. and completed deals in a range of sectors, including health, environment and transport. Wholesale Banking participated in 31 deals in the international project finance market in 2000, particularly in the power and energy sectors. Wholesale Banking also rapidly established itself as a significant provider of property finance in the U.K., participating in nine deals during the year.

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, the U.S. and Asia. Wholesale Banking also has a small 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, 2000 had investments in over 50 funds and a number of co-investments. These investments increased from £0.2 billion to £0.5 billion, with a further £0.7 billion of commitments, as at December 31, 2000.

Wholesale Banking provides funding to the social housing sector. Loan commitments increased from £2.2 billion in 1999, to £2.8 billion as at December 31, 2000. These loans are secured on that part of the property owned by the provider of the social housing.

Asset-backed Investments

Wholesale Banking manages substantial portfolios of asset-backed investments, including mortgage-backed securities. Wholesale Banking's portfolios backed by credit card receivables, student loans and collateralised debt obligations increased from £16.7 billion to £18.3 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. The portfolio of securities backed by loans with a first charge on residential property totaled £7.8 billion, down from £9.9 billion as at December 31, 1999. This decrease reflects a reduction in holdings in the home equity loan adjustable rate mortgage (HEL ARM) sector as a number of investments matured. It is expected that a decrease in certain holdings will continue in 2001.

Wholesale Banking's asset-backed investments are predominantly AAA rated by Moody's, Standard and Poor's and Fitch IBCA and provide a steady and substantial flow of net interest income.

Risk Management & Financial Products

The risk management & financial products business is undertaken by Abbey National Financial Products ("ANFP") and provides integrated derivative solutions to meet the risk management needs of external counterparties and the Group. ANFP combines expertise in fixed income products, structured products, equity derivatives, and most recently, credit derivatives.

ANFP executes transactions in the market and undertakes hedging operations to minimize risk within predetermined and approved limits. See "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 2000, ANFP was an active provider of retail price index (RPI) and house price index (HPI) swaps. It was also a significant provider to the U.K. guaranteed retail fund market of structured products using derivatives of the FTSE, Eurostoxx 50™, Standard and Poor's 500 and Nikkei 225™ indices. In 2000, ANFP established a credit derivatives team with the ability to transact a range of deals, from single name default swaps to baskets of corporate default swaps and credit derivatives on mortgage-backed and asset-backed securities. In December, ANFP completed its first synthetic collateralized bond obligation (CBO): Marylebone Road CBO 1 Ltd. ANTS plans to issue CBOs on behalf of external customers in due course.

Wholesale Banking has a U.S. subsidiary, ANFP (U.S.) LLC, which enables ANFP to offer derivative products to counterparties in the United States.

ANFP intends to develop its product range, build on its strong position in the U.K., and increase its penetration of international markets.

Securities Financing

Cater Allen International Limited ("CAIL"), Wholesale Banking's securities financing 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 sterling markets and in 2000 continued to diversify its portfolio to include a larger proportion of U.S. dollar and euro-denominated securities and a broader product range. CAIL plans to open a broker dealer operation in the U.S. in 2001 that would enable direct dealing with a wider range of counterparties in the U.S. Securities financing assets increased from £19 billion to £29 billion as at December 31, 2000. CAIL's obligations are fully and unconditionally guaranteed by Abbey National.

International operations

On November 2, 2000, Wholesale Banking launched a fully licensed branch and regional office in Hong Kong. The branch builds on Wholesale Banking's existing portfolio of high quality Asian assets and opportunities established by the representative office. Wholesale Banking has raised funding in the region since 1989 and the representative office was set up in 1996. The branch offers a range of Wholesale Banking's products and services to institutions across Asia, provides Wholesale Banking with the advantages of more specialized market knowledge, and enables funding transactions to be completed in the Asian time zone.

To further develop Wholesale Banking's penetration of the financial markets in the U.S., Wholesale Banking is applying to establish a branch, as well as a broker dealer, in the U.S.

Wholesale Banking also has a branch in Paris, France which enhances access to the euro securities financing and money markets.

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 "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 54% at December 31, 2000.

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 established a new MTN issuing vehicle, AN Structured Issues Limited, to issue credit-linked notes. Issuance from this vehicle totaled £0.2 billion as at December 31, 2000.

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. At December 31, 2000, the Group's debt securities outstanding totaled a dollar equivalent of over $85 billion. During 2000, Wholesale Banking raised over $13 billion in a range of currencies, maturities and geographical areas with a strategy in respect of public issues, to create large benchmark issues. The majority of such funding has been swapped into U.S. dollars, sterling or euros.

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

Program	Outstanding as at December 31, 2000	Comments
$15 billion medium term notes	$9.8 billion	Issued into European markets
U.S. medium term notes	$5.6 billion senior debt $4.1 billion subordinated debt[(2)]	Registered with the Commission
$4 billion commercial paper	$0.8 billion	Issued into European markets
$8 billion U.S. commercial paper[(3)]	$7.6 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 February 2001, 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 $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. In addition, Abbey National may issue dollar-denominated preference shares and various Group-related entities may issue other subordinated securities under the shelf facility.

As at December 31, 2000, 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	£191,690 million
Abbey National First Capital B.V.	£46 million
Abbey National	£63,172 million

As at December 31, 2000, 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.	£633 million
Abbey National	£6,578 million

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 2000 included a U.S.$1 billion tier one and a £1.24 billion upper tier two deal in four sterling tranches and one euro tranche.

In 2000, Abbey National established itself as the leading issuer in the European residential mortgage securitisation market. On behalf of the Group, Wholesale Banking managed the launch of mortgage-backed notes totaling £2.25 billion-equivalent via Holmes Financing (No.1) PLC followed by £2.4 billion-equivalent issued via Holmes Financing (No.2) PLC. The underlying mortgages were originated by Abbey National plc and are representative of Abbey National's mortgage portfolio. The terms and conditions of the securitised mortgages are not affected by the securitisation process. As at December 31, 2000, approximately 10% of Abbey National's mortgage book was securitized.

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.

Wholesale Banking sponsors a $10 billion asset-backed commercial paper ("CP") program 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. As at December 31, 2000, CP outstanding totaled $7.9 billion.

Business to Business

The Business to Business segment comprises Scottish Mutual Assurance (part of the Life Insurance segment prior to 2000), First National and Continental Europe.

Scottish Mutual Assurance plc ("Scottish Mutual")

See "Business Overview – Abbey National Life plc" for a description of the U.K. life insurance industry.

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, annuities, products linked to mortgages and healthcare products to cover critical illness and income protection.

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

In September 2000, Abbey National entered into an agreement to transfer (subject to policyholder and Court approval) the business of Scottish Provident. The Scottish Provident brand will be retained, and its operations will be combined with existing Life Insurance operations. It is anticipated that the integration will realise substantial cost synergies, and provide the means for significant increases in new business volumes through the promotion of individual protection products to a wider range of IFAs, and to the Retail Bank's customer base under the Abbey National brand. Integration of existing international businesses will raise the profile of Abbey National's international Life Insurance operations significantly. The plans for transfer and integration are currently progressing to schedule. Scottish Provident is a Life Company that specializes in the protection market and has a leading portfolio of products, service standards and a high market share.

First National

First National comprises four business divisions:

- Consumer finance – which consists of: (i) the provision of unsecured personal loans under the First National Bank ("FNB") brand, and (ii) the provision of secured loans under the First National Mortgage Company ("FNMC") brand, aimed at specialized market segments;
- Motor finance – the provision of hire purchase and conditional sale loans to consumers and also loans to supporting dealers;
- Business finance – operating in the areas of commercial mortgages, small ticket leasing, vehicle contract hire and factoring.

All businesses in the above three divisions, with the exception of small ticket leasing and vehicle contract hire, use introducer distribution channels.

- Retail finance – the provision of unsecured personal loans under the First National Tricity Finance ("FNTF") brand using the point-of-sale distribution channel.

As at December 31, 2000, First National had loan assets of £8.7 billion (1999: £8.6 billion).

In July 2000, Abbey National acquired Highway Vehicle Management Limited from Great Universal Stores plc. The transaction did not have a material effect on Abbey National's financial figures.

Continental Europe

Abbey National's operations in France, and Italy, which together constitute the Group's Continental Europe business, 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, primarily to Italian nationals.

Business to Consumer

The Business to Consumer segment comprises the following businesses: 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 two businesses launched in the course of 2000 – cahoot and Inscape.

Wealth Management

Abbey National's offshore operations uses the Abbey National Offshore brand. 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 provided personal banking and investment management services to higher net worth individuals. The Cater Allen brand was withdrawn from the offshore market in 2001.

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.

During the course of 2000 ANICG consisted of three businesses: Abbey National Benefit Consultants ("ANBC"), James Hay Pension Trustees ("JHPT") and the Group's share of its associate, Willis National. ANBC provided a range of services in connection with the setting-up and running of employee benefit arrangements and pension schemes, including administration and actuarial work. ANBC was sold in November 2000. 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.

Inscape

Inscape is an innovative wealth management business targeting individuals with at least £50,000 liquid assets to invest, offering customers value for money through competitive, transparent charges. The discretionary investment management service includes delivery through its network of advice centres where clients can meet dedicated relationship managers for face-to-face professional advice, seven days a week. Six client advice centers are already open, with six more planned for 2001. Inscape is a true multi-channel offering, with the advice centre network supported by a helpline, internet access providing daily updates, and monthly and quarterly performance reports distributed by post.

Portfolios are tailored to meet each client's specific needs, held in Open Ended Investment Company global sub-funds. They draw on Inscape's access to a selected range of fund managers; Abbey National Asset Managers, AXA Rosenberg, CDC Asset Management, Dresdner RCM Global Investors, Goldman Sachs Asset Management, Merrill Lynch, Schroder Investment Management, State Street Global Advisors, and Wellington Asset Management.

cahoot

cahoot is Abbey National's separately-branded, multi channel e-commerce financial services provider. cahoot targets 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 provides high quality, attractively priced services extending beyond financial services through link-ups with innovative providers. It is 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 Infrastructure

Group Infrastructure 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 January 2001, contracts were exchanged for the sale of Aitken Campbell & Company for a cash consideration of £60 million. The transaction, which is subject to regulatory consents, is due to be completed by July 2001. In addition, the Group's shareholding in the London Stock Exchange was sold in February and March 2001.

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 historically been U.K. based providers of personal financial services. These banks, building societies, life insurance companies and mutual insurance organizations, as a population, have traditionally met the financial services needs of the U.K.

In recent years, competitive pressures and consolidation have led to a blurring of the boundaries between banks, building societies and insurance companies in the U.K. In addition, new providers of financial services have emerged, providing sophisticated investment and banking products as technological advances have revolutionized delivery channels. All of these developments have served to increase customer access, customer choice and customer mobility.

Competitive Environment and Future Trends

The financial services sector has witnessed an increasing number of competitors from new financial services 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. Incumbent players with wide distribution and large customer bases continue to thrive, whilst a lack of effective access to customers, a lesser ability to collect appropriate customer data, and the cost of customer recruitment via direct/Internet channels, has limited the volume gains and financial viability of some new entrants.

The last year has seen the traditional players invest heavily in extending their existing services on-line and developing new on-line brands. It is not yet clear how large the internet-only segment will be. The incumbent 'bricks and clicks' propositions have the vast majority of on-line banking users.

Government initiatives and consumerism continue to impact on financial services. For example, stakeholder pensions will be introduced in April 2001. The Cruickshank Report (see "Supervision and Regulation" included elsewhere in this Annual Report) into banking competition may also have an impact, particularly in money transmission and services to small and medium sized businesses ('SME's). The latter is now the subject of a Competition Commission enquiry. The provisional conclusion of this enquiry is that a complex monopoly exists which restricts price competition in SME banking services. It also comments on restrictive practices and transparency issues in SME banking. This may provide opportunities for Abbey National, which has a stated intention to increase its market share in business banking.

The most significant U.K. consolidation activity in 2000 was the acquisition of National Westminster Bank by The Royal Bank of Scotland in February.

Competition Outlook

Abbey National continues to deliver strong performance and increased revenue despite tough competition in its traditional markets. This has been facilitated by the diversified nature of the business. Major growth is being generated within the Wholesale Bank and through the success of the Life Insurance businesses. Abbey National continues to invest in new and innovative businesses, bringing cahoot, a stand alone internet bank, and Inscape, a multi-channel offering for the mass affluent, to the market in 2000. This is in addition to the radical transformation of our existing businesses. Convenience Retailing, making it easier for customers to do business with us through more convenient channels and flexible products, is a key part of this strategy. This includes in-branch e-banking facilities, coffee shop formats, Safeway supermarket in-store branch openings and an extended ATM network. The branch network has been re-organized to focus on local markets, and aligning service to customer needs to maximize efficiency and revenue growth.

Management believes that Abbey National is well positioned to respond to changes in competitive pressures while achieving a balance between market share and profitability and continuing its track record of revenue growth. The company has a large customer base, a powerful brand, established products and services, an integrated distribution network, and access to both the wholesale and retail liability markets. Abbey National continues to diversify its earnings, moving into newer, fast growing markets. In 2000, over 53% of profits were generated from businesses other than mortgages and savings. By the end of 2001, the level of diversification is expected to increase to around 60%, and the aim is to achieve 65% by the end of 2002, one year ahead of the 2003 target. At the same time, Abbey National continues to develop an integrated multi-channel distribution network, giving customers more opportunities to conduct business with Abbey National in ways that suit them.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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 55, 57 and 58 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, 1999, unless stated otherwise.

Financial highlights

- Underlying income before tax* improved by 17% to £2,100 million. Income before tax increased 11% to £1,975 million (1999: £1,783 million).
- 53% of profit was generated by businesses other than mortgages and savings (1999: 45%).
- The strength of the existing diversified businesses was prominent in helping the Group deliver double-digit growth in income before tax for the 8th successive year. Life Insurance income before tax increased by 29% and Wholesale Banking by 37%.
- Total revenue grew 13% in 2000, and we have now achieved 17% compound average annual growth rates over the last 5 years.
- Significant investment spend of £190 million (1999: £73 million) was undertaken to transform the Group and develop new income streams resulting in headline cost growth of 14% and an increase in the cost:income ratio to 44.1%. Investment spend on such projects is expected to reduce by over 50% in 2001, and still further in 2002.
- On an underlying basis* the cost income ratio improved to 40.2% (1999: 41.2%) and cost growth was 7%.
- Credit quality remains strong. Despite a 13% increase in Group assets to £204 billion, the bad debt charge fell by 10%.
- Earnings per ordinary share was 93.4 pence (1999: 86.2 pence), dividend per share 45.5 pence (1999: 40.25 pence), post tax return on equity 21.5% (1999: 22.8%). The equity tier 1 capital ratio rose to 7.5% (1999: 7.1%).

*Underlying income before tax

Underlying income before tax is defined as income before tax excluding significant investment of £190 million (1999: £73 million) (to develop new income streams and transform the Group), and profits from significant asset disposals of £65 million in 2000 (1999: £60 million). Underlying income is not a recognized term under U.K. or U.S. GAAP; however, disclosure of underlying income before tax is considered necessary in order for a proper understanding of Abbey National's results. A detailed breakdown of underlying income before tax is shown below.

Restatement of Prior Year Numbers

Prior year comparatives for 1999 and 1998 have been restated to reflect the changes noted below:

In May 2000, a new management structure was introduced, creating four customer facing divisions responsible for increasing revenue growth. These are Retail Banking, Business to Consumer, Business to Business, and Wholesale Banking. In turn these are supported by a core infrastructure area spanning the whole Group. The reorganization is aimed at delivering our key strategic priorities: the radical transformation of our businesses to sustain revenue growth, whilst increasing cost and capital efficiency.

As a result, the segmental analysis has been revised as follows:

Retail Banking now includes General Insurance and Abbey National Life.

Business to Business comprises First National, Scottish Mutual Assurance and Continental Europe.

Business to Consumer comprises Wealth Management, Inscape, and cahoot.

Group Infrastructure is the new name for the Group Central Holdings segment.

These changes have no effect on the consolidated net income and shareholders' funds under both U.K. and U.S. GAAP. Prior year comparatives for 1999 and 1998 have been restated to reflect the changes. The numerical effect of the changes is detailed in Note 1 to the Consolidated Financial Statements included elsewhere in this Annual Report.

Depreciation on operating lease assets is now reported within Depreciation and amortisation and is separately identified because operating lease assets are used for a different purpose to fixed assets used in administrative functions. This represents a change in presentation from previous years, where such depreciation was reported as a charge against income on operating lease assets. This change results from the application of FRS 15, 'Tangible fixed assets', which first applies to the financial statements for the year ended December 31, 2000. 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 1999 and 1998 have been restated to reflect the change.

Following an accounting presentation change, the average balance sheet has been restated to show average trading assets and liabilities, and their relevant interest, separate from the average non-trading assets and liabilities of the Group. 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 1999 and 1998 have been restated to reflect the change.

Significant Events

Lloyds TSB Group plc ("Lloyds TSB")

During December, 2000 Abbey National received proposals from Lloyds TSB for a takeover of Abbey National by Lloyds TSB. These proposals were rejected by Abbey National as being inadequate and uncertain. On January 31, 2001 Lloyds TSB announced its firm intention, subject to pre-conditions, to make an offer to acquire Abbey National. The offer and the posting of the offer documentation was subject to satisfaction or waiver of the pre-conditions that the proposed transaction would not be referred to the Competition Commission and that the Abbey National Board would agree to recommend the offer.

The terms of Lloyds TSB's pre-conditional offer were the same as those put to Abbey National in December, 2000 and, on February 7, 2001, Abbey National announced that its Board had "concluded that the proposed offer terms remain inadequate and subject to material uncertainties."

Following the submission by Lloyds TSB of a Merger Notice to the Office of Fair Trading under Section 75A of the Fair Trading Act 1973, the Secretary of State for Trade and Industry announced on February 23, 2001 that Lloyds TSB's proposed takeover had been referred to the Competition Commission. In response, Abbey National announced that: "This decision means that the pre-conditions of Lloyds TSB's offer for Abbey National cannot now be satisfied. Lloyds TSB cannot now proceed in any circumstances with an offer to Abbey National shareholders until the result of the Competition Commission is known." Lloyds TSB announced that: "The pre-conditional Offer, announced on January 31, has lapsed" and further that: "Lloyds TSB will co-operate fully with the Competition Commission during its review". The Competition Commission is required to report to the Secretary of State for Trade and Industry by June 12, 2001 and a decision is expected by July 2001.

Bank of Scotland

Abbey National entered into discussions with a view to a possible combination with Bank of Scotland during 2000 and the first quarter of 2001; however on February 28, 2001 Abbey National announced that, in light of the continuing uncertainty created by Lloyds TSB, it had terminated these discussions.

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, 2000, 1999 and 1998. 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, 2000, 1999 and 1998 and total assets by principal business segment as at the end of such periods. The segmental analysis was revised at December 31, 2000, to reflect more clearly the results of the Group's business segments and to ensure improved comparability between segments.

Segmental profit and loss account

	2000	1999[(1)] (restated)	1998[(1)] (restated)
	(in millions of £)		
Income before tax			
Retail Banking	1,283	1,227	1,137
Wholesale Banking	575	419	361
Business to Business	254	234	171
Business to Consumer	(48)	1	26
Group Infrastructure	(89)	(71)	(107)
Income before tax and exceptional items	1,975	1,810	1,588
Year 2000 and EMU costs	—	(27)	(68)
Income before tax	1,975	1,783	1,520

Significant investment and asset disposals

	2000	1999	1998
	(in millions of £)		
Retail Banking			
e-commerce	(28)	(4)	—
branch restructuring	(18)	—	—
Business to Business			
integration/ transformation	(47)	(27)	—
Business to Consumer			
Inscape[(2)]	(34)	(19)	—
cahoot[(2)]	(63)	(16)	—
Group Infrastructure			
e-commerce	—	(7)	—
	(190)	(73)	—
Group Infrastructure			
Sale of property portfolio	65	—	—
Irish Permanent share sales	—	60	—
	65	60	—
Impact on income before tax and exceptional items	(125)	(13)	—

Underlying income before tax

	2000	1999	1998
	(in millions of £)		
Retail Banking	1,329	1,231	1,137
Wholesale Banking	575	419	361
Business to Business	301	261	171
Business to Consumer	49	36	26
Group Infrastructure	(154)	(124)	(107)
Underlying income before tax and exceptional items	2,100	1,823	1,588
Year 2000 and EMU costs	—	(27)	(68)
Underlying income before tax	2,100	1,796	1,520

(1) 1999 and 1998 total assets have been restated to reflect the revised segmental presentation following the Group's change in management structure in May 2000.

(2) Significant investment in Inscape and cahoot is taken as being the loss before tax.

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, 2000, 1999 and 1998 elsewhere in this Annual Report).

Total Assets by Principal Business Segment

	As at December 31,		
	2000	1999[(1)] (restated)	1998[(1)] (restated)
	(in millions of £)		
Retail Banking	69,097	68,943	66,845
Wholesale Banking	102,495	81,741	69,916
Business to Business	26,722	25,087	20,689
Business to Consumer[(2)]	5,517	4,491	4,225
Group Infrastructure	560	482	1,078
Total assets[(3)]	204,391	180,744	162,753

(1) 1999 and 1998 total assets have been restated to reflect the revised segmental presentation following the Group's change in management structure in May 2000.

(2) In 1999, the Abbey National-branded unsecured lending business was reclassified from Business to Business to Retail Banking. 1998 numbers were restated to reflect the reclassification. The effect on 1998 numbers was to increase Retail Banking's total assets by £1,225m at December 31, 1998. Business to Business segment total assets were reduced accordingly.

(3) In 1999, 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 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 for December 31, 1998. There is no effect on net income or shareholders' funds resulting from this change.

Year ended December 31, 2000 compared to year ended December 31, 1999

For a discussion of overall results, see "Financial Highlights", above.

Retail Banking

	2000	1999	1998
	(in millions of £)		
Net interest income	1,578	1,624	1,515
Commissions, fees and other income	810	670	651
Total operating income	2,388	2,294	2,166
Operating expenses	(944)	(885)	(849)
Provisions	(161)	(182)	(180)
Income before tax	1,283	1,227	1,137
Add back:			
Investment in e-commerce	28	4	—
Branch restructuring	18	—	—
Underlying income before tax	1,329	1,231	1,137
Income by business			
Mortgages and Savings	934	982	896
Banking and unsecured lending	51	14	30
U.K. Retail Bank	985	996	926
Abbey National Life	182	127	113
General Insurance	116	104	98
Total income before tax	1,283	1,227	1,137
Cost : income ratio (%)	39.5	38.6	39.2
Underlying cost : income ratio (%)	37.6	38.4	39.2
Retail Banking net interest spread (%)(1)	2.01	2.20	2.10
Retail Banking net interest yield (%)(1)	6.79	6.53	8.22
Retail Banking net interest cost (%)(1)	4.78	4.33	6.12
Retail Banking margin (%)(1)	2.27	2.45	2.39
Average interest earning assets (£bn)(2)	65.4	61.8	59.5
Average risk weighted assets (RWA) (£m)(2)	35,347	34,223	33,395
Return on regulatory equity (RoE) (%)(2)	28.5	29.1	27.2

(1) Spread and margin calculations exclude unsecured lending, General Insurance and Abbey National Life

(2) RWAs and RoE analysis are for U.K. Retail Bank only

Retail Banking increased its income before tax by 5% to £1,283 million, whilst the cost:income ratio increased to 39.5% (1999: 38.6%). Excluding non-recurring costs of investing in the business, the cost:income ratio improved to 37.6% (1999: 38.4%).

Net interest income decreased by 3% to £1,578 million (1999: £1,624 million). The spread between Retail Banking's average lending rates and average funding rates decreased from 2.20% to 2.01% (excluding Unsecured Personal Loans ("UPLs"), General Insurance and Abbey National Life), due to active management of the mortgages and savings customer base through competitive pricing, against a backdrop of stable base rates. This was in part offset by the impact of strong new business flows.

Commissions, fees and other income increased by 21% to £810 million (1999: £670 million). The growth was driven by increased banking and mortgage fee income earned from customers, and record levels of new business in Abbey National Life, notably a 44% increase in new business premiums and the launch of three structured ISA tranches. These increases were partially offset by reduced fixed-rate mortgage booking fees as the demand for fixed-rate products reduced.

Operating expenses rose by 7% to £944 million (1999: £885 million). Excluding a £28 million investment in developing the retail e-banking service (1999: £4 million) and redundancy costs of £18m relating to branch network reorganization, expense growth of £17m represents only a 2% increase in costs. An 11% reduction in mortgage processing costs was achieved through re-engineering processes and workflow management. A proposed joint venture with Electronic Data Systems is expected to deliver close to best-in-class loan processing costs from 2001 onwards through advanced systems utilization and process re-engineering. In addition, the branch network has been reorganized to focus on local markets, aligning service to customer needs and removing £16 million from the cost base from 2001 onwards.

The provisions charge fell by 12% to £161 million (1999: £182 million). This was achieved through improving both the quality of business underwritten and arrears management. The largest improvement was within Banking where the full year charge fell by 19% to £59 million (1999: £73 million) as a result of more proactive management of early arrears and improved recoveries. There was a 16% decrease in the charge for unsecured personal loans to £53 million (1999: £63 million). This reflects an improvement in the quality of business written during the latter half of 1999 and £3 million additional recoveries. The secured loan charge increased to £38 million (1999: £31 million) arising from growth in mortgage assets.

As at December 31, 2000, Abbey National had a U.K. mortgage asset of £67.9 billion (1999: £64.7 billion), an estimated 12.7% market share (1999: 13.1%). The £3.2 billion increase during the year represents an estimated 7.9% (1999: 6.3%) market share of the increase in U.K. mortgages outstanding. This reflects an estimated 10.7% (1999: 10.7%) share of gross mortgage lending, amounting to £12.8 billion (1999: £12.2 billion), and an estimated 12.2% (1999: 12.9%) market share of mortgage capital repayments (equating to £9.6 billion). The improvement to 7.9% market share of net lending was achieved through new product innovation, such as flexible mortgages, enhanced service delivery backed by cutting edge internet functionality for introducers, and proactive customer management through dedicated retention teams.

As at December 31, 2000, Abbey National had retail household liabilities of £50.9 billion (1999: £49.7 billion), an estimated 8.3% (1999: 8.6%) 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 2000 (1999: £0.5 billion). This represents an estimated 3.6% (1999: 1.8%) market share of the increase in U.K. liquid savings. Abbey National cash ISAs took £1.3 billion (1999: £1.2 billion), an 11% market share (1999: 14%), while sales of Investment ISAs increased to £0.7 billion (1999: £0.4 billion), a market share of 7% (1999: 8%). Positive net receipts of retail liabilities have been achieved by retention initiatives, and by encouraging customers to transfer to higher rate accounts or longer-term investment products. In particular, positive flows into Direct Saver of £2.4 billion, and e-saver of £1.3 billion have been achieved since launch. Of the increase £0.9 billion relates to deposits taken through Business to Consumer operations.

The number of Abbey National bank accounts increased to 2,101,000 (1999: 1,976,000). Openings of new bank accounts increased by 40% to 172,000 (1999: 123,000), and the quality of lending has improved due to enhanced credit risk management techniques. Bank account and credit card arrears improved by 5% and 8% respectively. A number of banking initiatives have been launched over the last year to increase the account base. This includes market leading overdraft rates, a no-hassle switcher service and the launch of the student bank account. Together these initiatives resulted in a very strong fourth quarter, with openings up 150% on the equivalent period in 1999.

Abbey National Life's performance has been outstanding in 2000 with income before tax increasing by 43% to £182 million (1999: £127 million) in line with new business premium growth of 44% to £1.7 billion (1999: £1.2 billion). Within single premium business, pensions increased by 17% to £21 million (1999: £18 million), Life assurance increased by 83% to £850 million (1999: £464 million), and PEP, Unit Trust and ISAs increased by 21% to £772 million (1999: £636 million). In annual premium business, pensions increased 63% to £13 million (1999: £8 million), Life assurance decreased by 56% to £16 million (1999: £36 million), and PEP, Unit Trust and ISAs increased by 70% to £39 million (1999: £23 million). The growth in premiums reflects success in selling investment and protection products to 14% of the active customer base. Significant increases have occurred in most product areas, notably through sales of the With Profit Bond increasing by 114% and through the launch of three structured ISA tranches during the year. The ISA products were provided with the help of Wholesale Banking's Risk Management and Financial Products division.

General Insurance income before tax increased by 12% to £116 million (1999: £104 million). In 2000, motor insurance volumes have increased by 28%, supported by the launch of the motor insurance Internet site in November

2000. In addition, the business focus on retention initiatives has been maintained with overall levels showing good improvements. In January 2001, we announced plans to accelerate the growth of the general insurance business. This will be achieved by using a panel of competing insurers to offer a wider choice of products and more competitive retail pricing. In addition, Capita Eastgate will be responsible for the management and development of new systems to support the business, using its new Consumer Direct platform. This will aim to provide market leading product flexibility and straight through processing, improved customer service and lower costs. By mid 2001, a full internet service is planned to be available, including on-line quotes, applications, claims handling, and policy processing. Investment in the region of £50 million will be required over the next 36 months to implement the new arrangements fully, and is expected to have a favorable impact on headline profitability from 2002 onwards. The objective of this investment is to create a new platform, which will support the target of growing the insurance book to over 2.0 million policies by the end of 2003.

Wholesale Banking

	2000	1999	1998
	(in millions of £)		
Net interest income	441	393	411
Commissions, fees and other income	423	169	55
Total operating income	864	562	466
Operating expenses excluding depreciation on operating lease assets	(155)	(115)	(86)
Depreciation on operating lease assets	(100)	(2)	—
Provisions	(34)	(26)	(19)
Income before tax	575	419	361
Income by business			
Wholesale lending	135	101	80
Asset financing	159	61	74
Asset-backed investments	149	165	149
Risk management and financial products	76	49	14
Securities financing	38	30	29
Treasury and other	18	13	15
Income before tax	575	419	361
Balance sheet by business type	(in billions of £)		
Wholesale lending	21	17	15
Asset financing	13	9	7
Asset-backed investments	26	27	25
Risk management and financial products	3	2	1
Securities financing	29	19	16
Treasury and other	11	8	6
Total assets	103	82	70
Cost : income ratio (%)	20.3	20.5	18.5
Net interest margin (%)	0.43	0.41	0.51
Average interest earning assets (£bn)	103.0	94.6	80.9
Average risk weighted assets (RWA) (£m)	34,274	30,036	25,345
Return on regulatory equity (%)	17.2	14.0	13.9

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

Wholesale Banking delivered an exceptionally strong set of results, with a 37% increase in income before tax to £575 million (1999: £419 million), while total revenue increased by 54% to £864 million (1999: £562 million). Total assets increased to £103 billion (1999: £82 billion), and average risk weighted assets increased to £34 billion (1999: £30 billion). The return on regulatory equity increased to 17.2% (1999: 14.0%). These results reflect the robust performance of existing income streams, and the development of new businesses targeting markets with strong sustainable growth potential, and attractive risk rewards. A significant pipeline of deals for 2001 has been established and the Wholesale Bank's responsive and innovative approach, and market expertise will contribute to the sustainability of these results. A branch with a full banking license was launched in Hong Kong in November, and a physical U.S. presence is being considered for 2001.

Wholesale Banking participates in five main business areas:

(i) Strong growth was generated in Wholesale Lending with income up 34% to £135 million (1999: £101 million). Assets increased to £21 billion (1999: £17 billion) including the provision of acquisition finance. Income growth reflects successful management of the portfolios of assets and increased volumes in acquisition finance, where the remit was extended to underwrite selected deals.

(ii) Asset Financing was the fastest growing business area in 2000, increasing profits by 161% to £159 million (1999: £61 million). Assets increased to £13 billion (1999: £9 billion). The business provides finance solutions in operating and finance leasing, project finance and social housing markets and invests in private equity. Growth reflects the acquisition of the operating lease business Porterbrook (income of £40 million), private equity investment realizations, and increased project finance business.

(iii) Within Asset-backed Investments, income decreased by 10% to £149 million (1999: £165 million), and assets decreased to £26 billion (1999: £27 billion). The business manages substantial portfolios in asset-backed securities, including investments backed by credit card receivables, student loans, collateralized debt obligations and mortgages. Return on equity increased to 11.5% (1999: 10.8%).

(iv) Within Securities Financing, income increased 27% to £38 million (1999: £30 million), and assets increased to £29 billion (1999: £19 billion). Cater Allen International Limited (CAIL) is an active participant in the sale and repurchase of U.K. and international securities, and the lending and borrowing of equity, fixed income and government securities. CAIL is currently developing plans to establish a broker-dealer in the U.S. market to capitalize on the expected investor demand for the products and services of a company with Abbey National's financial backing.

(v) Within Risk Management and Financial Products income increased by 55% to £76 million (1999: £49 million) and assets increased to £3 billion (1999: £2 billion). Abbey National Financial Products (ANFP) combines expertise in structured products, fixed income, equity and credit derivatives to offer comprehensive derivative solutions to Group companies and third parties.

Treasury and Other increased income to £18 million (1999: £13 million), while total assets grew to £11 billion (1999: £8 billion). Treasury division ensures that wholesale funding and capital is available to the Group, managing liquidity needs and contributing to the risk management of the Group's balance sheet. Treasury established Abbey National as the leader in the European residential mortgage securitisation market in 2000, managing the launch of two mortgage-backed floating rate note issues totaling £4.7 billion. Also on behalf of the Group, Treasury launched U.S.$1 billion perpetual preferred securities and £1.2 billion equivalent perpetual notes raising tier one and upper tier two capital respectively. Reflecting Treasury's performance in the capital markets, Abbey National was selected by the International Financing Review as the 'Best Bank Borrower in 2000'.

Total operating income increased by 54% to £864 million (1999: £562 million). Net interest income increased by 12% to £441 million (1999: £393 million). The net interest margin increased to 0.43% (1999: 0.41%) with the benefits of higher margin income streams offset by funding costs associated with fee-earning assets. Average interest earning assets increased to £103 billion (1999: £82 billion). Interest income is mainly delivered by Wholesale Lending, through a range of financing instruments including debt securities, asset swaps, direct loans and syndicated loans, to highly rated banks, financial institutions, corporates and governments. In addition, predominantly AAA rated Asset backed investments provide substantial net interest income. Wholesale Banking focuses on lending to investment grade institutions, and is extending its presence in markets where it can use its expertise to optimize risk:reward trade offs, while maintaining its selective and discerning approach. Changes in the risk profile are partly offset by shorter maturities of assets in newer business areas and the effect of collateralization of some highly rated counterparty exposures. Exposure to individual sectors, including the telecoms and high yield sector, continues to be tightly managed and remains at an appropriate level within the Group's stated risk appetite.

Commissions, fees and other income (excluding dealing profits and operating lease income) increased by 63% to £119 million (1999: £73 million), largely reflecting the contributions of project finance and private equity. Wholesale Lending participated in a total of 34 acquisition finance deals, consolidating the Wholesale Bank's position in this market and extending its remit to include underwriting and co-arranging finance for selected corporate mergers and acquisitions. The steady growth of this business is expected to continue through increased penetration in growing international markets. Asset Financing participated in 50 project finance deals worldwide and 9 property finance deals. The book value of commitments increased from £1.2 billion to £3.6 billion. Wholesale Banking is also a leading provider of finance through the U.K. government's private finance initiative (PFI) and participated in a total of 15 deals. The diverse private equity investment portfolio, built up since 1997, delivered strong returns. Investments increased from £0.2 billion to £0.5 billion with holdings in 50 funds across 20 industrial sectors. It focuses on funds whose strategies concentrate on managing buy-outs of small and medium sized businesses. The portfolios are held at cost and as at December had unrealized gains amounting to around £60 million. The Wholesale Bank will continue to respond to the growing demand for private finance for large projects both in the U.K. and internationally.

Operating lease income increased from £4 million to £197 million as a result of the acquisition of Porterbrook. Associated depreciation costs increased from £2 million to £100 million. The exercise to integrate Porterbrook is complete. Since acquisition, it has completed deals to provide funding totaling £359 million. This includes funding for 400 new vehicles for commuter routes in southern England to be delivered over the next few years.

Dealing profits increased 16% to £107 million (1999: £92 million), reflecting increased deal flow in Securities Financing and Risk Management and Financial Products, where a strong performance was complemented by new business flows and extended presence in a number of niche markets. In 2000, ANFP was a very active participant in the U.K. retail price index (RPI) swap market. ANFP also extended its range of equity index-linked structured retail products and was a significant provider of these products to major financial companies, and established a credit derivatives business, which completed its first synthetic collateral bond obligation in December. ANFP will continue to develop its product range, build on its strong position in the U.K., and increase penetration of international markets. Within Securities Financing, CAIL continued to deliver a high return on regulatory equity, maintained its strong position in the sterling securities financing market and continued to make progress in diversifying its portfolio to include a broader product range and a larger proportion of euro and U.S.$-denominated securities.

Operating expenses increased by 35% to £155 million (1999: £115 million). The increase in costs is due to growth in headcount and investment in new businesses and enhanced systems. Notwithstanding this increase, the cost income ratio improved from 20.5% to 20.3%. An additional £34 million (1999: £26 million) was added to provisions.

Business to Business

	2000	1999	1998
	(in millions of £)		
Net interest income	593	593	249
Commissions, fees and other income	180	133	114
Total operating income	773	726	363
Operating expenses excluding depreciation on operating lease assets	(326)	(301)	(142)
Depreciation on operating lease assets	(78)	(50)	(21)
Provisions	(115)	(141)	(29)
Income before tax	254	234	171
Add back:			
Investment in integration	47	27	—
Underlying income before tax	301	261	171
Income by business			
First National	147	140	94
Scottish Mutual	113	102	77
France	(4)	(2)	(11)
Italy	(2)	(6)	—
Spain (only 4 months in 1998)	—	—	(2)
Income arising from sale of the Spanish operation	—	—	13
Income before tax	254	234	171

Business to Business income before tax increased by 9% to £254 million (1999: £234 million). Excluding £47 million (1999: £27 million) of integration costs in First National, income increased 15% to £301 million (1999: £261 million). Total net interest income was unchanged at £593 million, due to First National Bank growth in consumer finance lending, offset by declining Motor Finance asset and lending, and a decrease in the net interest margin to 7.06% (1999: 7.20%). Commissions, fees and other income increased by 35% to £180 million (1999: £133 million), partly within Scottish Mutual Assurance due to strong growth of new business premiums, and within First National due to higher fee charging loans and insurance rates within the consumer finance division. The acquisition of Highway Vehicle Management increased leasing income by £33m, while related depreciation increased by £28m.

Business to Business expenses increased by 8% to £326 million (1999: £301 million), however excluding the implementation of the First National transformation process, expenses increased by only 2% to £279 million (1999: £274 million). The scope of the program includes integrating businesses, replacing systems, outsourcing back-office operations, consolidation of branch networks and improved credit and fraud prevention procedures. Over 50% of projects are complete, and the program is due for completion by the end of 2001. In total, projects expected to provide future annualized cost and revenue enhancements of £28 million were completed in 2000. Provisions for bad and doubtful debts have fallen by 18% to £115 million (1999: £141 million) due to a review of general provisions across the First National Group, affecting all divisions, especially Consumer and Motor Finance.

First National Group increased income before tax by 5% to £147 million (1999: £140 million), with a change in business mix towards higher credit quality lending, and improved credit processes, resulting in reduced bad debt charge. The cost:income ratio increased to 52.5% (1999: 48.8%), however excluding one-off transformation costs the ratio was 43.9% (1999: 43.8%). Average risk weighted assets increased to £9.4 billion (1999: £8.5 billion), and the return on regulatory equity decreased to 16.1% (1999: 16.4%).

First National Group total net loan assets increased by 1% to £8,674 million (1999: £8,624 million). Within Consumer Finance, unsecured assets increased by 7% to £949 million (1999: £885 million), and secured assets increased by 7% to £1,936 million (1999: £1,802 million). The increase was driven by second mortgage and home improvement lending. Household Mortgage Corporation was re-branded First National Mortgage Company in October, launching a competitive range of non-status mortgages. A leading position in the new litigation funding market was established, securing deals with two of the major claims management companies. Motor Finance assets decreased by 10% to £2,906 million (1999: £3,238 million), with trade continuing to be profitable despite difficult market conditions in the motor industry. Despite lower volumes, market share was maintained. The 'First On-Line' internet introducer facility was launched and is operational in over 900 motor dealerships, enabling dealers to submit credit applications and receive approvals on-line. Business Finance assets increased by 35% to £1,111 million (1999: £821 million), reflecting strong growth in commercial lending and invoice finance. Highway Vehicle Management was acquired in August 2000, increasing the vehicle contract hire and managed fleet from 44,000 to 70,000. Abbey National Business and Professional Banking increased its bank account base by 81% to 34,237, taking in net new deposits of £646 million to bring total deposits to over £1.5 billion. Retail Finance assets decreased 6% to £1,772 million (1999: £1,878 million) due to a program of re-pricing and tighter credit control, resulting in improvement in margins on new business and lower bad debts. Outsourcing of operational functions was completed giving access to more flexible systems and a lower cost base.

Scottish Mutual increased income before tax by 11% to £113 million (1999: £102 million), with funds under management increasing by 13% to £15 billion. New business premiums increased by 30% to £2.6 billion (1999: £2.0 billion), which on an annualized basis equates to an increase of 22% to £306 million (1999: £250 million). Within single premium business, pensions increased by 60% to £720 million (1999: £450 million), and Life premiums increased by 19% to £1,796 million (1999: £1,512 million) reflecting continued strong demand for longer term investments. Despite new market entrants, the success of the With Profit Bond has continued, with sales exceeding £1 billion for the second successive year (an IFA market share of 14%). In annual premium business, pensions decreased 12% to £37 million (1999: £42 million), and Life premiums increased by 42% to £17 million (1999: £12 million). Overall, group personal pensions volumes increased 38%, and the commitment to stakeholder pensions was demonstrated with the launch of the pre-stakeholder Universal Group Pension. Scottish Mutual International (SMI) increased profit before tax by £6 million to £8 million. SMI new business premiums increased by 141% largely due to With Profit Bond sales and the launch of the Complete Investment Portfolio contract. Scottish Mutual Pegasus volumes of regular premiums increased 83% to £13.7 million.

Scottish Mutual new business contribution to embedded value of £63 million (1999: £49 million) is up 29% from 1999 showing that despite increased margin pressures throughout the industry, Life Insurance continues to contribute significant earnings. See "Accounting Policies" in the consolidated financial statements for a definition of embedded value.

The very low total expense ratio in Scottish Mutual of 75% (1999: 76.6%) demonstrates that the business is well placed to respond to further margin pressure with the advent of Stakeholder Pensions. Scottish Mutual has become the most efficient active life insurance provider through the IFA channel in the U.K., when comparing total expense ratios using the latest available industry data (1999 FSA returns).

In September, Abbey National entered into an agreement to transfer (subject to policyholder and Court approval) the business of Scottish Provident. The Scottish Provident brand will be retained, and its operations will be combined with existing Life Insurance operations. It is anticipated that the integration will realize substantial cost synergies, and provide the means for significant increases in new business volumes through the promotion of individual protection products to a wider range of IFAs, and to the Retail Bank's customer base under the Abbey National brand. Integration of existing international businesses will raise the profile of Abbey National's international operations significantly. The plans for transfer and integration are currently progressing to schedule.

Continental Europe reduced losses to £6 million in 2000 (1999: loss of £8 million). Net lending increased by 84% to £376 million, mainly within AN Italy. Results for AN France include £3 million non-recurring Euro conversion costs. Good progress has been made, and useful experience gained, in converting these retail operations to the Euro.

Business to Consumer

	2000	1999	1998
	(in millions of £)		
Net interest income	76	62	47
Commissions, fees and other income	56	46	38
Total operating income	132	108	85
Operating expenses	(177)	(107)	(58)
Provisions	(3)	—	(1)
(Loss)/profit before tax	(48)	1	26
Add back investment in business development:			
cahoot	63	16	—
Inscape	34	19	—
Underlying profit before tax	49	36	26
Profit/(loss) by business type			
Wealth Management	49	36	26
cahoot	(63)	(16)	—
Inscape	(34)	(19)	—
(Loss)/profit before tax	(48)	1	26

Business to Consumer division incurred a loss before tax of £48 million (1999: income of £1 million). The segment is made up largely by new business ventures. Both Inscape and cahoot have invested heavily during the year to establish the infrastructure required to develop the businesses and product range in 2001. Excluding the investment in cahoot of £63 million (1999: £16 million), and investment in Inscape of £34 million (1999: £19 million), the pre-tax profit of the existing Wealth Management business increased by 36% to £49 million (1999: £36 million). Net interest income increased by 23% to £76 million (1999: £62 million) from strong growth in Wealth Management retail deposits, reaching £4.8 billion (1999: £4.0 billion), and expansion of the wholesale investment book to £5.2 billion (1999: £4.0 billion). Commissions, fees and other income increased by 22% to £56 million (1999: £46 million), mainly due to increased fee income from business growth in pension scheme administration. Operating expenses increased to £177 million (1999: £107 million). Expenses in cahoot increased by £44 million to £60 million, largely from IT development, PR and advertising. Costs within Inscape increased by £17 million to £36 million due to staff costs and software purchase & development. Wealth Management costs increased by £9 million, mainly from a 15% increase in Offshore average FTEs, and consultancy spend connected with the sale of the business of Cater Allen Trust company, offset by cost savings from outsourcing back office services in City Deal.

Wealth Management income before tax increased by 36% to £49 million (1999: £36 million), which equates to a return on regulatory equity of 30.7%, (1999: 23.7%) and a 9% increase in average risk weighted assets to £1,633 million (1999: £1,494 million). The cost:income ratio improved to 61.8% (1999: 66.7%). The business has focused on the development of its onshore and offshore retail deposits and wholesale asset book, targeting the U.K. expatriate market, which has significant investment potential. Fee income is generated by pensions administration business within the Self Invested Personal Pensions market, with 60% growth in clients subscribed to over 15,000. This business is expected to continue to grow strongly. City Deal Services sharedealing business completed its outsourcing program, achieving £5 million cost savings and a 31% increase in transactions. Ongoing investment continued in Wealth Management business systems and centralization, and the businesses are well poised for growth in 2001.

The Inscape investment management business was launched in November and began advertising in January 2001. Since launch the average amount invested is well ahead of target, and over two thirds of funds invested is new money to the Group. Funds under management are targeted to be £8 billion by the end of 2004 from 100,000 clients.

cahoot, Abbey National's internet bank, received over 189,000 applications by February 4, 2001 (December 31, 2000: 142,000). By February 4, 2001 41,000 money transmission accounts and 66,000 credit card accounts were accepted (December 31, 2000: 27,000 and 49,000 respectively), and bank account liability, bank account asset and credit card asset were £302 million (December 31, 2000: £177 million), £6 million (December 31, 2000: £5 million) and £66 million (December 31, 2000: £52 million) respectively. During the first 6 months of operations, cahoot has achieved 38% brand awareness, making it the second best known on-line U.K. financial services brand. cahoot has been recognized on two separate occasions as the best on-line credit card in the U.K. by Gomez ratings agency. It has also received the Design Council-sponsored IVCA award for the best transactional website, and was rated the best online bank in the U.K. market by Personal Computer World in February 2001. A range of new product developments is planned for 2001 as a further step towards becoming a full service bank. The recent link up with Selftrade to offer a stock broking service to customers is already proving successful. A total account base of 200,000 is targeted by the end of 2001.

Group Infrastructure

	2000	1999	1998
	(in millions of £)		
Net interest income	(8)	(11)	19
Commissions, fees and other income	145	129	40
Total operating income	137	118	59
Operating expenses	(213)	(186)	(150)
Provisions	(13)	(3)	(16)
Loss before tax	(89)	(71)	(107)
Add/(reduce) by:			
Investment in e-commerce	—	7	—
Profit on sale and leaseback of property portfolio	(65)	—	—
Profit on sale of Irish Permanent shares	—	(60)	—
Underlying loss before tax	(154)	(124)	(107)
(Loss)/income by business type			
Central Services	(175)	(133)	(125)
Financial Holdings	86	62	18
Loss before tax	(89)	(71)	(107)

Group Infrastructure's loss before taxes increased by 25% to £89 million (1999: £71 million), of which income of £86 million was recorded against Financial Holdings (1999: £62 million), and net expenses of £175 million (1999: £133 million) were taken in Central Services. In 2000, interest payable has decreased to £8 million (1999: £11 million). Commissions, fees and other income increased to £145 million (1999: £129 million) largely within Financial Holdings as a result of £65 million profit from the sale and leaseback of the Group's entire property portfolio. In 1999, the profit on sale of the equity holding in Irish Permanent was £60 million. Excluding the above, the increase in income resulted from the disposal of other small non-core businesses, including Abbey National Benefit Consultants and the Cater Allen Trust Company business. Operating expenses have increased by £27 million to £213 million (1999: £186 million) in Central Services, resulting from additional IT development expenditure, and Group performance related bonus costs. Provisions of £13 million relate primarily to pension misselling provisions within Central Services.

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

For a discussion of overall results, see "Financial Highlights", above.

Retail Banking

Retail Banking increased its income before tax and exceptional items by 8% to £1,227 million, whilst the cost:income ratio improved to 38.6% (1998: 39.2%).

Net interest income increased by 7% to £1,624 million (1998: £1,515 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 3% to £670 million (1998: £651 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. The growth was also driven by Abbey National Life, which increased 15% to £136 million. This is mainly due to new business premiums which increased 40%, largely due to strong sales of With Profit Bonds (£253 million) and Investment Bonds (£256 million).

Operating expenses rose by 4% to £885 million (1998: £849 million). This reflects an increase in salary and bonus payments, as additional staff were 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 12% to £196 million (1998: £175 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. General Insurance 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.

The total provisions charge has remained flat at £182 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 took £1.8 billion since its launch in September 1999. 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.

Abbey National Life increased income before tax by 12% to £127 million (1998: £113 million). Funds under management increased 21% to £5.2 billion from £4.3 billion as at December 31, 1998. The new business contribution to embedded value of £49 million (1998: £44 million) was up 11% from 1998. The total expense ratio improved to

68% (1998: 78%) demonstrating that Abbey National Life is well placed to respond to further margin pressure with the advent of Stakeholder Pensions.

Abbey National Life annualized new premium income increased by 31% 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.

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 offset this growth and reduced income to around 1998 levels.

Wholesale Banking

In 1999, Wholesale Banking increased its income 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 21% to £562 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 £17.0 billion (1998: £15.2 billion); and investments in asset backed securities (including mortgage backed securities) increased to £27.1 billion (1998: £24.8 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 175% from £28 million to £77 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 £186 million saw an increase of £16 million in its market value which was not reflected in profits as at December 31, 1999. 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 totaling £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 totaling £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 average 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 finalized in 2000. An additional £26 million (1998: £19 million) was added to provisions, reflecting the prudent approach taken in relation to potential credit risks.

Business to Business

Business to Business income before tax increased 37% to £234 million (1998: £171 million). This increase reflects improved performance in First National and Scottish Mutual. First National income before tax increased 49% to £140 million (1998: £94 million), whereas Scottish Mutual reported income before tax of £102 million, a 32% increase on the previous year (1998: £77 million). Business to Business income was reduced by an £8 million loss incurred by continental Europe (1998: break-even).

First National 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 to £30 million from £6 million in 1998. This was due, in part, to increased insurance commission income driven by higher volumes of new business in addition to growth generated by the acquisition of the point-of-sale consumer finance businesses. In addition, other operating income has increased due to higher management and joint venture fees arising from the PSA joint venture as well as increased operating lease income. Introducer fees have partially offset these income gains, driven by volume rather than rate increases. Depreciation on operating lease assets increased by £29 million to £50 million, largely due to the acquisition of First National Motor Finance and First National Business Equipment Leasing in December 1998. 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 centralization of debt collection activity and 5% lower residual value of vehicles.

First National 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.

Scottish Mutual has further diversified internationally with Scottish Mutual International entering markets in mainland Europe. Funds under management have increased 40% to £13.3 billion from £9.5 billion as at December 31, 1998. The new business contribution to embedded value of £49 million (1998: £21 million) is up 133% from 1998 showing that despite increased margin pressures throughout the industry, Scottish Mutual continues to contribute significant earnings. The total expense ratio improved to 77% (1998: 80%).

Scottish Mutual annualized new premium income increased by 14% to £250 million (1998: £219 million). New single life business premiums rose 72% to £1,512 million (1998: £878 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.

Continental Europe 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.

Business to Consumer

Business to Consumer income before tax decreased to £1million from £26 million in 1998. This is due to the initial costs of setting up both Inscape and cahoot.

Wealth management income 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. Excluding Inscape and cahoot initial set up costs, operating expenses increased by £14 million to £72 million (1998: £58 million), mainly due to initiatives relating to centralization 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.

Inscape, the new wealth management business aimed at meeting the investment and cash management needs of customers with more than £50,000 in net assets, incurred a £19 million loss (1998: nil), which represents the initial set-up costs.

cahoot, Abbey National's separately branded e-commerce financial service provider, incurred £16 million (1998: nil) of initial set-up costs.

Group Infrastructure

Group Infrastructure'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 amortization 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.

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

Net interest income

	Year ended December 31,		
	2000	1999	1998
	(in millions of £)		
Interest receivable	11,210	9,229	9,925
Interest payable	(8,530)	(6,568)	(7,684)
Net interest income	2,680	2,661	2,241

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 First National 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. During 2000, the retail net interest spread reduced by 19 basis points to 2.01%, in the middle of its historic range. Abbey National expects the retail net interest spread to become narrower over the next phase in the business cycle, and expects it to be in the region of 1.75% – 1.80% for 2001. Additionally, the Group utilizes the expertise of Wholesale Banking to design innovative retail products that contribute positively to margin management.

Year ended December 31, 2000 compared to year ended December 31, 1999

Net interest income remained broadly level at £2,680 million (1999: £2,661 million), with the reduction in Retail Banking interest income being more than offset by interest income from Wholesale Banking balance sheet growth. Average interest earning assets grew 8% to £163.7 billion (1999: £151.2 billion), largely reflecting the increase in Wholesale Banking's investment assets. The Group's net interest margin decreased by 14 basis points to 1.61% (1999: 1.75%), while the Group net interest spread decreased by 13 basis points to 1.42% (1999: 1.55%). The fall in the Group net interest margin largely reflects margin management in the Retail Bank, through active management of the existing and new customer base, which reduced the Retail Banking spread by 19 basis points, plus the impact of funding costs associated with fee-based income streams in the Wholesale Bank, such as Porterbrook and private equity funds, and the increased proportion of Wholesale Banking assets on the balance sheet.

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, First National's assets, and U.K. Retail Banking and mortgage assets. The Group net interest margin increased by 9 basis points to 1.75% (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.

The following tables set forth prevailing interest rates and yields, spreads and margins for the three years ended December 31, 2000, 1999 and 1998.

	Year ended December 31,		
	2000	**1999**	**1998**
		(percent)	
Prevailing Average Interest Rates			
United Kingdom:			
U.K. banks base rate	5.96	5.35	7.24
Abbey National base mortgage rate(1)	7.68	7.05	8.77
London inter-bank offered rate:			
three month sterling	6.19	5.54	7.34
three month eurodollar	6.53	5.42	5.56
United States:			
prime rate	9.23	8.00	8.35
Yields, Spreads and Margins			
Gross yield:(2)			
Group	6.85	6.10	7.35
U.K.	6.89	6.15	7.39
Non-U.K.	6.29	5.45	6.41
Interest spread:(3)			
Group	1.42	1.55	1.36
U.K.	1.53	1.65	1.38
Non-U.K.	0.36	0.38	0.84
Net interest margin:(4)			
Group	1.61	1.75	1.66

(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).

The following table sets forth average interest-earning assets and average interest-bearing liabilities for the three years ended December 31, 2000, 1999 and 1998.

	Year ended December 31,		
	2000	1999	1998
	(in millions of £)		
Average interest-earning assets:			
Group	163,713	151,178	135,117
U.K.	151,049	141,950	129,581
Non-U.K.	12,664	9,228	5,536
Average interest-bearing liabilities:			
Group	157,810	144,436	128,510
U.K.	141,081	131,335	119,578
Non-U.K.	16,729	13,101	8,932

Commissions, fees and other income

	2000	1999 (restated)	1998 (restated)
	(in millions of £)		
Total dividend income	3	2	4
Insurance income	239	210	176
Administration, survey and legal fees	211	197	179
Other Retail Banking income	246	182	177
Wholesale banking fees	72	55	28
Other commissions receivable	99	93	83
Fees and commissions receivable	867	737	643
Introducer fee charge	(199)	(174)	(73)
Financial markets permanent fees / brokerage fees	(9)	(9)	(13)
Other commissions payable	(61)	(63)	(50)
Fees and commissions payable	(269)	(246)	(136)
Net fees and commissions	598	491	507
Dealing profits	116	98	32
Increase in value of long term assurance business	227	202	162
Fee income on high loan to value loans	95	77	72
Income from operating lease assets	303	78	30
Other financial income	196	139	90
Other operating income	821	496	354
Underlying commissions, fees and other income	1,538	1,087	897
Profit on sale and leaseback of property portfolio	76	—	—
Disposal of shares in Irish Permanent	—	60	—
Total commissions, fees and other income(1)(3)	1,614	1,147	897

(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 20 to, the Consolidated Financial Statements included elsewhere in this Annual Report.

(3) Following an accounting presentation change, depreciation on operating lease assets is now included within operating expenses. The restatement has resulted in Other operating income being increased by £52 million and £20 million for December 31, 1999 and 1998 respectively.

Year ended December 31, 2000 compared to year ended December 31, 1999

In total, commissions, fees and other income increased by 41% to £1,614 million (1999: £1,147 million), reflecting growth in Retail Banking, Wholesale Banking and Life Assurance new business levels across the Group. Insurance income receivable and other net fees and fees and commissions receivable amounted to £598 million (1999: £491 million). Included within this amount are gross fees and commissions receivable which grew by 18% to £867 million (1999: £737 million), helped by a 14% increase in insurance income to £239 million (1999: £210 million) through strong growth in Abbey National Life, sales in Retail Banking, and creditor protection volumes in First National. Administration, survey and legal fees increased by 7% to £211 million (1999: £197 million), reflecting record Abbey National Life ISA policy sales in part offset by reduced fixed rate booking fees in the Retail Bank. Other Retail Banking income increased 35% to £246 million (1999: £182 million) mainly from revised ATM and banking charges. Wholesale Banking fees increased 31% to £72 million (1999: £55 million), primarily relating to project finance and property finance transactions. Other commissions receivable were up 6% to £99 million (1999: £93 million). The increases described above were partially offset by fees and commissions payable which increased 9% to £269 million (1999: £246 million) as a result of an increase in the amount of business introduced to the Group for which fees and commissions are paid – most significantly in First National Bank.

Dealing profits increased by 18% to £116 million (1999: £98 million), largely in Wholesale Banking, reflecting the increased deal flow in Securities Financing and Risk Management and Financial Products.

Other operating income, excluding Dealing profits and the impact of significant one-off disposals, increased by 66% to £821 million (1999: £496 million). Significant growth was achieved in several areas: Income from long-term insurance business increased by 12% to £227 million (1999: £202 million), which was underpinned by growth in both Scottish Mutual and Abbey National Life. The Fee income in respect of high loan-to-value ratio loans, amortized on a level yield basis, increased by 23% to £95 million (1999: £77 million). Income from operating lease assets has risen to £303 million (1999: £78 million) mainly due to the acquisition of Porterbrook. The increased depreciation on operating lease assets is included under operating expenses. Other financial income increased by 41% to £196 million (1999: £139 million), driven by growing fee-based income streams in Wholesale Banking, primarily realizations from private equity investments and operating lease income. In First National, there were higher fees from its joint venture with PSA, and, in Retail Banking, from the sale of shares in CGU Underwriting Limited.

In 2000, a profit of £76 million, less £11 million in associated transaction costs, was made on the sale and leaseback of the Group's entire property portfolio. The transaction was one of the largest of its kind in the private sector, and secured cost effective operational flexibility for the next 20 years. In addition there was the disposal of other small non-core businesses, including Abbey National Benefit Consultants and the business of Cater Allen Trust Company. In 1999, a profit of £60 million was made from the disposal of shares in Irish Permanent.

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

In total, commissions, fees and other income increased by 28% to £1,147 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 First National, 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 First National 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 First National.

Dealing profits increased by £66 million to £98 million (1998: £32 million), largely reflecting the success of the risk management and financial products business. Other operating income increased by 40% to £496 million. 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. 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. Income from operating lease assets has risen due to the larger number of operating leases that are now undertaken by First National. Increased income in Wholesale Banking's Special Finance business arising from the realization of gains and increases in First National from higher income earned from the joint-venture vehicle, PSA also contributed to the total increase.

Operating Expenses

	1999	2000	Growth	
		(in millions of £)		
Total 1999 operating expenses*				1,594
Significant investment to transform the Group	73	189	116	
Ongoing investment in business infrastructure/processing efficiency	79	66	(13)	
Newly acquired businesses		8	8	
Other growth (including efficiency savings)			110	
Underlying cost growth			105	
Total cost growth			221	
Total 2000 operating expenses				1,815

* excluding exceptional items in 1999 of £21 million, and depreciation on operating lease assets of £178 million (1999: £52 million).

	2000	1999	1998
	(in millions of £)		
Salaries and other staff costs	821	725	599
Bank legal and professional fees	174	133	82
Advertising and marketing	82	65	60
Bank, legal, marketing and professional expenses	256	198	142
Software, computer and other administration expenses	452	401	297
Premises and equipment depreciation	122	108	105
Goodwill amortization	12	11	1
Depreciation on fixed assets other than operating lease assets	134	119	106
Rent payable	73	70	60
Rates payable	22	27	25
Other running costs	57	54	56
Other property and equipment expenses	152	151	141
Total operating expenses excluding depreciation on operating lease assets	1,815	1,594	1,285
Depreciation on operating lease assets	178	52	20

Year ended December 31, 2000 compared to year ended December 31, 1999

Total operating expenses, excluding exceptional items in 1999 of £21 million, and depreciation on operating lease assets of £178 million (1999: £52 million), increased by 14% from £1,594 million to £1,815 million. This increase included £116 million of investment spend within several areas: £28 million was invested in developing the Retail e-banking service, bringing total expenditure to £39 million. Branch re-organization to improve service levels by addressing local market structures resulted in redundancy costs of £18 million incurred in the first half of the year. Annualized benefits of £16 million are expected in 2001. The launch and development costs of cahoot and Inscape were £60 million and £36 million respectively, compared to £16 million and £19 million in 1999. The First National integration program, radically re-engineering existing and recently acquired businesses, incurred a further £47 million of expenditure (1999: £27 million).

Investment in these projects will continue into 2001, although absolute levels will reduce by over 50% of those incurred in 2000.

In addition to the major investment programs, there has been a range of other projects aimed at improving the business infrastructure and processing efficiency. Expenditure on these projects has totaled £66 million. This includes £37 million within Retail Banking, focusing on re-engineering key processes and developing and enhancing IT systems. In Wholesale Banking, expenditure also focused on the enhancement of systems, as well as the development of new businesses. In Group Infrastructure, £14 million was incurred, mainly on Internet, telephony and e-procurement projects. Expenditure of £8 million related primarily to the newly acquired businesses of Highway Vehicle Management and Porterbrook.

Of the remaining cost growth of £110 million, £25 million was incurred in Retail Banking, £40 million in Wholesale Banking and £32 million in Group Infrastructure. This is explained by: increased staff costs, particularly in Wholesale Banking; expenditure on software and IT development projects; additional depreciation costs incurred in accelerating the write-off of desktop equipment; and costs associated with merger and acquisition activity across the Group.

Salaries and other staff costs increased by 13% to £821 million (1999: £725 million), reflecting growth in headcount to support rapid growth in Wholesale Banking and the development of new businesses in Business to Consumer, redundancy costs of £18 million from the retail branch network reorganization to address local market structures, and annual salary increases and bonus payments across the Group, particularly in Wholesale Banking, reflecting exceptional performance during 2000. Bank, legal, marketing and professional expenses increased by 29% to £256 million (1999: £198 million) due to costs associated with the set-up and marketing of cahoot, consultancy costs in Retail Banking relating to e-commerce, other business efficiency and systems development projects and costs associated with merger and acquisition activity. Software, computer and other administration expenses increased by 13% to £452 million (1999: £401 million), primarily from the purchase and development of software in Inscape and cahoot and increased project costs in Group Infrastructure, mainly focusing on the development and enhancement of IT systems and key processes. Additional depreciation on fixed assets of £15 million, excluding operating lease assets, relates mainly to the acceleration of desktop depreciation within the Retail Bank and Group Infrastructure. Other property and equipment expenses of £152 million remained in line with those incurred in 1999. Rent payable is expected to increase during 2001 following the sale and leaseback of the property portfolio.

Depreciation on operating lease assets increased by £126 million to £178 million, largely due to the acquisition of Porterbrook.

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 Inscape, cahoot and other e-commerce initiatives across the Group. Investment in improving business infrastructure includes mainly integration and re-engineering in First National, 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 amortization. These investments were partly funded by £50 million of process efficiencies which have been realized 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 program.

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 Retail Banking. The increases in depreciation and amortization 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.

Depreciation on operating lease assets increased by £32 million to £52 million, largely due to the acquisition of First National Motor Finance and First National Business equipment Leasing in December 1998.

Provisions

	2000	1999	1998
	(in millions of £)		
Retail Banking:			
Secured	38	31	54
Unsecured (overdrafts and credit card balances)	59	73	56
Abbey National-branded unsecured personal loans	53	63	57
	150	167	167
Business to Business:			
First National	118	132	26
Continental Europe	2	4	4
	120	136	30
Business to Consumer: cahoot	2	—	—
Group Infrastructure	1	—	4
Total	273	303	201
Provisions	273	303	201
Suspended interest (in net interest income)	32	27	47
High LTV loans fee income released to offset provisions	(40)	(41)	(39)
Net cost of bad debt	265	289	209
Contingent liabilities and commitments	21	23	16
Amounts written off fixed asset investments	32	26	28

Year ended December 31, 2000 compared to year ended December 31, 1999

The total loan loss provision charge reduced by 10% to £273 million (1999: £303 million). This reflects a combination of favourable economic conditions, and improved quality of lending and effective debt management. In the Retail Bank, revised credit and fraud detection scorecards have been introduced and debt management activities have been centralised into fewer sites. As a result, the provisions charge reduced by 10% to £150 million (1999: £167 million).

Provisions against secured lending on residential properties in Retail Banking increased to £38 million (1999: £31 million) arising from growth in mortgage assets. Arrears levels on secured loans fell by 21% to 22,416 cases three or more months in arrears (1999: 28,270), the lowest level in the last decade. Given the growth in volume during 2000, the trend of falling arrears seen over the last few years is not expected to continue.

The provision charge for credit card and overdrafts fell by 19% to £59 million (1999: £73 million). This resulted from improved recoveries on bank account debt previously written off and from more proactive management of early arrears. Bank account arrears as a percentage of asset fell from 30% to 27%.

There was a 16% decrease in the charge for unsecured personal loans to £53 million (1999: £63 million). This reflects an improvement in the quality of business written during the latter half of 1999 and £3 million additional recoveries.

In First National, provisions for bad and doubtful debts fell 11% to £118 million (1999: £132 million). This largely resulted from changing the business mix (with more higher credit quality lending), and the implementation of better collection systems and processes, and the alignment of provisioning methodologies as part of the First National integration program. Prudent pricing in the vehicle leasing business has mitigated the effect of falling residual car prices.

The net cost of bad debt decreased by 8%. This represents loan provisions, plus suspended interest charges, less high LTV fee income (see commissions, fees and other income).

Contingent liabilities and commitments remained broadly flat. Within the Wholesale Bank, a further £34 million was added to provisions for amounts written off fixed investments.

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 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: 2,069 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 centralizing 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.

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, 2000, 1999 and 1998.

	Year ended December 31,		
	2000	**1999**	**1998**
	(in millions of £)		
Taxation at standard U.K. corporation rate of 30%, 30.25% (1999) and 31% (1998)	593	548	492
Effect of non-allowable provisions and other non-equalized items	(3)	22	9
Effect of non-U.K. profits and losses	(7)	(9)	(8)
Adjustment to prior year tax provisions	3	(12)	(10)
Effect of loss utilization	(27)	(19)	—
Taxes before the effect of exceptional items	559	530	483
Effective tax rate before the effect of exceptional items [(1)]	28.3%	29.3%	30.4%

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

In 2000, the directors of Abbey National received a demand against its subsidiary, Abbey National U.K. Investments, by an overseas tax authority relating to a reassessment of the tax payable by the company. At market exchange rates prevailing at December 31, 2000, this amounted to approximately £40 million.

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, 2000, this amounted to approximately £100 million (1999: £100 million). As at December 31, 2000, additional interest in relation to the demand could amount to £18 million (at the balance sheet exchange rate) (1999: £13 million).

The subsidiaries have received legal advice that they have strong grounds to challenge the validity of the demands and, accordingly, no specific provisions have been made.

Year ended December 31, 2000 compared to year ended December 31, 1999

In the year ended December 31, 2000 taxes before the effect of exceptional items increased by 5% to £559 million compared to £530 million in the year ended December 31, 1999. 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 28.3% in 2000 compared to 29.3% in 1999. 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 30.25% to 30%), and to the net effects of non-allowable provisions and other non-equalized items, non-U.K. losses, adjustments to prior year tax provisions and the effect of loss utilization.

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-equalized items, non-U.K. losses, adjustments to prior year tax provisions and the effect of loss utilization.

Exceptional Items

	Year ended December 31,		
	2000	1999	1998
	(in millions of £)		
Year 2000 and EMU costs	—	27	68

Year ended December 31, 2000 compared to year ended December 31, 1999

There were no exceptional items in the year.

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.

Capital Management and Resources

Capital Management

Abbey National continues to manage its capital resources and explore capital and balance sheet management opportunities.

Wholesale Banking manages all the Group's capital raising and capital efficiency. In addition to the activities quoted above, Wholesale Banking also managed two further tranches of mortgage asset-backed securitisations. In July, Abbey National issued £2.2 billion mortgage-backed securities in its fourth transaction. In November, a fifth transaction — amounting to £2.4 billion — was the largest ever residential mortgage-backed deal in the European securitisation market. This brings Abbey National's total mortgage securitisation to £6.9 billion, and establishes the Group as the leader in the European securitisation market. Securitisation is seen as a key part of balance sheet management strategy, increasing return on capital and enhancing funding flexibility in the longer term markets. There are plans to progress the securitisation program further during 2001.

In February 2001, the Group raised £300 million perpetual reserve capital instruments, adding Tier 1 capital.

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.

An assessment has been made of existing dividend policy in the light of the Group's capital requirements. Based on current plans, the Board is of the view that greater returns for shareholders can continue to be achieved by retaining capital in the business, rather than returning it to shareholders. If, however, future plans do not generate satisfactory value creation for shareholders, the Board would then consider returning 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 a 13% increase in the proposed dividend payment to 45.5 pence per share.

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 Supervision (the "Basel Committee") and subsequently implemented in the United Kingdom by the U.K. banking regulator (the Financial Services Authority, which took this role over from the Bank of England in June 1998).

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, originally referred to the EC's Own Funds Directive ("OFD") and Solvency Ratio Directive ("SRD"). These directives were repealed and replaced by the Banking Consolidation Directive ("BCD") in June 2000.

Bank capital is defined by reference to the BCD, in the same terms as the OFD defined it, and is divided into "Tier 1" capital — consisting broadly of ordinary and certain preference shareholders' funds after deducting goodwill; and "Tier 2" capital — including general provisions, certain debt capital instruments, particularly subordinated debt, and dated preference share issues. "Tier 3" 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 and certain off-balance sheet liabilities are weighted to allow for relative risk according to rules contained in the BCD (but originally derived from the SRD) 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 ordinarily assigned a weighting of 50%.

In January 2001, the Basel Committee published a final draft of a new capital adequacy framework to replace its 1988 Capital Accord. The objective of the proposals is to align regulatory capital requirements more closely with underlying risks and to provide banks and their supervisors with several options for the assessment of capital adequacy. After consultation through the first half of 2001, the Basel Committee intends to issue its New Capital Accord at the end of 2001, for implementation in 2004. Although the Committee intends to deliver a more risk-sensitive methodology, including a new operational risk capital charge, its goal is that, on average, the new approach should not raise nor lower regulatory capital for banks. The international minimum risk asset ratio of 8% will be unchanged.

Also in January 2001 the European Commission launched a second round of consultations on the proposals for a new EU capital adequacy framework. This process is progressing in parallel with the Basel Committee's work and is aimed to be implemented at the same time as the New Basel Accord. The EU review will cover capital adequacy for investment firms as well as banks.

On the basis of the developing proposals, management do not expect any material adverse change to 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,		
	2000	**1999**	**1998**
	(in millions of £ except percentages)		
Tier 1	7,204	5,871	5,205
Tier 2 and Tier 3	5,902	4,532	3,146
less supervisory deductions	(2,129)	(1,606)	(1,107)
Total capital resources	10,977	8,797	7,244
Risk weighted assets			
Banking Book			
On balance sheet	71,564	69,598	65,380
Off balance sheet	3,192	2,108	2,109
	74,756	71,706	67,489
Trading book	6,445	4,170	3,787
Total	81,201	75,876	71,276
Capital ratios			
Risk asset ratio	13.5%	11.6%	10.2%
Tier 1 ratio	8.9%	7.7%	7.3%
Equity Tier 1 ratio	7.5%	7.1%	6.7%

Total Tier 2 and Tier 3 capital as a percentage of Tier 1 capital as at December 31, 2000 was 81.9% (1999: 77.2%). At December 31, 2000, the Group had no Tier 3 capital (1999: nil). Supervisory deductions mainly represent investments in life assurance and insurance companies within the Group.

Tier 1 capital at December 31, 2000, 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 capitalized as an intangible fixed asset, whereas such goodwill continues to be deducted from Tier 1 capital for regulatory purposes.

Year ended December 31, 2000 compared to year ended December 31, 1999

The Group's Tier 1 capital increased by £1,333 million to £7,204 million, mainly due to the issue of US$1 billion preferred perpetual notes. The increase in Tier 2 capital of £1,370 million, was principally due to the issue of £1.2 billion subordinated debt in September 2000.

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.

Property, Plants and Equipment

	Year ended December 31,		
	2000	1999	1998
	(in millions of £)		
Capital expenditure	115	138	111

Capital expenditure to December 31, 2000 amounted to £115 million. Expenditure was mainly within Retail Banking (£74 million), arising from the installation of the Costa Coffee and Safeway in-store branches and other branch refurbishments, the construction of a new Head Office, new computer software mainly for the e-commerce project, remote ATM installations, and upgrading the telecommunications system. In Business to Business, Business to Consumer and Wholesale Banking, £16 million, £11 million and £3 million respectively were spent, mainly on IT to build infrastructure for new businesses. The principal capital divestitures in the year related to the sale of substantially all the Group's freehold properties. See Note 7 to the Consolidated Financial Statements for further details.

Capital expenditure to December 31, 1999 amounted to £138 million, with 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.

The principal capital expenditure in the year ended December 31, 1998 was £62 million relating to computer infrastructure and ATM investment.

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. As a result, the Group's operations were not disrupted over the period. The Board continued to monitor the Year 2000 issue during 2000 and all business critical systems continue to operate effectively.

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. The Group continues to prepare for the possibility of the U.K. entering EMU.

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 unrealized 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 55 to the Consolidated Financial Statements included elsewhere in this Annual Report.

Current Developments in U.K. and US GAAP

U.K. GAAP. In 1999, the Accounting Standards Board issued Financial Reporting Standard (FRS) 15, "Tangible Fixed Assets" and FRS 16, "Current Tax".

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 was 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 capitalization, valuation guidelines where a policy of revaluation is adopted, and a description of the accounting objective and methods of accounting for depreciation. Disclosures required by FRS 15 can be found in Notes 25 and 26 to the Consolidated Financial Statements included elsewhere in this Annual Report. In addition, the application of FRS 15 has resulted in a change in the accounting presentation of depreciation on operating lease assets, details of which are given on page 22 of this Annual Report. Net income and Shareholders funds under U.S. GAAP were unaffected.

FRS 16 addresses all aspects of accounting for current tax and supercedes SSAP 8, "The treatment of taxation under the imputation system in the accounts of companies". FRS 16 was effective for accounting periods ending on or after March 23, 2000. Disclosures required by FRS 16 can be found in Note 10 to the Consolidated Financial Statements included elsewhere in this Annual Report. Net income and Shareholders funds under U.S. GAAP were unaffected.

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

U.K. GAAP. In 2000 the Accounting Standards Board issued FRS 17, "Retirement Benefits", on the treatment of pensions and other retirement benefits in an entity's accounts, FRS 18, "Accounting Policies", and FRS 19, "Deferred Tax".

The main requirements of FRS 17 are:

- pension scheme assets measured using market values;
- pension scheme liabilities measured using a projected unit method and discounted at an AA corporate bond rate;
- the pension scheme surplus (to the extent it can be recovered) or deficit recognized in full on the balance sheet;
- the movement in the scheme surplus/deficit analyzed into the current service cost and any past service costs (recognized in operating profit), the interest cost and expected return on assets (recognized as other finance costs) and actuarial gains and losses (recognized in the statement of total recognized gains and losses).
- Implementation of FRS 17 is phased as follows:
- for accounting periods ending on or after June 22, 2001, closing balance sheet information (no comparatives required) to be given in the notes only;
- for accounting periods ending on or after June 22, 2002, opening and closing balance sheet information and performance statement information for the period (no comparatives required) to be given in the notes only;
- for accounting periods ending on or after June 22, 2003, FRS 17 is fully effective.

Abbey National is currently reviewing FRS 17 to determine its impact on the Group's results for U.K. reporting purposes.

FRS 18, effective for accounting periods ending on or after June 22, 2001, deals primarily with the selection, application and disclosure of accounting policies.

FRS 19 requires deferred tax to be provided for on a "full provision" basis – rather than the "partial provision" basis previously required by SSAP 15 ("Accounting for deferred tax") – on most types of timing difference. It is effective for years ending on or after January 23, 2002. FRS 19 is not expected to have a material adverse effect on the Group's results for U.K. reporting purposes.

Abbey National is currently reviewing these standards to determine their 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", and SFAS 137 and SFAS 138, which make various amendments to SFAS 133, apply to all periods beginning after June 15, 2000 (January 1, 2001 for the Group). As described in the Form 20-F for the year ended December 31, 1999, SFAS 133 requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair values of derivatives in each period are recorded in current earnings or other comprehensive income depending on whether a derivative contract is designated as part of a hedge transaction or not, and, if it is so designated, depending on the type of hedge transaction.

Derivatives designated as used for non-trading purposes in the Group's U.K. financial statements are designated as hedging transactions in accordance with U.K. GAAP, and are accounted for in the U.K. financial statements on a consistent basis with the asset, liability or position being hedged. A significant number of such transactions are undertaken with the Group's in-house trading operation ANFP. ANFP matches internal hedging transactions with external transactions on an aggregate portfolio basis rather than on an individually matched basis, in order to manage risk in the most cost-effective and operationally practicable manner.

While such internal transactions with ANFP meet U.K. hedge accounting requirements, they do not satisfy the more restrictive requirements of U.S. GAAP. The Group has chosen not to change its risk management practices to comply with the specific requirements of U.S. GAAP. In accordance with previous requirements which were first effective for transactions entered into after January 1, 1999, all such transactions entered into after that date were not treated as hedges for the purposes of U.S. GAAP. From January 1, 2001, on implementation of SFAS 133, no such transactions will be treated as hedges for the purposes of U.S. GAAP.

From January 1, 2001, therefore, a significant proportion of the Group's non-trading derivatives will not be designated as hedging transactions as defined by SFAS 133. The volatility in U.S. GAAP earnings, that resulted from implementation of the previous requirements, will increase under SFAS 133.

Abbey National has adopted SFAS 133 in its U.S./U.K. GAAP reconciliation from January 1, 2001, and all hedges were designated anew for U.S. reporting purposes on this date. The transitional adjustment as at that date was an increase in consolidated net income of £7 million, and a decrease in other comprehensive income of £151 million.

SFAS 140, "Accounting for Transfers of Financial Assets and Extinguishments of Liabilities", replaces SFAS 125 and is effective for securitisations and other transfers of financial assets and collateral undertaken post March 31, 2001, except for certain additional disclosures which are effective for fiscal periods ending on or after December 15, 2000. SFAS 125 continues to apply to similar transactions undertaken prior to that date.

Disclosures required under SFAS 140 can be found on Note 58(h), Securitisations, and Note 58(m), Collateralised loans and secured borrowings, to the Consolidated Financial Statements included elsewhere in this Annual Report.

SELECTED STATISTICAL INFORMATION

Average Balance Sheet

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

	2000 Average Balance	2000 Interest	2000 Average rate %	1999 (restated) Average balance (1)	1999 Interest (2)	1999 Average rate %	1998 (restated) Average balance (1)	1998 Interest (2)	1998 Average rate %
	(in millions of £, except percentages)								
Assets									
Loans and advances to banks									
U.K.	2,711	174	6.40	3,263	159	4.86	4,465	265	5.94
Non-U.K.	377	26	6.82	281	17	6.42	316	25	7.85
Loans and advances to customers(3)									
U.K.	76,829	5,946	7.74	72,603	5,308	7.31	66,403	5,668	8.54
Non-U.K.	1,663	97	5.82	1,453	81	5.56	1,368	85	6.23
Lease receivables									
U.K.	4,847	345	7.12	5,341	336	6.29	4,679	339	7.24
Non-U.K.	20	1	2.70	26	1	4.94	29	1	4.19
Debt securities									
U.K.	36,847	2,280	6.19	35,220	1,706	4.84	33,478	1,935	5.77
Non-U.K.	10,604	674	6.36	7,468	403	5.39	3,818	244	6.38
Total average interest earning assets and interest income – banking(5)	133,898	9,543	7.13	125,655	8,011	6.38	114,556	8,562	7.47
Total average interest earning assets and interest income – trading(5)	29,815	1,667	5.59	25,523	1,218	4.77	20,561	1,363	6.63
Total average interest earning assets and interest income	163,713	11,210	6.85	151,178	9,229	6.10	135,117	9,925	7.35
Allowance for loan losses	(635)	—	—	(694)	—	—	(614)	—	—
Non-interest earning assets:									
Long term insurance fund assets	18,207	—	—	14,687	—	—	11,264	—	—
Other	10,855	—	—	11,062	—	—	8,554	—	—
Total average assets and interest income	192,140	11,210	5.83	176,233	9,229	5.24	154,321	9,925	6.43
Non-U.K. assets as a percentage of total	6.59%	—	—	5.67%	—	—	3.52%	—	—
Total average interest-earning assets and net interest income	163,713	2,680	1.64	151,178	2,661	1.76	135,117	2,241	1.66

	2000 Average Balance	2000 Interest	2000 Average rate %	1999 (restated) Average balance (1)	1999 Interest (2)	1999 Average rate %	1998 (restated) Average balance (1)	1998 Interest (2)	1998 Average rate %
	(in millions of £, except percentages)								
Liabilities and shareholders' funds									
Deposits by banks									
U.K.	9,645	572	5.93	5,654	332	5.88	9,591	597	6.23
Non-U.K.	819	47	5.76	750	33	4.66	748	25	3.27
Customer accounts — retail demand deposits(4)									
U.K.	31,351	1,164	3.71	28,922	862	2.98	23,234	997	4.29
Non-U.K.	1,384	64	4.62	1,298	58	4.43	848	46	5.37
Customer accounts – retail time deposits(4)									
U.K.	14,861	847	5.70	16,654	882	5.30	22,420	1,577	7.03
Non-U.K.	2,345	145	6.21	2,027	129	6.35	2,000	138	6.88
Customer accounts – wholesale deposits(4)									
U.K.	9,977	620	6.22	9,664	494	5.11	3,740	270	7.21
Non-U.K.	464	28	5.96	330	19	5.61	210	9	4.45
Bonds and medium-term notes									
U.K.	27,353	1,563	5.71	27,702	1,221	4.41	24,361	1,420	5.83
Non-U.K.	314	15	4.85	156	5	3.45	270	17	6.38
Other debt securities in issue									
U.K.	18,144	1,103	6.08	13,572	716	5.28	12,142	790	6.50
Non-U.K.	10,791	649	6.01	7,918	382	4.82	4,221	221	5.24
Dated and undated loan capital and other subordinated liabilities									
U.K.	4,532	278	6.13	3,450	205	5.94	2,036	158	7.77
Non-U.K.	612	43	7.10	622	37	5.89	635	42	6.58
Other interest bearing liabilities									
U.K.	64	3	5.52	106	7	6.21	545	34	6.27
Non-U.K.	—	—	—	—	—	—	—	—	—
Total average interest-bearing liabilities and interest expense – banking(5)	132,656	7,141	5.38	118,825	5,382	4.53	107,001	6,341	5.93
Total average interest-bearing liabilities and interest expense – trading(5)	25,154	1,389	5.52	25,611	1,186	4.63	21,509	1,343	6.24
Total average interest-bearing liabilities and interest expense	157,810	8,530	5.41	144,436	6,568	4.55	128,510	7,684	5.98
Non-interest bearing liabilities:									
Long term insurance fund liabilities	18,207	—	—	14,687	—	—	11,264	—	—
Other	9,511	—	—	11,219	—	—	9,236	—	—
Shareholders' funds	6,612	—	—	5,891	—	—	5,311	—	—
Total average liabilities, shareholders' funds and interest expense	192,140	8,530	4.44	176,233	6,568	3.73	154,321	7,684	4.98
Non-U.K. liabilities as a percentage of total	8.71%	—	—	8.29%	—	—	6.41%	—	—
Interest income as a percentage of average interest-earning assets			6.85			6.10			7.35
Interest expense as a percentage of average interest-bearing liabilities			5.41			4.55			5.98
Interest spread			1.44			1.55			1.37
Net interest margin			1.64			1.76			1.66

Interest earning assets, interest bearing liabilities and the associated interest reflect a 'linked presentation' treatment for certain securitised assets (see note 16 to the Consolidated Financial Statements included elsewhere in this Annual Report). If linked presentation was not adopted, the interest spread and net interest margin would be as follows:

	2000	1999	1998
Interest spread	1.42	1.55	1.36
Net interest margin	1.61	1.75	1.66

(1) Average balances for 2000 and 1999 are based upon daily data for ANTS and its subsidiaries and upon monthly data for all other operations. Average balances for 1998 are based upon daily data for ANTS and its subsidiaries, excluding Cater Allen International Limited, 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, the average balance sheet has been restated to show average trading assets and liabilities, and their relevant interest, separate from the average non-trading assets and liabilities of the Group.

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" elsewhere in this Annual Report). 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 "Risk Management" elsewhere in this Annual Report.

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, 2000 and December 31, 1999. 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.

	2000/1999 Total change	2000/1999 Changes due to increase/(decrease) in: Volume	Rate	1999/1998 (1) (restated) Total change	1999/1998 (1) (restated) Changes due to increase/(decrease) in: Volume	Rate
			(in millions of £)			
Interest income						
Loans and advances to banks						
U.K.	15	(27)	42	(106)	(71)	(35)
Non-U.K.	9	6	3	(8)	(3)	(5)
Loans and advances to customers						
U.K.	637	308	329	(360)	529	(889)
Non-U.K.	16	12	4	(4)	5	(9)
Lease receivables						
U.K.	10	(31)	41	(3)	48	(51)
Non-U.K.	—	—	—	—	—	—
Debt securities						
U.K.	574	79	495	(229)	101	(330)
Non-U.K.	271	169	102	159	233	(74)
Trading assets						
U.K.	449	205	244	(145)	329	(474)
Non-U.K.	—	—	—	—	—	—
Total interest income						
U.K.	1,685	534	1,151	(843)	936	(1,779)
Non-U.K.	296	187	109	147	235	(88)
Total	1,981	721	1,260	(696)	1,171	(1,867)
Interest expense						
Deposits by banks						
U.K.	240	235	5	(265)	(245)	(20)
Non-U.K.	14	3	11	8	—	8
Customer accounts – retail demand deposits						
U.K.	302	72	230	(135)	244	(379)
Non-U.K.	6	4	2	12	24	(12)
Customer accounts – retail time deposits						
U.K.	(35)	(95)	60	(695)	(405)	(290)
Non-U.K.	16	20	(4)	(9)	2	(11)
Customer accounts – wholesale deposits						
U.K.	126	16	110	224	427	(203)
Non-U.K.	9	8	1	10	5	5
Bonds and medium-term notes						
U.K.	342	(15)	357	(199)	195	(394)
Non-U.K.	10	5	5	(12)	(7)	(5)
Other debt securities in issue						
U.K.	387	242	145	(74)	93	(167)
Non-U.K.	267	139	128	161	194	(33)
Dated and undated loan capital and other subordinated liabilities						
U.K.	73	64	9	47	110	(63)
Non-U.K.	6	(1)	7	(5)	(1)	(4)
Other interest bearing liabilities						
U.K.	(4)	(3)	(1)	(27)	(28)	1
Non-U.K.	—	—	—	—	—	—
Trading liabilities						
U.K.	203	(21)	224	(157)	256	(413)
Non-U.K.	—	—	—	—	—	—
Total interest expense						
U.K.	1,634	495	1,139	(1,281)	647	(1,928)
Non-U.K.	328	178	150	165	217	(52)
Total	1,962	673	1,289	(1,116)	864	(1,980)
Net interest income before exceptional items	19	48	(29)	420	307	113

(1) The 1999/1998 comparative has been restated to reflect the split between banking and trading accounts, with total trading assets now identified as a separate class of assets. There is no net effect on the total change in interest income or interest expense.

Deposits

The following tables set forth the average balances of deposits for each of the three years ended December 31, 2000. Average deposits are based on the location of the office in which the deposits are recorded.

	Average: Year ended December 31,		
	2000	**1999 (1) (restated)**	**1998 (1) (restated)**
		(in millions of £)	
Deposits by banks			
U.K.	9,645	5,654	9,591
Non-U.K.	819	750	748
Total	10,464	6,404	10,339
Customers' accounts (all interest bearing)			
U.K.	56,189	55,589	50,671
Non-U.K.	4,193	3,655	3,058
Total	60,382	59,244	53,729

(1) The 1999 and 1998 comparatives have been restated to reflect the split between banking and trading accounts. The effect is a £24,061m decrease in the U.K. deposits reported in 1999 and a corresponding £19,916m decrease in 1998.

Customers' Accounts – By Type

	Average: Year ended December 31,		
	2000	**1999 (1) (restated)**	**1998 (1) (restated)**
		(in millions of £)	
U.K.			
Retail Demand deposits	31,351	28,922	23,234
Retail Time deposits	14,861	16,654	22,420
Wholesale deposits	9,977	9,664	3,740
	56,189	55,240	49,394
Non-U.K.			
Retail Demand deposits	1,384	1,298	848
Retail Time deposits	2,345	2,027	2,000
Wholesale deposits	464	330	210
	4,193	3,655	3,058
Total	60,382	58,895	52,452

(1) The 1999 and 1998 comparatives have been restated to reflect the split between banking and trading accounts. The effect is a £349m decrease in the U.K. Wholesale deposits reported in 1999 and a corresponding £1,227m decrease in 1998.

Substantially all retail demand deposits and retail time deposits are obtained through, and administered by, the Retail Banking branch network. In addition, retail demand and time deposits are obtained outside the U.K., principally through the Jersey operations of the Business to Consumer segment. 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, instant saver accounts, Investor 30 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, 2000. 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,		
	2000	1999 (1) (restated)	1998 (1) (restated)
	(in millions of £, except percentages)		
Year-end balance[(2)]	12,086	7,598	20,458
Average balance[(3)]	10,464	6,404	10,339
Maximum balance	13,042	13,535	27,195
Average interest rate during year	5.92%	5.73%	6.02%
Year-end interest rate[(4)]	5.35%	5.25%	5.17%

As at December 31, 2000, deposits by foreign banks amounted to £3,076 million (1999: £2,883 million).

Commercial Paper

	Year ended December 31,		
	2000	1999	1998
	(in millions of £, except percentages)		
Year-end balance	10,800	10,082	3,595
Average balance[(2)]	10,550	7,974	3,314
Maximum balance	11,851	10,082	4,555
Average interest rate during year	6.05%	4.68%	5.71%
Year-end interest rate[(3)]	5.91%	6.21%	5.28%

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 2000 is £5.3 billion (1999: £5.3 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,		
	2000	1999	1998
	(in millions of £, except percentages)		
Year-end balance	18,464	13,307	13,182
Average balance(3)	18,650	14,078	12,888
Maximum balance	22,376	15,567	16,170
Average interest rate during year	5.96%	5.06%	6.09%
Year-end interest rate(4)	6.02%	4.96%	5.99%

(1) The 1999 and 1998 comparatives have been restated to reflect the split between banking and trading accounts. The reported amounts for 1999 and 1998 now reflect the banking balances only.

(2) The year-end deposits by banks balance includes non-interest bearing items in the course of transmission of £236 million (1999: £262 million; 1998: £277 million).

(3) Average balances for 2000, 1999 and 1998 are based upon daily data for ANTS and its subsidiaries and monthly data for all other operations.

(4) 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, 2000. 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 2000. 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.	11,321	4,384	2,733	26	18,464
Non-U.K.	—	—	—	—	—
Wholesale time deposits:					
U.K.	3,815	554	101	1,722	6,192
Non-U.K.	329	22	—	—	351
Total	15,465	4,960	2,834	1,748	25,007

As at December 31, 2000, there were an additional £1,635 million of wholesale deposits which were repayable on demand. All wholesale time deposits exceeded £50,000 as at December 31, 2000.

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 18 and 19 to the Consolidated Financial Statements included elsewhere in this Annual Report.

	2000 Book value	2000 Market value(1)	1999 Book value	1999 Market value(1)	1998 Book value	1998 Market value(1)
				(in millions of £)		
Investment securities(2)(3)						
Debt securities:						
U.K. Government	16	16	31	31	1,804	1,825
U.S. Treasury and other U.S. Government agencies and corporations	2,016	2,039	2,660	2,648	3,776	3,772
Other public sector securities	4,277	4,464	3,303	3,446	2,945	3,112
Bank and building society certificates of deposit	282	291	399	400	401	405
Other issuers(4):						
Floating rate notes	5,553	5,536	6,222	6,230	4,934	4,932
Mortgage-backed securities	8,454	8,413	6,897	6,894	8,160	8,128
Other asset-backed securities(6)	15,484	15,349	11,108	10,972	8,728	8,629
Other	12,545	12,350	13,133	13,109	7,889	8,029
Shares of common stock and similar securities	567	648	248	267	121	164
Provisions	(109)	—	(72)	—	(46)	—
Sub Total	49,085	49,106	43,929	43,997	38,712	38,996
Other securities(5)						
Debt securities:						
U.K. Government	328	328	648	648	335	335
Other public sector securities	2,274	2,274	970	970	1,528	1,528
Bank and building society certificates of deposit	11,748	11,748	10,506	10,506	9,724	9,724
Other Issuers(4):						
Floating rate notes	363	363	15	15	1,251	1,251
Mortgage-backed securities	217	217	45	45	36	36
Other asset-backed securities	214	214	229	229	567	567
Other	5,310	5,310	3,351	3,351	2,170	2,170
Shares of common stock and similar securities	34	34	47	47	3	3
Sub Total	20,488	20,488	15,811	15,811	15,614	15,614
Total	69,573	69,594	59,740	59,808	54,326	54,610

(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, 2000, 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 SFAS 115, "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, 2000, with unrealized gains and losses reported in a separate component of shareholders' funds. Further details are provided in Note 55 to the Consolidated Financial Statements included elsewhere in this Annual Report.

(4) As at December 31, 2000, 85% 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 securities financing 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 "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 modeled 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 "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, 2000.

	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	—	—	15	7.18	1	8.75	—	—	16	6.48
U.S. Treasury and other U.S. Government agencies and corporations(2)	—	—	170	6.41	—	—	1,846	7.81	2,016	7.69
Other public sector securities	535	6.50	1,909	6.68	1,833	7.68	—	—	4,277	7.09
Bank and building society certificates of deposit	266	5.72	16	7.97	—	—	—	—	282	5.85
Other issuers(2)	1,476	5.88	13,947	6.06	9,962	6.97	16,651	7.27	42,036	6.75
Sub-total	2,277	6.01	16,057	6.14	11,796	7.08	18,497	7.32	48,627	6.81
Shares of common stock(3)	—		—		—		567		567	
Total book value before provisions	2,277		16,057		11,796		19,064		49,194	
Provisions									(109)	
Total book value									49,085	
Total market value	2,295		16,189		11,786		18,836		49,106	

(1) The weighted average yield for each range of maturities is calculated by dividing the annualized interest income prevailing at December 31, 2000 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 "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, 2000.

	Book value	Market value
	(in millions of £)	
Republic of Italy	3,711	3,811
Halifax plc	1,666	1,666
The Royal Bank of Scotland Group plc	1,575	1,576
Bank of Scotland Group	1,401	1,401
Barclays plc	1,271	1,272
Deutsche Bank AG Group	1,138	995
Government National Mortgage Association	856	867
European Investment Bank	725	726
Ford Motor Credit Corporation Group	702	672
AFC Home Equity Loan Trust	698	699

For the purposes of determining the above, shareholders' funds amounted to £6,830 million at December 31, 2000.

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,				
	2000	1999	1998	1997	1996
	(in millions of £)				
U.K.	12,031	11,216	7,054	7,883	2,449
Non-U.K.	137	256	374	388	376
Total	12,168	11,472	7,428	8,271	2,825

The following tables set forth loans and advances to banks by maturity and interest rate sensitivity at December 31, 2000.

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.	5,521	5,384	372	560	194	12,031
Non-U.K.	73	64	—	—	—	137
Total	5,594	5,448	372	560	194	12,168

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.	10,418	1,384	11,802
Non-U.K.	54	83	137
	10,472	1,467	11,939
Items in the course of collection (non-interest bearing)			
U.K.			229
Non-U.K.			—
			229
Total			12,168

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,				
	2000	1999	1998	1997	1996
	(in millions of £)				
U.K.					
Advances secured on residential properties	64,053	63,693	62,338	61,023	59,561
Purchase and resale agreements	6,875	77	749	701	—
Other secured advances	2,367	2,539	2,018	449	1,094
Corporate lending	5,534	3,780	1,402	1,046	571
Unsecured personal lending	4,901	4,724	5,009	2,843	2,346
Finance lease receivables	5,174	5,420	5,296	4,626	4,279
	88,904	80,233	76,812	70,688	67,851
Non-U.K.					
Advances secured on residential properties	1,635	1,270	1,071	1,025	922
Other secured advances	104	115	143	189	255
Unsecured lending	108	103	92	59	12
Finance lease receivables	18	21	30	29	31
	1,865	1,509	1,336	1,302	1,220
Total	90,769	81,742	78,148	71,990	69,071

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, 2000. 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	1,590	1,313	953	4,972	55,225	64,053
Purchase and resale agreements	4,660	2,215	—	—	—	6,875
Other secured advances	202	280	560	1,144	181	2,367
Corporate lending	142	3,313	529	395	1,155	5,534
Unsecured personal lending	438	790	1,505	1,990	178	4,901
Finance lease receivables	—	147	265	735	4,027	5,174
Total U.K.	7,032	8,058	3,812	9,236	60,766	88,904
Non-U.K.						
Advances secured on residential properties	40	18	60	287	1,230	1,635
Other secured advances	58	2	3	9	32	104
Unsecured lending	5	3	31	69	—	108
Finance lease receivables	—	—	2	10	6	18
Total Non-U.K.	103	23	96	375	1,268	1,865
Total	7,135	8,081	3,908	9,611	62,034	90,769

Interest Rate Sensitivity of Loans and Advances to Customers

	Fixed rate	Variable rate	Total
	(in millions of £)		
U.K.	30,391	58,502	88,893
Non-U.K.	406	1,470	1,876
Total	30,797	59,972	90,769

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 either by a first charge on residential property in the United Kingdom or other appropriate security depending on the nature of the loan.

The Group's provisioning policy is as follows:

Suspended interest — where loans are deemed to be impaired or non-performing interest continues to be debited to all impaired loans. Advances secured by a charge on residential property loans are deemed to be impaired or non-performing when they are 90 days overdue. 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. The exception to this being some lending in France and the First National Finance Corporation where there is either no realistic prospect of recovery or it is deemed more appropriate to place the loan assets on non-accrual status.

Specific allowance — a specific allowance is established for all impaired loans after a specified period of repayment default where it is likely that some of the capital will not be repaid or recovered through enforcement of security, where the loan is secured. The length of the default period depends on the nature of the advance and is generally no more than three months. Once a loan is considered to be impaired 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 judgment of economic conditions. These techniques estimate the propensity of loans to result in losses net of any recovery where applicable. For advances secured on residential property the propensity of loans to become repossessions is also calculated.

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 any attached security, or from claiming on any mortgage indemnity guarantee or other insurance. This charge-off is determined on a case-by-case basis. In the case of secured loans it 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. In the case of unsecured loans, the circumstances surrounding the asset will be considered before deciding to write off completely. 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.

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 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

	2000	1999	1998	1997	1996
		(in millions of £)			
Specific					
Advances secured on residential properties — U.K.	50	64	91	85	127
Other secured advances — U.K.	57	50	50	56	112
Unsecured personal lending — U.K.	170	160	136	109	89
Advances secured on residential properties — Non-U.K.	11	12	15	15	18
Other secured advances — Non-U.K.	41	47	68	74	90
Unsecured personal lending — Non-U.K.	4	3	2	1	3
Total specific allowances	333	336	362	340	439
General					
Advances secured on residential properties — U.K.	139	128	107	81	64
Other secured advances — U.K.	15	18	18	6	6
Unsecured personal lending — U.K.	31	38	67	20	17
Advances secured on residential properties — Non-U.K.	3	3	2	3	3
Other secured advances — Non-U.K.	5	5	5	7	5
Unsecured personal lending — Non-U.K.	1	1	—	—	—
Total general allowances	194	193	199	117	95
Total allowances	527	529	561	457	534
Ratios					
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	0.30	0.32	0.27	0.32
Other secured advances — U.K.	3.03	2.64	3.37	13.81	10.79
Unsecured personal lending — U.K.	4.09	4.19	4.05	4.54	4.52
Advances secured on residential properties — Non-U.K.	0.87	1.18	1.68	1.76	2.28
Other secured advances — Non-U.K.	44.23	45.28	51.05	42.86	37.25
Unsecured personal lending — Non-U.K.	4.39	3.89	2.17	1.69	25.00
Total loans and advances to customers	0.62	0.69	0.77	0.69	0.82
Amounts charged off (net of recoveries)(1)	0.35	0.43	0.26	0.28	0.27
Percent of loans in each category to total loans					
Advances secured on residential properties — U.K.	70.57	77.92	79.77	84.77	86.23
Purchase and resale agreements — U.K.	7.57	0.09	0.96	0.97	0.00
Other secured advances — U.K.	2.61	3.10	2.58	0.62	1.58
Corporate lending — U.K.	6.10	4.63	1.79	1.45	0.83
Unsecured personal lending — U.K.	5.40	5.78	6.41	3.95	3.40
Finance lease receivables — U.K.	5.70	6.63	6.78	6.43	6.20
Advances secured on residential properties — Non-U.K.	1.80	1.55	1.37	1.43	1.33
Other secured advances — Non-U.K.	0.11	0.14	0.18	0.26	0.37
Unsecured lending — Non-U.K.	0.12	0.13	0.12	0.08	0.02
Finance lease receivables — Non-U.K.	0.02	0.03	0.04	0.04	0.04

(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

	2000	1999	1998	1997	1996
			(in millions of £)		
Allowances at the beginning of the year	529	561	457	534	483
Acquisition of subsidiary undertakings	—	—	86	—	101
	529	561	543	534	584
Amounts charged off — net of recoveries					
Advances secured on residential properties — U.K.	(36)	(38)	(28)	(44)	(75)
Other secured advances — U.K.	(29)	(46)	(38)	(53)	(13)
Unsecured personal lending — U.K.	(201)	(224)	(108)	(75)	(52)
	(266)	(308)	(174)	(172)	(140)
Advances secured on residential properties — Non-U.K.	(2)	(2)	(1)	(2)	(5)
Other secured advances — Non-U.K.	(7)	(13)	(5)	(9)	(10)
Unsecured lending — Non-U.K.	—	(1)	—	(3)	—
Total amounts charged off	(275)	(324)	(180)	(186)	(155)
Specific provisions charged against income					
Advances secured on residential properties — U.K.	24	12	33	1	31
Other secured advances — U.K.	52	49	1	(2)	4
Unsecured personal lending — U.K.	213	209	134	95	57
	289	270	168	94	92
Advances secured on residential properties — Non-U.K.	1	—	2	1	2
Other secured advances — Non-U.K.	—	1	2	3	9
Unsecured lending — Non-U.K.	1	2	1	—	—
	2	3	5	4	11
Total specific provisions charged against income	291	273	173	98	103
General provisions charged against income	(18)	30	28	23	24
Exchange and other adjustments	—	(11)	(3)	(12)	(22)
Allowances at the end of the year	527	529	561	457	534

Total allowances for lending losses, at £527 million, are £2 million lower than in 1999 (£529 million) due to a combination of lower arrears as a result of continuing improvement in economic conditions and improved debt management procedures being mostly offset by growth in lending.

Allowances on U.K. advances secured on residential properties have remained constant at 0.30% of the total portfolio as the benefit of improved arrears and increased house prices has been offset by asset growth and an increase in the level of general provision. The ratio for non-U.K. has continued to improve 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 risen since 1999 due principally to the additional specific allowances within First National reflecting the fall in residual values of motor vehicles experienced in the year.

Other non-U.K. secured allowances as a percentage of the total portfolio have continued to reduce since 1999 due to an increase in amounts charged off in France in respect of certain historic commercial lending.

Allowances on U.K. unsecured personal lending as a percentage of the total portfolio have fallen from 1999 due to improvements in arrears in real terms and better debt management processes. This has been partially offset by the continued growth in personal banking products and unsecured personal loans. Non-U.K. allowances as a percentage of loans have risen due to some unsuccessful pilot lending programs which have now been suspended in France and Italy.

Interest in Suspense

	2000	1999	1998	1997	1996
			(in millions of £)		
Interest in suspense at the beginning of the year	114	150	181	197	183
Acquisition of subsidiary undertakings	—	—	1	—	46
Net interest suspended during the year	32	26	47	35	49
	146	176	229	232	278
Interest written off	(46)	(51)	(84)	(42)	(65)
Exchange and other adjustments	—	(11)	5	(9)	(16)
Interest in suspense at the end of the year	100	114	150	181	197

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, 2000 was £100 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, 2000 was £32 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, 2000, 1999 and 1998 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

	2000	1999	1998	1997	1996
	(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.	777	789	985	707	816
Non-U.K.	138	149	199	185	218
	915	938	1,184	892	1,034
Accruing lendings 90 days overdue on which no interest has been suspended and on which no specific allowance has been made:					
U.K.	871	1,100	1,334	1,214	1,382
Non-U.K.	14	11	1	2	3
	885	1,111	1,335	1,216	1,385
Non-accruing lendings:					
U.K.	125	103	107	130	203
Non-U.K.	35	42	63	78	109
	160	145	170	208	312
Total non-performing lendings:					
U.K.	1,773	1,992	2,426	2,051	2,401
Non-U.K.	187	202	263	265	330
	1,960	2,194	2,689	2,316	2,731
Non-performing lendings as a percentage of loans and advances to customers excluding finance leases	2.60%	2.90%	3.69%	3.44%	4.22%
Allowances as a percentage of total non-performing lendings	26.89%	24.11%	20.86%	19.73%	19.55%

Overall, non-performing lendings as a percentage of loans and advances to customers excluding finance leases and assets held under purchase and resale agreeements has reduced from 2.90% to 2.60% 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. This was partially offset by the asset growth in unsecured personal lending.

Allowances as a percentage of total non-performing lendings have increased from 24.11% to 26.89%. The continued increase was principally due to the lower levels of arrears at the end of the year but the fall was not as significant as in 1999. Total allowances were not reduced in proportion to the reduction in non-performing lendings. Falling arrears levels for residential lending were offset by the growth in absolute levels of arrears in unsecured lending, resulting in a small reduction in the total amount of specific allowances required from £336 million to £333 million. The level of general allowances has increased slightly to £194 million from £193 million in 1999. This reflects the lower levels of arrears and favourable economic environment offset by the continued asset growth in advances secured on residential property and unsecured personal lending.

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.

	2000	1999	1998	1997	1996
		(in millions of £)			
6 months to 12 months in arrears	341	466	578	512	618
12 months or more in arrears	192	297	348	293	434
Properties in possession	57	80	102	112	139

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, 2000, 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, governments and official institutions and commercial, industrial and other private sector entities. 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 £183.6 billion as at December 31, 2000 compared to £161.8 billion as at December 31, 1999 and £148.3 billion as at December 31, 1998.

Cross Border Outstandings Exceeding 1% of Adjusted Assets

	As % of adjusted assets	Total	Banks and other financial institutions	Governments and official institutions	Commercial, industrial and other private sector
		(in millions of £, except percentages)			
At December 31, 2000:					
United States	1.23	2,254	421	141	1,692
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

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

As at December 31, 2000 the Group had aggregate cross border outstandings with Hong Kong of 0.90% of adjusted assets with aggregate outstandings of £1,661 million.

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. 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.

RISK MANAGEMENT

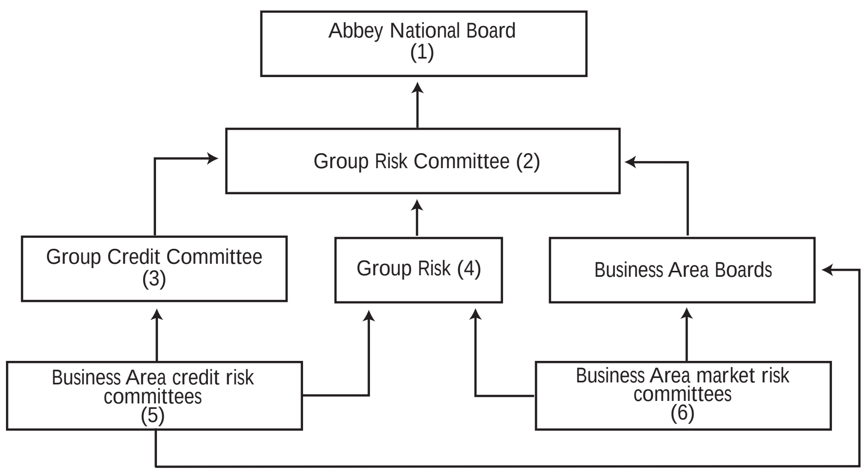
Financial Risk Management

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) Approve 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) Authorize 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 unrealized gains (less any security held). Credit risk occurs mainly in the Group's loan and investment assets, and in derivative contracts.

Managing Credit Risk in 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 first mortgage 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. In the case of a further advance below 75% loan-to-value ("LTV") the original property value is subject to indexation and no further survey is carried out.

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 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 LTV 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 over the average anticipated life of the loan.

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, a tightening of controls on lending as described below, the centralization of all debt management and use of collections scoring/risk segmentation, Abbey National's performance is much improved compared to the early 1990s.

- When a mortgage falls into arrears action is taken to prevent wherever possible the account deteriorating further. The debt management strategy is based around telephone contact undertaken by professional advisers which help the customer to resolve any difficulties and agree arrears repayment arrangements.
- If the agreed repayment 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 on 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 Retail Banking segment decreased from 1,783 properties at December 31, 1999 to 1,378 at December 31, 2000.

The following table sets forth information on U.K. residential mortgage arrears and properties in possession as at December 31, 2000, 1999 and 1998 for Abbey National compared to the industry average as provided by the Council of Mortgage lenders ("CML").

	Abbey National	CML
	(percentage of total mortgage loans by number)	
6 months to 12 months in arrears		
December 31, 1998	0.83	0.68
December 31, 1999	0.69	0.52
December 31, 2000	0.51	0.41
12 months or more in arrears		
December 31, 1998	0.37	0.32
December 31, 1999	0.31	0.27
December 31, 2000	0.17	0.17
Properties in possession		
December 31, 1998	0.14	0.13
December 31, 1999	0.12	0.10
December 31, 2000	0.10	0.07

Abbey National figures shown above exclude the activities of First National Group (part of the Business to Business segment). The activities of First National Group account for 2% 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 debt management strategies, bank account transaction processing and the upgrade strategy for Instant Plus customers to full banking facilities.

Managing Credit Risk in the Business to Business Segment

First National Group is the only entity with material credit risks within this segment. 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, First National made a number of acquisitions which have been integrated by accommodating all activities into four distinct divisions: motor, retail, consumer and business.

First National Group activities are generally more risky than those of a residential mortgage lender. This, together with the relative diversity of First National Group'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.

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 utilized 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.

The divisional risk management units report to a centralized risk function to maintain objectivity, adoption of best practice and appropriate overall control. First National Group has a mandate set by GRC to operate within agreed policies and limits. These are subject to monitoring by GCC.

Managing Credit Risk in Wholesale Banking

With respect to asset quality in Wholesale Banking, a set of specific credit mandates and policies has been established by GRC which is designed to ensure that a 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; in Retail Banking primarily from the provision of fixed rate and structured mortgage and savings products; and from the management of long term structural positions in the Group balance sheet.

Within the life insurance businesses, 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: such market risk arises within the Retail Banking and Business to Business segments. 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 (using a historical simulation approach) are used as additional risk management tools as appropriate to individual business areas, and at both Group and business area levels such analysis is complemented by stress testing. 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 risk factors 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 up 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, 2000, 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 modeling 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.

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	
	2000	1999	2000	1999	2000	1999	2000	1999
	(in millions of £)							
Trading Instruments								
Short Term Market Risk								
Interest Rate Risks	9.5	7.0	10.8	4.4	14.3	17.6	6.3	1.9
Equity Risks	0.5	0.3	0.4	0.1	1.0	0.6	—	—
Spread Risk	2.7	2.2	2.2	3.1	2.8	5.5	2.0	2.2
Other Risks[1]	0.2	0.1	0.4	0.3	1.5	0.6	0.1	—
Structural Market Risk								
Interest Rate Risks	2.8	0.8	2.0	0.6	3.4	1.6	0.7	—
Equity Risks	9.4	10.8	8.6	5.4	11.0	10.8	5.9	1.3

(1) Other risks include 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. Trading instruments are held only in Wholesale Banking.

A hypothetical fall of 10% in the relevant market prices or rates as at December 31, 2000 would lead to an effect on reported earnings for the trading instruments in respect of short term market risk of £7.7 million, £1.6 million, £4.4 million and £1.2 million (1999: £22.8 million, £1.7 million, £3.4 million, and £0.1 million) for interest rate risks, equity risks, spread risk and other risks, respectively. For structural market risk, the effect on earnings would be £3.9 million and £3.7 million (1999: £2.5 million and £7.6 million) for interest rate risks and equity risks, respectively. A hypothetical fall of 5% in the relevant market prices or rates as at December 31, 2000 would lead to an effect on reported earnings for the trading instruments in respect of short term market risk of £3.8 million, £0.8 million, £2.2 million and £0.6 million (1999: £11.9 million, £0.5 million, £1.7 million, and £0.1 million) for interest rate risks, equity risks, spread risk and other risks, respectively. For structural market risk, the effect on earnings would be £1.9 million and £1.9 million (1999: £1.2 million and £3.8 million) for interest rate risks and equity risks, 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. Separate earnings at risk measures are used to supplement these analyses for appropriate portfolios. Non-trading instruments are held for collection in the form of cash over time, and are accounted for at amortized 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 wherever appropriate, 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	
	2000	1999	2000	1999	2000	1999	2000	1999
	(in millions of £)							
Non-Trading Instruments								
Short Term Market Risk								
Interest Rate Risks	2.3	3.4	2.3	3.1	4.3	5.2	1.1	1.6
Equity Risks	0.3	0.2	0.2	0.1	0.4	0.3	0.2	—
Spread Risk	0.8	0.8	0.8	0.2	0.9	1.1	0.7	—
Structural Market Risk								
Interest Rate Risks	59.3	42.0	60.3	31.6	65.8	50.0	44.8	17.7
Equity Risks	0.7	0.6	2.9	0.6	6.0	1.1	0.7	—
Foreign Exchange Risks	3.3	0.6	2.4	1.1	3.8	2.4	0.9	0.3

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

During 2000, no major changes have been implemented to the methodology used for consolidated reporting. Certain risks and portfolios have been reclassified from short term market risks to structural market risks (and vice versa) following reviews of the management of such exposures through liquid market markets. Prior period exposures have been similarly reclassified to reflect these changes.

Managing Market Risk in Retail Banking. Abbey National is able to mitigate the impact of interest rate movements on net interest income in 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 Retail Banking balance sheet is exposed to changes in the relationship between administered rates and market rates.

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 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 exposures below also incorporate those associated with Abbey National Life borne by the shareholder.

The following table shows the sensitivity based exposures for Retail Banking as at December 31, 2000 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 as at December 31		Exposure for the year ended December 31 — Average Exposure		Highest Exposure		Lowest Exposure	
	2000	1999	2000	1999	2000	1999	2000	1999
			(in millions of £)					
Non-Trading Instruments								
Short Term Market Risk								
Interest Rate Risks	0.8	0.5	0.3	0.6	1.0	1.9	—	—
Equity Risks	0.2	0.2	0.2	0.1	0.2	0.2	0.1	—
Structural Market Risk								
Interest Rate Risks	10.5	20.0	15.4	21.0	21.7	28.9	10.5	11.8
Equity Risks	0.7	0.6	1.5	0.6	4.7	0.9	0.7	—

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 2000. 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, 2000 and 1999, 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	
	2000	1999	2000	1999	2000	1999	2000	1999
			(in millions of £)					
Trading Instruments								
Short Term Market Risk								
Interest Rate Risks	9.5	7.0	10.8	4.4	14.3	17.6	6.3	1.9
Equity Risks	0.5	0.3	0.4	0.1	1.0	0.6	—	—
Spread Risk	2.7	2.2	2.2	3.1	2.8	5.5	2.0	2.2
Other Risks	0.2	0.1	0.4	0.3	1.5	0.6	0.1	—
Structural Market Risk								
Interest Rate Risk	2.8	0.8	2.0	0.6	3.4	1.6	0.7	—
Equity Risks	9.4	10.8	8.6	5.4	11.0	10.8	5.9	1.3
Non-Trading Instruments								
Short Term Market Risk								
Interest Rate Risks	1.4	2.8	1.7	2.6	3.4	2.8	0.7	1.5
Spread Risk	0.8	0.8	0.8	0.2	0.9	1.1	0.7	—
Structural Market Risk								
Foreign Exchange Risk	2.4	0.3	1.6	0.8	3.0	2.1	0.3	0.2

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 Business to Business segment;
- exposures borne by the shareholder from the launch of retail investment products and the management of unit linked business within the Business to Business 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, 2000 and 1999, 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	
	2000	1999	2000	1999	2000	1999	2000	1999
			(in millions of £)					
Non-trading Instruments								
Short Term Market Risk								
Interest Rate Risks	0.2	0.1	0.2	0.3	0.9	0.5	0.1	0.1
Equity Risks	—	—	—	—	0.2	—	—	—
Structural Market Risk								
Interest Rate Risks	48.8	21.8	44.9	11.0	53.5	26.7	23.2	5.9
Equity Risks	—	—	1.3	0.4	3.1	—	—	—
Foreign Exchange Risks	0.9	0.3	0.8	0.4	0.9	0.6	0.6	0.2

Liquidity Risk

Liquidity risk arises across the Group balance sheet. Liquidity is managed on behalf of the banking subsidiaries of the Group by ANTS, within a policy framework laid down by the Board and monitored by GRC. This framework, together with the Group Wholesale Banking Liquidity Policy, is reviewed annually to ensure compliance with the FSA's "Sterling Stock Liquidity" requirements and the "Sound Principles for Managing Liquidity in Banking Organizations" issued by the Basel Committee. 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 cash flow planning and day-to-day cash flow 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 First National Group and Wholesale Banking.

Within First National, 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, 2000 amounted to £345 million. This value is greater than 1999 due to contract hire acquisitions completed during the year. Revaluations are undertaken every quarter and any reductions in assumed values are treated in accordance with generally accepted accounting practice.

Within Wholesale Banking, exposure increased significantly during the year upon the acquisition of Porterbrook Limited from Stagecoach plc. Porterbrook's principal activity involves the provision of operating leases for railway rolling stock. Total exposure within Wholesale Banking at December 31, 2000 amounts to £2,185 million, of which £1,666 million relates to Porterbrook and £519 million to other smaller portfolios. Periodic revaluations are undertaken and any reductions in assumed values are treated in accordance with generally accepted accounting practice.

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

Impact of Repricing Risks on the Group

The interest rate repricing gap information is shown in note 48 to the Consolidated Financial Statements elsewhere in this Annual Report.

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.

Operational Risk Management

Operational risk is the risk of direct or indirect loss to Abbey National resulting from inadequate or failed internal processes, people and systems or from external events. It is inherent throughout the Group and is managed and controlled at business unit level. Operational risk is monitored by the Group including semi-annual reporting to the Board. Operational Risk Committee considers and discusses operational risk issues.

The Group also maintains contingency arrangements, to ensure that it can continue to function in the event of an unforeseen interruption. The management of environmental risk is supported by the Environmental Working Group tasked with monitoring and improving Abbey National's environmental performance. Insurance cover is arranged to mitigate potential losses associated with certain operational events.

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 "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 "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 the Retail Banking, Business to Business and Business to Consumer segments, 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 and foreign exchange swaps. Foreign currency funding.
Profits earned in foreign currencies.	Sensitivity to strengthening of sterling against other currencies.	Forward foreign exchange contracts. Purchased foreign exchange 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.	Purchase 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, 2000 and 1999. 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, 2000				
	Nominal amounts(1)(3)	Positive market values(2)	Related book value	Negative market values(2)	Related book value
	(in millions of £)				
Non-trading derivatives					
Exchange rate contracts	21,488	762	447	1,019	938
Interest rate contracts	112,101	2,920	1,847	1,763	739
Equity and commodity contracts	1,413	32	(17)	48	7
	135,002	3,714	2,277	2,830	1,684

	At December 31, 1999				
	Nominal amounts(1)(3)	Positive market values(2)	Related book value	Negative market values(2)	Related book value
	(in millions of £)				
Non-trading derivatives					
Exchange rate contracts	21,073	489	561	979	895
Interest rate contracts	97,341	2,251	1,116	1,485	487
Equity and commodity contracts	842	31	14	16	(4)
	119,256	2,771	1,691	2,480	1,378

(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 contracts, interest rate contracts and equity and commodity contracts, with underlying principal amounts of £2,618 million, (1999: £2,098 million), £61,205 million (1999: £54,025 million) and £126 million (1999: £152 million) respectively, which were undertaken by Group entities with ANFP. The total net positive market value of such contracts amounted to £433 million (1999: £209 million). Associated contracts which ANFP transacted with external counterparties are included in the analysis of trading derivatives. Net negative market values of £433 million (1999: net negative £209 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 analyzed by maturity and contract amount, and currency denomination of other derivative contracts as at December 31, 2000, see Note 49 of the Consolidated Financial Statements 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 non-trading credit derivative contracts are included under Guarantees and assets pledged as collateral security in Note 44 to the Consolidated Financial Statements, 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, credit 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, 2000 and 1999.

	At December 31, 2000		
	Nominal amounts	**Positive market values**	**Negative market values**
	(in millions of £)		
Trading derivatives			
Exchange rate contracts	19,462	424	354
Interest rate contracts	244,150	3,110	3,330
Equity and credit contracts	12,391	438	1,097
	276,003	3,972	4,781

	At December 31, 1999		
	Nominal amounts	**Positive market values**	**Negative market values**
	(in millions of £)		
Trading derivatives			
Exchange rate contracts	8,161	111	147
Interest rate contracts	195,216	2,334	2,418
Equity and credit contracts	6,216	267	1,447
	209,593	2,712	4,012

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

DESCRIPTION OF PROPERTIES

The property interest of the Group at December 31, 2000 consisted of the following:

	Freehold	Leasehold[(1)]	Operating leases[(2)]	Total	Floor space (Sq.ft)
Retail Banking					
Branches and sales offices	4	48	711	763	2,243,800
Administration centers	—	—	11	11	74,042
	4	48	722	774	2,317,842
Wholesale Banking					
Branches and sales offices	—	1	—	1	2,000
Administration centers	—	3	—	3	35,024
	—	4	—	4	37,024
Business to Consumer					
Branches and sales offices	—	11	14	25	117,938
Administration centers	16	8	2	26	109,147
Other	—	2	—	2	10,391
	16	21	16	53	237,476
Business to Business					
Branches and sales offices	2	31	62	95	650,750
Administration centers	—	3	11	14	74,241
Head Office sites	—	—	1	1	265,173
Other	—	13	—	13	13,052
	2	47	74	123	1,003,216
Group Infrastructure					
Branches, sales offices and ATM sites	—	12	—	12	129
Administrational	2	5	25	32	1,412,909
Other	4	14	19	37	399,644
	6	31	44	81	1,812,682
Total	28	151	856	1,035	5,408,840

(1) The Group's leasehold properties are subject to leases ranging from 1 to 999 years in maturity with the majority being 9 years in average duration and subject to annual contractual rental increases.

(2) On October 19, 2000 Abbey National entered into a sale and leaseback agreement with Mapeley Columbus Limited for substantially all of the Groups' properties. The lease agreements are treated as operating leases and allow Abbey National to alter the Group's property requirements in order to meet future business needs, thereby significantly enhancing the Group's competitive position. The only option to repurchase properties under the deal relates to a small group of flagship properties, almost all of which are administrative headquarters. The repurchase would be at market value, is fully discretionary, and exercisable only in 20 years.

The above table shows the number of individual properties owned by the Group. This is less than the number of unique property interests as the Group has more than one interest in some properties.

Of the above total properties, 980 are located in the United Kingdom, 53 in mainland Europe and 2 in the rest of the world. Also in the above table under Other are 9 closed branch sites which were not occupied by the Group as at December 31, 2000. There are no material environmental issues associated with the use of these properties.

The Group has two main Head Office sites at Baker Street, London and Grafton Gate East, Milton Keynes. The Baker Street office is also the registered office. The main computer center is Shenley Wood House in Milton Keynes. These properties are held under operating leases. The only material construction project at December 31, 2000 related to a new head office site in London which is due to be completed by July 2001 and will be used under an operating lease from Mapeley Columbus.

Management believes its existing properties in conjunction with the operating lease arrangements in place with Mapeley Columbus Limited are adequate and suitable for its business as presently conducted or to meet future business needs. All properties are adequately maintained.

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.

MATERIAL CONTRACTS

Abbey National and its subsidiaries are party to various contracts in the ordinary course of business. For the year ended December 31, 2000 there have been no material contracts entered into outside the ordinary course of business.

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 were the initial participants in the third stage of EMU: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. Greece joined as an additional participant on January 1, 2001. The three EU member states that retain their national currencies and have not adopted the Euro are therefore Denmark, Sweden and the U.K. Neither the Danish nor Swedish Government has indicated any current intention to apply to participate.

Under the Treaty on European Union (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 favor 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. The U.K. has not joined 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 transition to the Euro currency will be concluded in 2002 with the adoption of euro notes and coins in the participating states to replace their existing notes and coinage.

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 Banking Codification Directive ("BCD") 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 authorized in its "home" state.

Prudential Supervision and Capital Adequacy

The BCD sets 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 arising in the trading book, that is broadly positions and securities that a U.K. bank or investment firm holds for proprietary trading purposes. For other (non-trading) risks, the CAD refers to the BCD, which regulates the quality and proportions of different types of capital to be held by an institution, the amount of capital to be held for counterparty exposures arising outside the trading book and restrictions on exposures to an individual counterparty or group of connected counterparties. In addition, the CAD and the BCD require consolidated supervision of financial groups.

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. and certain exemptions, 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 Financial Services Authority ("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 retail 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 acted, in relation to building and contents insurance, as a broker for CGU Underwriting Limited, the underwriting company which formed part of Abbey National's joint venture with CGU, receiving commissions for the policies arranged. Abbey National sold its interests in the joint venture on December 29, 2000. 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 authorized 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 authorized person or exempted person for the purposes of the Act. The Act requires that firms involved in investment business must be authorized and then conform to the applicable rules relating to conduct of business and financial resources, unless certain exemptions apply. Authorization is normally granted by one of the self regulating organizations ("SROs") recognized 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 authorization from, and is regulated by, the Securities and Futures Authority ("SFA") in respect of its investment business activities. CAIL has also obtained authorization 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 authorized 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. ANTS is subject to the "Grey Paper" (the FSA's rules for the "Regulation of the wholesale cash and OTC derivatives markets") and is also required to observe the "London Code of Conduct" in its dealings on the wholesale money markets.

Current and Future Developments

The U.K. Government is currently finalizing 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 Act 2000 (FSMA) was enacted in June 2000. It creates a statutory framework for a new regime under which the FSA will acquire the responsibility for supervising all banks, investment firms, insurance companies, building societies and other financial institutions not mentioned in the context of this discussion. The various regulators mentioned above in the context of the Abbey National Group's regulated activities will no longer have any responsibility for supervising financial institutions.

FSMA is expected to be brought into force in the second half of 2001, when the details of the new regime are ready to be implemented. It is not expected that the reforms will lead to any extension in the scope, as opposed to the nature, of regulation of Abbey National except in the case of residential mortgage lending. The rules for mortgage lenders will cover such matters as: the fitness, propriety and solvency of lenders; the suitability of their controllers and managers; the advertising and other promotion of mortgages; the disclosure of the essential features of a mortgage loan; and the ongoing relationship between lender and borrower.

It is not proposed that mortgage advice be regulated. It is proposed that mortgage lending be brought into the scope of regulation some six months after the initial implementation of FSMA.

In the meantime, the Government has encouraged voluntary benchmark standards for certain types of mortgages.

Apart from the fact that the Abbey National Group will have one regulator, the FSA, for all the activities described above it is not yet possible to say what other implications the reforms will have.

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 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. Further banking 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 published its response to the report in August 2000, having already confirmed that banking services to small and medium-sized enterprises will be the subject of a Competition Commission enquiry. It has broadly welcomed the other two main recommendations noted above and will explore further the possibility of a licensing system for money transmission services. Apart from the case of residential mortgages, already mentioned, the Government agrees that the case for regulating retail banking products is weak.

On March 6, 2001 the Competition Commission published its provisional conclusions on its investigation into the provision of banking services to small and medium-sized enterprises, in which Abbey National is identified (amongst others) as being part of a complex monopoly situation.

The Competition Commission has provisionally identified two complex monopoly situations that exist in relation to the U.K. clearing banks, both including Abbey National. The first relates to the terms on which business accounts are offered to SMEs. The second relates to clearing services provided under agency arrangements.

A provisional finding that a complex monopoly situation exists does not imply the existence of any facts which operate or may be expected to operate against the public interest. The Competition Commission is still considering the effects on the public interest of the matters it has identified. However, it has stated in its provisional findings that in considering the effects on the public interest, it is unlikely to conclude that a clearing bank with a very small market share operates or may be expected to operate against the public interest. Although the Commission is still considering what the relevant markets may be, Abbey National considers that it has a market share of around 1% in the supply of banking services to SMEs.

The Competition Commission is due to deliver its final report to the Secretary of State by June 19, 2001. The report will be published some time after that date.

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 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.

MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

Major Shareholders

As at December 31, 2000, 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.

As at December 31, 2000 Abbey National had no major shareholders, defined as owning 5% or more of the outstanding ordinary share capital. There have been no significant changes in the percentage ownership of major shareholders in the past three years.

There were 1,987,885 recorded holders of Ordinary Shares with U.K. addresses at December 31, 2000 whose shareholdings represented approximately 99.6% of total issued and outstanding Ordinary Shares on that date.

Interests of Directors and Officers

In 2000, loans were made by the Group to 12 directors and the executive officers of the Group and connected persons and of these loans, principal amounts of £1,583,000 were outstanding as at December 31, 2000. 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, 2000.

In 2000 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.

The following table sets forth the aggregate shareholdings, as at December 31, 2000, of the directors and executive officers of Abbey National as a group. No director or executive officer held more than one per cent of the Ordinary shares of Abbey National during the year ended December 31, 2000.

Title of Class	Owner	Number Owned	% of Class
Ordinary shares of nominal value 10p each	Directors and executive officers of Abbey National	470,491	0.03

DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors and Senior Management

The following table sets forth the directors and executive officers of Abbey National as at March 15, 2001, 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)	Non-Executive Director, Eurotunnel plc Chairman, Blue Circle Industries PLC Non-Executive 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 Non-Executive Director, Rentokil Initial plc	1993
Timothy C W Ingram, F.C.I.B.	Managing Director, Business to Business Banking (since 2000)		1996
Yasmin Jetha	Group IT and Infrastructure Director (since 2001)		2001
D Gareth Jones, F.C.A., F.C.T.	Managing Director, Wholesale Banking (since 1993)	Non-Executive Director, Somerfield plc	1993
John King	Corporate Development & Resources Director (since 1999)		1999
Malcolm Millington	Managing Director, Business to Consumer Banking (since 2000)		1999
Mark A Pain, F.C.A.	Group Finance Director (since 1998)		1998
Andrew H Pople	Managing Director, Retail Banking (since 1996)		1996
Ian K Treacy, F.C.A.	Director and Secretary (since 1998)		1998
Non-Executive Directors			
Leon Allen		Non-Executive Chairman, Braes Group Ltd	1998
Mair Barnes		Non-Executive Director, Scottish Power plc	1992
The Lord Currie		Non-Executive Director, Joseph Rowntree Reform Trust Limited	2001
Richard Hayden		Executive Chairman, GSC Partners, Europe Ltd	1999
Sir Terence Heiser, G.C.B.			1992
Peter J Ogden		Director, Computacenter PLC Chairman, Computasoft Limited Chairman, Omnia Ltd. Director, PSION PLC	1994
The Lord Shuttleworth, F.R.I.C.S.			1996
Keith Woodley, F.C.A.	Deputy Chairman and Senior Independent Non-Executive Director (since 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 15, 2001, 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 Chairman, Association of Payment Clearing Services Non-Executive Director, Rentokil Initial plc
D Gareth Jones, F.C.A., F.C.T.	Chief Executive	Managing Director, Wholesale Banking, Abbey National plc 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	
Robin Garratt, A.C.A., F.C.I.B., 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, 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	Group 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
Raphael W Hodgson	Independent Non-Executive Director	

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 scheduled occasions during 2000, 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 comprises four members. Richard Hayden replaced James Tuckey on the Audit Committee in September 2000. The Audit Committee met six times in 2000. 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 Audit 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 Audit 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 companies' audit committees set up for key trading subsidiaries and key issues are reported to the Group Audit Committee. 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 and met eight times in 2000. 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 Personnel and Remuneration Committee determines the individual remuneration package of each executive director.

Nomination Committee

The Nomination Committee is chaired by Lord Tugendhat and comprises four members. It met twice during 2000. The Nomination 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

Overall remuneration strategy

Abbey National operates in a competitive market. 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 its entire staff remuneration packages which are competitive in the relevant employment market and which are 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 stakeholding in the Company. Through a series of offers under the sharesave, share participation and employee share option schemes, nearly all staff continue to have a shareholding interest.

Personnel and Remuneration Committee (the '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 is chaired by Mair Barnes. 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 Corporate Development and Resources Director and regularly obtains advice from external advisers.

Remuneration policy

The aim of the Board and the Committee is to maintain a policy which:

- is market driven within each business aimed at ensuring Abbey National can attract, develop and retain high quality staff at all levels in the organisation;
- ensures employee behaviours are closely aligned with Business and Group objectives through the use of performance-related rewards;
- is designed to motivate and reinforce superior performance;
- seeks to align the interest of shareholders and staff by giving staff an opportunity to build up a shareholding in the Company.

Executive Directors' Remuneration

Basic salary

Basic salaries are reviewed annually and are set to reflect market conditions, personal performance and the pay of those in similar jobs in comparable organisations. The comparator group used in consideration of remuneration matters comprises retail banks, insurance companies and other companies with market capitalisation similar to Abbey National's. The Committee obtains advice and information from external experts when making its comparisons.

The base salaries of the executive directors were increased during 2000 following a review, which is explained in more detail below.

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 2001 in relation to performance in 2000. The maximum potential cash payment, to be shared among the executive directors, is 50% of that group's basic salary earned during the year.

The aggregate payment under the scheme is determined by the Committee's assessment of the Company's performance against a range of measures agreed at the beginning of the financial year and approved by the Board.

Payments to individual executive directors reflect their individual performance and contribution during the year. Total payments under the scheme for 2000 represented 40% of the salaries earned during the year (1999: 18.5%).

Benefits

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

Long Term Incentive Plan ('LTIP')

An LTIP for senior executives was adopted at the 1997 Annual General Meeting. Each year individuals are conditionally granted shares to a maximum value of 70% of their basic salary. The number 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.

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. No award will be made for any part where 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. 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 for the performance period 1998 to 2000 will not generate an award in 2001.

The LTIP is currently open only to the nine members of the Executive Committee.

Shareholders have approved an employee sharesave scheme, an employee share option scheme, an employee share participation scheme and the all employee share ownership plan. These schemes are available to all employees. The last grant to executive directors, under the executive share option scheme, was in 1996, however existing options remain exercisable.

Pensions

Directors are eligible to join one of the Company's pension schemes. There are no elements of remuneration, other than basic salary, which are treated as pensionable.

Service contracts

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 able to receive pay in lieu of notice. If an executive director is made redundant within the meaning of the relevant employment legislation, he/she will be eligible to receive a redundancy severance payment in line with the Company's terms applicable to the majority of staff. This will be calculated based on 3.25 weeks pay for each year of continuous service up to a maximum of two years' salary. Over 30 years of continuous service will be required to achieve a maximum payout.

Chairman and non-executive directors' fees

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

The Chairman's emoluments consist wholly of fees, benefits and expenses in respect of services. He is not entitled to participate in any bonus or profit sharing arrangements nor is he entitled to participate in the 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 is reviewed every two years and this review took place during 2000. As a result, the basic fee of £25,000 per annum was increased to £30,000 per annum. The basic fee is augmented by £5,000 for service on each of the Audit Committee, Personnel and Remuneration Committee, and the Retail Strategy Board. There is 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 National and Provincial Building Society Pension Fund Trustees Limited. Keith Woodley's remuneration includes payments for services as a Deputy Chairman of Abbey National plc, a non-executive director of Abbey National Treasury Services plc and as Chairman of both their audit committees.

The Articles of Association set a limit on non-executive directors' fees, but this has not been changed since 1996. The opportunity is therefore being taken to increase the aggregate of all fees paid from the current level of £750,000 to £1,250,000.

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

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. This provides for payment of fees for a period of twelve months.

Executive directors' remuneration policy for the future

During 2000, the Committee undertook a major review of executive remuneration policy in the light of current best practice in this area, particularly bearing in mind the guidelines published by the Association of British Insurers in July 1999.

As a consequence of this review, the Board is proposing amendments to directors remuneration and will be seeking separate shareholder approval at the Annual General Meeting in April 2001 for each of the two key elements of the remuneration policy — the 2001 executive share option scheme and the share matching scheme. Under the circumstances, the Board does not consider it appropriate, at this time, for shareholders to be asked to approve a full remuneration report.

Details of the proposed key changes to directors' remuneration arrangements are set out below.

Basic salary

The base salaries of the executive directors were adjusted during 2000 to take into account the findings of the review.

Annual performance related bonus

The maximum potential payment associated with this bonus, for the year 2001, will be increased from 50% to 70%. Payments under the scheme will be dependent upon achievement of challenging performance targets agreed by the Committee.

Share matching scheme

Senior executives, including executive directors, may also participate in a share matching scheme. Under the share matching scheme, executives may choose to invest some or all of their annual bonus in the Company's shares ('the purchased shares'). This will strengthen the alignment of their interests with shareholders' interests. Executives will receive matching awards ('the matching shares') equal in value to the pre-tax bonus invested in the purchased shares. These matching shares will be available in full only if the Company's earnings per share growth exceeds inflation by an average of at least 7% per annum; 10% of the shares will be matched if growth in earnings per share exceeds inflation by an average of 3% per annum; and pro rata between these two points. This will apply over a fixed three year period provided the executive has not sold the purchased shares in the meantime.

2001 Executive share option scheme (the 'Scheme')

The Scheme will replace the LTIP and the existing executive share option scheme. On adoption of this Scheme, no further grants will be made under either of the previous two schemes.

The Scheme will provide for the grant of options to executive directors (as well as senior executives and other managers) on an annual basis and will incorporate a range of demanding performance targets. Operating the Scheme in this way will mean that there is a direct link between executives' remuneration and the Company's longer-term performance. Since executives will only benefit under the Scheme to the extent the Company's share price rises, executives' interests will be clearly aligned with those of shareholders. The value of shares under option which an executive may initially receive in any financial year will not normally exceed twice basic salary. These options will be exercisable in full only if the Company's total shareholder return performance is ranked in the upper quartile relative both to other financial services companies and to FTSE-100 companies, and if Abbey National's earnings per share growth exceeds inflation by an average of at least 7% per annum.

The Board believes that these changes to the remuneration arrangements reflect current market practice and is convinced that they will be an essential element in attracting, developing and retaining the highest quality executives required to carry out the Company's challenging plans.

Analysis of Directors' Remuneration

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

	Salary/Fee	Performance related annual bonus	Performance related three year bonus — LTIP awards	Taxable benefits	2000 Total	1999 Total
			(in £)			
Chairman						
The Lord Tugendhat	339,333	—	—	19,911	359,244	347,746
Executive directors						
I Harley	520,833	208,333	43,050	1,946	774,162	544,886
T C W Ingram	300,615	120,245	31,461	1,921	454,242	321,096
D G Jones	338,771	135,508	39,743	1,493	515,515	427,628
J King	219,542	87,816	26,989	1,557	335,904	238,177
M J Millington	234,792	93,916	—	1,605	330,313	238,428
M A Pain	287,917	115,167	—	1,871	404,955	267,916
A H Pople	313,333	125,333	34,777	1,295	474,738	333,054
I K Treacy	229,833	91,933	28,974	2,197	352,937	251,063
C N Villiers	312,750	125,100	41,401	2,041	481,292	357,422
Non-executive directors						
L R Allen	36,250	—	—	309	36,559	28,480
M Barnes	38,750	—	—	2,790	41,540	33,781
R M Hayden	30,417	—	—	47	30,464	6,935
Sir Terence Heiser	33,750	—	—	1,416	35,166	30,952
P J Ogden	33,750	—	—	309	34,059	28,672
The Lord Shuttleworth	43,750	—	—	2,223	45,973	45,409
J L Tuckey (retired September 1, 2000)	25,000	—	—	—	25,000	30,339
K S Woodley	93,375	—	—	3,179	96,554	83,183
Totals	3,432,761	1,103,351	246,395	46,110	4,828,617	3,615,167

Note:

Amounts included under 'Performance related three year bonus — LTIP awards' represent the value of ordinary shares transferred to the directors during the year, calculated using the market price of the Company's ordinary shares at the date of receipt by the directors, irrespective of whether the shares were sold or retained.

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 2000 for executive directors participating in the Company's defined benefits pension schemes.

	Contributions from directors during 2000[6]	Increase in accrued pensions during 2000[1][4]	Transfer value of the increase in accrued pensions during 2000[2]	Total accrued pensions as at December 31, 2000[3]	Total accrued pensions as at December 31, 1999
			(in £)		
Executive directors					
I Harley	13,333	40,887	627,187	239,307	196,261
T C W Ingram[5]	—	22,576	325,998	113,566	90,000
D G Jones	3,388	17,831	284,255	112,359	93,500
J King	30,189	7,367	100,307	124,981	116,344
M J Millington	2,348	19,854	302,028	113,892	93,015
M A Pain	2,879	20,062	193,699	63,649	43,113
A H Pople	9,995	14,370	154,649	80,422	65,333
I K Treacy	34,475	18,626	303,123	132,920	113,050
C N Villiers	46,912	19,288	308,948	169,927	149,000
Totals	143,519	180,861	2,600,194	1,151,023	959,616

Notes:

1. The increase in accrued pension during 2000 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 1.1%, where relevant), if he had left service voluntarily at December 31, 2000 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, 2000 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, 2000 or at his actual retirement date if earlier.
4. In most cases the figure for the increase in accrued pension during 2000 which appears in the table does not equal the difference between the total accrued pension as at December 31, 2000 and the total accrued pension as at 31 December 1999. 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 had 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.
5. 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.
6. Additional Voluntary Contributions made have been included in the above table where these payments result in an increase in the value of the directors' pension entitlements.

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:

	Number of shares		
Ordinary shares	**At January 1, 2000**	**At December 31, 2000**	**At March 15, 2001**
L R Allen	4,000	4,000	4,000
M Barnes	1,000	1,000	1,000
The Lord Currie (appointed January 23, 2001)	—	—	—
I Harley	58,782	76,081	76,081
R M Hayden	4,000	4,000	4,000
Sir Terence Heiser	1,000	1,000	1,000
T C W Ingram	30,636	39,425	39,425
Yasmin Jetha (appointed January 23, 2001)*	50	32,159	31,246
D G Jones	31,189	38,152	38,152
J King	39,897	45,964	45,136
M J Millington	32,916	37,752	37,752
P J Ogden	4,000	4,000	4,000
M A Pain	17,964	22,964	22,964
A H Pople	50,661	55,489	55,489
The Lord Shuttleworth	816	832	832
I K Treacy	46,079	49,364	49,364
The Lord Tugendhat	18,867	19,885	19,885
C N Villiers	26,152	33,264	33,264
K S Woodley	2,160	5,160	5,160

Note: In addition, £36,529 Abbey National Floating Rate Unsecured Loan Notes 2000, issued on August 23, 1995 in consideration for shares held in FNFC plc to TCW Ingram, were redeemed on June 30, 2000.

* Yasmin Jetha was an executive officer, but not a director, during 2000.

Directors' Share Interests continued

Share options	At January 1, 2000	Number of options: granted	exercised	cancelled	At December 31, 2000	Exercise price £	Market price at date of exercise £	Gain on exercise £	Date from which exercisable £	Expiry date	Scheme
I Harley	2,418		2,418		—	4.28	8.90	11,171	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
	38,053		10,000		28,053	5.65	7.13	14,800	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
	77,917		12,418		65,499			25,971			
T C W Ingram	3,701				3,701	4.66			04/01/01	09/30/01	Sharesave
	150				150	5.91			09/09/99	09/08/06	Employee
	3,851				3,851						
D G Jones	2,418		2,418		—	4.28	8.90	11,171	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			03/25/97	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
		1,052			1,052	5.13			04/01/05	09/30/05	Sharesave
	70,262	1,052	2,418		68,896			11,171			
J King	291		291		—	6.68	8.58	551	04/01/00	09/03/00	Sharesave
	2,418		2,418		—	4.28	8.90	11,171	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†
	23,181				23,181	5.91			09/09/99	09/08/06	Executive#
	150				150	5.91			09/09/99	09/08/06	Employee
		657			657	5.13			04/01/05	09/30/05	Sharesave
	30,844	657	2,709		28,792			11,722			
M J Millington	4,836		4,836		—	4.28	8.90	22,342	10/01/00	03/31/01	Sharesave
	19,000				19,000	4.83			04/10/98	04/09/05	Executive
	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	11.70			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	03/31/08	Employee
		1,315			1,315	5.13			04/01/05	09/30/05	Sharesave
	78,859	1,315	4,836		75,338			22,342			
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	09/30/06	Sharesave
	13,008		5,000		8,008	5.65	7.13	7,400	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
		1,973			1,973	5.13			04/01/05	09/30/05	Sharesave
	29,362	1,973	5,000	1,069	25,266			7,400			
A H Pople	2,418		2,418		—	4.28	8.90	11,171	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
	150				150	5.91			09/09/99	09/08/06	Employee
		657			657	5.13			04/01/05	09/30/05	Sharesave
	3,485	657	2,418	349	1,375			11,171			
I K Treacy	25,042				25,042	5.91			09/09/99	09/08/06	Executive#
	150				150	5.91			09/09/99	09/08/06	Employee
		1,714			1,714	5.65			04/01/03	09/30/03	Sharesave
	25,192	1,714			26,906						
The Lord Tugendhat	1,745			1,745	—	9.88			04/01/03	09/30/03	Sharesave
		1,714			1,714	5.65			04/01/03	09/30/03	Sharesave
	1,745	1,714		1,745	1,714						
C N Villiers	2,418		2,418		—	4.28	8.90	11,171	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
	36,988				36,988	5.91			09/09/99	09/08/06	Executive#
	150				150	5.91			09/09/99	09/08/06	Employee
	85,375		2,418		82,957			11,171			

\# Replacement options

† Parallel discounted options (see below)

Notes:

1. 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.
2. 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.
3. Parallel discounted options are exercisable at £3.98 from 4/11/99 to 4/10/04. Parallel discounted options become exercisable if the average growth in earnings per ordinary share exceeds the average increase in the retail prices index by at least 10% in any five year period prior to the date of exercise. The option holder may exercise either the standard or discounted option, but not both, thereby reducing both options, subject to the achievement of the appropriate performance criteria. The Board determined in 1994 that it would no longer make grants of discounted options.
4. 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 Consolidated Financial Statements, included elsewhere in this Annual Report.
5. Options shown under the headings 'Number of options: granted, exercised or cancelled' refer to options granted, exercised or cancelled during the year.
6. 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 29, 2000, the last day of trading in 2000, was 1219p (December 31, 1999: 990p) and the range during 2000 was 622p to 1219p.
7. The gains made upon the exercise of options during the year 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.

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, 2000**	**Conditional rights granted during year**	**Shares awarded during year**	**Conditional rights lapsed during year**	**Conditional rights held under plan at December 31, 2000**
I Harley	47,025	53,435	—	22,474	77,986
T C W Ingram	28,125	30,081	—	13,484	44,722
D G Jones	32,248	35,347	—	15,881	51,714
J King	21,219	22,282	—	10,308	33,193
M J Millington	20,500	22,282	—	9,589	33,193
M A Pain	22,763	28,320	—	10,488	40,595
A H Pople	29,359	31,206	—	14,083	46,482
I K Treacy	23,443	23,404	—	11,986	34,861
C N Villiers	15,761	—	—	15,761	—

Shares held in trust	**Shares held in trust at January 1, 2000**	**Shares awarded during year**	**Shares transferred during year**	**Shares held in trust at December 31, 2000**	**These shares are receivable in:**	
					2001	**2002**
I Harley	9,763	—	4,881	4,882	—	4,882
T C W Ingram	7,135	—	3,567	3,568	—	3,568
D G Jones	9,012	—	4,506	4,506	—	4,506
J King	6,121	—	3,060	3,061	—	3,061
M J Millington	—	—	—	—	—	—
M A Pain	—	—	—	—	—	—
A H Pople	7,886	—	3,943	3,943	—	3,943
I K Treacy	6,571	—	3,285	3,286	—	3,286
C N Villiers (retired January 31, 2001)	9,388	—	4,694	4,694	—	4,694

Notes:

1. Shares sufficient to satisfy the conditional rights granted under the LTIP 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 rights is being charged to the profit and loss account over the three year performance period to which they relate. In 2000, £2,219,976 (1999: £1,869,123) 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 shares awarded 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 29,2000, the last day of trading in 2000, 1219p (1999: 990p), would have been £4,763,559 (1999: £2,934,449). 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 the shares held in the Trust. At December 31, 2000, the Trust held 604,362 ordinary shares (December 31, 1999: 389,320 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, 2000 was £1,151,023. 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, 2000, 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, 2000 was £nil, based upon the contributions paid by Abbey National.

At March 15, 2001, directors and executive officers of Abbey National as a group held options to purchase 457,351 ordinary shares of Abbey National at prices ranging from £5.13 to £10.87 under the Sharesave scheme, from £4.68 to £13.06 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 2010.

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 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. The company's Articles of Association also require that a director must retire at the first Annual General Meeting after their 70th birthday.

Employees

Abbey National has a "Partnership Agreement" with ANSA, the Trade Union it recognizes for employee representation. Consultation takes place at both national and local levels. Regular relationship management meetings are held to ensure communication is open and two-way.

Details of the number of staff employed by Abbey National are included in Note 1 to the Consolidated Financial Statements, included elsewhere in this Annual Report.

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. Abbey National pursues a progressive dividend policy (i.e. the dividend will be increased year-on-year); this annual growth has been double digit in each of the last ten years.

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

Pence per 10 pence Ordinary Share

	2000	1999	1998	1997	1996
Interim	15.15	13.40	11.75	10.20	8.70
Final	30.35	26.85	23.55	20.50	17.40
Total	45.50	40.25	35.30	30.70	26.10

Cents per 10 pence Ordinary Share

	2000	1999	1998	1997	1996
Interim	22.66	21.64	19.54	16.45	13.60
Final	45.39	43.36	39.80	33.68	29.79
Total	68.05	65.00	59.34	50.13	43.39

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 8 3/4% 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, 2000, 1,431,673,590 Ordinary Shares were issued and outstanding.

There were 2,729 recorded holders of Ordinary Shares with U.S. addresses at December 31, 2000 whose shareholdings represented approximately 0.04% 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, 2000, there were 2,550,239 ADSs outstanding for which one holder was registered.

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

At December 31, 2000, Abbey National had outstanding 8,000,000 Series A Non-cumulative Dollar-denominated Preference Shares, nominal value $0.01 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, 2000, the Series A American Depositary Shares were held by 39 holders of record, 2 with Canadian addresses, the remainder with U.S. addresses. The Series A American Depositary Shares traded on the New York Stock Exchange at prices ranging from a high of $25.50 to a low of $22.13 during 2000.

Share History

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 the following periods:

(i) The five most recent financial years;

(ii) Each financial quarter for the two most recent financial years; and

(iii) Each of the six most recent months.

(i) Five most recent financial years

	Ordinary Shares	
	High	**Low**
	(pence)	
2000	1,219	622
1999	1,435	939
1998	1,340	882
1997	1,147	715
1996	765	529

(ii) Quarterly for the two most recent financial years

	High	Low
2000: Fourth quarter	1,219	823
Third quarter	899	711
Second quarter	939	732
First quarter	990	622
1999: Fourth quarter	1,201	939
Third quarter	1,241	974
Second quarter	1,435	1,191
First quarter	1,358	1,134

(iii) The six most recent months

	High	Low
March 2001, through March 15, 2001	1,198	1,085
February	1,240	1,100
January	1,274	1,155
December 2000	1,219	1,092
November	1,108	955
October	951	823

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

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 conversion transaction, synthetic security or other integrated financial transaction 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. 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 recently announced by the Internal Revenue Service, 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.

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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 financial statements.

The directors of Abbey National plc are required by United Kingdom company law to prepare financial statements for each financial year 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 financial statements the directors are required to:

- ensure that suitable accounting policies, which follow generally accepted accounting practice, have been applied consistently;
- ensure that reasonable and prudent judgments and estimates have been used in the preparation of the financial statements;
- prepare the financial statements 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 United Kingdom accounting standards have been followed and to disclose and explain any material departures in the financial statements.

AUDITORS

The consolidated financial statements of Abbey National plc and its subsidiary undertakings for December 31, 2000 and December 31, 1999 and for the years then ended were audited by Deloitte & Touche.

The consolidated financial statements of Abbey National plc and its subsidiary undertakings for the year ended December 31, 1998 were audited by PricewaterhouseCoopers.

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

We have audited the Consolidated Financial Statements of Abbey National plc and its subsidiary undertakings for each of the two years in the period ended December 31, 2000 on pages F-5 to F-96 inclusive. These Consolidated Financial Statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these Consolidated Financial Statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United Kingdom, and in the United States of America. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the Consolidated Financial Statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Consolidated Financial Statements. 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 Consolidated Financial Statements referred to above present fairly, in all material respects, the consolidated financial position of Abbey National plc and its subsidiary undertakings at December 31, 2000 and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2000, 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 of America as set out in Note 55 to the Consolidated Financial Statements.

Deloitte & Touche
Chartered Accountants
London, England.
April 2, 2001

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

We have audited the Consolidated Financial Statements of Abbey National plc and its subsidiary undertakings for the year ended December 31, 1998 on pages F-5 to F-96 inclusive. These Consolidated Financial Statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these Consolidated Financial Statements 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 Consolidated Financial Statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Consolidated Financial Statements. 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 Consolidated Financial Statements 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 the year 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 55 to the Consolidated Financial Statements.

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 2, 2001.

CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEARS ENDED 31 DECEMBER 2000, 1999, AND 1998

	Notes	2000 Total £m	1999 (restated) Total £m	1998 (restated) Total £m
Interest receivable:				
Interest receivable and similar income arising from debt securities		3,968	2,902	3,103
Other interest receivable and similar income	2	7,242	6,327	6,822
Interest payable	4	(8,530)	(6,568)	(7,684)
Net interest income		2,680	2,661	2,241
Dividend income	5	3	2	4
Fees and commissions receivable		867	737	643
Fees and commissions payable		(269)	(246)	(136)
Dealing profits	6	116	98	32
Other income:				
Income from long term assurance business	20	240	196	155
Other operating income	7	657	354	192
Total operating income		4,294	3,802	3,131
Administrative expenses	8	(1,681)	(1,496)	(1,240)
Depreciation on fixed assets excluding operating lease assets	24,25	(134)	(119)	(106)
Depreciation on operating lease assets	26	(178)	(52)	(20)
Depreciation and amortisation		(312)	(171)	(126)
Provisions:				
Provisions for bad and doubtful debts	9	(273)	(303)	(201)
Provisions for contingent liabilities and commitments	37	(21)	(23)	(16)
Amounts written off fixed asset investments		(32)	(26)	(28)
Profit on ordinary activities before tax		1,975	1,783	1,520
Tax on profit on ordinary activities	10	(559)	(522)	(462)
Profit on ordinary activities after tax		1,416	1,261	1,058
Minority interests – non-equity	39	(51)	—	—
Profit for the financial year		1,365	1,261	1,058
Transfer to non-distributable reserve	41	(156)	(13)	(125)
Dividends including amounts attributable to non-equity interests	11	(687)	(610)	(535)
Profit retained for the financial year		522	638	398
Earnings per ordinary share – basic	12	93.4p	86.2p	72.4p
Earnings per ordinary share – diluted	12	92.8p	85.5p	71.7p

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

The 1999 and 1998 comparative results have been restated to reflect a change in presentation of depreciation on operating lease assets. For details of the change in presentation, see Accounting policies – Assets leased to customers.

All results arise from continuing operations.

CONSOLIDATED BALANCE SHEET
AS AT 31 DECEMBER 2000 AND 1999

	Notes	2000 £m	2000 £m	1999 £m	1999 £m
Assets					
Cash and balances at central banks			437		701
Treasury bills and other eligible bills	13		1,159		1,114
Loans and advances to banks	14		12,168		11,472
Loans and advances to customers	15		81,752		75,221
Loans and advances to customers subject to securitisation	16	7,927		1,930	
Less: non-returnable finance		(4,629)		(1,379)	
			3,298		551
Net investment in finance leases	17		5,192		5,441
Debt securities	18		68,972		59,445
Equity shares and other similar interests	19		601		295
Long term assurance business	20		1,538		1,042
Interests in associated undertakings	21		57		59
Intangible fixed assets	24		245		203
Tangible fixed assets excluding operating lease assets	25	389		759	
Operating lease assets	26	1,963		358	
Tangible fixed assets			2,352		1,117
Other assets	27		4,351		3,930
Prepayments and accrued income	28		3,186		2,714
Assets of long term assurance funds	20		19,083		17,439
Total assets			204,391		180,744
Liabilities					
Deposits by banks	30		34,996		29,824
Customer accounts	31		66,795		59,911
Debt securities in issue	32		57,078		51,407
Dividend proposed			433		382
Other liabilities	33		7,948		6,930
Accruals and deferred income	34		3,250		2,857
Provisions for liabilities and charges	35		1,443		1,275
Subordinated liabilities including convertible debt	38		5,871		4,641
Liabilities of long term assurance funds	20		19,083		17,439
Minority interests — non-equity	39		664		—
			197,561		174,666
Called up share capital — ordinary shares	40	143		142	
— preference shares		325		325	
Share premium account	40	1,610		1,536	
Reserves	41	616		449	
Profit and loss account	41	4,136		3,626	
Shareholders' funds including non-equity interests	42		6,830		6,078
Total liabilities			204,391		180,744
Memorandum items					
Contingent liabilities					
Guarantees and assets pledged as collateral security	44		2,134		2,214
Other contingent liabilities	45		299		477
			2,433		2,691
Commitments					
Obligations under stock borrowing and lending agreements	46		19,763		17,024
Other commitments	46		8,047		6,235
			27,810		23,259

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
FOR THE YEARS ENDED 31 DECEMBER 2000, 1999 AND 1998

	Notes	2000	1999	1998
		£m	£m	£m
Profit attributable to the shareholders of Abbey National plc		1,365	1,261	1,058
Translation differences on foreign currency net investment	41	—	(1)	—
Unrealised surplus on revaluation of investment properties	41	11	3	—
Total recognised gains relating to the year		1,376	1,263	1,058

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEARS ENDED 31 DECEMBER 2000, 1999 AND 1998

	Notes	2000	1999	1998
		£m	£m	£m
Net cash inflow from operating activities	50a	6,093	10,527	4,688
Returns on investments and servicing of finance:				
Interest paid on subordinated liabilities		(289)	(198)	(195)
Preference dividends paid		(38)	(41)	(36)
Payments to non-equity minority interests		(51)	—	—
Net cash outflow from returns on investments and servicing of finance		(378)	(239)	(231)
Taxation:				
UK corporation tax paid		(402)	(316)	(236)
Overseas tax paid		(4)	(3)	(52)
Total taxation paid		(406)	(319)	(288)
Capital expenditure and financial investment:				
Purchases of investment securities		(18,169)	(20,384)	(26,335)
Sales of investment securities		4,971	4,166	14,314
Redemptions and maturities of investment securities		10,898	7,383	8,102
Purchases of tangible fixed assets		(502)	(364)	(219)
Sales of tangible fixed assets		508	95	70
Transfers to life assurance funds		(328)	(145)	(4)
Net cash outflow from capital expenditure and financial investment		(2,622)	(9,249)	(4,072)
Acquisitions and disposals	50e,g	(968)	(30)	(214)
Equity dividends paid		(548)	(520)	(454)
Net cash inflow (outflow) before financing		1,171	170	(571)
Financing:				
Issue of ordinary share capital		11	18	17
Issue of preferred securities (non-equity minority interests)		620	—	—
Issue of loan capital		1,355	1,525	857
Repayments of loan capital		(365)	(195)	—
Net cash inflow from financing	50c	1,621	1,348	874
Increase in cash	50b	2,792	1,518	303

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

ACCOUNTING POLICIES

Basis of presentation

The consolidated financial statements 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 financial statements under the historical cost convention, modified by the revaluation of certain assets. They are prepared in accordance with applicable accounting standards of the Accounting Standards Board and pronouncements of its Urgent Issues Task Force and with the Statements of Recommended Accounting Practice issued by the British Bankers' Association and the Irish Bankers' Federation.

Basis of consolidation

The Group financial statements comprise the financial statements 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 financial statements of these subsidiaries have been consolidated on the basis of interim financial statements for the period to 31 December 2000.

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

Interests in subsidiary undertakings and associated undertakings

The Group's interests in associated undertakings are stated as 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 the 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 excluding operating lease assets 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 'Assets 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 received on loans with high loan-to-value ratios are taken to the profit and loss account over the average anticipated life of the loan, as described under Deferred income, and are included under the heading, Other operating income. Income on investments in equity shares and other similar interests is recognised as and when dividends are received, and included within Dividend income.

Lending-related fees and commissions payable and discounts

Under certain schemes, payments and discounts may be made 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 amounts 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.

Deferred income

The arrangement of certain UK loans and advances secured on residential properties with high loan-to-value ratios may result in a fee being 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 taken to the profit and loss account over the average anticipated life of the loan.

Securities

Debt securities, equity shares and other similar interests 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 agreements

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 the purpose of acquiring and selling equities. Obligations taken on pursuant to entering into such agreements are reported as Commitments.

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

Debt securities in issue

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

Derivatives

Transactions are undertaken in derivative financial instruments, ('derivatives'), which include interest rate swaps, cross-currency swaps, futures, equity and credit 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.

Assets leased to customers

Assets leased to customers under agreements which transfer substantially all the risks and rewards associated with ownership, other than legal title, are classified as finance leases. 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 reported at cost less depreciation, calculated on the actuarial after tax method, and are shown as a separate class of tangible fixed asset because they are held for a different purpose to tangible fixed assets used in administrative functions. In the profit and loss account, income in respect of operating lease assets is reported within Other operating income, and depreciation on operating lease assets is reported within Depreciation and amortisation. This represents a change in presentation from previous years, where such depreciation was reported as a charge against income on operating lease assets. This change results from the application of FRS 15, 'Tangible fixed assets', which first applies to the financial statements for the year ended 31 December 2000.

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 as stipulated in FRS 5 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. The 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 financial statements 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 financial statements 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. Monetary 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 financial statements, 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 1999 and 1998 have been restated to reflect the changes noted below:

1. In May 2000, a new management structure was introduced, creating four customer facing divisions responsible for increasing revenue growth. These are Retail Banking, Business to Consumer, Business to Business, and Wholesale Banking. In turn these are supported by a core infrastructure area spanning the whole Group. The reorganization is aimed at delivering our key strategic priorities: the radical transformation of our businesses to sustain revenue growth, whilst increasing cost and capital efficiency. As a result, the segmental analysis has been revised as follows:

   Retail Banking now includes General Insurance and Abbey National Life.

   Business to Business comprises First National, Continental Europe and Scottish Mutual Assurance.

   Business to Consumer comprises Wealth Management, Inscape and cahoot.

   Group Infrastructure is the new name for the Group Central Holdings segment.

   These changes have no effect on the consolidated net income and shareholders' funds under both UK and US GAAP. Prior year comparatives for 1999 and 1998 have been restated to reflect the changes. The numerical effect of the changes is detailed in note 1 included elsewhere in this Annual Report.

2. Depreciation on operating lease assets is now reported within Depreciation and amortisation and is separately identified because operating lease assets are used for a different purpose to fixed assets used in administrative functions. This represents a change in presentation from previous years, where such depreciation was reported as a charge against income on operating lease assets. This change results from the application of FRS 15, 'Tangible fixed assets', which first applies to the financial statements for the year ended 31 December, 2000. This change has no effect on the consolidated net income and shareholders' funds under both UK and US GAAP. Prior year comparatives for 1999 and 1998 have been restated to reflect the change.

3. In 1999, the accounting policy and presentation of interest income on dealing assets was 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 was an £8 million reduction in dealing profit, a £321 million increase in interest receivable, and a £313 million increase in interest payable. The 1998 comparative balance was restated with the effect being a £12 million reduction in dealing profits, a £447 million increase in interest receivable and a £435 million increase in interest payable. These changes had no effect on net income and shareholders' funds under both UK and US GAAP.

1. Segmental analysis

	Retail Banking £m	Wholesale Banking £m	Business to Business £m	Business to Consumer £m	Group Infrastructure £m	Group Total £m
2000						
Net interest income	1,578	441	593	76	(8)	2,680
Other income and charges	810	423	180	56	145	1,614
Total operating income	2,388	864	773	132	137	4,294
Operating expenses excluding depreciation on operating lease assets	(944)	(155)	(326)	(177)	(213)	(1,815)
Depreciation on operating lease assets	—	(100)	(78)	—	—	(178)
Provisions for bad and doubtful debts	(150)	—	(120)	(2)	(1)	(273)
Provisions for contingent liabilities and commitments	(11)	—	5	(3)	(12)	(21)
Amounts written off fixed asset investments	—	(34)	—	2	—	(32)
Profit (loss) before taxation	1,283	575	254	(48)	(89)	1,975
Total assets	69,097	102,495	26,722	5,517	560	204,391
Net assets	2,674	2,510	1,231	129	286	6,830
The average number of staff employed by the Group during the year was as follows:						
Employees	18,141	702	6,750	1,465	4,210	31,268
1999						
Net interest income	1,624	393	593	62	(11)	2,661
Other income and charges	670	169	133	46	129	1,147
Total operating income	2,294	562	726	108	118	3,808
Operating expenses excluding depreciation on operating lease assets	(885)	(115)	(301)	(107)	(186)	(1,594)
Depreciation on operating lease assets	—	(2)	(50)	—	—	(52)
Provisions for bad and doubtful debts	(167)	—	(136)	—	—	(303)
Provisions for contingent liabilities and commitments	(15)	—	(5)	—	(3)	(23)
Amounts written off fixed asset investments	—	(26)	—	—	—	(26)
Profit (loss) before taxation and exceptional items	1,227	419	234	1	(71)	1,810
Year 2000 and EMU costs	(16)	(2)	(7)	(1)	(1)	(27)
Profit (loss) before taxation	1,211	417	227	—	(72)	1,783
Total assets	68,943	81,741	25,087	4,491	482	180,744
Net assets	2,740	2,087	1,442	107	(298)	6,078
The average number of staff employed by the Group during the year was as follows:						
Employees	18,005	561	6,693	1,141	2,809	29,209
1998						
Net interest income	1,515	411	249	47	19	2,241
Other income and charges	651	55	113	38	40	897
Total operating income	2,166	466	362	85	59	3,138
Operating expenses excluding depreciation on operating lease assets	(849)	(86)	(142)	(58)	(150)	(1,285)
Depreciation on operating lease assets	—	—	(20)	—	—	(20)
Provisions for bad and doubtful debts	(167)	—	(30)	—	(4)	(201)
Provisions for contingent liabilities and commitments	(13)	—	1	—	(4)	(16)
Amounts written off fixed asset investments	—	(19)	—	(1)	(8)	(28)
Profit (loss) before taxation and exceptional items	1,137	361	171	26	(107)	1,588
Year 2000 and EMU costs	(48)	(2)	(9)	(1)	(8)	(68)
Profit (loss) before taxation	1,089	359	162	25	(115)	1,520
Total assets	66,845	69,916	20,689	4,225	1,078	162,753
Net assets	2,642	1,922	716	98	29	5,407
The average number of staff employed by the Group during the year was as follows:						
Employees	18,496	454	4,455	928	3,323	27,656

The segmental analysis has been revised to reflect the changes in the management structure of the Group, announced in May 2000.

Retail Banking now includes General Insurance and Abbey National Life.

Business to Business comprises First National, Continental Europe and Scottish Mutual Assurance.

Business to Consumer comprises Wealth Management, Inscape, and cahoot.

Group Infrastructure is the new name for the Group Central Holdings segment.

The effect on the results for the year ended 31 December 2000 is as follows:

	Previously reported basis £m	Retail Banking £m	Wholesale Banking £m	Business to Business £m	Business to Consumer £m	Group Infrastructure £m
Profit before taxation and exceptional items						
UK Retail Banking	985	985				
Wholesale Banking	575		575			
Life Assurance	295	182		113		
Finance House	147			147		
General Insurance	116	116				
Wealth Management	15				15	
Continental Europe	(6)			(6)		
Group Central Holdings	(89)					(89)
cahoot	(63)				(63)	
2000 Revised basis	1,975	1,283	575	254	(48)	(89)

The comparative segmental results for the years ended 31 December 1999 and 31 December 1998 have been restated as follows:

	Previously reported basis £m	Retail Banking £m	Wholesale Banking £m	Business to Business £m	Business to Consumer £m	Group Infrastructure £m
Profit before taxation and exceptional items						
UK Retail Banking	996	996				
Wholesale Banking	419		419			
Life Assurance	229	127		102		
Finance House	140			140		
General Insurance	104	104				
Wealth Management	17				17	
Continental Europe	(8)			(8)		
Group Central Holdings	(71)					(71)
cahoot	(16)				(16)	
1999 Revised basis	1,810	1,227	419	234	1	(71)

	Previously reported basis £m	Retail Banking £m	Wholesale Banking £m	Business to Business £m	Business to Consumer £m	Group Infrastructure £m
Profit before taxation and exceptional items						
UK Retail Banking	926	926				
Wholesale Banking	361		361			
Life Assurance	190	113		77		
Finance House	94			94		
General Insurance	98	98				
Wealth Management	26				26	
Continental Europe	—					
Group Central Holdings	(107)					(107)
cahoot	—					
1998 Revised basis	1,588	1,137	361	171	26	(107)

Consistent with previous years, when arriving at the segmental analysis, certain adjustments have been made. They include an adjustment to reflect the capital notionally absorbed by each segment, based on the Group's Financial Services Authority regulatory requirements, and an allocation across the segments of the earnings on Group reserves.

No separate geographical analysis is presented because the non-UK businesses represent less than 5% of total assets and profit before tax.

2. Other interest receivable and similar income

	2000	1999	1998
	£m	£m	£m
On secured advances	5,227	4,550	5,171
On unsecured advances	1,055	839	582
On finance leases	346	337	340
On other interest earning assets and investments	614	601	729
	7,242	6,327	6,822

Interest receivable on secured advances has been reduced by £384m (1999: £235m, 1998: £207m) in respect of the charge for lending-related fees and discounts payable, which are charged against interest income over the period of time in which the Group has the right to recover the incentives in the event of early redemption. The movements on such incentives are as follows:

	Interest rate discounts	Cashbacks	Total
	£m	£m	£m
At 1 January 2000	110	470	580
Expenditure incurred in the year	205	82	287
Transfer to profit and loss account	(232)	(152)	(384)
At 31 December 2000	83	400	483

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 9.

3. Exceptional items

2000

There were no exceptional items recorded in the period.

1999: Year 2000 and EMU costs

The costs incurred during 1999 in preparing the Group for Year 2000 and Economic and Monetary Union (EMU) were treated as exceptional items but included within existing captions in the profit and loss account. No such costs were incurred in 2000. 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

4. Interest payable

	2000	**1999**	**1998**
	£m	**£m**	**£m**
On retail customer accounts	2,220	1,930	2,757
On sale and repurchase agreements	110	776	1,000
On other deposits and loans	5,879	3,621	3,727
On subordinated liabilities including convertible debt	321	241	200
	8,530	6,568	7,684

5. Dividend income

	2000	**1999**	**1998**
	£m	**£m**	**£m**
Income from equity shares	3	2	4

6. Dealing profits

	2000	**1999**	**1998**
	£m	**£m**	**£m**
Securities	34	20	2
Interest rate, equity and credit derivatives	82	78	30
	116	98	32

7. Other operating income

	2000	1999 (restated)	1998 (restated)
	£m	£m	£m
Deferred income release (see note 34)	95	77	70
Profits less losses on disposal of investment securities	33	33	17
Profit on disposal of equity shares (see (1) below)	28	60	—
Profit on disposal of fixed assets (see (2) below)	67	11	18
Income from operating leases	303	78	31
Profit on disposal of subsidiaries and associates	45	—	4
Income from associated undertakings	17	12	—
Other	69	83	52
	657	354	192

(1) The 1999 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.

(2) On 19 October 2000 Abbey National entered into a sale and leaseback transaction with Mapeley Columbus Ltd (Mapeley), a company owned by Fortress Investment Group, Soros Real Estate Partners and Delancey Estates Plc.

Under the terms of the transaction, substantially all of the Group's freehold and leasehold properties were purchased by Mapeley for a cash consideration of £457m and Mapeley committed to provide the Abbey National Group's property management for a twenty year term. The deal comprised an outright sale of freeholds, the disposal of a subsidiary owning freehold properties, and a combination of legal and equitable assignments of leasehold property interests. The resulting leases of the portfolio to Abbey National have been accounted for as operating leases under the applicable accounting standards.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

8. Administrative expenses

	2000	1999	1998
	£m	£m	£m
Staff costs[1]:			
Wages and salaries	700	621	516
Social security costs	55	49	42
Other pension costs	72	69	53
	827	739	611
Property and equipment expenses:			
Rents payable	75	72	61
Rates payable	23	27	25
Hire of equipment	4	5	6
Other property and equipment expenses	53	50	50
	155	154	142
Other administrative expenses[2]	699	603	487
	1,681	1,496	1,240

Notes:

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

	2000	1999	1998
	£m	£m	£m
Staff costs:			
Wages and salaries	44	39	37
Social security costs	4	3	3
Other pension costs	4	4	4
	52	46	44

(2) The aggregate remuneration for audit and other services payable to Deloitte & Touche is analysed below:

	2000	1999	1998
	£m	£m	£m
Audit services	3.4	3.2	3.2
Reporting accountants and other regulatory reporting	0.6	0.9	1.0
Sub-total: Audit and similar services	4.0	4.1	4.2
Tax services	—	0.1	0.6
Consultancy and advisory services	3.8	1.9	2.2
Sub-total: Other services	3.8	2.0	2.8
	7.8	6.1	7.0

Of the fees payable to the Group's auditors for audit services £3.2m (1999: £3.0m; 1998: £2.7m) 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. 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 2000				
General	131	23	39	193
Specific	76	97	163	336
Transfer from profit and loss account	34	34	205	273
Irrecoverable amounts written off	(38)	(36)	(201)	(275)
At 31 December 2000	203	118	206	527
Being for the Group:				
General	142	20	32	194
Specific	61	98	174	333
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
Total provisions as at:				
31 December 2000				
UK	189	72	201	462
Non-UK	14	46	5	65
31 December 1999				
UK	192	68	198	458
Non-UK	15	52	4	71
31 December 1998				
UK	198	68	203	469
Non-UK	17	73	2	92

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 2000				
UK	0.3	2.5	1.8	0.6
Non-UK	0.9	37.9	4.4	3.5
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

Analysis of movements on suspended interest

	£m	£m	£m	£m
At 1 January 2000	42	62	10	114
Amounts suspended in the period	16	4	12	32
Irrecoverable amounts written off	(22)	(12)	(12)	(46)
At 31 December 2000	36	54	10	100
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
The value of loans and advances at 31 December 2000 on which interest is suspended is as follows:				
Loans and advances to customers	362	283	212	857
Provisions on these amounts	(66)	(53)	(129)	(248)
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)

NOTES TO THE FINANCIAL STATEMENTS (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.

	2000	1999	1998
	£m	£m	£m
Loans and advances on which a proportion of interest has been suspended and/or on which specific provision has been made	915	938	1,184
Loans and advances 90 days overdue on which no interest has been suspended and on which no specific provision has been made	885	1,111	1,335
Non-accruing loans and advances	160	145	170
Total non-performing loans and advances	1,960	2,194	2,689
Non-performing loans and advances as a percentage of total loans and advances to customers	2.60%	2.90%	3.69%
Provisions as a percentage of total non-performing loans and advances	26.89%	24.11%	20.86%

10. Tax on profit on ordinary activities

	2000	1999	1998
	£m	£m	£m
UK Corporation tax:			
Current year at 30% (1999: 30.25%; 1998: 31%)	466	457	387
Prior years	(37)	(53)	113
Double tax relief	—	(1)	(58)
Deferred tax:			
Current year	78	73	90
Prior years	43	41	(123)
Share of associated undertakings taxation	6	3	—
Overseas taxation	3	2	53
	559	522	462

11. Dividends

	2000	1999	1998	2000	1999	1998
	Pence per share	Pence per share	Pence per share	£m	£m	£m
Ordinary shares (equity)						
Interim (paid)	15.15	13.40	11.75	216	190	167
Final (proposed)	30.35	26.85	23.55	433	382	334
	45.50	40.25	35.30	649	572	501
Preference shares (non-equity)				38	38	34
				687	610	535

NOTES TO THE FINANCIAL STATEMENTS (Continued)

12. Earnings per ordinary share

	2000	1999	1998
Profit attributable to the shareholders of Abbey National plc (£m)	1,365	1,261	1,058
Preference dividends (£m)	(38)	(38)	(34)
Profit attributable to the ordinary shareholders of Abbey National plc (£m)	1,327	1,223	1,024
Weighted average number of ordinary shares in issue during the year – basic (million)	1,420	1,418	1,414
Dilutive effect of share options outstanding (million)	9	12	13
Weighted average number of ordinary shares in issue during the year – diluted (million)	1,429	1,430	1,427
Basic earnings per ordinary share (pence)	93.4	86.2	72.4
Diluted earnings per ordinary share (pence)	92.8	85.5	71.7

13. Treasury bills and other eligible bills

	2000		1999	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£m
Treasury bills	53	53	12	12
Other eligible bills	1,106	1,106	1,102	1,102
	1,159	1,159	1,114	1,114

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.

14. Loans and advances to banks

	2000	1999
	£m	£m
Items in the course of collection	229	259
Purchase and resale agreements	9,896	6,397
Other loans and advances	2,043	4,816
	12,168	11,472
Repayable:		
On demand	5,594	4,942
In not more than 3 months	5,448	5,643
In more than 3 months but not more than 1 year	372	217
In more than 1 year but not more than 5 years	560	481
In more than 5 years	194	189
	12,168	11,472
Banking business	2,272	3,140
Trading business	9,896	8,332
	12,168	11,472

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

	2000	1999
	£m	£m
Fixed rate	10,472	6,907
Variable rate	1,467	4,306
Items in the course of collection (non-interest bearing)	229	259
	12,168	11,472

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.

15. Loans and advances to customers

	2000	1999
	£m	£m
Advances secured on residential properties	65,430	64,756
Purchase and resale agreements	6,875	77
Other secured advances	2,450	2,534
Unsecured advances	10,214	8,310
Collateralised and guaranteed mortgage loans	81	95
	85,050	75,772
Repayable:		
On demand or at short notice	7,133	3,644
In not more than 3 months	7,934	3,367
In more than 3 months but not more than 1 year	3,642	2,992
In more than 1 year but not more than 5 years	8,868	8,599
In more than 5 years	58,000	57,699
Less: provisions (see note 9)	(527)	(529)
	85,050	75,772
Banking business	78,175	75,686
Trading business	6,875	86
	85,050	75,772

Included in Group loans and advances to customers are loans to associated undertakings of nil (1999: £10m).

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

	2000	1999
	£m	£m
Fixed rate	28,682	22,508
Variable rate	56,895	53,793
Provisions	(527)	(529)
	85,050	75,772

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.

16. 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, or assigned to, 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. These special purpose securitisation companies comprise ILSE No.1 plc, Holmes Funding No.1 plc, Holmes Funding No.2 plc, Holmes Trustees Ltd, Holmes Financing (No.1) plc and Holmes Financing (No.2) plc. These companies are consolidated and included in the Group financial statements as quasi-subsidiaries.

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 Treasury Services plc has entered into a number of interest rate swaps with the securitisation companies with the exception of Holmes Financing (No.1) plc and Holmes Financing (No.2) plc. 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.

During the year Abbey National plc assigned a portfolio of residential mortgage loans with a book value of £6.4bn to Holmes Trustees Limited for the purpose of securitisation. Holmes Funding Limited acquired, at book value, a beneficial interest in the trust property vested in Holmes Trustees Limited. The beneficial interest in the trust property was acquired in two stages, the first for £2.3bn on 19 July 2000 and the second for £2.4bn on 29 November 2000. Holmes Funding Limited financed its acquisitions through borrowing from Holmes Financing (No.1) plc and Holmes Financing (No.2) plc. Both Holmes Financing (No.1) plc and Holmes Financing (No.2) plc funded their advances to Holmes Funding Limited principally through the issue of mortgage-backed floating rate notes. The remaining share of the beneficial interest in residential mortgage loans held by Holmes Trustees Limited belongs to Abbey National plc, and amounts to £1.7bn as at 31 December 2000.

The balances of assets securitised and non-returnable finance at 31 December 2000 were as follows:

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	87	70	7
Holmes Funding No. 1 plc	25 February 1999	619	458	13
Holmes Funding No. 2 plc	25 October 1999	862	653	11
Holmes Financing (No. 1) plc	19 July 2000	2,256*	1,669	—
Holmes Financing (No. 2) plc	29 November 2000	2,405*	1,779	—

* Represents the interest in the trust property at book value held by Holmes Funding Limited related to the debt issued by these companies.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

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 2000 for the above companies is set out below:

	2000 £m	1999 £m
Net interest income	2	8
Other operating income	(2)	1
Administrative expenses	(5)	(2)
Provisions	(4)	(7)
Loss for the financial period	(9)	—

17. Net investment in finance leases

	2000 £m	1999 £m
Amounts receivable	9,559	10,930
Less: deferred income	(4,355)	(5,477)
Less: provisions for impairment (see below)	(12)	(12)
	5,192	5,441
Repayable:		
In not more than 3 months	147	168
In more than 3 months but not more than 1 year	267	383
In more than 1 year but not more than 5 years	745	666
In more than 5 years	4,033	4,224
	5,192	5,441
Cost of assets acquired for the purpose of letting under finance leases in the year	313	427
Gross rentals receivable	483	494
Commitments as lessor for the purchase of equipment for use in finance leases	124	384
Amounts outstanding subject to a sub-participation	194	202

Provisions for impairment relate to small ticket leasing assets.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

18. Debt securities

	2000		1999	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£m
Investment securities				
Issued by public bodies:				
Government securities	4,404	4,592	3,722	3,858
Other public sector securities	1,905	1,927	2,272	2,267
	6,309	6,519	5,994	6,125
Issued by other issuers:				
Bank and building society certificates of deposit	282	291	399	400
Other debt securities	42,036	41,648	37,360	37,205
	42,318	41,939	37,759	37,605
Less: provisions	(109)	—	(72)	—
Sub-total – Non-trading book	48,518	48,458	43,681	43,730
Other securities				
Issued by public bodies:				
Government securities	2,602	2,602	1,618	1,618
Issued by other issuers:				
Bank and building society certificates of deposit	11,748	11,748	10,506	10,507
Other debt securities	6,104	6,104	3,640	3,640
	17,852	17,852	14,146	14,147
Sub-total -Trading book	20,454	20,454	15,764	15,765
Total	68,972	68,912	59,445	59,495

Investment securities held by the Group include £20m (1999: £20m) of subordinated investments in associates and are included within Other debt securities.

	2000		1999	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£m
Analysed by listing status:				
Investment securities				
Listed in the UK.	4,995	5,004	2,528	2,562
Listed or registered elsewhere	40,250	40,344	38,710	38,700
Unlisted	3,273	3,110	2,443	2,468
Sub-total – Non-trading book	48,518	48,458	43,681	43,730
Other securities				
Listed in the UK.	2,146	2,146	681	681
Listed or registered elsewhere	7,084	7,084	3,134	3,134
Unlisted	11,224	11,224	11,949	11,950
Sub-total – Trading book	20,454	20,454	15,764	15,765
Total	68,972	68,912	59,445	59,495

	2000	1999
	£m	£m
Book value analysed by maturity:		
Due within 1 year	16,190	12,985
Due in more than 1 year but not more than 5 years	21,388	18,355
Due in more than 5 years but not more than 10 years	12,337	9,545
Due in more than 10 years	19,166	18,632
Less: provisions	(109)	(72)
	68,972	59,445

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

	Cost	Provisions	Net book value
	£m	£m	£m
At 1 January 2000	43,753	(72)	43,681
Exchange adjustments	2,647	(5)	2,642
Additions	18,076	—	18,076
Disposals	(4,590)	—	(4,590)
Redemptions and maturities	(10,898)	—	(10,898)
Transfers to other securities (net)	(394)	—	(394)
Transfer from profit and loss account	—	(32)	(32)
Amortisation of discounts (premiums)	33	—	33
At 31 December 2000	48,627	(109)	48,518

The total net book value of debt securities held for investment purposes at 31 December 2000 includes unamortised discounts of £239m (1999: £134m).

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

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

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

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

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

An aggregated summary profit and loss account for the years ended 31 December 2000 and 1999 and an aggregated balance sheet as at 31 December 2000 and 1999 for these entities are shown below.

Profit and loss account for the year ended 31 December

	2000	1999
	£m	£m
Interest receivable	359	166
Interest payable	(334)	(156)
Net interest income	25	10
Profit on disposal of investment debt securities	4	—
Profit for the financial year	29	10
Amounts charged by the Group	(29)	(10)
Retained Profits	—	—

Balance sheet as at 31 December

	2000	1999
Investment debt securities	5,217	5,160
Prepayments and accrued income	52	192
Total assets	5,269	5,352
Debt securities in issue	5,261	5,347
Accruals and deferred income	8	5
Total liabilities	5,269	5,352

19. Equity shares and other similar interests

	2000		1999	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£m
Listed in the UK	21	30	19	23
Listed elsewhere	40	50	36	35
Unlisted	540	602	240	256
	601	682	295	314

Included within unlisted securities of the Group are equity shares held for purposes other than investment, having book and market values of £34m (1999: £47m). All other equity shares and similar interests are held in the non-trading book for investment purposes and are carried at cost less any provision for impairments.

Where available, equity shares and other similar interests 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 similar interests held for investment purposes was as follows:

	Cost	Provisions	Net book value
	£m	£m	£m
At 1 January 2000	248	—	248
Additions	357	—	357
Disposals	(50)	—	(50)
Acquisitions	8	—	8
Exchange adjustment	4	—	4
At 31 December 2000	567	—	567

20. Long term assurance business

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

	2000	1999
	£m	£m
Value of shareholders' interest in the long term assurance funds	1,538	1,042

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:

	2000	1999
	%	%
Risk adjusted discount rate (net of tax)	10.0	10.0
Return on equities (gross of tax — pension business)	8.5	8.5
Return on equities (gross of tax — life business)	9.0	9.0
Return on gilts (gross of tax)	6.5	6.5
Inflation	4.0	4.0

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

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

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

	2000	1999
	£m	£m
Value of shareholders' interest in the long term assurance funds at 31 December	1,538	1,042
Value of shareholders' interest in the long term assurance funds at 1 January	1,042	760
Increase in value of long term assurance business	496	282
Transfers into long term assurance funds	(340)	(240)
Net increase in value of long term assurance business	156	42
Surplus transferred from long term funds	12	95
Income after tax from long term assurance business	168	137
Income before tax from long term assurance business	240	196

Income before tax from long term assurance business includes £14m profit on disposal of fixed assets arising from the Group's sale and leaseback transaction. See note 7 for further information on this transaction.

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:

	2000 £m	1999 £m
Investments	12,046	9,972
Assets held to cover linked liabilities	5,956	6,092
Debtors and prepayments	699	1,084
Other assets	382	291
Assets of the long term assurance funds	19,083	17,439
Technical provisions	9,690	7,217
Technical provisions for linked liabilities	5,965	6,086
Fund for future appropriations	251	1,459
Other creditors	3,177	2,677
Liabilities of the long term assurance funds	19,083	17,439

21. Interests in associated undertakings

The movement in interests in associated undertakings for 2000 and 1999 was as follows:

	£m
At 1 January 2000	59
Additions	1
Disposals	(15)
Retained profits	12
At 31 December 2000	57

On 8 September 2000, DAH Holdings underwent a restructure and all of the convertible B shares were consolidated into ordinary A shares on a 1:1 basis. The Group's economic interest in DAH Holdings was unchanged as a result of this restructure, but the Group now has a 24.5% voting interest in DAH Holdings (previously 9.9%).

On 29 December 2000, Abbey National plc disposed of its interest in CGU Underwriting Ltd. The amount receivable for the issued share capital was £26m and was received in cash. The Group profit on disposal of £17m is included within Other operating income.

	£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.

The principal associated undertakings at 31 December 2000 are:

Name and nature of business	Issued share capital	Interest (%)
DAH Holdings Ltd, Private banking	1,000,000 US$1 ordinary A shares	24.5
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, whose principal area of operation is the Channel Islands, and all are registered in England & Wales, except for DAH Holdings which is registered in Bermuda.

All associated undertakings are unlisted and have a year end of 31 December. Income from associated undertakings is included within Other operating income.

22. Shares in Group undertakings

	2000 Cost and book value £m	1999 Cost and book value £m
Subsidiary undertakings		
Banks	1,320	1,191
Others	3,483	2,996
	4,803	4,187

The movement in shares in Group undertakings was as follows:

	£m
At 1 January 2000	4,187
Exchange adjustments	(1)
Additions	836
Disposals	(240)
Amounts written back	21
At 31 December 2000	4,803

Subscriptions for additional share capital in existing subsidiary undertakings during the year amounted to £836m, including £200m in Abbey National Treasury Services plc, £200m in Abbey National SMA Holdings Limited, £155m in Abbey National Property Jersey Limited and £120m in First National Finance Corporation plc.

The investment in the share capital of Abbey National Beta Investments Limited has been written back by £21m to its historical cost, following a review which identified that a provision for permanent diminution in value was no longer necessary.

Subsidiaries of Abbey National plc entered into the following transactions in 2000:

Date	Company purchased/ business acquired	Purchaser	Consideration
25 April	Porterbrook Limited	ANTS plc	£786m cash
20 July	Brooklyn vehicle contracts	First National Vehicle Holdings Ltd	£2m cash
1 August	Highway Vehicle Management Ltd	First National Vehicle Holdings Ltd	£171m cash
30 November	Bluecoats contract	First National Vehicle Holdings Ltd	£1m cash
30 November	Investec Bank legal claims funding business	First National Professional Solutions Ltd	£66m cash

All of the above transactions are included in the consolidated financial statements as acquisitions. Further disclosures relating to these transactions can be found in note 23, Summary of the effect of acquisitions and note 50, Consolidated cash flow statement.

Date	Company disposed of	Consideration
5 June	First Scottish Searching Services	£3m cash
31 July	Abbey National December 8 Leasing	£6m cash
19 October	Abbey National Property (Jersey) Ltd	£276m cash
16 November	Tinty Ltd	£6m cash
16 November	Abbey National Benefit Consultants Ltd	£23m cash

The principal subsidiaries of Abbey National plc at 31 December 2000 are shown below, all of which are directly held and unlisted except where indicated.

Name of business	Nature of business	Country of Incorporation or registration
Abbey National General Insurance Services Ltd	General insurance	England & Wales
Abbey National Leasing Companies* (24 companies)	Finance leasing	England & Wales
Abbey National Treasury Services plc	Treasury operations	England & Wales
Abbey National Unit Trust Managers*	Unit trust management	Scotland
Abbey National Treasury International Ltd*	Personal finance and treasury operations	Jersey
Cater Allen International Ltd*	Money market and stockbroking	England & Wales
First National Bank plc*	Personal finance and commercial lending	England & Wales
Scottish Mutual Investment Managers Ltd	Investment managers	Scotland
Carfax Insurance Ltd	Insurance	Guernsey
Abbey National Life plc	Insurance	England & Wales
Abbey National PEP and ISA Managers Ltd*	PEP and ISA management	Scotland
Scottish Mutual Assurance plc*	Insurance	Scotland
Scottish Mutual Pension Funds Investment Ltd	Investment	Scotland
Abbey National North America Corporation	Funding	United States

* Held indirectly through subsidiary companies.

All the above companies are included in the consolidated financial statements. All companies operate principally in their country of incorporation or registration. Abbey National Treasury Services plc also has branch offices in France and 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.

23. Summary of the effect of acquisitions

The following table summarises the effect of all subsidiary undertakings and purchases of businesses in the year ended 31 December 2000:

	Book value before acquisition	Accounting policy adjustments	Revaluation adjustments	Total fair value adjustments	Fair value at acquisition
	£m	£m	£m	£m	£m
Loans and advances to banks	275	—	—	—	275
Net investment in finance leases	2	—	—	—	2
Tangible fixed assets	1,063	—	424	424	1,487
Other assets	56	(1)	1	—	56
Total assets	1,396	(1)	425	424	1,820
Debt securities in issue	549	—	—	—	549
Deferred taxation	136	12	(1)	11	147
Deposits by banks	1	—	—	—	1
Other liabilities	165	(15)	1	(14)	151
Total liabilities excluding shareholders' funds	851	(3)	—	(3)	848
Net assets acquired	545	2	425	427	972
Total fair value of the consideration and cost of acquisitions					1,026
Goodwill on acquisition of subsidiary undertakings					54

The only significant undertakings included in the above table are Porterbrook Limited ('Porterbrook') and Highway Vehicle Management ('Highway'). Porterbrook's profit after tax for the period 1 May 1999 to 20 April 2000, and for the year ended 30 April 1999, calculated using Porterbrook's accounting policies, was £112m and £78m respectively. Highway's profit after tax for the period 1 April 2000 to 1 August 2000 and for the year ended 31 March 2000, calculated using Highway's accounting policies, was £nil and £nil respectively.

The only material fair value adjustment made to the book values on acquisition, as included above, are revaluation adjustments made to the operating lease assets of Porterbrook. The total fair value adjustment to such operating lease assets was £433m.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

24. Intangible fixed assets

	Purchased goodwill
	£m
Cost	
At 1 January 2000	215
Additions	54
At 31 December 2000	269
Amortisation	
At 1 January 2000	12
Charge for the year	12
At 31 December 2000	24
Net book value	
At 31 December 2000	245
At 31 December 1999	203

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 £1,201m (1999: £1,204m).

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

25. Tangible fixed assets excluding operating lease assets

	Investment properties	Other premises	Equipment	Total
	£m	£m	£m	£m
Cost or valuation				
At 1 January 2000	68	425	1,035	1,528
Additions	—	7	108	115
Disposals	(17)	(412)	(101)	(530)
Revaluation adjustment	11	—	—	11
At 31 December 2000	62	20	1,042	1,124
Depreciation				
At 1 January 2000	—	82	687	769
Charge for the year	—	5	117	122
Disposals	—	(83)	(73)	(156)
At 31 December 2000	—	4	731	735
Net book value				
At 31 December 2000	62	16	311	389
At 31 December 1999	68	343	348	759

Disposals of tangible fixed assets principally reflect the sale and leaseback transaction entered into on 19 October 2000, including premises sold through disposal of a subsidiary. Further details can be found in note 7.

As at 31 December 2000, 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.

	2000	1999
	£m	£m
The net book value of Other premises comprises:		
Freeholds	12	273
Long leaseholds	1	27
Short leaseholds	3	43
Land and buildings occupied for own activities:		
Net book value at 31 December	16	250
The net book value of equipment includes:		
Assets held under finance leases	19	11
Depreciation charge for the year on these assets	6	2
Capital expenditure which has been contracted, but not provided for in the financial statements	30	34

26. Operating lease assets

	Group
	£m
At 1 January 2000	431
Acquisitions of subsidiary undertakings	2,058
Additions	361
Disposals	(114)
At 31 December 2000	2,736
Depreciation	
At 1 January 2000	73
Acquisitions of subsidiary undertakings	571
Charge for the year	178
Disposals	(49)
At 31 December 2000	773
Net book value	
At 31 December 2000	1,963
At 31 December 1999	358

	2000	1999
	£m	£m
Capital expenditure which has been contracted, but not provided for in the financial statements	24	14

27. Other assets

	2000	1999
	£m	£m
Foreign exchange, interest rate, equity and credit contracts:		
Positive market values of trading derivative contracts (see note 49)	1,600	930
Translation differences on foreign exchange derivatives used for hedging purposes	605	565
Debtors and other settlement balances	1,505	1,905
Introducer fees	264	305
Own shares	29	19
Other	348	206
	4,351	3,930

Own shares represent Abbey National plc shares held in trust to be used to satisfy exercises under certain employee share option schemes.

The charge for the period in respect of introducer fees is £199m (1999: £174m).

28. Prepayments and accrued income

	2000	1999
	£m	£m
Unamortised lending-related fees (see note 2)	483	580
Other accrued interest	2,490	1,897
Prepayments and other accruals	213	237
	3,186	2,714

NOTES TO THE FINANCIAL STATEMENTS (Continued)

29. Assets subject to sale and repurchase transactions

	2000	1999 (restated)
	£m	£m
Treasury bills and other eligible bills	506	306
Debt securities	7,046	4,989
	7,552	5,295

The above amounts are the assets held under sale and repurchase transactions included within the amounts disclosed in note 13, Treasury bills and other eligible bills and note 18, Debt securities.

30. Deposits by banks

	2000	1999
	£m	£m
Items in the course of transmission	236	262
Sale and repurchase agreements	23,630	18,127
Other deposits	11,130	11,435
	34,996	29,824
Repayable:		
On demand	10,495	15,156
In not more than 3 months	20,441	11,709
In more than 3 months but not more than 1 year	3,221	2,327
In more than 1 year but not more than 5 years	192	117
In more than 5 years	647	515
	34,996	29,824
Banking business	12,086	7,598
Trading business	22,910	22,226
	34,996	29,824

31. Customer accounts

	2000	1999
	£m	£m
Retail deposits	51,340	49,914
Sale and repurchase agreements	7,287	97
Other customer accounts	8,168	9,900
	66,795	59,911
Repayable:		
On demand	46,966	40,305
In not more than 3 months	16,177	16,523
In more than 3 months but not more than 1 year	1,498	1,179
In more than 1 year but not more than 5 years	387	258
In more than 5 years	1,767	1,646
	66,795	59,911
Banking business	59,383	59,749
Trading business	7,412	162
	66,795	59,911

Included in Group customer accounts are amounts due to associated undertakings of £3m (£4m).

32. Debt securities in issue

	2000		1999	
	Book value	Market value	Book value	Market value
	£m	£m	£m	£m
Bonds and medium term notes	27,707	27,983	27,986	27,836
Other debt securities in issue	29,371	29,390	23,421	23,411
	57,078	57,373	51,407	51,247

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.

	2000	1999
	£m	£m
Bonds and medium term notes are repayable:		
In not more than 3 months	2,851	2,517
In more than 3 months but not more than 1 year	5,765	8,382
In more than 1 year but not more than 2 years	4,775	3,472
In more than 2 years but not more than 5 years	9,749	9,912
In more than 5 years	4,567	3,703
	27,707	27,986
Other debt securities in issue are repayable:		
In not more than 3 months	21,448	20,103
In more than 3 months but not more than 1 year	7,792	1,411
In more than 1 year but not more than 2 years	1	1,887
In more than 2 years but not more than 5 years	55	—
In more than 5 years	75	20
	29,371	23,421

33. Other liabilities

	2000	1999
	£m	£m
Creditors and accrued expenses	1,263	1,573
Short positions in government debt securities	2,300	1,521
Taxation	474	481
Foreign exchange, interest rate, equity and credit contracts:		
Negative market value of trading derivative contracts (see note 49)	2,842	2,439
Translation differences on foreign exchange derivatives used for hedging purposes	1,052	907
Obligations under finance leases all payable in:		
less than 1 year	7	4
1 year to 5 years	10	5
	7,948	6,930

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

34. Accruals and deferred income

	2000 £m	1999 £m
Other accrued interest	2,915	2,499
Deferred income from residential mortgage lending	240	277
Other deferred income	95	81
	3,250	2,857

See Accounting policies for a description of the accounting treatment of deferred income from residential mortgage lending. During the year, £95m (1999: £77m) of deferred income was taken to the profit and loss account.

35. Provisions for liabilities and charges

	2000 £m	1999 £m
Deferred taxation (see note 36)	1,351	1,173
Other provisions for liabilities and charges (see note 37)	92	102
	1,443	1,275

36. Deferred taxation

	£m
At 1 January 2000	1,173
Transfer from profit and loss account	121
Acquisitions of subsidiary undertakings	147
Disposals of subsidiary undertakings	(87)
Other movements	(3)
At 31 December 2000	1,351

The amounts provided and total potential liability are:

	Amount provided £m	Total potential liability £m
Tax effect of timing differences due to:		
Excess of capital allowances over depreciation	170	170
Capital allowances on finance lease receivables	1,078	1,078
Other	103	103
	1,351	1,351

37. Other provisions for liabilities and charges

	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 2000	(9)	28	35	48	102
Transfer from profit and loss account	70	16	10	5	101
Pension contributions/provisions utilised	(80)	(12)	(8)	(1)	(101)
Unutilised provisions reversed	—	—	—	(10)	(10)
At 31 December 2000	(19)	32	37	42	92

(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 £21m (1999: £23m) as at 31 December 2000, is being amortised over the remaining service lives of employees contributing to the scheme, and £2m (1999: £2m) was charged to the profit and loss account in the year ended 31 December 2000. See also note 51, 'Retirement Benefits'.

(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 businesses.

(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 the Life Assurance businesses 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 £2m (1999: £8m) was transferred from the profit and loss account in respect of the Life Assurance businesses and the amount currently provided is £11m (1999: £14m). 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.

38. Subordinated liabilities including convertible debt

	2000 £m	1999 £m
Dated subordinated liabilities:		
4.513% Registered junior subordinated floating rate extendible notes 2000 (US $275m)	—	170
Registered junior subordinated fixed rate notes 2000 (US $53m)	—	33
9.00% Subordinated guaranteed bond 2002 (LUX Fr 1bn)	15	15
Subordinated guaranteed floating rate notes 2002 (US $75m)	50	46
8.00% Subordinated guaranteed bond 2002 (NLG 200m)	57	57
10.375% Subordinated guaranteed bond 2002	100	100
Subordinated guaranteed floating rate notes 2003 (US $100m)	67	62
Subordinated collared floating rate notes 2004 (CAN $100m)	45	42
8.75% Subordinated guaranteed bond 2004	150	151
8.2% Subordinated bond 2004 (US $500m)	336	309
6.69% Subordinated bond 2005 (US $750m)	501	462
10.75% Subordinated bond 2006	101	101
Subordinated guaranteed floating rate step-up notes 2009 (Swiss Fr 130m)	53	50
5.00% Subordinated bond 2009 (DEM 1bn)	317	315
4.625% Subordinated notes 2011 (€500m)	310	309
11.50% Subordinated guaranteed bond 2017	150	152
10.125% Subordinated guaranteed bond 2023	149	152
7.983% Subordinated notes 2029 (US $1,000m)	663	611
6.50% Subordinated notes 2030	148	148
Undated subordinated liabilities:		
10.0625% Exchangeable subordinated capital securities	199	199
7.35% Perpetual subordinated Reset Capital Securities (US $500m)	334	308
7.25% Perpetual subordinated capital securities (US $150m)	98	90
7.10% Perpetual callable subordinated notes (US $150m)	99	91
7.00% Perpetual subordinated capital securities (US $250m)	163	150
6.70% Perpetual subordinated Reset Capital Securities (US $500m)	333	307
6.00% Step-down perpetual callable subordinated notes (€100m)	61	61
5.56% Subordinated guaranteed notes (YEN 15bn)	87	90
5.50% Subordinated guaranteed notes (YEN 5bn)	29	30
Fixed/Floating rate subordinated notes (YEN 5bn)	29	30
7.50% 10 Year step-up perpetual subordinated notes	319	—
7.50% 15 Year step-up perpetual subordinated notes	318	—
7.38% 20 Year step-up perpetual subordinated notes	173	—
7.13% 30 Year step-up perpetual subordinated notes	170	—
7.13% Fixed to floating rate perpetual subordinated notes (€400m)	247	—
	5,871	4,641

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

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

The 7.50% 10 Year step-up perpetual subordinated notes are redeemable at par, at the option of Abbey National, on 28 September 2010 and each fifth anniversary thereafter.

The 7.50% 15 Year step-up perpetual subordinated notes are redeemable at par, at the option of Abbey National, on 28 September 2015 and each fifth anniversary thereafter.

The 7.38% 20 Year step-up perpetual subordinated notes are redeemable at par, at the option of Abbey National, on 28 September 2020 and each fifth anniversary thereafter.

The 7.13% 30 Year step-up perpetual subordinated notes are redeemable at par, at the option of Abbey National, on 30 September 2030 and each fifth anniversary thereafter.

The 7.13% Fixed to floating rate perpetual subordinated notes are redeemable at par, at the option of Abbey National, on 28 September 2010 and each fifth anniversary thereafter.

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

Subordinated liabilities including convertible debt securities in issue are repayable:

	2000	1999
	£m	£m
In one year or less	—	203
In more than one year but not more than two years	222	—
In more than two years but not more than five years	1,099	832
In more than five years	1,891	2,250
Undated	2,659	1,356
	5,871	4,641

Subordinated liabilities including convertible debt issued by the Group have a market value, calculated using quoted market prices where available, of £6,491m (1999: £4,783m).

39. Minority Interests – non-equity

On 7 February 2000 Abbey National Capital Trust I (the 'trust') issued US $1,000m of 8.963% non-cumulative trust preferred securities (the 'preferred securities'). Each preferred security represents an undivided beneficial interest in the assets of the trust, the assets of which consist of partnership preferred securities representing non-cumulative, perpetual preferred limited partnership interests issued by Abbey National Capital LP I, a Delaware limited partnership (the 'partnership'). Abbey National plc has 100% indirect ownership of the general partnership interest and priority limited partnership interest.

Distributions on the preferred securities are made on 30 June and 31 December of each year, beginning on 30 June 2000. The distribution rate is initially 8.963% per annum. After 30 June 2030, the distribution rate on the preferred securities will be at the rate of 2.825% per annum above the three-month US $ LIBOR rate for the relevant distribution period.

The preferred securities are not redeemable at the option of the holders and the holders do not have any rights against other Abbey National Group companies. The partnership preferred securities may be redeemed by the partnership, in whole or in part, on 30 June 2030 and on each distribution payment date thereafter. Redemption by the partnership of the partnership preferred securities may also occur in the event of a tax or regulatory change. Generally, holders of the preferred securities will have no voting rights.

The preferred securities and the partnership preferred securities have the benefit of subordinated guarantees of Abbey National plc. On a return of capital or on a distribution of assets on a winding up of the partnership, holders of the partnership preferred securities will be entitled to receive, for each partnership preferred security a liquidation preference of US $1,000, together with any due and accrued distributions and any additional amounts, out of the assets of the partnership available for distribution.

The preferred securities, the partnership preferred securities and the subordinated guarantees taken together will not entitle the holders to receive more than they would have been entitled to receive had they been the holders of directly issued non-cumulative, non-voting preference shares of Abbey National plc.

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	Preference shares of €0.01 each	Total
	£m	£m	£m	£m	£m
Authorised share capital					
At 31 December 1999	175	1,000	6	—	1,181
At 31 December 2000	175	1,000	6	6	1,187
Issued and fully paid share capital					
At 31 December 1999	142	325	—	—	467
At 31 December 2000	143	325	—	—	468
Share premium account					
At 1 January 2000	1,411	9	116	—	1,536
Shares issued	59	—	—	—	59
Capitalisation of reserves in respect of shares issued via QUEST	15	—	—	—	15
At 31 December 2000	1,485	9	116	—	1,610
Issued and fully paid share capital					
At 1 January 1999	142	325	—	—	467
At 31 December 1999	142	325	—	—	467
Share premium account					
At 1 January 1999	1,368	9	116	—	1,493
Shares issued	18	—	—	—	18
Capitalisation of reserves in respect of shares issued via QUEST	25	—	—	—	25
At 31 December 1999	1,411	9	116	—	1,536

Under the Company's Executive, All Employee and Sharesave Schemes, employees hold options to subscribe for 31,478,172 (1999: 26,013,596) ordinary shares at prices ranging from 299 to 1306 pence per share, exercisable up to August 2010. During the year 4,245,329 (1999: 4,554,522) ordinary shares were issued on the exercise of options for a consideration of £34m (1999: £43m). In addition, 5,474,853 ordinary shares were issued in lieu of cash for the interim dividend in 2000, in accordance with the terms of the Alternative Dividend Plan.

The Group has taken advantage of the exemption from the provisions of UITF 17 (Revised 2000), 'Employee Share Schemes', as they relate to the Group's Sharesave Scheme which is an Inland Revenue approved SAYE scheme.

The Qualifying Employee Share Trust (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 option price.

During the year the QUEST has subscribed at market value for ordinary shares at a total cost of £27m (1999: £33m). The Company provided £15m (1999: £25m) to the QUEST for this purpose and £12m (1999: £8m) 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 428 pence per share (five year options) and 322 pence per share (seven year options). The Company's contribution has been included as a capitalisation of reserves.

As of 31 December 2000 there were 2,010,898 shareholders. The following tables show 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	1,227,241	118,750,633	1	100	7	700
101-1,000	748,434	300,720,294	23	17,345	28	12,440
1,001+	34,043	1,012,202,663	1,117	324,982,555	4	7,986,860
	2,009,718	1,431,673,590	1,141	325,000,000	39	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 2000	3,626
Profit retained for the financial year	522
Goodwill transferred to profit and loss account during the year	3
Capitalised on exercise of share options issued via QUEST	(15)
At 31 December 2000	4,136

Exchange gains arising from foreign currency borrowings used to hedge investments in overseas Group undertakings of £2m (1999: £16m) have been taken to the reserves of the Group. These exchange movements are matched by corresponding exchange movements on the net assets of overseas Group undertakings in the Group financial statements.

Goodwill transferred to profit and loss account during the year represents the goodwill previously taken to reserves in respect of the acquisition of GM Benefit Consultants Ltd (subsequently renamed Abbey National Benefit Consultants Ltd), which was disposed of in November 2000.

	Non-distributable reserve	Revaluation reserve
	£m	£m
At 1 January 2000	446	3
Transfer from profit and loss account	156	—
Revaluation movement in the year	—	11
At 31 December 2000	602	14

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

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

42. Reconciliation of movements in shareholders' funds

	2000	1999	1998
	£m	£m	£m
Profit attributable to the shareholders of Abbey National plc	1,365	1,261	1,058
Dividends (see note 11)	(687)	(610)	(535)
	678	651	523
Other recognised net gains and losses relating to the year	—	(1)	—
Increases in ordinary share capital including share premium	75	43	34
Capitalised reserves on exercise of share options	(15)	(25)	(17)
Movement on other reserves	11	3	—
Goodwill transferred from (taken to) profit and loss account reserve during the year	3	—	(11)
Net addition to shareholders' funds	752	671	529
Shareholders' funds at 1 January	6,078	5,407	4,878
Shareholders' funds at 31 December	6,830	6,078	5,407
Comprising			
Equity shareholders' funds	6,380	5,628	4,957
Non-equity shareholders' funds	450	450	450

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:

	2000	1999
	£m	£m
Assets	72,389	50,747
Liabilities	77,622	57,425

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. Contingent liabilities: guarantees and assets pledged as collateral security

	2000	1999
	£m	£m
Guarantees given to third parties	1,009	1,183
Mortgaged assets granted	1,125	1,031
	2,134	2,214

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 £374m (£432m). Credit derivatives include contracts such as credit default swaps, spread put options and credit linked notes, whereby credit risk is accepted in respect of reference assets.

45. Other contingent liabilities

	2000	1999
	£m	£m
Other contingent liabilities	299	477

The principal other contingent liabilities are as follows:

Rediscounted commercial bills

Cater Allen International Limited has sold eligible bills to the Bank of England under the 'Master Agreement', amounting to £132m (1999: £355m).

Overseas tax demands

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) (1999: £100m) relating to the repayment of certain tax credits received and related charges. As at 31 December 2000, additional interest in relation to the demand could amount to £18m (at the balance sheet exchange rate) (1999: £13m).

Abbey National UK Investments has received a demand from an overseas tax authority for an amount of £40m (at the balance sheet exchange rate) relating to a reassessment of the tax payable by the company.

The subsidiaries have received legal advice that they have strong grounds to challenge the validity of the demands and accordingly no specific provisions have been made.

46. 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 right 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).

	2000	1999
	£m	£m
Formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year	1,567	999
1 Year and over	4,415	2,591
Forward sale and repurchase agreements	2,064	2,644
Other commitments	1	1
	8,047	6,235

47. Operating leases

	2000 Property	2000 Equipment	1999 Property	1999 Equipment
	£m	£m	£m	£m
Further rental commitments under operating leases expiring:				
In not more than 1 year	11	1	1	2
In more than 1 year but not more than 5 years	29	3	17	3
In more than 5 years	67	—	50	—
	107	4	68	5

As at 31 December 2000 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:

	2000
	£m
Year ended 31 December:	
2001	111
2002	100
2003	87
2004	90
2005	71
Total thereafter	725

	2000	1999
	£m	£m
Group rental expense comprises:		
In respect of minimum rentals	81	64
Less: sub-lease rentals	(5)	(6)
	76	58

48. Financial instruments

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 'Risk management' on page 71.

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

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

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

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

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, equity derivatives and traded asset swaps. Abbey National Financial Products (ANFP), a part of Wholesale Banking, provides the Group and external counterparties with products to facilitate their financial business requirements, and also uses derivatives to take advantage of short-term price movements in relative market prices. During 2000, ANFP also commenced trading in credit derivatives.

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.

For a more detailed description of the Group's use of derivatives, see note 49. The accounting policy and financial disclosures for derivatives are given on pages F-11 and F-55 of the financial statements, respectively.

In addition, the Business to Consumer and Business to Business divisions enter 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, detailed within 'Risk management' on page 74.

Disclosures required under FRS 13 regarding financial instruments can be found as follows:

(1) In the Risk management section:

Financial risk management policies: see 'Financial risk management', page 71;

Trading financial instrument exposure sensitivity analysis: see 'Risk management — Market risk', page 74.

(2) In the financial statements:

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'.

In summary, fair value (i.e. market value) disclosures are required by FRS 13 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; and
- all other financial instruments for which there is a liquid and active market.

Such disclosures required by FRS 13 are provided in the note to the financial statements relevant to the financial instrument type. These may be found in: note 13, 'Treasury bills and other eligible bills'; note 18, 'Debt securities'; note 19, 'Equity shares and other similar interests'; note 32, 'Debt securities in issue'; note 38, 'Subordinated liabilities including convertible debt'; 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 FRS 13.

Interest rate risk

In accordance with FRS 13, interest rate repricing gap information is shown in the table (the 'gap table') below, as at 31 December 2000. 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, the gap table shows 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 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 no 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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

Interest Rate Repricing Gap as at 31 December 2000

	Non-Trading							
	Not more than 3 months	In more than 3 months but not more than 6 months	In more than 6 months but not more than 12 months	In more than 1 year but not more than 5 years	In more than 5 years	Non-interest bearing amounts	Trading	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Treasury and other eligible bills	—	—	—	—	—	—	1,159	1,159
Loans and advances to banks [1]	1,539	71	48	264	128	659	9,896	12,605
Loans and advances to customers [2]	57,172	1,721	1,915	13,450	3,735	60	6,997	85,050
Net investment in finance leases	4,009	643	219	234	87	—	—	5,192
Securities and investments	35,043	2,796	469	3,801	6,410	566	20,488	69,573
Other assets	—	—	—	—	—	9,531	2,198	11,729
Assets of long term assurance funds	—	—	—	—	—	19,083	—	19,083
Total assets	97,763	5,231	2,651	17,749	10,360	29,899	40,738	204,391
Liabilities								
Deposits by banks [1]	4,490	897	1,347	29	131	578	27,524	34,996
Customer accounts	51,884	1,974	2,072	3,094	159	199	7,413	66,795
Debt securities in issue	33,302	5,699	4,715	11,620	1,716	—	26	57,078
Subordinated liabilities	95	121	—	1,158	4,497	—	—	5,871
Other liabilities	—	—	—	—	—	7,299	5,775	13,074
Liabilities of long term assurance funds	—	—	—	—	—	19,083	—	19,083
Minority interests – non-equity	—	—	—	—	—	664	—	664
Shareholders' funds – non-equity	—	—	—	—	—	450	—	450
– equity	—	—	—	—	—	6,380	—	6,380
Total liabilities	89,771	8,691	8,134	15,901	6,503	34,653	40,738	204,391
Off-balance sheet items [3]	(10,362)	3,174	4,574	4,222	(1,429)	(179)	—	—
Interest rate repricing gap	(2,370)	(286)	(909)	6,070	2,428	(4,933)	—	—
2000 Cumulative gap	(2,370)	(2,656)	(3,565)	2,505	4,933	—		
1999 Cumulative gap	(5,659)	(5,851)	(5,369)	710	4,825	—		

(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', in the 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 predominantly affected by movements in the exchange rates between the Euro and Sterling. Such 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 page 74 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 currency of the local operation.

The Group's structural currency exposures as at 31 December 2000 were as follows:

Structural currency exposures as at 31 December 2000

	Net investments in overseas operations 2000	Borrowings hedging net investments in overseas operations 2000	Net structural currency exposures 2000	Net structural currency exposures 1999
	£m	£m	£m	£m
Euro – Subsidiary	66	(65)	1	1
– Branches	(25)	—	(25)	(21)
Other non-sterling amounts	2	(1)	1	1
Total	43	(66)	(23)	(19)

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.

Transactional currency exposures — Non-Trading book

At 31 December 2000 – Functional currency of Group operation	Net foreign currency monetary assets/(liabilities) Sterling £m	US Dollar £m	Euro £m	Other £m	Total £m
Sterling	n/a	17	7	(11)	13
Euro	24	—	n/a	—	24
Total	24	17	7	(11)	37

Transactional currency exposures — Non-Trading book

At 31 December 1999 – Functional currency of Group operation	Net foreign currency monetary assets/(liabilities) Sterling £m	US Dollar £m	Euro £m	Other £m	Total £m
Sterling	n/a	3	8	(2)	9
Euro	4	—	n/a	—	4
Total	4	3	8	(2)	13

The Wholesale Banking and Business to Consumer 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 2000 was £49m, 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 Retail Banking, Business to Business and Business to Consumer segments and medium term note issues, capital issues and fixed rate asset purchases within Wholesale Banking.

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

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.

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 and foreign exchange swaps. Foreign currency funding.
Profits earned in foreign currencies.	Sensitivity to strengthening of sterling against other currencies.	Forward foreign exchange contracts. Purchased foreign exchange 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.	Purchase 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.

Trading derivatives

Abbey National Financial Products (ANFP) is the principal business within the Abbey National Group actively trading derivative products and is additionally responsible for implementing Group hedging activities involving derivative contracts with the external market. ANFP's objective is to gain margin value by marketing derivatives to end-users and hedging the resulting exposures efficiently. Products offered by ANFP include interest rate and cross-currency swaps, caps, floors, swaptions, equity derivatives and credit derivatives. 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 value at risk (VAR) limit structure has been established for ANFP which includes exposures to interest rates, yield curve shape, volatility, volatility surfaces, equity indices and credit risk 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.

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, positive and negative market values and related book 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 fair values represent 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.

2000 – Non-trading derivatives:	**Contract or underlying principal**	**Positive fair values**	**Related book value**	**Negative market values**	**Related book value**
	£m	**£m**	**£m**	**£m**	**£m**
Exchange rate contracts:					
Cross-currency swaps	18,574	740	425	873	792
Forward foreign exchange	2,885	19	21	146	146
Foreign exchange options	29	3	1	—	—
	21,488	762	447	1,019	938
Interest rate contracts:					
Interest rate swaps	99,343	2,823	1,670	1,755	740
Caps, floors and swaptions	9,043	97	177	8	(1)
Futures (exchange traded)	2,030	—	—	—	—
Forward rate agreements	1,685	—	—	—	—
	112,101	2,920	1,847	1,763	739
Equity and commodity contracts:					
Equity index options	939	1	—	6	—
Equity and commodity index swaps	474	31	(17)	42	7
	1,413	32	(17)	48	7
Total	135,002	3,714	2,277	2,830	1,684

1999 – Non-trading derivatives:	Contract or underlying principal	Positive fair values	Related book value	Negative market values	Related book value
	£m	£m	£m	£m	£m
Exchange rate contracts:					
Cross-currency swaps	14,090	468	506	964	890
Forward foreign exchange	6,954	19	54	15	5
Foreign exchange options	29	2	1	—	—
	21,073	489	561	979	895
Interest rate contracts:					
Interest rate swaps	85,595	1,967	923	1,452	482
Caps, floors and swaptions	9,069	283	193	33	5
Futures (exchange traded)	1,029	—	—	—	—
Forward rate agreements	1,648	1	—	—	—
	97,341	2,251	1,116	1,485	487
Equity and commodity contracts:					
Equity index options	448	24	32	—	—
Equity and commodity index swaps	394	7	(18)	16	(4)
	842	31	14	16	(4)
Total	119,256	2,771	1,691	2,480	1,378

Included in the above analysis of non-trading derivatives are exchange rate contracts, interest rate contracts and equity and commodity contracts with underlying principal amounts of £2,618m (1999: £2,098m), £61,205m (1999: £54,025m) and £126m (1999: £152m) respectively, which were undertaken by Group entities with ANFP. The total net positive fair value of such contracts amounted to £433m (1999: £209m).

	Contract or underlying principal 2000	Positive fair values 2000	Negative fair values 2000	Contract or underlying principal 1999	Positive fair values 1999	Negative fair values 1999
	£m	£m	£m	£m	£m	£m
Trading derivatives:						
Exchange rate contracts:						
Cross-currency swaps	8,677	230	211	4,851	110	135
Forward foreign exchange	10,785	194	143	3,310	1	12
	19,462	424	354	8,161	111	147
Interest rate contracts:						
Interest rate swaps	191,549	2,848	2,927	145,389	1,969	2,145
Caps, floors and swaptions	41,356	260	401	31,355	361	270
Futures (exchange traded)	8,836	—	—	13,644	—	—
Forward rate agreements	2,409	2	2	4,828	4	3
	244,150	3,110	3,330	195,216	2,334	2,418
Equity and credit contracts:						
Equity index options	7,274	429	1,084	6,171	267	1,447
Equity index options (exchange traded)	3,407	2	11	45	—	—
Credit derivatives	1,710	7	2	—	—	—
	12,391	438	1,097	6,216	267	1,447
Total	276,003	3,972	4,781	209,593	2,712	4,012
Effect of netting		(2,372)	(2,372)		(1,782)	(1,782)
Fair values of contracts between ANFP and other Group entities		—	433		—	209
Amount included in Other assets/ Other liabilities		1,600	2,842		930	2,439

Included in the negative fair value of equity index options are amounts due under guaranteed retail products, the cash for which was received at inception.

Associated contracts which ANFP has transacted with external counterparties are included in the analysis of trading derivatives. Net negative fair values of £433m (1999: £209m) on all contracts held by ANFP with other Group entities are included within Other liabilities, as shown in the above table:

Positive fair values arise where gross positive fair values exceed gross negative fair values on a contract by contract basis. This equates to net replacement cost. Negative fair values arise where gross negative fair values exceed gross positive fair values on a contract by contract basis. The totals of positive and negative fair values arising on trading derivatives as at 31 December 2000 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 FINANCIAL STATEMENTS (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 2000	Net replacement cost 2000	Contract or underlying principal amounts 1999	Net replacement cost 1999
	£m	£m	£m	£m
Derivatives maturing:				
In not more than 1 year	37,546	1,143	31,789	551
In more than 1 year but not more than 5 years	67,454	1,395	62,798	1,401
In more than 5 years	27,972	1,176	23,640	819
	132,972	3,714	118,227	2,771

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

	Contract or underlying principal amounts 2000	Net replacement cost 2000	Contract or underlying principal amounts 1999	Net replacement cost 1999
	£m	£m	£m	£m
Trading derivatives maturing (before netting):				
In not more than 1 year	56,718	835	39,365	233
In more than 1 year but not more than 5 years	126,301	1,610	100,983	1,367
In more than 5 years	80,741	1,525	55,556	1,112
	263,760	3,970	195,904	2,712

Unrecognised gains and losses on financial assets and financial liabilities 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
At 31 December 2000			
In 1 year or less	664	(533)	131
After 1 year	1,222	(1,062)	160
	1,886	(1,595)	291
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)

The net loss unrecognised at 31 December 1999 and recognised during the year was £43m (1999: net gain £203m).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

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

Deferred balances relating to settled derivatives and other financial transactions previously 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 transactions. The movement in the period is as follows:

	Gains	Losses	Total net gains (losses)
	£m	£m	£m
At 1 January 2000	64	(29)	35
Previous years deferred gains and losses recognised in the year	(17)	11	(6)
Gains and losses deferred in the year	34	(1)	33
At 31 December 2000	81	(19)	62
Gains and losses expected to be recognised:			
In 1 year or less	16	(8)	8
After 1 year	65	(11)	54

In addition, unamortised deferred cap and option premium expense amounted to £179m as at 31 December (1999: £227m). Of this balance, £25m will be released to the profit and loss account within one year (1999: £60m), and £154m will be released to the profit and loss account after one year (1999: £167m).

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.

	2000			1999		
	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)	38,287	12,093	50,380	32,449	11,824	44,273
At 1 January (contracts with ANFP)	47,308	1,997	49,305	44,232	1,427	45,659
New contracts	23,377	8,069	31,446	21,264	6,535	27,799
Acquisitions with a subsidiary	660	—	660	—	—	—
Matured and amortised contracts	(17,018)	(3,407)	(20,425)	(14,593)	(6,115)	(20,708)
Terminated contracts	(1,462)	(215)	(1,677)	(297)	(20)	(317)
Effect of foreign exchange rate and other movements	1,969	(78)	1,891	(536)	(131)	(667)
Net increase in contracts with ANFP	6,222	115	6,337	3,076	570	3,646
At 31 December	99,343	18,574	117,917	85,595	14,090	99,685

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 2000 were as follows:

	Pay fixed		Receive fixed		Pay variable		Receive variable	
	Nominal amount (£m)	Rate (%)	Nominal amount (£m)	Rate (%)	Nominal amount (£m)	Rate (%)	Nominal amount (£m)	Rate (%)
Contracts maturing[1]:								
Less than 1 year	5,930	5.19	22,794	6.59	25,906	4.13	9,054	5.83
1 to 3 years	12,916	6.14	16,626	6.41	28,329	4.49	24,591	5.87
3 to 5 years	6,699	5.67	8,330	5.93	12,820	3.32	10,856	6.41
Over 5 years	9,302	5.22	9,102	6.11	16,329	4.63	16,564	6.22
Total	34,847		56,852		83,384		61,065	

(1) For the purpose of this analysis, the maturity date has been taken to be the date when the contract expires.

The total pay fixed nominal amount comprises £34,345 million in respect of interest rate swaps and £502 million in respect of cross-currency swaps. The total receive fixed nominal amount comprises £52,231 million in respect of interest rate swaps and £4,621 million in respect of cross-currency swaps. The total pay variable nominal amount comprises £64,934 million in respect of interest rate swaps and £18,450 million in respect of cross-currency swaps. The total receive variable nominal amount comprises £47,112 million in respect of interest rate swaps and £13,953 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.

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 2000 are set forth by currency in the table below. Of these contracts £7,811 million mature within one year and £9,274 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	402	1,101	5,767	271	984
US dollars	2,052	584	3,133	1,361	213
European currency units	16	—	162	398	167
Swiss francs	127	—	—	—	—
Canadian dollars	27	—	—	—	—
Deutschemarks	—	—	5	—	6
French francs	—	—	5	—	14
Spanish pesetas	—	—	—	—	3
Italian lire	—	—	—	—	26
Portugese escudo	26	—	—	—	—
Japanese yen	235	—	—	—	—
Total	2,885	1,685	9,072	2,030	1,413

(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 2000 was a £3 million increase in interest payable. There was no material impact on interest receivable. However, these figures should not be analysed 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 £71 million as at 31 December 2000. 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 analysed 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 2000, ANFP contributed £82 million (1999: £78 million) to the dealing profits of the Group.

For a discussion of risk management of derivatives within the trading and non-trading portfolios see “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

	2000	1999	1998
	£m	£m	£m
Profit on ordinary activities before tax	1,975	1,783	1,520
Increase (decrease) in interest receivable and prepaid expenses	(647)	342	(1,157)
Increase (decrease) in interest payable and accrued expenses	918	(155)	245
Provisions for bad and doubtful debts	273	303	201
Provisions for contingent liabilities and commitments	21	23	16
Net advances written off	(308)	(317)	(176)
Increase in the value of long term assurance business	(240)	(196)	(155)
Depreciation and amortisation	312	171	126
Income from associated undertakings	(17)	(12)	—
Profit on sale of subsidiary and associated undertakings	(45)	—	—
Profit on sale of tangible fixed assets and investments	(104)	(108)	(30)
Effect of other deferrals and accruals of cash flows from operating activities	(43)	98	16
Net cash inflow from trading activities	2,095	1,932	606
Net increase in loans and advances	(6,656)	(5,504)	(1,811)
Net decrease (increase) in investment in finance leases	164	(100)	20
Net increase (decrease) in bills and securities	(4,307)	3,314	(2,678)
Net increase in deposits and customer accounts	12,197	445	5,616
Net increase in debt securities in issue	4,612	8,404	3,005
Net increase in other liabilities less assets	472	2,243	487
Exchange movements	(2,484)	(207)	(557)
Net cash inflow from operating activities	6,093	10,527	4,688

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

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 and balances with central banks	Loans and advances to other banks repayable on demand	Total
	£m	£m	£m
At 1 January 2000	701	2,483	3,184
Net cash (outflow) inflow	(264)	3,056	2,792
At 31 December 2000	437	5,539	5,976
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

The Group is required to maintain balances with the Bank of England which at 31 December 2000 amounted to £111m (1999: £98m, 1998: £101m). These are shown in Loans and advances to banks, and are not included in cash for the purposes of the cash flow statement.

c) Analysis of changes in financing during the year

	Share capital inc. share premium	Non-equity minority interests	Subordinated liabilities	Total
	£m	£m	£m	£m
At 1 January 2000	2,003	—	4,642	6,645
Net cash inflow from financing	11	620	990	1,621
Shares issued for a non-cash consideration	49	—	—	49
Effect of foreign exchange rate changes	—	44	239	283
Capitalised on exercise of share options	15	—	—	15
At 31 December 2000	2,078	664	5,871	8,613
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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

d) Acquisitions of subsidiary undertakings and purchase of businesses

	2000 £m	1999 £m	1998 £m
Net assets acquired:			
Loans and advances to banks	275	—	4
Loans and advances to customers	—	—	3,386
Net investment in finance leases	2	—	691
Tangible fixed assets	1,487	36	153
Other assets	56	30	255
Deposits by banks	(1)	—	(3,992)
Debt securities in issue	(549)	—	—
Other liabilities	(298)	—	(265)
Goodwill on acquisitions	54	—	202
	1,026	66	434
Satisfied by:			
Unsecured interest bearing loan notes	—	—	5
Cash	1,026	30	364
Deferred consideration	—	—	4
Loan prepayment	—	36	61
	1,026	66	434

e) Analysis of the net outflow of cash in respect of acquisitions of subsidiary undertakings and purchase of businesses

	2000 £m	1999 £m	1998 £m
Cash consideration	1,026	30	364
Cash acquired	—	—	(7)
Net outflow of cash in respect of acquisitions of subsidiary and associated undertakings/ purchase of business	1,026	30	357

f) Sale of subsidiary and associated undertakings

	2000 £m	1999 £m	1998 £m
Net assets disposed of:			
Tangible fixed assets	—	—	5
Loans and advances	—	—	327
Other assets	16	—	8
Cash at bank and in hand	5	—	4
Deposits by banks and customer accounts	—	—	(214)
Other liabilities	(3)	—	(5)
Provisions for liabilities and charges	—	—	(1)
Goodwill written back	3	—	19
	21	—	143
Profit on disposal	42	—	4
Consideration received	63	—	147
Satisfied by:			
Cash	63	—	147

g) Analysis of the net inflow of cash in respect of the sale of subsidiary undertakings

	2000 £m	1999 £m	1998 £m
Cash received as consideration	63	—	147
Cash disposed of	(5)	—	(4)
Net inflow of cash in respect of sale of subsidiary undertakings	58	—	143

51. Retirement benefits

The Abbey National Amalgamated Pension Fund, Abbey National Group Pension Scheme and National & Provincial Building Society Pension Fund are the principal pension schemes within the Group, covering 77% (1999: 80%) 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 2000 for the National & Provincial Building Society Pension Fund.

The main long term financial assumptions, as stated in absolute terms, used in the 2000 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 financial statements. As at 31 March 2000, the combined market value of the schemes' assets was £2,094m, and the combined funding level 105%. All of the pension funds are valued using the projected unit method with pension assets valued at their full market value on the valuation date.

As shown in the table below, the pension cost reflects the regular contribution rate less amounts in respect of the surplus or deficit 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'. Surpluses or deficits are amortised on the basis of straight line amortisation with interest on the reducing balance. The pension cost charged to the profit and loss account for the year was as follows:

	2000 £m	1999 £m
Regular cost	79	73
Amortisation of surpluses arising on the Abbey National Amalgamated Pension Fund and the National & Provincial Pension Fund	(12)	(9)
Amortisation of deficit arising on the Abbey National Group Pension Scheme	1	1
Amortisation of surplus arising from fair value adjustment on acquisition of N&P	2	2
Charged to profit and loss account (note 37)	70	67

An asset of £21m (1999: £10m) in respect of the surplus and a liability of £2m (1999: £1m) in respect of the deficit have been included in the balance sheet accordingly. In addition, included in Other assets as at 31 December 2000 was an amount of £21m (1999: £23m) in respect of the unamortised pension scheme surplus assessed at the date the business of National & Provincial 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 FRS 7. This balance is being amortised over the average remaining service lives of employees in the scheme as shown above.

52. Directors' emoluments and interests

Further details of directors' emoluments and interests are included in the Directors, Senior Management and Employees section on pages 93 to 104. These details include, as specified for audit by the UK Listing Authority, an analysis, by director, of salary and other payments and benefits on page 99, an analysis of directors' share interests and share options on pages 101 and 102 and details of the directors' conditional rights over the Company's shares under the Long Term Incentive Plan on page 103, all of which form part of these audited financial statements.

Ex gratia pensions paid to former directors of Abbey National plc in 2000, which have been provided for previously, amounted to £139,220 (1999: £157,900). The Board no longer awards any new such ex gratia pensions and accordingly, no charge (1999: 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	1,540
Quasi loans	6	18
Credit transactions	—	—

	Number of persons	Aggregate amount outstanding
		£000
Officers		
Loans	25	2,379
Quasi loans	13	26
Credit transactions	24	419

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
2000		
Secured loans, unsecured loans and overdrafts		
Net movements in the year	12	307
Balances outstanding as at 31 December	11	1,583
Deposit, investment, bank and instant access accounts		
Net movements in the year	16	(180)
Balances outstanding as at 31 December	15	3,464
Life assurance policies and investments		
Net movements in the year	3	280
Total sum insured/value of investment	3	451
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

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

Two directors have also undertaken share dealing transactions through a subsidiary company of an aggregate net value of £56,359. 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 had a joint venture agreement with Commercial General Union plc. Abbey National plc acted as agent for CGU Underwriting Ltd (CGUUL), under which it passed insurance premiums to CGUUL and earned an agent's margin. The agency margin amounted to £130m (£132m) for the period ended 29 December 2000. On 29 December 2000 Abbey National sold its interests in CGUUL for £26m.

Abbey National Independent Consulting Group Ltd holds a 49% share in Willis National Holdings Ltd (Willis National), a company offering independent financial advice. Willis National earns a commission on insurance premiums, for which it pays introductory fees. The net income from such fees amounted to nil (nil) for the year ended 31 December 2000.

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 2000, nil (nil) was paid to Safeway plc.

First National Bank plc holds a 50% share in PSA Finance plc (PSA), a subsidiary of Peugeot SA. PSA 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 £16m (£11m) in the year.

Abbey National Jersey International Limited holds 24.5% of the 'A' 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 (£1m) in the year.

Balances outstanding between the Group and associated companies as at 31 December 1999 are detailed in notes 15 and 31. Further details of the Group's interests in associated undertakings are shown in note 21.

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 2000, Group entities owed £202m (£232m) to, and were owed £327m (£31m) by, the long term assurance funds. Of these respective amounts £198m (£230m) relates to amounts deposited by the long term assurance funds with Abbey National plc or Abbey National Treasury Services plc (ANTS), and £271m (£4m) relates to amounts owed by the long term assurance funds to Abbey National plc or ANTS. 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 £1,121m (£897m) of investment assets to a subsidiary of ANTS under stock lending agreements as at 31 December 2000.

Included in Fees and commissions receivable in the year is an amount of £48m (£32m) 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 £98m (£96m) on behalf of the long term assurance funds. All such costs were recharged to the long term assurance funds and included within the charge to Income from long term assurance business.

Details of transfers of funds between shareholders' funds and long term assurance funds are provided in note 20. 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 £1m (£6m).

The value of the funds' holdings in internally managed unit trusts amounted to £4,281m (£4,431m) at 31 December 2000. The unit trusts are managed by Abbey National Unit Trust Management Ltd, Scottish Mutual International Fund Managers Ltd, Scottish Mutual International Managers Ltd and Abbey National Asset Managers Ltd.

54. Proposed acquisition of Scottish Provident

Abbey National has entered into an agreement with Scottish Provident under which the business of Scottish Provident will be transferred to the Abbey National Group. In connection with the transaction, Abbey National will provide £1.8 billion, subject to final calculations, so that members of Scottish Provident will receive £1.6 billion as compensation for loss of membership rights and a further £0.2 billion will be paid into the with profit fund.

The transfer is subject to, amongst other things, approval by Scottish Provident members, approval by certain regulatory authorities and the sanction of the Court. It is anticipated that completion of the acquisition will take place in summer 2001.

55. Differences between UK GAAP and US GAAP

The significant differences applicable to Abbey National's financial statements 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 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 Position (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.

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.

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.

SFAS 140 replaces SFAS 125, however, it is effective for transactions undertaken after March 31, 2001.

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, 'Derivatives'). In the Group accounts, the hedging contracts are accounted for on an accruals basis as non-trading instruments.

US GAAP Such non-trading contracts designated after 1 January 1999 will only qualify at Group level for hedge accounting treatment where risks are transferred to the external markets on a matched offsetting contract basis. It is commercially viable for ANFP to hedge risks on a portfolio basis, not a matched contract basis. For this reason, such contracts are restated at market value for the purposes of the US/UK GAAP reconciliation.

Dividend payable

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

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

Sale and repurchase agreements ("repos") and purchase and resale agreements ("reverse repos")

UK GAAP Repos are included within Deposits by banks and Customer accounts. Reverse repos are included within Loans and advances to banks and Loans and advances to customers.

US GAAP SFAS 140 is effective for periods ending after 15 December 2000 in respect of repos and reverse repos where the terms of the agreement give the transferee the right to sell or repledge the collateral.

Under repo agreements, where the transferee has the right to sell or repledge the collateral, Abbey National reports the securities separately in its financial statements from other securities not so encumbered. For reverse repos, where Abbey National has the right to sell or repledge the collateral, the fair value of the collateral is disclosed. Where Abbey National sells collateral pledged to it for cash, the proceeds from the sale and Abbey National's obligation to return the collateral are recognised.

56. Future developments

UK GAAP In 2000 the Accounting Standards Board issued FRS 17, 'Retirement Benefits', on the treatment of pensions and other retirement benefits in an entity's accounts, FRS 18, 'Accounting Policies', and FRS 19, 'Deferred Tax'.

The main requirements of FRS 17 are:

- pension scheme assets measured using market values;
- pension scheme liabilities measured using a projected unit method and discounted at an AA corporate bond rate;
- the pension scheme surplus (to the extent it can be recovered) or deficit recognised in full on the balance sheet;
- the movement in the scheme surplus/deficit analysed into the current service cost and any past service costs (recognised in operating profit), the interest cost and expected return on assets (recognised as other finance costs) and actuarial gains and losses (recognised in the statement of total recognised gains and losses).

Implementation of FRS 17 is phased as follows:

- for accounting periods ending on or after 22 June 2001, closing balance sheet information (no comparatives required) to be given in the notes only;

- for accounting periods ending on or after 22 June 2002, opening and closing balance sheet information and performance statement information for the period (no comparatives required) to be given in the notes only;
- for accounting periods ending on or after 22 June 2003, FRS 17 is fully effective.

Abbey National is currently reviewing FRS 17 to determine its impact on the Group's results for U.K. reporting purposes.

FRS 18, effective for accounting periods ending on or after 22 June 2001, deals primarily with the selection, application and disclosure of accounting policies.

FRS 19 requires deferred tax to be provided for on a 'full provision' basis — rather than the 'partial provision' basis previously required by SSAP 15 ('Accounting for deferred tax') — on most types of timing difference. It is effective for years ending on or after 23 January 2002. FRS 19 is not expected to have a material adverse effect on the Group's results for U.K. reporting purposes.

Abbey National is currently reviewing these standards to determine their 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", and SFAS 137 and SFAS 138, which make various amendments to SFAS 133, apply to all periods beginning after 15 June, 2000 (1 January 2001 for the Group). As described in the Form 20-F for the year ended 31 December 1999, SFAS 133 requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair values of derivatives in each period are recorded in current earnings or other comprehensive income depending on whether a derivative contract is designated as part of a hedge transaction or not, and, if it is so designated, depending on the type of hedge transaction.

Derivatives designated as used for non-trading purposes in the Group's UK financial statements are designated as hedging transactions in accordance with UK GAAP, and are accounted for in the UK financial statements on a consistent basis with the asset, liability or position being hedged. A significant number of such transactions are undertaken with the Group's in-house trading operation ANFP. ANFP matches internal hedging transactions with external transactions on an aggregate portfolio basis rather than on an individually matched basis, in order to manage risk in the most cost-effective and operationally practicable manner.

While such internal transactions with ANFP meet UK hedge accounting requirements, they do not satisfy the more restrictive requirements of US GAAP. The Group has chosen not to change its risk management practices to comply with the specific requirements of US GAAP. In accordance with previous requirements which were first effective for transactions entered into after 1 January 1999, all such transactions entered into after that date were not treated as hedges for the purposes of US GAAP. From 1 January, 2001 on implementation of SFAS 133, no such transactions will be treated as hedges for the purposes of US GAAP.

From 1 January, 2001, therefore, a significant proportion of the Group's non-trading derivatives will not be designated as hedging transactions as defined by SFAS 133. The volatility in US GAAP earnings, that resulted from implementation of the previous requirements, will increase under SFAS 133.

Abbey National has adopted SFAS 133 in its US/UK GAAP reconciliation from 1 January, 2001, and all hedges were designated anew for US reporting purposes on this date. The transitional adjustment as at that date was an increase in consolidated net income of £7m, and a decrease in other comprehensive income of £151m.

SFAS 140, "Accounting for Transfers of Financial Assets and Extinguishments of Liabilities", replaces SFAS 125 and is effective for securitisations and other transfers of financial assets and collateral undertaken post March 31, 2001, except for certain additional disclosures which are effective for fiscal periods ending on or after December 15, 2000. SFAS 125 continues to apply to similar transactions undertaken prior to that date.

Disclosures required under SFAS 140 can be found on note 58 (h), Securitisations, and note 58(m), Collateralised loans and secured borrowings, to the Consolidated Financial Statements included elsewhere in this Annual Report.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

57. US GAAP Reconciliation

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.

	2000	1999	1998
	£m	£m	£m
Income statement			
Profit on ordinary activities after tax	1,416	1,261	1,058
Preference dividends	(38)	(38)	(34)
Dividends paid to non-equity minority interests	(51)	—	—
Consolidated net income of Abbey National plc (UK GAAP)	1,327	1,223	1,024
Depreciation and amortisation(1)	(136)	(99)	(89)
Pensions cost	(25)	(39)	2
Leasing	(44)	(17)	10
Shareholders' interest in long term insurance business	(186)	(165)	(195)
Other(1)	61	82	(13)
Unrealised gains/(losses) on derivative contracts with in-house trading operations	117	(28)	—
Deferred tax	72	54	86
Consolidated net income of Abbey National plc (US GAAP)	1,186	1,011	825
Earnings per 10 pence ordinary share (US GAAP) – basic	83.5p	71.3p	58.3p
– diluted	83.2p	70.8p	57.9p
Statement of comprehensive income			
Consolidated net income of Abbey National plc	1,186	1,011	825
Consolidated other comprehensive income of Abbey National plc:			
Unrealised deficit on securities available for sale	(47)	(216)	(343)
Unrealised surplus on derivatives hedging securities available for sale	21	305	207
Shareholders' interest in long term insurance business	15	(79)	37
Deferred tax	7	28	38
Other comprehensive income	(11)	24	—
Translation differences on foreign currency net investment	—	(1)	—
Consolidated total income of Abbey National plc	1,171	1,072	764
Shareholders' funds			
Shareholders' funds including non-equity interests (UK GAAP)	6,830	6,078	5,407
Depreciable assets	1,130	1,012	920
Pensions cost	(132)	(107)	(62)
Leasing	(132)	(88)	(71)
Shareholders' interest in long term insurance business	(730)	(559)	(315)
Share premium	23	21	16
Other	(78)	(34)	(50)
Unrealised gains/(losses) on derivative contracts with in-house trading operations	89	(28)	—
Dividend payable	433	382	334
Net unrealised deficit on available for sale securities and related hedging contracts	(42)	(16)	(105)
Deferred tax	183	286	299
Shareholders' funds including non-equity interests (US GAAP)	7,574	6,947	6,373

(1) Following a review of accounting presentation, the 1999 adjustment to capitalise £78m of software expenditure, which is expensed under the Group's UK accounting policies, has been reclassified and is now reported within Other, having previously been reported within Depreciation and amortisation. No adjustment is required in respect of 1998.

58. Further note disclosures on differences between UK and US GAAP, and certain additional US disclosures

a) Depreciable Assets

The following tables provide analyses of intangible fixed assets and tangible fixed assets included in the balance sheet under US GAAP for the three years ended 31 December 2000, 1999 and 1998.

Intangible Fixed Assets

	Year ended 31 December		
	2000	1999	1998
	£m	£m	£m
Arising on consolidation			
At 1 January	1,543	1,447	1,235
Acquisitions of subsidiary undertakings	234	13	212
Other movements	4	—	—
Adjustment for deferred tax on core deposit intangible	—	83	—
At 31 December	1,781	1,543	1,447
Amortisation			
At 1 January	379	277	188
Charge for the year	124	102	89
At 31 December	503	379	277
Net Book Value			
Total intangible assets capitalised per US GAAP	1,278	1,164	1,170
Total intangible assets capitalised per UK GAAP	245	203	201
US/UK GAAP difference	1,033	961	969
Net assets of businesses acquired	(19)	(20)	(49)
US/UK GAAP adjustments to shareholders' funds	1,014	941	920

Tangible Fixed Assets

	Year ended 31 December		
	2000	1999	1998
	£m	£m	£m
Total tangible fixed assets capitalised per US GAAP	2,468	1,188	954
Total tangible fixed assets capitalised per UK GAAP	2,352	1,117	954
US/UK GAAP adjustment to shareholders' funds	116	71	—

Total Depreciable Assets — Net Book Value

Total depreciable assets capitalised per US GAAP	3,727	2,332	2,075
Total depreciable assets capitalised per UK GAAP	2,597	1,320	1,155
US/UK GAAP adjustments to shareholders' funds	1,130	1,012	920

NOTES TO THE FINANCIAL STATEMENTS (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 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		
	2000	**1999**	**1998**
	£m	**£m**	**£m**
Service cost	125	121	92
Interest cost	108	89	79
Expected return on assets	(125)	(100)	(101)
Amortisation of initial transition gain	(7)	(8)	(8)
Recognised gain	(4)	—	(8)
Recognised prior service cost	2	2	1
Net periodic pension cost	99	104	55

The following table sets forth a reconciliation of beginning and ending balances of the projected benefit obligation.

	Year ended 31 December	
	2000	**1999**
	£m	**£m**
Benefit obligation at the beginning of the year	1,643	1,499
Service cost	125	121
Interest cost	108	89
Members' contributions	16	12
Acquisitions	59	—
Actuarial loss/(gain)	57	(40)
Benefits paid	(50)	(38)
Benefit obligation at end of year	1,958	1,643

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	
	2000	**1999**
	£m	**£m**
Fair value of plan assets at beginning of year	1,870	1,523
Actual return on plan assets	280	299
Acquisitions	64	—
Employer contributions	82	74
Employee contributions	16	12
Benefits paid	(50)	(38)
Fair value of plan assets at end of year	2,262	1,870

The following table sets forth the funded status of the plans.

	Year ended 31 December	
	2000	**1999**
	£m	**£m**
Funded status	304	227
Unrecognised prior service cost	7	9
Unrecognised gain	(401)	(302)
Unamortised initial transition gain	(25)	(32)
Accrued liabilities	(115)	(98)

The estimated accumulated benefit obligation at 30 September 2000 amounted to £1,809m (30 September 1999: £1,530m), of which £1,625m was vested (30 September 1999: £1,368m). 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 2000 and 1999 were as follows:

	Year ended 31 December	
	2000	**1999**
	% pa	**% pa**
Discount rate	6.5	6.5
Rate of pay escalation	4.5	4.5
Rate of pension increase	3.0	3.0
Rate of return on assets	7.0	7.0

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 £99m US GAAP pension cost (1999: £104m, 1998: £55m) compares with £74m (1999: £65m, 1998: £57m) under UK GAAP. The difference net of UK corporation tax is a decrease to net income of £17m (1999: £28m decrease, 1998: £1m increase) 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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

c) Leasing

Under US GAAP, SFAS No. 13 requires the following disclosures relating to finance leases as at 31 December 2000 and 1999.

	Year ended 31 December	
	2000	**1999**
	£m	**£m**
Total minimum lease payments to be received	9,415	10,930
Provision for impairment	(12)	(12)
Amounts representing estimated executory costs	(43)	(45)
Minimum lease payments receivable	9,360	10,873
Unearned income	(4,300)	(5,520)
Net investment in direct financing leases	5,060	5,353

At 31 December 2000, minimum lease payments for each of the next five years are as follows: £642m in 2001, £582m in 2002, £500m in 2003, £477m in 2004 and £476m in 2005.

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 "Directors, Senior Management and Employees – 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 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:

		2000	**1999**
		£m	**£m**
Net income under US GAAP	As reported	1,186	1,011
	Pro forma	1,181	1,006
Earnings per share under US GAAP	As reported	83.5p	71.3p
	Pro forma	83.2p	70.9p

NOTES TO THE FINANCIAL STATEMENTS (Continued)

The fair value of each option for 2000 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%-34.8%
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 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

* 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
2000						
Options outstanding at the beginning of the year	3,947,077	8.57	16,675,519	6.92	5,391,000	9.39
Options granted during the year	1,693,732	6.46	15,958,683	5.30	—	—
Options exercised during the year	(284,354)	6.49	(3,795,652)	4.44	(219,825)	5.91
Options forfeited during the year	(370,622)	9.55	(7,226,903)	8.84	(279,900)	10.46
Options expired during the year	(10,583)	6.25	—	—	—	—
Options outstanding at the end of the year	4,975,250	7.87	21,611,647	5.52	4,891,275	9.48
Options exercisable at the end of the year	2,098,726	6.17	126,868	4.14	—	—
The weighted-average grant-date fair value of options granted during the year	£12,195,509		£112,826,836		—	
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	

(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 2000, there were no such options outstanding (1999: 10,583), with an exercise price of £nil (1999: £8.25).

(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 "Directors, Senior Management and Employees — Directors' share interests" elsewhere in this Annual Report for a description of such options.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

The following table summarises information about the options outstanding at 31 December 2000.

Executive Share Option	**Options Outstanding**			**Options Exercisable**	
Range of Exercise Prices	**Number Outstanding at 31/12/2000**	**Weighted-Average Remaining Contractual Life (Years)**	**Weighted-Average Exercise Prices (£)**	**Number Exercisable at 31/12/2000**	**Weighted-Average Exercise Prices (£)**
Between £2 and £3	5,000	1.32	2.99	5,000	2.99
Between £3 and £4	82,666	2.24	3.69	82,666	3.69
Between £4 and £5	367,869	3.95	4.79	367,869	4.79
Between £5 and £6	660,326	4.33	5.22	660,326	5.72
Between £6 and £7	1,475,895	9.16	6.46	—	—
Between £7 and £8	1,079,209	6.59	7.25	982,865	7.22
Between £10 and £12	670,340	7.19	11.62	—	—
Between £13 and £14	616,445	8.16	13.06	—	—

Employee Sharesave	**Options Outstanding**			**Options Exercisable**	
Range of Exercise Prices	**Number Outstanding at 31/12/2000**	**Weighted-Average Remaining Contractual Life (Years)**	**Weighted-Average Exercise Prices (£)**	**Number Exercisable at 31/12/2000**	**Weighted-Average Exercise Prices (£)**
Between £3 and £4	433,825	1.20	3.15	16,220	3.22
Between £4 and £5	2,610,745	1.21	4.58	110,648	4.28
Between £5 and £6	14,655,624	4.16	5.30	—	—
Between £6 and £7	2,748,165	2.10	6.07	—	—
Between £9 and £11	1,163,288	3.09	10.07	—	—

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 31/12/2000**	**Weighted-Average Remaining Contractual Life (Years)**	**Weighted-Average Exercise Prices (£)**	**Number Exercisable at 31/12/2000**	**Weighted-Average Exercise Prices (£)**
Between £5 and £6	1,788,075	5.66	5.91	—	—
Between £9 and £11	3,103,200	7.25	11.54	—	—

e) *Taxes*

(i) No significant element of the tax expense in each of the three years ended 31 December 2000, 1999 and 1998 is attributable to discontinued operations.

(ii) The significant components of tax expense attributable to continuing operations are shown in note 10.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

(iii) A reconciliation of taxes payable at the standard UK corporation tax rate and the Group's effective tax rate for each of the three years ended 31 December 2000, 1999, and 1998 is shown as follows.

	Year ended 31 December		
	2000	1999	1998
	£m	£m	£m
Taxation at standard UK corporation tax rate (30%, 30.25%, 31%)	593	548	492
Effect of non-allowable provisions and other non-equalised items	(3)	22	9
Effect of non-UK profits and losses	(7)	(9)	(8)
Adjustment to prior year tax provisions	3	(12)	(10)
Effect of loss utilisation	(27)	(19)	—
Taxes before the effect of exceptional items	559	530	483
Effective tax rate before the effect of exceptional items	28.3%	29.3%	30.4%

(iv) The tax effects of the principal components of deferred tax liabilities and deferred tax assets at 31 December 2000 and 1999 were as follows:

	2000	1999
	£m	£m
Deferred tax liabilities recognised in UK financial statements		
Excess of capital allowances over depreciation	170	16
Capital allowances on finance lease receivables	1,078	1,084
Other	103	73
	1,351	1,173
Additional deferred tax assets/(liabilities) arising from application of US GAAP		
Operating loss carry forwards	67	87
Deductible temporary differences	(73)	81
	(6)	168
Less valuation allowance	(66)	(101)
Deferred tax (liabilities)/assets (US GAAP)	(72)	67
Deferred tax assets arising from US GAAP adjustments	255	219
Net deferred tax liabilities	1,168	887

Of the additional deferred tax asset in respect of operating loss carry forwards shown above, £1m is expected to expire at the end of 2003.

£38m of the valuation allowance at 31 December 2000 (£42m at 31 December 1999) 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.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

f) Earnings per share ("EPS")

Under US 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 2000, 1999 and 1998.

	Year ended 31 December 2000		
	Income	**Shares**	**EPS**
	£m	**m**	**pence**
Basic EPS			
Income available to ordinary shareholders	1,186	1,420	83.5
Effect of dilutive securities:			
Share options	—	6	—
Diluted EPS	1,186	1,426	83.2

	Year ended 31 December 1999		
	Income	**Shares**	**EPS**
	£m	**m**	**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	**Shares**	**EPS**
	£m	**m**	**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

Options to purchase 5.6m ordinary shares (1999: 8.0m; 1998: 4.3m) at prices ranging from £9.88 to £13.06 (1999: £9.88 to £13.06; 1998: £11.54 to £11.95) were outstanding throughout the year ended 31 December 2000 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 September 2001 to August 2009.

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 FINANCIAL STATEMENTS (Continued)

g) Securities and Investments

(i) Under US GAAP, SFAS No. 115 requires certain disclosures relating to securities and investments as at 31 December 2000 and 1999. The following table provides an analysis of the relevant balance sheet totals under both US and UK GAAP.

	As at 31 December			
	2000		1999	
	UK GAAP	US GAAP	UK GAAP	US GAAP
	£m	£m	£m	£m
Trading securities	20,488	20,488	15,811	15,811
Available for sale securities (ii)	49,174	49,086	43,981	43,977
Securities held to maturity (iii)	20	20	20	20
	69,682	69,594	59,812	59,808
Less provision against available for sale securities	(109)	—	(72)	—
	69,573	69,594	59,740	59,808

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
	£m	£m	£m	£m
As at 31 December 2000				
Equity securities	567	84	(3)	648
Debt securities issued or backed by US Treasury and other US government corporations and agencies	2,039	11	(10)	2,040
Debt securities issued or backed by foreign governments	4,284	158	(8)	4,434
Corporate debt securities	33,348	107	(418)	33,037
Mortgage backed securities other than those issued or backed by US government agencies	8,431	10	(6)	8,435
Other debt securities	505	—	(13)	492
	49,174	370	(458)	49,086
Provision against available for sale debt securities	(109)			—
	49,065			49,086
As at 31 December 1999				
Equity securities	248	20	(1)	267
Debt securities issued or backed by US Treasury and other US 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 US 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

NOTES TO THE FINANCIAL STATEMENTS (Continued)

The majority of Corporate debt securities are issued or 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 2000					
Book value before provision	2,257	16,057	11,796	19,064	49174
Fair value	2,275	16,189	11,786	18,836	49,086
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

(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 2000	20	—	—	20
As at 31 December 1999	20	—	—	20

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 2000					
Book value	20	—	—	—	20
Fair value	20	—	—	—	20
As at 31 December 1999					
Book value	—	20	—	—	20
Fair value	—	20	—	—	20

(iv) Sales of available for sale securities during the year to 31 December 2000 and 1999.

	2000	**1999**
	£m	**£m**
Gross proceeds from sales	4,673	4,461
Gross realised losses on sales	1	39
Gross realised gains on sales	(34)	(124)
Amortised cost of sales	4,640	4,376

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:

	2000	1999
	£m	£m
Amortised cost b/f.	20	248
Acquisitions – cost.	—	20
Redemptions at maturity	—	(251)
Exchange adjustments	—	3
Amortised cost c/f.	20	20

(vi) Unrealised gains and losses on transfers from available for sale securities during the year ended 31 December:

	2000	1999
	£m	£m
Gross unrealised gains	—	—
Gross unrealised losses	—	(1)
	—	(1)

(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 2000 is a gain of £74m (1999: loss of £117m).

h) Securitisations

In accordance with SFAS 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", the assets that 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 16 of the Consolidated Financial Statements.

The assets were transferred to special purpose entities at book value, which were considered to be their fair value at the time of transfer. As a result, no gain or loss on transfer has been recognised.

Additionally, as required by SFAS 125, an Interest only strip ("IO") asset has been recognised which represents Abbey National plc's retained interest in the securitised assets. The fair value of the IO strip is represented by the present value of the future income streams expected to be received from the Group's retained interest in the securitised assets. Abbey National plc determines the present value of future income streams by discounting future income. Details in relation to the Group's rights and obligations under the securitisations are detailed in note 16 of the Consolidated Financial Statements. In compliance with SFAS 125, the receivable is treated as an available for sale security that is revalued at the end of each reporting period. Increases and decreases in value are taken to the Statement of comprehensive income.

In September 2000, the FASB issued SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", which replaces SFAS 125. SFAS 140 is effective for transfers occurring after 31 March 2001, and for disclosures relating to securitisation transactions and collateral for fiscal periods ending after 15 December 2000. Such disclosures are shown below.

Mortgage asset securitisations

	2000	1999
	£m	£m
Value of interest only strip at inception(1)	123	50
Decrease in value of interest only strip	(2)	(1)
Value of interest only strip at 31 December(1)	121	49

(1) The valuation of the interest only 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 2000.
- A discount rate of 7.5%.
- The weighted average life of the strip assets was 9.3 years at 31 December 2000.

Summarised cash flows between the special purpose securitisation companies and Abbey National plc are set out below:

	Holmes Financing (No 1) plc	Holmes Financing (No 2) plc	Holmes Funding Limited	Holmes Trustees Limited
	£m	£m	£m	£m
Inter-company receipts	—	—	4,721	4,660
Inter-company payments	(2,223)	(2,405)	(4,693)	(60)
	(2,223)	(2,405)	28	4,600
Other cash flows from (to) Abbey National plc:				
Purchase of mortgages	—	—	—	(4,660)
Interest received	—	—	1	2
Revenue payments	—	—	—	(68)
Capital payments	—	—	—	(291)
Other payments	—	—	—	(7)
Asset transfers	—	—	—	105
	—	—	1	(4,919)
Net cash flows	(2,223)	(2,405)	29	(319)

The principal amount of loans held by the above special purpose securitisation companies 90 days or more past due at 31 December 2000 was £12m. Net credit losses were nil in the period ended 31 December 2000.

Sensitivity Analysis

A sensitivity analysis to illustrate the effect of changes in the rate of repayments and Abbey National's discount rate is shown below:

	Repayment rate 10%	Repayment rate 20%
Value of interest only strip assets at 31 December 2000 (1% increase)	124	106
Value of interest only strip assets at 31 December 2000 (1% decrease)	138	118

NOTES TO THE FINANCIAL STATEMENTS (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 £2,043m during the year ended 31 December 2000. Under FRS 1(Revised), the Group experienced an inflow of cash of £2,792m 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 2000, 1999 and 1998.

	2000	1999	1998
	£m	£m	£m
Cash and cash equivalents at 1 January	23,763	17,204	12,905
Net cash inflow before adjustment for the effect of foreign exchange rate changes	1,946	6,566	4,257
Effect of foreign exchange rate changes	97	(7)	42
Cash and cash equivalents at 31 December	25,806	23,763	17,204
Consisting of:			
Cash and balances with central banks	437	701	329
Treasury and other eligible bills	1,113	1,054	1,686
Loans and advances to banks	10,671	10,984	6,330
Other advances	—	70	8
Debt securities	13,585	10,954	8,851
	25,806	23,763	17,204

Other principal differences between FRS 1 and SFAS No. 95 relate to the classification of cash flow transactions and are as follows:

	Classification under FRS 1	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 disposalof 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 US dollar preference shares. These cumulative adjustments were £(28)m, £(28)m and £(27)m at 31 December 2000, 1999 and 1998 respectively.

k) Presentation of the consolidated profit and loss account

The presentation of the profit and loss accounts for the years ended 31 December 2000, 1999 and 1998 as shown on page F-5, would be no different under US GAAP except provisions would be shown as a component of total operating income.

l) Exceptional items

US 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 UK GAAP and are not interchangeable with extraordinary items as defined under US GAAP.

m) Collateralised loans and secured borrowings

Abbey National enters into purchase & resale agreements (reverse repos) which are accounted for as collateralised loans. Upon entering into such transactions the Group receives collateral equal to 100%-105% of the loan amount. The level of collateral held is monitored daily and, if required, further calls are made to ensure the market value of collateral remains equal to the loan balance. Net assets under reverse repos of £9,896m (1999: £6,397m) and £6,875m (1999: £77m) are included in Loans and advances to banks and Loans and advances to customers respectively.

Under reverse repos, the Group is permitted to sell or repledge the collateral held. At 31 December 2000, the fair value of such collateral was £16,771m of which £15,556m related to collateral that was sold or repledged.

Abbey National enters into sale and repurchase (repo) agreements, which are accounted for as secured borrowings. Upon entering into such transactions the Group pledges collateral equal to 100%-105% of the borrowed amount. Net liabilities under repo transactions of £23,630m (1999: £18,127m) and £7,287m (1999: £97m) are included in Deposits by banks and Customer accounts respectively. As detailed in Note 29, at 31 December 2000 the Group had provided £7,552m of its own assets as collateral in respect of these transactions, the remaining collateral having been obtained through stock borrowing transactions and reverse repo business.

Abbey National has pledged a further £13,499m of its own collateral pursuant to stock borrowing agreements (see note 46) and certain structured transactions. On application of SFAS140, the provision of collateral as detailed above would result in £19,946m of Debt securities and £1,105m of Treasury & eligible bills being reported as pledged to counterparties.

Abbey National also enters into outright equity sales and purchases in combination with total return swaps which are accounted for as in substance reverse repos and repos for UK GAAP. These transactions however are treated as outright asset purchases and sales and separate derivative contracts under US GAAP. Under SFAS 140, Loans and advances to customers would be reduced by £2,066m and this amount would be reported within Equity shares, representing the equity purchase. Customer accounts would be reduced by £3,081m and this amount would be reported within Other liabilities, representing the short equity sale. The related total return swaps would be marked to market. Any relevant value is paid or received as margin call. The £5,147m of nominal value of the total return swaps would be included within the trading derivative disclosures.

59. 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 UK Retail Banking, First National Group's secured and unsecured lending, and in the wholesale lending and investment activities of Wholesale Banking.

Residential mortgages represented 34% (1999: 36%) of total assets at 31 December 2000; 98% (1999: 98%) of the residential mortgage asset is located in the UK. In 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.

First National Group's £8.7 billion portfolio is diversified between: Consumer Finance (33%), split between unsecured (11%) and secured (22%); Motor Finance (34%); Business Finance (13%); and Retail Finance (20%).

Although the Group's Wholesale Banking operations are based mainly in the UK, it has built up exposures to various entities around the world.

40% of ANTS credit exposures were to counterparties from the United States, and 24% were to counterparties from the UK. The remaining exposures were mainly to counterparties from Europe. Less than 2% of ANTS exposures are to countries which are not members of the Organization for Economic Co-operation and Development. More than 60% of ANTS assets are rated AA- or better, with approximately 21% of exposures being to banks, financial institutions, supranationals and sovereigns.

See 'Risk management – Credit risk' elsewhere in this Annual Report for further discussion of controls over credit risk.

60. 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 2000 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 UK 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:

	2000 Carrying amount	2000 Fair value(1)	2000 Surplus/ (Deficit)	1999 Carrying amount (restated)(3)	1999 Fair value(1) (restated)(3)	1999 Surplus/ (Deficit)
	£m	£m	£m	£m	£m	£m
Non-Trading Assets						
Cash and balances at central banks	437	437	—	701	701	—
Loans and advances to banks	2,272	2,279	7	3,140	3,153	13
Related derivatives	—	(1)	(1)	86	87	1
Loans and advances to customers	78,175	78,549	374	75,686	75,635	(51)
Related derivatives	188	(134)	(322)	159	352	193
Debt securities	48,518	48,458	(60)	43,681	43,730	49
Related derivatives	(124)	(461)	(337)	(243)	(343)	(100)
Equity shares and other variable yield securities	567	648	81	248	267	19
Non-Trading Liabilities						
Deposits by banks	(12,086)	(12,086)	—	(7,598)	(7,597)	1
Related derivatives	(74)	(71)	3	(61)	(60)	1
Customer accounts	(59,383)	(59,484)	(101)	(59,749)	(59,798)	(49)
Related derivatives	(18)	97	115	(70)	(49)	21
Debt securities in issue	(57,078)	(57,373)	(295)	(51,407)	(51,247)	160
Related derivatives	(498)	(264)	234	(246)	(335)	(89)
Subordinated liabilities including convertible debt	(5,871)	(6,491)	(620)	(4,641)	(4,886)	(245)
Related derivatives	120	731	611	45	(11)	(56)
Other non-trading derivatives(2)	(6)	(18)	(12)	8	15	7
Trading Assets/Liabilities						
Treasury bills and other eligible bills	1,159	1,159	—	1,114	1,114	—
Loans and advances to banks	9,896	9,896	—	8,332	8,332	—
Loans and advances to customers	6,875	6,875	—	86	86	—
Debt securities	20,454	20,454	—	15,764	15,764	—
Equity shares and other variable yield securities	34	34	—	47	47	—
Deposits by banks	(22,910)	(22,910)	—	(22,226)	(22,226)	—
Customer accounts	(7,412)	(7,412)	—	(162)	(162)	—
Short positions in government debt securities	(2,300)	(2,300)	—	(1,521)	(1,521)	—
Derivative contracts with third parties	(809)	(809)	—	(1,300)	(1,300)	—
Derivative contracts with ANFP	(433)	(433)	—	(209)	(209)	—

(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.

(3) The balance sheet has been restated to more accurately split trading assets and liabilities and the associated borrowing and lending upon them. Accordingly the fair value table has been restated to reflect this split. The restated 1999 fair value of related hedges now also includes the effect of off-balance sheet derivatives held by the special purpose securitisation companies which are consolidated as quasi-subsidiaries. Upon further consideration these off-balance sheet items have been included in accordance with FRS 5, 'Reporting the substance of transactions'. The effect of this restatement is to increase the negative fair value of the related hedges of debt securities in issue by £103m.

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 2000. 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 UK 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 2000 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.

61. 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 UK GAAP.

Summary of profit and loss account data

	For the year ended 31 December				
	2000	2000	1999 (restated)	1999 (restated)	1998 (restated)
	$m	£m	$m	£m	£m
Total interest income	9,634	6,442	7,821	4,843	5,263
Total interest expense	(9,025)	(6,035)	(7,246)	(4,487)	(4,893)
Net interest income	609	407	575	356	370
Other operating income	647	433	296	183	73
Operating expenses	(387)	(259)	(202)	(125)	(115)
Loss on transfer to wealth management	—	—	—	—	(11)
Amounts written off fixed asset investments	(51)	(34)	(42)	(26)	(19)
Income before taxes	818	547	627	388	298
Taxes	(269)	(180)	(210)	(130)	(105)
Net income	549	367	417	258	193

Summary of balance sheet data

	As at 31 December			
	2000	2000	1999	1999
	$m	£m	$m	£m
Total assets	180,556	120,733	163,861	101,462
including:				
Loans to banks and customers	62,696	41,923	54,849	33,962
Net investment in finance leases	7,313	4,890	8,035	4,975
Securities and investments	97,178	64,980	90,739	56,185
Total liabilities excluding shareholders' equity	177,348	118,588	160,828	99,584
including:				
Deposits by banks and customers	81,977	54,816	67,171	41,592
Debt securities in issue	75,071	50,198	75,235	46,585
Subordinated liabilities	4,120	2,755	4,058	2,513
Shareholders' equity	3,208	2,145	3,033	1,878

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.

GROUP FINANCIAL SUMMARY — PROFIT AND LOSS ACCOUNTS

	Total 2000	Total 1999	Total 1998	Total 1997	Total 1996
	£m	£m	£m	£m	£m
Net interest income	2,680	2,661	2,241	1,905	1,815
Commissions, fees and other income	1,614	1,141	890	716	539
Operating expenses excluding operating lease depreciation	(1,815)	(1,615)	(1,346)	(1,194)	(1,038)
Depreciation on operating lease assets	(178)	(52)	(20)	(8)	(5)
Provisions for bad and doubtful debts	(273)	(303)	(201)	(121)	(127)
Provisions for contingent liabilities and commitments	(21)	(23)	(16)	(16)	(4)
Amounts written off fixed asset investments	(32)	(26)	(28)	(3)	(13)
Profit on ordinary activities before tax	1,975	1,783	1,520	1,279	1,167
Tax on profit on ordinary activities	(559)	(522)	(462)	(326)	(403)
Profit on ordinary activities after tax	1,416	1,261	1,058	953	764
Minority interests – equity	—	—	—	1	3
Minority interests – non-equity	(51)	—	—	—	—
Profit attributable to the shareholders of Abbey National plc	1,365	1,261	1,058	954	767
Transfer to non-distributable reserve	(156)	(13)	(125)	(78)	(67)
Dividends including amounts attributable to non-equity interests	(687)	(610)	(535)	(469)	(373)
Profit retained for the financial year	522	638	398	407	327
Earnings per ordinary share (pence)					
– basic	93.4p	86.2p	72.4p	65.2p	56.5p
– diluted	92.8p	85.5p	71.7p	64.7p	56.0p
Dividends per ordinary share (pence)					
Net	45.50p	40.25p	35.30p	30.70p	26.10p
Gross equivalent	50.56p	44.72p	40.85p	38.38p	32.63p
Dividend cover (times)	2.00	2.10	2.00	2.10	2.10

The Group financial summary is based on the audited consolidated financial statements of the Abbey National Group for the five years ended 31 December 2000, and has been derived from the consolidated financial statements for each of the relevant years.

For a description of exceptional items in 1999 see note 3 to the financial statements. Exceptional items in 1998 and 1997 include Year 2000 and EMU costs of £74m and £28m respectively. In addition tax changes introduced in 1997 resulted in a £133m reduction in net interest income and a £12m provision against the embedded value profits for the Life Assurance businesses (included within Commissions, fees and other income), with credits of equivalent amount to the tax charge. Operating expenses in 1996 include exceptional costs of £61m incurred in the integration of the business of the National and Provincial Building Society (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

	2000 £m	1999 £m	1998 £m	1997 £m	1996 £m
Assets					
Cash, treasury bills and other eligible bills	1,596	1,815	2,386	1,957	339
Loans and advances to banks	12,168	11,472	7,428	8,271	2,825
Loans and advances to customers	81,752	75,221	72,257	66,878	64,227
Loans and advances subject to securitisation	7,927	1,930	217		
less: non-returnable finance	(4,629)	(1,379)	(213)		
	3,298	551	4	—	—
Net investment in finance leases	5,192	5,441	5,326	4,655	4,310
Securities and investments	69,573	59,740	54,326	46,537	39,774
Long term assurance business	1,538	1,042	760	649	555
Intangible fixed assets	245	203	201	—	—
Tangible fixed assets excluding operating lease assets	389	759	731	698	689
Operating lease assets	1,963	358	223	67	26
Tangible fixed assets	2,352	1,117	954	765	715
Other assets	7,594	6,703	5,728	4,317	3,397
Assets of long term assurance funds	19,083	17,439	13,383	10,101	7,869
Total assets	204,391	180,744	162,753	144,130	124,011
Liabilities					
Deposits by banks	34,996	29,824	35,610	23,814	17,718
Customer accounts	66,795	59,911	52,924	55,719	49,678
Debt securities in issue	57,078	51,407	42,989	40,201	35,193
Other liabilities	13,074	11,444	9,107	6,954	6,786
Subordinated liabilities including convertible debt	5,871	4,641	3,333	2,463	2,374
Liabilities of long term assurance funds	19,083	17,439	13,383	10,101	7,869
	196,897	174,666	157,346	139,252	119,618
Minority interests – non-equity	664	—	—	—	—
Non-equity shareholders' funds	450	450	450	450	321
Equity shareholders' funds	6,380	5,628	4,957	4,428	4,072
Total liabilities, minority interests and shareholders' funds	204,391	180,744	162,753	144,130	124,011

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 2, 2001

EXHIBIT INDEX

Exhibits

1.1* Memorandum and Articles of Association of Abbey National.

1.2 Documents concerning Abbey National referred to within this document may be inspected at Abbey House, Baker Street, London NW1 6XL, the principal executive offices and registered office of the company.

* Incorporated by reference to the Registration Statement on Form F-1 (No. 333-11320).

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